

# Bank Hapoalim

Report on Risks

Pillar 3 Disclosure and Additional

Information Regarding Risks

as at December 31, 2016

# 2016





## Contents

<b>Introduction</b>	<b>7</b>
<b>Forward-Looking Information</b>	<b>7</b>
<b>A. General Disclosure Principle</b>	<b>8</b>
<b>B. Applicability of Implementation</b>	<b>8</b>
<b>C. Capital – Structure and Capital Adequacy</b>	<b>9</b>
<b>Structure of Supervisory Capital and Composition of Capital</b>	<b>9</b>
<b>Calculation of the Capital Ratio</b>	<b>11</b>
<b>Capital Adequacy</b>	<b>29</b>
<b>Leverage Ratio</b>	<b>37</b>
<b>D. Risk Assessment and Management</b>	<b>39</b>
<b>Risk Management System Structure and Organization</b>	<b>41</b>
<b>Risk Culture<sup>AI</sup></b>	<b>46</b>
<b>Credit Risk</b>	<b>49</b>
Management of Credit Risks	49
Hedges and Risk Mitigation	54
Credit Risk Exposures	57
Additional Information Regarding Exposures to Credit Risk <sup>AI</sup>	62
Credit Risk Mitigation: Standardized Approach Disclosures	68
Credit Risks in Respect of Derivative Financial Instruments	74
Securitization Exposures	76
<b>Market Risk</b>	<b>76</b>
Management of Market Risks	77
Market Risk Management Policy <sup>AI</sup>	78
Means for Policy Supervision and Realization <sup>AI</sup>	80
Management of Positions <sup>AI</sup>	80
Portfolio Management Models <sup>AI</sup>	81
Capital Requirements in Respect of Market Risks	83
<b>Operational Risk</b>	<b>83</b>
Management of Operational Risks	83
Information Technology Risks	86
Information Security and Cyber Risks	86
Cloud Computing Risks	87
Emergency Preparedness	87
<b>Share and Credit Spread Risk: Investment Risk</b>	<b>89</b>
Management of Investment Risk	89
Positions in Shares in the Banking Book	90
<b>Interest-Rate Risk in the Banking Book</b>	<b>91</b>
<b>Top and Emerging Risks<sup>AI</sup></b>	<b>92</b>
<b>Compliance Risk<sup>AI</sup></b>	<b>93</b>
<b>Legal Risk<sup>AI</sup></b>	<b>96</b>
<b>Reputational Risk<sup>AI</sup></b>	<b>97</b>
<b>Regulatory and Legislative Risk<sup>AI</sup></b>	<b>97</b>
Restrictions and Supervision of the Activity of the Banking Corporation	97
Regulatory Risk Management Methods	98
<b>Economic Risk<sup>AI</sup></b>	<b>98</b>
<b>Strategic Risk<sup>AI</sup></b>	<b>99</b>
<b>Environmental Risk<sup>AI</sup></b>	<b>100</b>
<b>E. Liquidity Risk</b>	<b>100</b>
<b>F. Remuneration Disclosure</b>	<b>108</b>
<b>Entities Supervising Remuneration</b>	<b>108</b>
<b>Planning and Structure of Remuneration Processes</b>	<b>109</b>
<b>Ways in Which Present and Future Risks Are Taken Into Consideration in the Remuneration Process</b>	<b>110</b>
<b>Ways in Which the Banking Corporation Links Performance During the Measurement Period With Remuneration Levels</b>	<b>110</b>
<b>Ways in Which the Banking Corporation Adjusts Remuneration in Order to Take Longer-Term Performance Into Consideration</b>	<b>110</b>
<b>Description of Different Means of Variable Remuneration Used by the Banking Corporation and of the Considerations in the Use of Such Different Means</b>	<b>112</b>

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

## List of Tables

<b>Capital – Structure and Capital Adequacy</b>	<b>9</b>
Table C-1: Calculation of the ratio of capital to risk-adjusted assets	11
Table C-2: Capital components for the calculation of the capital ratio <sup>AI</sup>	12
Table C-3: Effect of transitional directives and Efficiency Plan Adjustments on common equity Tier 1 capital ratio <sup>AI</sup>	13
Table C-4: Capital components subject to volatility <sup>AI</sup>	13
Table C-5: Composition of capital for the purpose of calculating the ratio of capital to risk-adjusted assets	14
Table C-6: Composition of supervisory capital, by components, with references to the supervisory balance sheet	15
Table C-7: Composition of the supervisory balance sheet, with references to the components of supervisory capital	22
Table C-8: Statement of changes in components of supervisory capital	25
Table C-9: Methods used by the Bank to calculate supervisory capital for each of the major risk categories	31
Table C-10: 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)	34
Table C-11: Risk-adjusted assets by supervisory activity segment <sup>AI</sup>	35
Table C-12: Statement of changes in risk-weighted assets during the period <sup>AI</sup>	36
Table C-13: Leverage ratio	37
Table C-14: Comparison of balance sheet assets to exposure measurement, for the purposes of the leverage ratio	37
Table C-15: Leverage ratio disclosure	38
<b>Risk Assessment and Management</b>	<b>39</b>
Table D-1: Severity of risk factors <sup>AI</sup>	41
Table D-2: Risk and capital management governance diagram of the Bank <sup>AI</sup>	43
Table D-3: Risk management organizational structure <sup>AI</sup>	44
Table D-4: Segmentation of credit-risk exposures by counterparty and by main types of credit exposures, before allowance for credit losses	57
Table D-5: Total principal exposures to foreign countries	58
Table D-6: Segmentation of the portfolio by term to maturity and by principal type of credit exposure	59
Table D-7: Amount of problematic credit risk, impaired credit risk, 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	60
Table D-8: Change in allowance for credit losses	61
Table D-9: Segmentation of credit risk of the Bank Group in the construction and real-estate sectors, by principal area of activity <sup>AI</sup>	62
Table D-10: 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 <sup>AI</sup>	62
Table D-11: Balances of balance sheet credit and off-balance sheet credit risk to the six largest borrowers, by sector of the economy <sup>AI</sup>	63
Table D-12: Balance of credit to private individuals in Israel <sup>AI</sup>	64
Table D-13: Information regarding problematic debts in respect of private individuals in Israel <sup>AI</sup>	64

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 <sup>A/</sup>	65
Table D-15: Details of characteristics of housing credit granted by the Bank – percentage of total new loans executed <sup>A/</sup>	66
Table D-16: The Bank's exposures to leveraged financing, by economic sector of the borrower <sup>A/</sup>	67
Table D-17: Mapping of ratings of the major international rating agencies	68
Table D-18: Amount of gross credit exposures before credit risk mitigation	70
Table D-19: Amount of net credit exposures after credit risk mitigation	71
Table D-20: 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	73
Table D-21: Details of credit exposures of the Bank arising from derivatives	75
Table D-22: Details of face value of the Bank's credit-derivatives portfolio, used for risk management in the Bank's credit portfolio	76
Table D-23: Main limits on exposures to market risks in the overall activity of the Bank, and separately for trading activity	79
Table D-24: Risk estimates of trading activity (VaR)	82
Table D-25: Capital requirements in respect of market risks	83
Table D-26: Details of the Bank's investments in shares in the banking book	90
Table D-27: 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)	92
<b>Liquidity Risk</b>	<b>100</b>
Table E-1: Liquidity coverage ratio – limited banking corporation and consolidated subsidiaries, for the three-month period ended December 31, 2016	101
Table E-2: Details of liquid assets, by level, as required in the Basel directives <sup>A/</sup>	106
Table E-3: Pledged and unpledged available assets <sup>A/</sup>	107
<b>Remuneration Disclosure</b>	<b>108</b>
Table F-1: Key employees of the Bank	108
Table F-2: General quantitative information	112
Table F-3: Total deferred compensation not yet paid to senior officers and other key employees (in NIS millions)	112
Table F-4: Additional details of the remuneration amount in respect of the reported year for senior officers and other key employees (in NIS millions)	113
Table F-5: Quantitative information on the exposure of senior executives and other key employees to implicit adjustments	113



## Introduction

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 <sup>A/</sup> next to the heading of the paragraph.

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. This report should be perused in conjunction with the financial statements as at December 31, 2016, and the accompanying notes – hereinafter the “Financial Statements.”

## 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 annual 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 Banking Supervision Department.

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 December 31, 2016, there are no differences between the consolidation base according to GAAP and the supervisory consolidation base for the purposes of capital adequacy.

The capital requirements of banking subsidiaries overseas are calculated in accordance with the regulatory directives established by the regulator in the subsidiary's country.

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 Financial Statements for 2016.

Some of the subsidiaries overseas have not yet fully adopted the requirements concerning the leverage ratio. The Basel Committee working framework is therefore applied only on the consolidated level.

For further details regarding the principal subsidiary and affiliated companies of the Bank, see Note 15C to the [Financial Statements for 2016](#).



## **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 [Financial Statements](#).

## Calculation of the Capital Ratio

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

	<b>December 31, 2016</b>	December 31, 2015
	NIS millions	
<b>1. Capital for the calculation of the capital ratio after supervisory adjustments and deductions</b>		
Common equity Tier I capital	<sup>(1)</sup> <b>35,045</b>	33,246
Additional Tier I capital	<b>1,465</b>	1,709
Total Tier I capital	<sup>(1)</sup> <b>36,510</b>	34,955
Tier 2 capital	<b>11,609</b>	14,593
Total overall capital	<sup>(1)</sup> <b>48,119</b>	49,548
<b>2. Weighted balances of risk-adjusted assets</b>		
Credit risk	<sup>(2)</sup> <b>290,139</b>	317,891
Market risks	<b>4,866</b>	4,562
Operational risk	<b>23,374</b>	22,671
Total weighted balances of risk-adjusted assets	<sup>(2)</sup> <b>318,379</b>	345,124
	%	
<b>3. Ratio of capital to risk-adjusted assets</b>		
Ratio of common equity Tier I capital to risk-adjusted assets	<b>11.01%</b>	9.63%
Ratio of Tier I capital to risk-adjusted assets	<b>11.47%</b>	10.13%
Ratio of total capital to risk-adjusted assets	<b>15.11%</b>	14.36%
Minimum common equity Tier I capital ratio required by the Banking Supervision Department	<sup>(3)</sup> <b>9.17%</b>	<sup>(3)</sup> 9.07%
Minimum total capital ratio required by the Banking Supervision Department	<sup>(3)</sup> <b>12.67%</b>	<sup>(3)</sup> 12.57%

(1) The data are presented in accordance with Proper Conduct of Banking Business Directive 202, "Capital Measurement and Adequacy – Supervisory Capital," and in accordance with the transitional directives established in Proper Conduct of Banking Business Directive 299. The data also include adjustments in respect of the efficiency plan, established based on the letter of the Banking Supervision Department of January 12, 2016, "Improvement of the Operational Efficiency of the Banking System in Israel" (hereinafter: Efficiency Plan Adjustments), allocated in equal parts over five years, from 2017 forward. For additional details regarding the effect of the transitional directives and the Efficiency Plan Adjustments, see Note 25 to the [Financial Statements](#).

(2) A total of NIS 1,065 million was deducted from the total weighted balances of risk-adjusted assets, due to Efficiency Plan Adjustments, which, in accordance with the approval of the Banking Supervision Department, will be allocated gradually over five years, beginning in 2017.

(3) The minimum required common equity Tier I 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 I capital ratio and the minimum total capital ratio required by the Banking Supervision Department as at January 1, 2017, on a consolidated basis, based on data at the reporting date, stand at 10.2% and 13.7%, respectively. With regard to the balance of housing loans, see Note 30A<sup>(2)</sup> to the [Financial Statements](#) as at December 31, 2016.

Table C-2: Capital components for the calculation of the capital ratio<sup>A/</sup>

	December 31, 2016	December 31, 2015
	NIS millions	
<b>Common equity Tier I capital</b>		
Total capital	<b>34,225</b>	33,219
Differences between total capital and common equity Tier I capital	<b>95</b>	160
Total common equity Tier I capital, before supervisory adjustments and deductions	<b>34,320</b>	33,379
<b>Supervisory adjustments and deductions</b>		
Goodwill and intangible assets	-	-
Deferred tax assets	<b>(27)</b>	(108)
Investments in capital of financial corporations not consolidated in the financial statements	-	-
Other supervisory adjustments and deductions – common equity Tier I capital	<b>(10)</b>	(25)
Total supervisory adjustments and deductions, before Efficiency Plan Adjustments – common equity Tier I capital	<b>(37)</b>	(133)
Total Efficiency Plan Adjustments – common equity Tier I capital*	<b>762</b>	-
Total common equity Tier I capital, after supervisory adjustments and deductions	<b>35,045</b>	33,246
<b>Additional Tier I capital</b>		
Additional Tier I capital – instruments, before deductions	<b>1,465</b>	1,709
Additional Tier I capital – total deductions	-	-
Total additional Tier I capital, after deductions	<b>1,465</b>	1,709
Total Tier I capital, after supervisory adjustments and deductions	<b>36,510</b>	34,955
<b>Tier 2 capital</b>		
Tier 2 capital – instruments, before deductions	<b>7,982</b>	10,678
Tier 2 capital – allowance for credit losses, before deductions	<b>3,627</b>	3,915
Total Tier 2 capital, before deductions	<b>11,609</b>	14,593
<b>Deductions</b>		
Total deductions – Tier 2 capital	-	-
Total Tier 2 capital	<b>11,609</b>	14,593
Total overall capital	<b>48,119</b>	49,548

\* Efficiency Plan Adjustments, established based on the letter of the Banking Supervision Department of January 12, 2016, on the subject "Improvement of the operational efficiency of the banking system in Israel," are allocated in equal parts over five years, from 2017 forward.

Table C-3: Effect of transitional directives and Efficiency Plan Adjustments on common equity Tier I capital ratio<sup>A/</sup>

	December 31, 2016	December 31, 2015
	%	
<b>Ratio of capital to risk-adjusted assets</b>		
Ratio of common equity Tier I capital to risk-adjusted assets before the effect of the transitional directives in Directive 299 and before the effect of the Efficiency Plan Adjustments	<b>10.66%</b>	9.50%
Effect of the transitional directives	<b>0.07%</b>	0.13%
Ratio of common equity Tier I capital to risk-adjusted assets before the effect of the Efficiency Plan Adjustments	<b>10.73%</b>	9.63%
Effect of Efficiency Plan Adjustments*	<b>0.28%</b>	-
Ratio of common equity Tier I capital to risk-adjusted assets	<b>11.01%</b>	9.63%

\* Efficiency Plan Adjustments, established based on the letter of the Banking Supervision Department of January 12, 2016, on the subject "Improvement of the operational efficiency of the banking system in Israel," are allocated in equal parts over five years, from 2017 forward.

Table C-4: Capital components subject to volatility<sup>A/</sup>

The Bank manages its capital-adequacy ratio with the aim of complying with the minimum capital requirements of the Banking Supervision Department. The capital of the Bank and the volume of risk-adjusted assets are subject to changes, due to the following factors, among others:

- Actuarial changes resulting from changes in the interest rate for the calculation of the Bank's liabilities, or other actuarial assumptions, such as mortality and departure rates.
- Effects of changes in the interest rate on capital reserves from securities available for sale.
- Effects of changes in the CPI and in exchange rates on asset balances.

Scale of effect of a decrease in capital and an increase in risk-adjusted assets on the common equity Tier I capital ratio as at December 31, 2016

	Effect of decrease of NIS 100 million in common equity Tier I capital	Effect of increase of NIS 1 billion in total risk-adjusted assets
	%	
Bank in consolidated data	<b>(0.03%)</b>	<b>(0.03%)</b>
Isracard	<b>(0.77%)</b>	<b>(1.49%)</b>

Table C-5: Composition of capital for the purpose of calculating the ratio of capital to risk-adjusted assets

	<b>December 31, 2016</b>	December 31, 2015
	NIS millions	
<b>Tier 1 capital</b>		
Paid-up common share capital and premium	<b>8,146</b>	8,094
Retained earnings	<b>26,665</b>	24,720
Non-controlling interests in equity of consolidated subsidiaries	<b>116</b>	148
Unrealized profits from adjustments of securities available for sale to fair value	<b>355</b>	451
Other capital instruments	<b>(200)</b>	(34)
Amounts deducted from Tier 1 capital	<b>(37)</b>	(133)
Total common equity Tier 1 capital	<b>35,045</b>	33,246
Innovative hybrid instruments	<b>1,465</b>	1,709
Total Tier 1 capital	<b>36,510</b>	34,955
<b>Tier 2 capital</b>		
Hybrid capital instruments and subordinated notes	<b>264</b>	1,150
Collective allowances for credit losses before the effect of related tax	<b>3,627</b>	3,915
Tier 2 capital instruments issued by subsidiaries of the banking corporation to third-party investors	<b>7,718</b>	9,528
Amounts deducted from Tier 2 capital	-	-
Total Tier 2 capital	<b>11,609</b>	14,593
Total qualifying capital	<b>48,119</b>	49,548

For further details, see Note 25 to the [Annual Financial Statements for 2016](#).

Table C-6: Composition of supervisory capital, by components, with references to the supervisory balance sheet

	<b>December 31, 2016</b>		December 31, 2015		References to the supervisory balance sheet
	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					
<b>Common equity Tier I capital</b>					
<b>Common equity Tier I capital – instruments and retained earnings</b>					
Ordinary share capital issued by the banking corporation and premium on ordinary shares included in common equity Tier I capital	<b>8,146</b>		8,094		1+2
Retained earnings, including dividends proposed or declared after the balance sheet date	<b>26,665</b>	<b>2</b>	24,720	4	3
Accumulated other comprehensive income and disclosed retained earnings	<b>(607)</b>	<b>(159)</b>	417	(203)	4A+4B
Common equity Tier I 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)	<b>116</b>	<b>42</b>	148	58	5
Common equity Tier I capital before supervisory adjustments and deductions	<b>34,320</b>		33,379		
<b>Common equity Tier I capital – supervisory adjustments and deductions</b>					
Stabilization adjustments of valuations	-	-	-	-	
Goodwill, net of deferred taxes payable	-	-	-	-	
Other intangible assets, excluding mortgage service rights, net of deferred taxes payable	-	-	-	-	6+7
Deferred tax assets, realization of which depends on future profitability of the banking corporation, excluding deferred tax assets arising from timing differences	<b>27</b>	<b>18</b>	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	<b>(1)</b>	<b>(1)</b>	(2)	(2)	9
Negative difference between provisions and expected losses	-	-	-	-	
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	<b>11</b>	<b>7</b>	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	-	-	-	-	

Table C-6: Composition of supervisory capital, by components, with references to the supervisory balance sheet (continued)

	December 31, 2016		December 31, 2015		References to the supervisory balance sheet
	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				
Investment in own ordinary shares held directly or indirectly (including commitments to purchase shares under contractual agreements)	-	-	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 I 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 I capital	-	-	-	-	
Deferred tax assets arising from timing differences in amounts exceeding 10% of common equity Tier I capital	<b>116</b>	<b>77</b>	89	134	13
Amounts of mortgage service rights, deferred tax assets 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 I 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 tax assets arising from timing differences	-	-	-	-	
Additional supervisory adjustments and deductions established by the Banking Supervision Department	<b>(878)</b>	<b>(77)</b>	-	-	
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 I capital	<b>(878)</b>	<b>(77)</b>	-	-	
Of which: in respect of the efficiency plan	<b>(762)</b>		-		
Of which: in respect of wage tax	<b>(116)</b>	<b>(77)</b>	-		



Table C-6: Composition of supervisory capital, by components, with references to the supervisory balance sheet (continued)

	<b>December 31, 2016</b>		December 31, 2015		References to the supervisory balance sheet
	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				
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	<b>(725)</b>	<b>24</b>	133	202	
Common equity Tier 1 capital	<b>35,045</b>		33,246		
<b>Additional Tier 1 capital</b>					
<b>Additional Tier 1 capital – instruments</b>					
Additional Tier 1 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 1 capital instruments issued by the corporation, which are eligible for inclusion in supervisory capital during the transitional period	<b>1,465</b>		1,709		11B
Additional Tier 1 capital instruments issued by subsidiaries of the banking corporation and held by third-party investors	-		-		
Of which: additional Tier 1 capital instruments issued by subsidiaries of the banking corporation and held by third-party investors, which are gradually deducted from additional Tier 1 capital	-		-		
Additional Tier 1 capital before deductions	<b>1,465</b>		1,709		
<b>Additional Tier 1 capital – deductions</b>					
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	-	-	-	-	

Table C-6: Composition of supervisory capital, by components, with references to the supervisory balance sheet (continued)

	<b>December 31, 2016</b>		December 31, 2015		References to the supervisory balance sheet
	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 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 Banking Supervision Department	-	-	-	-	
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	<b>1,465</b>	-	1,709	-	
Tier 1 capital	<b>36,510</b>	-	34,955	-	
<b>Tier 2 capital</b>					
<b>Tier 2 capital – instruments and provisions</b>					
Instruments issued by the banking corporation (not included in Tier 1 capital) and premium on such instruments	-	-	-	-	I 1A
Tier 2 capital instruments issued by the corporation, which are eligible for inclusion in supervisory capital during the transitional period	<b>264</b>	-	1,150	-	I 1B
Tier 2 capital instruments issued by subsidiaries of the banking corporation to third-party investors	<b>7,718</b>	-	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	<b>7,718</b>	-	9,528	-	I 1B
Collective allowances for credit losses before the effect of related tax	<b>3,627</b>	-	3,915	-	I 2
Tier 2 capital before deductions	<b>11,609</b>	-	14,593	-	

Table C-6: Composition of supervisory capital, by components, with references to the supervisory balance sheet (continued)

	<b>December 31, 2016</b>		December 31, 2015		References to the supervisory balance sheet
	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					
<b>Tier 2 capital – deductions</b>					
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	-	-	-	-	
Additional deductions established by the Banking Supervision Department	-	-	-	-	
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	<b>11,609</b>		14,593		
Total capital	<b>48,119</b>		49,548		
<b>Weighted risk-adjusted assets</b>					
Total weighted risk-adjusted assets according to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	<b>317,813</b>		344,152		
Of which: credit risk assets	<b>289,573</b>		316,919		
Of which: market risk assets	<b>4,866</b>		4,562		
Of which: operational risk assets	<b>23,374</b>		22,671		
Total weighted risk-adjusted assets	<b>318,379</b>		345,124		

Table C-6: Composition of supervisory capital, by components, with references to the supervisory balance sheet (continued)

	December 31, 2016		December 31, 2015		References to the supervisory balance sheet
	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					
<b>Capital ratios and capital preservation cushions</b>					
Common equity Tier I capital	<b>11.01%</b>		9.63%		
Tier I capital	<b>11.47%</b>		10.13%		
Total capital	<b>15.11%</b>		14.36%		
<b>Minimum requirements established by the Banking Supervision Department</b>					
The minimum required common equity Tier I 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 I capital ratio required by the Banking Supervision Department as at January 1, 2017, on a consolidated basis, according to data at the reporting date, is 10.2%	<b>9.17%</b>		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 Banking Supervision Department as of January 1, 2017, on a consolidated basis, according to data at the reporting date, is 13.7%	<b>12.67%</b>		12.57%		
<b>Amounts below the deduction threshold (before risk weighting)</b>					
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	<b>951</b>		1,437		
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	<b>559</b>		553		
Mortgage service rights (net of deferred taxes payable)	<b>-</b>		-		
Deferred tax assets arising from timing differences, below the deduction threshold	<b>3,505</b>		3,333		

Table C-6: Composition of supervisory capital, by components, with references to the supervisory balance sheet (continued)

	<b>December 31, 2016</b>		December 31, 2015		References to the supervisory balance sheet
	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					
<b>Ceiling for inclusion of provisions in Tier 2</b>					
Provision qualifying for inclusion in Tier 2, with reference to exposures under the standardized approach, before application of the ceiling	<b>3,800</b>		3,915		
Ceiling for inclusion of provision in Tier 2 under the standardized approach	<b>3,627</b>		3,974		
Provision qualifying 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	-		-		
<b>Capital instruments not qualifying as supervisory capital, which are subject to the transitional directives</b>					
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	<b>1,465</b>		1,709		
Amount deducted from additional Tier 1 capital due to the ceiling	<b>936</b>		708		
Current ceiling amount for instruments included in Tier 2 capital subject to the transitional directives	<b>9,153</b>		10,678		
Amount deducted from Tier 2 capital due to the ceiling	-		426		

Table C-7: Composition of the supervisory balance sheet, with references to the components of supervisory capital

	<b>December 31, 2016</b>	December 31, 2015	References to components of supervisory capital
	Consolidated supervisory balance sheet		
	NIS millions		
<b>Assets</b>			
Cash and deposits with banks*	<b>80,378</b>	64,976	
* Of which: collective allowance for credit losses included in Tier 2 capital	<b>(7)</b>	(3)	12
Securities*	<b>71,449</b>	62,884	
* Of which: investments in capital of financial corporations that do not exceed 10% of the share capital of the financial corporation	<b>951</b>	1,437	
* Of which: other securities	<b>70,498</b>	61,447	
Securities borrowed or purchased under agreements to resell	<b>375</b>	119	
Credit to the public	<b>276,084</b>	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	<b>421</b>	421	
Allowance for credit losses*	<b>(4,127)</b>	(4,414)	
* Of which: collective allowance for credit losses included in Tier 2 capital	<b>(3,060)</b>	(3,318)	12
* Of which: allowance for credit losses not included in supervisory capital	<b>(1,067)</b>	(1,096)	
Net credit to the public	<b>271,957</b>	278,497	
Credit to governments	<b>2,561</b>	2,564	
Investment in equity-basis investees*	<b>153</b>	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	<b>138</b>	132	
Buildings and equipment	<b>3,363</b>	3,409	
Intangible assets and goodwill*	-	-	
* Of which: goodwill	-	-	
* Of which: other intangible assets	-	-	6
Assets in respect of derivative instruments	<b>11,916</b>	12,789	
Other assets*	<b>5,953</b>	6,257	
* Of which: deferred tax assets**	<b>3,742</b>	3,604	
** Of which: deferred tax assets attributed to timing differences, over 10% of common equity Tier 1 capital	-	223	13
** Of which: deferred tax assets excluding those attributed to timing differences	<b>45</b>	48	8
** Of which: other deferred tax assets	<b>3,697</b>	3,333	
* Of which: surplus of amount funded over provision	-	-	
* Of which: additional other assets	<b>2,211</b>	2,653	
<b>Total assets</b>	<b>448,105</b>	431,638	

Table C-7: Composition of the supervisory balance sheet, with references to the components of supervisory capital (continued)

	<b>December 31, 2016</b>	December 31, 2015	References to components of supervisory capital
	Consolidated supervisory balance sheet		
	NIS millions		
<b>Liabilities and capital</b>			
Deposits from the public	<b>338,502</b>	321,727	
Deposits from banks	<b>4,377</b>	4,773	
Government deposits	<b>345</b>	354	
Securities lent or sold under agreements to repurchase	<b>484</b>	83	
Bonds and subordinated notes*	<b>33,560</b>	34,475	
* Of which: subordinated notes not recognized as supervisory capital	<b>8,073</b>	7,498	
* Of which: subordinated notes recognized as supervisory capital**	<b>9,447</b>	12,387	
** Of which: eligible as supervisory capital components	-	-	I I A
** Of which: ineligible as supervisory capital components and subject to transitional directives	<b>9,447</b>	12,387	I I B
Liabilities in respect of derivative instruments*	<b>12,587</b>	13,806	
* Of which: in respect of own credit risk	<b>18</b>	17	10
Other liabilities	<b>24,025</b>	23,201	
* Of which: collective allowance for credit losses included in Tier 2 capital	<b>560</b>	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	<b>413,880</b>	398,419	

Table C-7: Composition of the supervisory balance sheet, with references to the components of supervisory capital (continued)

	<b>December 31, 2016</b>	December 31, 2015	References to components of supervisory capital
	Consolidated supervisory balance sheet		
	NIS millions		
Shareholders' equity*	<b>34,047</b>	33,032	
* Of which: ordinary share capital and premium, retained earnings, other comprehensive income, and capital reserves**	<b>34,047</b>	33,032	
** Of which: ordinary share capital	<b>1,334</b>	1,329	1
** Of which: premium on ordinary shares	<b>6,812</b>	6,765	2
** Of which: retained earnings	<b>26,667</b>	24,724	3
** Of which: accumulated other comprehensive income (loss)***	<b>(840)</b>	101	4A
*** Of which: adjustments for presentation of securities available for sale at fair value	<b>355</b>	451	
*** Of which: net losses in respect of cash-flow hedges	<b>(2)</b>	(4)	9
*** Of which: net adjustments from translation, after hedge effects	<b>(33)</b>	(8)	
** Of which: capital reserves from a benefit due to share-based payment transactions	<b>74</b>	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*	<b>178</b>	187	
* Of which: non-controlling interests attributable to common equity Tier 1 capital	<b>116</b>	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	<b>62</b>	39	
Total capital	<b>34,225</b>	33,219	
Total liabilities and capital	<b>448,105</b>	431,638	



Table C-8: Statement of changes in components of supervisory capital

	For the year ended December 31, 2016				
	Common equity Tier I capital	Additional Tier I capital	Total Tier I capital	Tier 2 capital	Total capital
	NIS millions				
Balance as at December 31, 2015	<b>33,246</b>	<b>1,709</b>	<b>34,955</b>	<b>14,593</b>	<b>49,548</b>
<b>Changes in capital components</b>					
Ordinary share capital	<b>5</b>	-	<b>5</b>	-	<b>5</b>
Premium on ordinary shares	<b>47</b>	-	<b>47</b>	-	<b>47</b>
Net profit for the period attributed to shareholders of the Bank	<b>2,628</b>	-	<b>2,628</b>	-	<b>2,628</b>
Dividends	<b>(685)</b>	-	<b>(685)</b>	-	<b>(685)</b>
Effect of adoption of accounting rules concerning employee benefits, included in retained earnings*	<b>2</b>	-	<b>2</b>	-	<b>2</b>
Unrealized losses from adjustments of securities available for sale to fair value	<b>(96)</b>	-	<b>(96)</b>	-	<b>(96)</b>
Unrealized gains in respect of cash-flow hedges	<b>2</b>	-	<b>2</b>	-	<b>2</b>
Translation adjustments of autonomous affiliated units overseas	<b>(25)</b>	-	<b>(25)</b>	-	<b>(25)</b>
Benefit due to share-based payment transactions	<b>(39)</b>	-	<b>(39)</b>	-	<b>(39)</b>
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*	<b>(104)</b>	-	<b>(104)</b>	-	<b>(104)</b>
Effect of the efficiency plan, included in other comprehensive income	<b>(762)</b>	-	<b>(762)</b>	-	<b>(762)</b>
Adjustments in respect of the effect of the efficiency plan	<b>762</b>	-	<b>762</b>	-	<b>762</b>
Non-controlling interests in share capital of consolidated subsidiaries*	<b>(32)</b>	-	<b>(32)</b>	-	<b>(32)</b>
Other	-	-	-	-	-
Total change before supervisory adjustments and deductions	<b>1,703</b>	-	<b>1,703</b>	-	<b>1,703</b>

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

Table C-8: Statement of changes in components of supervisory capital (continued)

	For the year ended December 31, 2016				
	Common equity Tier I capital	Additional Tier I capital	Total Tier I capital	Tier 2 capital	Total capital
	NIS millions				
<b>Change due to the effect of supervisory adjustments and deductions</b>					
Goodwill and intangible assets	-	-	-	-	-
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 I 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*	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*	4	-	4	-	4
Self investment in ordinary shares (held directly or indirectly)*	(20)	-	(20)	-	(20)
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 I capital	-	-	-	-	-
Others	-	-	-	-	-
Total change in supervisory adjustments and deductions	(96)	-	(96)	-	(96)
Decrease in supervisory capital instruments	-	(244)	(244)	(2,696)	(2,940)
Capital instruments issued	-	-	-	-	-
Change in collective allowances for credit losses before the effect of related tax	-	-	-	(288)	(288)
Other	-	-	-	-	-
Balance as at December 31, 2016	35,045	1,465	36,510	11,609	48,119

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

Table C-8: Statement of changes in components of supervisory capital (continued)

	For the year ended December 31, 2015				
	Common equity Tier I capital	Additional Tier I capital	Total Tier I capital	Tier 2 capital	Total capital
	NIS millions				
Balance as at December 31, 2014*	31,482	1,954	33,436	16,041	49,477
<b>Changes in capital components</b>					
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
Dividends	(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-8: Statement of changes in components of supervisory capital (continued)

	For the year ended December 31, 2015				
	Common equity Tier I capital	Additional Tier I capital	Total Tier I capital	Tier 2 capital	Total capital
	NIS millions				
<b>Change due to the effect of supervisory adjustments and deductions</b>					
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 I 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 I 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.

The changes in the components of supervisory capital in 2016 resulted primarily from net profit for the period, in the amount of NIS 2,628 million, which was offset by dividend distribution in the amount of NIS 685 million and unrealized losses from securities available for sale, in the amount of NIS 96 million; and from a decrease in supervisory capital instruments, in the amount of NIS 2,940 million. The data include Efficiency Plan Adjustments established based on the letter of the Banking Supervision Department of January 12, 2016, "Improvement of the Operational Efficiency of the Banking System in Israel," allocated in equal parts over five years, from 2017 forward.

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 and unrealized losses from securities available for sale, in the amount of NIS 510 million; and from 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 Banking Supervision Department 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 (the 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 Banking Supervision Department.
- 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." 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. In 2016, the rate of deductions from supervisory capital is 60%, and the ceiling for instruments qualifying as supervisory capital is 60%. The rate of deductions from supervisory capital will stand at 80% in 2017, and at 100% beginning January 1, 2018.

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

### **Improving Operational Efficiency**

In January 2016, the Banking Supervision Department issued a letter on the subject, "Improving the operational efficiency of the banking system in Israel" (hereinafter: the "Letter"). Pursuant to the Letter, the boards 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 relief 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 ratios and of the leverage ratio. In October 2016, the Board of Directors of the Bank approved an efficiency plan at an estimated cost in the amount of NIS 762 million, net of tax effect, which was allocated to capital. The effect of the costs of the efficiency plan on capital-adequacy ratios, estimated at approximately 0.28%, will be allocated in equal parts over five years, from 2017 forward.

## **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 January 1, 2017)**

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 acting as a clearing member of 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.
- Exposures of a banking corporation as a client of a clearing member.
- A banking corporation's contributions to a central counterparty's default fund.
- Collateral posted by a banking corporation with a clearing 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 contributions to a default fund shall be weighted at 1,250%.

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

On December 28, 2016, the Banking Supervision Department issued a letter noting that notwithstanding the foregoing, the calculation of the amount of the exposure in respect of customers active on the Maof market would continue to be based on the scenarios approach.

According to the Bank's estimates, the expected effect of the adoption of the Circular, based on the relevant balances as at the reporting date, is immaterial, assuming that the stock exchange in Israel is a qualified party.

## Implementation of the Basel Directives

### Implementation of Pillar I

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

Table C-9: 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 Banking Supervision Department 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 Banking Supervision Department 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 2016 to the Bank of Israel at the end of January 2017. 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<sup>AI</sup>**

On May 30, 2013, the Banking Supervision Department 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 I 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 are required to maintain a minimum common equity Tier I capital ratio of 10%, by January 1, 2017.

The Banking Supervision Department 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 would stand at 13.5% beginning January 1, 2017. The Bank meets the conditions for the definition of a banking corporation of significant importance.

The Banking Supervision Department 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.

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

On April 20, 2015, the Board of Directors of the Bank resolved to increase the target common equity Tier I 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<sup>AI</sup>**

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 ensures:

- 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.

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 department 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, with the necessary adjustments to the Proper Conduct of Banking Business Directives for the calculation of capital requirements; 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-10: 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)

	December 31, 2016		December 31, 2015	
	Risk-adjusted assets	Capital requirements <sup>(1)</sup>	Risk-adjusted assets	Capital requirements <sup>(1)</sup>
NIS millions				
<b>Credit risk</b>				
Sovereign debts	<b>1,649</b>	<b>209</b>	2,115	266
Debts of public-sector entities	<b>2,863</b>	<b>363</b>	3,138	394
Debts of banking corporations	<b>6,357</b>	<b>805</b>	5,535	696
Debts of corporations	<b>118,620</b>	<b>15,029</b>	131,054	16,473
Debts secured by commercial real estate	<b>46,207</b>	<b>5,854</b>	63,500	7,982
Retail exposures to individuals	<b>47,005</b>	<b>5,956</b>	45,427	5,710
Loans to small businesses	<b>7,323</b>	<b>928</b>	7,219	907
Housing loans	<b>38,288</b>	<b>4,851</b>	35,849	4,506
Securitization	<b>96</b>	<b>12</b>	98	12
Other assets	<b>18,180</b>	<b>2,303</b>	19,431	2,442
CVA risk	<b>3,551</b>	<b>450</b>	4,525	569
Total in respect of credit risk	<b>290,139</b>	<b>36,760</b>	317,891	39,957
Market risks	<b>4,866</b>	<b>617</b>	4,562	573
Operational risk	<b>23,374</b>	<b>2,961</b>	22,671	2,850
Total risk-adjusted assets in respect of the various risks	<b>318,379</b>	<b>40,338</b>	345,124	43,380
Common equity Tier I capital	<b>35,045</b>		33,246	
Tier I capital	<b>36,510</b>		34,955	
Total capital	<b>48,119</b>		49,548	
%				
Ratio of common equity Tier I capital to risk-adjusted assets	<b>11.01%</b>		9.63%	
Ratio of Tier I capital to risk-adjusted assets	<b>11.47%</b>		10.13%	
Ratio of total capital to risk-adjusted assets	<b>15.11%</b>		14.36%	
Minimum common equity Tier I capital ratio required by the Banking Supervision Department	<b><sup>(2)</sup>9.17%</b>		<sup>(2)</sup> 9.07%	
Minimum total capital ratio required by the Banking Supervision Department	<b><sup>(2)</sup>12.67%</b>		<sup>(2)</sup> 12.57%	

(1) The capital requirements were calculated in accordance with the minimum total capital ratio required by the Banking Supervision Department, at 12.67% as at December 31, 2016, and 12.57% as at December 31, 2015. The following approaches are used at the Bank to calculate supervisory capital, with respect to the main risk categories: standardized approach (used for credit risks, market risks, operational risk, and securitization risk); current exposure approach (for counterparty credit risk); and calculation based on risk weights established in the Proper Conduct of Banking Business Directives (used in the calculation of other assets).

(2) The minimum required common equity Tier I 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 I capital ratio and the minimum total capital ratio required by the Banking Supervision Department as at January 1, 2017, on a consolidated basis, based on data at the reporting date, stand at 10.2% and 13.7%, respectively. With regard to the balance of housing loans, see Note 30A(2) to the [Financial Statements as at December 31, 2016](#).

Table C-11: Risk-adjusted assets by supervisory activity segment<sup>A/</sup>

December 31, 2016											
Households	Private banking	Small businesses and microbusinesses	Mid-sized businesses	Large businesses	Institutional entities	Financial management	Private individuals - overseas	Business activity - overseas	Other	Total	
NIS millions											
<b>Credit risk</b>											
Activity in Israel	83,877	2,567	62,471	35,795	54,938	4,599	19,914	-	-	3,920	268,081
Activity abroad	-	-	-	-	-	-	-	1,346	20,712	-	22,058
Total credit risk assets	83,877	2,567	62,471	35,795	54,938	4,599	19,914	1,346	20,712	3,920	290,139
Market risk	-	-	-	-	-	-	4,866	-	-	-	4,866
Operational risk	7,447	437	4,700	1,617	3,002	435	2,822	339	1,251	1,324	23,374
Total risk-adjusted assets	91,324	3,004	67,171	37,412	57,940	5,034	27,602	1,685	21,963	5,244	318,379

December 31, 2015*											
Households	Private banking	Small businesses and microbusinesses	Mid-sized businesses	Large businesses	Institutional entities	Financial management	Private individuals - overseas	Business activity - overseas	Other	Total	
NIS millions											
<b>Credit risk</b>											
Activity in Israel	79,793	2,928	58,976	37,842	80,373	5,978	20,731	-	-	3,794	290,415
Activity abroad	-	-	-	-	-	-	-	2,256	25,220	-	27,476
Total credit risk assets	79,793	2,928	58,976	37,842	80,373	5,978	20,731	2,256	25,220	3,794	317,891
Market risk	-	-	-	-	-	-	4,562	-	-	-	4,562
Operational risk	6,873	502	4,514	1,517	2,838	364	3,168	398	1,110	1,387	22,671
Total risk-adjusted assets	86,666	3,430	63,490	39,359	83,211	6,342	28,461	2,654	26,330	5,181	345,124

\* Reclassified.

## Change in Risk-Weighted Assets During the Period<sup>A/</sup>

Table C-12: Statement of changes in risk-weighted assets during the period<sup>A/</sup>

	For the year ended December 31, 2016			
	Credit risk	Market risk	Operational risk	Total risk-adjusted assets
NIS millions				
Balance as at December 31, 2015	<b>317,891</b>	<b>4,562</b>	<b>22,671</b>	<b>345,124</b>
Changes in portfolio volume <sup>(1)</sup>	<b>(13,647)</b>	<b>304</b>	<b>703</b>	<b>(12,640)</b>
Changes in portfolio quality <sup>(2)</sup>	<b>(10,006)</b>	-	-	<b>(10,006)</b>
Changes in methodology and policy <sup>(3)</sup>	<b>(41)</b>	-	-	<b>(41)</b>
Sales <sup>(4)</sup>	<b>(3,315)</b>	-	-	<b>(3,315)</b>
Effect of changes in exchange rates	<b>(743)</b>	-	-	<b>(743)</b>
Balance as at December 31, 2016	<b>290,139</b>	<b>4,866</b>	<b>23,374</b>	<b>318,379</b>

	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 <sup>(1)</sup>	8,933	(707)	396	8,622
Changes in portfolio quality <sup>(2)</sup>	(284)	-	-	(284)
Changes in methodology and policy <sup>(3)</sup>	(1,364)	-	-	(1,364)
Sales <sup>(4)</sup>	(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, 2016, includes the effect of sales of loans and mortgages. In 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

The Bank has implemented Proper Conduct of Banking Business Directive 218, "Leverage Ratio" (hereinafter: the "Directive"), beginning April 1, 2015. 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 I 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.

Banking corporations are required to maintain this leverage ratio as of January 1, 2018. Pursuant to the Directive, the minimum required leverage ratio for the Bank is 6%. 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.

**Table C-13: Leverage ratio**

	<b>December 31, 2016</b>	December 31, 2015
	NIS millions	
<b>Consolidated data</b>		
Tier I capital	<b>*36,510</b>	34,955
Total exposures	<b>*503,875</b>	492,192
	%	
Leverage ratio	<b>7.25%</b>	7.10%
Minimum leverage ratio required by the Banking Supervision Department	<b>6.00%</b>	6.00%

\* These data also include Efficiency Plan Adjustments, established based on the letter of the Banking Supervision Department of January 12, 2016, "Improvement of the Operational Efficiency of the Banking System in Israel." The effect of the costs of the efficiency plan on the leverage ratio, estimated at approximately 0.16%, will be allocated in equal parts over five years, from 2017 forward.

**Table C-14: Comparison of balance sheet assets to exposure measurement, for the purposes of the leverage ratio**

	<b>December 31, 2016</b>	December 31, 2015
	NIS millions	
Total consolidated assets as per published financial statements	<b>448,105</b>	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	<b>(5,400)</b>	(5,454)
Adjustments for securities financing transactions	-	-
Adjustments for off-balance sheet items	<b>58,390</b>	62,798
Other adjustments	<b>2,780</b>	3,210
Exposure for the purposes of the leverage ratio	<b>503,875</b>	492,192

Table C-15: Leverage ratio disclosure

	<b>December 31, 2016</b>	December 31, 2015
	NIS millions/percent	
<b>On-balance sheet exposures</b>		
On-balance sheet items (excluding derivatives and securities financing transactions, but including collateral)	<b>438,614</b>	422,040
Asset amounts deducted in determining Tier I capital	<b>(27)</b>	(108)
Total on-balance sheet exposures (excluding derivatives and securities financing transactions)	<b>438,587</b>	421,932
<b>Derivative exposures</b>		
Replacement cost associated with all derivatives transactions	<b>2,774</b>	3,578
Add-on amounts for potential future exposure associated with all derivatives transactions	<b>5,194</b>	5,813
Gross-up for collateral provided in respect of derivatives deducted from balance sheet assets pursuant to the Public Reporting Directives	-	-
Deductions of receivables assets for cash variation margin provided in derivatives transactions	<b>(1,580)</b>	(2,185)
Exempted central counterparty leg of client-cleared trade exposures	-	-
Adjusted effective notional amount of written credit derivatives	<b>135</b>	137
Adjusted effective notional offsets and add-on deductions for written credit derivatives	-	-
Total derivative exposures	<b>6,523</b>	7,343
<b>Securities financing transaction exposures</b>		
Gross securities financing transaction assets (with no recognition of netting), after adjusting for sale accounting transactions	<b>375</b>	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	<b>375</b>	119
<b>Other off-balance sheet exposures</b>		
Off-balance sheet exposure at gross notional amount	<b>170,005</b>	191,347
Adjustments for conversion to credit equivalent amounts	<b>(111,615)</b>	(128,549)
Off-balance sheet items	<b>58,390</b>	62,798
<b>Capital and total exposures</b>		
Tier I capital	<b>36,510</b>	34,955
Total exposures	<b>503,875</b>	492,192
<b>Leverage ratio</b>		
Leverage ratio pursuant to Proper Conduct of Banking Business Directive 218	<b>7.25%</b>	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. For additional information and details regarding each type of risk, see below.

Pursuant to the directive of the Bank of Israel, the principal risk factors to which the Group is exposed have been mapped. The risk factors and the Board of Management's estimates regarding the severity of the risk of each factor are listed in the following table. The scale for levels of severity of the risk factors is determined with reference to the risk appetite defined by the Bank. This scale consists of five levels of severity for each risk factor. Quantitative metrics have been established for three of the levels (low, medium, and high):

- **Low severity level** – The damage to annual profit due to an extreme event would be smaller than the average annual profit before tax in the ordinary course of business; in other words, the extreme event would not cause the Bank a shift to a loss.
- **Medium severity level** – The damage to annual profit due to an extreme event would be larger than the average annual profit before tax in the ordinary course of business, and would therefore cause the Bank a shift to a loss in at least one of the years of occurrence of the event, and would cause a decrease in the Tier I capital ratio; however, the capital ratio would not fall below the risk capacity that has been established (6.5%).
- **High severity level** – The damage to profit due to an extreme event would cause the Tier I capital ratio to fall below the risk capacity of the Bank.

In order to quantify the effect of the risk factors on the Bank's profit and capital ratio, systemic extreme scenarios and single risk factor scenarios were examined for most of the risk factors, and the scenario with the more severe effect was used in the risk-factor table.

Note that this quantification refers to the effect on the capital of the Bank. Possible scenarios may involve a decrease in profit, or losses, with a non-negligible effect on the profitability of the Bank; however, the effect of these scenarios on capital adequacy is low, and they are therefore classified at a low level of severity.

Also, the opinion of a team of experts is taken into consideration if the team estimates that the quantitative indicators do not sufficiently express the severity of the risk factor, or if it is not possible to determine the risk level of a particular risk factor using reliable quantitative methods.

Each risk factor listed in the table below was tested in its own right, under an assumption of independence of each risk factor relative to the other risk factors listed in the table. However, for the risk factors “condition of the global economy” and “condition of the Israeli economy” in the table, systemic scenarios were tested to estimate the effect on profit and on the capital ratio of the combination of a number of risk factors.

Note that the risk scenarios simulate a situation in which unexpected damages materialize beyond the expected level of damage events in the regular course of the Group’s business.

The Bank also assesses the level of risk using another method, based on expert evaluations of the inherent risk level and of the quality of risk management and the effectiveness of controls.

The inherent risk is the aggregate risk inherent in the activity in which the Bank engages, and is defined as the potential loss from this activity. Inherent risk is evaluated from a forward-looking perspective as well as in view of the past, but without taking management and control processes into consideration. Inherent risk is affected by the following factors, among others:

- Past losses and estimated future losses;
- Strategic and business plans, including new products;
- Credit portfolio mix and composition;
- Complexity of the activity;
- Effect of external factors, including the economy, industry, legislation, and technology.

In order to estimate the residual risk, taking into account management and control processes, evaluations by experts from the second line of defense were added to the model, addressing the quality of risk management and the effectiveness of controls.

The combination of estimates using the two methods to obtain an overall assessment of residual risk, presented in the table below on a scale of five levels of severity, was performed as an expert evaluation, reflecting the input of the experts in the various areas, and is subject to all of the qualifications noted with respect to forward-looking information.



Table D-I: Severity of risk factors<sup>A/</sup>

Number	Risk factor	Risk effect
<b>Financial risks</b>		
<b>1.</b>	Credit risk	Medium
<b>1.1.</b>	Risk in respect of the quality of borrowers and/or collateral	Medium
<b>1.2.</b>	Risk in respect of sectoral concentration	Medium
<b>1.3.</b>	Risk in respect of concentration of borrowers/borrower groups	Medium
<b>2.</b>	Market risk	Low-Medium
<b>2.1.</b>	Interest-rate risk	Low-Medium
<b>2.2.</b>	Inflation risk/exchange-rate risk	Low
<b>2.3.</b>	Share price and credit spread risk	Low-Medium
<b>3.</b>	Liquidity risk	Low-Medium
<b>Operational and legal risks</b>		
<b>4.</b>	Operational risk	Low-Medium
<b>5.</b>	Legal risk	Low
<b>Other risks</b>		
<b>6.</b>	Reputational risk	Low-Medium
<b>7.</b>	Strategic and competitive risk	Medium
<b>8.</b>	Regulatory and legislative risk	Medium
<b>9.</b>	Economic risk – condition of the Israeli economy	Medium
<b>10.</b>	Economic risk – condition of the global economy	Medium
<b>11.</b>	Compliance risk*	Medium

\* Compliance risk also includes risks arising from the investigations by US authorities, as noted in Notes 26D and 26E to the Financial Statements.

## 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 exposure significant 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 fundamental 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 primary 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 risk appetite and risk capacity limits 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 Internal Audit, 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:

- Establishing the risk appetite and risk capacity framework of the Group.
- Approving a risk-management policy consistent with the risk appetite framework, including the establishment of risk limits in the various areas of activity and main risk areas.
- Approving the control concept framework 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 of the Bank, including the management of the Areas, 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 principal 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, Head of Financial Markets and International Banking. 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.

Table D-2: Risk and capital management governance diagram of the Bank<sup>AI</sup>

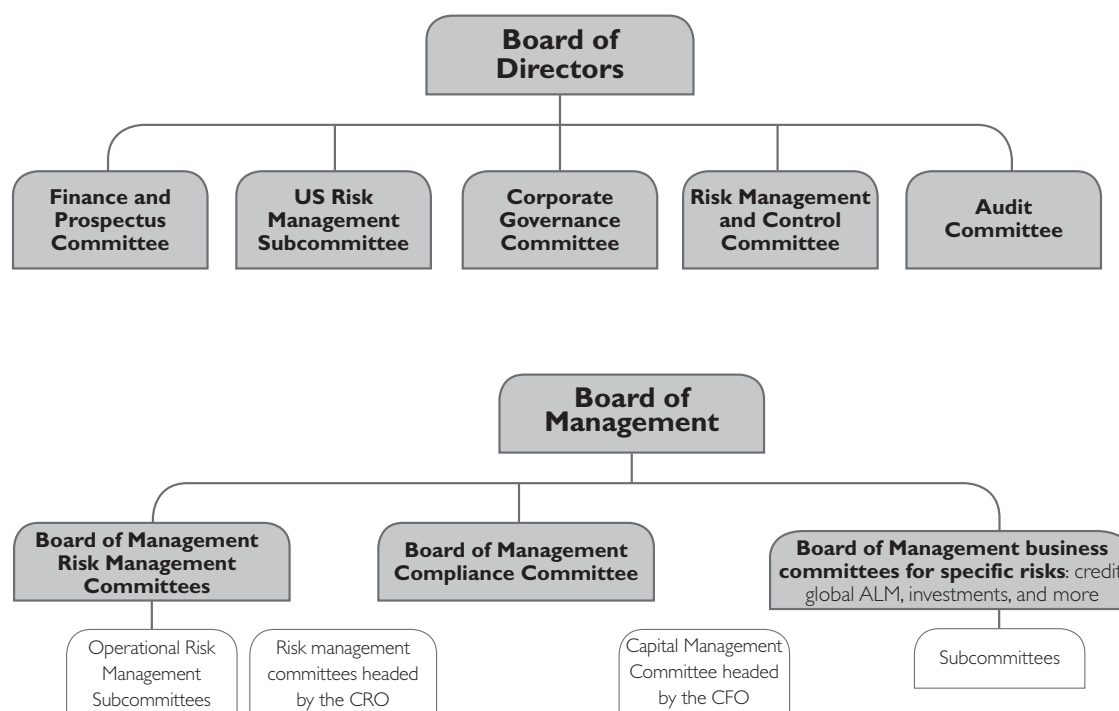
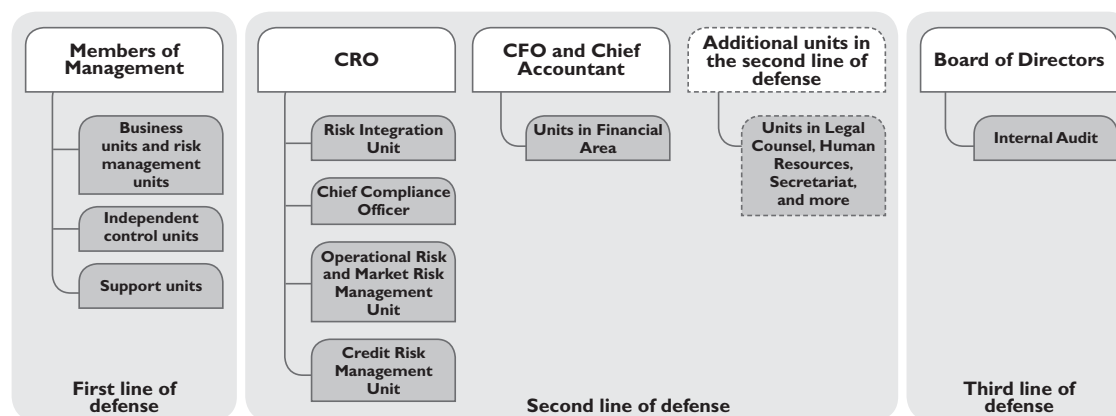


Table D-3: Risk management organizational structure<sup>A/</sup>



**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.

**US Risk Management Subcommittee** – This committee was established pursuant to the resolution of the Board of Directors of June 29, 2016, in order to supervise the risk-management policy of the Bank's operation in the United States. The subcommittee examines the risk-management policy of the Bank's activity in the United States, and ascertains that the Bank's activity in the United States is conducted within the bounds of the risk-management policy that has been established.

**Additional committees of the Board of Directors** are engaged in matters related to risk management, most notably the Finance and Prospectus Committee, the Corporate Governance Committee, and the Audit 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 and control 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's mission is to strengthen compliance at the Bank 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.

**Additional committees of the Board of Management** operate in specific areas of risk, subject to the risk policies and limits established by the Board of Directors and the Board Committees.

In February 2017, a decision was made to change the structure of the Board of Management committees and subcommittees, in order to improve work processes and the Board of Management committees' supervision of risks and risk management. This change has no material effect on the manner in which risks are managed.

**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, with the aim of maximizing the profitability of the Group at a risk level aligned with its risk appetite, 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 Area comprises four units, headed by the manager of the Area, who has the rank of a Member of Management: (1) the Credit Risk Management Unit, (2) the Operational and Market Risk Management Unit, (3) the Chief Compliance Officer and Securities Enforcement Unit, and (4) the Risk Integration Unit.

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

**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 methodology for the collective allowance, formulating policy for classifications and individual allowances, determining credit classifications, and determining individual allowances for credit losses, subject to the hierarchy of authority.

**Board of Management Committee for Addressing Financial Crises** – A dedicated management committee with special authority for the focused handling of a material financial crisis with organization-wide implications. The committee shall be activated according to a decision of, or in coordination with, the Head of Risk Management.

## **Risk Culture<sup>AI</sup>**

The Group develops and maintains a risk-management culture that aids awareness of risk and appropriate behavior and judgment in connection with risk taking in the context of corporate governance, supports 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: (1) achieving the proper balance between risk and compensation, in alignment with the risk appetite of the Bank when taking risks; (2) an effective system of controls congruent with the scale and complexity of the Bank; (3) 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; (4) monitoring violation of limits and divergence from established policies, and application of proportional disciplinary proceedings, as necessary; (5) cultivating integrity, with a focus on fair service to customers.

The material 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 above, 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, including:
  - 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 characteristics, etc.).
  - Risk limits: Quantitative indicators that 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 stakeholders 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 in a manner that encourages performance and talent management, and reinforces the desired risk-management behavior (see the section on remuneration of employees).
- Responsibility: Risk governance 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 open communication and effective criticism, 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, in order to support effective compliance with the risk-management framework.
- The code of ethics and conduct 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; an independent evaluation of 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 document;
- Credit risk management policy document;
- Treasury risk management policy document;
- Operational risk management policy document;
- Policy document – control concept;
- Policy document – compliance officer;
- Counterparty risk management policy document;
- Digital banking risk management policy document;
- Bank Hapoalim Group reputational risk management policy document;
- Policy document on the launch of new products/activities at the Bank Hapoalim Group;
- 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.

### **Stress Scenarios**

In order to understand the possible consequences of various shocks for the financial robustness of the Bank, given both the existing balance sheet and the materialization of work plans and other business intentions, a process of stress testing is carried out. Three types of scenarios are examined at the Bank for this purpose: holistic systemic scenarios, single-factor scenarios, and reverse scenarios. The Bank adapts the range and characteristics of the scenarios to financial, political, and environmental developments in Israel and globally. In addition, the Bank implements the directives of the Bank of Israel and applies the uniform stress test established by the Banking Supervision Department.

#### **Goals of Analysis of Stress Scenarios**

- Identification of risk concentrations and potential weaknesses in the Bank's portfolio;
- Examination of the effect of strategic decisions of the Bank;
- Integration in the planning process and examination of the effects of the business plan on potential exposures;
- Examination of the financial robustness of the Bank and evaluation of the potential damage that may be caused by extreme events of various types;
- Analysis of the sensitivity of the Bank to shocks or exceptional but possible events;
- Assessment of the materiality of the various risks;
- Examination of the Bank's compliance with its risk appetite and risk capacity, and breakdown of risk appetite by Area;
- Support for the business units in understanding the risk map of the various areas of activity and sectors;
- Support for the ICAAP and for the formulation of contingency plans in order to minimize the damage of extreme events.



Some of the scenarios are examined on a monthly or quarterly basis, while others are examined annually. Assumptions, methodology, and results are discussed and approved by the Stress Scenarios and Risk Concentrations Committee and in meetings of the Board of Management and committees of the Board of Directors.

Capital management takes the results of various stress scenarios into consideration, in several ways: first, the capital target of the Bank is determined in view of the risk capacity, which establishes the minimum capital adequacy that the Bank is willing to reach in the event of a stress scenario. Second, capital planning includes contingency plans which the Bank can activate if a stress scenario materializes, in order to improve its capital adequacy. In addition, stress scenarios are tested for each planning year, given the capital targets and expected capital ratio, in order to ascertain that the capital planning ensures compliance with the risk capacity throughout the years of the plan. In addition, the Bank examines the effect of a moderate stress scenario, primarily consisting of changes in the financial markets, including changes in interest rates, spreads, exchange rates, and more, on the capital-adequacy ratio, in order to measure and limit the potential erosion of the capital-adequacy ratio.

## **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:

- **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 (market value) of derivatives and financial instruments.
- **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 derivative financial instruments.

The credit risk arising from transactions in derivative financial instruments is counterparty risk – the risk that the counterparty to the transaction will default before the final settlement of cash flows in the derivatives transaction.

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 (name concentration) or has a high degree of exposure to a particular economic 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 different sectors of the economy, a large number of borrowers, different linkage segments, and 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:

- **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.
- **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.
- **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.
- **Credit policies and procedures** – 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.

- **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 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.

- **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.
- **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](#)").
- **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.
- **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;
- Corporate Credit Unit – Corporate Banking Area
- Retail Credit and Mortgages Division – Retail Banking Area;
- Overseas Credit Review 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:

- Developing methodologies for the identification, control, and management of credit risks.
- Development of models for the allocation of economic capital in respect of credit risk to the various segments.
- Monitoring credit exposure, the level of credit risk, and compliance with the credit limits of the Group on a monthly and quarterly basis.
- Running extreme scenarios at the level of the Bank and the Group.
- Monitoring, measuring, and managing credit concentration risk.
- Responsibility for the credit policy of the Bank, and leading the processes of writing and updating the policy book.
- Overseeing and reporting to the Board of Management and Board of Directors on the development of the credit portfolio of the corporate areas.
- 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 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.
- Preparing a written opinion addressing credit applications and credit ratings, in which the transaction is analyzed and, as relevant, the judgment exercised by the business function is challenged.
- Examining applications to upgrade ratings.

- Overseeing credit classifications and credit losses.
- Developing methodologies for the calculation of the collective allowance.
- Overseeing reporting on the fairness of classifications and total allowances (collective and individual).
- Development of models for the measurement of credit risk ratings, and pricing at the level of the individual borrower.
- Validation of credit risk rating models, as part of the process of development and performance evaluation, on an annual basis.
- Performing statistical analysis of the portfolio of exposures and of the various segments.
- In the area of counterparty risk in derivative financial instruments, the Market and Liquidity Risk Management Department serves as the second line of defense, and is responsible for establishing methodology for the management of counterparty risk, instilling this methodology at the Bank, and calculating customers' credit exposure in respect of their activity in the dealing room, both for the purpose of collateral requirements and for the purpose of the allocation of economic capital.

### **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 opinions they prepare regarding the various borrowers, 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 repayment 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 of small customers 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 regains 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**

The individual allowance for credit losses in respect of credit classified as “impaired,” 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 the following three steps, in accordance with the guidelines of the Bank of Israel:

- Calculation of a multi-year average of charge-off rates – On January 19, 2015, the Banking Supervision Department issued a circular updating the Public Reporting Directives, including guidelines for calculation of the collective allowance. Pursuant to the circular, in establishing the allowance for credit losses, the Bank must, among other matters, take past losses into consideration, calculated according to the average past losses in the last five years. On February 20, 2017, the Banking Supervision Department issued a letter pursuant to which in 2016 and 2017, the years from 2011 forward would continue to be taken into account in establishing the historical loss rates used as the basis for the calculation of the collective allowance (i.e. six years in 2016 and seven years in 2017);
- Adjustments in the event that significant changes occurred over the last quarter;
- Establishment of adjustment coefficients. The purpose of the adjustment coefficients is 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 in the collective allowance rates. The Bank has developed an advanced model for establishing adjustment coefficients, in accordance with the instructions of the Bank of Israel. This model reflects the wide range of environmental risk factors that may affect the rate of credit losses at the Bank. 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-4: Segmentation of credit-risk exposures by counterparty and by main types of credit exposures, before allowance for credit losses<sup>(1)</sup>

December 31, 2016												
Sovereigns	Public sector corporations	Banking Corporations	Secured by commercial real estate	Retail to individuals	Small businesses	Housing loans	Securitization	Others	Gross credit exposure <sup>(2)</sup>	Average gross credit exposure		
NIS millions												
Loans <sup>(3)</sup>	<b>72,899</b>	<b>3,293</b>	<b>8,716</b>	<b>93,050</b>	<b>34,552</b>	<b>63,570</b>	<b>9,932</b>	<b>68,640</b>	-	-	<b>354,652</b>	<b>348,838</b>
Bonds <sup>(4)</sup>	<b>49,930</b>	<b>981</b>	<b>5,576</b>	<b>3,678</b>	<b>38</b>	-	-	-	-	-	<b>60,203</b>	<b>56,175</b>
Derivatives <sup>(5)</sup>	<b>79</b>	<b>1,082</b>	<b>3,230</b>	<b>4,440</b>	<b>183</b>	<b>29</b>	<b>18</b>	<b>7</b>	-	-	<b>9,068</b>	<b>9,706</b>
Other off-balance sheet exposures	<b>163</b>	<b>2,159</b>	<b>2,134</b>	<b>60,336</b>	<b>56,287</b>	<b>42,440</b>	<b>3,713</b>	<b>2,235</b>	<b>192</b>	-	<b>169,659</b>	<b>178,506</b>
Other assets <sup>(6)</sup>	-	-	-	-	-	-	-	-	-	<b>15,316</b>	<b>15,316</b>	<b>15,668</b>
<b>Total</b>	<b>123,071</b>	<b>7,515</b>	<b>19,656</b>	<b>161,504</b>	<b>91,060</b>	<b>106,039</b>	<b>13,663</b>	<b>70,882</b>	<b>192</b>	<b>15,316</b>	<b>608,898</b>	<b>608,893</b>

December 31, 2015												
Sovereigns	Public sector corporations	Banking Corporations	Secured by commercial real estate	Retail to individuals	Small businesses	Housing loans	Securitization	Others	Gross credit exposure <sup>(2)</sup>	Average gross credit exposure		
NIS millions												
Loans <sup>(3)</sup>	59,351	4,549	5,490	100,821	38,527	60,447	9,657	66,495	-	-	345,337	335,661
Bonds <sup>(4)</sup>	42,091	1,055	4,668	4,958	508	-	-	-	-	-	53,280	49,426
Derivatives <sup>(5)</sup>	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 <sup>(6)</sup>	-	-	-	-	-	-	-	-	-	16,233	16,233	16,708
<b>Total</b>	<b>101,963</b>	<b>8,859</b>	<b>15,003</b>	<b>185,423</b>	<b>93,821</b>	<b>112,053</b>	<b>13,487</b>	<b>68,833</b>	<b>195</b>	<b>16,233</b>	<b>615,870</b>	<b>600,911</b>

(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-5: Total principal exposures to foreign countries<sup>(1)</sup>**

Balance sheet exposure to foreign countries as at December 31, 2016 amounted to NIS 60.7 billion, compared with NIS 58.0 billion at the end of 2015.

Off-balance sheet exposure to foreign countries as at December 31, 2016 amounted to NIS 26.3 billion, compared with NIS 17.5 billion at the end of 2015.

The Bank operates in accordance with an ordered policy that sets limits and terms for the exposure to foreign countries.

Country	December 31			
	2016		2015	
	Total balance sheet exposure <sup>(2)</sup>	Total off-balance sheet exposure <sup>(2)(3)(4)</sup>	Total balance sheet exposure <sup>(2)</sup>	Total off-balance sheet exposure <sup>(2)(3)(4)</sup>
	NIS millions			
United States	27,079	7,836	23,846	9,194
Europe*	19,340	15,345	20,480	4,283
Others	14,252	3,119	13,713	4,030
Total exposures to foreign countries	60,671	26,300	58,039	17,507
Of which: total exposure to PIIGS (Portugal, Ireland, Italy, Greece, and Spain)	350	387	444	394
Of which: total exposure to LDCs	2,009	1,073	2,468	1,627

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).

\* Information regarding total exposures to foreign countries and exposures to countries total exposure to each of which constitutes more than 1% of total balance sheet assets or 20% of capital, whichever is lower.

- (1) Based on the final risk, after the effect of guarantees, liquid collateral, and credit derivatives.
- (2) 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.
- (3) 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.
- (4) The balance of the off-balance sheet exposure to foreign countries includes a total of NIS 13,344 million in respect of the acquisition of insurance for the portfolio of Sale Law guarantees from international reinsurers.

Table D-6: Segmentation of the portfolio by term to maturity and by principal type of credit exposure<sup>(1)</sup>

	December 31, 2016					
	Up to one year	1 year to 5 years	Over 5 years	Other	Effect of netting agreements	Gross credit exposure <sup>(2)</sup>
	NIS millions					
Loans <sup>(3)</sup>	<b>172,576</b>	<b>76,632</b>	<b>105,444</b>	-	-	<b>354,652</b>
Bonds <sup>(4)</sup>	<b>25,889</b>	<b>24,008</b>	<b>10,306</b>	-	-	<b>60,203</b>
Derivatives <sup>(5)</sup>	<b>6,032</b>	<b>7,781</b>	<b>6,929</b>	-	<b>(11,674)</b>	<b>9,068</b>
Other off-balance sheet exposures	<b>39,310</b>	<b>126,281</b>	<b>4,068</b>	-	-	<b>169,659</b>
Other assets <sup>(6)</sup>	<b>2,738</b>	-	-	<b>12,578</b>	-	<b>15,316</b>
<b>Total</b>	<b>246,545</b>	<b>234,702</b>	<b>126,747</b>	<b>12,578</b>	<b>(11,674)</b>	<b>608,898</b>

	December 31, 2015					
	Up to one year	1 year to 5 years	Over 5 years	Other	Effect of netting agreements	Gross credit exposure <sup>(2)</sup>
	NIS millions					
Loans <sup>(3)</sup>	158,600	84,504	102,233	-	-	345,337
Bonds <sup>(4)</sup>	13,249	25,084	14,947	-	-	53,280
Derivatives <sup>(5)</sup>	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 <sup>(6)</sup>	2,619	-	-	13,614	-	16,233
<b>Total</b>	<b>206,454</b>	<b>278,826</b>	<b>129,102</b>	<b>13,614</b>	<b>(12,126)</b>	<b>615,870</b>

- (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-7: Amount of problematic credit risk, impaired credit risk, 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

Sector	December 31 2016					
	Total credit risk	Of which: problematic credit risk	Rate of problematic risk	Impaired credit risk	Provision (income) for credit losses	Net charge-offs
	NIS millions		%		NIS millions	
Industry	40,943	1,509	3.7%	601	(140)	(12)
Construction and real estate - construction	56,737	1,266	2.2%	740	(213)	(172)
Construction and real estate - real-estate activities	30,746	610	2.0%	445	(257)	(132)
Commerce	40,482	1,993	4.9%	654	335	327
Financial services	38,592	531	1.4%	253	(15)	(19)
Private individuals - housing loans	63,851	615	1.0%	-	(5)	21
Private individuals - other	85,571	1,089	1.3%	752	482	386
Other sectors	69,839	1,546	2.2%	1,150	78	144
Total public	426,761	9,159	2.1%	4,595	265	543
Total banks	45,484	-	0.0%	-	1	-
Total governments	62,278	-	0.0%	-	3	-
Total	534,523	9,159	1.7%	4,595	269	543

Sector	December 31 2015						
	Total credit risk	Of which: problematic credit risk	Rate of problematic risk	Impaired credit risk	Provision (income) for credit losses	Net charge-offs	Allowance for credit losses
	NIS millions		%		NIS millions		
Industry	46,280	2,263	4.9%	880	(150)	(144)	479
Construction and real estate - construction	59,263	1,401	2.4%	693	(129)	(170)	649
Construction and real estate - real-estate activities	31,712	1,123	3.5%	650	(137)	(148)	590
Commerce	40,456	2,334	5.8%	1,303	1,303	1,303	1,303
Financial services	49,533	566	1.1%	483	(18)	77	263
Private individuals - housing loans	63,730	640	1.0%	-	5	-	392
Private individuals - other	93,413	1,045	1.1%	704	180	268	844
Other sectors	73,593	1,886	2.6%	1,277	(578)	(958)	563
Total public	457,980	11,258	2.5%	5,990	476	228	5,083
Total banks	41,963	-	0.0%	-	(1)	-	3
Total governments	52,514	-	0.0%	-	-	-	-
Total	552,457	11,258	2.0%	5,990	475	228	5,086

Table D-8: Change in allowance for credit losses

	2016					
	Credit to the public				Banks and governments	Total
	Commercial	Housing	Other private	Total		
NIS millions						
Allowance for credit losses at beginning of year	<b>3,847</b>	<b>392</b>	<b>844</b>	<b>5,083</b>	<b>3</b>	<b>5,086</b>
Provision for credit losses <sup>(1)</sup>	<b>(212)</b>	<b>(5)</b>	<b>482</b>	<b>265</b>	<b>4</b>	<b>269</b>
Charge-offs	<b>(910)</b>	<b>(21)</b>	<b>(703)</b>	<b>(1,634)</b>	-	<b>(1,634)</b>
Recoveries of debts charged off in previous years	<b>774</b>	-	<b>317</b>	<b>1,091</b>	-	<b>1,091</b>
Net charge-offs	<b>(136)</b>	<b>(21)</b>	<b>(386)</b>	<b>(543)</b>	-	<b>(543)</b>
Adjustments from translation of financial statements	-	-	<b>(1)</b>	<b>(1)</b>	-	<b>(1)</b>
Other	-	-	-	-	-	-
Allowance for credit losses as at December 31, 2016 <sup>(2)</sup>	<b>3,499</b>	<b>366</b>	<b>939</b>	<b>4,804</b>	<b>7</b>	<b>4,811</b>
(1) Of which: in respect of off-balance sheet credit instruments	<b>10</b>	-	<b>(2)</b>	<b>8</b>	-	<b>8</b>
(2) Of which: in respect of off-balance sheet credit instruments	<b>626</b>	-	<b>51</b>	<b>677</b>	-	<b>677</b>
	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 <sup>(1)</sup>	291	5	180	476	(1)	475
Charge-offs	(918)	-	(586)	(1,504)	-	(1,504)
Recoveries of debts charged off in previous years	958	-	318	1,276	-	1,276
Net charge-offs	40	-	(268)	(228)	-	(228)
Adjustments from translation of financial statements	-	-	-	-	-	-
Other	(14)	-	(3)	(17)	-	(17)
Allowance for credit losses as at December 31, 2016 <sup>(2)</sup>	3,847	392	844	5,083	3	5,086
(1) Of which: in respect of off-balance sheet credit instruments	12	-	(15)	(3)	-	(3)
(2) Of which: in respect of off-balance sheet credit instruments	616	-	53	669	-	669

## Additional Information Regarding Exposures to Credit Risk<sup>AI</sup>

### Construction and Real Estate<sup>AI</sup>

Overall credit risk in the construction and real-estate sectors totaled approximately NIS 87 billion as at December 31, 2016.

Table D-9: Segmentation of credit risk of the Bank Group in the construction and real-estate sectors, by principal area of activity<sup>AI</sup>

	Balance as at December 31, 2016		
	Balance sheet credit risk	Off-balance sheet credit risk	Total credit risk
	NIS millions		
Construction for commerce and services	3,008	1,150	4,158
Construction for industry	489	169	658
Housing construction	10,857	*29,028	39,885
Yield-generating properties	22,265	5,248	27,513
Other	8,365	6,904	15,269
Total construction and real-estate sectors	44,984	42,499	87,483

\* Includes off-balance sheet credit risk in the amount of approximately NIS 13,430 million, in respect of which insurance was acquired from foreign insurance companies for the portfolio of Sale Law guarantees. For additional information, see Note 25I to the [Financial Statements](#).

### Credit Risk in Respect of Exposures to Borrowers and to Groups of Borrowers<sup>AI</sup>

Table D-10: 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<sup>AI</sup>

	December 31, 2016			
	Number of borrowers	Balance sheet credit risk	Off-balance sheet credit risk	Total
	NIS millions			
<b>Economic sector</b>				
Industry	3	872	5,800	6,672
Construction and real estate - construction	1	136	1,438	1,574
Construction and real estate - real-estate activities	2	1,632	1,091	2,723
Electricity and water supply	1	673	1,968	2,641
Financial services	4	5,262	2,152	7,414
Total	11	8,575	12,449	21,024

Table D-11: Balances of balance sheet credit and off-balance sheet credit risk to the six largest borrowers, by sector of the economy<sup>A/</sup>

	December 31, 2016		
	Balance sheet credit risk	Off-balance sheet credit risk	Total
	NIS millions		
<b>Economic sector</b>			
Industry	<b>150</b>	<b>3,518</b>	<b>3,668</b>
Financial services	<b>2,787</b>	<b>429</b>	<b>3,216</b>
Electricity and water supply	<b>673</b>	<b>1,968</b>	<b>2,641</b>
Financial services	<b>927</b>	<b>717</b>	<b>1,644</b>
Construction and real estate - construction	<b>136</b>	<b>1,438</b>	<b>1,574</b>
Industry	<b>-</b>	<b>1,519</b>	<b>1,519</b>
<b>Total</b>	<b>4,673</b>	<b>9,589</b>	<b>14,262</b>

### Credit Risk in Respect of Exposure to Borrower Groups

As at December 31, 2016, there is no 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).

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.

Pursuant to the directive, the rate of the "indebtedness" of a "borrower" and of a "group of borrowers," as defined therein, after deduction of the permitted amounts, shall not exceed 15% and 25%, respectively, of the capital of the bank, as defined above. The directive further states that the total indebtedness (after deduction of the permitted amounts) of the borrowers, borrower groups, and banking borrower groups, each of whose net indebtedness to the banking corporation exceeds 10% of the capital of the bank, shall not exceed 120% of the capital of the bank, as defined above.

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. As at the reporting date, the Bank is in compliance with these limits.

## Credit to Private Individuals (Excluding Housing)<sup>AI</sup>

Table D-12: Balance of credit to private individuals in Israel<sup>AI</sup>

	For the year ended December 31		Change	
	2016	2015		
	NIS millions			%
<b>Balance sheet</b>				
Negative balance in current accounts	<b>3,683</b>	3,634	49	1.35%
Loans	<b>37,573</b>	35,957	1,616	4.49%
Debtors in respect of credit-card activity	<b>12,203</b>	12,234	(31)	(0.25%)
Total balance sheet credit risk	<b>53,459</b>	51,825	1,634	3.15%
<b>Off-balance sheet</b>				
Off-balance sheet credit risk	<b>30,597</b>	38,368	(7,771)	(20.25%)
Total credit risk	<b>84,056</b>	90,193	(6,137)	(6.80%)

Table D-13: Information regarding problematic debts in respect of private individuals in Israel<sup>AI</sup>

	For the year ended December 31		Change	Percentage of total balance sheet credit risk	
	2016	2015		For the year ended December 31	2015
	NIS millions			%	
Problematic credit risk	<b>1,048</b>	999	4.90%	<b>1.96%</b>	1.93%
Of which: impaired credit risk	<b>720</b>	672	7.14%	<b>1.35%</b>	1.30%
Debts in arrears of more than 90 days	<b>81</b>	84	(3.57%)	<b>0.15%</b>	0.16%
Net charge-offs	<b>381</b>	252	51.19%	<b>0.71%</b>	0.49%
Allowance for credit losses	<b>906</b>	809	11.99%	<b>1.69%</b>	1.56%

The balance of loans to private individuals in Israel grew by approximately 4.5% in 2016. The increase was influenced by the low interest rates, among other factors. Total balance sheet credit risk increased by approximately 3.2%, influenced by a smaller increase in negative current-account balances and by a slight decrease in the balance of debtors in respect of credit-card activity. The total balances of overall credit risk to private individuals in Israel decreased by approximately 6.8% in 2016, due to a decrease of approximately 20.3% in off-balance sheet credit risk. The decrease in off-balance sheet credit risk was influenced by the reduction of credit facilities in credit cards.

Concurrently with the increase in credit exposures, the risk level of the portfolio of credit to private individuals also rose, as reflected in the rate of net charge-offs in 2016, among other matters. The Bank conducts processes to track and monitor the risk of credit to private individuals, and updates processes as necessary.

The balances of credit risk to private individuals include balances in respect of the activity of Isracard and Poalim Express, which focus on credit cards. Isracard is also active in the area of credit, but its share of the total loan portfolio is low, constituting approximately 5.5% of the balance of loans in 2016, compared with approximately 4.2% in 2015.

For further details, see the section "Credit Risk" in the Review of Risks in the [Board of Directors' Report](#).



## Risks in the Housing Loan Portfolio<sup>A/</sup>

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<sup>A/</sup>

	Unlinked segment				CPI-linked segment				Foreign-currency segment		Total	
	Fixed interest rate		Floating interest rate		Fixed interest rate		Floating interest rate		Floating interest rate		Recorded debt balance in NIS millions	Rate of change during the period
	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 %		
<b>December 31, 2016</b>	<b>10,570</b>	<b>15.3%</b>	<b>25,360</b>	<b>36.6%</b>	<b>12,630</b>	<b>18.2%</b>	<b>20,120</b>	<b>29.1%</b>	<b>574</b>	<b>0.8%</b>	<b>69,254</b>	<b>3.0%</b>
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%
December 31, 2014	4,250	6.8%	21,374	34.4%	13,379	21.5%	22,241	35.8%	870	1.4%	62,114	6.6%

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 conditions and changes in macro-economic indicators 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, 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 expected loss 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).

### 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.

Table D-15: Details of characteristics of housing credit granted by the Bank – percentage of total new loans executed<sup>A/</sup>

	For the year ended		
	December 31, 2016	December 31, 2015	December 31, 2014
<b>Characteristics</b>			
Financing rate over 60%	<b>24.5%</b>	33.3%	36.6%
Ratio of repayment to income greater than 40% (for acquisition and in monthly payments)	<b>0.2%</b>	0.7%	5.6%
Financing rate over 60% and repayment rate over 40%	<b>0.1%</b>	0.3%	1.9%
Percentage of execution of floating-rate loans with interest varying at a frequency of less than 5 years (Bank of Israel limit 33.3%)	<b>30.0%</b>	30.0%	31.0%
Percentage of all-purpose loans	<b>3.0%</b>	2.7%	4.5%
Loans for investment purposes as a percentage of acquisition	<b>14.6%</b>	16.7%	16.8%
Average loan per acquisition (in NIS thousands), excluding refinancing of Ministry of Finance loans	<b>632</b>	657	613
Average original term to maturity per acquisition, in years (excluding bridge loans)	<b>23.2</b>	21.6	20.9
Percentage over 25 years (including refinancing)	<b>34.6%</b>	24.7%	20.8%

Note that financing rates were calculated pursuant to Reporting Directive 876 of the Banking Supervision Department, "Report on Housing Loans."

The percentages of execution of credit at a financing rate greater than 60% and at payments at rates of more than 40% of income have decreased in recent years. Concurrently, the average maturity period and the percentage of loans executed for periods of more than 25 years have increased. These trends were influenced by the policy of the Bank, by regulation, and by the increase in prices of homes.

### Leveraged Financing<sup>A/</sup>

The Bank provides leveraged financing to its customers from time to time.

A new directive, Proper Conduct of Banking Business Directive 327, "Management of Leveraged Loans," issued in April 2015, took effect on January 1, 2016. The leveraged financing category was updated as a result of this directive.

Among other matters, leveraged financing includes equity transactions, and financing for borrowers in various segments of specified economic sectors characterized by exceptional levels of certain parameters, relative to the accepted norms in the economic sectors, such as a high financing rate that deviates from the policy for the sector; or financing of mezzanine debt.

An internal limit applies to leveraged financing as a percentage of the Tier I capital of the Bank. Developments in leveraged financing and compliance with the established limit are reported each quarter to the Board of Management and the Board of Directors of the Bank, for monitoring of the risks inherent in this type of financing.

Data regarding credit risks in respect of leveraged financing are presented below. The disclosure focuses on exposures in respect of leveraged borrowers/transactions where the balance of credit exceeds the amount of 0.5% of Tier I capital.

Table D-16: The Bank's exposures to leveraged financing, by economic sector of the borrower<sup>A/</sup>

Economic sector of the borrower	December 31, 2016			Total
	Number of borrowers	Balance sheet credit balance	Off-balance sheet credit balance	
	NIS millions			
Construction and real estate - construction	1	781	-	781
Construction and real estate - real-estate activities	2	688	981	1,669
Hotels, hospitality, and food services	1	200	2	202
Mining and quarrying	2	1,501	67	1,568
Commerce	2	957	221	1,178
Financial services and insurance services	1	354	-	354
Industry	3	967	64	1,031
<b>Total</b>	<b>12</b>	<b>5,448</b>	<b>1,335</b>	<b>6,783</b>

Exposures of the Bank in respect of leveraged financing by economic sector of the borrower, as at December 31, 2015 (restated due to a change in the reporting threshold)

Economic sector of the borrower	December 31, 2015			Total*
	Number of borrowers	Balance sheet credit balance	Off-balance sheet credit balance	
	NIS millions			
Construction and real estate - construction	3	1,366	206	1,572
Construction and real estate - real-estate activities	2	794	992	1,786
Mining and quarrying	2	1,398	112	1,510
Information and communications	1	232	-	232
Commerce	2	622	-	622
Financial services and insurance services	2	598	-	598
Industry	2	844	125	969
<b>Total</b>	<b>14</b>	<b>5,854</b>	<b>1,435</b>	<b>7,289</b>

\* Net of an individual allowance for credit losses in the amount of approximately NIS 89 million.

## 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-17: 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 ECAs 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 Banking Supervision Department. 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.

As at December 31, 2016, several significant processes have been completed that have improved the capital-adequacy ratio of the Bank, including the following:

- **Insurance for the portfolio of Sale Law guarantees for purchasers of homes** – A contractual engagement with international reinsurers was completed in July 2016, for the purchase of insurance for the portfolio of guarantees pursuant to the Sale Law (Homes) and commitments to issue such guarantees. This purchase is aimed at enabling the Bank, among other matters, to reduce the volume of capital allocated in respect of the credit risk arising from the issuance of Sale Law guarantees and commitments to issue such guarantees, by using the policy as a “credit risk mitigator,” in accordance with Proper Conduct of Banking Business Directive 203. The volume of the insured part of the portfolio of Sale Law guarantees and credit facilities is approximately NIS 29 billion (approximately NIS 13 billion after weighting with CCF (credit conversion factors)). The agreement led to the reduction of risk-adjusted assets by approximately NIS 9.7 billion, and to an improvement of approximately 0.3% in the common equity Tier I capital ratio of the Bank.
- **Mortgage sales** – A contractual engagement for the sale of housing loans was completed in July 2016, with the retention of 20% of each loan under the ownership of the Bank. The balance of the loans transferred to the buyer (80% of each loan) is approximately NIS 665 million. An additional sale at a volume of approximately NIS 260 million was performed in November 2016. The Bank will consider selling additional loans, according to its needs and the relevant regulatory limits.

Table D-18: Amount of gross credit exposures before credit risk mitigation

	December 31, 2016								
	0%	20%	35%	50%	75%	100%	150%	250%	Gross credit exposure <sup>(1)</sup>
	NIS millions								
Sovereigns	<b>116,840</b>	<b>4,105</b>	-	<b>329</b>	-	<b>1,796</b>	-	-	<b>123,070</b>
Public sector	-	<b>837</b>	-	<b>6,678</b>	-	-	-	-	<b>7,515</b>
Banking corporations	<b>302</b>	<b>16,006</b>	-	<b>3,064</b>	-	<b>284</b>	-	-	<b>19,656</b>
Corporations	-	<b>1,177</b>	-	<b>2,633</b>	-	<b>156,133</b>	<b>909</b>	-	<b>160,852</b>
Secured by commercial real estate	-	-	-	-	-	<b>90,386</b>	<b>481</b>	-	<b>90,867</b>
Retail to individuals	-	-	-	-	<b>105,391</b>	<b>105</b>	<b>437</b>	-	<b>105,933</b>
Small businesses	-	-	-	-	<b>13,505</b>	<b>41</b>	<b>58</b>	-	<b>13,604</b>
Housing loans	-	-	<b>27,415</b>	<b>14,714</b>	<b>22,729</b>	<b>5,819</b>	<b>205</b>	-	<b>70,882</b>
Securitization	-	-	-	-	-	<b>192</b>	-	-	<b>192</b>
Others	<b>2,880</b>	-	-	-	-	<b>7,760</b>	<b>923</b>	<b>3,753</b>	<b>15,316</b>
<b>Total</b>	<b>120,022</b>	<b>22,125</b>	<b>27,415</b>	<b>27,418</b>	<b>141,625</b>	<b>262,516</b>	<b>3,013</b>	<b>3,753</b>	<b>607,887</b>

	December 31, 2015								
	0%	20%	35%	50%	75%	100%	150%	250%	Gross credit exposure <sup>(1)</sup>
	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
<b>Total</b>	<b>96,712</b>	<b>23,235</b>	<b>30,710</b>	<b>24,119</b>	<b>144,070</b>	<b>288,069</b>	<b>3,897</b>	<b>3,887</b>	<b>614,699</b>

(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-19: Amount of net credit exposures after credit risk mitigation

	December 31, 2016								Net credit exposure <sup>(1)</sup>
	0%	20%	35%	50%	75%	100%	150%	250%	
	NIS millions								
Sovereigns	<b>116,840</b>	<b>4,105</b>	-	<b>329</b>	-	<b>680</b>	-	-	<b>121,954</b>
Public sector	<b>2,932</b>	<b>837</b>	-	<b>6,780</b>	-	-	-	-	<b>10,549</b>
Banking corporations	<b>302</b>	<b>17,240</b>	-	<b>15,913</b>	-	<b>182</b>	-	-	<b>33,637</b>
Corporations	-	<b>24,256</b>	-	<b>7,937</b>	-	<b>148,778</b>	<b>888</b>	-	<b>181,859</b>
Secured by commercial real estate	-	-	-	-	-	<b>60,283</b>	<b>480</b>	-	<b>60,763</b>
Retail to individuals	-	-	-	-	<b>89,207</b>	<b>105</b>	<b>436</b>	-	<b>89,748</b>
Small businesses	-	-	-	-	<b>12,104</b>	<b>39</b>	<b>56</b>	-	<b>12,199</b>
Housing loans	-	-	<b>27,415</b>	<b>14,714</b>	<b>22,729</b>	<b>5,819</b>	<b>205</b>	-	<b>70,882</b>
Securitization	-	-	-	-	-	<b>192</b>	-	-	<b>192</b>
Others	<b>2,880</b>	-	-	-	-	<b>7,760</b>	<b>923</b>	<b>3,753</b>	<b>15,316</b>
<b>Total</b>	<b>122,954</b>	<b>46,438</b>	<b>27,415</b>	<b>45,673</b>	<b>124,040</b>	<b>223,838</b>	<b>2,988</b>	<b>3,753</b>	<b>597,099</b>

	December 31, 2015								Net credit exposure <sup>(1)</sup>
	0%	20%	35%	50%	75%	100%	150%	250%	
	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
<b>Total</b>	<b>98,523</b>	<b>25,191</b>	<b>30,710</b>	<b>37,774</b>	<b>125,364</b>	<b>279,932</b>	<b>3,792</b>	<b>3,887</b>	<b>605,173</b>

(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-20: 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

December 31, 2016							
	Gross credit exposure <sup>(1)</sup>	Exposure covered by guarantees	Exposure covered by derivatives	Total amounts subtracted	Total amounts added <sup>(2)</sup>	Exposure covered by financial collateral <sup>(3)</sup>	Net credit exposure <sup>(4)</sup>
NIS millions							
Sovereigns	123,070	(1,116)	-	(1,116)	-	-	121,954
Public sector	7,515	-	-	-	3,034	-	10,549
Banking corporations	19,656	(1,556)	-	(1,556)	16,442	(905)	33,637
Corporations	160,852	(1,984)	-	(1,984)	29,387	(6,396)	181,859
Secured by commercial real estate	90,867	(29,345)	-	(29,345)	-	(759)	60,763
Retail to individuals	105,933	(14,528)	-	(14,528)	-	(1,657)	89,748
Small businesses	13,604	(254)	-	(254)	-	(1,151)	12,199
Housing loans	70,882	-	-	-	-	-	70,882
Securitization	192	-	-	-	-	-	192
Others	15,316	-	-	-	-	-	15,316
<b>Total</b>	<b>607,887</b>	<b>(48,783)</b>	<b>-</b>	<b>(48,783)</b>	<b>48,863</b>	<b>(10,868)</b>	<b>597,099</b>

December 31, 2015							
	Gross credit exposure <sup>(1)</sup>	Exposure covered by guarantees	Exposure covered by derivatives	Total amounts subtracted	Total amounts added <sup>(2)</sup>	Exposure covered by financial collateral <sup>(3)</sup>	Net credit exposure <sup>(4)</sup>
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
<b>Total</b>	<b>614,699</b>	<b>(18,734)</b>	<b>-</b>	<b>(18,734)</b>	<b>18,780</b>	<b>(9,572)</b>	<b>605,173</b>

(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 risk** – The credit risk arising from transactions in derivative financial instruments is the risk that the counterparty to the transaction will default before the final settlement of cash flows in the derivatives transaction. The market value of the transaction may be positive or negative for any of the parties to the transaction; the market value is not certain, and may change over time and according to movements in the underlying market factors.

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 exposure 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.

The potential risk of future loss arising from transactions in derivative financial instruments in respect of the counterparty 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, in order 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 Proper Conduct of Banking Business Directive 203. 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-21: Details of credit exposures of the Bank arising from derivatives**

	<b>December 31, 2016</b>					
	Interest-rate derivatives	Foreign-currency and gold derivatives	Equity derivatives	Precious metals	Commodity derivatives	Total
	NIS millions					
Positive gross fair value	<b>7,542</b>	<b>3,692</b>	<b>852</b>	<b>12</b>	<b>16</b>	<b>12,114</b>
Add-on values	<b>3,093</b>	<b>4,704</b>	<b>797</b>	<b>4</b>	<b>30</b>	<b>8,628</b>
Effect of netting agreements	-	-	-	-	-	<b>(11,674)</b>
Eligible collateral	-	-	-	-	-	<b>(1,534)</b>
Net credit exposure	<b>10,635</b>	<b>8,396</b>	<b>1,649</b>	<b>16</b>	<b>46</b>	<b>7,534</b>

	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-22: Details of face value of the Bank's credit-derivatives portfolio, used for risk management in the Bank's credit portfolio

	December 31, 2016		
	Face value in NIS millions		
	Banking book		Total face value of credit derivatives
	Protection acquired	Protection sold	
Credit derivatives	50	135	185

	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

The Bank is not a party to CDS transactions originating in intermediary activities.

### Securitization Exposures

The volume of the Bank's exposure in respect of securitization is approximately NIS 192 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 December 31, 2016, amounted to NIS 192 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 December 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

**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.

### **Management of Market Risks**

The main 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 exposure in the banking book and 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 and liquidity 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**

The activity that generates market risks is under the responsibility of 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 subcommittees, with the participation of senior officers of the Bank; one subcommittee is headed by the Head of Financial Markets and International Banking and another is headed by the Head of the Asset and Liability Management 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 Banking Supervision Department 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 market risk appetite is established in terms of VaR and/or sensitivities and/or scenarios.

The Financial Markets and International Banking Area is responsible for managing all exposures to market risks generated as a result of the activity of all of the business units of the Bank. Market risks in the banking book are managed by the Asset and Liability Management 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 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 suited 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<sup>A/</sup>**

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 exposure 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.

The potential risk of future loss arising from transactions in derivative financial instruments in respect of the counterparty 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, in order 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 on this subject.

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

**Table D-23: Main limits on exposures to market risks in the overall activity of the Bank, and separately for trading activity**

Limit	NIS millions	% of active financial capital
<b>Overall Bank activity</b>		
Overall risk estimate (VaR)	<b>950</b>	
Sensitivity of economic value to parallel changes of 1% in interest-rate curves:		
Unlinked NIS*	<b>620</b>	
CPI-linked NIS	<b>620</b>	
Foreign currency	<b>500</b>	
Sensitivity to 10% change in NIS/USD exchange rate	<b>500</b>	
Linkage-base exposures by segment:		
CPI-linked NIS		<b>+/-110</b>
Foreign currency, including foreign-currency linked		<b>+/-30</b>
<b>Of which: Trading book</b>		
Overall risk estimate (VaR)	<b>150</b>	
Sensitivity of economic value to parallel changes of 1% in interest-rate curves:		
Unlinked NIS	<b>120</b>	
Foreign currency	<b>70</b>	
Parallel and non-parallel change in NIS/USD basis swap spread curve	<b>180</b>	
CPI exposure - net position limit	<b>4,000</b>	
NIS/foreign-currency exposure		<b>+/-10</b>

\* This limit was raised to NIS 720 million, as of the beginning of 2017.

## **Means for Policy Supervision and Realization<sup>AI</sup>**

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 the activity; 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 exposures significant 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<sup>AI</sup>**

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 main limits are detailed above. Risk assessments as well as limit control of trading positions are performed at least once daily, both by control units within the Financial Markets and International Banking Area and by units in the second line of defense.

The VaR estimate for trading activity is performed using a horizon of ten business days, indicating an assumption that it is possible to hedge and sell the positions within ten business days.



## **Portfolio Management Models<sup>A/</sup>**

### **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 considered. 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 portfolio is performed at least once daily, under various scenarios, in order to generate an estimate.

In addition, a backtesting 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. No deviations were observed in 2016. 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**

- The Monte Carlo simulation assumes a normal distribution of risk factors. This assumption does not always apply in reality;
- The historical simulation assumes that the historical behavior of the risk factors will recur in the future, which may not be the case;
- It is not possible to forecast a sudden change in a risk factor using either of the two methods;
- With the use of a 99% significance level, losses that could occur beyond that level are ignored;
- 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;
- 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

- The credit risk inherent in assets does not constitute a parameter in the calculations made for the purposes of market risk, which focus on quantifying the market risks in the banking book;
- The information used for the risk estimates is assembled from various automated systems;
- The use of behavioral models to reflect the optionality of various products;
- The historical simulation assumes that the historical behavior of the risk factors will recur in the future, which may not be the case;
- 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-24: Risk estimates of trading activity (VaR)**

	<b>December 31, 2016</b>	<b>Average in 2016</b>
	NIS millions	
Total trading in dealing rooms	<b>15</b>	<b>16</b>
	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.

- 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;
- 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;
- Macro-economic scenarios – Subjective scenarios developed in collaboration with the Economics Department of the Bank;
- 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;
- Extreme scenarios based on a methodology similar to that used to create VaR scenarios, based on the volatility of risk factors during a period 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-25: Capital requirements in respect of market risks

	December 31, 2016 <sup>(1)</sup>			December 31, 2015 <sup>(1)</sup>		
	Specific risk	General risk	Total	Specific risk	General risk	Total
	NIS millions					
Interest-rate risk	<b>2</b>	<b>341</b>	<b>343</b>	17	387	404
Share risk	<b>7</b>	<b>7</b>	<b>14</b>	6	6	12
Foreign currency exchange-rate risk	-	<b>144</b>	<b>144</b>	-	108	108
Option risk	-	<b>116</b>	<b>116</b>	-	49	49
Total	<b>9</b>	<b>608</b>	<b>617</b>	23	550	573

(1) The capital requirements were calculated in accordance with the minimum total capital ratio required by the Banking Supervision Department, at 12.67% as at December 31, 2016, and 12.57% as at December 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 Banking Supervision Department as of January 1, 2017, on a consolidated basis, according to data at the reporting date, is 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.

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 operates in accordance with the Basel 2 standardized approach and the corresponding requirements of the Proper Conduct of Banking Business Directives. 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:

- Quarterly 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.
- 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.

- 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.
- 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 quantification thereof.
- Reduction of the activity that creates the risk.

Additional related activities:

- An automated operational risk management system (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, control committees convene and 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.
- Special attention, including the formulation of a dedicated policy, has been devoted to the management of digital banking risks, in accordance with the guidelines in Proper Conduct of Banking Business Directive 367, "Digital Banking."

The operational risk profile is monitored periodically in relation to the operational risk appetite established in the policy, using various parameters.

Parameters have been established at the level of the overall Group, and at the level of specific units and processes. Reports on compliance with risk-appetite limits are submitted on a quarterly basis, within the consolidated risk document. In addition, the operational risk environment is monitored using the quantitative metric described below, as defined in one of the comparative surveys of the Basel Committee.

Capital in respect of operational risk is examined in relation to the frequency of materialization of damages greater than EUR 100,000. At the time of the survey, in 2009, with respect to economic capital, this ratio stood at 16.9 on average at banks that apply advanced models, and at 28.9 on average at other banks. A higher ratio indicates a higher level of capital held relative to the materialization of damages. This figure, calculated based on the Pillar I capital requirement in respect of operational risk as at the end of 2016, stood at 25 at the Bank.

### **Information Technology Risks**

The Bank is dependent upon IT systems and infrastructures for its various activities. Information technology risk is the risk of damage to the proper activity of the Bank and to customer service, loss, or damage to reputation due to inadequacy or failure of the IT systems and infrastructures of the Bank. In general, the Bank maintains its information systems and infrastructures, adopts new technologies, and continually acts to provide technological infrastructures to allow the operation of its business and the promotion of strategic initiatives at the various areas, in accordance with the information technology management policy of the Bank. This policy addresses matters including information and cyber security aspects, principles for backup and recovery in cases of malfunction or disaster; outsourcing and cloud computing, policy for the development and use of new technologies in digital banking, and the management of IT risks. In addition, in order to cope with the challenges of the future, simplify and improve the efficiency of technological platforms, improve response capabilities, and build new abilities, the Bank examines various alternatives, from time to time, for upgrades of legacy core systems.

IT risks are examined routinely, based on accepted methodologies, on the level of material IT processes conducted at the Bank as well as on the level of the information systems and infrastructures used at the Bank.

Risks arising from material IT processes are addressed as part of the control approach implemented at the Information Technology Area, by several dedicated professional units reporting to the management of the Area. These units act in accordance with the various regulatory guidelines, such as Proper Conduct of Banking Business Directives 357 and 361. The units include the Information System Security and Cyber Defense Department; the Planning and Control, Development Control, and Business Continuity Unit; and the IT Risk Management Unit.

### **Information Security and Cyber Risks**

Cyber activity 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 risks. Information security and cyber risks at the Bank are managed by the Information Systems and Cyber Security Department in the Information Technology Area.

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.

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. The Bank invests extensive (human and technological) resources to minimize and prevent this risk, but absolute protection cannot be ensured. 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 Information Security and Cyber Security Department conducts frequent, extensive controls in all channels in order to minimize risks, with the aim of preventing harmful penetration, activation of malicious software, and information leakage. The lines of defense consist of a large number of advanced information-security systems deployed in the Bank's network. All systems report to the Information Security Event Center, which is staffed by a team of experts at all times.

In addition, within the wide range of activities conducted by the department, emphasis has been placed on activity aimed at raising awareness of the various cyber risks among the employees and customers of the Bank.

### **Cloud Computing Risks**

In June 2015, the Banking Supervision Department 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, and provides guidance regarding the use of cloud computing while hedging the concomitant risks. A draft update, which includes details of the cases in which the Bank of Israel requires a permit to be obtained, was issued in November 2016.

The Bank is examining the potential advantages of cloud computing and the appropriate way of coping with the concomitant operational risks, in conformity with regulatory guidelines and with the appropriate work processes.

### **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 Head of Technology).

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 established a new remote central IT site, to ensure the availability and protection of its information systems and of the information itself.

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 operational risks, which includes: (1) banking insurance to cover damages that may arise from embezzlement by employees, loss of documents, forged documents, etc.; this policy includes coverage for damages due to computer crimes incurred by the Bank and/or its customers as a result of penetration of the computer systems of the Bank by an unauthorized third party; (2) professional liability insurance, to protect against claims filed by customers regarding damage caused by negligent banking actions. These 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' liability insurance, and additional insurance policies.

The liability limits in the policies were established by the Bank based on an assessment of the risk involved in the activity of the Group, 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). 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 held by the branch/subsidiary do not bear investment risk, and are therefore not included in the measurement of investment risk at the Bank.

Investment risk arises at the Group in three frameworks:

1. An investment portfolio managed under the responsibility of the Financial Markets and International Banking Area; in general, these investments are performed through tradable securities.
2. Non-tradable investments through the subsidiary Poalim Capital Markets (PCM), according to policy established periodically by the board of directors of PCM, in conformity with the policy of the Group.
3. Affiliates: strategic holdings in shares of subsidiaries. For details, see Note 15 to the [Financial Statements](#).

The Group holds shares and bonds, primarily for investment purposes, a decrease in the value of which may damage the capital of the Bank.

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 investment framework was established from a global, systemic perspective, with the approval of the Board of Directors of the Bank, and includes 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. Management in practice is performed by the Nostro Investment Management Unit in the Financial Markets and International Banking Area, using dedicated 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.

This 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.

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-26: Details of the Bank's investments in shares in the banking book

	December 31, 2016		December 31, 2015	
	Balance sheet value and fair value	Capital requirements <sup>(1)</sup>	Balance sheet value and fair value	Capital requirements <sup>(1)</sup>
	NIS millions			
Investments classified into the trading portfolio	<b>54</b>	<sup>(2)</sup> <b>14</b>	48	<sup>(2)</sup> 12
Investments classified into the available-for-sale portfolio	<b>2,202</b>	<b>308</b>	2,486	341
<b>Total investments in shares</b>	<b>2,256</b>	<b>322</b>	2,534	353
Of which: Traded on the stock exchange	<b>1,367</b>		1,891	
Privately held	<b>889</b>		643	
Unrealized gains included in supervisory capital	<b>202</b>		224	

(1) The capital requirements were calculated in accordance with the minimum total capital ratio required by the Banking Supervision Department, at 12.67% as at December 31, 2016, and 12.57% as at December 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 Banking Supervision Department as of January 1, 2017, on a consolidated basis, according to data at the reporting date, is 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 12 to the [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 the investment portfolio. 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 exposure significant for 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 risk 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 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 exposure significant 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 is 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 examined on a monthly basis.

**Table D-27: 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)**

	<b>December 31, 2016</b>			<b>Maximum in 2016</b>		<b>Minimum in 2016</b>	
	1% increase	1% decrease	0.1% increase	1% increase	1% decrease	1% increase	1% decrease
	NIS millions						
<b>Scenario</b>							
Change in CPI-linked interest rate	<b>(264)</b>	<b>324</b>	<b>(29)</b>	<b>(264)</b>	<b>324</b>	<b>(118)</b>	<b>163</b>
Change in unlinked interest rate:	<b>(227)</b>	<b>271</b>	<b>(25)</b>	<b>(235)</b>	<b>278</b>	<b>(103)</b>	<b>134</b>
Change in foreign-currency interest rates	<b>(26)</b>	<b>31</b>	<b>(3)</b>	<b>168</b>	<b>(173)</b>	<b>(26)</b>	<b>31</b>

	<b>December 31, 2015</b>			<b>Maximum in 2015</b>		<b>Minimum in 2015</b>	
	1% increase	1% decrease	0.1% increase	1% increase	1% decrease	1% increase	1% decrease
	NIS millions						
<b>Scenario</b>							
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 the interest-rate curve, without taking into account the credit risk spread of the counterparty, and 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<sup>AI</sup>**

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.

Risk management at the Bank Group is described extensively in the Report on Risks. The Board of Management of the Bank discussed the development of the additional risks detailed below as top or emerging risks:

- **Macro-economic environment:** The activity of the Bank is dependent on the business environment, in Israel and globally; on the condition of the global economy; on the increase in interest rates in the markets; and on the economic, political, and security situation in Israel and in the region. It should be taken into consideration that a high level of uncertainty remains with regard to growth rates during the recovery of the real economy in Israel and globally in the coming years. The Bank's multi-year strategic plan takes the caution necessitated by the risks still present in the global economy and the Israeli market into account, and balances risk and return considerations.
- **Regulatory environment in Israel:** Several regulatory initiatives have been formulated over the last few years, with the primary aim of increasing competition in the banking system in Israel; several additional regulatory initiatives are in the process of being generated. These regulatory initiatives and trends are likely to affect the banking system in general, and the Bank in particular. At this stage, it is too early to estimate and assess the effect thereof on the Bank. For details regarding the Law for Increasing Competition and Reducing Concentration in the Banking Market in Israel, 2017, see Note 36 to the [Financial Statements](#).
- **Regulatory environment overseas:** International regulatory reforms with implications for the business of the Bank, in Israel and globally, including the Dodd-Frank Act and the Volcker Rule in the United States, and the EMIR legislation in Europe.
- **Compliance risk:** The continuing investigations of banks and the imposition of fines on banks around the world in connection with the violation of regulatory directives, such as in the areas of assisting tax evasion, the prevention of terrorism financing, money laundering, and investigations of corruption. See Note 26D and E to the [Financial Statements](#) concerning the investigation of the Bank Group's business with American clients and the investigation regarding FIFA.
- **Information security and cyber incident risk:** Increasing cyber threats to financial institutions and the channeling of resources in the banking industry to cope with this risk. The Bank conducts frequent controls in all channels in order to prevent harmful penetration, activation of malicious software, and information leakage. The lines of defense consist of a large number of advanced information-security systems, deployed internally in the Bank's network as well as externally as a perimeter defense.

For details regarding legal proceedings, see the section "Review of Risks" in the [Financial Statements](#).

For details regarding legal claims and investigations, see Note 26C-E to the [Financial Statements](#).

For details regarding notable regulatory initiatives, see Note 36 to the [Financial Statements](#).

## **Compliance Risk<sup>A/</sup>**

Compliance risk is the risk of imposition of legal or regulatory sanctions, material financial loss, or damage to its image which the corporation (the Bank) may suffer as a result of a failure to comply with compliance directives.

The Bank applies a policy of compliance with all legal and regulatory directives, and works to implement this policy at its units and among its employees. For the purposes of risk management, the key compliance risks against which the Bank seeks to defend itself can be described 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 with the law.

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, the activity of the Bank and of its customers, 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 the responsible officer pursuant to FATCA. The Chief Compliance Officer and Securities Enforcement Unit consists of the Anti-Money Laundering Department; the Securities Enforcement, Consumer Protection Directives Compliance, and Subsidiaries Department; the International Compliance Department; the International Taxation Compliance 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 lead a policy of 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 identify, document, and actively assess compliance risks inherent in the business operations of the Bank;
- To monitor and examine compliance in the Bank Group through sample testing, and to report the findings to the organs of the Bank.

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;
- The Board of Management of the Bank, headed by the CEO;
- Reports, at least once annually, to senior management and to the Board of Directors on compliance issues.

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 and in the relevant locations. 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 has also established an overall policy of declared funds, 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.

An amendment to Proper Conduct of Banking Business Directive 308 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 discussions held on this subject by the Bank with the Bank of Israel and the Ministry of Finance, in November 2006 the Minister of Finance granted the Bank a permit, pursuant to Section 9(D) of the Money Laundering Prohibition Law, indicating that the directives of the Money Laundering Prohibition Law concerning "prohibition of transactions in terrorism property" would 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 asked to cease the provision of services to banks in the Palestinian Authority again in 2016, in light of the increasing risks involved in the provision of services to the Palestinian banks, both in the civil arena and in the criminal and regulatory arena (the prohibition of money laundering, the prohibition of terrorism financing, tax offenses, and more). State authorities requested a postponement of implementation of this move, emphasizing that the state is acting to ensure that the Bank receives the required protections in the civil, criminal, and regulatory arenas in connection with the provision of services to banks in the Palestinian Authority. The Ministry of Finance informed the Bank that from its perspective, progress had recently occurred with respect to this matter. Discussions between the Bank and the state authorities continue.

In December 2016, a group of family members of victims of terrorism filed a petition with the High Court of Justice against the Minister of Finance, the Director General of the Ministry of Finance, the Bank, and Discount Bank Ltd. In summary, the petitioners are asking the High Court of Justice to prohibit the Minister of Finance and the Ministry of Finance from making a commitment to protect and/or indemnify the Bank and Discount Bank Ltd. in the event that they are sued or prosecuted in connection with their relationships with banks in the Palestinian Authority. This petition is still pending.

## **Legal Risk<sup>A/</sup>**

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, such that these risks encompass 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;
- Drawing conclusions 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 sets forth 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<sup>AI</sup>**

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<sup>AI</sup>**

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 Banking Supervision Department as well as other supervisory agencies in specific areas of activity, such as the Israel Securities Authority; the Capital Market, Insurance, and Savings Authority 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 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.

For details regarding material regulatory initiatives, see paragraph 6.14 in the "Review of Risks" section of the [Financial Statements](#).

### **Economic Risk<sup>AI</sup>**

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 possible but low probability of future materialization, which in its opinion may 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 the scenarios into the impact on its business activity, according to the various risk areas, and examines the effect on its profitability, capital, and capital adequacy, while monitoring risks and segments that may be affected by economic changes in Israel and worldwide, and adapting 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, and routinely complies with the liquidity requirements, as required by the supervisory directives.

For details regarding conditions in the Israeli and global economy, see the section "Economic Review" in the [Board of Directors' Report](#).

## **Strategic Risk<sup>A/</sup>**

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 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 1** – 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 2** – Formulation of objectives and of a high-level work plan, adapted to the business environment and to the strategic trajectory.

**Stage 3** – 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<sup>AI</sup>**

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 association of the Bank to a party causing environmental damage.

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 economic 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.

The Bank, or any senior officer of the Bank, were not a party, during the reported period, to any material legal or administrative proceedings related to the environment, as noted in Section 28 of the First Addendum to the Securities Regulations.

## **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 December 31, 2016

	Total unweighted value*	Total weighted value**
<b>Total high-quality liquid assets</b>		
Total high-quality liquid assets (HQLA)		<b>108,881</b>
<b>Cash outflows</b>		
Retail deposits from individuals and from small business customers, of which:	<b>188,931</b>	<b>14,632</b>
Stable deposits	<b>59,386</b>	<b>2,969</b>
Less stable deposits	<b>91,724</b>	<b>10,539</b>
Deposits for a period greater than 30 days (Section 84 of Proper Conduct of Banking Business Directive 221)	<b>37,821</b>	<b>1,124</b>
Unsecured wholesale financing, of which:	<b>112,110</b>	<b>70,271</b>
Operational deposits (all counterparties) and deposits in networks of cooperative banks	<b>1,522</b>	<b>381</b>
Non-operational deposits (all counterparties)	<b>109,876</b>	<b>69,178</b>
Unsecured debts	<b>712</b>	<b>712</b>
Secured wholesale financing	<b>41</b>	<b>-</b>
Additional liquidity requirements, of which:	<b>100,864</b>	<b>18,578</b>
Outflows related to derivative exposure and other collateral requirements	<b>11,862</b>	<b>10,187</b>
Outflows related to loss of funding on debt products	<b>-</b>	<b>-</b>
Credit and liquidity facilities	<b>89,002</b>	<b>8,391</b>
Other contractual funding obligations	<b>12,906</b>	<b>12,906</b>
Other contingent funding obligations	<b>56,564</b>	<b>1,977</b>
Total cash outflows		<b>118,364</b>
<b>Cash inflows</b>		
Secured lending (e.g. reverse repos)	<b>415</b>	<b>415</b>
Inflows from fully performing exposures	<b>29,170</b>	<b>21,219</b>
Other cash inflows	<b>14,541</b>	<b>8,932</b>
Total cash inflows	<b>44,126</b>	<b>30,566</b>
		Total adjusted value***
Total high-quality liquid assets (HQLA)		<b>108,881</b>
Total net cash outflows		<b>87,798</b>
Liquidity coverage ratio (%)		<b>124%</b>

\* 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 a cap on inflows).

Liquidity coverage ratio – limited banking corporation and consolidated subsidiaries, for the three-month period ended December 31, 2015

	Total unweighted value*	Total weighted value**
<b>Total high-quality liquid assets</b>		
Total high-quality liquid assets (HQLA)		90,364
<b>Cash outflows</b>		
Retail deposits from individuals and from small business customers, of which:	179,369	13,583
Stable deposits	55,424	2,771
Less stable deposits	83,935	9,621
Deposits for a period greater than 30 days (Section 84 of Proper Conduct of Banking Business Directive 221)	40,010	1,191
Unsecured wholesale financing, of which:	114,063	71,858
Operational deposits (all counterparties) and deposits in networks of cooperative banks	1,477	369
Non-operational deposits (all counterparties)	112,396	71,299
Unsecured debts	190	190
Secured wholesale financing	198	39
Additional liquidity requirements, of which:	118,584	21,355
Outflows related to derivative exposure and other collateral requirements	13,882	11,439
Outflows related to loss of funding on debt products	-	-
Credit and liquidity facilities	104,702	9,916
Other contractual funding obligations	10,994	10,994
Other contingent funding obligations	56,888	2,309
Total cash outflows		120,138
<b>Cash inflows</b>		
Secured lending (e.g. reverse repos)	109	109
Inflows from fully performing exposures	26,324	18,095
Other cash inflows	17,466	10,408
Total cash inflows	43,899	28,612
		Total adjusted value***
Total high-quality liquid assets (HQLA)		90,364
Total net cash outflows		91,526
Liquidity coverage ratio (%)		99%

\* 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 a 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 lines 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 lines, 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 lines and guarantees subject to a liquidity requirement, etc., may lead to a change in the ratio.

In accordance with the transitional directives, the minimum requirement was 80% in 2016, and increased to 100% from January 1, 2017, forward. 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 Banking Supervision Department; 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 are calculated on a monthly basis, in accordance with the transitional directives, and reported as the average of three monthly observations. The consolidated ratio has been calculated daily as of January 1, 2017. 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 stricter than the internal models applied at the Bank. During the quarter, the average consolidated ratio (as noted, an average of three monthly observations) was 124%, and the average standalone ratio (an average of daily observations) for the banking corporation was 118%, versus the minimum requirement of 80%. The ratio rose during the fourth quarter as compared to the preceding quarter, due to an increase in liquid assets, as a result of an increase in deposits exceeding the increase in credit as well as a change in the composition of resources. The consolidated ratio rose from 99% to 124% (quarterly average) during the year. The increase mainly resulted from an increase in liquid assets, due to an increase in deposits, with an emphasis on retail deposits in NIS, and deposits for a period of over one month of financial corporations in foreign currency, combined with the effects of changes in credit, the reduction of unutilized credit lines, and a decrease in deposits with clearinghouses, in addition to profitability accrued over the year. 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 crisis (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 from some of the subsidiaries during a crisis. 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). Changes in international operations are expected to lead to certain changes in the composition of resources, with an emphasis on the overseas branches and on subsidiaries. For details, see "International Activity" in the section "Segments of Activity Based on Management Approach" in the [Corporate Governance Report](#). 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. In the calculation of liquid assets, the Bank does not include collateral which it is required to deposit against derivatives activity; 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, as noted; as of January 1, 2017, the consolidated ratio is calculated daily). 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 Asset and Liability Management 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 Asset and Liability Management 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 expected business changes, future liquidity requirements, and future liquidity risks into consideration, in order to ensure that the Bank continues to comply with all limits. 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).

<sup>A</sup>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 the preferred level; monitors early-warning systems to identify liquidity stress situations as early as possible; and maintains 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<sup>A/</sup>

	Balance at report date	Average in reported quarter
Level A assets	<b>112,832</b>	<b>107,990</b>
Level B1 assets	<b>448</b>	<b>453</b>
Level B2 assets	<b>427</b>	<b>438</b>
<b>Total HQLA</b>	<b>113,707</b>	<b>108,881</b>

	Balance as at December 31, 2015	Average in the quarter ended December 31, 2015
Level 1 assets	91,261	88,704
Level 2A assets	1,132	1,120
Level 2B assets	503	540
<b>Total HQLA</b>	<b>92,896</b>	<b>90,364</b>

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\*<sup>A/</sup>

	Fair value balance as at December 31, 2016		
	Total balance in the balance sheet	Of which: pledged**	Of which: unpledged
Cash and deposits with banks	<b>80,378</b>	<b>1,615</b>	<b>78,763</b>
Israeli government bonds	<b>50,844</b>	<b>5,974</b>	<b>44,623</b>
Foreign government bonds	<b>8,256</b>	<b>805</b>	<b>7,536</b>
Bonds of financial institutions in Israel	<b>577</b>	-	<b>575</b>
Bonds of foreign financial institutions	<b>5,739</b>	-	<b>5,728</b>
Bonds of others in Israel	<b>916</b>	-	<b>898</b>
Bonds of foreign others	<b>2,861</b>	<b>33</b>	<b>2,817</b>
Shares of others	<b>2,256</b>	-	<b>2,014</b>
<b>Total securities</b>	<b>71,449</b>	<b>6,812</b>	<b>64,191</b>

\* In addition, other assets in the amount of NIS 577 million are pledged.

\*\* Includes surplus pledges.

	Fair value balance as at December 31, 2015		
	Total balance in the balance sheet	Of which: pledged**	Of which: unpledged
Cash and deposits with banks	64,976	2,784	62,192
Israeli government bonds	43,642	9,136	34,506
Foreign government bonds	5,622	551	5,071
Bonds of financial institutions in Israel	634	-	634
Bonds of foreign financial institutions	4,737	-	4,737
Bonds of others in Israel	2,048	-	2,048
Bonds of foreign others	3,667	42	3,625
Shares of others	2,534	-	2,534
<b>Total securities</b>	<b>62,884</b>	<b>9,729</b>	<b>53,155</b>

\* In addition, other assets in the amount of NIS 741 million are pledged.

\*\* Includes surplus pledges.

## F. Remuneration Disclosure

For details regarding remuneration for interested parties and officers of the Bank, in accordance with Regulations 21 and 22 of the Securities Regulations (Periodic and Immediate Reports), 1970, see the section on corporate governance, audit, and additional information regarding the Bank's business and the management thereof in the [Annual Report of the Bank for 2016](#).

### Entities Supervising Remuneration

The entities supervising remuneration are the Board of Directors of the Bank, through the Remuneration Committee of the Board of Directors. The Remuneration Committee consists of three members, which included, in 2016, two external directors and an additional director. The chairman of the committee is an external director. The powers of the Remuneration Committee are those granted to it in accordance with the applicable law – inter alia, in accordance with the directives of the Companies Law, 1999, and the directives of the Supervisor of Banks (Proper Conduct of Banking Business Directive 30I and Proper Conduct of Banking Business Directive 30IA), and as defined in the procedures of the Bank. The Remuneration Committee supervises the implementation of the remuneration policy and of the remuneration plans, and for that purpose is assisted by the risk management, control, and audit functions of the Bank. The Remuneration Committee, with the assistance of the risk management, control, and audit functions of the Bank, as necessary, has designed and designs the means of control to ensure that the principles of the remuneration policy are maintained, in such a manner as to ensure on a regular basis that the actual remuneration of the officers, the risk and performance indicators, and the results thereof are consistent with the chosen remuneration mechanisms and with the policy objectives, and adjustments may be made as necessary.

The committee is also assisted in its work by external advisors – economic (Cognum Financial Consulting Ltd.) and legal (Goldfarb Seligman Law Offices) – who advise the committee with respect to the remuneration policy and remuneration plans in accordance with applicable laws, and in connection with information required by the committee in order to make informed decisions, remuneration approval processes at the Bank, and various controls, all as required by the applicable laws.

The remuneration policy of the Bank contains a chapter addressing the Bank Group, which applies similar principles to those of the Bank's remuneration policy to selected subsidiaries of the Bank in Israel, while with respect to the overseas subsidiaries and overseas branches of the Bank, there are certain adjustments which apply, in order to adjust the remuneration to the laws that apply in the relevant country and to the terms of the labor market there.

Table F-1: Key employees of the Bank

	2016	2015
<b>Key employees of the Bank</b>		
Chairman, CEO, and members of the Board of Management	18	14
Other officers	4	4
Senior executives	129	119
Chief Economist	1	1
Traders	8	9
Managers subordinate to CEO	3	4
Total	163	151

## **Planning and Structure of Remuneration Processes**

The main characteristics and objectives of the policy are described below, including a reference to the way in which the Bank ensures that employees engaged in risk management and compliance are remunerated without dependence upon the business under their supervision.

General – The Bank aspires to remunerate officers and executives for their work and contribution to the Bank, and to retain them over the long term, while creating appropriate incentives and linking their best interests with the best interests of the Bank and of its stakeholders, in alignment with the goals of the Bank, its work plans, and its policies from a long-term perspective. The remuneration policy is consistent with the Bank's vision and strategy and with its work plans and risk appetite, and its purpose is to lead to maximization of the Bank's value, while emphasizing the Bank's stability and the interchange between achieving returns and taking risks.

The main goals of the remuneration policy are:

- To motivate officers to act to create long-term economic value for the Bank and its stakeholders, in a manner that strengthens the connection between remuneration and the creation of value for the stakeholders in general and for shareholders of the Bank in particular.
- To adjust the remuneration to the Bank's vision, to the overall strategic plan of the Bank and of its secondary units, and to the work plan derived from the strategic plans. Accordingly, remuneration incentives shall also be adjusted to the long-term objectives formulated in the strategic plan and in periodic work plans.
- To adjust the total remuneration to the risk appetite of the Bank.
- To maintain the Bank's competitiveness in recruiting and retaining high-quality personnel for senior executive positions; the remuneration amounts shall be proportionate and shall take into consideration the terms of the market and the structure of remuneration at the Bank.
- To comply with regulatory requirements. Officers' remuneration shall include a component reflecting attainment of the general objectives of the Bank with respect to risk management and compliance with laws, regulatory directives, and the procedures of the Bank.
- To promote a remuneration structure that prevents harm to working relationships at the Bank.
- To adjust remuneration to the type of officers' activities and responsibilities, and to their skills.
- Remuneration for the organizational functions that are involved in supervision and control shall be determined based on standards that take into consideration the importance and sensitivity of these roles. The bonus budget for these functions shall be determined according to the cost of capital, and shall increase or decrease by up to 20% based on the attainment of key performance indicators (hereinafter: "KPIs"), to be established in advance by the supervisors of the executives in the supervision and control functions, according to the role of the executive. Pursuant to the Bank's remuneration plan of 2010, which was adopted prior to the approval of the remuneration policy (the "2010 Remuneration Plan"), the budget for the aforesaid executives was established in part according to the rate of return on equity, and in part as a multiple of the monthly salary, partly subject to the executive's KPIs and partly according to a supervisor's opinion.

### **Ways in Which Present and Future Risks Are Taken Into Consideration in the Remuneration Process**

The annual and multi-annual work plans are constructed, among other matters, with reference to the volume and types of the risks that the Bank is willing to undertake. The achievement of objectives of the work plan, including capital-adequacy targets, and the achievement of a surplus return over the required cost of capital set the threshold for the distribution of bonuses. This objective is also achieved through a ceiling on variable remuneration, and through postponement of the payment of part of the annual bonus, which is contingent on the Bank's performance in future years, so that executives are exposed to the consequences of materialization of the risks that they take, and their remuneration decreases if or when the risks materialize in the future.

Risk management, control, and audit functions at the Bank assisted the Board of Directors of the Bank and the Remuneration Committee of the Board of Directors in ensuring that risk indicators and performance indicators used in the remuneration mechanisms of the officers are consistent with the objectives of the remuneration policy and provide assurance of the effectiveness of the remuneration mechanisms.

The principal risks taken into consideration by the Bank in applying remuneration indicators include credit and concentration risks, market risks, operational risks, and compliance risks.

### **Ways in Which the Banking Corporation Links Performance During the Measurement Period With Remuneration Levels**

The main performance indicator for the Bank is the attainment of the required rate of return on equity, as detailed in the Bank's remuneration policy. The main individual performance indicators are established according to the work plans of the Bank, and are drawn from different fields, such as finance; customers; processes, including long-term projects; and technological infrastructures and human resources. Lateral objectives are also integrated in the individual objectives, based on the needs of the organization, such as objectives related to efficiency, employee satisfaction, and intra-organizational service.

Once a year, within the approval process of the annual bonus, the Bank examines the correlation between the degree of success of the unit as reflected in scores on the indicators, and the degree of its success as reflected in BSC.

In exceptional cases, the objectives shall be presented for discussion at the end of the year, in aggregate, in order to make changes.

### **Ways in Which the Banking Corporation Adjusts Remuneration in Order to Take Longer-Term Performance Into Consideration**

On February 11, 2014, the general meeting of shareholders of the Bank approved the Bank's remuneration policy for officers, pursuant to Amendment 20 to the Companies Law, 1999 (the "Companies Law"), and in accordance with Proper Conduct of Banking Business Directive 301A of the Supervisor of Banks of November 19, 2013 (the "Banking Corporation Remuneration Policy Directive") (the "Remuneration Policy"). The Bank adopted a comprehensive remuneration policy for its senior executives and employees who are not officers, and a remuneration plan consistent with its comprehensive policy, on June 22, 2014 (the "Remuneration Plan (2014)").

On March 28, 2016, the Knesset passed the Financial Corporations Officer Remuneration Law (Special Approval and Non-Deduction of Expenses for Tax Purposes due to Exceptional Remuneration), 2016 (hereinafter: the "Remuneration Limit Law"). In accordance with and subsequent to the Remuneration Limit Law, the Companies Law, and the Banking Corporation Remuneration Policy Directive in the formulation of September 29, 2016, the general meeting of shareholders of the Bank approved a new remuneration policy for officers on December 19, 2016 (the "New Remuneration Policy"). On November 29, 2016, the Bank adopted a comprehensive new remuneration policy for its senior executives and employees who are not officers (all parts of these remuneration policies, for all populations, shall hereinafter be referred to, jointly, as the "New Remuneration Policy"). A remuneration plan consistent with the New Remuneration Policy (the "2016 Plan") was also approved on that date.

In general, variable remuneration shall consist, among other components, of an annual bonus contingent upon the financial performance of the Bank, based on risk-adjusted profit and the cost of capital of the Bank, and shall also be determined according to the attainment of measurable quantitative and qualitative individual key performance indicators (the model for establishing the bonus budget for traders differs from the foregoing description, and takes into account factors including the specific performance of the group and room to which they belong).

50% of the annual bonus shall be spread over three years, in a manner that compensates for unsatisfactory performance during that period, if any, and shall be paid in share-based instruments (usually in the form of restricted stock units (RSU), with a vesting condition of an ROE difference of no less than -5%), provided that the variable remuneration in a given year is higher than 1/6 of the fixed remuneration in that year; otherwise, the deferral shall not be performed, all subject to the applicable law. In this context, in September 2016, Proper Conduct of Banking Business Directive 301A was updated, and the New Remuneration Policy and 2016 Plan of the Bank were formulated accordingly, such that the postponement of variable remuneration is required only when the variable remuneration exceeds 40% of the fixed remuneration. Pursuant to the 2010 Remuneration Plan, executives' annual bonus shall be accrued, for each executive, in a "bonus bank." 60% of that amount (or 50% for members of the Board of Management) shall be paid at the end of each year; and the remaining amount shall continue to accumulate in the bonus bank. In the event of an annual net loss from regular activities, or a material deviation from the capital-adequacy ratio, the payment shall be deferred until annual profit is presented, or until the deviation from capital adequacy ceases, as the case may be.

Pursuant to the remuneration policy, the Remuneration Committee and the Board of Directors shall be authorized to subtract up to 50% of the annual bonus of an executive (with the exception of the Chairman of the Board and the CEO), in cases in which the financial or business position of the Bank makes it necessary, and/or due to reasons related to the functioning of the executive or reasons to be explained by such organs.

The remuneration policy states that in the event that the audited financial statements of the Bank for a given year are amended, such that if the amount of the bonus owed to the executive in respect of that year had been calculated based on the amended data the executive would have received a bonus in a different amount, the executive shall reimburse the Bank for; or the Bank shall pay the executive, as relevant, the difference between the amount of the bonus received or the amount unpaid by the Bank, as relevant, and the amount to which the executive is entitled based on the said amendment, provided that, if the executive has left the Bank, no more than three years have elapsed from the end of the executive's employment at the Bank. In this context, in September 2016, Proper Conduct of Banking Business Directive 301A was updated, and the New Remuneration Policy and 2016 Plan of the Bank were formulated accordingly, with the addition of new directives concerning the obligation to reimburse variable remuneration, and expansion of this obligation.

## Description of Different Means of Variable Remuneration Used by the Banking Corporation and of the Considerations in the Use of Such Different Means

Subject to the foregoing, half of the variable remuneration is paid in cash, and the other half is paid as deferred remuneration.

The deferred variable remuneration is usually paid in the form of restricted stock units. However, at the Bank's subsidiaries in general, and at the subsidiaries overseas in particular, it is possible for such remuneration to be paid in the form of phantom restricted stock units (or to be deferred and paid in cash). The foregoing also applies to employees on assignment overseas for the Bank, for tax reasons.

**Table F-2: General quantitative information**

	<b>2016</b>	2015
Number of meetings held by the principal entity supervising remuneration during the reported year	<b>50</b>	19
Total remuneration paid to the members of the principal entity supervising remuneration during the reported year (in NIS millions)	<b>0.8</b>	0.3
Number of senior officers and other key executives who received variable remuneration during the reported year	<b>248</b>	233
Number of guaranteed bonuses granted during the reported year	-	-
Total guaranteed bonuses granted during the reported year (in NIS millions)	-	-
Number of signing bonuses granted during the reported year	-	-
Total signing bonuses granted during the reported year (in NIS millions)	-	-
Number of severance payments granted during the reported year	<b>10</b>	4
Total severance payments granted during the reported year (in NIS millions)	<b>29</b>	1
Total deferred compensation paid to senior officers and other key employees in the reported year (in NIS millions)	<b>81</b>	87

**Table F-3: Total deferred compensation not yet paid to senior officers and other key employees (in NIS millions)**

	<b>2016</b>	2015
Cash	<b>39</b>	68
Shares*	-	-
Share-based instruments	<b>69</b>	90
Other forms	-	-

\* Does not exist at the Bank.



Table F-4: Additional details of the remuneration amount in respect of the reported year for senior officers and other key employees (in NIS millions)

	2016				2015			
	Senior officers		Other key employees		Senior officers		Other key employees	
	Undeferred	Deferred	Undeferred	Deferred	Undeferred	Deferred	Undeferred	Deferred
<b>Fixed remuneration</b>								
Cash-based	<b>35</b>	-	<b>212</b>	-	36	-	203	-
Shares and share-based instruments	-	<b>(2)</b>	-	<b>1</b>	-	4	-	6
Others	<b>4</b>	-	<b>26</b>	-	4	-	11	-
<b>Variable remuneration</b>								
Cash-based	<b>5</b>	-	<b>28</b>	<b>6</b>	13	9	45	18
Shares and share-based instruments	-	<b>5</b>	-	<b>18</b>	-	9	-	29
Others	<b>2</b>	-	<b>3</b>	-	1	-	1	-

Table F-5: Quantitative information on the exposure of senior executives and other key employees to implicit adjustments

	2016	2015
Total unpaid amount of balance of deferred remuneration and retained remuneration exposed to explicit and/or implicit retroactive adjustments (in NIS millions)	<b>108</b>	165
Total amount of deductions during the reported year due to explicit retroactive adjustments (in NIS millions)	-	-
Total amount of deductions during the reported year due to implicit retroactive adjustments (in NIS millions)*	-	4

\* Contingent RSU forfeited due to partial attainment of the ROE Difference that would grant entitlement to the maximum amount.

**Oded Eran**

Chairman of the Board of Directors

**Ari Pinto**

President and Chief Executive Officer

**Tsahi Cohen**

Senior Deputy Managing Director; Chief Risk Officer (CRO)

Tel Aviv, March 29, 2017