

Bank Hapoalim

Report on Risks

Pillar 3 Disclosure and Additional
Information Regarding Risks

as at March 31, 2020



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Contents

Report on Risks	7
A. Introduction	8
A.1. Forward-looking information	8
A.2. Disclosure declaration	8
B. Principal supervisory ratios, risk-management review, and weighted risk-adjusted assets	9
B.1. Principal supervisory ratios	9
B.2. Risk assessment and management	10
B.3. Severity of risk factors	11
B.4. Top and emerging risks	12
B.5. Effect of the spread of the coronavirus	13
B.6. Discontinuation of publication of the LIBOR interest rates	16
B.7. Review of weighted risk-adjusted assets	17
C. Capital and leverage	18
C.1. Composition of capital	18
C.2. Capital adequacy	21
C.3. Leverage ratio	24
D. Credit risk	26
D.1. Credit quality of credit exposures	27
D.2. Credit risk exposures	31
D.3. Additional information regarding exposures to credit risks	37
D.4. Credit risk mitigation: standardized approach disclosures	43
E. Counterparty credit risks	47
F. Market risk	48
F.1. Market risk in the trading book	48
F.2. Interest-rate risk in the banking book	50
F.3. Share and credit spread risk – investment risk	53
G. Liquidity risk	54
H. Operational risk	60
H.1. Information security and cyber risks	60
H.2. Emergency preparedness	61
I. Compliance risk	63
J. Legal risk	64
K. Reputational risk	64
L. Regulatory risk	64
M. Economic risk	64
N. Strategic risk	65
O. Environmental risk	65

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

List of Tables

Principal supervisory ratios, risk-management review, and weighted risk-adjusted assets	
Table B-1: Principal supervisory ratios	9
Table B-2: Severity of risk factors	11
Table B-3: Review of weighted risk-adjusted assets	17
Capital and leverage	
Table C-1: Composition of supervisory capital	18
Table C-2: Comparison of balance sheet assets to exposure measurement, for the purposes of the leverage ratio	24
Table C-3: Leverage ratio disclosure	25
Credit risk	
Table D-1: Details regarding the balance of debts the terms of which have been changed in the course of coping with the spread of the coronavirus, which are not classified as troubled debt restructuring	28
Table D-2: Credit risk indicators	28
Table D-3: Credit quality of credit exposures	30
Table D-4: Details of exposures by economic sector	31
Table D-5: Exposure of the Bank Group to foreign financial institutions	35
Table D-6: 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	37
Table D-7: Details of credit risk balances for each group of borrowers whose net indebtedness on a consolidated basis exceeds 15% of the capital of the banking corporation (as defined in Directive 313)	38
Table D-8: 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	38
Table D-9: Details of characteristics of housing credit granted by the Bank – percentage of total new loans executed	39
Table D-10: Balance of credit to private individuals in Israel	40
Table D-11: Information regarding problematic debts in respect of private individuals in Israel	41
Table D-12: The Bank's exposures to leveraged financing, by economic sector of the borrower	42
Table D-13: Credit risk mitigation	43
Table D-14: Standardized approach – exposures by asset type and risk weight	44
Counterparty credit risks	
Table E-1: Analysis of exposure to counterparty credit risk based on the supervisory approach	47
Table E-2: Capital allocation in respect of credit value adjustment	47
Market risk	
Table F-1: Risk estimates of trading activity (VaR)	49
Table F-2: Sensitivity to changes in the exchange rates of foreign currencies with a significant volume of activity and to changes in the consumer price index	49
Table F-3: Market risk based on the standardized approach	50
Table F-4: Adjusted net fair value of the financial instruments of the Bank and its consolidated companies	51
Table F-5: Effect of scenarios of changes in interest rates on the adjusted* net fair value of the Bank and its consolidated companies	52
Table F-6: Sensitivity of the economic capital of the Bank to parallel changes in interest-rate curves (theoretical change in economic value as a result of each scenario)	52
Table F-7: Effect of scenarios of changes in interest rates on interest income	53
Liquidity risk	
Table G-1: Liquidity coverage ratio – limited banking corporation and consolidated subsidiaries, for the three-month period	55
Table G-2: Details of liquid assets, by level, as required in the Basel directives	59

Report on Risks

We are honored to present the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks as at March 31, 2020 (hereinafter: the "Report on Risks" or the "Report").

The information in this Report, 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.

This Report on Risks is published within the financial reporting of Bank Hapoalim B.M., and contains information regarding the management of risks and capital. This report should be perused in conjunction with the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks as at December 31, 2019; the Annual Financial Statements for 2019; and the Condensed Financial Statements as at March 31, 2020.

Sincerely yours,

Oded Eran

Chairman of the
Board of Directors

Dov Kotler

President and
Chief Executive Officer

Amir Bachar

Senior Deputy Managing Director,
Chief Risk Officer

Tel Aviv, May 13, 2020

A. Introduction

A.1. 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, macroeconomic 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 to 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," "intends," "plans," "aims," "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.

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 even that actual developments may be the opposite of expectations.

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.

A.2. Disclosure declaration

Pursuant to the instructions of the Bank of Israel, the disclosure declarations in the periodic financial report of the Bank are also valid for the Report on Risks – Pillar 3 Disclosure and Additional Information Regarding Risks. Within the discussions of the financial statements of the Bank, the Board of Directors of the Bank approved the publication of the Report on Risks – Pillar 3 Disclosure and Additional Information Regarding Risks as at March 31, 2020.

B. Principal supervisory ratios, risk-management review, and weighted risk-adjusted assets

B.1. Principal supervisory ratios

Table B-1: Principal supervisory ratios

	On a consolidated basis, as at				
	March 31, 2020	December 31, 2019	September 30, 2019	June 30, 2019	March 31, 2019
NIS millions					
Available capital					
Common equity Tier 1 capital	38,152	38,795	39,528	39,852	38,903
Common equity Tier 1 capital before effect of transitional directives ⁽¹⁾	37,551	38,138	39,185	39,471	38,484
Tier 1 capital	38,640	39,528	40,261	40,585	39,636
Tier 1 capital before effect of transitional directives ⁽¹⁾	37,551	38,138	39,185	39,471	38,484
Total capital	48,192	49,235	50,458	50,846	49,072
Total capital before effect of transitional directives ⁽¹⁾	44,360	44,810	45,865	46,176	44,158
Risk-weighted assets					
Total risk-weighted assets (RWA)	340,232	336,387	332,922	332,991	339,691
Total risk-weighted assets (RWA) before effect of transitional directives ⁽¹⁾	341,040	337,271	333,401	333,523	340,277
Capital-adequacy ratios according to the directives of the Banking Supervision Department					
Common equity Tier 1 capital ratio	11.21%	11.53%	11.87%	11.97%	11.45%
Common equity Tier 1 capital ratio before effect of transitional directives ⁽¹⁾	11.01%	11.31%	11.75%	11.83%	11.31%
Tier 1 capital ratio	11.36%	11.75%	12.09%	12.19%	11.67%
Tier 1 capital ratio before effect of transitional directives ⁽¹⁾	11.01%	11.31%	11.75%	11.83%	11.31%
Total capital ratio	14.16%	14.64%	15.16%	15.27%	14.45%
Total capital ratio before effect of transitional directives ⁽¹⁾	13.01%	13.29%	13.76%	13.84%	12.98%
Common equity Tier 1 capital ratio required by the Banking Supervision Department ⁽²⁾	9.27%	10.27%	10.26%	10.26%	10.24%
Available common equity Tier 1 capital ratio beyond the requirement of the Banking Supervision Department ⁽²⁾	1.94%	1.26%	1.61%	1.71%	1.21%
Leverage ratios according to the directives of the Banking Supervision Department					
Total exposures	541,421	519,648	508,609	511,322	523,012
Total exposures before effect of transitional directives ⁽¹⁾	541,744	520,001	508,801	511,535	523,246
Leverage ratio	7.14%	7.61%	7.92%	7.94%	7.58%
Leverage ratio before effect of transitional directives ⁽¹⁾	6.93%	7.33%	7.70%	7.72%	7.35%

(1) Before the effect of the transitional directives, including the effect of the adoption of US GAAP on employee benefits, and before the effect of adjustments for the efficiency plans.

(2) Including a capital requirement at a rate representing 1% of the balance of housing loans at the dates of the financial statements.

Table B-1: Principal supervisory ratios (continued)

	Average for the three months ended				
	March 31, 2020	December 31, 2019	September 30, 2019	June 30, 2019	March 31, 2019
Liquidity coverage ratio according to the directives of the Banking Supervision Department					
Total high-quality liquid assets	114,646	109,137	106,503	111,017	109,781
Total net cash outflows	90,974	90,145	85,681	87,247	87,721
Liquidity coverage ratio (in %)	126%	121%	124%	127%	125%

B.2. Risk assessment and management

The Bank performs a comprehensive examination to assess the risks to which it is exposed and to determine the materiality of such risks. Within the ICAAP (the Internal Capital Adequacy Assessment Process), the Bank defined the following risks as material risks: credit risk, concentration risk, market risk, investment risk, operational risk (including IT risk and cyber risk), counterparty risk, interest-rate risk in the banking book, liquidity risk, reputational risk, strategic and competitive risk, regulatory risk, and compliance risk. Other risks to which the Bank is exposed are handled directly as part of the management of its business: legal risk, economic risk, and environmental risk.

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. The subsidiaries are instructed to manage risks based on the strategy and policy of the Group, with adjustments according to the circumstances, which are reported to the parent company. Risks are managed separately by each company in the Bank Group, according to policy formulated by each company's board of directors. The Bank manages the various risks while hedging some risks. 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 Chief Risk Officer (CRO) and the member of the Board of Management responsible for the Risk Management Division is Dr. A. Bachar.

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 the Head of Corporate Banking, Mr. T. Cohen, and the Head of Retail Banking, Ms. D. Raviv.

The member of the Board of Management responsible for managing market, investment, and liquidity risks is the Head of Financial Markets and International Banking, Mr. Y. Antebi.

Legal risk is managed by Attorney Y. Almog, Chief Legal Advisor.

Technological risk, including cyber risk, is managed by Ms. E. Ben-Zeev, Head of Information Technology.

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

For details and more extensive information regarding risk management governance, including the control approach, the responsible parties, and the committees of the Board of Directors and Board of Management relevant to risk management, see [the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks as at December 31, 2019](#).

B.3. Severity of risk factors

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). For details, see [the Report on Risks for 2019](#).

Table B-2: Severity of risk factors

	Risk factor	Risk effect
Financial risks		
1.	Credit risk (including counterparty risk)*	Medium-High
1.1.	Of which: risk in respect of the quality of borrowers and/or collateral*	Medium-High
1.2.	Of which: risk in respect of sector concentration	Medium
1.3.	Of which: risk in respect of concentration of borrowers/borrower groups	Medium
2.	Market risk	Low-Medium
2.1.	Of which: interest-rate risk	Low-Medium
2.2.	Of which: inflation risk/exchange-rate risk	Low
2.3.	Of which: share price and credit spread risk	Low-Medium
3.	Liquidity risk	Low-Medium
Operational and legal risks		
4.	Operational risk	Medium
4.1.	Of which: cyber risk	Medium
4.2.	Of which: IT risk	Medium
5.	Legal risk	Low
Other risks		
6.	Reputational risk	Low-Medium
7.	Strategic and competitive risk	Medium
8.	Regulatory and legislative risk	Medium
9.	Economic risk – condition of the Israeli economy	High
10.	Economic risk – condition of the global economy	High
11.	Compliance risk**	Medium

* The level of credit risk has been raised to Medium-High, in light of the spread of the coronavirus and its present and possible future effects on economic conditions.

** Following the approval of the resolutions with the United States authorities regarding the tax investigation and the FIFA investigation (see [Note 10D and 10E to the Condensed Financial Statements](#), including with regard to the Bank's obligations pursuant to the resolutions), the level of compliance risk has been returned to Medium (from the previous level of Medium-High). This includes the ongoing risk to which the Bank is exposed as a result of the aforesaid resolutions.

B.4. Top and emerging risks

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 for 2019.

The Board of Management and Board of Directors of the Bank have discussed the effect of the top and emerging risks described below on the Bank; from time to time, they examine the need to adjust business strategy to such developments.

- **Compliance risk:** Pursuant to Proper Conduct of Banking Business Directive 308, compliance risk also includes risks related to the fairness of the Bank towards its customers, conflicts of interest, the prohibition of money laundering and financing of terrorism, provision of advice to customers, protection of privacy (excluding information-technology aspects), taxation aspects relevant to products or services for customers, or directives of a similar nature. The materialization of this risk on the global level is reflected in the continuing investigations of banks around the world and in the fines imposed on them in connection with the violation of laws or regulations, such as in the areas of assisting tax evasion, the prevention of terrorism financing, money laundering, and investigations of corruption. The Bank Group's business with American customers and the issue of FIFA were investigated by the authorities in the United States; resolutions between the Bank Group and the DOJ and additional United States authorities bringing these investigations to conclusion were recently approved and announced. For details, see [Note 10D and 10E to the Condensed Financial Statements](#).
- **Macroeconomic environment:** The activity of the Bank is dependent on the business environment, in Israel and globally. The condition of the global economy; significant changes in monetary policies and interest-rate curves; market volatility; changes in prices of financial assets in Israel and worldwide, and in real-estate prices; and the economic, political, and security situation in Israel and in the region have the potential to affect the activity of the Bank. The Bank's multi-annual strategic plan includes certain assumptions regarding the macro-economic environment, taking into consideration the existing risks in the global and Israeli economy, and balances risk and return considerations. The Bank is evaluating and examining its strategic plan in view of the changes in the macroeconomic environment.

The spread of the coronavirus is an event with material macroeconomic implications, affecting the ways in which the Bank works as well as the potential for materialization of various risks, including credit risk, market risks, and operational risk. At this stage, there is uncertainty regarding the duration of the event and its future impacts on the activity of the global economy, the local economy, the customers of the Bank, and the Bank itself, and correspondingly on the various risks. For details, see [the section "Economic and financial review" in the Report of the Board of Directors and Board of Management](#), and [the section "Effect of the spread of the coronavirus,"](#) below.

- **Regulatory environment in Israel and overseas:** International regulatory reforms have implications for the business of the Bank, in Israel and globally. 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. The regulatory initiatives and trends, and specifically the separation of the Bank from the credit-card companies and the significant changes in this area of activity, as well as the mobility of bank accounts and open API, may affect the banking system in general and the Bank in particular. At this stage, it is too early to estimate all of the effects of these changes on the Bank. For details regarding the Law for Increasing Competition and Reducing Concentration in the Banking Market in Israel, 2017, see [Note 16 to the Condensed Financial Statements](#).
- **Information security and cyber incident risk:** Increasing cyber threats to financial institutions have led to the channeling of resources in the banking industry to cope with this risk. The Bank applies 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. Due to the spread of the coronavirus, there was a significant transition of employees to remote work this quarter, as well as additional changes in modes of activity of the Bank, concurrently with an increase in threats. The cyber defense units have developed a response in order to reduce the risks, as detailed in the section "Operational risk," below.
- **Competitive and strategic risk:** New competition from big tech companies (Apple, Google, Facebook, Amazon, and others) and fintech companies, alongside the entry of new technologies, changes in customer behavior, and new business models in the financial sphere, may significantly affect the banking system, in Israel and worldwide, in the medium to long term. Concurrently, regulatory and competitive changes in the domestic arena, with an emphasis on measures aimed at increasing competition in the retail credit market, such as the Credit Data Law, which took effect in April 2019, bank account switching, and open API, may affect the business results of the Bank. The Bank has formulated a strategic plan for 2020-2022, encompassing action in the areas of innovation, technology, the structure of its operations, and more, in order to respond to all such threats.

For details regarding legal proceedings, see [Note 10 to the Condensed Financial Statements](#).

For details regarding material regulatory initiatives with an effect on the activity of the Bank during the reported period, see [Note 16 to the Condensed Financial Statements](#).

B.5. Effect of the spread of the coronavirus

The coronavirus spread rapidly around the world during the first quarter of 2020; in response, governments, including in Israel, took defensive measures such as restriction of international travel, quarantines, reduction of congregation and movement, lockdowns, restrictions of the activity of private businesses and of government and municipal services, and more. The spread of the virus and the defensive measures have caused material economic damage and negative trends in the global economy and in the Israeli economy, and have hurt global capital markets and the local market. In response, governments and central banks worldwide, including in Israel, have taken various measures, including grants, loans, intervention in capital markets, and more.

The spread of the virus has caused material worsening of activity in the economy in Israel, to which the activity of the Bank is exposed, and it has and is expected to have impacts on the business of the Bank, including due to an increase in credit risk and in liquidity problems of borrowers, in both the corporate and private sectors, and due to the deceleration of economic activity. The reduction of short-term interest rates by the central banks – the rate cuts already performed as well as probable additional reductions – also has the effect of reducing the future financing income and interest income of the Bank. This adds to the decreases in prices of tradable assets and the changes in bond spreads, which have an adverse effect on the value of the tradable assets of the Bank, and additional effects.

It is not possible to estimate the scope of the future spread of the virus, or the responses of governments and central banks, either in terms of the restrictions to be imposed on the economy and the duration thereof, or in terms of the measures to support and stimulate economic activity, or the reaction of the economies and the markets. It is also not possible to estimate or quantify the duration and extent of the event, or its future impact on the global economy, the Israeli economy, the customers of the Bank, and the Bank itself.

The Bank has established a dedicated committee of the Board of Management to address the financial crisis in the context of the coronavirus crisis, headed by the CEO of the Bank. The committee regularly reviews various scenarios for the progression of the event and its financial effects on the Bank; the effects of the event on credit risks and counterparty credit risks in respect of customers, banks, and others; and its effects on liquidity, the investment portfolio, the dealing room, and more, and directs the actions of the Bank in these areas.

Accordingly, as part of the Bank's preparations for the consequences of the coronavirus crisis, and in order to assess its potential effects, various scenarios for the progression of a series of economic parameters are being examined and used by the Bank to estimate the impacts on the Bank. In the baseline scenario, the Bank assumes that GDP will contract sharply in the first two quarters this year, and later recover. In this scenario, GDP contracts by approximately 7% in the full year of 2020, while the unemployment rate (excluding unpaid leave) rises to approximately 10% at its peak. The Bank of Israel interest rate remains at 0.1% throughout 2020 in this scenario. The scenario also assumes that most of the restrictions due to the coronavirus will be lifted by the end of June 2020, and that routines will resume, with health-related cautionary measures. These estimates and scenarios are continuously updated based on various forecasts, the economic plans of the government, and events in Israel and worldwide.

On the operational level, and on the level of business continuity, the Bank has applied a series of processes and measures, including remote work, reducing and/or splitting unit personnel, changes in the manner of operation of branches and in activity with customers, deferral of mortgage and loan payments, and more, in accordance with the instructions of the government and of the Ministry of Health, and the changes in regulation by the Bank of Israel, in particular Temporary Proper Conduct of Banking Business Directive 250 of the Banking Supervision Department, which is updated from time to time. In general, the operational risks, including cyber risks, related to the crisis and its effects have been analyzed, and controls and appropriate measures to minimize risk are being considered and implemented accordingly.

In view of the spread of the coronavirus, and in order to ensure the ability of the banks to continue to offer credit, on March 31, 2020, the Banking Supervision Department reduced credit requirements for banks, within the Temporary Order, for a period of six months, with an option for extension. Accordingly, the minimum common equity Tier 1 capital ratio and the minimum total capital ratio required of the Bank by the Banking Supervision Department, on a consolidated basis, as at March 31, 2020, and for the duration of the period of the Temporary Order, stand at 9.27% and 12.77%, respectively (instead of 10.27% and 13.77% prior to the Temporary Order). In the statement issued by the Supervisor of Banks in connection with the Temporary Order, she asked boards of directors of banks, among other matters, to reexamine their dividend policies, with the intention of using the capital resources released as a result of the reduced capital requirements to increase credit, rather than for distribution. Following the statement of the Supervisor of Banks, in order to allow realization of the purpose of the directive, the Board of Directors of the Bank resolved, on March 31, 2020, to adjust the target common equity Tier 1 capital ratio to 9.5%, and further resolved that, taking into consideration the existing distribution policy of the Bank, in light of the uncertainty in macroeconomic conditions, and in order to fulfill the purpose of the Temporary Order and of the policy of the Banking Supervision Department, until the end of the period of the Temporary Order and until conditions are clearer, the Bank will continue to refrain from performing distributions from ongoing earnings. For further details regarding the directives of the Supervisor of Banks, capital-adequacy targets, and dividends, see [the section "Capital, capital adequacy, and leverage" in the Report of the Board of Directors and Board of Management](#).

The common equity Tier 1 capital ratio as at March 31, 2020, decreased to 11.21%, while the leverage ratio decreased to 7.14%, due to the effects of the coronavirus event, including an increase in customers' business credit needs and an increase in the allowance for credit losses; the decrease in capital resulting from the distribution of the remaining shares of Isracard as a dividend in kind to shareholders; and additional effects, as detailed in Section 2.3.2 of the Report of the Board of Directors and Board of Management.

This quarter, due to the spread of the virus, the Bank recorded an increase in the provision for credit losses of approximately NIS 757 million. Most of the increase resulted from an increase in the collective allowance, in the amount of approximately NIS 603 million, and from an increase in the individual allowance, in the amount of approximately NIS 154 million, mainly in respect of borrowers in the energy sector who were adversely affected by the crisis or its consequences. This increase is further to an increase in the provision for credit losses in the amount of approximately NIS 676 million recorded in the annual financial statements for 2019 (published in the second half of March 2020, after the spread of the coronavirus), which included the effects of the spread of the virus already known at that time. For details regarding the exposure and credit risk by economic sector, see [the section concerning credit](#), below. In this context, note that due to the coronavirus event, loan payments (principal and/or interest) in the amount of NIS 897 million were deferred in March 2020, as detailed in the section "Credit risk," below, and additional payments were deferred in the second quarter of 2020. Following the spread of the coronavirus, the Bank recorded an increase in the provision for credit losses in this quarter and in the preceding quarter in a total amount of approximately NIS 1,433 million, beyond the change in the allowance for credit losses unrelated to the coronavirus event.

The spread of the coronavirus has led to an increase in the risk of activity with foreign banks, including an increase in credit risks and settlement risks with such banks. The Bank is examining this risk and managing it continually; see [the section "Credit risk," below](#).

The volatility in the financial markets led to an increase in risk estimates of the activity of the dealing room of the Bank and of its customers, concurrently with pressures in the foreign-currency market in Israel observed during the month of March (which have since subsided), and an increase in risk on indicators of systemic and global liquidity pressures. The average liquidity ratio of the Bank in the quarter ended March 31, 2020, was 126%; the liquidity ratio as at March 31, 2020, was 135%.

Decreases in prices of tradable assets, and changes in interest-rate curves in Israel and globally and in bond spreads, have exerted a negative effect on the value of the tradable assets of the Bank. The value of the share portfolio and the available for sale bond portfolio decreased by approximately NIS 705 million during the quarter. The effect of this decrease on capital is mitigated by the allocation to capital of offsetting effects, mainly arising from the widening of the credit spreads used to determine the discount rate of employee benefit liabilities; the effect of the increase in the discount rate led to a decrease in the actuarial liability and to a corresponding increase in capital in the amount of approximately NIS 662 million. The financial markets recovered somewhat during the month of April, moderating the effects described above. For details regarding the effect on market risks, see [the section "Market risks," below](#).

As noted, at this stage it is not possible to assess the full effects of the event on the Bank or the extent thereof, due to uncertainty regarding the duration of the event of the spread of the virus, the measures to be taken to stop its spread, and the severity of such measures, as well as uncertainty regarding the consequent impacts on economic activity, capital-market trends, and various financial measures to be applied by governments, central banks, and regulators on this subject (see [Section B.4 in the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks for 2019](#)); for further details, see [the sections concerning risk](#) below. The estimates of the Bank regarding the possible effects of the spread of the coronavirus and its impact on the markets constitute forward-looking information, as defined in the Securities Law, 1968, which is based, among other matters, on information and publications of third parties, and on estimates available to the Bank at this time. Such estimates are uncertain, and may materialize in a manner materially different from the foregoing statements, depending, among other matters, on the extent of the spread of the virus, the response of the governments and the central banks, and the duration of the event.

B.6. Discontinuation of publication of the LIBOR interest rates

Beginning at the end of 2021, the global financial system is expected to discontinue publication of the LIBOR interest rates and cease using these rates. The LIBOR rates serve as the basis for calculation of interest rates applicable to financial products with floating rates in principal foreign currencies, or linked to these currencies. Within the intention to establish alternative benchmark rates for the relevant currencies, global institutions such as the ISDA (International Swaps and Derivatives Association) and the ARRC (Alternative Reference Rate Committee) are formulating alternatives to these interest rates, new legal language, and proposals for substitution mechanisms. The anticipated change will affect the entire banking industry, globally and in Israel. Accordingly, a steering committee has been established at the Bank, to follow the international publications, examine the impact of the substitution on the activity of the Bank, and update the Board of Management and Board of Directors periodically. Within the activity of the committee, the various products at the Bank that are based on these interest rates have been mapped; changes have been made to legal documents; and training has been provided to Bank employees. In late January 2020, letters were sent to customers of the Bank describing the future change, according to the information in the possession of the Bank at that time.

In light of the uncertainty concerning the continued execution of this process, which is influenced, as noted, by international decisions, the Bank is unable to perform quantitative evaluations regarding the effect of the substitution of the interest rates. The Bank will continue to monitor the international publications and to act with the aim of reducing the risks arising from the interest-rate substitution process. For further details, see [Note 1D to the Condensed Financial Statements](#).

B.7. Review of weighted risk-adjusted assets

Table B-3: Review of weighted risk-adjusted assets

	Risk-weighted assets		Minimum capital requirements*
	March 31, 2020	December 31, 2019	March 31, 2020
NIS millions			
1 Credit risk (standardized approach)**	296,487	289,023	37,861
6 Counterparty credit risk (standardized approach)	5,121	5,462	654
10 Credit valuation adjustment (CVA)	2,328	2,713	297
15 Settlement risk	-	-	-
16 Securitization exposures (standardized approach)	28	28	4
25 Amounts below deduction thresholds (subject to 250% risk weight)	9,430	12,077	1,204
Total credit risk	313,394	309,303	40,020
20 Market risk (standardized approach)	3,226	3,528	412
24 Operational risk	23,612	23,556	3,015
27 Total	340,232	336,387	43,447

* Capital requirements according to the minimum required total capital ratio, plus a capital requirement reflecting 1% of the balance of housing loans at the reporting date, at a rate of 12.77%.

** Credit risk does not include counterparty credit risk, adjustment in respect of credit risk, settlement risk, securitization exposures, and amounts below the deduction thresholds.

C. Capital and leverage

C.1. Composition of capital

Table C-1: Composition of supervisory capital

	March 31, 2020	March 31, 2019	December 31, 2019	
	NIS millions			
Common equity Tier 1 capital				
Common equity Tier 1 capital – instruments and retained earnings				
1	Ordinary share capital issued by the banking corporation and premium on ordinary shares included in common equity Tier 1 capital	8,170	8,153	8,167
2	Retained earnings, including dividends proposed or declared after the balance sheet date	30,818	31,368	31,346
3	Accumulated other comprehensive income and disclosed retained earnings	(1,356)	(1,040)	(1,332)
5	Ordinary shares issued by subsidiaries of the banking corporation which were consolidated and are held by a third party (non-controlling interests)	13	43	15
6	Common equity Tier 1 capital before supervisory adjustments and deductions	37,645	38,524	38,196
Common equity Tier 1 capital – supervisory adjustments and deductions				
9	Other intangible assets, excluding mortgage service rights, net of deferred taxes payable	-	-	7
10	Deferred tax assets, realization of which depends on future profitability of the banking corporation, excluding deferred tax assets arising from timing differences	44	39	50
11	Total accumulated other comprehensive income in respect of cash-flow hedges of items not presented in the balance sheet at fair value	(1)	(1)	(1)
14	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	51	2	2
16	Investment in own ordinary shares held directly or indirectly (including commitments to purchase shares under contractual agreements)	-	-	-
21	Deferred tax assets arising from timing differences in amounts exceeding 10% of common equity Tier 1 capital	-	-	-
26	Additional supervisory adjustments and deductions established by the Banking Supervision Department	(601)	(419)	(657)
26C	Of which: additional supervisory adjustments to common equity Tier 1 capital	(601)	(419)	(657)
26C	Of which: in respect of the efficiency plans	(601)	(419)	(657)
26C	Of which: in respect of wage tax	-	-	-
28	Total supervisory adjustments and deductions in common equity Tier 1 capital	(507)	(379)	(599)
29	Common equity Tier 1 capital	38,152	38,903	38,795

Table C-1: Composition of supervisory capital (continued)

	March 31, 2020	March 31, 2019	December 31, 2019
	NIS millions		
Additional Tier 1 capital			
Additional Tier 1 capital – instruments			
33			
33	Additional Tier 1 capital instruments issued by the corporation, which are eligible for inclusion in supervisory capital during the transitional period	488	733
36	Additional Tier 1 capital before deductions	488	733
Additional Tier 1 capital – deductions			
43	Total deductions from additional Tier 1 capital	-	-
44	Additional Tier 1 capital	488	733
45	Tier 1 capital	38,640	39,636
Tier 2 capital			
Tier 2 capital – instruments and provisions			
47	Tier 2 capital instruments issued by the corporation, which are eligible for inclusion in supervisory capital during the transitional period	27	45
48	Tier 2 capital instruments issued by subsidiaries of the banking corporation to third-party investors	5,608	5,535
49	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	2,727	3,717
50	Collective allowances for credit losses before the effect of related tax	3,917	3,856
51	Tier 2 capital before deductions	9,552	9,436
Tier 2 capital – deductions			
57	Total supervisory adjustments to Tier 2 capital	-	-
58	Tier 2 capital	9,552	9,436
59	Total capital	48,192	49,072
Risk-weighted assets			
	Total risk-weighted assets according to the requirements prior to the adoption of Directive 202, in accordance with Basel 3	339,775	339,204
	Of which: credit risk assets	312,937	311,921
	Of which: market risk assets	3,226	2,998
	Of which: operational risk assets	23,612	24,285
60	Total risk-weighted assets	340,232	339,691

Table C-1: Composition of supervisory capital (continued)

	March 31, 2020	March 31, 2019	December 31, 2019	
	NIS millions/percent			
Capital ratios and capital preservation cushions				
61	Common equity Tier 1 capital	11.21%	11.45%	11.53%
62	Tier 1 capital	11.36%	11.67%	11.75%
63	Total capital	14.16%	14.45%	14.64%
Minimum requirements established by the Banking Supervision Department				
69	The minimum required common equity Tier 1 capital ratio is 10%, and 9% beginning with the report for March 31, 2020. A capital requirement at a rate representing 1% of the balance of housing loans at the dates of the financial statements was added to this ratio	9.27%	10.24%	10.27%
71	The minimum required total capital ratio is 13.5%, and 12.5% beginning with the report for March 31, 2020. A capital requirement at a rate representing 1% of the balance of housing loans at the dates of the financial statements was added to this ratio	12.77%	13.74%	13.77%
Amounts below the deduction threshold (before risk weighting)				
72	Investments in the capital of financial corporations which do not exceed 10% of the ordinary share capital issued by the financial corporation and which are below the deduction threshold	1,500	1,474	1,443
73	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	472	671	1,378
75	Deferred tax assets arising from timing differences, below the deduction threshold	3,623	3,749	3,806
Ceiling for inclusion of provisions in Tier 2				
76	Provision qualifying for inclusion in Tier 2, with reference to exposures under the standardized approach, before application of the ceiling	4,267	3,856	3,778
77	Ceiling for inclusion of provision in Tier 2 under the standardized approach	3,917	3,905	3,866
Capital instruments not qualifying as supervisory capital, which are subject to the transitional directives				
82	Present ceiling amount for instruments included in additional Tier 1 capital subject to the transitional directives	488	733	733
83	Amount deducted from additional Tier 1 capital due to the ceiling	1,047	1,126	809
84	Present ceiling amount for instruments included in Tier 2 capital subject to the transitional directives	3,051	4,577	4,577
85	Amount deducted from Tier 2 capital due to the ceiling	-	-	-

C.2. Capital adequacy

C.2.a. Capital-adequacy target

On March 31, 2020, the Banking Supervision Department issued a circular on the subject, "Adjustments to the Proper Conduct of Banking Business Directives for the purpose of coping with the coronavirus crisis (temporary order)" (the "Temporary Order"), in view, according to the statement of the Banking Supervision Department, of the spread of the coronavirus, and in order to ensure the ability of the banks to continue to offer credit. Pursuant to the circular, the Bank, as a banking corporation of significant importance (a banking corporation whose total balance sheet assets on a consolidated basis constitute at least 24% of the total balance sheet assets of the banking system in Israel), is required to maintain a minimum common equity Tier 1 capital ratio of 9% (versus 10% prior to this change), and a minimum total capital ratio of 12.5% (versus 13.5% prior to this change). These capital requirements will be in effect for six months, and will be extended for an additional six months if necessary, after which, as relevant, the Bank will be required to present a trajectory for gradual reaccumulation of capital, to the extent that its capital is eroded, over a period of two years.

A capital requirement at a rate representing 1% of the balance of housing loans at the dates of the financial statements is added to the minimum capital ratios.

Accordingly, the minimum common equity Tier 1 capital ratio and the minimum total capital ratio of the Bank (which is a banking corporation of significant importance) required by the Banking Supervision Department, on a consolidated basis, as at March 31, 2020, and for the duration of the period of the Temporary Order, stand at 9.27% and 12.77%, respectively (instead of 10.27% and 13.77% prior to the Temporary Order).

In the statement issued by the Banking Supervision Department in connection with the Temporary Order, boards of directors of banks were asked, among other matters, to reexamine their dividend policies, with the intention of using the capital resources released as a result of the reduced capital requirements in order to increase credit, rather than for distribution. In view of the statement of the Banking Supervision Department, and in order to allow realization of the purpose of the directive, the Board of Directors of the Bank resolved on March 31, 2020, to adjust the target common equity Tier 1 capital ratio to 9.5%. The Board of Directors further resolved that, taking into consideration the existing distribution policy of the Bank (distribution of up to 40% of quarterly net operating profit), in light of the uncertainty in macroeconomic conditions, and in order to fulfill the purpose of the Temporary Order and the policy of the Banking Supervision Department, until the end of the period of the Temporary Order and until conditions are clearer, the Bank will continue to refrain from performing distributions from ongoing earnings.

C.2.b. Planning and management of capital by the Bank

Dividends

Before the date of approval of the financial statements as at June 30, 2018, the Banking Supervision Department notified the Bank that in light of the substantive uncertainty with respect to the investigation of the United States authorities, and for reasons of caution and conservatism, the Banking Supervision Department was of the opinion that, at that time, dividends from ongoing earnings should not be distributed by the Bank. Accordingly, for reasons of conservatism and in coordination with the Bank of Israel, beginning in the second quarter of 2018, the Board of Directors of the Bank has not declared the distribution of dividends from ongoing earnings, with no change to the Bank's dividend distribution policy. See [also Note 24 to the Annual Financial Statements for 2019](#).

As a result of the sale of approximately 65% of the shares of Isracard in the second quarter of 2019 (see [Note 15E to the Financial Statements](#)), the Bank accumulated additional capital surplus in the amount of approximately NIS 1.3 billion (of which approximately NIS 0.3 billion is in respect of a decrease in the operational risk of Isracard, which will be recognized gradually, over a period of three years). In September 2019, the Board of Directors of the Bank declared the distribution of dividends in respect of this capital surplus, in the amount of NIS 1 billion, paid in October 2019.

The remaining holdings of the Bank in the shares of Isracard (approximately 33% of the issued and paid-up capital of Isracard) were distributed as a dividend in kind to the shareholders of the Bank on March 9, 2020.

C.2.c. Implementation of regulatory directives with an effect on measurement and capital-adequacy matters

Sale of Isracard

In accordance with the requirements of the Law for Increasing Competition and Reducing Concentration in the Banking Market in Israel (Legislative Amendments), 2017 (the "Law for Increasing Competition"), and the publication of the prospectus for a public sale offering of the shares of Isracard, the Bank sold approximately 65.2% of the capital of Isracard in a public sale offering on April 8, 2019. The sale led to an increase of approximately 0.3% in the common equity Tier 1 capital ratio and in the total capital ratio. For details regarding the holdings of the Bank in the Isracard Group, see [Section 2.6.1, "Principal companies," in the Report of the Board of Directors and Board of Management](#).

On February 2, 2020, the Board of Directors of the Bank approved distribution of the remaining holdings in the shares of Isracard as a dividend in kind to the shareholders of the Bank. The distribution was performed on March 9, 2020. The Bank thereby completed its separation from the Isracard Group, as required by the Law for Increasing Competition. The share distribution was performed according to the value of the shares on the stock exchange at the date of the distribution. The effect of the distribution of the dividend in kind is a decrease of approximately 0.2% in the common equity Tier 1 capital ratio and in the total capital ratio.

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" (the "Efficiency Directive"). Pursuant to the Efficiency Directive, 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 directive 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.

Further to the Efficiency Directive, in June 2017, the Banking Supervision Department issued a letter entitled, "Improving the operational efficiency of the banking system in Israel – efficiency in the area of real estate," which encourages banking corporations to also examine, in addition to improved efficiency in personnel expenses, the possibility of reducing real-estate and maintenance costs of headquarters and management units, including through a reexamination of the geographical location of such units ("Real-Estate Efficiency"). In order to encourage the implementation of a plan for Real-Estate Efficiency, the Banking Supervision Department will approve reliefs for the banks in the area of capital adequacy.

In a letter dated December 16, 2019, the Banking Supervision Department extended the period for implementation of the efficiency plan until December 31, 2021.

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 plan is being allocated in equal installments over five years, beginning in 2017, for the purpose of the calculation of capital-adequacy ratios and the leverage ratio.

In January 2020, the Board of Directors of the Bank approved an efficiency plan at an estimated cost in the amount of NIS 352 million, net of tax effect, which was allocated to capital as at December 31, 2019. The plan is being allocated in equal installments over five years, beginning in 2020, for the purpose of the calculation of capital-adequacy ratios and the leverage ratio.

The effect of the reliefs in respect of the efficiency plans on the ratio of common equity Tier 1 capital to risk components is estimated at approximately 0.2% as at March 31, 2020.

The subsidiary of the Bank in Turkey

In January 2019, a letter was received from the Bank of Israel concerning the subsidiary of the Bank in Turkey, Bank Pozitif. In the letter, the Bank of Israel stated that the activity of the Bank in Turkey exposes it to significant risks, and therefore, until the realization of the full holdings of the Bank in Bank Pozitif, the Bank is required to increase the risk weighting rates of risk-adjusted assets in respect of the activity of Bank Pozitif, in the calculation of the consolidated capital ratio only, as follows:

- Beginning January 1, 2020, risk-adjusted assets in respect of the activity of Bank Pozitif will be weighted at a rate of at least 300%.
- Beginning January 1, 2021, risk-adjusted assets in respect of the activity of Bank Pozitif will be weighted at a rate of at least 600%.

Accordingly, beginning January 1, 2020, the Bank weighted risk-adjusted assets in respect of Bank Pozitif at 300%. The effect on the financial statements for the first quarter of 2020 is a decrease of approximately 0.04% in the common equity Tier 1 capital ratio. The effect of this instruction on the common equity Tier 1 capital ratio, assuming weighting of the risk-adjusted assets at 600%, based on data as at March 31, 2020, is an additional decrease of approximately 0.05%.

Within the Bank's strategic plan, a decision has been made to act to sell the investment in Bank Pozitif. Accordingly, the Bank is working to gradually reduce the credit portfolio of Bank Pozitif.

Leases

The effect of the implementation of the new accounting standard concerning leases, implemented as of January 1, 2020, is a decrease of approximately 0.04% in the common equity Tier 1 capital ratio and a decrease of approximately 0.05% in the total capital ratio. For further details, see [Note 1C to the Condensed Financial Statements](#).

C.2.d. Basel 3 directives

The Basel 3 directives took effect on January 1, 2014. Implementation is gradual, in accordance with the transitional directives established in Proper Conduct of Banking Business Directive 299, "Capital Measurement and Adequacy – Supervisory Capital – Transitional Directives." In accordance with the transitional directives, 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. Accordingly, the ceiling for instruments qualifying as supervisory capital was 30% and 20%, respectively, in 2019 and 2020.

C.3. Leverage ratio

The Bank applies Proper Conduct of Banking Business Directive 218, "Leverage Ratio" (hereinafter: the "Directive"). The Directive establishes a simple, transparent, non-risk-based leverage ratio, which serves as a complementary measurement to risk-based capital requirements, and which is designed to limit the accumulation of leverage at banking corporations.

The leverage ratio is expressed as a percentage, and is defined as the ratio of the capital measurement to the exposure measurement. Capital, for the purpose of measurement of the leverage ratio, is Tier 1 capital, as defined in Proper Conduct of Banking Business Directive 202, taking into consideration the transitional arrangements that have been established. The total exposure measurement is the total of balance sheet exposures, exposures to derivatives and to securities financing transactions, and off-balance sheet items.

Table C-2: Comparison of balance sheet assets to exposure measurement, for the purposes of the leverage ratio

	March 31, 2020	March 31, 2019	December 31, 2019
	NIS millions		
Total consolidated assets as per published financial statements	491,459	465,778	463,688
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 in the balance sheet pursuant to the Public Reporting Directives, but excluded from the leverage ratio exposure measurement	-	-	-
Adjustments for derivative financial instruments	(8,060)	(658)	(3,474)
Adjustments for securities financing transactions	-	-	-
Adjustments for off-balance sheet items	54,650	54,763	56,545
Other adjustments	3,372	3,129	2,889
Exposure for the purposes of the leverage ratio	541,421	523,012	519,648

Table C-3: Leverage ratio disclosure

	March 31, 2020	March 31, 2019	December 31, 2019
	NIS millions/percent		
On-balance sheet exposures			
On-balance sheet items (excluding derivatives and securities financing transactions, but including collateral)	479,560	457,986	455,020
Asset amounts deducted in determining Tier 1 capital	(44)	(39)	(57)
Total on-balance sheet exposures (excluding derivatives and securities financing transactions)	479,516	457,947	454,963
Derivative exposures			
Replacement cost associated with all derivatives transactions	3,902	4,818	4,008
Add-on amounts for potential future exposure associated with all derivatives transactions	6,399	6,153	5,959
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	(3,415)	(1,383)	(2,298)
Exempted central counterparty leg of client-cleared trade exposures	-	-	-
Adjusted effective notional amount of written credit derivatives	-	-	-
Adjusted effective notional offsets and add-on deductions for written credit derivatives	-	-	-
Total derivative exposures	6,886	9,588	7,669
Securities financing transaction exposures			
Gross securities financing transaction assets (with no recognition of netting), after adjusting for sale accounting transactions	369	714	471
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	369	714	471
Other off-balance sheet exposures			
Off-balance sheet exposure at gross notional amount	163,526	185,035	170,946
Adjustments for conversion to credit equivalent amounts	(108,876)	(130,272)	(114,401)
Off-balance sheet items	54,650	54,763	56,545
Capital and total exposures			
Tier 1 capital*	38,640	39,636	39,528
Total exposures*	541,421	523,012	519,648
Leverage ratio			
Leverage ratio pursuant to Proper Conduct of Banking Business Directive 218	7.14%	7.58%	7.61%
Minimum leverage ratio required by the Banking Supervision Department	6.00%	6.00%	6.00%

* These data include adjustments in respect of the efficiency plans, in accordance with the directives of the Banking Supervision Department (see [the section "Improving operational efficiency,"](#) above). The effect of the reliefs in respect of the efficiency plans on the leverage ratio as at March 31, 2020, estimated at approximately 0.12%, is allocated in equal parts over five years, beginning at the inception date thereof.

The decrease in the leverage ratio as at March 31, 2020, mainly resulted from an increase in total exposures, due to factors including an increase in customers' credit needs, as a result of the worsening of the economic environment while coping with the coronavirus, and from a decrease in capital due to the distribution of the remaining shares of Isracard as a dividend in kind to shareholders.

D. 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** – Present 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. Counterparty risk is addressed separately in Section E, below.

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).

In accordance with the reporting directives of the Bank of Israel, this section contains items to which the Basel credit-risk framework applies, pursuant to Proper Conduct of Banking Business Directive 203, unless explicitly noted otherwise.

Effect of the spread of the coronavirus

The spread of the virus, as well as the coping measures applied by governments in Israel and worldwide, have caused significant damage to business activity in Israel and globally, encompassing most sectors of the economy, although the damage is more explicit and clear in certain areas, such as aviation, tourism, commerce in shopping centers, restaurants, events, entertainment and leisure, and energy. The ability to cope with the economic damage depends on many factors that are insufficiently clear at this stage, including the pace of the return to routine functioning in the various sectors, the ability of businesses and households to contend with the crisis through changes in processes and finding alternative solutions, the support of the government, the recovery of global trade, and more. Exceptions are areas in which demand has grown, while the conditions have not led to substantial damage to business, such as pharmacies and commerce in food. Within the crisis, the percentage of job seekers has risen sharply, and the effects of the crisis are also creating significant economic uncertainty among households.

The Bank is acting to support its customers during the crisis, taking into consideration the effects of the crisis on credit risk. Towards that end, the Bank has taken several measures, detailed in Section B.5 above. In view of the high uncertainty, the Bank expects credit losses to grow; however, at this stage it is difficult to determine to what extent, or when, due to factors including the processes and measures applied by the government and the Bank of Israel, which may assist the economy in emerging from the crisis more quickly, but if they are unsuccessful, will only postpone the realization of credit risks. As an advance measure in confronting the effect of the crisis, the Bank decided to increase its collective allowance for this quarter, in order to reflect the expected increase in individual credit losses and in automatic charge-offs. A calculation based on the collective allowance without this addition would give rise to a decrease in the collective allowance for this quarter.

D.1. Credit quality of credit exposures

Changes in terms of debts within measures to cope with the coronavirus

In view of the spread of the coronavirus and its possible impacts on the condition of the economy and of borrowers, with the aim of encouraging banking corporations to act to stabilize borrowers who fail or are likely to fail to fulfill their contractual payment obligations due to the coronavirus, the Bank of Israel issued emphases for addressing debts the terms of which have been changed. Pursuant to the circular, it has been determined that changes in the terms of loans do not automatically lead to classification of the loans as restructuring of problematic debt when short-term changes in payments are performed due to the coronavirus event for borrowers who were not previously in arrears. It has also been determined that borrowers are not considered borrowers in arrears if the arrears are of less than thirty days at the date of implementation of the changes.

Stabilization of borrowers who are not in arrears on their existing loans and who are sound borrowers who encounter financial or operational problems in the short term due to the coronavirus event, in general, is not considered restructuring of problematic debt, particularly when the following conditions are fulfilled:

1. The change was performed due to the coronavirus event.
2. The borrower was not in arrears when the changes were implemented.
3. The change is for a short period.

With regard to the establishment of the state of arrears, debts that were not previously in arrears and are granted a deferral due to the coronavirus event shall not be classified as debts in arrears as a result of the deferral. When deferral of payments is performed for debts that were in arrears prior to the deferral, the state of arrears should be frozen during the period of deferral of payments, except if the debt has been classified as impaired or charged off. It is possible that without the suspension of the count of days of arrears with respect to deferred payments, as noted above, the balance of debts in arrears would be higher.

For details regarding the instructions of the Banking Supervision Department on coping with the coronavirus, see [Note 1C to the Condensed Financial Statements](#).

Details are presented below regarding the balance of debts the terms of which were changed during the month of March 2020 as part of the measures to cope with the spread of the coronavirus, which were not classified as restructuring of problematic debt, in accordance with the instructions of the Banking Supervision Department, as noted above. Such changes were also performed during the second quarter of 2020.

The Bank offers its customers tools, credit products, and additional products aimed at coping with the crisis. For additional details, see [the section, "Segments of activity based on management approach" in the Corporate Governance Report](#).

Table D-1: Details regarding the balance of debts the terms of which have been changed⁽¹⁾ in the course of coping with the spread of the coronavirus, which are not classified as troubled debt restructuring

	March 31, 2020	
	Balance of credit for which payments have been deferred	Balance of actual deferred payments
	NIS millions	
Commercial	6,426	605
Private individuals – housing loans	11,297	196
Private individuals – other	916	74
Total in Israel	18,639	875
Activity overseas	1,333	22
Total	19,972	897

(1) Changes in terms in the form of deferral of payment of principal and/or interest for a period not exceeding six months.

Table D-2: Credit risk indicators

	As at	
	March 31, 2020	December 31, 2019
Balance of impaired credit to the public, as a percentage of the balance of credit to the public*	1.39%	1.49%
Balance of unimpaired credit to the public, in arrears of 90 days or more, as a percentage of the balance of credit to the public*	0.29%	0.31%
Allowance for credit losses in respect of credit to the public, as a percentage of the balance of credit to the public*	1.73%	1.58%
Collective allowance for credit losses, as a percentage of the balance of credit to the public*	1.40%	1.27%
Allowance for credit losses in respect of credit to the public, as a percentage of the balance of impaired credit to the public*	124.30%	105.97%
Allowance for credit losses in respect of credit to the public, as a percentage of the balance of impaired credit to the public plus the balance of credit to the public in arrears of 90 days or more*	103.07%	87.90%
Problematic credit risk in respect of the public, as a percentage of total credit risk in respect of the public*	2.35%	2.42%
Provision (income) for credit losses as a percentage of the average recorded balance of credit to the public	1.07%	0.44%
Net charge-offs in respect of credit to the public as a percentage of the average recorded balance of credit to the public	0.25%	0.12%
Net charge-offs in respect of credit to the public as a percentage of the allowance for credit losses in respect of credit to the public	14.20%	7.48%

* Before deduction of the allowance for credit losses.

Portfolio quality analysis

The following indicators increased (worsened) in the first three months of 2020, compared with the end of 2019:

- The allowance for credit losses in respect of credit to the public, as a percentage of the balance of credit to the public.
- The collective allowance for credit losses, as a percentage of the balance of credit to the public.
- The provision (income) for credit losses as a percentage of the average recorded balance of credit to the public.
- Net charge-offs in respect of credit to the public, as a percentage of the average recorded balance of credit to the public.

The following indicators decreased (improved):

- The balance of impaired credit to the public, as a percentage of the balance of credit to the public.
- The balance of unimpaired credit to the public, in arrears of 90 days or more, as a percentage of the balance of credit to the public.
- Problematic credit risk in respect of the public, as a percentage of total credit risk in respect of the public.

The changes in the portfolio quality indicators are the result of an increase in the allowance for credit losses and in the provision for credit losses, concurrently with a decrease in problematic credit risk and in the balance of impaired credit to the public. These opposing trends reflect the fact that although the impact of the spread of the coronavirus is not materially apparent at this stage, due to factors including the Bank of Israel's guidance on suspension of the state of arrears following deferral of payments, which may have had some effect on the improvement of the indicators, the Bank decided to increase its collective allowance for the quarter in order to reflect the expected increase in credit losses. Calculation of the collective allowance without this addition would indicate a decrease in the collective allowance. This increase is added to the provision for credit losses recorded in the annual financial statements for 2019 (published in March 2020), which was influenced by the impacts of the spread of the virus, as noted above.

With regard to other indicators that refer to only to the risk in the portfolio of credit for private individuals, see [Table D-11: Information regarding problematic debts in respect of private individuals in Israel](#), below.

Table D-3: Credit quality of credit exposures

		March 31, 2020			
		Gross balances		Allowances	Net balances
		Impaired or in arrears of 90 days or more	Others	for credit losses or impairment	
		NIS millions			
1	Debts, excluding bonds	4,951	401,411	1,530	404,832
2	Bonds	-	57,164	-	57,164
3	Off-balance sheet exposures	-	163,602	76	163,526
4	Total	4,951	622,177	1,606	625,522

		March 31, 2019			
		Gross balances		Allowances	Net balances
		Impaired or in arrears of 90 days or more	Others	for credit losses or impairment	
		NIS millions			
1	Debts, excluding bonds	4,126	389,690	665	393,151
2	Bonds	-	58,520	-	58,520
3	Off-balance sheet exposures	-	185,109	74	185,035
4	Total	4,126	633,319	739	636,706

		December 31, 2019			
		Gross balances		Allowances	Net balances
		Impaired or in arrears of 90 days or more	Others	for credit losses or impairment	
		NIS millions			
1	Debts, excluding bonds	4,158	392,970	1,408	395,720
2	Bonds	-	50,809	-	50,809
3	Off-balance sheet exposures	-	171,011	65	170,946
4	Total	4,158	614,790	1,473	617,475

For further details, see [Table 3-3: Additional information regarding changes in problematic debts in respect of credit to the public and in the individual allowance, in the Report of the Board of Directors and Board of Management.](#)

D.2. Credit risk exposures

Table D-4: Details of exposures by economic sector

	March 31, 2020									
	Total credit risk ⁽¹⁾			Debts ⁽²⁾ and off-balance sheet credit risk (excluding derivatives) ⁽³⁾						
	Total	Credit execution rating ⁽⁵⁾	Problematic ⁽⁶⁾	Total	Of which: Problematic ⁽⁶⁾ debts ⁽²⁾	Impaired	Provision (income) for credit losses	Net charge-offs	Allowance for credit losses	Credit losses for the period ended March 31, 2020 ⁽⁴⁾
NIS millions										
In respect of borrower activity in Israel										
Public – commercial										
Agriculture	2,920	2,721	95	2,908	2,222	95	20	3	-	22
Mining and quarrying	2,712	1,420	1,290	2,667	1,917	1,257	1,010	123	-	658
Industry	31,646	30,158	992	30,787	15,486	992	412	64	5	389
Construction and real estate – construction ⁽⁷⁾	67,528	65,679	863	67,343	28,145	863	561	78	9	599
Construction and real estate – real-estate activities	25,999	24,529	1,103	25,533	22,009	1,088	289	55	(6)	464
Electricity and water supply	10,367	9,303	963	9,592	5,972	929	271	18	2	167
Commerce	35,700	33,496	1,174	35,454	24,986	1,167	481	147	58	893
Hotels, hospitality, and food services	10,482	9,667	334	10,393	8,818	334	134	39	5	109
Transportation and storage	9,367	8,429	543	9,134	6,976	404	89	(14)	10	124
Information and communications	6,448	6,037	321	6,386	3,989	321	269	(16)	3	319
Financial services	41,951	41,478	131	34,047	21,283	131	30	53	(1)	253
Other business services	13,698	12,967	116	13,618	8,620	116	97	41	20	167
Public and community services	7,580	7,250	65	7,558	5,805	65	22	16	4	69
Total commercial ⁽⁸⁾	266,398	253,134	7,990	255,420	156,228	7,762	3,685	607	109	4,233
Private individuals – housing loans	97,679	95,215	710	97,679	91,979	710	2	32	-	475
Private individuals – other	58,188	54,175	883	58,175	36,815	883	762	119	76	829
Total public – activity in Israel	422,265	402,524	9,583	411,274	285,022	9,355	4,449	758	185	5,537
Banks in Israel ⁽⁹⁾	3,750	3,750	-	1,374	398	-	-	-	-	-
Israeli government	60,903	60,903	-	1,514	1,514	-	-	-	-	-
Total activity in Israel	⁽¹⁾ 486,918	467,177	9,583	414,162	286,934	9,355	4,449	758	185	5,537

(1) Balance sheet credit risk and off-balance sheet credit risk⁽³⁾, including in respect of derivative instruments. Includes debts⁽²⁾, bonds, securities borrowed or purchased under agreements to resell, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limit on borrower indebtedness, in the amount of NIS 286,934, 59,224, 369, 7,800, and 132,591 million, respectively.

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

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

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

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

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

(7) Including balance sheet credit risk in the amount of approximately NIS 732 million and off-balance sheet credit risk in the amount of approximately NIS 730 million extended to certain purchasing groups, which are currently in the process of construction. Also includes off-balance sheet credit risk in the amount of approximately NIS 3,589 million, in respect of which insurance was acquired from foreign insurance companies for the portfolio of Sale Law guarantees.

(8) The balance of commercial debts includes the balance of housing loans, in the amount of approximately NIS 84 million, of commercial borrowers, or extended to purchasing groups currently in the process of construction.

(9) Excluding cash balances of the Bank and deposits with the Bank of Israel, and before deducting the allowance for credit losses.

Table D-4: Details of exposures by economic sector (continued)

	March 31, 2020									
	Total credit risk ⁽¹⁾			Debts ⁽²⁾ and off-balance sheet credit risk (excluding derivatives) ⁽³⁾						
	Total	Credit execution rating ⁽⁵⁾	Problematic ⁽⁶⁾	Total	Of which: Problematic ⁽⁶⁾ debts ⁽²⁾	Impaired	Provision (income) for credit losses	Net charge-offs	Allowance for credit losses	Credit losses for the period ended March 31, 2020 ⁽⁴⁾
NIS millions										
In respect of borrower activity overseas										
Public – commercial										
Agriculture	407	407	-	407	265	-	-	-	-	2
Mining and quarrying	758	704	55	252	84	55	-	-	-	-
Industry	3,564	3,351	144	2,987	2,107	144	38	3	-	14
Construction and real estate	7,829	6,887	381	7,829	6,126	381	199	35	5	159
Electricity and water supply	935	924	10	514	227	10	10	(1)	(1)	7
Commerce	2,839	2,542	224	2,543	2,073	224	109	(3)	-	17
Hotels, hospitality, and food services	3,314	3,000	56	3,314	2,702	56	19	3	-	27
Transportation and storage	858	713	141	728	621	141	90	5	3	31
Information and communications	1,334	1,302	29	1,086	812	29	21	2	-	6
Financial services	7,857	7,835	22	3,868	2,897	22	22	4	(5)	40
Other business services	783	621	-	783	578	-	-	(1)	-	5
Public and community services	955	911	40	864	769	40	5	2	-	11
Total commercial ⁽⁷⁾	31,433	29,197	1,102	25,175	19,261	1,102	513	49	2	319
Private individuals – housing loans	487	474	7	487	473	7	-	-	-	3
Private individuals – other	231	224	5	231	61	5	5	1	-	5
Total public – activity overseas	32,151	29,895	1,114	25,893	19,795	1,114	518	50	2	327
Banks overseas ⁽⁸⁾	40,974	40,974	-	27,749	26,971	-	-	1	-	3
Governments overseas	7,544	7,544	-	1,304	1,193	-	-	-	-	6
Total activity overseas	(1)80,669	78,413	1,114	54,946	47,959	1,114	518	51	2	336
Total in Israel and overseas	567,587	545,590	10,697	469,108	334,893	10,469	4,967	809	187	5,873

(1) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments. Includes debts⁽²⁾, bonds, securities borrowed or purchased under agreements to resell, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limit on borrower indebtedness, in the amount of NIS 47,959, 13,778, 0, 7,144, and 11,788 million, respectively.

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

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

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

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

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

(7) The balance of commercial debts includes the balance of housing loans, in the amount of approximately NIS 0 million, of commercial borrowers, or extended to purchasing groups currently in the process of construction.

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

Table D-4: Details of exposures by economic sector (continued)

	December 31, 2019									
	Total credit risk ⁽¹⁾			Debts ⁽²⁾ and off-balance sheet credit risk (excluding derivatives) ⁽³⁾						
	Total	Credit execution rating ⁽⁵⁾	Problematic ⁽⁶⁾	Total	Of which: debts ⁽²⁾	Problematic ⁽⁶⁾	Impaired	Credit losses for the year ended December 31, 2019 ⁽⁴⁾		
Provision (income) for credit losses								Net charge-offs	Allowance for credit losses	
NIS millions										
In respect of borrower activity in Israel										
Public – commercial										
Agriculture	2,892	2,742	91	2,879	2,230	91	20	(22)	(18)	19
Mining and quarrying	2,449	1,188	1,250	2,440	1,962	1,177	987	490	1	511
Industry	31,029	29,736	915	30,514	14,237	912	405	26	33	333
Construction and real estate – construction ⁽⁷⁾	67,577	65,812	951	67,454	27,798	951	603	(125)	(100)	523
Construction and real estate – real-estate activities	24,702	23,390	1,214	24,532	20,228	1,208	305	13	(112)	402
Electricity and water supply	10,803	9,649	1,069	9,574	5,730	1,032	359	87	2	149
Commerce	35,380	33,746	953	35,147	24,548	952	539	157	120	806
Hotels, hospitality, and food services	10,120	9,598	247	10,025	8,396	247	124	(10)	15	77
Transportation and storage	9,708	8,670	639	9,594	6,726	626	94	125	39	148
Information and communications	6,628	6,157	325	6,589	4,043	325	274	98	3	339
Financial services	38,346	38,001	138	33,318	20,005	138	30	19	(38)	200
Other business services	13,297	12,775	130	13,262	8,616	130	112	65	50	148
Public and community services	7,582	7,403	70	7,572	5,724	70	22	21	15	57
Total commercial ⁽⁸⁾	260,513	248,867	7,992	252,900	150,243	7,859	3,874	944	10	3,712
Private individuals – housing loans	96,480	94,590	696	96,480	89,228	696	2	31	9	443
Private individuals – other	59,540	56,420	904	59,532	38,626	904	760	193	297	785
Total public – activity in Israel	416,533	399,877	9,592	408,912	278,097	9,459	4,636	1,168	316	4,940
Banks in Israel ⁽⁹⁾	2,905	2,905	-	1,120	132	-	-	-	-	-
Israeli government	41,585	41,585	-	794	794	-	-	-	-	-
Total activity in Israel	⁽¹⁾ 461,023	444,367	9,592	410,826	279,023	9,459	4,636	1,168	316	4,940

(1) Balance sheet credit risk and off-balance sheet credit risk⁽³⁾, including in respect of derivative instruments. Includes debts⁽²⁾, bonds, securities borrowed or purchased under agreements to resell, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limit on borrower indebtedness, in the amount of NIS 279,023, 40,319, 471, 4,575, and 136,635 million, respectively.

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

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

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

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

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

(7) Including balance sheet credit risk in the amount of approximately NIS 754 million and off-balance sheet credit risk in the amount of approximately NIS 967 million extended to certain purchasing groups, which are currently in the process of construction. Also includes off-balance sheet credit risk in the amount of approximately NIS 13,797 million, in respect of which insurance was acquired from foreign insurance companies for the portfolio of Sale Law guarantees.

(8) The balance of commercial debts includes the balance of housing loans, in the amount of approximately NIS 74 million, of commercial borrowers, or extended to purchasing groups currently in the process of construction.

(9) Excluding cash balances of the Bank and deposits with the Bank of Israel, and before deducting the allowance for credit losses.

Table D-4: Details of exposures by economic sector (continued)

	December 31, 2019									
	Total credit risk ⁽¹⁾			Debts ⁽²⁾ and off-balance sheet credit risk (excluding derivatives) ⁽³⁾						
	Total	Credit execution rating ⁽⁵⁾	Problematic ⁽⁶⁾	Total	Of which: Problematic ⁽⁶⁾ debts ⁽²⁾	Impaired	Credit losses for the year ended December 31, 2019 ⁽⁴⁾			
Provision (income) for credit losses							Net charge-offs	Allowance for credit losses		
NIS millions										
In respect of borrower activity overseas										
Public – commercial										
Agriculture	383	383	-	383	267	-	-	-	-	2
Mining and quarrying	747	747	-	207	63	-	-	(1)	-	-
Industry	3,756	3,475	218	3,056	2,032	218	61	11	15	10
Construction and real estate	8,714	7,956	576	8,572	6,652	576	279	63	(13)	150
Electricity and water supply	903	823	10	516	210	10	10	(1)	-	6
Commerce	3,119	2,673	151	2,855	2,364	151	107	24	26	20
Hotels, hospitality, and food services	3,317	3,068	57	3,317	2,688	57	20	(1)	-	24
Transportation and storage	778	629	146	653	590	146	95	(3)	(2)	31
Information and communications	1,366	1,330	36	1,053	706	36	36	8	8	3
Financial services	7,279	7,233	44	3,411	2,262	44	39	12	-	34
Other business services	818	728	-	818	616	-	-	(1)	-	4
Public and community services	907	864	44	818	557	44	8	-	(1)	11
Total commercial ⁽⁷⁾	32,087	29,909	1,282	25,659	19,007	1,282	655	111	33	295
Private individuals – housing loans	489	471	6	489	474	6	-	-	-	3
Private individuals – other	256	248	6	256	69	6	6	(2)	3	5
Total public – activity overseas	32,832	30,628	1,294	26,404	19,550	1,294	661	109	36	303
Banks overseas ⁽⁸⁾	32,439	32,439	-	18,549	17,933	-	-	-	-	2
Governments overseas	9,294	9,294	-	1,183	1,183	-	-	(1)	-	6
Total activity overseas	⁽¹⁾ 74,565	72,361	1,294	46,136	38,666	1,294	661	108	36	311
Total in Israel and overseas	535,588	516,728	10,886	456,962	317,689	10,753	5,297	1,276	352	5,251

(1) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments. Includes debts⁽²⁾, bonds, securities borrowed or purchased under agreements to resell, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments, as calculated for the purpose of the limit on borrower indebtedness, in the amount of NIS 38,666, 17,394, 0, 6,568, and 11,937 million, respectively.

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

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

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

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

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

(7) The balance of commercial debts includes the balance of housing loans, in the amount of approximately NIS 1 million, of commercial borrowers, or extended to purchasing groups currently in the process of construction.

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

D.2.a. Credit exposure to foreign financial institutions

Table D-5: Exposure of the Bank Group to foreign financial institutions⁽¹⁾

	March 31, 2020			December 31, 2019		
	Balance sheet credit risk ⁽²⁾	Present off-balance sheet credit risk ⁽³⁾	Total present credit risk	Balance sheet credit risk ⁽²⁾	Present off-balance sheet credit risk ⁽³⁾	Total present credit risk
	NIS millions					
External credit rating⁽⁵⁾						
AAA to AA-	5,447	3,114	8,561	4,032	2,949	6,981
A+ to A-	17,106	2,746	19,852	13,911	1,709	15,620
BBB+ to BBB-	1,019	36	1,055	867	139	1,006
BB+ to B-	7	23	30	12	22	34
Lower than B-	-	-	-	-	-	-
Unrated	386	120	506	312	74	386
Total present credit exposures to foreign financial institutions*	23,965	6,039	30,004	19,134	4,893	24,027
Of which: problematic credit risk ⁽⁴⁾	-	-	-	-	-	-
Of which: balance of impaired debts	-	-	-	-	-	-
Individual allowance for credit losses	-	-	-	-	-	-
Total credit exposure to foreign financial institutions after deduction of the individual allowance for credit losses	23,965	6,039	30,004	19,134	4,893	24,027
Collective allowance for credit losses	5	1	6	4	1	5

* The balances include the exposure of the Bank Group to financial institutions in the following countries:
 Spain – Total exposure of approximately NIS 27 million, rated A-, of which a total of NIS 26 million rated A- and a total of NIS 1 million rated BBB- (total exposure at the end of 2019 was approximately NIS 163 million, rated A-).
 Italy – Total exposure of approximately NIS 25 million, of which a total of NIS 20 million rated BBB and the remaining amount of NIS 5 million rated BBB- (total exposure at the end of 2019 was approximately NIS 83 million, of which a total of NIS 76 million rated BBB and the remaining amount of NIS 7 million rated BBB-).
 There is no exposure to financial institutions in Ireland, Greece, or Portugal.

- (1) Foreign financial institutions include: banks, investment banks, broker/dealers, insurance companies, institutional entities, and entities controlled by such entities. However, credit exposure to foreign financial institutions backed by government guarantees is not included.
- (2) Deposits with banks, credit to the public, investments in bonds, securities borrowed or purchased in agreements to resell, and other assets in respect of derivative instruments.
- (3) Mainly guarantees and commitments to grant credit. Does not include credit risk in off-balance sheet financial instruments, as calculated for the purposes of the limits on indebtedness of a borrower.
- (4) Credit risk that is impaired, substandard, or under special supervision.
- (5) According to the lowest of the long-term foreign-currency credit ratings assigned by any of the major rating agencies: S&P, Moody's, and Fitch.

The exposure of the Bank Group to foreign financial institutions totaled approximately NIS 30.0 billion on March 31, 2020, an increase of approximately NIS 6.0 billion, compared with approximately NIS 24.0 billion at the end of 2019. This increase resulted from an increase in balance sheet exposure in the amount of approximately NIS 4.8 billion, and an increase in off-balance sheet exposure in the amount of approximately NIS 1.1 billion. Approximately 94.7% of the exposure to foreign financial institutions is to financial institutions rated A- or higher.

The Bank Group's exposure to foreign financial institutions is distributed as follows: 82.14% in banks and bank holding companies, 17.23% in insurance companies, and 0.63% in another financial institution.

Most of the Bank Group's exposure is to foreign financial institutions operating in Western European countries (65.34%) and in the United States (21.65%).

In light of the expected negative effects of the spread of the coronavirus on the financial results of financial institutions worldwide, increases were recorded in the spreads and CDS prices of most of the foreign financial institutions with which the Bank has activity. In addition, the rating agencies (Fitch, S&P, and Moody's) changed the rating outlooks for many of these institutions to Negative, while long-term credit ratings have also been downgraded for a few of the institutions. The Bank frequently and regularly monitors the financial institutions, and, as necessary, acts to reduce all of the relevant risks, including credit risk and settlement risk.

The data on "banks and governments overseas" in the disclosure of credit risk by economic sector, in the section "Review of risks" and in the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks as at March 31, 2020 (hereinafter: the disclosure by economic sector), includes exposures in respect of banks overseas and does not include other financial institutions, which are primarily presented within the financial services sector. This sector also includes central banks, whereas the table above does not include exposure in respect of central banks.

In the disclosure by economic sector, "total credit risk" includes balance sheet and off-balance sheet balances in respect of derivatives, whereas the table above includes only balance sheet balances in respect of derivatives.

In addition, the total of "debts and off-balance sheet credit risk" in the disclosure by economic sector includes credit to the public and deposits with banks, but does not include bonds and securities borrowed or purchased under agreements to resell, which are included in the table above. Balance sheet and off-balance sheet credit in respect of derivatives is not included in the total of "debts and off-balance sheet credit risk." However, the table above includes balance sheet balances in respect of derivatives.

D.3. Additional information regarding exposures to credit risks

D.3.a. Credit risk in respect of exposures to borrowers and to groups of borrowers

Table D-6: 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

	March 31, 2020			
	Number of borrowers	Balance sheet credit risk	Off-balance sheet credit risk	Total
	NIS millions			
Economic sector				
Industry	2	875	3,236	4,111
Electricity and water supply	1	929	1,380	2,309
Financial services	6	10,239	7,520	17,759
Total	9	12,043	12,136	24,179

	December 31, 2019			
	Number of borrowers	Balance sheet credit risk	Off-balance sheet credit risk	Total
	NIS millions			
Economic sector				
Industry	2	26	4,012	4,038
Electricity and water supply	1	1,419	1,261	2,680
Hotels, hospitality, and food services	1	941	261	1,202
Financial services	6	9,225	6,320	15,545
Total	10	11,611	11,854	23,465

Credit risk in respect of exposure to borrower groups

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 the limits.

Table D-7: Details of credit risk balances for each group of borrowers whose net indebtedness on a consolidated basis exceeds 15% of the capital of the banking corporation (as defined in Directive 313)

	Balance sheet credit risk	Off-balance sheet credit risk	Of which: off-balance sheet credit risk in respect of derivative instruments ⁽²⁾	Gross indebtedness ⁽³⁾	Deductions ⁽⁴⁾	Net indebtedness ⁽¹⁾	Percentage of regulatory capital
NIS millions							
Borrower group A	3,862	3,504	-	7,366	-	7,366	18.63%
Borrower group B	2,769	3,473	209	6,242	38	6,204	15.69%

(1) The data presented below represent exposure to borrower groups, and are stated after the permitted deductions pursuant to Directive 313. These data are therefore not comparable with data regarding borrowers' indebtedness provided in other disclosures in the report.

(2) Off-balance sheet credit risk in respect of derivative instruments, as calculated for the purposes of the limits on indebtedness of borrowers and of borrower groups.

(3) This amount includes third-party guarantees outside the group.

(4) Deductions permitted under Directive 313, mainly including deposits deposited at the Bank, bonds issued by the State of Israel, and deductible indemnity letters of the State of Israel or financial institutions.

D.3.b. Risks in the housing loan portfolio

Table D-8: 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

	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 %		
March 31, 2020	18,485	20.0%	35,707	38.6%	13,776	14.9%	24,316	26.3%	252	0.3%	92,536	3.1%
Dec. 31, 2019	17,301	19.3%	34,565	38.5%	13,811	15.4%	23,834	26.5%	266	0.3%	89,777	10.2%
Dec. 31, 2018	14,503	17.8%	31,060	38.1%	13,539	16.6%	21,984	27.0%	368	0.5%	81,454	9.3%

Risk quantification and measurement – housing credit portfolio

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.

The Bank manages and hedges risk, among other means, 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 Division. The limits address LTV rates, repayment capability, distribution of credit products in the portfolio, volume of problematic debt, loan durations, geographical distribution, the 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 macroeconomic indicators in general, and in the business environment of the industry in particular. Events have been defined as requiring a reexamination of policy, such as a sharp increase in the floating interest rate or in inflation, an increase in unemployment in the Israeli economy, or a material change in housing prices.

Data are reported on a monthly basis in a divisional 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, within stress scenario testing, the effect on the mortgage portfolio is also examined. Insurance arrangements are also in place (life insurance and building insurance).

Table D-9: Details of characteristics of housing credit granted by the Bank – percentage of total new loans executed

	For the three months ended				
	March 31, 2020	December 31, 2019	September 30, 2019	June 30, 2019	March 31, 2019
Characteristics					
Financing rate over 60%	39.7%	40.2%	37.7%	37.9%	38.1%
Ratio of repayment to income greater than 40% (for purchases of homes and in monthly payments)	0.1%	0.0%	0.1%	0.0%	0.0%
Percentage with floating interest rates varying at a frequency of less than 5 years	32.0%	30.8%	32.7%	31.7%	31.5%
Percentage with floating rates	58.4%	58.1%	59.9%	59.2%	59.2%
Percentage of all-purpose loans	4.9%	5.7%	5.6%	5.7%	6.0%
Loans for investment purposes as a percentage of total purchases of homes	8.6%	9.2%	9.2%	10.0%	9.7%
Principal planned for repayment after age 67 (excluding investments)	7.9%	7.4%	7.1%	7.4%	6.9%
Average original term to maturity of loans for purchases of homes, in years (excluding bridge loans)	24.3	24.3	24.1	24.5	24.7

The upward trend in balances of housing loans continued in the first three months of 2020.

The effects of the spread of the coronavirus led to earlier execution of loans of buyers of residences in March 2020, but are expected to lead to deceleration in the number of housing transactions in the coming quarters. Data on housing-loan execution show an increase (worsening) on the following indicators:

- The percentage of loans with floating interest rates, particularly the percentage of loans with interest rates varying at a frequency of less than 5 years.
- An increase in the percentage of principal scheduled for repayment after the age of 67.

Several indicators showed improvement:

- A decrease in the percentage of credit granted with a financing rate greater than 60%. Although this rate is lower than in the preceding quarter, it remains high relative to past quarters. This rate is influenced by the volume of transactions in Mechir Lamishtaken ("Tenant Price") projects and by the relatively low rate of credit for investment and all-purpose loans, in which financing rates do not exceed 50%.
- A decrease in the percentage of execution of all-purpose loans.
- A decrease in loans for investment purposes as a percentage of total purchases of homes.

Several indicators were stable:

- The percentage of loans with payment to income ratios greater than 40%. A slight increase occurred, but the figure remains near zero.
- The average term to maturity of loans for purchases of homes (excluding bridge loans).

Overall, housing credit indicators demonstrate that balances grew, while underwriting quality was maintained. The main threat to this portfolio arises from possible developments due to the spread of the coronavirus, and in particular its effect on the repayment capability of borrowers in the portfolio, as a result of a higher probability of a decrease in wages and an increase in unemployment.

D.3.c. Credit to private individuals (excluding housing)

Table D-10: Balance of credit to private individuals in Israel

	Balance as at		Change	
	March 31, 2020	December 31, 2019		
NIS millions				
Balance sheet				
Negative balance in current accounts	2,961	3,216	(255)	(7.93%)
Loans ⁽¹⁾	26,397	26,918	(521)	(1.94%)
Of which: bullet and balloon loans	77	78	(1)	(1.28%)
Credit for purchases of motor vehicles ⁽²⁾	3,122	3,511	(389)	(11.08%)
Debtors in respect of credit-card activity	4,312	4,958	(646)	(13.03%)
Total balance sheet credit risk	36,869	38,681	(1,812)	(4.68%)
Off-balance sheet				
Off-balance sheet credit risk	21,529	21,092	437	2.07%
Total credit risk	58,398	59,773	(1,375)	(2.30%)

(1) Excluding loans for purchases of motor vehicles.

(2) Including loans granted for the purchase of motor vehicles or with a lien on a motor vehicle.

Table D-11: Information regarding problematic debts in respect of private individuals in Israel

	Balance as at		Change	Percentage of total balance sheet credit risk	
	As at			As at	
	March 31, 2020	December 31, 2019		March 31, 2020	December 31, 2019
	NIS millions				
Problematic credit risk	883	905	(2.3%)	2.4%	2.3%
Of which: impaired credit risk	762	760	0.3%	2.1%	2.0%
Debts in arrears of more than 90 days	70	93	(24.7%)	0.2%	0.2%
Net charge-offs for the period	76	297	⁽¹⁾ 2.4%	0.8%	⁽¹⁾ 0.8%
Allowance for credit losses	829	785	5.6%	2.2%	2.0%

(1) Calculated on an annualized basis.

In the first three months of 2020, the balance of loans to private individuals in Israel, including credit for the purchase of motor vehicles, decreased by approximately 2.9%. Total balance sheet credit risk decreased by approximately 4.7%.

The following indicators decreased, in comparison to the end of 2019:

- The balance of problematic credit risk decreased by approximately 2.3%.
- The balance of debts in arrears of more than 90 days decreased by approximately 24.7%.

The following indicators increased:

- The balance of impaired credit risk increased by approximately 0.3%.
- Net charge-offs increased by approximately 2.4%.
- The allowance for credit losses increased by approximately 5.6%.

First-quarter data indicate a mixed trend, with decreases on two indicators and increases on three other indicators. The effects of the spread of the coronavirus, which are reflected, at this stage, in suspension of activity in many economic sectors and a sharp increase in the number of job seekers, are expected to affect credit losses in this portfolio in the future. The extent of this effect depends on the extent of the actual damage to employers and the ability of the economy to recover rapidly. If the damage to borrowers' wages, and particularly the increase in unemployment, are significant, credit losses may increase significantly.

For additional information regarding the risk of credit to private individuals, see [the section "Review of risks" in the Report of the Board of Directors and Board of Management as at March 31, 2020](#).

D.3.d. Leveraged financing

Table D-12: The Bank's exposures to leveraged financing, by economic sector of the borrower

	March 31, 2020			
	Number of borrowers	Balance sheet credit balance	Off-balance sheet credit balance	Total
	NIS millions			
Economic sector of the borrower				
Mining and quarrying*	2	413	60	473
Information and communications	1	219	-	219
Industry	2	637	-	637
Other business services	1	81	194	275
Total	6	1,350	254	1,604

* Net of charge-offs and an individual allowance for credit losses in the amount of approximately NIS 360 million.

	December 31, 2019			
	Number of borrowers	Balance sheet credit balance	Off-balance sheet credit balance	Total
	NIS millions			
Economic sector of the borrower				
Construction and real estate – real-estate activities	1	103	110	213
Mining and quarrying*	2	498	-	498
Electricity and water*	1	-	266	266
Information and communications	1	235	9	244
Commerce	1	338	83	421
Industry	2	633	-	633
Total	8	1,807	468	2,275

* Net of charge-offs and an individual allowance for credit losses in the amount of approximately NIS 591 million.

D.4. Credit risk mitigation: standardized approach disclosures

Table D-13: Credit risk mitigation

	March 31, 2020								
	Unsecured			Secured					
	Total balance sheet balance	Total balance sheet balance	Of which: amount secured	Of which: by collateral		Of which: by financial guarantees		Of which: by credit derivatives	
				Balance sheet balance	Of which: amount secured	Balance sheet balance	Of which: amount secured	Balance sheet balance	Of which: amount secured
NIS millions									
1 Debts, excluding bonds	390,969	13,863	7,258	10,967	4,905	2,896	2,353	-	-
2 Bonds	57,164	-	-	-	-	-	-	-	-
3 Total	448,133	13,863	7,258	10,967	4,905	2,896	2,353	-	-
4 Of which: impaired or in arrears of 90 days or more	3,571	12	3	12	3	-	-	-	-
March 31, 2019									
	Unsecured			Secured					
	Total balance sheet balance	Total balance sheet balance	Of which: amount secured	Of which: by collateral		Of which: by financial guarantees		Of which: by credit derivatives	
Balance sheet balance				Of which: amount secured	Balance sheet balance	Of which: amount secured	Balance sheet balance	Of which: amount secured	
NIS millions									
1 Debts, excluding bonds	372,233	20,918	14,215	12,278	5,983	8,640	8,232	-	-
2 Bonds	58,520	-	-	-	-	-	-	-	-
3 Total	430,753	20,918	14,215	12,278	5,983	8,640	8,232	-	-
4 Of which: impaired or in arrears of 90 days or more	3,401	21	6	21	6	-	-	-	-
December 31, 2019									
	Unsecured			Secured					
	Total balance sheet balance	Total balance sheet balance	Of which: amount secured	Of which: by collateral		Of which: by financial guarantees		Of which: by credit derivatives	
Balance sheet balance				Of which: amount secured	Balance sheet balance	Of which: amount secured	Balance sheet balance	Of which: amount secured	
NIS millions									
1 Debts, excluding bonds	383,102	12,618	6,560	9,927	4,306	2,691	2,254	-	-
2 Bonds	50,809	-	-	-	-	-	-	-	-
3 Total	433,911	12,618	6,560	9,927	4,306	2,691	2,254	-	-
4 Of which: impaired or in arrears of 90 days or more	3,361	13	3	13	3	-	-	-	-

D.4.a. Standardized approach – exposures by asset type and risk weight

Table D-14: Standardized approach – exposures by asset type and risk weight⁽¹⁾⁽²⁾

		March 31, 2020									Total amount of credit exposures (after CCF and after CRM)
		0%	20%	35%	50%	60%	75%	100%	150%	Other ⁽³⁾	
		NIS millions									
1	Sovereigns, central banks thereof, and national monetary authority	122,913	4,986	-	19	-	-	284	57	-	128,259
2	Public-sector entities (PSE) other than the central government	1,861	192	-	3,995	-	-	-	-	-	6,048
3	Banks (including multilateral development banks (MDB))	-	16,731	-	3,853	-	-	64	-	-	20,648
5	Corporations	-	4,977	-	2,556	-	-	110,431	-	-	117,964
6	Retail exposures to individuals	-	-	-	-	-	52,051	-	-	-	52,051
7	Loans to small businesses	-	-	-	-	-	9,189	-	-	-	9,189
8	Secured by a residential property	-	-	28,258	25,544	11,414	23,165	4,043	-	-	92,424
9	Secured by commercial real estate	-	-	-	-	-	-	63,398	-	-	63,398
10	Loans in arrears	-	-	-	-	-	-	1,546	1,670	-	3,216
11	Other assets*	3,086	-	-	-	-	-	8,517	812	992	13,407
11A	* Of which: in respect of shares	-	-	-	-	-	-	984	512	-	1,496
12	Total	127,860	26,886	28,258	35,967	11,414	84,405	188,283	2,539	992	506,604

(1) The balances in the disclosure include balance sheet and off-balance sheet balances reflecting credit risk, excluding amounts of deferred taxes and investments in financial corporations below deduction thresholds (which are subject to a risk weight of 250%), exposures in respect of counterparty credit risk, and securitization exposures.

(2) The balances reflect the supervisory exposure amounts net of allowances and charge-offs, after credit conversion factors and after credit risk mitigation methods.

(3) In accordance with the letter of the Banking Supervision Department, the risk-adjusted assets of the subsidiary of the Bank in Turkey are weighted at a rate of 300%, beginning January 1, 2020. The balance reflects the addition in respect of the calculation of risk-adjusted assets in accordance with this letter, relative to the calculation of risk-adjusted assets pursuant to Proper Conduct of Banking Business Directive 203.

Table D-14: Standardized approach – exposures by asset type and risk weight⁽¹⁾⁽²⁾ (continued)

		March 31, 2019									Total amount of credit exposures (after CCF and after CRM)
		0%	20%	35%	50%	60%	75%	100%	150%	Other ⁽³⁾	
		NIS millions									
1	Sovereigns, central banks thereof, and national monetary authority	112,825	4,386	-	69	-	-	308	43	-	117,631
2	Public-sector entities (PSE) other than the central government	2,241	306	-	4,395	-	-	-	-	-	6,942
3	Banks (including multilateral development banks (MDB))	540	17,282	-	6,973	-	-	72	-	-	24,867
5	Corporations	-	5,363	-	2,280	-	-	108,026	-	-	115,669
6	Retail exposures to individuals	-	-	-	-	-	64,908	-	-	-	64,908
7	Loans to small businesses	-	-	-	-	-	9,795	-	-	-	9,795
8	Secured by a residential property	-	-	27,779	22,763	5,273	23,509	3,532	-	-	82,856
9	Secured by commercial real estate	-	-	-	-	-	-	57,446	-	-	57,446
10	Loans in arrears	-	-	-	-	-	-	1,273	1,891	-	3,164
11	Other assets*	3,000	-	-	-	-	-	8,336	688	-	12,024
11A	* Of which: in respect of shares	-	-	-	-	-	-	1,419	457	-	1,876
12	Total	118,606	27,337	27,779	36,480	5,273	98,212	178,993	2,622	-	495,302

(1) The balances in the disclosure include balance sheet and off-balance sheet balances reflecting credit risk, excluding amounts of deferred taxes and investments in financial corporations below deduction thresholds (which are subject to a risk weight of 250%), exposures in respect of counterparty credit risk, and securitization exposures.

(2) The balances reflect the supervisory exposure amounts net of allowances and charge-offs, after credit conversion factors and after credit risk mitigation methods.

(3) In accordance with the letter of the Banking Supervision Department, the risk-adjusted assets of the subsidiary of the Bank in Turkey are weighted at a rate of 300%, beginning January 1, 2020. The balance reflects the addition in respect of the calculation of risk-adjusted assets in accordance with this letter, relative to the calculation of risk-adjusted assets pursuant to Proper Conduct of Banking Business Directive 203.

Table D-14: Standardized approach – exposures by asset type and risk weight⁽¹⁾⁽²⁾ (continued)

		December 31, 2019									Total amount of credit exposures (after CCF and after CRM)
		0%	20%	35%	50%	60%	75%	100%	150%	Other ⁽³⁾	
		NIS millions									
1	Sovereigns, central banks thereof, and national monetary authority	118,436	4,662	-	-	-	-	285	38	-	123,421
2	Public-sector entities (PSE) other than the central government	1,858	212	-	4,110	-	-	-	-	-	6,180
3	Banks (including multilateral development banks (MDB))	17	15,408	-	3,810	-	-	51	-	-	19,286
5	Corporations	-	4,232	-	2,185	-	-	105,984	-	-	112,401
6	Retail exposures to individuals	-	-	-	-	-	54,223	-	-	-	54,223
7	Loans to small businesses	-	-	-	-	-	9,078	-	-	-	9,078
8	Secured by a residential property	-	-	28,469	25,264	10,202	21,868	3,800	-	-	89,603
9	Secured by commercial real estate	-	-	-	-	-	-	63,842	-	-	63,842
10	Loans in arrears	-	-	-	-	-	-	1,177	1,839	-	3,016
11	Other assets*	2,896	-	-	-	-	-	7,347	781	-	11,024
11A	* Of which: in respect of shares	-	-	-	-	-	-	1,279	492	-	1,771
12	Total	123,207	24,514	28,469	35,369	10,202	85,169	182,486	2,658	-	492,074

(1) The balances in the disclosure include balance sheet and off-balance sheet balances reflecting credit risk, excluding amounts of deferred taxes and investments in financial corporations below deduction thresholds (which are subject to a risk weight of 250%), exposures in respect of counterparty credit risk, and securitization exposures.

(2) The balances reflect the supervisory exposure amounts net of allowances and charge-offs, after credit conversion factors and after credit risk mitigation methods.

(3) In accordance with the letter of the Banking Supervision Department, the risk-adjusted assets of the subsidiary of the Bank in Turkey are weighted at a rate of 300%, beginning January 1, 2020. The balance reflects the addition in respect of the calculation of risk-adjusted assets in accordance with this letter, relative to the calculation of risk-adjusted assets pursuant to Proper Conduct of Banking Business Directive 203.

E. Counterparty credit risks

Counterparty risk is defined at the Bank, according to the definition in Proper Conduct of Banking Business Directive 203, as the credit risk arising from transactions in derivative financial instruments. The risk is that the counterparty to the transaction will default before the final settlement of cash flows in the derivative 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-risk factors.

During the first quarter of 2020, as a result of the effects of the spread of the coronavirus, the level of volatility of risk factors in the financial markets increased, including exchange rates, basis spreads, share prices, and bond prices. In addition, interest rates of central banks decreased. As a result, increases were recorded in internal risk estimates for customers with derivatives activity at the Bank.

For details, see [Section B.5](#) above, and the section "Economic and financial review" in the Report of the Board of Directors and Board of Management.

Table E-1: Analysis of exposure to counterparty credit risk based on the supervisory approach

		March 31, 2020				March 31, 2019			
		Replacement cost	Potential future exposure	EAD after CRM	RWA	Replacement cost	Potential future exposure	EAD after CRM	RWA
NIS millions									
1	Present exposure method	1,689	5,987	7,676	4,807	2,000	5,913	7,913	5,111
3	Comprehensive approach to credit risk mitigation (for securities financing transactions (SFT))	-	-	-	-	-	-	-	-
6	Total	1,689	5,987	7,676	4,807	2,000	5,913	7,913	5,111

		December 31, 2019			
		Replacement cost	Potential future exposure	EAD after CRM	RWA
NIS millions					
1	Present exposure method	2,220	5,580	7,800	5,130
3	Comprehensive approach to credit risk mitigation (for securities financing transactions (SFT))	-	-	-	-
6	Total	2,220	5,580	7,800	5,130

Table E-2: Capital allocation in respect of credit value adjustment

		March 31, 2020		March 31, 2019		December 31, 2019	
		EAD after CRM	RWA	EAD after CRM	RWA	EAD after CRM	RWA
NIS millions							
3	Total portfolios in respect of which CVA is calculated according to the standardized approach	7,676	2,328	7,913	3,047	7,800	2,713

For more extensive information regarding counterparty risk and the management thereof, see [the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks as at December 31, 2019](#).

F. Market risk

Market risk is the risk of loss or decline in value as a result of change in the economic value of a financial instrument, or of a particular portfolio, due to changes in prices, rates, spreads, and other market parameters. This includes:

- **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;
- **Spread risk** – The risk of loss as a result of changes in the spreads between different interest-rate curves or different interest bases.

The main market risk factors to which the Bank is exposed are NIS interest rates in the linked and unlinked segments, inflation, the NIS/USD exchange rate, and spreads between different interest-rate curves. During the first quarter of 2020, as a result of the effects of the coronavirus outbreak, the level of volatility of risk factors in the financial markets increased, including exchange rates, basis spreads, share prices, and bond prices. In addition, interest rates of central banks decreased. As a result, increases were recorded in some market and investment risk estimates of activity in the trading book, the banking book, and the investment portfolio of the Bank. The reduction of short-term interest rates by the central banks – the rate cuts already performed as well as probable additional reductions – and the changes in yield curves in the market affect the reduction of the future financing income and interest income of the Bank, as well as the fair value and economic value, as detailed in the tables below. For further details, see [Section B.5 above](#) and the section “Economic and financial review” in the Report of the Board of Directors and Board of Management.

F.1. Market risk in the trading book

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. The Bank’s risk level is measured and controlled according to procedures that include, among other things, limits on the risk estimate in terms of VaR and on the sensitivity of economic value to changes in the primary risk factors. A risk estimate using the VaR (value at risk) method assesses 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 (see the risk estimate methodology [in the Report on Risks for 2019](#)).

Table F-1: Risk estimates of trading activity (VaR)

	March 31, 2020	Average in 2020	December 31, 2019	Average in 2019
NIS millions				
Total trading in dealing rooms	78	34	31	24

The increase in risk estimates in the present quarter primarily results from the effects of the spread of the coronavirus on the financial markets, mainly the increase in the volatility of risk factors, as detailed above.

Table F-2: Sensitivity to changes in the exchange rates of foreign currencies with a significant volume of activity and to changes in the consumer price index

	March 31, 2020		December 31, 2019	
	10% increase	10% decrease	10% increase	10% decrease
NIS millions				
USD	(18)	55	189	68
EUR	8	23	45	26
3% increase 3% decrease 3% increase 3% decrease				
CPI	275	(420)	220	(347)

* Sensitivity data for 2019 were updated due to the reclassification of the balance of employee liabilities in respect of employee benefits from the unlinked segment to the CPI-linked segment.

The table above presents an analysis of the sensitivity of the economic value of the Bank to changes in exchange rates, based on revaluation of all balance sheet and off-balance sheet instruments in the risk-management system, using prevalent models for revaluation of each instrument and using representative rates as the baseline exchange rate. For the purposes of the calculation, the portfolio is revalued again at an exchange rate reflecting an increase/decrease at the presented rate, with no additional assumptions. Sensitivity to the consumer price index is calculated according to the exposure of the Bank to the index, as detailed in Note 14 to the Condensed Financial Statements, plus the effect of the CPI floor on the expected accounting profit.

Due to the reclassification of employee benefit liability balances from the unlinked segment to the CPI-linked segment, sensitivity to a 3% change in the CPI at the end of 2019 changed by approximately NIS 135 million.

Table F-3: Market risk based on the standardized approach

The Bank is required to allocate capital in respect of market risk assets, on the basis of a standardized model defined by the Bank of Israel. Regulatory capital adequacy is calculated for interest-rate and share risks, as defined above, in the trading book only, and for currency risks in the banking book and in the trading book.

	March 31, 2020	March 31, 2019	December 31, 2019
	Risk-adjusted assets in NIS millions		
Direct products			
1	2,178	2,174	2,081
2	4	20	4
3	713	213	950
4	-	-	-
Options			
5	-	-	-
6	331	591	493
7	-	-	-
8	-	-	-
9	3,226	2,998	3,528

For more extensive information regarding trading book risk and the management thereof, see [the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks as at December 31, 2019](#).

F.2. 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. Limits apply at the Bank both to the sensitivity of economic value and to the sensitivity of income (including financial subsidiaries under the Bank's management and subsidiaries with exposure significant for the Group) to scenarios of change in the shekel, CPI-linked, and foreign-currency interest-rate curves.

The table below 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 interest-rate curves that do not take into account the credit risk spread of the counterparty, with the use of internal models for some products. This differs from the calculation in fair-value tables, which is based on factors including the discounting of expected cash flows by a discount rate also reflecting the risk level inherent in the financial instrument, taking into consideration liabilities to employees, which are not used by the Bank in the management of economic value sensitivity. Pursuant to the Public Reporting Directives of the Bank of Israel, the Bank applies hypothetical shock and stress scenarios of changes in interest rates to the adjusted net fair value of the financial instruments used by the Bank. The stress scenarios are calculated according to formulas defined in the BOI reporting requirements. The required scenarios are steepening (a decrease in the short-term interest rate and an increase in the long-term interest rate), flattening (an increase in the short-term interest rate and a decrease in the long-term interest rate), an increase in the short-term interest rate, and a decrease in the short-term interest rate. The scenarios were applied uniformly to all of the currencies included in the report to the public.

Table F-4: Adjusted* net fair value of the financial instruments of the Bank and its consolidated companies

	March 31, 2020					December 31, 2019				
	Unlinked NIS	CPI-linked NIS	Foreign currency – USD	Foreign currency – other	Total	Unlinked NIS*	CPI-linked NIS*	Foreign currency – USD	Foreign currency – other	Total
	NIS millions									
Financial assets***	336,387	51,160	66,473	12,330	466,350	323,633	50,697	58,409	10,977	443,716
Other amounts receivable in respect of derivative, hybrid, and off-balance sheet financial instruments	413,079	18,302	312,234	60,466	804,081	431,288	19,575	269,874	63,047	783,784
Financial liabilities***	287,271	36,158	92,908	14,265	430,602	270,294	39,823	83,705	14,532	408,354
Other amounts payable in respect of derivative, hybrid, and off-balance sheet financial instruments	440,263	19,406	289,519	55,940	805,128	459,513	20,318	246,843	58,070	784,744
Net fair value of financial instruments	21,932	13,898	(3,720)	2,591	34,701	25,114	10,131	(2,265)	1,422	34,402
Effect of employee benefit liabilities	-	(4,735)	-	-	(4,735)	-	(4,918)	-	-	(4,918)
Effect of spreading over periods of on-demand deposits	2,544	-	776	140	3,460	1,856	-	1,124	101	3,081
Adjusted net fair value*	24,476	9,163	(2,944)	2,731	33,426	26,970	5,213	(1,141)	1,523	32,565
Of which: banking book	24,507	9,009	(2,892)	2,763	33,387	27,207	5,100	(1,622)	1,327	32,012

* Reclassification of employee benefit liability balances from the unlinked segment to the CPI-linked segment.

** Net fair value of financial instruments, excluding non-monetary items, and after the effect of employee benefit liabilities and spreading over periods of on-demand deposits. For further details regarding the assumptions used to calculate the fair value of financial instruments, see [Note 15 to the Condensed Financial Statements](#).

*** Excluding balance sheet balances of derivative financial instruments, fair value of off-balance sheet financial instruments, and fair value of hybrid financial instruments.

The increase in fair value mainly resulted from a change in discount spreads, offset by the effects of the increase in the long-term government interest rate.

Table F-5: Effect of scenarios of changes in interest rates on the adjusted* net fair value of the Bank and its consolidated companies

	March 31, 2020					December 31, 2019				
	Unlinked NIS	CPI-linked NIS	Foreign currency – USD	Foreign currency – other	Total	Unlinked NIS**	CPI-linked NIS**	Foreign currency – USD	Foreign currency – other	Total
NIS millions										
Parallel changes										
1% parallel increase	(45)	(348)	322	88	17	160	(104)	37	52	145
Of which: banking book	(36)	(347)	318	89	24	150	(115)	54	52	141
1% parallel decrease	89	364	(337)	(103)	13	(112)	93	(33)	(63)	(115)
Of which: banking book	61	363	(332)	(104)	(12)	(103)	105	(41)	(64)	(103)
Non-parallel changes										
Steepening ⁽¹⁾	(274)	(65)	(75)	31	(383)	(230)	21	(162)	24	(477)
Of which: banking book	(310)	(70)	(86)	29	(437)	(336)	10	(203)	25	(504)
Flattening ⁽²⁾	275	(11)	94	(18)	340	416	(47)	143	(14)	498
Of which: banking book	281	(6)	107	(15)	367	385	(38)	203	(15)	535
Increase in short-term interest rate	216	(154)	155	18	235	391	(82)	88	(4)	393
Of which: banking book	230	(149)	170	21	272	355	(79)	161	(6)	431
Decrease in short-term interest rate	(244)	150	(179)	(17)	(290)	(416)	76	(92)	3	(429)
Of which: banking book	(285)	145	(193)	(20)	(353)	(387)	73	(155)	4	(465)

* Net fair value of financial instruments, excluding non-monetary items, and after the effect of employee benefit liabilities and spreading over periods of on-demand deposits.

** Reclassification of employee benefit liability balances from the unlinked segment to the CPI-linked segment.

(1) Steepening – decrease in the short-term interest rate and increase in the long-term interest rate.

(2) Flattening – increase in the short-term interest rate and decrease in the long-term interest rate.

Table F-6: Sensitivity of the economic capital of the Bank to parallel changes in interest-rate curves (theoretical change in economic value as a result of each scenario)

	March 31, 2020			December 31, 2019		
	Unlinked NIS	CPI-linked NIS	Foreign currency	Unlinked NIS	CPI-linked NIS	Foreign currency
NIS millions						
Parallel changes						
1% parallel increase	(377)	(947)	419	(319)	(855)	106
1% parallel decrease	453	1,084	(438)	410	987	(98)

The increase in the sensitivity of economic capital in the first quarter of 2020 in the NIS segments mainly resulted from mortgages granted and bond purchases, offset by the update of the current-account model balance layout and the effect of the interest rate. The increase in foreign-currency interest rate sensitivity mainly resulted from the sale of bonds and the update of the current-account model balance layout.

The difference between economic value sensitivity and fair value sensitivity as at March 31, 2020, mainly stems from the use of different discount curves, as described above, the effect of which is estimated at approximately NIS 0.26 billion in the unlinked segment and approximately NIS 0.2 billion in the CPI-linked segment. In addition, an amount of approximately NIS 0.4 billion in the linked NIS segment originates with the discounting of employee liabilities in the fair-value model, which are not used by the Bank in the management of economic value sensitivity.

Table F-7: Effect of scenarios of changes in interest rates on interest income

	March 31, 2020			December 31, 2019		
	Interest income	Non-interest financing income	Total	Interest income	Non-interest financing income	Total
	NIS millions					
1% parallel increase	1,025	312	1,337	924	327	1,251
Of which: banking book	1,025	338	1,363	924	323	1,247
1% parallel decrease	(942)	(380)	(1,322)	(746)	(406)	(1,152)
Of which: banking book	(942)	(386)	(1,328)	(746)	(395)	(1,141)

Income sensitivity in the table above was calculated by changing interest-rate curves, using assumptions regarding changes in deposit spreads; assumptions of transfer of monies from current accounts to deposits in the case of an increase in the interest rate, versus stability of balances in the case of a decrease in the interest rate; and assumption of interest-rate floors, such that the various interest-rate curves fall to zero. In the foreign-currency segment, the interest-rate curve falls to the lower of zero or the existing negative interest rate. In some of the scenarios, the theoretical loss in the event of a negative interest rate (below the floor) may be higher. The sensitivity of the trading book was calculated using the MTM approach.

F.3. Share and credit spread risk – 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 definition at the Bank, Israeli government bonds in NIS and in foreign currency and government bonds of the country 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.

For details regarding investments of the Bank, see [Note 5 to the Condensed Financial Statements](#).

For details regarding the effect of the spread of the coronavirus, see [Section B.5](#) above.

For more extensive information regarding market risks and the management thereof, see [the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks as at December 31, 2019](#).

G. 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 examined from a broader perspective, encompassing the ability to repay liabilities on schedule, including during times of stress, without damage to routine operations within the business plans 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 of the Bank, 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.

Liquidity risk is 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. Routine liquidity risk management is under the responsibility of the Asset and Liability Management Area, and is conducted in accordance with a Group-level policy, with the aim of maintaining the ability of the Bank to meet all of its present liabilities without damage to its routine operations and existing capabilities, and without incurring exceptional losses. Reports are submitted to Board of Management committees on a monthly basis, and to Board of Directors committees on a quarterly basis. The Bank continually monitors its stable financing ratio, examines the effects of the business plan on its liquidity profile, and ensures that in the course of the expected changes on the business level it continues to comply with all limits. The Market and Liquidity Risk Management Department in the Risk Management Division 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.

Table G-1: Liquidity coverage ratio – limited banking corporation and consolidated subsidiaries, for the three-month period

	For the quarter ended March 31, 2020	
	Total unweighted value*	Total weighted value**
Total high-quality liquid assets		
Total high-quality liquid assets (HQLA)		114,646
Cash outflows		
Retail deposits from individuals and from small business customers, of which:	206,589	15,737
Stable deposits	68,715	3,436
Less stable deposits	98,041	11,106
Deposits for a period greater than 30 days (Section 84 of Proper Conduct of Banking Business Directive 221)	39,833	1,195
Unsecured wholesale financing, of which:	116,474	73,085
Operational deposits (all counterparties) and deposits in networks of cooperative banks	2,083	521
Non-operational deposits (all counterparties)	113,607	71,780
Unsecured debts	784	784
Secured wholesale financing	4	-
Additional liquidity requirements, of which:	100,986	25,057
Outflows related to derivative exposure and other collateral requirements	15,676	15,033
Outflows related to loss of funding on debt products	-	-
Credit and liquidity facilities	85,310	10,024
Other contractual funding obligations	3,914	3,914
Other contingent funding obligations	52,470	1,780
Total cash outflows		119,573
Cash inflows		
Secured lending (e.g. reverse repos)	432	419
Inflows from fully performing exposures	23,498	13,825
Other cash inflows	20,052	14,355
Total cash inflows	43,982	28,599
		Total adjusted value***
Total high-quality liquid assets (HQLA)		114,646
Total net cash outflows		90,974
Liquidity coverage ratio (%)		126%

* Unweighted values were calculated as outstanding balances maturing or callable within 30 days (for inflows and outflows), based on an average of daily observations.

** Weighted values were calculated after the application of respective haircuts or inflow and outflow rates (for inflow and outflow), based on an average of daily observations. The number of observations used to calculate the averages in the reported quarter is 66.

*** Adjusted values were 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).

Table G-1: Liquidity coverage ratio – limited banking corporation and consolidated subsidiaries, for the three-month period (continued)

	For the quarter ended March 31, 2019*	
	Total unweighted value**	Total weighted value***
Total high-quality liquid assets		
Total high-quality liquid assets (HQLA)		109,781
Cash outflows		
Retail deposits from individuals and from small business customers, of which:	199,076	15,148
Stable deposits	64,572	3,229
Less stable deposits	94,389	10,716
Deposits for a period greater than 30 days (Section 84 of Proper Conduct of Banking Business Directive 221)	40,115	1,203
Unsecured wholesale financing, of which:	111,114	70,477
Operational deposits (all counterparties) and deposits in networks of cooperative banks	1,817	454
Non-operational deposits (all counterparties)	108,300	69,026
Unsecured debts	997	997
Secured wholesale financing	3	-
Additional liquidity requirements, of which:	119,329	26,120
Outflows related to derivative exposure and other collateral requirements	17,713	16,182
Outflows related to loss of funding on debt products	-	-
Credit and liquidity facilities	101,616	9,938
Other contractual funding obligations	15,299	15,299
Other contingent funding obligations	54,076	1,813
Total cash outflows		128,857
Cash inflows		
Secured lending (e.g. reverse repos)	725	725
Inflows from fully performing exposures	31,739	24,627
Other cash inflows	20,242	15,784
Total cash inflows	52,706	41,136
		Total adjusted value****
Total high-quality liquid assets (HQLA)		109,781
Total net cash outflows		87,721
Liquidity coverage ratio (%)		125%

* Includes balances attributed to a discontinued operation.

** Unweighted values were calculated as outstanding balances maturing or callable within 30 days (for inflows and outflows), based on an average of daily observations.

*** Weighted values were calculated after the application of respective haircuts or inflow and outflow rates (for inflow and outflow), based on an average of daily observations. The number of observations used to calculate the averages in the reported quarter is 63.

**** Adjusted values were 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).

Table G-1: Liquidity coverage ratio – limited banking corporation and consolidated subsidiaries, for the three-month period (continued)

	For the quarter ended December 31, 2019	
	Total unweighted value*	Total weighted value**
Total high-quality liquid assets		
Total high-quality liquid assets (HQLA)		109,137
Cash outflows		
Retail deposits from individuals and from small business customers, of which:	199,825	15,097
Stable deposits	65,896	3,295
Less stable deposits	94,148	10,609
Deposits for a period greater than 30 days (Section 84 of Proper Conduct of Banking Business Directive 221)	39,781	1,193
Unsecured wholesale financing, of which:	112,954	71,819
Operational deposits (all counterparties) and deposits in networks of cooperative banks	1,996	499
Non-operational deposits (all counterparties)	110,479	70,841
Unsecured debts	479	479
Secured wholesale financing	4	-
Additional liquidity requirements, of which:	93,378	20,440
Outflows related to derivative exposure and other collateral requirements	11,341	10,740
Outflows related to loss of funding on debt products	-	-
Credit and liquidity facilities	82,037	9,700
Other contractual funding obligations	4,345	4,345
Other contingent funding obligations	53,023	1,774
Total cash outflows		113,475
Cash inflows		
Secured lending (e.g. reverse repos)	332	331
Inflows from fully performing exposures	20,734	12,578
Other cash inflows	15,538	10,421
Total cash inflows	36,604	23,330
		Total adjusted value***
Total high-quality liquid assets (HQLA)		109,137
Total net cash outflows		90,145
Liquidity coverage ratio (%)		121%

* Unweighted values were calculated as outstanding balances maturing or callable within 30 days (for inflows and outflows), based on an average of daily observations.

** Weighted values were calculated after the application of respective haircuts or inflow and outflow rates (for inflow and outflow), based on an average of daily observations. The number of observations used to calculate the averages in the reported quarter is 58.

*** Adjusted values were 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).

The average ratio during the first quarter of 2020 (the average of the daily observations) is 126%, consolidated, and 125% for the stand-alone banking corporation, while the minimum requirement is 100%. This ratio increased during the quarter, in comparison to the preceding quarter. The increase in the ratio mainly resulted from an increase in deposits from the public, beyond the increase in credit to the public, particularly deposits of private customers. 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.

Due to the spread of the coronavirus, liquidity pressures were observed during the month of March in the foreign-currency market in Israel, which led to increases in prices and depreciation. These pressures subsided towards the end of the month, concurrently with an increase in indicators of systemic and global liquidity pressures. Within the management of liquidity risk, the Bank took actions contributing to maintaining and improving its liquidity ratio, in addition to the increase arising from the change in the composition of deposits, which included an increase in retail deposits towards the end of the quarter. The consolidated liquidity ratio as at March 31, 2020, is 135%.

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 itself, 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 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, see the table below. The Board of Directors of the Bank has adopted an internal limit stricter than the regulatory LCR requirement, both for the stand-alone banking corporation and consolidated.

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 from private customers and from corporate clients in Israel, foreign residents, Israeli companies abroad, issues of CDs and other instruments secured by the FDIC in the United States, and additional resources. 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.

Table G-2: Details of liquid assets, by level, as required in the Basel directives

	Balance as at March 31, 2020	Average in the quarter ended March 31, 2020
Level 1 assets	124,351	113,201
Level 2A assets	1,397	1,180
Level 2B assets	241	265
Total HQLA	125,989	114,646

	Balance as at March 31, 2019	Average in the quarter ended March 31, 2019
Level 1 assets	105,803	108,157
Level 2A assets	1,293	1,296
Level 2B assets	347	328
Total HQLA	107,444	109,781

	Balance as at December 31, 2019	Average in the quarter ended December 31, 2019
Level 1 assets	113,250	107,648
Level 2A assets	1,171	1,185
Level 2B assets	302	305
Total HQLA	114,724	109,137

H. 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, and the Chief Compliance Officer, as well as comprehensive procedures and systems in areas related to banking activity, management of human resources, process control, emergency operation, and more.

In view of the spread of the coronavirus, the Bank applied a series of processes and measures, including those described below in the sections on information security and cyber risks and emergency preparedness. In general, the operational risks related to the crisis and its effects have been analyzed. The estimate is that reduced and remote work is likely to increase exposure to operational risks. Appropriate controls and measures to minimize risk are being considered and implemented.

H.1. Information security and cyber risks

Cyber risk is the risk of damage, including disruption, disturbance, shutdown of operations, theft of property, collection of intelligence, or damage to reputation or the confidence of the public, as a result of a cyber event. Cyber activity is conducted as required in the directives of the Bank of Israel, including Proper Conduct of Banking Business Directive 361, "Cyber Defense Management"; Proper Conduct of Banking Business Directive 363, "Supply Chain"; 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 Security and Cyber Defense Unit in the Information Technology Division.

The sophistication and severity of cyber attacks on the global financial sector have escalated in recent years. Technological development trends such as cloud computing, openness to external interfaces, and the expansion of digital services, on one hand, and the advanced tools available to attackers, on the other hand, have led to higher exposure to cyber risks. The banking sector in Israel, including the Bank, regularly experiences cyber attacks, such as DDOS (distributed denial of service – attacks designed to shut down a computer system by overloading its resources), phishing (attempts to steal sensitive information through impersonation on the Internet), etc. No material cyber events were discovered at the Bank in the first quarter of 2020.

The Bank invests extensive resources (both human and technological) in strengthening its information security and cyber defense system, in order to cope with the development of these threats. The Bank's defense framework consists of layers of protection using advanced technologies. The Bank operates cyber defense processes in order to minimize the risk of penetration, unauthorized access to information systems, and materialization of attacks, and to ensure the correctness, availability, and confidentiality of its databases. Concurrently, the Bank operates processes to discover and identify cyber events, at all times, including the operation of the Information Security Event Center. The Bank also prepares to contain cyber events and minimize the damage to the assets of the Bank and its customers. The Bank continually works to identify targets to defend, threats, risks, and the effectiveness of defenses, and to build work plans for improvement of the defensive framework accordingly.

The Bank routinely updates its risk assessment in view of insights from cyber events in Israel and worldwide relevant to the systems and business of the Bank. The Bank also accords high importance to maintaining an organizational culture of risk management, and therefore takes various actions (such as lectures, messaging, and exercises at various levels) to raise employee awareness of cyber risks.

The Cyber Risk Management Unit in the Risk Management Division establishes indices and methodologies for the evaluation of the maturity of defenses, analyzes the business implications of cyber scenarios, challenges the defense system, and examines developments in the area of cyber risk relevant to the technological and business systems of the Bank.

The Bank has updated its cyber risk estimate, in accordance with the development of threats during the period of the spread of the coronavirus, and is taking comprehensive action to reduce this risk, particularly in view of the change in the form of work at the Bank and the significant transition of employees to remote work. The cyber defense units have developed a response aimed at reducing the risk of remote work, and in addition, have instructed employees and suppliers on ways of reducing the risk, including by raising awareness of the new and developing cyber risks. Preparedness has also been increased with respect to possible phishing and fraud against customers through exploitation of the crisis and the fears of the public.

H.2. 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 globally prevalent methodologies. The action plan involves all divisions of the Bank, through divisional 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 Bank Emergency Committee (the Head of Information Technology).

The business continuity policy has also been adopted by the subsidiaries in Israel and globally, and at the Bank's overseas branches, in congruence with the corporate-governance policy and 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 divisions 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 contingency plans are in place. Stress scenarios are reviewed and discussed periodically by the Committee on Stress 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.

As part of its preparedness for business continuity, the Bank is prepared to handle a range of possible scenarios, including a pandemic scenario. The Bank, like most organizations in the economy, operated in an emergency format due to the spread of the coronavirus. The work schedule at the Bank was reduced relative to ordinary conditions, thus far with no material change in employees' terms of employment and benefits. The Bank is acting on all levels, in accordance with the emergency regulations for the reduction of the spread of the coronavirus, the instructions of the Ministry of Health, the regulatory reliefs and instructions of the Bank of Israel, and other binding regulations, in order to ensure the continued delivery of service through the various channels. The Bank's emergency plans have been activated, in order to reduce the probability of extensive contagion, including splitting of essential units among different buildings or floors, and/or transition to working in homogeneous shifts, to the extent possible. Remote work (work from home) capabilities have also been enhanced. Sanitizing, hygiene, and protective materials have been distributed at all of the buildings of the Bank; the required distance is maintained between employees in all spaces; and temperature checks are conducted in accordance with requirements. Instructions are continuously communicated to managers and employees. Ongoing monitoring and communication are maintained with employees who are in isolation or sick, and a system for assistance and information for employees has been established. The branches comply with the instructions concerning the reception of the public, including deployment of reinforced security teams outside the branches, instructions regarding hygiene, and maintaining a maximum number of customers permitted inside the branch. Extensive communication with the customers of the Bank is conducted through the various channels in order to provide updates regarding the routine operation of the branch network; the application of eased requirements regarding connection or identification of customers on the direct channels in order to facilitate service, including with regard to the delivery of credit cards and checkbooks to customers; and the application of eased requirements permitted by regulators. The Bank is in contact with its suppliers to ensure continued and continuous service, as well as with its subsidiaries in Israel and overseas branches, and with its various partners in the banking system and in financial services. The Bank of Israel receives reports daily, or upon exceptional events, according to the instructions. The work schedule is updated from time to time, according to instructions and various developments.

For additional information regarding operational risk and the management thereof, see [the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks as at December 31, 2019](#).

I. Compliance risk

Compliance risk is the risk of imposition of a legal or regulatory sanction, material financial loss, or reputational damage which the banking corporation may suffer as a result of a failure to comply with the compliance directives, as defined in Proper Conduct of Banking Business Directive 308.

Pursuant to Proper Conduct of Banking Business Directive 308, compliance risk also includes risks related to the fairness of the Bank towards its customers, conflicts of interest, the prohibition of money laundering and financing of terrorism (including with respect to tax laws), provision of advice to customers, securities enforcement, protection of privacy (excluding information-technology aspects), the US FATCA directives and the international CRS directives, and taxation aspects relevant to products or services for customers, or directives of a similar nature. Compliance risk also includes the reputational risk that accompanies failure to comply with such directives.

Compliance risk also encompasses risk related to the activity of the Bank with banks located in the Palestinian Authority, which requires the fulfillment of 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.

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.

In January 2018, the Bank received signed letters of immunity and indemnity from the Attorney General and the Ministry of Finance. The letter of immunity protects the Bank, its officers, and its employees from indictment in Israel for certain offenses related to money laundering and the prevention of terrorism financing in relation to services granted, or to be granted, by the Bank to Palestinian banks from March 28, 2016, to May 31, 2019 (the "Immunity and Indemnity Period"). Further to the letter of immunity, in January 2018, the Bank received a letter from the Supervisor of Banks, in which she gave notice that no enforcement measures would be taken in all matters related to actions of the Bank in connection with the provision of correspondent services to which the letter of immunity applies.

In the letter of indemnity, the State of Israel made a commitment to indemnify the Bank, in an amount up to NIS 1.5 billion, for expenses (liability according to a verdict and legal expenses) borne by the Bank, within civil proceedings or criminal proceedings that do not end in a conviction, prosecuted against the Bank or an officer or employee thereof in connection with the provision of the correspondent services during the Immunity and Indemnity Period. The immunity and indemnity commitments granted to the Bank, as noted, are subject to reservations stated therein and to conditions that the Bank must fulfill.

In light of the request of the State to postpone the termination of correspondent services until the establishment of a government company to provide Palestinian banks with correspondent services, an updated letter of indemnity was issued on June 30, 2019, extending the indemnity period until February 28, 2021 (and May 31, 2021 at the latest). Pursuant to the updated letter of indemnity, the indemnity to which the State has committed towards the Bank, as detailed above, has been amended to an amount of up to NIS 1.5 billion in respect of each proceeding (not cumulatively). An updated letter was also issued by the Attorney General extending the immunity period until June 30, 2020.

For additional information regarding compliance risk and the management thereof, see [the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks as at December 31, 2019](#).

J. Legal risk

Legal risk comprises, among other matters, legal claims, rulings, inability to enforce contracts, and exposure to fines, penalties, or enforcement measures as a result of supervisory actions and private settlements that may disrupt or adversely affect the activity of the Bank Group. The Group has internal and external legal counsel in order to manage this risk.

For additional information regarding legal risk and the management thereof, see [the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks as at December 31, 2019](#); [Note 25 to the Annual Financial Statements for 2019](#); and [Note 10 to the Condensed Financial Statements](#).

K. Reputational risk

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. This risk, which usually accompanies other activities and other risks, may materialize in various ways, such as customer departures, new regulation, and more.

For additional information regarding reputational risk and the management thereof, see [the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks as at December 31, 2019](#).

L. Regulatory risk

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.

For additional information regarding regulatory and legislative risk and the management thereof, see [the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks as at December 31, 2019](#).

For details regarding material regulatory initiatives with an effect on the activity of the Bank during the reported period, see [Note 16 to the Condensed Financial Statements](#).

M. Economic risk

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 stress 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 stress scenarios are updated annually, according to the risk map, and approved by the authorized parties, in accordance with procedures. The Economics Department also examines a series of warning indicators that may signal an increase in the probability of a stress 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 centers 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 the spread of the coronavirus, see [Section B.5](#) above.

For details regarding conditions in the Israeli and global economy, see [the section “Economic and financial review” in the Report of the Board of Directors and Board of Management](#).

N. Strategic risk

Strategic risk is material present or future risk to profits, capital, reputation, or status that may be caused by changes in the business environment; faulty business decisions; improper implementation of strategy or business decisions; or failure to respond to changes in the industry (e.g. competitors' actions), the economy, or technology. Strategic risk is also a function of the congruence of the organization's strategic objectives with its environment, adaptation of the business plans that it develops to achieve these objectives, resource allocation, and quality of implementation. As such, this risk constitutes forward-looking information.

Following the spread of the coronavirus and its effect on the global and local economy, the Bank has examined the short-term effects and is currently assessing and examining the long-term effects on the Bank's strategic plan and its adaptation to this situation.

For additional information regarding strategic risk and the management thereof, see [the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks as at December 31, 2019](#).

O. Environmental risk

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.

For additional information regarding environmental risk and the management thereof, see [the Report on Risks: Pillar 3 Disclosure and Additional Information Regarding Risks as at December 31, 2019](#).