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Contents

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Bank of Jerusalem – Annual Report for the year 2013

A Word of the CEO

The year 2013 continued to be one of economic uncertainty. Although capital markets recorded handsome yields, and the general state of the economy in Israel and around the world recorded a certain improvement, the level of uncertainty is still high. The Bank of Jerusalem continued to implement its strategic plan in the various sectors: In the retail sector, the Bank continued to implement its retail expansion strategy in several areas, in a largely innovative and different manner than its competitors.

1. Entry into the Current Account sector – in the last quarter of 2012, the Bank launched a large-scale campaign to enter the current accounts sector and attract new customers. The campaign centered on an extremely attractive value offer that includes management of current accounts for private customers in shekels without current account commissions, without preconditions and for an unlimited period of time.

   The move is unique in the world of Israeli banking and following it, the Bank has today over 10,000 current accounts in accordance with its plans.

   The Bank of Jerusalem views this move as part of the implementation of its long-term retail expansion strategy.

2. Increased marketing of short-term deposits (up to one year) at extremely attractive prices in relation to the competition, through both the branches and the closed system. This is a significant move in terms of competitiveness in this field. Standard practice in the banking system is that the Banks' table prices are approximately 20% of the Bank of Israel's interest rate, while the Bank of Jerusalem offers at least 80% of the Bank of Israel's interest rate and for any deposit amount.

3. The Bank presented a profile of its future branches – the video branches. Several video branches were opened in 2013.

   The video branch provides services to customers 10-12 consecutive hours a day, six days a week. The branch occupies a small space and service is provided via video by a banker at the call center. The level of service involved is higher and the service cost is lower – a fact that allows the Bank to stand behind its value offer of no current account commissions, as well as to provide high interest rates on deposits and current accounts with credit balances.

4. Continued deepening of consumer credit activity for customers without a current account, based on a work model that combines a review of each and every customer under a decision-supporting model, as well as an individual review by a branch banker.

   This year, the bank continued to improve the quality of its underwriting model, while continuing its steady growth in the quality of borrowers and portfolio size.

5. Continuation of the sale of traditional bank products. Mortgages, deposits, securities, credit cards and credit for vehicles, with emphasis on the second-hand vehicle market.

6. Extensive upgrade of work processes and supervisory entities in the Bank, primarily in the retail sector.

7. Continuation of the upgrading of the computer systems, while strengthening the bank's core system and adopting a multi-channel environment. The telephone call center continued to grow and expand in its areas of operation and in the volume of customer services it provides. In addition, the Bank's new website was launched. Over the next several months, the Bank is planning to complete its deployment of ATM machines in all of its branches.

8. This year, the Bank completed the acquisition and merger of the brokerage activity of Clal Batucha. For the Bank, the move significantly strengthens the brokerage and capital market activity, as well as this source of revenue in the Bank's overall revenue mix. The volume of Bank's customers in the securities sector increased from approx. 4 thousand customers to 13 thousand customers.

   Furthermore, the volume of the securities portfolio held in custody that is managed by the Bank increased from approx. NIS 2 billion to approx. NIS 16 billion. In the construction project oversight sector, the Bank continued to flourish, although at lower rates than last year. This year saw a significant rise in the revenues of the Bank in the financing activity from core businesses. As a result of this expansion, and correspondingly, expenses increased as a direct result of the preparations for this activity.

   In 2014, the Bank plans on continuing these efforts and further expand in the retail sector, with a sharper rise in revenues vs. moderate growth in expenses, after having exhausted the majority of investments in its expansion efforts.

Uriel Paz
Chief Executive Officer

Part of the above information constitutes forward-looking information. The Bank's actual conduct may essentially differ from the above-mentioned description due to a large number of factors, including, inter alia, as a result of unexpected political/security events, changes in customer preferences and changes in regulation, legislative provisions or provisions from supervisory entities.

Report of the Board of Directors

to the General Assembly of Shareholders

Financial Statement for 2013

Bank of Jerusalem Ltd. and its consolidated companies

Report of the Board of Directors to the General Assembly of Shareholders

At the Board of Directors meeting that took place on February 27, 2014, the decision was made to approve and publish the consolidated financial statements of the Bank of Jerusalem Ltd. (hereinafter: the "Bank" or "Bank of Jerusalem") and its subsidiaries for the year 2013 (hereinafter: the "Reporting Year"). The financial statements were prepared in compliance with the directives of the Supervisor of Banks, and data are presented in reported amounts.

First part – Description of the General Development of the Banking Corporation's Bussinesses

Activity of the banking corporation and description of its businesses development

The Bank

The Bank of Jerusalem was founded in 1963 as a public company, as defined in the Companies Ordinance, New Version, 5743 – 1983, under the name Bank of Jerusalem for Development and Mortgages Ltd. In 1992, the Bank issued its shares to the public for the first time, thereby becoming a company whose shares are traded on the Tel Aviv Stock Exchange. In 1996, the Bank's name was changed to its present name, Bank of Jerusalem Ltd. Mrs. Kena Shoval is the controlling shareholder in the Bank pursuant to a control permit issued by the Bank of Israel.

The Bank is a banking corporation, with a banking license in accordance with the Banking Law (Licensing), 5741 – 1981, and has been operating as a commercial bank as of 1998. The Bank relies on an extensive customer base of households, Israeli and foreign residents, and operates in the mortgage, consumer credit, savings and deposits, financing of residential construction, credit financing for vehicle acquisition purposes, other commercial credit and capital market activity sectors.

The Bank's headquarters are located in Airport City. As of the date of publication of the report, the Bank operates through 22 branches located across the country.

Objectives and business strategy

The Bank has a strategic plan that focuses on extensive retail growth, while increasing the customer base and the basket of products and services to households and diversifying and spreading its areas of retail activity, such as current accounts, consumer credit and deposits (hereinafter in this report: the "Plan" or the "Strategic Plan").

According to the Plan, the strategic growth is accompanied by offering differentiated value to customers, while developing the Bank's retail expertise. Underlying the Strategic Plan is a reduction of the Bank's systemic risk, through diversification and centering of customers and sources of financing income, with emphasis on household sector activity, in both recruiting deposits and in providing credit, including consumer credit.

The Strategic Plan is supported by a competitive environment analysis, that indicates a positive potential for customer recruitment from the household sector, in light of the centralization of the banking system on one hand, and an increase in customer awareness and readiness to improve their situation on the other.

In order to achieve the Plan's aforementioned objectives, the Bank is operating in several areas of operation that were defined in the Strategic Plan as follows:

- Expansion of the Bank's activity, with emphasis on expansion of the activity in the current accounts and consumer credit sectors.

- Transition to a widespread use of technological means for communication with customers, including multi-channel banking, enabling the opening of a deposit account via the Internet, while reducing the dependency on the activity in the physical branches.

- Continuation of the upgrade of the Bank's IT system, including continuation of the assimilation of the CRM system, continuation of the development of an advanced telephony service center, which allows for most banking transactions to be carried out without having to arrive at the branch, full deployment and assimilation of ATM machines and continued expansion of the Bank's website. The overall investment is estimated at dozens of millions of shekels, and is being carried out gradually and in a controlled manner.

- Offering better financial value to the customer, in the savings and deposits sector, as well as in additional consumer areas. The value offer does not come only at the expense of the profitability from customers, but is based on diverting the operating model to technological means. This model allows for lower costs, without affecting the quality of the service provided to the customer, and without the Bank having to compromise on the quality of risk management.

- Increasing consumer awareness of the Bank's image as a competitive and creative bank.

In October 2012, the Bank began a gradual process for recruiting household current accounts (private accounts). Such process is eamarked to recruiting thousands of new accounts from among both new and existing customers over the ensuing years. In order to accomplish this, the Bank formulated a value offer with a sweeping exemption from current account commitions for individuals who are Israeli residents.

As a result of the move, the Bank currently has over 10,000 current accounts, in accordance with the outline of the Strategic Plan.

A current account is considered an anchor product and therefore, the expansion in the current accounts activity is expected to significantly contribute to reducing credit risks, by strenghtening the connection with customers and diversifying banking products. Furthermore, it is expected to allow the Bank to expand its customer base over time. Increased profitability is expected to be attained as a result of the sale of the accompanying products.

The Bank aims to serve customers, while retaining a narrow and optimal cost base. As a result, the concept of the video branch was develop. Such a branch can serve about 3,000 customers, is staffed by one or two employees per shift and relies on technology that enables video conferencing between the customer and a professional banker at a call center.

In the consumer credit sector, the Bank is continuing, in accordance with its Strategic Plan, the process that had already begun in 2010, to provide consumer credit to the Bank's customers, as well as to new customers from the household sector. This process gradually results in the spread and centering of the Bank's credit portfolio, which is concentrated in mortgages. Since 2010, an extensive volume of consumer credit has been provided to customers. The Board of Directors and Management continued to monitor the consumer credit underwriting process, including improvement of underwriting models and continuing follow-ups of conclusions. In 2013, the volume of the portfolio and borrowers continued to grow, with improvements in the quality of credit underwriting. The Bank considers this sector as a significant growth engine for its profits.

Furthermore, the Bank placed increased emphasis on reinforcing the supervision and control setup, in the three control levels. For more information, see details in the chapter on Risks and Risk Management Methods.

The Bank continues its business activity in the financial oversight of construction and other projects, and this while conservatively reviewing the profitability of the transactions, and incorporating institutional entities in syndicates aimed at spreading the credit risk in large transactions, while regularly monitoring the real estate market situation.

The change in the definition of the Bank's core activity, and the massive expansion of the contact points with the customer and of the supply of retail services are accompanied by the Bank's meticulous review of changes in the risk profile derived from the new activity characteristics, and the allocation of required capital suitable for the aforementioned risks.

In July 2013, the decision was made to implement a streamlining plan in the Bank, to reduce the Bank expenses. For information, see below the chapter on Events in the Reporting Year

In August 2013, an agreement was signed in which the Bank acquired from Clal Finance Ltd. all of the shares of Clal Finance Batucha Investment Management Ltd. (hereinafter: "Clal Batucha"), as specified below in the chapter on Events in the Reporting Year. Clal Batucha was listed on the TASE and in the TASE Clearing House up to the date of completion of the acquisition transaction, on December 15, 2013, and engaged in the provision of trading services on the Stock Exchange and in foreign markets. In accordance with the purchase agreement, the Bank acquired all of Clal Batucha shares, in consideration for an amount equivalent to Clal Betucha's equity plus adjustments on the date of completion of the Agreement.

In December 2013, the acquisition and merger of activities with the Bank was completed.

This move is expected to increase the volume of the Bank's activity in the capital market sector, while entering additional areas of activity in which the Bank had not been previously operating.

The Bank's plans and assessments, as specified above, are forward-looking information, and are based on assumptions and various forecasts presented to the Bank's Board of Directors. This information may not be realized due to changes that may occur due to various factors that are not controlled solely by the Bank. Influencing factors include forecasts and assessments concerning economic developments in Israel and globally, especially concerning the economic situation, including the influence of macroeconomic and geopolitical conditions, changes in capital markets, as well as other additional factors influencing risk exposure: public preferences, instructions by supervisory entities and others, aspects related to the Bank's image, technological developments and personnel issues.

The activities of the Bank during the year 2013

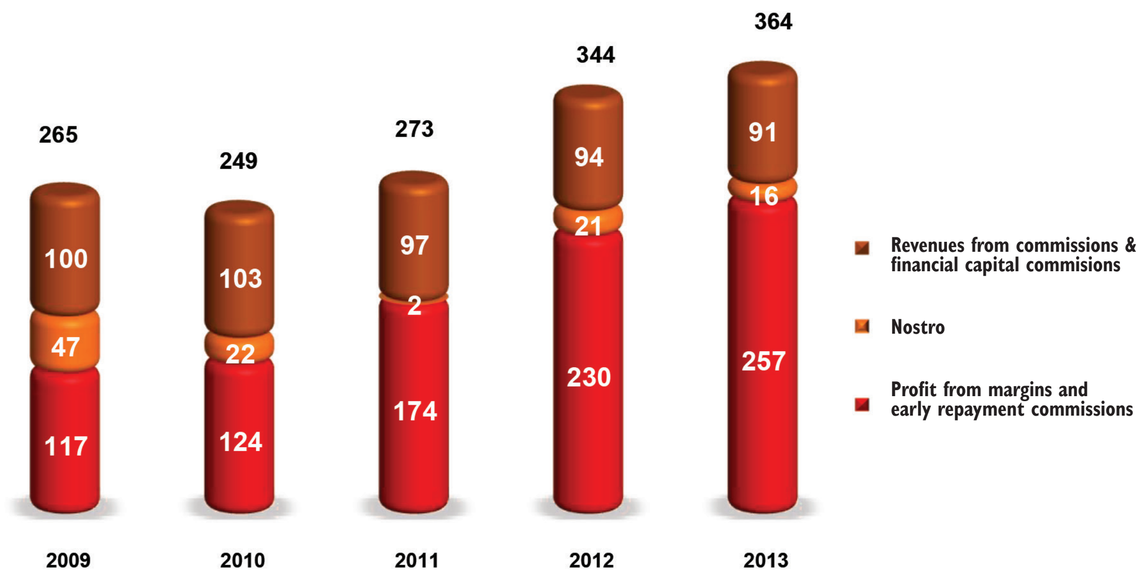
In 2013, the Bank of Jerusalem operated in a challenging environment, against the background of the local market's coping with increasing economic uncertainty and attempts to recover from the global financial crisis that broke out during 2008.

Developments in Profit and Loss Items

Net profitin the reporting year amounted to NIS 17.2 million, in contrast with NIS 36.1 million last year, a 52% decline, despite the continuing increase in interest income, net (an increase of NIS 26.3 million, compared to the same period last year). A sharp increase in expenses for credit losses was recorded, approx. NIS 18.7 million, primarily attributed to a one-time provision for credit losses for housing, due to debts that were reviewed on a group basis in the amount of NIS 19.2 million, following the instructions of the Bank of Israel from March 21, 2013, as specified below in the chapter on Events in the Reporting Year, and an increase in operating and other expenses in the amount of NIS 31.9 million.

The net profit yield on average equity was 2.5%, compared to 5.4% in the previous year.

Listed below is the composition of the Bank's income in millions of NIS:



Interest income, net in the Reporting Year amounted to NIS 257.2 million, compared to NIS 230.9 million in 2012 – an 11% increase. Most of the growth of approx. NIS 21 million is attributed to a sharp increase in the Bank's core businesses – from the continued improvement in mortgage margins, from increased consumer credit balances and margins and from an increase of approx. NIS 14 million attributed to a markdown in sources. In contrast, a decrease of approx. NIS 8 million was recorded in income, due to the lower interest rate environment.

Expenses for credit losses during the Reporting Year totaled NIS 54.7 million, compared to NIS 36.0 million in the same period last year. Most of the growth is attributed to a one-time provision for credit losses in respect of debts that were reviewed on a group basis for housing in the amount of approx. NIS 19.2 million, following the Bank of Israel's instruction from March 21, 2013, as specified below in the chapter on Material Events in the Reporting Year, as well as from an increase in the provision for housing based on the depth of arrears in the amount of approx. NIS 4.1 million. In contrast, a reduction was recorded in the provision for credit for vehicles and business credit, in the amount of approx. NIS 2.7 million and approx. NIS 2.4 million, respectively.

The ratio of expenses for credit losses for the reviewed period, on an annual basis, to the total public credit, net (including off-balance sheet credit risk) is 0.57%, compared to 0.37% in 2012 (if the one-time provision described above is neutrilized, the ratio is 0.37%, similar to the ratio in 2012).

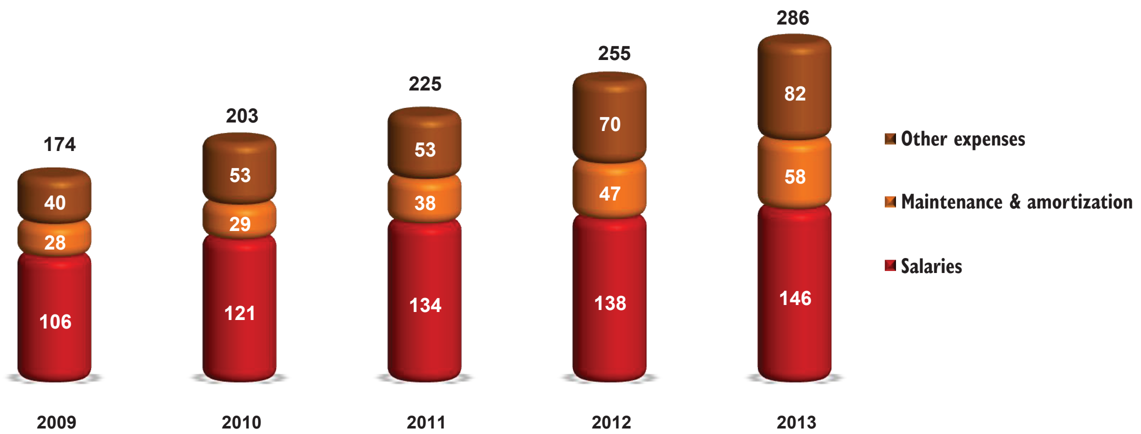
Non-interest financing income in the Reporting Year amounted to NIS 14.2 million, compared to NIS 22.6 million in the same period last year. The main decrease is attributed to a decrease in Nostro earnings.

Commissions in the Reporting Year totaled NIS 91.4 million, compared to NIS 90.2 million in the same period last year. The increase is attributed to an increase in the amount of approx. NIS 4.5 million in income from project's financial oversight. In contrast, a decrease in income from credit processing was recorded in the amount of NIS 2.3 million.

Operating and other expenses in the Reporting Year amounted to NIS 286.4 million, compared to NIS 254.5 million in the same period last year – a 13% increase. The main increase is attributed to an increase in expenses from depreciation, payroll, computers and call center, in light of the implementation of the Bank's Strategic Plan.

Payroll expenses in the Reporting Year amounted to NIS 146.1 million, compared to NIS 137.8 million in the same period last year. In light of the Bank's continued growth and development, this is a moderate increase.

Listed below is a breakdown of the Bank's expenses in millions of NIS:



Provision for taxes on profits from regular activities The effective tax rate in 2013 reached approx. 23.9%, in comparison with the statutory tax rate in financial institutions of 36.2%. The effective tax is lower than the statutory tax primarily due to a change in the balance of deferred taxes, following a change in the tax rate. For more information, see Note 29 to the financial statements.

Below are details of net earnings per share in the last three years:

	2013	2012	2011
Net Earnings per Share	0.24	0.51	0.35*

* In 2011, the net Earnings Per Share does not include the gain from the sale of the administration building. Without neutralization of this gain, the Earnings Per Share for 2011 would have been NIS 0.65.

Developments in Other Comprehensive Income items

Adjustments due to the presentation of securities available-for- sale at fair value, net (after the tax effect) amounted to a decrease of approx. NIS 0.8 million, compared to an increase of NIS 12.7 million in 2012. The decrease is primarily attributed to a reduction in net profits that have not yet been realized from fair value adjustments.

Developments in Balance Sheet items

The balance sheet total as at December 31, 2013 amounted to NIS 13,412 million, compared to NIS 12,292 million at the end of 2012 – an increase of about 9%. The increase derives from an increase in the balance of cash and deposits at banks, as detailed below.

The balance of liquid assets (cash, deposits in banks and securities) as at December 31, 2013 totaled NIS 3,510 million, compared to NIS 2,524 million at the end of 2012 – an increase of about 39%. Most of the increase is attributed to an increase in the balance of the Bank's sources.

Due to the low interest rate environment, in 2013, the Bank increased the balance of cash and deposits at banks, at the expense of the securities portfolio balance.

The balance of cash and deposits at banks as at December 31, 2013, amounted to NIS 2,833 million, compared to NIS 1,361 million at the end of 2012 – an increase of about 108%.

The balance of securities as at December 31, 2013 amounted to NIS 677 million, compared to NIS 1,163 million at the end of 2012 – a decrease of about 42%.

Below is the composition of the securities portfolio:

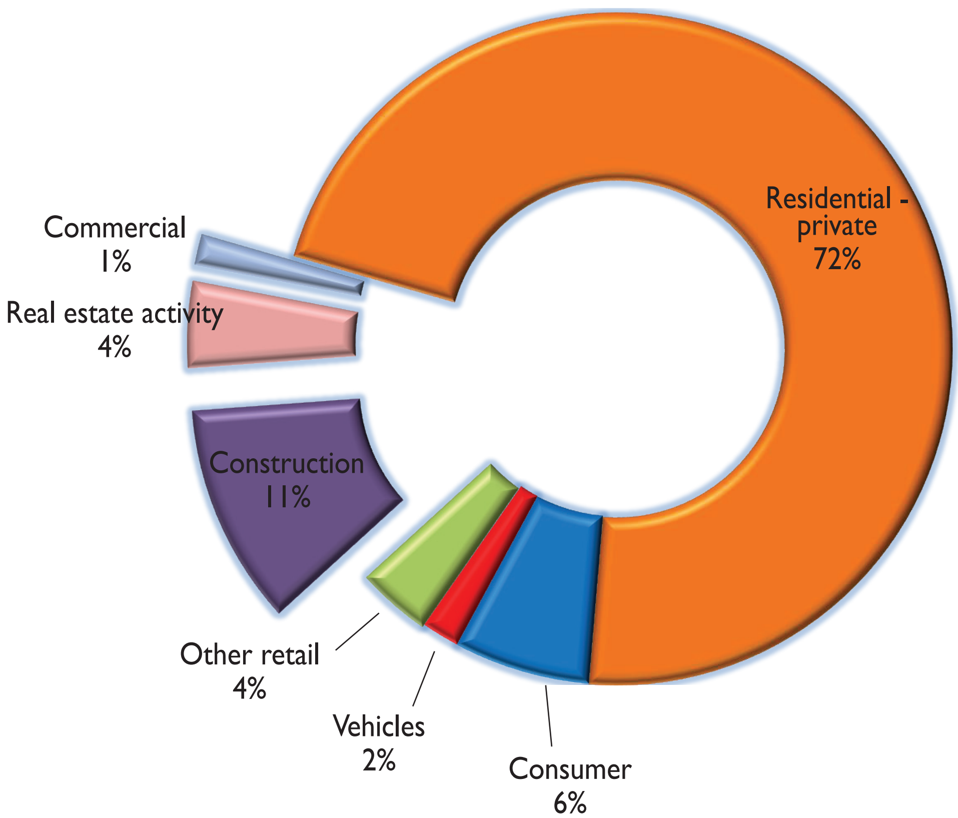
	Balance as at December 31,		Percentage of the securities portfolio as at December 31, 2013
	2013	2012	
	Millions of NIS		
Israeli government debentures	**661**	1,140	98%
Israeli bank debentures	**11**	17	1%
Israeli corporate and other debentures	**5**	6	1%
Total securities	**677**	**1,163**	**100%**

The balance of credit to the public, net as at December 31, 2013 amounted to NIS 9,627 million, compared to NIS 9,581 million at the end of 2012.

Below is the composition of the balance of credit to the public:

	Balance as at December 31, 2013	2012	
	Millions of NIS		Change in %
Credit to individuals			
Credit for housing	**6,921**	6,822	1%
Consumer credit	**629**	450	40%
Credit for vehicle acquisition	**175**	226	-23%
Individuals – Other	**342**	367	-7%
Total credit to individuals	**8,067**	**7,865**	**3%**
Commercial credit			
Construction and Real Estate – Construction (including projects, buyers groups and solar energy)	**1,021**	1,159	-12%
Construction and Real Estate – Activity in Real Estate (particularly commercial assets)	**396**	377	5%
Other commercial	**143**	180	-21%
Total commercial credit	**1,560**	**1,716**	**-9%**
Total credit to the public, net	**9,627**	**9,581**	**0.5%**

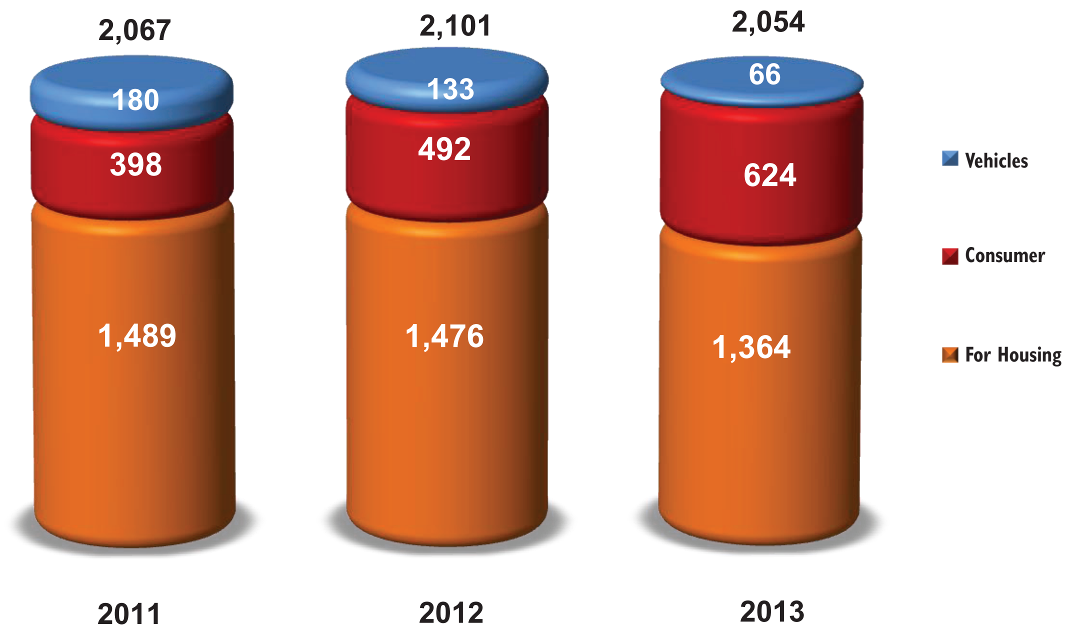
Below is the composition of the credit portfolio:



Below is a table showing retail credit performance data:

	For the year ended on December 31,		
	2013	2012	
	Millions of NIS		Change in %
Credit for housing performances	**1,259**	1,340	-6%
Recycling of housing loans	**105**	136	-23%
Total credit for housing (including recyclings)	**1,364**	**1,476**	**-8%**
Consumer credit performances (including credit cards and current account credit lines*)	**624**	492	27%
Vehicle credit performances	**66**	133	-51%
Total retail credit	**2,054**	**2,101**	**-2%**

(*) Net accumulation of balances of current accounts and credit cards during the period.



The balance of deposits from the public amounted as at December 31, 2013 to NIS 11,071 million, as compared to NIS 9,814 million at the end of 2012 – a 13% increase. The majority of the growth is attributed to an increase in the balance of household deposits in the amount of approx. NIS 700 million, as specified below in the Raising of Funding chapter.

The balance of debentures and deferred liability notes as at December 31, 2013 totaled NIS 1,406 million (from this – a balance of deferred liability notes of NIS 537 million), compared to NIS 1,581 million at the end of 2012 (from this – a balance of deferred liability notes of NIS 491 million). The main decrease is attributed to redemption of liability notes.

The total balance of deposits from the public, debentures and deferred liability notes amounted as at December 31, 2013 to NIS 12,477 million, as compared to NIS 11,395 million at the end of 2012 – a 9% increase.

Developments in off-balance sheet items

The balance of loans from deposits by collection level (loans to entitled, from government funds) as at December 31, 2013 totaled NIS 1,703 million, compared to NIS 1,997 million at the end of 2012 – a decrease of about 15%. The main decrease is attributed to an ongoing curtailment of performance volume of loans to entitled in the economy as a whole, among other reasons due to the low-interest environment that caused low economical profitability for utilizing these loans. Revenue from collection commissions by collection level amounted to NIS 15.5 million in 2013, compared to NIS 17.0 million in 2012.

The balance of security portfolios in the Bank's custody held by about 13,000 customers amounted as at December 31, 2013 to about NIS 16 billion, compared to NIS 2 billion, held by 4,000 customers, at the end of 2012. The main increase is attributed to the acquisition of Clal Batucha (for details about the Clal Batucha acquisition, see below the chapter on Events in the Reporting Year). Revenue from securities activity in 2013 amounted to NIS 11.8 million, compared to NIS 8.1 million in 2012.

The Trust Company of Bank of Jerusalem Ltd (a subsidiary fully owned and controlled by the Bank) handles the trust accounts and financial assets of foreign residents and others. The balance of assets held by the company as at December 31, 2013 amounted to NIS 0.1 million (compared to a total of NIS 2.0 million during 2012). In 2013, the company's income totaled about NIS 21 thousand, compared to NIS 2 thousand in 2012.

Developments in revenue and expense ratios

Below are the interest disparity of all the assets of the Bank (including securities), against the Bank's liabilities in various linkage sectors (including the derivatives effect):

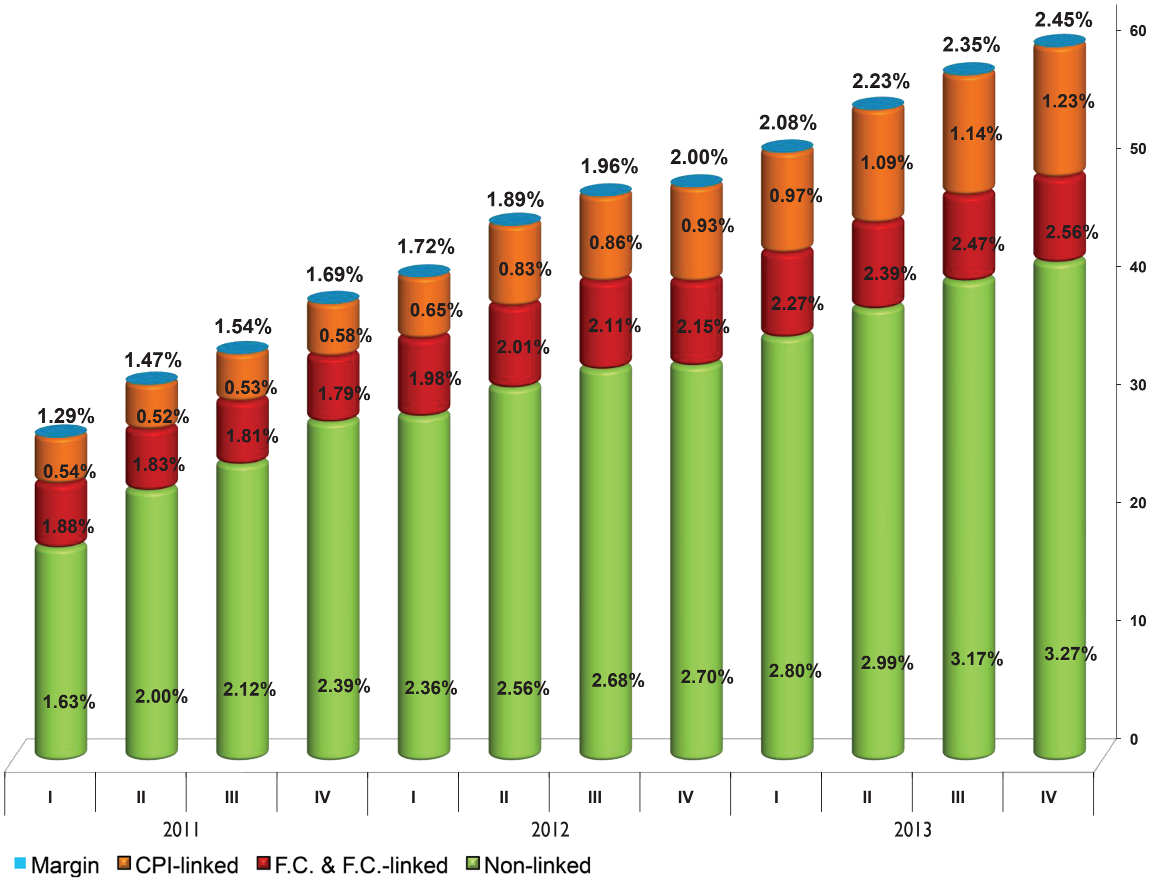
	2013	2012
Unlinked	2.35	2.34
Index-linked	1.34	0.91
Foreign currency and foreign currency-linked	2.04	1.85
Total	**1.92**	**1.72**

The widening of the interest gaps in the index-linked sector is mainly attributed to the improvement in housing credit profitability, as well as a decrease in raising costs of index-linked sources.

The widening of the interest gaps in the foreign currency and in the foreign currency-linked sector is primarily attributed to improved profitability in housing credit.

For more extensive information, see Appendix C to the Management Review.

Below are data on credit margins – quarterly average for 2011-2013 (in millions of NIS):



Events in the Reporting Year

1. On January 7, 2013, Jerusalem Investment Portfolio Management Ltd., a wholly owned subsidiary (hereinafter: the "Subsidiary"), entered into an agreement with a third party not related to the Bank, for the sale of the portfolio management activity, as defined in the Regulation of Investment Advice, Investment Marketing and Portfolio Management Law 5755-1995, that it had managed. On March 21, 2013, the transfer of the Subsidiary's portfolio management activity to a third party not related to the Bank was completed, in accordance with the agreement between the parties. It should be noted that the income generated for the Subsidiary from said sale, as well as the consideration from said sale, are of an amount that is not material to the Bank.

2. On March 21, 2013, the Supervisor of Banks published directives regarding the allocation of capital and provision for doubtful debts for housing loans and change in the risk weight of guarantees in accordance with the Sales Law. The background for the publication of the directives is a rapid

increase in the volume of loan portfolios in housing property security, in light of the significant increase in housing prices that resulted in an increase in risks entailed in the housing loan portfolios in banking corporations.

Below are the key points of the guidelines that were included in the new provision:

Up to the date of the guideline, in order to calculate the capital adequacy ratios, a housing loan was weighted at 35%, with the exception of a leverage housing loan that includes a variable interest component, that since October 2010 has been weighted at 100%. In accordance with the new directive, capital for housing loans will be allocated based on the following weighted rates:

Housing loans in which the financing rate is up to 45% will be weighted at a risk weight of 35% – remains unchanged.

Housing loans whose financing rate is higher than 45% and up to 60% will be weighted at a risk weight of 50%, instead of 35%.

Housing loans whose financing rate is higher than 60%, will be weighted at a risk weight of 75% for capital requirement purposes, instead of 35%, or at 100% (for leveraged loans).

Correspondingly, the requirement from October 2010 to weigh at a risk weight of 100%, leverage loans whose financing rate exceeds 60% and in an amount that exceeds NIS 800 thousand and whose variable interest rate exceeds 25%, was canceled and was replaced, as previously mentioned, by a weighted rate of 75%.

The guidelines set forth that the balance of the group provision for credit losses held for housing loans will be at a minimal rate of 0.35% of the balance of said loans, beginning from the financial statements for the public for the second quarter of 2013. This will not apply to housing loans for which a provision is held based on the depth of the arrears or a private provision.

Furthermore, the guidelines set forth a reduction in the allocation of capital required for Sales Law guarantees, in the event that the apartment had already been delivered to the tenant. These guarantees will be weighted with a conversion coefficient for credit of 10%, instead of 20%. This move constitutes a relief in the capital allocation requirements and may increase the supply of bank credit in the construction and real estate industry.

As a result of the implementation of the guidelines, the provision for credit losses increased in the reviewed period, for debts that were reviewed on a group basis, in the amount of NIS 19.2 million gross before tax (NIS 12.2 million net after tax).

In addition, as a result of the update of the risk weights of the housing loans, the Tier 1 capital to risk component ratio is expected to decline over the next several years by 0.1%-0.2%.

3. On May 30, 2013, Maalot announced that after monitoring the Bank's rating with Maalot's updated methodology for rating banks (as published on November 9, 2011), it was leaving the Bank's rating of ilA+ in place and was updating the rating forecast from negative to stable.

4. In June 2013, the Value Added Tax Order (Tax Rate on NPOs and Financial Institutions) (Amendment) 5773-2013 was published. The order established that the wage tax rate that applies to financial institutions will be 18% of the wages paid for work in June and afterwards, and the profit tax will stand at 18% of the profits generated. The provision regarding the profit tax in the 2013 tax year will apply to the relative share of the profit for this year.

   On July 30, 2013, the Knesset ratified on the second and third calls the economic plan for 2013-2014 (The Budget Law), which includes, inter alia, fiscal changes whose primary goal is to broaden tax collection for said years.

   Said changes include, inter alia, increasing the corporate tax from 25% to 26.5%, beginning on January 1, 2014.

   C. Below are the statutory tax rates that apply to financial institutions, including the Bank, as a result of said changes:

	Corporate tax rate	Profit tax rate	Comprehensive tax rate
		%	
2012	25.00	16.33*	35.53
2013	25.00	17.58*	36.22**
2014 and later	26.50	18.00	37.71

* Weighted rate.

** Compared to a tax rate of 35.90% on the eve of the publication of the amendment.

   The balance of deferred taxes included in the financial statements as at December 31, 2013 is calculated based on the new tax rates, whose legislation was essentially completed as of the balance sheet date and as such, include the said changes.

   Said changes in the aforementioned tax rates have resulted in an increase in net profit of NIS 1.9 million in 2013.

5. On June 4, 2013, the Bank received notice regarding the filing of a motion with the Committee to Impose Financial Sanctions on Banking Corporations, to impose on the Bank a financial sanction in accordance with the Anti-Money Laundering Law 5760-2000, for alleged violations of said law. The motion, which does not specify the requested amount of the sanction, refers to alleged violations mentioned in the audit report from February 2013, that was prepared by the Supervisor of Banks with regards to the period between 2007 and until 2010.

The Bank responded to the motion and presented in its response its position, according to which it acted in compliance with the provisions of the Law, and following the Bank's response to the audit report itself, and the detailed treatment outline presented by the Bank in the framework of said response, which reflects, to the best of its understanding, a culture of proper compliance, and compliance by all levels with the provisions of the law.

At this stage, the Bank cannot assess whether financial sanctions will be imposed on the Bank as a result of this notice and if so, the amount of said sanctions. For more information, see details in the chapter on Risks and Risk Management Methods.

6. On July 14, 2013, the Bank (in Immediate Report Reference No.: 2013-01-091584) announced that due to changes in the capital requirements and other regulatory requirements, and their effect on the Bank, a decision was made to implement a streamlining plan in the Bank, in order to reduce the Bank's expenses.

   Implementation of the streamlining plan that includes, inter alia, a curtailment of positions at the headquarters and a salary freeze for a period of up to two years, was expected to result in an annual saving of approx. NIS 15 million before tax in the payroll expenses of the Bank, that would be reflected in increased annual yield of approx. 1.5%. As a result of non-material updates that were recently carried out in the streamlining plan, expected savings in 2014 (as compared to the situation if not for the plan) will amount to approx. NIS 14 million.

7. On August 6, 2013, the Bank entered into an agreement with Clal Finance Ltd. ("Clal Finance") and with the stock exchange member of Clal Finance Ltd. – Clal Finance Batucha Investment Management Ltd. ("Clal Batucha"), to purchase all of Clal Finance's holdings in Clal Batucha (the "Agreement"). In accordance with the Agreement, the Bank acquired, on the date of completion of the transaction – December 15, 2013, all of Clal Finance's holdings in Clal Batucha, for a consideration that was paid and that is not contingent, in an amount equivalent to Clal Batucha's adjusted equity on said date of NIS 257 million.

   On October 10, 2013, the Bank's Board of Directors decided to merge the Bank with Clal Finance Batucha Investment Management Ltd. and Clal Finance Batucha Brokerage Ltd., as specified in the immediate reports dated October 16, 2013 (Reference: 2013-01-167883) and October 21, 2013 (Reference: 2013-01-170553, 2013-01-170559), the information in which is included by way of reference. Clal Finance undertook to indemnify the Bank for a series of events listed in the Agreement, regarding damage or liability for the period preceding the date of completion of the Agreement, including for breach of representations, for a liability due to Clal activity during the period preceding the date of completion of the agreement, for tax liabilities, for liabilities resulting from work relations and other events set forth in the Agreement, pursuant to the Bank informing Clal of the occurrence of the indemnifying event no later than 84 months from the date of completion, or no later than 36 months from the date of completion (with regards to a liability due to past activity and breach of representations). The maximum amount of reimbursement (with the exception of past activity, for which the amount of reimbursement is not limited), will not exceed NIS 190 million, and NIS 250 million with regards to the additional events. Clal Insurance Enterprises Holdings Ltd., which wholly owns Clal Finance, assumed jointly and severally with Clal Finance, all of Clal Finance's liabilities for reimbursement. For more details, see the Immediate Report dated May 13, 2013 (Reference No.: 2013-01-060682) and the Immediate Report dated August 6, 2013 (Reference No.: 2013-01-110338), the Immediate Report dated September 12, 2013 (Reference No.: 2013-01-144048 regarding the Supervisor's approval), and the Immediate Report dated 28 October, 2013 (Reference No.: 2013-01-176949 regarding the Stock Exchange's approval) and the Immediate Report dated November 18, 2013 (Reference No.: 203-01-194358 regarding the Approval of the Supervisor of Banks), the information included in them being introduced by way of reference.

The Bank received a valuation of Clal Batucha's significant intangible assets, through an external accounting firm. The valuation of Clal Batucha's significant intangible assets was performed in compliance with International Financial Reporting Standard 3, Business Combinations (IFRS3), and in accordance with American Financial Accounting Standard ASC820-10 (FAS157).

The Bank recognized the fair value of the assets that were acquired and the liabilities that were assumed in the framework of the business combination, based on a provisional measurement, since the Bank has yet to receive preliminary approval from the Tax Authority with regards to the tax implications of the merger.

As of the date of approval of the Financial Statements, a final appraisal had not been received from the external value appraiser with regards to the fair value of the identified assets that were acquired and the liabilities that were assumed. The fair value of the assets and liabilities that were acquired are subject to final adjustment up to 12 months from the date of acquisition. According to International Reporting Standard Number 3 regarding Business Combinations, on the date of the final measurement, the adjustments are made by way of restatement of the comparison numbers that were reported in the past based on the provisional measurement.

8. On August 28, 2013, Jerusalem Finance and Issuances (2005) Ltd. (a subsidiary wholly owned and controlled by the Bank) published a shelf prospectus for the issuance of debentures and deferred liability notes.

9. On August 29, 2013, the Supervisor of Banks published directives imposing restrictions on the granting of housing loans by banks. The background for the publication of the guidelines is the increase in risks entailed in housing loan portfolios in banking corporations as well as increasing the ability of borrowers and the banking system to resist the potential negative effects that might occur when interest rates increase in the future.

Below are the key points of the guidelines that were included in the new provision:

A banking corporation will not approve and will not grant a housing loan whose repayment rate from income exceeds 50%.

Housing loans in which the monthly repayment rate from income falls between 40% and 50%, will be weighted at 100% for the purpose of calculating the capital adequacy ratio.

A banking corporation will approve and grant housing loans only if the following two conditions are met:

The ratio between the share of the housing loan in variable interest and the total loan does not exceed 66.66%.

The ratio between the share of the housing loan in variable interest, that bears an interest that might change in less than five years since the date of approval of the loan, will not exceed 33.33% of the total loan.

A banking corporation will not approve and will not grant a housing loan whose repayment period exceeds 30 years.

A banking corporation will not approve and will not refinance a housing loan if as a result of the refinancing, a deviation occurs in one of the aforementioned restrictions, or if a deviation that existed prior to the refinancing was increased.

The Bank is implementing the directives and operates in compliance with them.

10. On December 22, 2013, Maalot established a rating of ilA for the private expansion of the series of deferred liability notes 10 that was issued to institutional investors by Jerusalem Finance and Issuances Ltd.

    On December 24, 2013, Jerusalem Finance and Issuances issued, in a private issuing to classified investors, NIS 58,790 thousand par value of deferred liability notes (Series 10), from the listed series that was issued according to the shelf offer report dated December 24, 2012, for a consideration of NIS 60,612 thousand.

11. For details about the appointment and termination of the term of senior officers during the Reporting Period, see below the chapter on Senior Officers.

Events After the Balance Sheet Date

-none-

Details on Main Investee Companies

For details on Main Investee Companies, see Note 7 to the Financial Statements.

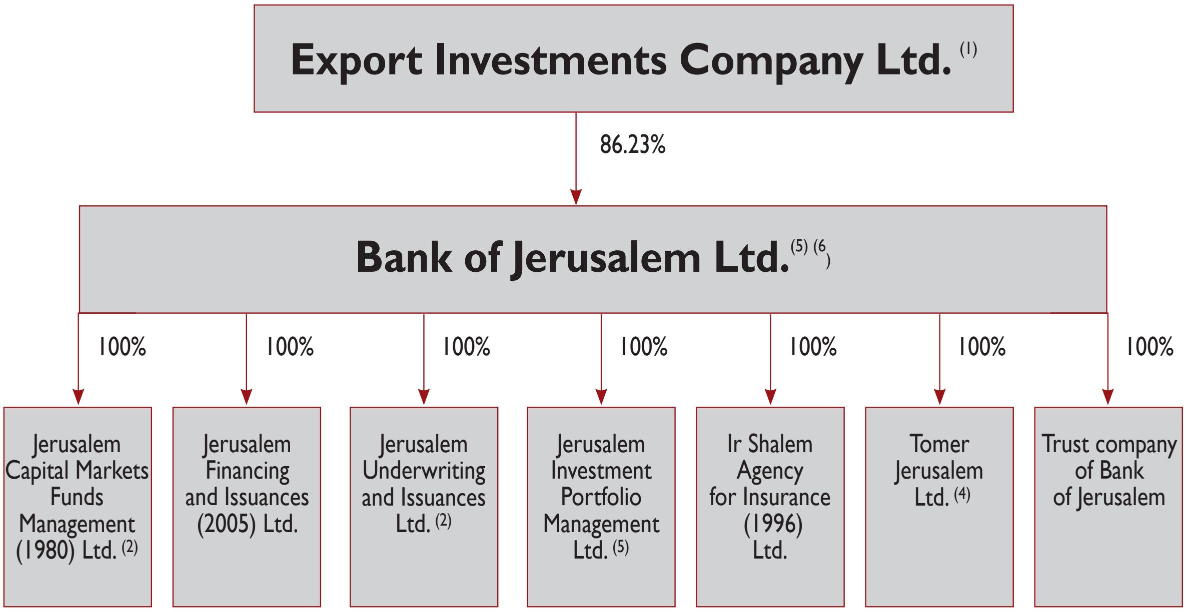
Principal data from the Financial Statements

Main data from the annual report of the Bank are attached in appendix A to the report of the Board of Directors.

Structural Diagram of the Bank's Holdings

Following is a structural diagram of the Bank's holdings in subsidiaries and in associates as at December 31, 2013.

For details of the sectors of activity of the subsidiaries and associates, see Note 7c to the Financial Statements.



(1) For details about the controlling shareholders in the Bank, see below.

(2) Not active.

(3) Mr. Zalman Shoval has negligible holdings in the company, as specified in Regulations 11-13 to the periodic report.

(4) The company's portfolio management activities were sold to a third party on January 7, 2013, and as at the Reporting Date, the company is inactive.

(5) The Bank or its subsidiaries, as the case may be, hold (100%) companies found in voluntary liquidation, as follows: Unitrust Future Financial Instruments Ltd.; Jerusalem Financial Operations (2005) Ltd.; Mabat Currency Trade 2007 Ltd.; Mabat Currencies Ltd; Ilanot Batucha Capital Ltd.; Magen TA 25 Trade Ltd.; Magen Financial Products Ltd.; Tsuot Mutual Funds Management (1993) Ltd.; Moment Investment Products Ltd.; Batucha Mutual Funds Management Ltd.; Ilanot – Batucha Capital Ltd.; Moment Investment and Trade Ltd.; Cleel Investment Products Ltd.; Magen Dollar Trade Ltd.

(6) The Bank holds shares of Stock Exchange Offices Ltd. (NIS 24,993 par value which comprises 5.21% of the issued and paid-up share capital of Stock Exchange Offices Ltd.)

Controlling shareholders in the Bank

Mrs. Kena Shoval is a controlling shareholder in the Bank, holding 74.30% of the issued and paid-up share capital of Export Investment Company Ltd., which is a public company whose shares are listed on the Tel-Aviv Stock Exchange (hereinafter: "Export"). Export holds 86.23% of the Bank's issued and paid-up share capital. In addition, Mrs. Shoval holds 0.33% of the Bank's issued and paid-up share capital through the companies: K. Shoval Holdings Ltd.; I.C.C. Israel Capital Corporation Ltd.; Financial Trust Corporation Ltd. and Foreign Trust Ltd.; which are privately owned companies controlled by Mrs. Kena Shoval.

According to the legal opinion presented to the Bank, Mr. Zalman Shoval (Mrs. Kena Shoval's spouse and a director in the Bank), Mr. Gideon Shoval (Mrs. Kena Shoval's son and a director in the Bank), are also considered controlling shareholders of the Bank, under the provisions of the Banking Licensing Law.

Mr. Zalman Shoval is considered a controlling shareholder also according to the instructions of the Securities Law.

Forward-looking information

Part of the information included in the Board of Directors' Report, which does not refer to known information, constitutes forward-looking information, as defined by the Securities Law, 5728 – 1968.

The bank's actual results may differ matterialy from those included, if included, in the framework of forward-looking information, as a result of numerous factors including, among others, as a result of special events, e.g. radical changes in interest rates, currency devaluation/revaluation and inflation, and unexpected political/security-related events that may alter the public's behavior, from the standpoint of taking out credit/loans, early payoff, refinancing or difficulties in current payoff in all sectors of activity in the Bank, and the ability to raise funding. Also, regulatory or legislative changes, instructions issued by supervisory authorities and behavior of competitors may affect the Bank's activity.

Forward-looking information is characterized by words or expressions including: "in the Bank's estimate", "the Bank intends …", "is expected to …", "may …", "might possibly …", "estimates that …", etc.

Such forward-looking expressions include risks and uncertainties since they are based on management's assessments regarding future events that include, among others:

- Mergers and acquisitions in the banking system and their influence on the competition structure in the sector.
- The effect of changes in regulatory instructions on customer preferences and/or on the banking system's scope of activity, the competitive structure therein, and/or the Bank's profitability.
- Ability to realize the Bank's programs according to the objectives determined in accordance with its strategies.
- Unexpected reactions of additional factors (customers, competitors, etc.) operating in the Bank's business environment.
- Future realization of sector estimates and macro-economic forecasts in accordance with preliminary estimates of the Bank.
- Possible results of legal procedures.
- Changes in consumer preferences and/or in consumer behavior.

The following information is based, among others, on professional evaluations of the Bank, on macro-economic forecasts of forecasters concerning the situation of the economy and the business environment, publications and assessments of entities active in the sector and statistical analysis prepared by the Bank concerning the behavior of its customers.

The aforementioned reflects the point of view of the Bank and its subsidiaries, as at the time of preparation of the Financial Statements, concerning future events, and it is based on uncertain assessments. The assessments of the Bank and its subsidiaries and their business plans are derived from these data and estimates. As mentioned above, the actual results may differ significantly and affect implementation of business plans or result in a change in those plans.

Summarized description of the activity sectors

The Bank operates through the Bank headquarters, its branches and subsidiaries. The activity sectors of the bank were classified according to the directives of the Supervisor of the Banks, according to the kind of customers included in each of the sectors, and do not necessarily correspond with the organizational structure of the Bank.

The Bank operates and provides various banking services in four main activity sectors. Below are details on the reported activity sectors:

- **The household sector** – Sector customers are households and small business with characteristics similar to those of households.

- **Private banking sector** – Sector customers are customers with a medium to high level of financial wealth, and services to them are provided through a branch specializing in private banking, mainly for foreign residents (mostly from North America, England and France).

- **Business sector** – Customers in this sector are construction companies, contractors and real estate companies, business customers, corporations, and associations.

- **Financial management sector** – This sector includes management of the Bank's available financial capital and positions, management of the Bank's nostro portfolio, activity with banks in Israel and abroad, as well as performance of transactions with derivative financial instruments.

The Bank's activity in raising funding from the public is concentrated in the Financial Division. Since this activity relates to all of the bank's operating sectors, and has unique and cross-sector characteristics, it is described in general in the chapter "Raising of funding sources", and not for each sector separately.

Attribution of income and expenses based on the activity sectors in the Bank was done as follows:

Interest income, net

Margin resulting from the difference between the interest on the credit provided to the sector's customers, and the price of money (economic transfer price that matches the linkage sector and the credit duration).

The profit includes cross-sector financing expenses – charging the sector providing the loan and crediting the sector that raises the deposit, at transfer prices (accordingly, income in the sector that raises the deposits is increased, while income in the sectors using the credit is reduced).

Expenses due to Credit Losses

The provision was attributed to the activity sector in which the customer's activity is classified for which the provision was implemented. In a similar way, collection from a provision that was made, or the reduction of it, is attibuted to the sector in which the customer's activity is classified.

Non-Interest Income

Income not from interest is directly charged to the sector in which the customers' activity is classified.

Operating and other expenses

Identifiable direct expenses were specifically attributed to the activity sectors. The balance of indirect expenses or direct expenses that were not accurately identifiable was attributed according to a model, by which these expenses are attributed according to the number of direct work positions in that sector relative to the Bank's total work positions, for each of the activity sectors.

Taxes on Income

Taxes were calculated according to the effective tax rate and attributed accordingly to each sector.

Yield on capital

The allocation of capital for purposes of calculating the capital yield in each of the activity sectors was based on the average risk assets in each sector. The yield for each sector was calculated according to the equity that, as aforementioned, was attributed to the sector.

Investments in the capital of the banking corporation and transactions with its shares

Equity

As at December 31, 2013, the Bank's equity amounted to NIS 697 million, compared to NIS 694 million at the end of 2012.

Most of the increase is attributed to the net profit in the amount of NIS 17.2 million, against a reduction in equity due to dividend distribution in the amount of NIS 13.7 million.

As at December 31, 2013, the balance of deferred liability notes issued to the public and of deferred deposits raised from households and institutional customers, which is included in equity for the purpose of calculating the ratio of equity to risk components, totaled NIS 342 million, compared to NIS 337 million at the end of 2012.

For details concerning recognition of Tier 2 capital under the Basel III regime, see below the chapter on Capital Adequacy in the Risk Management chapter and in Note 16 to the Financial Statements.

For information on the impairment of available-for-sale debentures (government and corporate) that was recorded to a capital reserve, distributed by periods of time and rate of impairment, see data in the Financial Management sector.

For details concerning changes in equity, see the Statement of Changes in Shareholders' Equity in the Financial Statements.

Concerning the capital objectives under the Basel II instructions, see below in the chapter on Capital Adequacy in the Risks and Risk Management Methods chapter.

The Bank examines its capital needs in the framework of the Bank's annual work plan, and in accordance with the directives of the Bank of Israel regarding the implementation of the Basel III instructions, and according to current business developments. The Bank cannot assess the types of capital instruments that will develop in accordance with the Bank of Israel directives. On December 24, 2013, the Bank issued deferred liability notes totaling NIS 58,790 thousand par value through a subsidiary, for a consideration of NIS 60,612 thousand.

Dividends distribution

On August 29, 2013, the Bank's Board of Directors decided to adopt a dividend distribution policy of up to 30% of the Bank's net income every year, as specified in the Immediate Report published by the Bank on August 29, 2013 (Reference: 2013-01-132396), the information in which is introduced by way of reference.

Nevertheless, the considerations for dividend distribution and its actual distribution, if there will be one, will be affected by the requirement to comply with the updated capital targets as determined by the Board of Directors (see below in the chapter "Capital Adequacy" within the "Risks and Risk Management Methods" chapter), and subject to the directives of the Supervisor of Banks, as are determined from time to time, and to the provisions of the law.

The dividend distribution is implemented subject to the provisions of the Companies Law, 5759 – 1999 and instructions of Proper Banking Management Number 331, which discusses dividend distribution by banking corporations. On June 30, 2010, the Supervisor of Banks notified banks that in addition to Proper Banking Management instruction № 331, a bank that fails to comply with the capital target of 7.5% or whose dividend distribution will not cause it to meet the target, is not allowed to distribute dividends, except after obtaining the Supervisor of Banks' approval.

Nothing stated above concerning the distribution of dividend creates any undertaking towards any third party (including on the issue of dividend payment dates and/or rates).

The aforementioned information regarding the dividend distribution constitutes forward-looking information, some or all of which might not occur or might occur differently than expected. This information is based on various assessments and forecasts that were available to the Bank's Board of Directors. This information might not occur due to changes that might take place in various factors that are not under the Bank's control. The affecting factors include forecasts and assessments regarding the changes in the state of the economy, legislation, directives from regulatory and other entities and changes in the Bank's profitability in the strategic plan, and in the work plan.

On August 29, 2013, the Bank's Board of Directors decided to pay an interim dividend in the total amount of NIS 11.0 million to the Bank's shareholders who held Bank shares on September 10, 2013, as specified in the Immediate Report published by the Bank on August 29, 2013 (Reference: 2013-01-132441), the information in which is introduced by way of reference.

On November 28, 2013, the Bank's Board of Directors decided to pay an interim dividend in the total amount of NIS 2.7 million, to the Bank's shareholders who held Bank shares on December 5, 2013, as specified in the Immediate Report published by the Bank on November 28, 2013 (Reference: 2013-01-207750), the information in which is introduced by way of reference.

Part Two – Other Information

Financial information concerning the activity sectors of the banking corporation

Details of the Bank's activity according to sectors are presented in Note 30 to the Financial Statements. Developments that took place in activity sectors are presented below in the section "Description of the corporation's business by activity sectors". In the activity sectors of the Bank, operating and other expenses attributed to the activity sector resulting from transactions between sectors, were not recorded.

Material developments in the business environment

General

In 2013, the Israeli economy grew by approx. 3.3% (according to preliminary estimates of the Central Bureau of Statistics), compared to approx. 3.4% in 2012 and approx. 4.6% in 2011. In the past year, growth significantly slowed due to a global recession, and particularly in Europe. In the last quarter of the year, export of goods (with the exception of diamonds, ships and planes) dropped by approx. 1.6%. The export of business services, which comprises about two-thirds of all service exports, dropped by approx. 2.5%. In contrast, the fourth quarter saw a sharp rise in credit card purchases, in the industrial manufacturing index and in the revenue index for all economy sectors (with the exception of the diamond sector).

The economy growth forecasts stood at approx. 3.3% and 3.2% for 2014 and 2015, respectively. With growth in 2014, less the contribution from the Tamar Reservoir, estimated to be 2.9%.

The unemployment rate in Israel for 2013 was 6.2%, compared to 6.9% in 2012. The number of people employed in 2013 increased by 2.7%.

The global economy recorded a 3.2% growth in 2013, compared to 3.3% in 2012. The World Trade Organization expects a slowdown in 2014 to 2.9%.

The real growth rate of the US economy stood at 1.9% in 2013, as compared to 2.8% in 2012. The slowdown in growth was recorded due to a decline in government expenses and an increase in taxes. In December 2013, the US Federal Reserve decided on a curtailment of quantitative easing. Nevertheless, it stated that in contrast with previous announcements, the negligible interest rates will remain in place even if unemployment drops below 6.5% and inflation remains below the target.

The European debt crisis continued to cast a shadow on European growth rate, but a moderation in the declining growth rate to -0.4% in 2013 was discernible, as compared to the -0.6% rate in 2012.

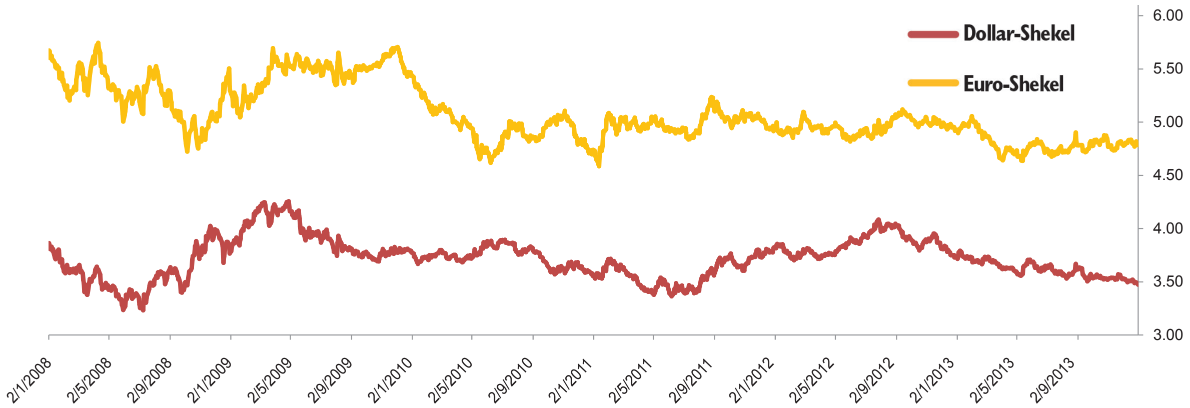
In Japan, the Central Bank began acquiring government debentures in an attempt to increase the inflation rate to the 2% target.

Inflation and Exchange Rates

In 2013, the Consumer Price Index rose by 1.8%, as compared to the 1.4% increase in 2012. The index without housing rose by 1.5%, the index without fruits and vegetables rose by 1.6%, the index without energy rose by 1.9%. The inflation rate was directly proportional to the forecasts at the beginning of the year and at a relatively low level, due to the strengthening of the shekel during the year and the low level of inflation around the world.

The inflation forecast for 2014, according to the Bank of Israel, is 1.8%, where the capital market forecasts are projected at 1.7%-1.8%.

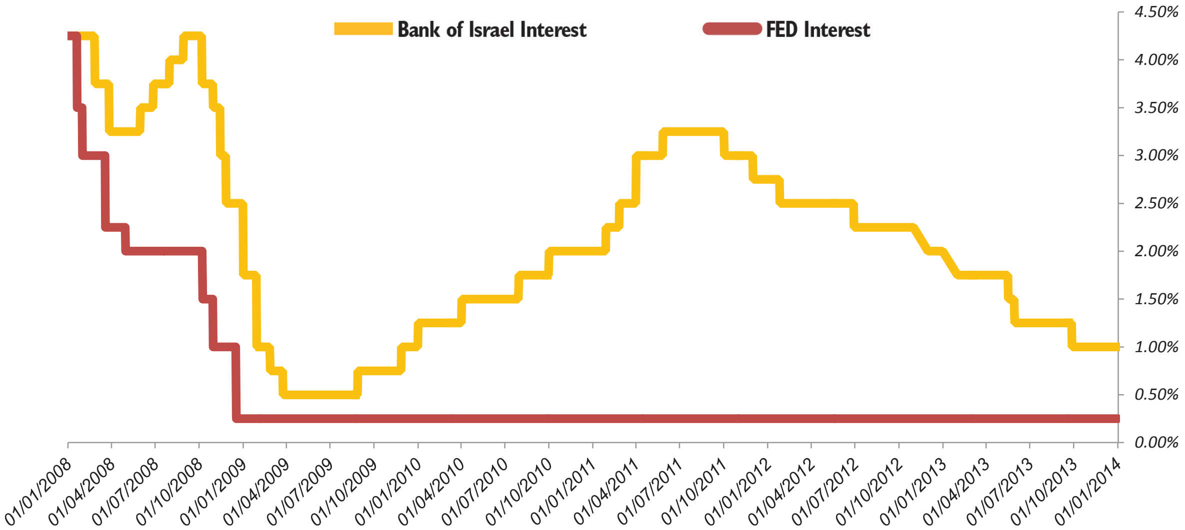
In 2013, the Shekel-Dollar exchange rate increased by approx. 7%, with the Shekel-Euro exchange rate increasing by approx. 3%. The exchange rate against Israel's main trading partners increased by approx. 7.6%, in light of the increase in the balance of payments due to the start of production of natural gas in the Mediterranean, and an alleviation of fears of an Israeli attack on Iran. Due to concerns of a sharp rise in the shekel, the Bank of Israel acquired foreign currency to moderate the effects of natural gas on the exchange rate, thereby moderating the revaluation of the shekel.



The Fiscal and Monetary Policy

In 2013, the Bank of Israel interest rate gradually declined from 1.75% in January 2013 to 1% at the end of the year. The Bank of Israel decision to continue lowering interest rates is attributed to a desire to encourage economic activity in the market, where concerns from an increase in inflation have alleviated and allowed for a continuation in the lowering of interest rates. In February 2014, the Bank of Israel's monetary committee decided to reduce the interest rate to 0.75%.

The total government deficit for 2013 amounted to NIS 33.2 billion, approx. 3.15% of the GNP, as compared to the original government target of approx. 4.3% of the GNP. The low deficit is attributed to the higher than expected income from taxes, in addition to an increase in corporate taxes and collection of trapped profits taxes.

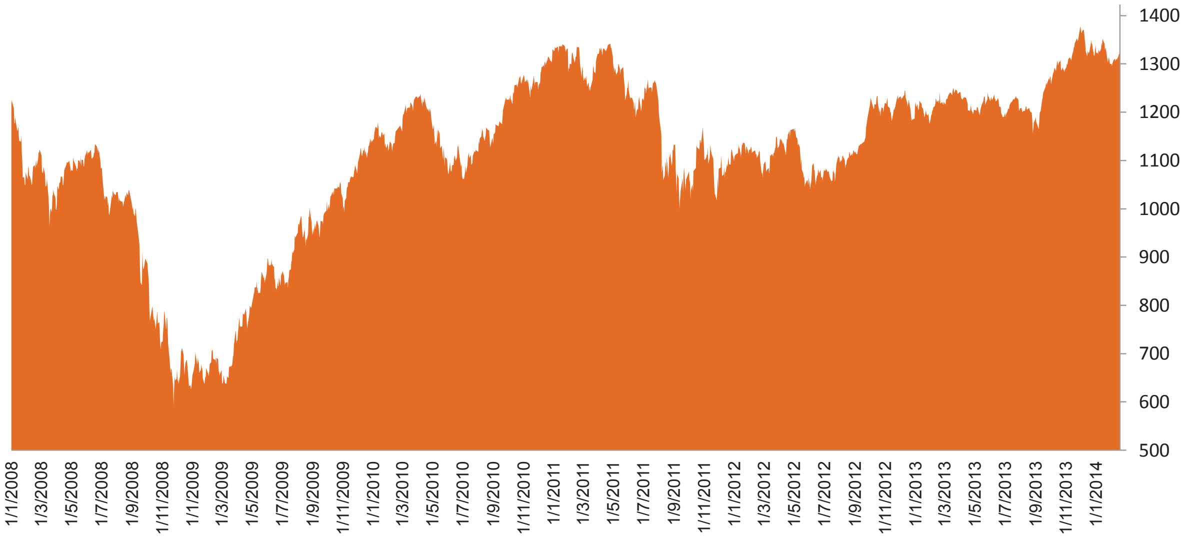


Capital and Monetary Markets

The stock market in Israel was characterized by high volatility in 2013, with September recording increases in the main share indexes. Daily trading volume on the stock exchange totaled NIS 1.2 billion, a 10% increase over 2012. The increase in trading volume was affected by a lowering of the Bank of Israel interest rates, a drop in the unemployment rate and a decrease in the government deficit.

The debentures market in Israel was characterized by increased rates in all debenture indexes, due to a drop in interest rate expectations during the year.

In 2013, the TA 25 Index and the TA 100 Index rose by 12% and by 15%, respectively. The government debentures index rose by approx. 4%.



The Construction Sector

In 2013, 24,450 new apartments were sold, a 9.7% increase over 2012.

A district-based breakdown shows an increase, compared to 2012: approx. 10% in the Haifa district and approx. 8% in the Jerusalem district. In contrast, decreases were recorded: approx. 11% in the Tel-Aviv district, approx. 5% in the northern district and approx. 2% in the southern district. In the central district, no change was recorded in comparison with 2012.

The number of new apartments remaining for sale at the end of December 2013 is estimated at 22,250 apartments – a 2.6% increase, in comparison with the end of December 2012.

The Automotive Sector

In 2013, 212 thousand new vehicles were delivered, a 3.7% increase, in contrast with 2012.

Accounting Policies on Critical Issues

The Bank's Financial Statements are prepared in accordance with generally accepted accounting principles in Israel (Israeli GAAP), and according to the directives and guidelines of the Supervisor of Banks concerning the preparation of a bank's Financial Statements. The principle accounting policies are specified in Note 2 to the Financial Statements. Implementation of the accounting policies by the Bank's management during the preparation of the Financial Statements involves various assumptions, estimates and forecasts that affect the Bank's reported amounts of assets and liabilities (including contingent liabilities) and its reported business results. Utilization of estimates involves extensive uncertainties and changes in such estimates might significantly affect the financial results presented in the Financial Statements. Part of the assessments and estimates are critical for the financial position and the activity results that are reflected in the Financial Statements, because of the subject's essence, complex calculations, or the degree of feasibility of the occurrence of events for which an uncertainty exists. These estimates are considered and called "critical issues". A possibility exists that future realization of assessments and estimates will differ from their presentation in the Financial Statements.

Listed below are the accounting policies on critical issues:

Provision for Credit Losses

The bank determines the provisions for credit losses on loans against mortgage of a residential housing according to the depth of arrears formula determined in the Proper Banking Management Instructions № 314 of the Supervisor of Banks. In addition, in compliance with the Supervisor of Banks' directive, the group provision for credit losses for the balance of housing loans was calculated to not less than 0.35% of the balance of the housing loans for which no provision is held based on the depth of the arrears or the individual provision.

With the remaining retail credit, as well as with business credit, the Bank determines its provisions in compliance with the Supervisor of Banks' circular: "Measurement and Disclosure of Defective Debts, Credit Risks, and Provision for Credit Losses", as published on December 31, 2007. The circular is based, inter alia, on the American Accounting Standards, and on regulatory instructions of the authorities supervising banks and the SEC (Securities and Exchange Commission) in the United States. This instruction is implemented in the Financial Statements of banking corporations and credit card companies as of January 1, 2011 (in the original instruction – in January 2010). The instruction is not implemented retrospectively in the Financial Statements for previous periods. The effect of this circular on the Bank is reflected in the following areas:

Individual review– The Bank recognizes the necessity of an individual review of each borrower (except for housing loans) whose contractual balance is NIS 1 million or more, as well as other debts identified by the Bank (such as fraud and bankruptcy). For every borrower who has been individually reviewed, and for whom there are indications of potential problems in the ability to repay the credit provided, the Bank will assess the collectible amount from said borrower according to the expected cash flow from his business activity, realization value of his assets, third-party guarantees, and realization date. Since this information is based on estimates and forecasts, there is no certainty that the actual amounts received will be identical to the estimates. Concerning fraud and bankruptcies – these debts are immediately and completely written off. Concerning the other debts that are individually examined – impairments are written off no later than two years from the date of the individual provision.

Debt classification – five main classifications were defined, that create a ranking of the problematic severity of the debt, and in determining provisions for it: proper debt, debt under special supervision, inferior debt, defective debt that accrues interest and defective debt that does not accrue interest.

Provision for credit losses – a distinction was made between provision on an individual basis for debts that were individually reviewed and identified as defective, and a group provision for all debts that are not classified as defective. The group provision rates for balance sheet and off-balance sheet credit losses are based on historical loss rates in the various market branches (some of the retail credit is based on historical loss rates in various activity sectors), broken down between non-problematic credit and problematic credit over the past 5 years, as well as on actual recorded net write-offs rates. In compliance with the Supervisor of Banks' transitional orders, the validation and update of these provision rates is implemented quarterly.

Write-off – for debts that were individually reviewed and identified as non-collectible debts. The Bank's policy is to write off all specific provisions whose duration exceeds two years. Furthermore, write-offs are implemented on debts for which group provisions have been made and are in arrears for more than 150 days. Additionally, the Bank's policy is to write off housing loan debts for which a provision was made, but as a result of collection proceedings, there is no collateral balance to realize the debt.

The group provision for credit losses for non-defective credit risks, cancels the additional and general provision for problematic debts and for risk characteristics that were defined in the Supervisor of Banks' directives. Among the included risk characteristics: debt classification, credit to individuals related to the Bank, lack of borrower financial data, credit to a borrower or to a group of borrowers who exceed the liability limitations of an "individual borrower". In compliance with the Supervisor of Banks' directives, the Bank continued to calculate the additional pre-tax provision for the purpose of comparing it to the group provision for credit losses, with the higher of the two provisions being recorded in the balance sheet.

The instruction on "Measurement of Defective Debts – Provision for Credit Losses", that has been implemented as of January 1, 2011, has caused a significant change in the review and classification method for debts, as well as in the way in which the provisions for credit losses are calculated and accounting write-offs performed.

In 2013, expenses for credit losses totaled approx. NIS 54.7 million, in contrast with NIS 36.0 million in 2012 – an increase of NIS 18.7 million. Most of the increase in the expense, approx. NIS 19.2 million, is attributed to the implementation of the Bank of Israel directive according to which the group provision for credit losses in respect of the balance of housing loans shall be not less than 0.35%.

For more details about the quantitative effect, see Note 5 to the Financial Statements and Appendix E to the Management Review.

Deferred Taxes

Deferred taxes are calculated for temporary differences between the value of assets and liabilities in the financial statements, and the amounts taken into consideration for tax purposes. Deferred taxes are calculated according to tax rates expected to be applicable when such taxes are imputed to profit and loss, as such rates are known near the approval date of the financial statements. Deferred taxes receivable are calculated for temporary differences for which a tax saving is expected to be created at the reversal date.

At the time the deferred taxes are accounted for, the Bank utilizes assessments and estimates concerning the possibility of future realization.

For information on the quantitative effect – see Note 29 to the Financial Statements.

Derivative Instruments

In accordance with the Supervisor of Banks' directives, the derivative instruments at the Bank are presented in the balance sheet at fair value. The fair value of the derivatives is determined according to quoted market prices in active markets or by the estimated fair value that is determined according to prices of similar assets or similar liabilities (Mark to model). The assessment methods include various parameters, such as interest curves, currency exchange rates and standard deviations. The assessment includes consideration of assumptions concerning various factors, such as the credit risks and liquidity of the other party to the transaction. There are no instances in which the revaluation of the derivatives and the fair value were not established based on the model, but on price quotes received from third parties.

For additional information and details on the quantitative effect – see Note 20 to the Financial Statements.

Measurement of Fair Value of Financial Instruments

On December 31, 2009, the Supervisor of Banks published a circular applying Standard ASC 820-10 (FAS 157), concerning fair value measurement on the banking system. While implementing this standard, the Bank uses valuation techniques that maximize the use of relevant observable inputs, and minimize the use of unobservable inputs. Observable inputs are data that reflect the assumptions that market participants would use for pricing the asset or liability, whose development was based on market data obtained from sources that are independent of the Bank. Unobservable inputs are data that reflect the assumptions of the Bank itself concerning assumptions that market participants would use for pricing the asset or liability, whose development was based on the best data available under same circumstances.

Fair value measurement is based on the assumption that the transaction will take place in the principal market for that asset or liability, or in the lack of principal market, at the most useful one.

The Bank classifies fair value measurements while using a fair value hierarchy that reflects the significance of the data used for implementing the measurements. Hierarchy of fair value consists of the following levels:

Level 1 – Measurement based on quoted prices (unadjusted) in active markets for identical assets or liabilities. Quoted prices in active markets are the most reliable evidence for fair value, and are used for fair value measurement so long as they are available.

Level 2 – Measurement based on observable inputs for the asset or liability, directly or indirectly, that are not quoted prices, including: quoted prices for similar assets and liabilities in active markets, quoted prices for similar or identical assets or liabilities in non-active markets, data derived mainly from observable market inputs, or that are supported by observable inputs by way of correlation or other means.

Level 3 – Measurement based on data concerning assets or liabilities that are not based on observable market data and are significant for the overall measuring of fair value.

This hierarchy requires that the Bank use observable market inputs, when such information exists. Whenever possible, the Bank considers observable and relevant market inputs in the framework of its assessment. The volume and frequency of transactions, the margin and the adjustment required when comparing similar transactions are factors that are taken into account when determining the relevance of prices observed in those markets.

Establishment of the fair value of financial instruments that belong to Level 2 and Level 3 is based on assessments and assumptions that rely, inter alia, on subjective discretion.

In general, the Bank has negligible balances that rely on inactive market data, and in all cases the measurement is reasonably and adequately reviewed by external experts and estimates.

The Bank acted to implement Standard ASC 820-10 in 2011, according the Bank of Israel's directives. However, there was no material change in the method for measuring fair value and in the estimates on which they were based prior to the implementation of this standard.

For additional details concerning the quantitative effect of implementing the measurement at fair value – see Note 21 to the Financial Statements and Appendix D to the Management Review.

Impairment of Securities that is not of Temporary Nature

Changes in the fair value of securities available-for-sale are imputed to equity after deducting the tax effect, unless a non-temporary impairment is evident. In such circumstances, the impairment is included in the profit and loss statement.

Periodically, the Bank examines the need to record a provision for an impairment that is not of a temporary nature. The Bank has defined criteria for tracking securities and the mentioned examination. These criteria are based, among others, on the following factors:

- Change in classification of securities by rating agencies.

- The length of time during which the security is traded at high yield.

- Exceptional cases such as irregular impairment.

In addition, criteria were set for implementation of the provision for impairment in respect of impairment that is not of a temporary nature, when two accrued conditions are met:

1. A 40% decline in the value of the security, as compared to the amortized cost.

2. A decrease for nine consecutive months.

These criteria were discussed by the Credit Committee of the Board of Directors and approved by it, and were reported to the Supervisor of Banks at the Bank of Israel.

In 2013, the Bank performed a provision for impairment that is not temporary in the amount of NIS 0.3 million (in 2012 – NIS 1.5 million).

Contingent Liabilities

The Bank is a party in legal processes filed against the Bank by its customers, former customers, and other third parties that considered themselves injured or harmed by the Bank's activity. To assess the risks in legal proceedings, the Bank’s management relies on the opinion of the Bank’s internal lawyers, or on opinions of external legal advisers which are reviewed by the Bank’s internal lawyers. These assessments are based on the best judgment of the legal advisers, taking into consideration the stage of the legal proceedings, as well as accumulated legal experience in various issues in Israel.

Assessment of the chances of class action suits involves greater difficulty due to the limited accumulated legal experience concerning the occurrence of such claims in Israel. Moreover, the chances of certain class action suits cannot be assessed due to the stage of the proceedings they are at.

It should be taken into consideration that results of legal proceedings might differ from the determined assessment, because in the legal area it is not possible to give definitive assessments.

For additional information on contingent liabilities – see Note 19 to the Financial Statements.

Business Combinations

A business combination occurs when a banking corporation acquires for the first time control over a subsidiary or separate operation. The Bank accounts for business combinations by the acquisition method. According to this method, the Bank identifies the acquirer, sets the acquisition date and recognizes the identifiable assets that were acquired and the liabilities that were assumed based on their fair value, apart from certain exceptions. All components of rights that do not grant control of the acquired entity are measured on the date of acquisition at fair value as at the date of acquisition, unless another measurement basis is required according to International Financial Reporting Standards.

The Bank recognizes goodwill on the date of acquisition as the excess of the total consideration that was transferred and the amount of rights that do not grant control, over the net amount as at the acquisition date of identifiable assets that were acquired and of liabilities assumed. In consecutive periods, goodwill is measured at cost less accumulated losses from impairment. If a gain must be recognized from an acquisition at opportunity cost, based on the gap between the net amount on the acquisition date of the identifiable assets that were acquired and of liabilities assumed (apart from certain exceptions), and the total consideration that was transferred and the amount of rights that do not grant control, the Bank must contact the Supervisor of Banks to obtain preliminary instructions.

The Bank measures the consideration that was transferred based on the fair values of assets that were delivered, liabilities that were assumed (apart from certain exceptions) and capital instruments that were issued. Any costs that can be attributed to the business combination are recognized as an expense during the period in which they were incurred, with the exception of costs for issuing capital or debt instruments of the Bank.

The Bank recognized the fair value of the assets that were acquired and the liabilities that were assumed as part of the business combination based on a provisional measurement. As of the date of approval of the Financial Statements, a final appraisal had not been received from the external value appraiser with regards to the fair value of the identified assets that were acquired and the liabilities that were assumed. The fair value of the assets and liabilities that were acquired are subject to final adjustment up to 12 months from the date of acquisition. According to International Reporting Standard Number 3 regarding Business Combinations, on the date of the final measurement, the adjustments are made by way of restatement of the comparative data that were reported in the past based on the provisional measurement.

For more information about business combinations – see Note 7 to the Financial Statements.

Third Part – Description of the banking corporation by activity sectors

In 2013, the net profit in sectors, with the exception of the business sector, declined. For details, see profitability data for each sector.

	Assets			Liabilities		
	2013	2012	Change	2013	2012	Change
Sectors	Millions of NIS		%	Millions of NIS		%
Households	7,273.2	7,028.7	3.5	7,269.8	6,292.4	15.5
Private banking	1,160.3	1,192.6	(2.7)	1,016.6	1,119.7	(9.2)
Business	1,397.2	1,311.9	6.5	3,485.9	3,405.1	2.4
Financial management	2,745.8	2,132.6	28.7	109.5	176.5	(37.9)
Total	12,576.5	11,665.8	7.8	11,881.8	10,993.7	8.1

Below are detailed the profits from regular activities, and the profit yield from regular activities on capital, by activity sectors:

	Net profit (loss)		Yield on capital	
	2013	2012	2013	2012
Sectors	Millions of NIS		%	
Households	(14.0)	3.5	(3.1)	0.7
Private banking	(0.8)	2.6	(1.4)	4.1
Business	21.7	15.0	15.6	9.9
Financial management	10.3	15.0	25.2	31.8
Total (excluding non-allocated amounts)	17.2	36.1	2.5	5.4

Household sector

General

The Bank provides a range of financial services and products to the household sector. The main products available to Bank's customers in this activity sector include: current accounts, deposits and savings, current account credit lines, consumer loans and credit cards, loans for purchasing residential housing and vehicles, loans for any purpose, activities in the capital market in securities, and investment consultation.

Most of the Bank's customers belonging to this activity sector, receive banking services from the Bank through its branches.

Objectives and business strategy

One of the main objectives placed at the basis of the strategic plans of the Bank (as described above), is development and expansion of the household sector, while significantly increasing the customer volume of this sector, and simultaneously expanding the range of services and products that are offered to this sector's customers, and increasing embedded profitability. The Bank intends to offer products in this activity area that include unique characteristics which provide added value, as compared to products currently existing in the Israeli banking system.

Below are the Bank's principles for the Strategic Plan in this activity sector:

Significant increase in existing customer base through:

- Expanding branch activity.
- Increasing the number of customers who manage their current account in the Bank (activity that began in October 2012).
- Increasing recruitment of deposits from households, through the Bank's branches and/or through the Internet.
- Providing consumer credit to existing and new customers.
- Providing mortgages that are tailored to the personal needs and preferences of the customer, while focusing on channels with high profitability.

Increasing marketing and sales efforts, including by means of continuous improvement of customer service level, inter alia, by:

- Continued expansion of the telephone call center that was established at the end of 2011 and expanded over the past two years, and is designed to provide a solution for most banking services.

- Assimilation of a CRM system and upgrading the Internet website, while turning it into a site that allows for transactions to be performed online.

- Deployment of advanced ATM machines that allow for other transactions to be carried out.

Continued operation and improvement of an advanced credit underwriting system as a decision-supporting tool that facilitates quick and proper customer service.

The Bank's plans and assessments, as specified above, are forward-looking information, and are based on assumptions and on various forecasts presented to the Bank. This information may not be realized due to changes that may occur due to various factors that are not controlled solely by the Bank. Influencing factors include forecasts and assessments concerning economic developments in Israel and globally, especially concerning the economic situation, including the influence of macroeconomic and geopolitical conditions, changes in capital markets, as well as other additional factors influencing risk exposure: public preferences, instructions by supervisory entities and others, aspects related to the Bank's image, technological developments and personnel issues.

Structure of the Activity Sector

Below is a description of the products and main services offered under this activity sector:

Mortgages:

- Provision of loans for housing and for any purpose against a lien on the residential housing for individual Israeli residents and for buyers groups for long periods, based on different linkages and according to a variety of interest tracks determined by the type of loan, customer preferences, and borrower's repayment capability.

- The activity in the mortgages sector also includes providing services related to life insurance and property insurance through the mortgage, that are issued in compliance with the directives of the Commissioner of Insurance and the Supervisor of Banks by means of: Ir Shalem Insurance Agency (1996) Ltd., the Bank's wholly owned and controlled subsidiary (hereinafter: "Ir Shalem").

Banking and Finance:

- Full current account management.

- Providing fixed-time credit for single-name consumers for households.

- Mobilization of deposits and savings from households.

- Issuing credit cards to Bank customers.

- Credit frames and current account activities determined by the customer's requirements and income level.

- Financing assistance in vehicle purchase.

- Providing fixed-term credit against securities.

The capital market:

- In August 2013, an agreement was signed in which the Bank acquired from Clal Finance Ltd. all of the shares of Clal Finance Batucha Investment Management Ltd. as specified in the chapter on Events in the Report Year. Clal Batucha was listed on the TASE and in the TASE Clearing House up to the date of completion of the acquisition transaction, on December 15, 2013, and engaged in the provision of trading services on the Stock Exchange and in foreign markets.

  This move is expected to increase the volume of Bank activity in the capital market sector while entering additional areas of activity in which the Bank had not been previously operating.

- Providing services for securities – execution of purchase, sales and operation as well as transactions with securities and derivatives in the Bank's branches in Israel and abroad.

- Investment consultancy – provision of securities consultancy to customers at all bank's branches through authorized consultants.

Legislative restrictions, standardization, directives and circulars from the Supervisor of Banks, and special constraints

The Bank in general, and the household sector in particular, operates within the framework of laws, standards, regulatory directives and instructions imposed on the banks by legislative and supervising entities, including the Supervisor of Banks, the Securities Authority, and the Commissioner for the Capital Market, Insurance and Savings in the Ministry of Finance.

Below are details concerning legislative updates and regulatory directives on matters concerning provision of banking services to households:

1. On March 21, 2013, the Supervisor of Banks published a directive regarding the allocation of capital and provision for doubtful debts for housing loans and change in the risk weight of guarantees in accordance with the Sales Law and its effect on the Bank. For details, see the chapter on Events in the Report Year.

2. On August 29, 2013, the Supervisor of Banks published directives on limitations, with reference to housing loans, rate of return from income, the part of the loan assigned variable interest and the final period for repayment of the loan.

For additional details about the directive, see the chapter Events in the Report Year above.

Joint Investments in Trust (Distribution Fees) Regulations (Amendment) 5773-2013

On May 1, 2013, the Amendment to the Joint Investments in Trust Regulations went into effect that lowers the distribution fees paid by investment houses to banks in consideration for distributing their trust funds. Within the confines of the amendment, fees were lowered on monetary funds from 0.125% to 0.1%, on debenture funds to 0.35% instead of 0.4%, in share funds to 0.35% instead of 0.8%, and in shekel funds to 0.2% instead of 0.25% today.

The adoption of this instruction is not expected to materially affect the Bank's financial statements.

The Team to Examine How to Increase Competitiveness in the Banking System

On March 19, 2013, a report was published summarizing the work of The Team to Examine How to Increase Competitiveness in the Banking System appointed by the Bank of Israel governor and Finance Minister following the recommendations of the committee for social and economic changes – The Trajtenberg Committee that details its conclusions and final recommendations.

From the date of the publication of the Committee's Interim Report (July 16, 2012), implementation of the Team's recommendations in banks began being regulated. In order to fully implement the recommendations, the Bank of Israel and the relevant government ministries are continuing to work on relevant legislative amendments that will anchor the Team's recommendations.

Below are specific legislative provisions that were amended to date as a result of the Team's work:

a. Banking Rules (Service to Customers)(Amendment) 5773-2012

On January 1, 2013, the amendment to said rules went into effect that will involve cancellation of securities management fees for short-term lender and for money funds, the imposition of bank fees for securities transactions and the cancellation of additional fees for households and small businesses.

Implementation of the amendment and the update of the fees rates in accordance with the new legislation is expected to lower the volume of fees collected from households and small businesses. Implementation of the amendment will not materially affect the Bank's revenue from fees, in light of the Bank's policy of granting sweeping exemption for current fees for individuals.

b. Re-pricing of fees for securities activity

On November 28, 2012, the Supervisor of Banks published a circular on re-pricing of fees collected for securities activity. Pursuant to the findings and recommendations of the Team's interim report regarding bonus fees for securities activity, and pursuant to the amendment to the first appendix of the Banking Rules (Service to Customers)(Fees) 5768-2008, as specified above, the Bank is required to establish the new rate of fees collected for the purchase, sale and redemption of securities while taking into account the changes that have taken place in the fee structure in the said amendment and on the need to adapt them, to the extent possible, to the actual price collected.

The Supervisor of Banks must also be informed of the new fee rates, as specified above, by March 1, 2013. Simultaneous with publication of notice to the public of the change, as is required by the Banking Rules (Service to Customers (Due Disclosure and Delivery of Documents) 5752-1992.

Furthermore, the Bank is required to change the way it engages with customers with regards to the provision of discounts in fees for securities activity so that they will be based on a percentage or sum of the fee, and not on the basis of the discount from the rate or sum of the rates fee, for new agreements or renewal of agreements from March 1, 2013. The update of the fees rates in accordance is expected to lower the volume of fees collected from households and small businesses. Implementation of the circular has no material effect on the Bank's revenues from fees. At the end of October 2013, the Supervisor of Banks distributed a draft of the new PBM "Annual Report for Banking Corporation Customers". The purpose of the directive is to arrange the reporting requirement of banking corporations to customers of all of the customer's assets and liabilities in banking corporation, including total income and expenses throughout the year, for assets, liabilities and current activity in the account, as well as to improve the customer's ability to monitor its activity in the account and to increase the ability to compare various banking products and services. The annual report will also note the credit rating of the customer in the banking corporation, as set forth in the banking corporation's rating model, so that potential lenders can assess the customer's financial position.

c. On April 1, 2014, the amendment to the Banking Rules (Service to Customer)(Fees)(Amendment) 5774-2013 (Hereinafter: The Amendment) will go into effect that requires banks to offer its customers fees plans in the current account.

Since in the Bank of Jerusalem, the customer population that is addressed by this amendment is exempt from payment of the fees that are the subject of the Amendment, in accordance with the Bank's fee policy, the amendment has no implication for the Bank.

Changes in Markets of the Activity Sector and in the Characteristics of its Customers

The Supervisor of Banks directives on limiting the financing percentage in housing loans as of March 21, 2013 and August 29, 2013 did not materially affect the volume of activity in the mortgage area, while apartment demand in the sector did not significantly decline. It should be noted that since publication of said directive, only several months passed that were needed to continue monitoring the impact of the directive, if any, on the mortgage industry.

In 2013, there were no changes in the characteristics of the Bank's customers in this activity sector.

Critical Success Factors in the Activity Sector and Their Applied Changes

- Building a variety of products adjusted to the needs of the existing and potential costumers that will have innovative and unique characteristics and proposing quality value offers to the customer.

- The Bank uses its knowledge and extensive experience accumulated in the mortgage sector to help it understand the various relevant variables that affect real estate values used as collateral against loans provided to customers; high capability of credit underwriting, and high profitability channels.

- Exposure and availability of the distribution array (branches) across the country.

- Provision of professional and reliable service to Bank customers, providing a solution to their needs and personal preferences.

- Expansion of the Bank's existing customer base in this activity area, as well as expanding the variety of products and services offered to this sector's customers.

- Flexibility and sensitivity to changes taking place in the market, including high response capability and access to new activity areas.

- Development of computer systems and infrastructures that will facilitate the provision of various and advanced products to Bank customers while maintaining low-risk levels.

- Development and monitoring of credit rating models.

The main entry and exit barriers of the activity sector

The sector's entry barriers include human capital in service that is professional and experienced, customer habits, advanced computer systems and their maintenance, and minimum capital requirements. Entry barriers for the area of credit provision for second-hand cars are credit price, the ability to quickly close a credit transaction resulting from a mature competition-saturated market to quickly provide finance services by non-bank companies, and subsidized finance transactions with the large banks.

Moreover, the exit from mortgages area will take years due to the long life of the loans, granted for a period of up to 30 years. Or, alternatively, sales of a mortgage portfolio to another financial institution.

Alternatives to Products and Services of the Activity Sector and Occurring Changes

Alternative to products and services offered by the Bank to the sector's customers are the same services and products offered by the non-banking system, including provision of loans for vehicle purchases that are also offered by various leasing companies and capital market services, which are also provided by investment houses with an internet trading platform. As for consumer credit, more financial non-banking entities and institutional entities (credit card and insurance companies) can be seen turning to relevant population sectors with credit provision offers. In addition, the food retail chains, in conjunction with credit card companies, issue credit cards to customers not by means of the banking system.

Competition in the Activity Sector

- In current accounts, competition is increasing. After years in which only medium-sized banks competed with the large banks, the past several years have seen increasing competition by small banks as well. The small banks offer household current accounts that are attractive in terms of fees and financial margin and therefore try to compensate for their shortages in retail coverage.

- Competition between the banks over the mortgage market is aggressive. According to the Financial Statements by the banks in recent years – the four largest banks have a market share of over 85% of the industry's total mortgage implementation. The other banks and insurance companies operating in this field share the remaining part. The Bank's share in the mortgage market is about 2.5%. In general, it should be mentioned that the mortgage products offered by various banks are similar and therefore competition focuses on the quality of the service, financing rates, credit prices, and fees paid by customers.

- The Bank deals with competition in the mortgage field through its expertise in examining collateral and the high and fast service level granted to customers even for complicated transactions.

- In the field of related mortgage services, banks face additional competition from insurance companies that offer bank customers their life and property insurance policies.

- In the credit financing for vehicle purchases sector, most the financing credit in previous years was granted by financing by non-bank companies. In recent years, with the entry of the large banks into the area, the profitability in financing new vehicles has been declining, and with the purpose of strengthening the loyalty of its customers, the banks (including the Bank) lowered prices and engaged in subsidizing campaigns with various importers. Over the past two years, the Bank, as a strategic decision, decided to reduce its activity in the aggressive competition in the vehicle financing sector and to selectively provide financing subject to pricing suitable for the Bank.

- Concurrently, in the financing market for the purchase of second-hand vehicles, significant presence of the large banks is still not felt and the level of competition is still low. This allows the Bank to finance the purchase of second-hand vehicles at relatively higher margins in the area of second-hand vehicle purchases. The competitors in this area are credit-card companies that established joint ventures in the vehicle area, and non-banking financing companies such as: "Pama," and "Direct Financing," that provide financing services that allow customers to complete the acquisition and a method of financing in one place.

- In the credit card sector, in addition to competition among the banks, credit card companies, in conjunction with retail and other chains , have been increasing their efforts to interest households in issuance of credit cards directly to the customer without bank intervention, including offers to grant credit.

- The capital market is characterized by fierce competition between banking factors, investment houses and institutional entities. As a result of the Bachar Committee, many customers now manage their capital market activity through institutional entities and investment houses, which try to attract customers with all of their capital market activities. Competition in this area primarily focuses on long hours of service, advanced Internet platforms, and competitive prices. A large number of players is active in the sector and the large banks play a very significant part. The fierce competition in the industry has resulted in a steady decline in the level of fees in the capital market in recent years, and has resulted in a series of mergers and acquisitions in the industry. The Bank took advantage of this trend to establish and expand the capital market sector by acquiring Clal Batucha as specified above. This acquisition positions the Bank as a significant player in this sector, with the Bank now offering a range of services that allows it to compete with large banks and investment houses, by offering added value to its customers in the form of investment consulting services that are based, inter alia, on a dedicated analysis and comprehensive information services, advanced trading platforms in foreign markets that benefit from cooperation with leading entities overseas, and a broad base of brokerage activity that allows customers to benefit from quality performance services.

Customers

The sector's customers are private customers, households, and Israeli residents. The Bank's proposed value in current accounts appeals to all sectors and all socioeconomic classes. Sector activity is characterized by tremendous spread of customers. In terms of credit, the focus on households should be noted, with credit provided to each of them is at a relatively low volume, and the Bank, therefore, is not significantly dependent on an individual customer or a limited number of customers whose loss might significantly affect the activity sector Moreover, this sector has a great deal of weight in the Bank's recruitment of resources in various channels.

Following the acquisition of Clal Batucha, private customers joined the bank that had previously operated through Clal Batucha and who sought premium services, independent active customers in the capital market, and customers who receive portfolio management services.

Of the Bank's 22 branches, four of the Bank's branches are located in areas characterized largely by a population of largely Ultra-Orthodox, three in areas of a mostly Arab population and two of the Bank's branches are currently V.C. branches.

Marketing and Distribution

The Bank's marketing activity in the household sector is based on a distribution array of bank branches, direct banking (Internet and call center), and direct mailing to customers. From time to time, the Bank conducts ad campaigns through various media.

In the area of financing credit for the purchase of vehicles, the Bank also operates by means of cooperation with importers, auto agencies that conduct special campaigns to encourage customers to purchase vehicles with financing provided by the Bank. The Bank is not dependent on the marketing and distribution channels in the framework of this activity sector.

Human resources

In 2013, the average number of positions in the sector totaled approx. 211 direct positions, vs. 189 positions in 2012.

In mortgages – average of 63 positions, vs. 61 in 2012. In banking and finances – average of 123 positions, vs. 102 in 2012, a 20% increase primarily attributed to competition in retail activity. In the capital markets sector – average of 26 positions vs. the previous year. Furthermore, the head office and management personnel were loaded onto this sector.

Below is a summary of the operating results of the household sector:

	For the year ended on December 31,							
	2013				2012*			
	Mortgages	Banking and Finance	Capital market	Total	Mortgages	Banking and Finance	Capital market	Total
	Millions of NIS							
Interest income, net								
Externals	109.6	88.6	-	**198.2**	106.8	79.0	-	185.8
Between sectors	(2.7)	(3.7)	-	**(6.4)**	(5.6)	(6.8)	-	(12.4)
Total interest income, net	106.9	84.9	-	**191.8**	101.2	72.2	-	173.4
Non-interest Income – from externals	35.9	6.3	11.7	**53.9**	40.7	7.9	8.0	56.6
Total income (before credit losses)	142.8	91.2	11.7	**245.7**	141.9	80.1	8.0	230.0
Expenses for credit losses	(20.1)	(32.9)	-	**(53.0)**	2.0	(35.4)	-	(33.4)
Other operating expenses, excluding depreciation and amortization	(57.7)	(112.3)	(28.7)	**(198.7)**	(59.4)	(92.0)	(26.7)	(178.1)
Depreciation and amortization	(6.0)	(11.9)	(2.7)	**(20.6)**	(4.4)	(7.2)	(1.9)	(13.5)
Profit (loss) before taxes	59.0	(65.9)	(19.7)	**(26.6)**	80.1	(54.5)	(20.6)	5.0
Provision for Taxes on Profit	(18.6)	24.0	7.2	**12.6**	(26.2)	17.9	6.8	(1.5)
Net profit (loss)	40.4	(41.9)	(12.5)	**(14.0)**	53.9	(36.6)	(13.8)	3.5
Capital yield (percentage of net profit from average equity)				**-3.1%**				0.7%
Average balance of assets	6,203.6	1,057.1	12.5	**7,273.2**	6,059.0	969.7	-	7,028.7
Average balance of liabilities	–	7,269.8	-	**7,269.8**	-	6,292.4	-	6,292.4
Average balance of risk assets (Basel 2)	3,780.5	888.0	6.9	**4,675.4**	3,428.5	951.7	-	4,380.2
Average balance of securities	–	-	2,369.4	**2,369.4**	-	-	1,476.0	1,476.0
Average balance of other assets under management	1,855.8	-	-	**1,855.8**	2,118.3	-	191.7	2,310.0
Margin from credit granting activity	89.1	71.1	-	**160.2**	82.0	54.6	-	136.6
Margin from deposit receiving activity	-	16.1	-	**16.1**	-	17.0	-	17.0
Other	17.8	(2.3)	-	**15.5**	19.2	0.6	-	19.8
Total interest income, net	**106.9**	**84.9**	**-**	**191.8**	**101.2**	**72.2**	**-**	**173.4**

* Reclassification.

Changes in the volume of sector activity and profitability

The revenue rate in this sector is approx. 68% of the Bank's total revenue, compared to 67% for 2012.

The total revenue in the sector totaled NIS 245.7 million in comparison with NIS 230.0 million; an increase of approx. 7% that is primarily attributed to increased revenue in the banking and finance sector as a result of increased balances.

Total expenses for credit losses totaled NIS 53.0 million, in comparison with NIS 33.4 million in 2012; an increase of approx. 59% that is primarily attributed to a rise in the one-time provision for housing in accordance with the Bank of Israel directives that was implemented in the first half of the year.

Total operating and other expenses totaled NIS 219.3 million, in comparison with NIS 191.6 million in 2012, an increase of approx. 14% that is primarily attributed to the Lending Bank's expansion in the retail area as part of its strategic plan that is accompanied by expansion of branches, advanced telephone call center, and ad campaigns. For more information, see the paragraph on Business Strategy and Goals.

The loss in the sector amounted to NIS 14.0 million, compared to a profit of NIS 3.5 million in the year 2012.

The majority of the profit decline is attributed to increased expenses for credit losses, and in operating and other expenses as specified above.

The net profit from mortgage activity in this sector amounted to NIS 40.4 million as compared to NIS 53.9 million in 2012. The majority of the decrease in profit is attributed to expenses for credit losses as specified above.

The loss from banking and finance activity in this sector amounted to NIS 41.9 million as compared to NIS 36.6 million in 2012. The majority of the growth in loss is attributed to an increase in other operating expenses as specified above.

The loss from capital market activity in this sector amounted to NIS 12.5 million, compared to NIS 13.8 million in 2012.

Material and Cooperation Agreements

Below are details on material and cooperation agreements in which the Bank is a relevant party for the household sector:

Agreements with Government of Israel for Granting Loans

The Bank has framework agreements with the Government of Israel to grant loans with government guarantees (including arrangement for implementing loans and their collection) to entitled Ministry of Housing borrowers. The agreements determine that the Bank is entitled to receive fees at different rates as determined in the aforementioned agreements and participation in collection expenses. The last framework agreement was signed in July 2004, for a period of two years, and is renewed automatically for additional periods of one year each, unless either party terminates the agreement 4 months prior to its termination date.

Additionally, in May 2008, the Bank signed an agreement with the Government of Israel concerning loans to entitled Ministry of Housing borrowers from the date of signing the agreement and onward. Loans that will be granted to entitled borrowers according to this agreement are mostly from Bank funds and are under the Bank's warranty. The Bank is entitled to receive a subsidy from the Government for loans granted from Bank funds, and commissions at various rates for loans granted from state funds. The agreement is in effect for one year and is renewed automatically for additional periods of one year each, unless either party terminates the agreement 3 months prior to its termination date.

The Bank undertook to the Israeli government that by providing the services according to the aforementioned agreements, it will operate in compliance with the provisions of the government's circular and that it will reimburse the State of Israel if it fails to do so. The Bank operates in compliance with the provisions of the government's circular on loans for eligibles, and therefore it estimates that the indemnification commitments does not create material exposure for the Bank.

Borrowers Life Insurance Agreement

The Bank is a party in agreements from 1992 (as periodically updated) with several insurance companies, Ir Shalem Insurance Agency, and other insurance agencies. According to the agreements, the insurance companies are committed to insuring the lives of the borrowers, subject to conditions determined in the agreements and in the insurance policies. The insurance companies are entitled to a premium, and the Bank and the aforementioned insurance agencies are entitled to payments from the insurance companies in accordance with their services. The bank is the policyholder and the beneficiary in accordance therewith. The aforementioned agreements apply only to life insurance of borrowers made up until December 31, 2005.

Borrowers Property Insurance Agreement

On April 1, 2007 agreements were signed between the Bank, Ir Shalem, and several insurance companies, according to which the insurance companies committed to insure property mortgaged in favor of the Bank, subject to conditions determined in the agreements and in the insurance policies, and to payment of commissions to Ir Shalem. The agreements were renewed at the end of March 2013, and were extended until March 31, 2014, and will be renewed yearly. These agreements apply only to property insurance because of loans granted until December 31, 2005.

Framework Agreement – Life Insurance and Property Insurance in Respect of Housing Loans

On April 10, 2006, an agreement was signed, effective from January 1, 2006, between Ir Shalem and an insurance company, according to which the insurer will issue life assurance and property insurance policies (including water damage), in respect of housing loans granted by the Bank to its customers, which will be marketed by Ir Shalem through a subsidiary of the insuring corporation.

Agreement with Bank Leumi of Israel Ltd.

The Bank has an agreement with Bank Leumi of Israel Ltd, ("Bank Leumi") as of November 15, 1998, according to which the Bank receives from Bank Leumi clearing services for transfers presented at the Bank and relays drawn at the Bank through Bank Leumi clearing, in consideration for commissions set forth in the Agreement.

Agreements with Credit Card Companies

As of August 8, 2002, the Bank has agreement with Israel Credit Cards Ltd. and as of February 25, 2010, with Poalim Express Ltd. These agreements reflect the relationship in the cooperating framework between the Bank and the aforementioned credit card companies, including the issue of dividing responsibility between the credit card companies and the Bank, and the commercial terms between the parties.

Private Banking sector

General

Activity in the private banking sector provides banking services and products granted under the household sector, to customers who are largely foreign residents who are moderately to highly affluent. The sector's services are provided through a bank branch that specializes in providing these services and products to foreign residents. Under this activity sector, greater emphasis is made on providing personal and highly professional service.

Objectives and business strategy

The Bank considers this activity sector as an important tier for its business activities, and accordingly operates, inter alia:

- To maintain the status and goodwill that the Bank has created among Jewish communities abroad.

- To expand the range of financial services and products relevant to this market sector.

Structure of the Activity Sector

Recent years have witnessed an increasing trend among most banks operating in Israel in the development and promotion of services and products that are provided as part of the private banking services.

The activity in this sector mainly consists of services and products as specified below:

Mortgages – Providing loans for financing the acquisition of housing in Israel, as well as providing credit for other purposes backed by pledging real estate properties.

Banking and Finance – Variety of products and services in this area including providing credit, activity in current accounts, recruiting deposits in foreign currency and others, with emphasis on providing advanced professional service that is tailored to the personal and specific needs of the customer.

The capital market – Providing customer securities services, including implementing and operating transactions in securities and in derivatives in Israel and abroad; investment advice by consultants who specialize in investment areas that are relevant for foreign residents, with special expertise in foreign markets.

Legislative Restrictions, Standardization, Directives, Regulations and Special Constraints

In addition to the details provided on this issue in relation to the above household sector and the relevance also concerning this activity area; the provided services are also subject, in the framework of this sector, to specific limitations of the applicable laws in the various countries of residence of customers from this sector.

In 2011, in the United States the FACTA Bill was enacted, according to which the world's financial institutions are required to identify all their American customers and issue reports of these customers' data to the U.S. Income Tax (IRS). In January 2013, the final version of the regulations on this issue were published and that are expected to go into effect at the start of 2014.

The Bank is prepared to implement as part of its ongoing preparations to implement the Law in 2014, including signing an agreement with the tax authorities in the United States. In October 2013, a draft standard version of the inter-country agreement, which the IRS plans to sign with foreign governments, including with the Israeli government, if this version of the agreement is signed with the Israeli government, the Bank will adapt is preparations on FACTA to the specified in this Agreement.

The Bank is prevented from providing any advice or assistance related to the manner in which accounts are identified as American or with regards to American taxation, including the provision of any advice pertaining to FACTA.

As of the report date, the Bank cannot assess the effect of said legislation on its activity.

Moreover, in view of the existing legislation in the United States, financial institutions that do not have the suitable American license are prevented from providing a variety of securities services to customers who are residents of the United States. Therefore, Bank of Jerusalem is required to provide security services to its customers who are US residents only within the confines of American legislation in this area.

Critical Success Factors in the Activity Sector

The unique success factors include, extensive ties with Jewish communities in various countries around the world, and provision of professional and personal services to sector customers in private banking areas, and this in addition to success factors that are extensively detailed in the household sector and also relevant to this sector.

The Main Entry and Exit Barriers of the Sector's Activity

Customer habits, regulatory limitations, training of professional and skilled human resources and technological infrastructure may be the entry barriers to this activity sector. The exit from mortgages area is long term due to the loans' long life.

Alternatives to Products and Services of the Sector of Activity

The majority of the products and services of the sector have no substitute, although there is competition between banking and financial institutions in Israel and around the world.

Customers

Customers of this sector are mainly foreign residents with a great attraction to the State of Israel as well as a medium to high financial status. Most of these customers are residents of the United States and Western Europe. The bank does not have significant dependency on any individual customer and the activity in this sector is characterized by distribution of credit risk and widely distributed funding. The services are provided through the private banking branch, while most of the assets purchased in the this sector are financed by the Bank and are in the Jerusalem area.

Marketing and Distribution

Most of the marketing is carried out through a personal appeal to potential customers during conferences and events in which the Bank participates, as well as through request of customers by professionals involved in the aforementioned communities abroad; among them, lawyers, consultants and accountants with whom the Bank maintains relations.

Competition

All the banks compete for this market sector. The Bank cannot assess its relative share of the banking system concerning this activity area. In order to deal with the competition, the Bank invests a great deal in unique professional training of the employees in the private banking branch. Another of the Bank's advantage in this activity sector is the service level and the availability of bankers at the Bank who speak various languages and who are capable of establishing a personal relationship with the sector's customers.

Human resources

In 2013, the average number of direct positions in the sector totaled 34 positions vs. 31 positions in 2012. In mortgages – an average of 14 positions, vs. 11 in 2012.

In the banking and financing area – an average of 19 positions, similar to 2012. In the capital markets sector – an average of 2 positions, similar to 2012. Furthermore, the head office and management personnel were loaded onto this sector. The sector's personnel includes tenured employees who received relevant training to provide service adapted to the sector's customers.

Below is a summary of the operating results for the private banking sector:

	For the year ended on December 31,							
	2013				2012*			
	Mortgages	Banking and Finance	Capital market	Total	Mortgages	Banking and Finance	Capital market	Total
	in millions of NIS							
Interest income, net								
Externals	15.1	4.9	-	**20.0**	13.2	8.0	-	21.2
Between sectors	(0.5)	(0.5)	-	**(1.0)**	(1.1)	(1.0)	-	(2.1)
Total interest income, net	14.6	4.4	-	**19.0**	12.1	7.0	-	19.1
Non-interest Income – from externals	0.5	7.4	3.1	**11.0**	0.7	7.3	3.6	11.6
Total income (before credit losses)	15.1	11.8	3.1	**30.0**	12.8	14.3	3.6	30.7
Expenses for credit losses	(0.7)	0.2	-	**(0.5)**	(0.2)	(0.4)	-	(0.6)
Other operating expenses, excluding depreciation and amortization	(10.2)	(15.6)	(1.9)	**(27.7)**	(8.3)	(14.8)	(1.0)	(24.1)
Depreciation and amortization	(1.3)	(1.8)	(0.1)	**(3.2)**	(0.8)	(1.2)	(0.1)	(2.1)
Profit (loss) before taxes	2.9	(5.4)	1.1	**(1.4)**	3.5	(2.1)	2.5	3.9
Provision for taxes on profit	(1.0)	2.0	(0.4)	**0.6**	(1.2)	0.7	(0.8)	(1.3)
Net profit (loss)	1.9	(3.4)	0.7	**(0.8)**	2.3	(1.4)	1.7	2.6
Capital yield (percentage of net profit from average equity)				**-1.4%**				4.1%
Average balance of assets	1,135.9	24.4	–	**1,160.3**	1,164.9	27.7	-	1,192.6
Average balance of liabilities	-	1,016.6	–	**1,016.6**	-	1,119.7	-	1,119.7
Average balance of risk assets (Basel 2)	608.5	45.5	–	**654.0**	599.5	53.6	-	653.1
Average balance of securities	-	-	271.8	**271.8**	-	-	263.7	263.7
Average balance of other assets under management	-	-	-	**–**	-	-	-	–
Margin from credit granting activity	14.6	0.6	-	**15.2**	12.1	1.0	-	13.1
Margin from deposit receiving activity	-	3.8	-	**3.8**	-	6.0	-	6.0
Other	-	-	-	-	-	-	-	-
Total interest income, net	**14.6**	**4.4**	-	**19.0**	**12.1**	**7.0**	-	**19.1**

* Reclassification

Changes in the volume of sector activity and profitability

The revenue rate in this sector is approx. 8% of the Bank's total revenue, compared to 9% for 2012.

The total revenue in the sector amounted NIS 30.0 million, similar to the sector's revenue in 2012.

Total expenses for credit losses totaled NIS 0.5 million, similar to 2012.

Total operating and other expenses amount to NIS 30.9 million, in comparison with NIS 26.2 million, an increase of approx. 18% that is primarily attributed to a higher allocation of employees to this sector.

The loss in the sector amounted to NIS 0.8 million, compared to a profit of NIS 2.6 million in 2012.

The majority of the decline in profit is attributed to an increase in operating and other expenses.

The net profit from mortgage activity in this sector this year totaled NIS 1.9 million compared to NIS 2.3 million in 2012. On the one hand, the increase in activity revenue for 2012 is primarily attributed to an increase in margin and, on the other hand, an increase in operating and other expenses.

The loss from banking and financing activity in this sector this year totaled NIS 3.4 million compared to NIS 1.4 million in 2012.

The profit from capital market activity in this sector this year totaled NIS 0.7 million compared to NIS 1.7 million in 2012.

Business Sector

General

The business sector provides banking services to business customers, corporations, and associations. These services are provided to the Bank's customers, mainly through the real estate sector and the retail division in the business department, which specializes in providing these services and located in Bank branches in Jerusalem and Tel Aviv, as well as in private banking branch. The sector includes activity in the real estate sector, overseeing housing construction projects mainly by the closed oversight method, inter alia, from project financing according to NOP 38 and buyers group financing. In addition, the Bank provides financing to companies implementing solar energy projects, as well as commercial loans.

Objectives and business strategy

Under its Strategic Plans (as described above), the Bank works to implement a selective policy in this area by providing credit to construction companies and residential real estate, with the emphasis on potential growth and without increasing the existing risk level. For this purpose, the Bank works to create cooperation between the Bank and between insurance companies and other institutions to provide project credit loans (the operator model) and by issuing guarantees according the Sales (Apartments) Law and other guarantees. This strategy enables the bank to increase the scope of projects it handles, and in accordance with the Bank's policy, use its accumulated expertise, enter large and complicated transactions, and spread risks, and respectively increases the capital yield deriving from this activity while reducing risk.

In addition, the Bank is working to shift risk and inputs, for financing projects (oversight of residential construction) or financing transactions that require as little allocation of capital as possible, and this while reducing, to the extent possible, the scope of commercial credit for financing current activity of small companies and business.

In addition, the Bank operates in the financing and management of the solar energy sector, with which it has a long-term agreement with the Electric Company, by cooperating between the Bank and insurance companies, as well as other institutional entities to provide credit. This cooperation, similar to the aforesaid with regards to financing projects (the operator model), enables entry into large transactions and spread of risks.

The Bank's plans and assessments, as specified above, are future facing information, as well as based upon assumptions and different forecasts presented to the Board of Directors. This information may not be realized due to changes that may occur due to various factors that are not controlled solely by the Bank. Influencing factors include forecasts and assessments concerning economic developments in Israel and globally, especially concerning the economic situation, including the influence of macroeconomic and geopolitical conditions, changes in capital markets, as well as other additional factors influencing risk exposure: public preferences, instructions by supervisory entities and others, aspects related to the Bank's image, technological developments and personnel issues.

Structure of the Activity Sector

The activity in this sector mainly includes:

Construction and Real Estate – The bank finances the acquisition of land and construction of housing projects, as well as providing various types of guarantees according to the transaction's requirements. Financing for construction of housing projects is mostly provided by the closed oversight method in accordance with the specific requirements of the project and its characteristics. In the closed oversight method, the project is separated from the customer's other activities. A special account is opened for the project, only for that project's purposes, into which proceeds from housing unit acquisitions, equity, and bank credit are deposited. The proceeds are used for implementing the project and are released as per the construction's rate of progress according to reports from the expert inspector. As part of the financing of the construction project, the Bank grants implementation, financial, and Sales Law guarantees for purchasers of project units. The realty and receivables are mortgaged to the bank. In the majority of transactions, Sales Law securities are issued by insurance companies with which the Bank has a cooperation agreement.

The Bank cooperates with financial entities for the purpose of expanding the scope of its activity and maximizing profitability, while spreading credit risks, and compliance with the required regulatory limitations.

The difference between the types of cooperation with institutional entities is expressed in the type of credit or collateral provided by the institutional entity: provision of guarantees according to Sales Law; provision of securities to the land owners in combination transactions; and provision of financial credit according to the operator model.

The operator model in the construction and real estate area is implemented according to the principles below:

The project is examined and approved by the financial partner institutions; the collaterals in the project will be pari-passu, when the ratio of distribution in case of collateral realization is determined in advance between the Bank and the financial partner; the volume ratio of the provided credit will be maintained during the project life. Release of surplus obtained for the project developer is implemented by the Bank according to the Bank's approved surplus release formula and is included in the cooperation agreement.

Management of the project, according to this model, is implemented by the Bank at its discretion and according to accepted banking standards; project progress reports are sent by the supervisor to the Bank and to an additional entity, while the Bank reports to the additional entity about irregular events in the project.

Banking and Finance

Credit provided to finance the current activity of companies – The Bank made a decision to reduce the credit volume provided under this area of activity in contrast with the credit provided during previous years, and this due to the large capital allocation and required current operations. Financing of commercial activity including financing of income-producing assets and current activity, is generally implemented against material collateral.The current activity of the companies is also financed, inter alia, against liens on the current assets.

Credit for the solar energy branch – the acquisition, installation and operation of solar energy systems financed against a contract with the Electricity Company for a period of 20 years at a defined and fixed electricity purchasing rate for the entire operating period. In addition, the bank mortgages the system equipment and the total arrangement of transaction contracts, and if necessary, accumulating various reserve funds during the financing period. In this area, the Bank cooperates with financial entities, similar to the real estate area, according to the operator model.

Operator model in the solar energy area is implemented according to the principles below:

The cooperation agreement between the Bank and financial entities is formed and generally signed before the project's setup stage.The solar project's setup stage, to the extent that financing is possible, is mostly financed only by the Bank.The joint financing starts in the operating stage of the project, when the credit provided until then by the Bank in the framework of the setup stage, is paid in full through the joint credit provided by the Bank and the financial partner under the operating stage; the collateral in the project will be pari-passu, when the ratio of distribution in case collateral realization is determined in advance between the Bank and the financial partner; the volume ratio of the provided credit between the Bank and the financial partner is also determined in advance and will remain during the project life.

Management of the project, according to this model, is implemented by the Bank as a representative of the lenders, at its discretion in accordance with the financing agreements and the cooperation agreement between the Bank and the financing entity, and according to accepted banking standards; the engineering reports are sent by the supervisor to the Bank and to an additional entity prior to the financing being made available. During the life of the project, the Bank reports to another entity the project's current data and extraordinary events in the project.

Legislative Restrictions, Standardization, Directives, Regulations and Special Constraints

The Bank in general, and the business sector in particular, operates within the framework of laws, standards, regulatory directives and instructions imposed on the banks by legislative and supervising entities, including the Supervisor of Banks, the Securities Authority, and the Commissioner for the Capital Market, Insurance and Savings in the Ministry of Finance.

Below are details concerning legislative updates and regulatory directives on matters concerning provision of banking services to households:

On March 21, 2013, the Supervisor of Banks published a directive regarding the allocation of capital and provision for doubtful debts for housing loans and change in the risk weight of guarantees in accordance with the Sales Law and its effect on the Bank. For details, see the chapter on Events in the Report Year.

Changes in Markets of the Activity Sector and in the Characteristics of its Customers

The construction and real estate sector was characterized by price increases in recent years and large demand for housing alongside a lack of available land for building. 2013 was characterized by significantly higher sales rate of housing units than expected at the start of the year, and price levels that were similar to the prices in previous years, despite the expectation of a decline in prices following the social protests that took place in the summer of 2011. This expectation did not materialize in light of the shortage of land available for construction, shortage of personnel in the construction industry, and regulatory restrictions that affected the banking system (most banks reached the industry limitation level for the construction branch). Therefore, there is still uncertainty in the real estate market concerning price levels, which are influenced, inter alia, by the lack of available land for construction and a decrease in the volume of construction starts in desired areas (marketing of the land of the Ministry of Housing and the Israel Lands Administration is mostly centralized in the peripheral areas), and a burden on mortgagers alongside expectations of government intervention that will result in declining prices.

Critical Success Factors in the Activity Sector and Their Applied Changes

- Professional training of manpower with experience and skills.

- Intelligent risk management, while establishing proper credit control systems for identifying and minimizing risk.

- Provision of qualitative and quick service.

In the real estate area:

Specific professional knowledge in this area, including understanding and ability to analyze the relevant variables affecting the risk level in real estate projects, such as demand areas, construction in stages, land ready for construction, and so forth.

– Identification of opportunities through connections with experienced entrepreneurs operating in this branch.

– Strong credit underwriting ability that is reflected in the correct choice of the accompanied project as a derivative of the project's location and its marketing possibilities in accordance with market needs.

– Defining a financing structure for the transaction that is tailored for the project and customer requirements.

- Control and supervision of project income and expenses until completion.

- Ability to manage credit in crisis conditions.

- Adequate assessment of the customer's repayment capability.

Banking and Finance:

- Careful management of credit, while implementing diligent control.

- Comprehensive, in-depth analysis of new transactions, including understanding of risks inherent in financing.

- Defining the obligo structure and adapting the amount of financing to cash flows in respect of corporate transactions and activity.

- Reliable current estimate of existing collateral in the Bank and follow-up regarding current reporting by the company.

- Development of expertise in the financing area of the solar energy branch and access to operating factors in the sector.

- Legal review concerning the provision of financing a solar energy transaction including review of the rights to the assets on which the solar systems are installed, review of the rental contract between the entrepreneur and the owner of the asset (as far as it concerns a transaction on this type), review of the financial model of the transaction, etc.

The Main Entry and Exit Barriers of the Sector's Activity and the Occurred Changes

- Regulatory limitations on banking corporations, including limitations on debts for a borrower or a group of borrowers, as well as also other regulatory limitations; for example, non-bank factors have limited independent access to the real estate branch as result of Sales Law that requires, in certain conditions, issuance of bank guarantees for buyers of construction project units.

- Minimum capital requirements

- Long-term relationships with factors operating in areas listed under the business sector.

- Knowledge and experience gained by working at financing under the closed oversight method.

Alternatives to Products and Services of the Activity Sector and Occurred Changes

As an alternative to banking credit, alternative financing products were developed and provided by non-banking entities. An alternative credit including mobilization on the capital market, inter alia, by issuing debentures to real estate companies, which may be backed by specific cash flows, including direct credit granted to these bodies. This credit alternative and its availability is affected by the capital market situation, resulting in a decline in the volume of issuances.

Customers

In the construction and real estate sector, the bank oversees about 180 projects with an average size of 58 residential units per project. More than half of the accompanied residential units are located in areas of high demand – greater Jerusalem area, the central and Sharon area.

The Bank's credit portfolio is spread and the Bank is not dependent on any individual customer or limited group of customers. The credit balance of Bank customers is not dependent on any single borrower. The spread of the portfolio is also enabled through the bank's strategic cooperation with insurance companies that generally issue policies according to the Sales Law (Apartments) to buyers in projects overseen by the bank. Also, there are also several joint projects with an insurance company to provide financial credit for the overseen projects (based on the operator model).

The credit granted for commercial activity and the solar energy sector is spread among a large number of customers across the country. In financing the solar energy branch there are two types of customers: the first, asset owners who install solar systems on roofs owned by them, and the second, entrepreneurs that rent roofs for the purpose of installing solar systems.

As previously mentioned, because all of the quotas approved in the past by the Electric Company have been used for small and moderate-sized solar devices, the majority of transactions are wtih enterpreneurial customers who purchase existing solar devices and not setup transactions for new devices.

Following the acquisition of Clal Batucha, the Bank now provides services to most institutional entities in Israel, including banks, insurance companies and pension and provident entities.

Marketing and Distribution

Marketing and distribution are performed through managers and employees of the real estate sector of the Bank and in the commercial departments in the Bank's branches in Tel Aviv, Jerusalem, and in the private banking branch.

The bank recruits customers and expands its activity in the realty branch, inter alia, by compiling information with regards to tenders for the acquisition of land designated for construction; anlaysis of the tenders, and then initiating contact with the tender winners through its extensive familiarity with those operating in this branch. Additionally, the Bank is working to expand its activity using its existing customer base.

The bank initiates exposure to the target public by sponsoring events organized by the Israel Builders Association and by local contractors organizations, and by participating in various conferences, including the participation of Bank professionals, lecturers and/or panelists on the professional panels during these events.

Competition

Competition among the banks to attract quality real estate customers is expressed in the equity rates invested in the project, transaction structure, commission size, interest on credit and the level of customer service. During 2013, insurance companies are planning to enter the project financing area. The Bank's principle methods for dealing with competition is based on the connections that it has been accumulating over the years, as well as its existing customer base, which constitutes leverage for continuing its activity. In addition, the bank sometimes utilizes surplus resources in existing projects to leverage future activity in its customers' new projects. The bank operates a mechanism to determine the amount of equity required for the project, derived from the rate of project implementation, as well as sales. This mechanism constitutes an incentive for promotion of project sales and therefore reduces the level of risk in the projects

Most of the banks in the banking system participate in financing the solar energy branch. In addition, in transactions with high volumes, institutional entities and insurance companies are also taking part in the financing. The level of professionalism, the knowledge and extensive familiarity with the branch enables the Bank to expand it activity with existing and new customers.

The Bank has no ability to assess its share in the credit balance in this area of the entire banking system. Nevertheless, by the Bank's assessment, in 2013, its relative share in overseeing new housing units stood at approx. 10% of all housing units starts in 2013. Furthermore, the Bank assesses that its share in the solar energy sector is greater than the Bank's share in the banking system.

Cooperation agreements

The Bank has cooperation agreements with several insurance companies to provide credit and/or to issue insurance policies to buyers of apartments in residential projects financed by the bank according to the closed oversight method (the policies are issued by the insurance companies as required in accordance with the Sales Law (Apartments), and in financing the solar energy sector. The agreements with the insurance companies include a cooperation arrangement between the Bank and the insurance companies regarding the following: responsibility for current management of the project and submission of reports, receipt and release of collateral and procedures for the realization of subordinated charges and creditor arrangements between the entities.

Human resources

In 2013, the average number of direct positions in the sector totaled 30 positions vs. 29 positions in 2012. In the construction and real estate – an average of 19 positions, in comparison with an average of 18 positions in 2012.

In the banking and financing area – an average of 9 positions, similar to 2012. In capital markets – an average of 2 positions, similar to 2012. Furthermore, the head office and management personnel were loaded onto this sector.

Below is a summary of the operating results of the business sector:

	For the year ended on December 31,							
	2013				2012*			
	Banking and Finance	Construction and real estate	Capital market	Total	Banking and Finance	Construction and real estate	Capital market	Total
	in millions of NIS							
Interest income, net								
Externals	13.5	26.4	-	**39.9**	15.1	21.8	-	36.9
Between sectors	(1.6)	(0.6)	-	**(2.2)**	(3.3)	(1.0)	-	(4.3)
Total interest income, net	11.9	25.8	-	**37.7**	11.8	20.8	-	32.6
Non-interest Income – from externals	4.1	22.2	1.1	**27.4**	5.2	16.3	1.1	22.6
Total income (before credit losses)	16.0	48.0	1.1	**65.1**	17.0	37.1	1.1	55.2
Expenses for credit losses	(1.3)	0.1	-	**(1.2)**	(2.6)	0.6	-	(2.0)
Other operating expenses, excluding depreciation and amortization	(8.6)	(16.3)	(1.7)	**(26.6)**	(10.9)	(15.9)	(2.0)	(28.8)
Depreciation and amortization	(1.0)	(1.8)	(0.1)	**(2.9)**	(0.7)	(1.3)	(0.1)	(2.1)
Profit (loss) before taxes	5.1	30.0	(0.7)	**34.4**	2.8	20.5	(1.0)	22.3
Provision for Taxes on Profit	(1.9)	(11.1)	0.3	**(12.7)**	(0.9)	(6.7)	0.3	(7.3)
Net profit (loss)	3.2	18.9	(0.4)	**21.7**	1.9	13.8	(0.7)	15.0
Capital yield (percentage of net profit from average equity)				**15.6%**				9.9%
Average balance of assets	502.2	895.0	–	**1,397.2**	501.5	810.4	–	1,311.9
Average balance of liabilities	3,033.3	452.6	–	**3,485.9**	3,165.6	239.5	–	3,405.1
Average balance of risk assets (Basel 2)	275.8	1,178.7	–	**1,454.5**	424.4	1,103.0	–	1,527.4
Average balance of securities	–	–	251.5	**251.5**	–	–	247.8	247.8
Average balance of other assets under management	–	–	–	**–**	–	–	72.7	72.7
Margin from credit granting activity	8.3	23.7	-	**32.0**	7.9	20.3	-	28.2
Margin from deposit receiving activity	3.3	2.4	-	**5.7**	2.9	2.4	-	5.3
Other	0.3	(0.3)	-	**-**	1.0	(1.9)	-	(0.9)
Total interest income, net	**11.9**	**25.8**	**-**	**37.7**	**11.8**	**20.8**	**-**	**32.6**

* Reclassification

Changes in the volume of sector activity and profitability

The revenue rate in this sector is about 18% of the Bank's total revenue, as compared to 16% in 2012.

The total revenue in the sector totaled NIS 65.1 million, compared to NIS 55.2 million, an increase of approximatley 18% that is primarily attributed to increased revenue as a result of an increase in credit balances primarily in the construction and real estate area.

Total expenses for credit losses totaled NIS 1.2 million, as compaired to revenue of NIS 2.0 million in 2012.

Total operating and other expenses totaled NIS 29.5 million, as compared to NIS 30.9 million in 2012.

The net profit in this sector amounted this year to NIS 21.7 million as compared to NIS 15.0 million in 2012.

The net profit from construction and real estate activity in this sector amounted this year to NIS 18.9 million as compared to NIS 13.8 million in 2012. The majority of the growth in profit is attributed to a net increase in income from interest, as a result of increased credit balances.

The net profit from banking and financing activity in this sector amounted this year to NIS 3.2 million, as compared to NIS 1.9 million in 2012.

The loss from capital market activity in this sector amounted this year to NIS 0.4 million, as compared to a loss of NIS 0.7 million in 2012.

Financial Management Sector

General

The activities in this sector are not with customers, including the Bank's financial management, and include:

- Management of the Bank's available financial capital.
- Management of the Bank's nostro portfolio.
- Management of exposure to market risks, including basis, interest and liquidity exposure.
- Activity with banks in Israel and abroad.

Objectives and Business Strategy

The purpose of this activity is to increase the yield on surplus liquidity while maintaining appropriate risk levels.

Structure of the Activity Sector

This sector's activity is concentrated in the Financial Division.The Bank currently manages the positions in the various linkage sectors through a variety of financial instruments available to it.This management is carriedo out in accordance with the risk management policy defined by the Board of Directors, and taking into account changes in relevant economic data and current supervision of risks resulting from such exposure.

The nostro portfolio is divided into the following types of activity:

- Activity for commercial purposes characterized by short-term investments in government securities in the primary market and in the secondary market.
- Activity used as protection for short-term, medium-term and long-term deposits with the bank, as well as investments against the bank's equity.
- Investment activity in debentures mainly for the purpose of reaching surplus yield on the Bank's liquidity balances.
- Investment activity in non-government securities, mainly bank debentures, according to the Bank's credit policy.

The investment portfolio and the financial products are regularly reviewed, taking into account macroeconomic forecasts of exchange rates, short-term and long-term interest rates, inflation, economic growth, and yield curves. Such analysis is required in order to arrive at correct costing of financial products and investment decisions relating to the nostro portfolio.

As part of managing the surplus liquidity, and in consideration of the limitations determined by the Bank's Board of Directors, surplus liquidity is deposited at the Bank of Israel and banks in Israel and abroad. For details concerning the liquidity model and limitations of the management and the Board of Directors, please see the "Risks and Risk Management" chapter.

The Bank has credit frameworks from banks in Israel, which it uses from time to time in accordance with its regular needs.

Dealer in government debentures

As part of the acquisition of Clal Batucha and its merger with the Bank (see chapter on Events in the Report Year), the Bank was appointed as primary dealer in government debentures in accordance with the Letter of Appointment from the General Ombudsman of the Ministry of Finance (replaced Clal Batucha, which served as the primary dealer until December 15, 2013), the term of the Bank's appointment is from January 1, 2014 and until December 31, 2015 (and there is an option for extension of another term).

The purpose of the dealer of government debentures is to ensure optimal allocation of said debentures to investors and to increase transparency and liquidity in trading of government debentures. This activity is carried out by virtue of the State Loan Law 5739-1979, which arranges the appointment of a primary dealer of government debentures and the engagement with them. The terms of the appointment establish a requirement to periodically purchase from the government debentures in small quantities, a requirement to publish the purchase and sales price of the debentures in the primary dealers' trading system, the right to participate in the purchase of debentures from the government, the right to receive an option to purchase debentures from the government, the right to borrow debentures from the government and the right to deal debentures in the primary dealers trading system. The terms of competency for a primary dealer of government debentures include, inter alia, a requirement that the dealer be a reputable financial entity (a banking corporation or a member of the stock exchange) and that it have minimum independent equity of at least NIS 400 million. In addition, the Letter of Appointment sets forth provisions regarding management of the debenture tenders in the primary market and in the secondary market, supervisory provisions by the Ministry of Finance, an undertaking to maintain confidentiality, rules of action, etc. The Bank's revenue from this activity is derived from the purchase and sales margins that are customary in the government debenture market, and from the benefits reserved for dealers and that are granted by the Ministry of Finance.

Legislative Restrictions, Standardization, Directives, Regulations and Special Constraints

The bank, and the financial management sector in particular, operates in the framework of laws, regulations and instructions from the authorities, imposed on the banks by the Supervisor of Banks, the Securities Authority, and the Commissioner for the Capital Market, Insurance and Savings as well as Ministry of Finance regarding dealing in the government debenture market.

Critical Success Factors in the Activity Sector

The critical success factors in this sector may correctly recognize the market conditions and the expected timing for a change in these conditions, the ability to understand and analyze the possible effect of macroeconomic factors on market conditions and to predict their power, and the ability to operate quickly and change the positions and exposure in accordance with market conditions. An additional factor is the professionalism of the employees relied upon to manage the financial sector in general, and the nostro portfolio in particular.

Human resources

In 2013, the number of direct positions in this sector amounted to 3 positions, as compared to an average of 2 positions in 2012.

Furthermore, the head office and management personnel were loaded onto this sector.

Below is a summary of the operating results of the financial management sector:

	For the year ended on December 31,	
	2013	2012
	in millions of NIS	
Interest income, net		
Externals	**(0.9)**	(13.0)
Between sectors	**9.6**	18.8
Total interest income, net	**8.7**	5.8
Income not from Interest – from Externals	**14.2**	22.6
Total income (before credit losses)	**22.9**	28.4
Expenses for credit losses	**-**	-
Other operating expenses, excluding depreciation and amortization	**(6.4)**	(5.6)
Depreciation and amortization	**(0.3)**	(0.2)
Profit before taxes	**16.2**	22.6
Provision for taxes on profit	**(5.9)**	(7.6)
Net profit	**10.3**	15.0
Capital yield (percentage of net profit from average equity)	**25.2%**	31.8%
Average balance of assets	**2,745.8**	2,132.6
Average balance of liabilities	**109.5**	176.5
Average balance of risk assets (Basel 2)	**412.3**	509.2
Average balance of securities	**–**	–
Average balance of other assets under management	**–**	–
Margin from credit granting activity	**(4.6)**	(13.6)
Margin from deposit receiving activity	**-**	-
Other	**13.3**	19.4
Total interest income, net	**8.7**	5.8

* Reclassified

Changes in the volume of sector activity and profitability

The net profit of the financial management sector amounted to NIS 10.3 million, as compared to NIS 15.0 million in 2012.

The main reduction in profits is attributed to a decline in the surplus profit from securities for trade and available for sale that were realized.

Following are data regarding the impairment of debentures available-for-sale (government and corporate) that was attributed to a capital reserve, by periods of time and rate of impairment:

Impairment rate as at the date of the financial statements	Impairment amount (in millions of NIS)					
	Period of time in which fair value of asset was less than its cost				Total impairment as at December 31,	
	Up to 6 months	6-9 months	9-12 months	Over 12 months	2013	2012
Up to 20%	-	-	-	0.5	0.5	1.7
40%-20%	-	-	-	-	-	-
Over 40%	-	-	-	-	-	-
Total	**-**	**-**	**-**	**0.5**	**0.5**	**1.7**
Of this: government debentures	-	-	-	0.5	0.5	1.7

Note: It should be emphasized that the rate of impairment and the period of time of the impairment relate to different periods – the period of time is measured from the date on which the fair value of the asset was lower that its cost, while the rate of impairment is stated as at a specific point in time: December 31, 2013 and December 31, 2012.

Fourth part – Matters related to the activities of the banking corporation as a whole

Raising of funding

General information

The Bank has over the years adopted a policy that aims to expand activity in the household sector, in order to expand its base for raising funding. This policy contributed during those years to a significant increase in the weight of households in all public deposits, simultaneous to a decrease in the weight of deposits from institutional entities. The balance of public deposits amounted as at December 31, 2013 to NIS 11,071 million, as compared to NIS 9,814 million at the end of 2012.

The bank's activity in the area of raising funding from the public is managed in the financial division.

Objectives and business strategy

The bank determined a long-term policy to expand the raising of funding, while increasing the part of the sources from households out of total deposits of the public, and maintaining the ability to raise funding from institutional customers. Long-term deposits are raised in accordance with the volume of new long-term credit granted. In addition, through the Jerusalem Financing and Issuances subsidiary, deposits are raised based on the Bank's raising needs and deferred liability notes are raised according to the Bank's capital requirements.

Bank management determines specific targets for the branches and for the head office units in all sectors of activity, and regularly monitors their compliance with the targets.

The Bank strives to achieve the targets through a variety of products and their adaptation to customer requirements and variable market conditions. Also, the Bank conducts campaigns for the depositing public through ads in the media and direct mail to existing and potential customers. The Bank offers closed circuit banking services that enable the raising of funds from customers of all banks, as specified below. Additionally, the Bank attributes importance to maintaining a relationship and cooperation with institutional customers.

Structure of the Sector

The financing sources of the banking system, in shekels and in foreign currency, are mainly deposits from households, from companies, from institutional entities, from banks in Israel and abroad, and from raising negotiable debentures in the capital market.

The sources include, inter alia, deposits in all linkage sectors, bearing fixed interest or variable interest, and that are deposited for various periods from one day to eighteen years.

In 2013, the net accrual of household deposits amounted to approx. NIS 700 million. The net accrual from households in recent years is attributed to improved work processes in branches, the offering of new products that suit the customer preferences, management of ad campaigns that result in recruitment of new customers in branches and through the closed circuit system, and changes in the pricing model for deposits.

Furthermore, in December 2013, the Bank completed the acquisition of the stock exchange member of Clal Batucha, and as part of this transaction, the majority of the deposits of customers of the operation that was acquired, were transferred to the Bank on the date of completion of the transaction.

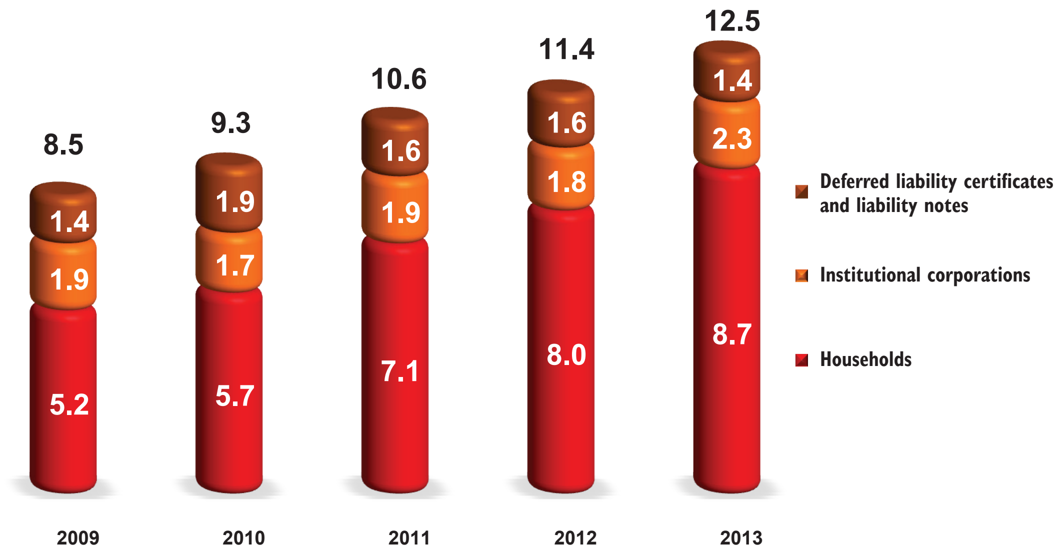
On August 28, 2013, Jerusalem Finance and Issuances (2005) Ltd. published a shelf prospectus for the issuance of debentures and deferred liability notes.

On December 24, 2013, Jerusalem Finance and Issuances issued, in a private issue for classified investors, NIS 58,790 thousand par value of deferred liability notes (Series 10), from the series traded in the stock exchange and that was issued according to the shelf offer report dated December 24, 2012, for a consideration of NIS 60,612 thousand.

Following is the composition of the Bank's main financing sources (deposits of the public, debentures and deferred liability notes):

		Balances as at December 31,		
		2013	2012	Change in percentages
		Millions of NIS		
1.	Shekel deposits and current accounts	**6,857**	5,367	28%
2.	Index-linked savings plans and deposits	**2,603**	3,012	-14%
3.	Foreign currency and foreign currency-linked deposits	**1,610**	1,435	12%
	Total deposits of the public	**11,071**	9,814	12%
4.	Debentures and deferred liability notes	**1,406**	1,581	-11%
	Total sources of funding	**12,477**	11,395	9%

Following is the composition of the Bank's main financing sources (in billions of NIS):



The average balance of liabilities in 2013 amounted to NIS 11,881.8 million, compared to NIS 10,993.7 million in 2012. This balance includes an average balance of liabilities to households in the amount of NIS 7,269.8 million (household sector), an average balance of liabilities to private banking entities in the amount of NIS 1,016.6 million, an average balance of liabilities to companies and institutional entities in the amount of NIS 3,485.9 million (business sector), and an average balance of liabilities to banks in the amount of NIS 109.5 million (financial management sector).

The Bank has daily credit lines from banks in Israel, which it uses from time to time in accordance with its current needs. As at the balance sheet date, the Bank did not use any credit lines from banks in Israel.

The Bank has daily credit lines from banks in Israel, which it uses from time to time in accordance with its current needs. As at the balance sheet date, the Bank did not use any credit lines from banks in Israel.

Legislative restrictions, standards, directives and circulars from the Supervisor of Banks and special constraints

The Bank operates in the framework of laws, regulations and instructions from the authorities, imposed on the banks by the Supervisor of Banks, the Securities Authority, and the Commissioner for the Capital Market, Insurance and Savings.

Structure of Competition

As a result of the structure of competition in the banking system, most customers in the banking system deposit their funds with the commercial bank in which their current account is being managed and these customers are generally indifferent to interest offers on various investment products in other banks. As a result, only part of the customers in the banking system compare prices between banks in order to obtain the maximum interest on their investment.

In 2011, the Bank launched a unique venture to raise deposits from households known as "Closed System". The System enables customers to deposit money in a deposit account with the Bank through the Internet, without the bother involved in opening a full account at a bank branch, and thus increasing the Bank's access to potential customers. The venture is built according to Proper Banking Management Directive № 417 of the Bank of Israel.

At the start of 2012, the Bank changed the deposit pricing model, including an undertaking, according to which the interest rate for NIS deposits of up to one year will not be less than 80% of the interest of the Bank of Israel, except for deposits with fixed interest for a period longer than three months, whose interest rate will not be less than 80% of the yield rate for the relevant treasury bill (Makam). For deposits for periods of one year or more, the Bank undertakes that the interest rate will not be less than 80% of the yield rate on government debentures or the cost of money, whichever is higher. This undertaking does not depend on the size of the deposit or requires the opening of a current account.

The success of the move resulted in an increase in the Bank's customer base, spread of sources, decrease in the reliance on raising negotiable debt from capital markets, and an improvement in the Bank's profitability.

The Bank acts to raise sources also through the capital market by issuance of debentures and deferred liability notes. The issuance is performed by a wholly controlled subsidiary, Jerusalem Financing and Issuances Ltd., that is the raising entity of the Bank, and therefore, the Bank undertook to comply with all the conditions of the liability certificates, to bear the payment of full amounts that will be required for the repayment of the liability certificates to their holders and their interest, pursuant to the conditions determined in the issuance prospectus published by Jerusalem Financing and Issuances Ltd.

On December 24, 2013, Jerusalem Finance and Issuances issued, in a private issue to classified investors, NIS 58,790 thousand par value NIS liability notes (Series 10), in consideration for NIS 60,612 thousand.

Customers

In recent years, the Bank placed emphasis on expanding the depositor base and increasing deposits from households in order to reduce the reliance on large depositors. The Bank's deposits portfolio is spread among many customers, thereby decreasing the liquidity risk and providing a low level of sensitivity of the Bank to individual depositors. The Bank does not have any customer or group of customers whose deposit balance exceeds 5% of the total deposits from the public. Following the purchase of the member of the stock exchange Clal Batucha, thousands of new household customers joined the Bank, which helped to diversify and expand the depositor base of the Bank.

Marketing and Distribution

The raising of funds from households is performed through the Bank branches, which are spread throughout the country, as well as through the Closed System, that enables raising of deposits through the Internet, without opening an account at a Bank's branch. In addition, the establishment of a capital market branch allows the Bank to approach new customers that conduct intensive activity in the capital market. The raising of funds from institutional customers is generally performed directly by the deposits department.

Competition and Alternatives to the Products and Services of the Activity Sector

The competition in the raising of funding area is strong and includes all the banks. Competition focuses mainly on that segment of customers that is sensitive to changes in interest rates. The Bank deals with the competition, inter alia, by conducting attractive campaigns for customers and developing new products to diversify the product basket. Moreover, the various capital market products constitute an investment alternative to the deposits offered by the Bank.

The Bank of Israel

The Bank of Israel acts as the central source of funds and short-term absorption of money for the banking system, and particularly for the Bank. It should be mentioned that every bank that borrows money from the Bank of Israel is required to provide collateral, and this fact is taken into consideration in current management of liquidity. An additional channel for raising short-term funding is the interbank money market.

The volume of deposits and their types in the banking system is influenced, inter alia, by the Bank of Israel's monetary policies. Below is a review of the monetary tools used by the Bank of Israel for the purpose of implementing its monetary policy:

Interest – On the last Monday of every liquidity month, the Bank of Israel publishes the interest rate for the following month. This interest comprises the basic interest of the loan and deposit tenders available to the banking system, as specified below.

Liquidity obligation – The Bank of Israel's instructions require banks to hold liquidity means balances against the deposits of the public, at different rates according to the deposit period. Current liquidity obligation rates are 6% on deposits for a period longer than one day and up to 6 days, and 3% on fixed-term deposits from one week up to one year. There is no liquidity obligation for deposits with a period of one year and more.

As of the end of January 2011, the Bank of Israel imposed a new liquidity obligation for currency swaps transactions and for NIS – foreign currency futures transactions performed with foreign residents, including foreign banks.

Deposits for absorbing surplus liquidity – The Bank of Israel provides deposit tenders for the banking system, as an absorption tool for liquidity surplus in the system. The deposit tenders are for the following time periods: one day, one week, and one month. The maximum interest in these tenders is the interest announced by the Bank of Israel. Additionally, there is a "monetary deposit window" for depositing daily deposits with the Bank of Israel not limited in amount, at an interest rate equal to the Bank of Israel interest rate less 0.5%.

Treasury Bills (Makam) – The main financial instrument for absorbing surplus NIS funds is the Makam (T-Bill), through ongoing issuances to the public and the Bank of Israel's secondary market activity.

Loan tenders at the Bank of Israel – The Bank of Israel provides short-term credit tenders (up to one week) to the banking system, as a means of injecting liquidity, and the minimum interest in these tenders is the Bank of Israel interest. Moreover, there is a daily "credit window" at the Bank of Israel, at an interest rate equal to the Bank of Israel interest rate plus 0.5%. Obtaining credit from the Bank of Israel, through tenders as well as the "credit window", is limited according to the amount of collateral that each bank has at the Bank of Israel.

Material Agreements and Cooperation Agreements

-none-

Rating of the Bank's liabilities by Standard & Poor's Maalot

On May 30, 2013, Maalot announced that after monitoring the Bank's rating with Maalot's updated methodology for rating banks (as published on November 9, 2011), it was leaving the Bank's rating of iIA+ in place and was updating the rating forecast from negative to stable. For details, see the Immediate Report dated May 30, 2013 (Reference 2013-01-079975).

This rating, that is ilA+, is also the rating for the debentures (except for the deferred liability notes, as detailed below) that were issued by Jerusalem Financing and Issuance, a Bank's fully owned and controlled subsidiary. The deferred liabilities notes that were issued by Jerusalem Financing and Issuance are rated at one rating level lower than the Bank's rating, in accordance with the rating agency's methodology. Therefore, their rating is ilA.

On December 22, 2013, Maalot determined a rating of ilA for a private expansion of the series of deferred liability notes (series 10) that was issued to institutional investors by Jerusalem Finance and Issuances Ltd. (Reference 2013-01-103393).

Fixed Assets and Installations

As at December 31, 2013, the depreciated cost of the Bank's buildings and equipment amounted to NIS 150.4 million, compared to NIS 117.9 million as at December 31, 2012. The growth is largely attributed to investments in software.

Most of the premises in which the Bank conducts its business are rented ones. As at December 31, 2013, the Bank had a total area of about 12,500 thousand sq.m. at its disposal, as compared to 11,000 sq.m. as at December 31, 2012.

As of the end of 2013, the Bank owned approx. 1,000 sq.m. of property, similar to that on December 31, 2012.

The rental agreement of the Bank's head office in Airport City was signed on December 19, 2010. The rental agreement is for a period of 7 years (until 2018), with an option for extending it for 7 additional years (until 2025, and an additional option of 7 years (until 2032).

Other fixed assets include software (see below chapter on computer systems), equipment, furniture, and vehicles that are utilized by the Bank for its current activity.

For additional information, see Note 8 to the Financial Statements.

It is the Bank's policy to only hold actually required real estate assets or that is expected to be required in the future. The Bank continually examines the scope, characteristics and location of the areas it needs, based on its business plans and nationwide deployment of branches, and makes the required adjustments.

Intangible Assets

Trademarks and Domain names – The Bank has the following intellectual property rights to trademarks, registered in its name at the Registrar of Trademarks: "Bank of Jerusalem" (in Hebrew), "BANK OF JERUSALEM", "Bank of Jerusalem for Important Decisions in Life" (in Hebrew), "BANKAUT LE'MEADRIN". Furthermore, the Bank is the registered owner of the domain names bankofjerusalem.co.il, bankjerusalem.co.il, www.bank-jerusalem.co.il (Hebrew)www.bankjerusalem.co.il (Hebrew).

Databases – The Bank and companies in its group are the owners of registered databases containing data concerning the Bank's business and its customers.

Customer Relations -As part of the acquisition of Clal Batucha as specified above in the chapter Events in the Reporting Year, the Bank acquired "Customer Relations" (i.e. the estimated fair value of the company's existing contracts, which represents the share in the purchase price attributed to the company's ability to generate future cash flows from the renewal of the contracts that exist as at the acquisition date). This asset was valuated at approx. NIS 2 million. This in addition to customers which were Bank customers prior to the acquisition transaction.

Goodwill – As part of the acquisition of Clal Batucha, as specified above in the chapter on Events in the Reporting Year, goodwill was created with an estimated value of approx. NIS 0.4 million.

With regards to the acquisition of Clal Batucha, the Bank received a valuation of Clal Batucha's significant intangible assets, through an external accounting firm. The valuation of Clal Batucha's significant intangible assets was performed in compliance with International Financial Reporting Standard 3, Business Combinations (IFRS3), and in accordance with American Financial Accounting Standard ASC820-10 (FAS**157).**

The Bank recognized the fair value of the assets that were acquired and the liabilities that were assumed in the framework of the business combination, based on a provisional measurement, since the Bank has yet to receive preliminary approval from the Tax Authority with regards to the tax implications of the merger.

As of the date of approval of the Financial Statements, a final appraisal had not been received from the external value appraiser with regards to the fair value of the identified assets that were acquired and the liabilities that were assumed. The fair value of the assets and liabilities that were acquired are subject to final adjustment up to 12 months from the date of acquisition. According to International Reporting Standard Number 3 regarding Business Combinations, on the date of the final measurement, the adjustments are made by way of restatement of the comparison numbers that were reported in the past based on the provisional measurement.

Information Systems and Computerization

The Bank's computer department works to develop advanced technological systems and to continuously improve the Bank's systems and computer infrastructure. This activity is managed through Tomer Jerusalem.

Computer Centers

The Bank's main computer center is at the head office in Airport City, Lod.

The Bank operates a backup site (DR) located in Jerusalem. As part of the operational merger of Clal Finance Batucha and the establishment of a unique capital market branch, an additional computer room is been established for capital market trading in Beit Rubinstein building in Tel-Aviv, a backup site for this will be at the Bank's main computer center.

Information Systems

The support to the Bank's business activities is provided on the basis of 3 core systems:

A commercial system (BankWare) – for management of commercial activities and the ledger; a mortgage system – for management of mortgage activity; a securities trading system – for management of capital market activity.

In addition to the core systems, the Bank operates additional software/hardware systems:

The CRM system for managing call center and branch activity, the internet marketing and transactions website system, DWH/BI systems for comprehensive managerial information, ATM array, various organizational systems to support Bank activity (supplier and payment management system, money laundering management system, archive system and work processes, back-office array, Control and Command system, process timing system), etc.

Integration and Connectivity

The Bank has software tools (ESB – Enterprise service bus) that facilitate integration between the channels systems and the core systems. The integration method between the systems is carried out through development of Web services.

Backup and Disaster Recovery

The Bank's disaster recovery policy is based on the operation of systems defined as vital in accordance with the amount of time established, at a backup site.

For this purpose, a backup site(DR) was established in Jerusalem, that includes the systems that were assigned a high critical rating.

In 2013, the site's expansion continued as did the establishment of backup systems for additional and new systems that were defined as critical systems, and this according to priorities that are determined by the Bank.

Information Security

The Bank invests vast resources for the assimilation of new products and the continuous improvement of the level of information security. In view of the high importance the Bank places on this issue, the Bank's information security policy is determined by the Bank's Board of Directors, which oversees actual policy implementation. The policy is implemented by the Information Security Manager and the Bank's computer department.

In 2013, the Bank performed the following activities:

- Operation of the ATM array

- Assimilation of a CRM system at the call center and in Bank branches.

- Operation of the new internet system, that includes a marketing site and information site.

Computer Infrastructures

The Bank's computer infrastructures fully support the Bank's various systems. The Bank performs standardization for uniform infrastructures, standards were set for the setup of databases, broad communications networks were built that enable a fast flow of information without loads even during peak hours, a modular telephony system was built, that supports growth of both quantity and volume of calls, including recordings required by regulation, the storage and backup system was replaced. In addition, organizational timing system and a C&C system were assimilated.

Supplier Management

The Bank relies on different systems, including the core systems, that were developed and are maintained by various companies. The Bank maintains proper connections with all the external suppliers of information technology, in order to ensure system normality, continuous operation, as well as technological and functional upgrading.

Periodically, the Bank verifies the situation of the companies and their economic soundness, mainly in respect of essential and central systems.

The Bank's relations are anchored in individual agreements with each supplier, specifying the supplier's obligations to the Bank (including SLA) and also the Bank's obligations to the supplier.

In the trading system and the mortgage system – the software and documentation are deposited in a trust.

The Bank is dependent on the software suppliers of the Bank's trading system and its mortgage system.

The source codes and documentation of these software are deposited in trust, in accordance with the directives of the Supervisor of Banks. With regards to capital markets, the Bank receives full services from FMR and is dependent on it in this context. The Bank relies on technological infrastructures of ORACLE, EMC, IBM andMICROSOFT.

Investment Scope

During 2013, the scope of investment in software and hardware amounted to approx. NIS 54.1 million, and NIS 49.6 is planned for 2014, for the purpose of compliance with work plans as approved by the Bank's management.

Computerization Costs for 2013

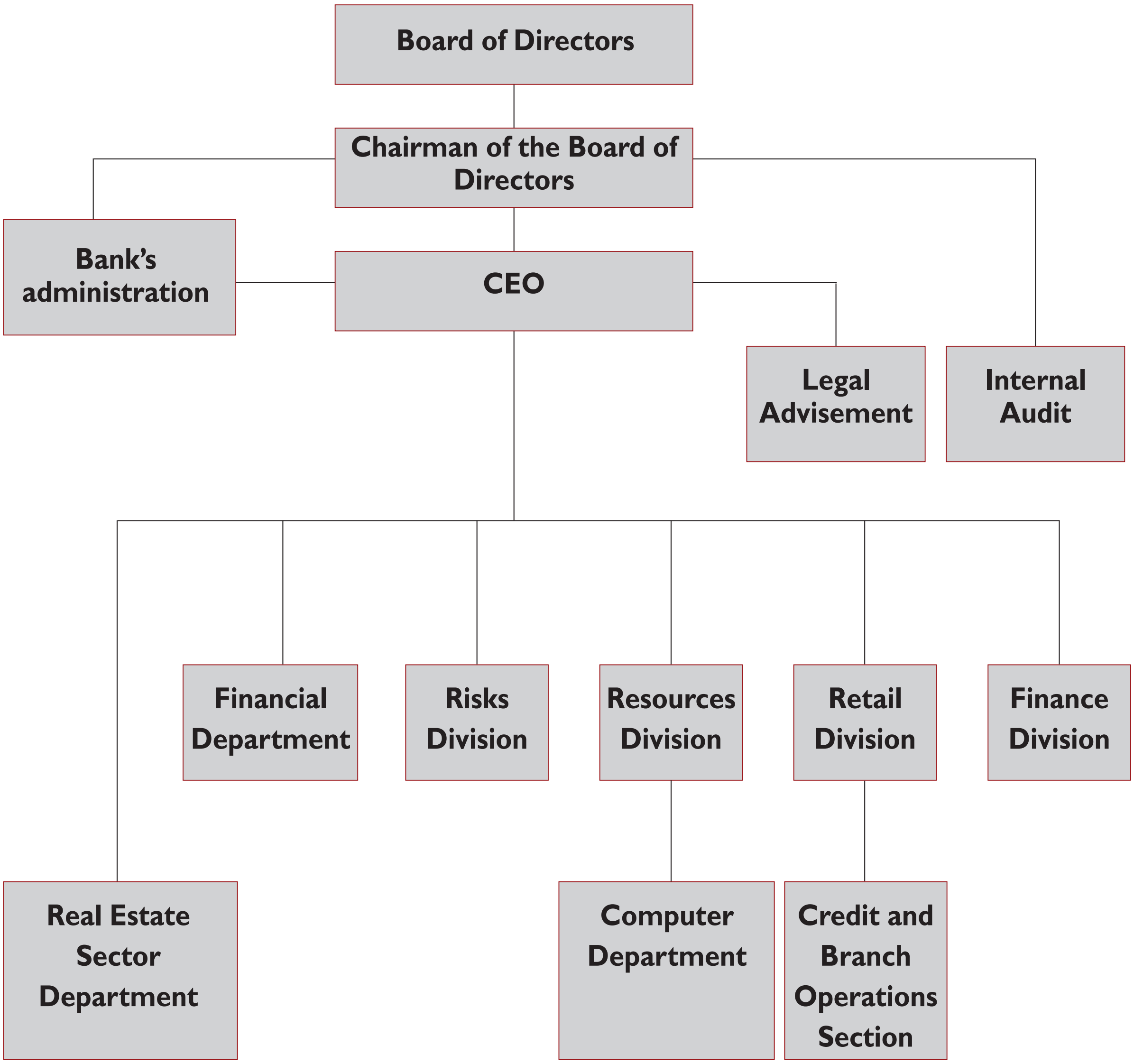
Expenses recorded in the Profit and Loss Statement (in millions of NIS)	
Payroll and related expenses	8.6
Outsourcing expenses	4.6
Depreciation expenses	22.3
Other expenses	27.6
Total	**63.1**

Costs recorded as assets (in millions of NIS)	
Capitalization of payroll and related expenses	10.7
Capitalization of outsourcing expenses	20.0
Total	**30.7**

Balance of assets for the information technology system (in millions of NIS)	
Amortized cost (software costs)	101.9
Depreciated cost (computer equipment)	4.3
Total	**106.2**

Flowchart of the Organizational Structure

Below is a Diagram of the Bank's Organization Structure:



In 2013, a change was made in the Bank's structure, in which a retail credit division and branching division were canceled, and their activity merged into the credit and branch operations section within the retail division. The change took place as part of the streamlining plan announced by the Bank in July 2013 to reduce Bank expenses.

Personnel Placement[1]

Below are details of the number of personnel in the Bank and in its subsidiaries:

	At the end of		Annual average	
	2013	2012	2013	2012
Number of employees:	550	509	542	479
From this: outsourcing	68	46	67	45
Number of positions:				
In regular hours	541	483	528	468
In other hours	6	-	21	19

Below details on the payroll expenses based on various salary levels:

	Number of positions[2]		Total expenses
NIS in thousands per year[3]	**Bank employees**	**Outsourcing**	**in millions of NIS**
Up to 100	8	35	4
Over 100 up to 300	314	18	67
Over 300	144	9	64
Total salaries	**466**	**62**	**145**
Plus expenses not included in salaries			7
Less salaries and related expenses that were capitalized			(6)
Total salaries and related expenses			**146**

(1) In this report, the section on Bank Personnel also includes managers who provide their services through the management companies controlled by them. The Outsourcing section includes workers employed through employment agencies, software houses, and other companies providing services to the Bank, from which certain workers for specific positions are hired.

(2) Including employees according to 100% position. Employees in part-time jobs were merged (annual average).

(3) The division into groups was based on the annual cost per employee, assuming a 100% position.

For details regarding the positions by sectors of activity, see section on "Financial Data by Sectors of Activity" in this report.

In 2013, as part of the acquisition of the activities of Clal Batucha, 40 employees were absorbed in the finance division, some of whom are directly employed by the Bank and some who are employed via a Bank's external service provider. For details on the acquisition of Clal Batucha, see the chapter Events in the Reporting Year above. Furthermore, in accordance with the Bank's strategic plan, deployment of the Bank's employees primarily in the branches increased, in order to staff new branches and to condense existing ones.

At the same time, as part of the streamlining plan announced by the Bank in July 2013, 18 positions in the Bank's head office were downsized. For details on the streamlining plan, see the chapter Events in the Reporting Year above.

In 2014, in accordance with the targets set in the work plan, the Bank plans to recruit 18 new employees, most of them for existing branches, and for the back-office system that will continue the process of expanding its activity and supporting business activity.

All or some of the information detailed in this paragraph is "forward-looking information" that might not occur in part or in whole, or might occur differently from expectations. This information is based on assessments of the Bank management concerning implementation of the Bank's annual work plan. These assessments might not occur, inter alia, due to economic events, political / security events, ability to realize the Bank's plans based on the targets established in accordance with its strategy, unexpected responses of additional factors (customers, competitors, etc) operating in the bank's business environment.

Rotation and Vacation

The Bank operates according to the Proper Banking Procedures instructions on the issue of rotation, and considers the rotation of sensitive functionaries an important component in the organization's internal auditing procedures. In the event that mobility between positions does not exist, the Bank implements compensating controls.

The Bank established an individual vacation usage target for Bank employees and conducts a monthly individual monitoring of compliance with the target. In 2013, inter alia, following increased enforcement of compliance with the vacation usage target, the provision for vacation declined by approx. NIS 1.1 million.

Training

The Bank provides regular guidance and professional training to its employees, in accordance with the employee's position and the Bank's requirements.

In 2013, Bank training focused on training the branch array, the call center and the backup system, for the support in new business objectives issued by Bank management. Training in the core area included, inter alia, current and consumer credit training and individual training for credit officers, as well as basic training in investments. The Bank continues to conduct training for call center bankers and for video conference bankers, while providing knowledge on various professional subjects and personal skills in service and sales. In addition to the aforementioned, training was given in the risk management channel (money laundering, operating risks, arrears controls management, compliance and administrative enforcement).

In the area of soft skills, quarterly training was given to middle managers in the branch array (top team leaders), to improve the connection with the business goals, understanding of lateral processes, managerial skills and team motivation. Branch managers received individual training and skills with emphasis on sales management. In addition, comprehensive assimilation of the CRM system was carried out in the head office and in the branches.

In 2013, the Bank provided 1,861 training days at a cost of NIS 425 thousand (NIS 325 thousand of which for training and instruction on sales), compared to 2,364 training days in 2012 at a cost of NIS 964 thousand. The majority of the reduction is attributed to a curtailment in sales training, following three years in which employees underwent intensive training in this area.

Employee Compensation Policy

On December 12, 2012, Amendment No. 20 to the Companies Law 5773-2012 went into effect, in which public companies are required to formulate a compensation policy with regards to the terms of service and employment for officers (hereinafter: "Amendment 20"). On November 19, 2013, the Supervisor of Banks published the Instruction on Proper Bank Management A301, regarding compensation policies in a banking corporation (hereinafter: "PBM301A"). This instruction contains additional requirements, inter alia, regarding compensation of officers in banking corporations and compensation of all banking corporation employees. Following the institution of PBM301A and after Amendment No. 20 went into effect, amendments were made to Proper Bank Management No. 301, with regards to the appointment and functions of a compensation committee.

In accordance with the Companies Regulations (Easements on the mandatory requirement for Compensation Policy) 5773 – 2013, it was established that despite the contents of Section 267a to the Companies Law, a company whose shares were not included in the TA 100 Index of the Tel-Aviv Stock Exchange on June 16, 2013, is entitled to establish for the first time a compensation policy by January 12, 2014. Since Bank of Jerusalem shares are not included in the TA 100, the easement applies to it.

In accordance with Section 23 of the Transition Provisions of PBM301A, the requirements in accordance to the provisions of PBM301A will apply to the compensation policies to be set forth from the date of publication of the provision, and no later than June 30, 2014, whereas for the individual compensation agreements of officers, the requirements according to the provisions of PBM301A will apply as specified below:

1. A compensation agreement that was approved on the date of publication of PBM301A and later, including an extension or amendment of an existing compensation agreement – will apply from the date of publication – November 19, 2013.

2. A compensation agreement that was approved between June 3, 2013 (date of publication of the draft PBM301A) and until the date of publication of PBM301A – no later than June 30, 2014.

3. A compensation agreement that was approved before June 3, 2013 – no later than December 31, 2016.

The requirements in accordance with PBM301A will not apply to the rights accrued by the officer by the date of publication of PBM301A.

On December 24, 2013, the Securities Authority published a clarification with regards to the convening of a General Assembly to approve the compensation policy in accordance with Amendment No. 20 to the Companies Law 5759-1999 (hereinafter: the "Companies Law"), following the clarification published on

August 28, 2013. In this clarification, the Authority clarified that considering the importance of the subject and the accrued load that accumulated as a result of multiple General Assemblies, it will not intervene in the postponement of the Assemblies beyond the updated deadline, under the assumption that an effort will be made by companies to expedite the handling of the compensation policy. However, until approval of the compensation policy, companies are required to act with regards to approval of the terms of service and employment of every officer, as companies that have not yet approved a compensation policy.

The Bank is working to adapt the existing compensation plan to the provisions of Amendment No. 20 and to the provisions of PBM301 A. As of the report date, the Bank's compensation committee convened several times to formulate the Bank's compensation policvy and to issue a recommendation to the Board of Directors to approve the compensation policy, and the Bank's Board of Directors also convened several times in order to expedite the adjustment of the compensation plan to the aforementioned provisions. Approval of the compensation plan by the Board of Directors, following the recommendation of the compensation committee, is expected at the beginning of March, after which it will be brought, in accordance with the requirements of Section 267a to the Companies Law, to the General Assembly of the Shareholders of the Bank for approval.

It is hereby clarified that subject to the aforementioned and to the transitional provisions of Amendment No. 20 and to the transitional provisions of PBM301A, the compensation policy that was in place in the Bank in 2013 is in accordance with the compensation plan for employees and management members (with the exception of the general manager) that was approved by the Bank's Board of Directors in 2010, which established criteria and threshold conditions for receiving an annual bonus (hereinafter: the "Plan"). The Plan was approved in accordance with the directives of the Bank of Israel pertaining to employee compensation that had been valid at that time.

Should the Bank meet the threshold conditions for bonus payment, as set by the Plan, the employees, including management members, will be entitled to an annual bonus payment according to brackets, as follows (data in thousands of NIS):

Calculated yield	Bonus to employees		Bonus to management members		Total amount of bonus to employees and members of management	
	From	Up to	From	Up to	From	Up to
8.5%-9%	1,200	1,200	-	-	1,200	1,200
9%-10%	2,900	4,500	400	700	3,300	5,200
10%-11%	4,500	6,000	700	950	5,200	6,950
11%-12%	6,000	7,250	950	1,500	6,950	8,750
12%-13%	7,250	8,500	1,500	2,000	8,750	10,500
13%-14%	8,500	11,000	2,000	2,700	10,500	13,700
14%-15%	11,000	13,000	2,700	3,300	13,700	16,300
15%-16%	13,000	15,000	3,300	4,500	16,300	19,500

It should be noted that according to the compensation policy in 2010, if the Bank fails in 2013 to meet the established threshold, an amount of NIS 800 thousand will be allocated to pay the bonus to select employees.

As threshold for receiving the bonus, two situations have been defined:

a. Before the Bank's Board of Directors approved the project (as determined below) or after the Board of Directors determined that the project bears accounting profits – minimum reported yield (as determined below) higher than 8.5%.

b. After the Board of Directors approved the project and before the Board of Directors determined that the project bears accounting profits – minimum reported yield higher than 5% (in case the reported yield was higher than 5% but did not reach 8.5%, only the relative part of the bonus as derived from the above table shall be distributed).

"Calculated Yield" is defined as the "Reported Yield" (as defined below), neutralized by the share of capital that is tied up by the project activity (as stipulated below) (for this purpose, capital tie-up is defined as the required capital based on the capital adequacy requirements for risk assets that are managed as part of the project), and neutralized by (1) project expenses and income (as defined below); (2) tax shield that will be formed as a result of the project; as these will be recorded in the bank's books. The mode of neutralizing the project's income and expenses and the tax shield that will be formed as a result of the project will be reviewed and approved by the Bank's Board of Directors or its committee, based on the opinion that will be submitted every year by an independent extern auditor whose identity was defined in the Plan.

"Reported Yield" is defined as the average between the annual yield (net) on equity, as reported in the Bank's audited annual Financial Statements, and the growth rate in the Bank's equity, as reported in the Bank's audited annual Financial Statements. A dividend declared and paid during the year and capital issuances, if there were any, will be neutralized for the purpose of calculating the growth in equity (meaning, it will not be taken into account for the purpose of calculating equity growth rate). To calculate the reported yield, the effects of non-recurring profits (it is clarified that an activity that has financial characteristics, such as the nostro account, will not be considered a one-time activity) and capital gains (with the exception of gain that may derive from the sale of a certain land asset) will be neutralized. To remove any and all doubt, the Reported Yield will be after taking into account the expenses for payment of grants to the CEO, to members of management and to employees, and after taking into account the expenses for options to the CEO and to management members (and to any other party, if any), as will be recorded in the Bank's books. The mode of neutralizing the said components will be reviewed and approved by the Bank's Board of Directors or its committee, based on the opinion that will be submitted every year by an independent extern auditor whose identity was defined in the Plan.

In the Plan, a "Project" was defined for the setup and operation of a new retail banking operation for the Bank; further defined was "Project Expenses and Income", which will be in accordance with the project's results of operations in the bonus year, so that at least 75% of said expenses and income, according to the matter, are derived or related, directly or indirectly, to the Project. It is hereby emphasized that if at least 75% of said expenses or income are derived from or related to, directly or indirectly, the Project, 100% of these expenses or income will be attributed to the Project.

It is noted that the bonus calculation in accordance with the aforementioned will be done in a linear and pro-rata manner, between the above specified brackets, within the set boundaries of such brackets. Furthermore, the bonus level is limited to 8 salaries for Bank employees and 12 salaries for Management.

The bonus will be paid on the dates and in the terms established in the Plan. It should be mentioned that, according to the Plan, the bonus for management members will be paid in stages over three years from the date of eligibility (60% for the eligibility year and 20% for one and two years after the date of eligibility), while the payment of each part of the annual bonus is contingent upon continuous compliance with the goals during the year established for payment.

The actual payment of the annual bonus depends therefore on the year in which the payment should be implemented, that there will be no regulatory limitation and/or capital adequacy limit on dividend distribution at a rate of at least 33% of the net profit in the payment year to the Bank's shareholders. As far as the aforementioned limitation applies to the dividend distribution, the bonus payment will be deferred, in whole or in part, to a date on which the aforementioned limitation is removed. In the event of the ability to make only a partial payment of the dividend, the dividend will be paid to the shareholders and the bonus, pro-rata, for the aforementioned limitation rate, and the payment of the balance of the bonus will be deferred to a date on which the regulatory and/or capital adequacy limitation is removed.

It should be noted that in accordance with the compensation plan for Management, at this stage, in accordance with the regulatory instructions for banks, this section will not be implemented.

The payment of the bonus according to the plan is conditional for at least six months of employment at the Bank, and actual employment on the day of bonus payment. Nevertheless, the Bank's CEO in relation to the employees, and the Bank's Board of Directors in relation to management members, have exclusive discretion to approve bonus payments also in the event in which the employer-employee relation is terminated prior to the bonus payment date and to stipulate conditions, as it sees fit.

The Bank’s Board of Directors will examine whether to increase the bonus ceiling while paying attention to the labor force, total profit, profitability, risk profile, and so forth.

For details concerning the compensation plan for the CEO and the Board of Directors, see Note 22 to the Financial Statements.

Description of employment agreements

Approx. 50% of the Bank's employees are employed under personal employment agreements that arrange the employment terms at the Bank. Once a year, the update of their terms of employment is reviewed based on the employee’s differential contribution to the Bank, as well as recommendations by the managers. The personal employment agreements are signed separately with each employee, according to the salary and social benefits arrangements as individually agreed with them at the time of recruitment.

The employment terms of about 50% of the Bank's employees are arranged under an agreement signed with the Bank's Employees Committee for arranging the employment terms and their salary increments (hierarchical employee agreement). This agreement has the status of a collective agreement. Every two years the agreement is updated with the consent of the employees committee through an additional letter signed by the management and the Employees Committee. This update includes salary increases in respect of the base salary and related expenses, and takes into consideration the increase of Consumer Price Index for the update period. In addition, the Bank also holds annual personal rating negotiations with the aforementioned employees. The aforementioned arrangement is also applied on part of the employees who are the Bank's authorized signatories and are included in the population of rank employees, except for the fact that in respect of their signing authority, they are entitled to an additional increment.

Retirement arrangements – retirement terms for employees with personal agreements are included in their employment agreement.

Employees of subsidiaries are employed according to the Bank's employment terms.

In addition, the Bank and its subsidiaries purchase services from employment agencies and software houses (for details, see "Outsourcing Workers" in the above table).

On July 14, 2013, the Bank announced implementation of a streamlining plan in the Bank that includes, inter alia, downsizing of positions in the Head Office and a salary freeze for a period of up to two years. This plan was amended and curtailed in a non-material manner in December 2013. For details, see the chapter on Events in the Reporting Year.

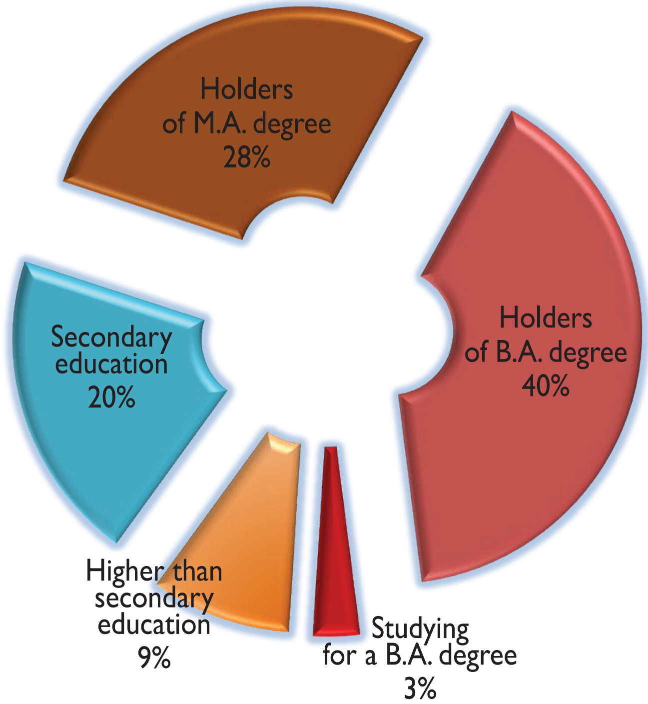
Development of Human Resources

The Bank focuses on ideological investment in its personnel, concurrently with development of employees and human resources.

In addition to internal structured training dealing with the Bank's core business and risk management, the Bank encourages its employees to participate in academic studies and external training in the areas that touch upon their activity areas. In addition, the Bank sends its employees to courses, seminars and professional conferences pertaining to banking industry.

In 2012, the Bank hosted a management training course that incorporated workshops for developing personal skills, professional instruction and personal coaching by an external moderator. In 2013, middle management employees in the branches underwent training for leading teams.

At present, the Bank recruits mainly academic personnel and as of the end of 2013, 68% of the Bank's employees possess an academic degree, of whom 28% have a master's degree and 5% are studying for a master's degree. A total of 80% of the Bank's employees possess a post secondary school education and 3% are studying for a bachelors degree.



The Bank also encourages mutual support between its employees, and established a mutual fund between the Bank and its employees for supporting employees in financial distress.

Officers and Authorized Signatories

As at December 31, 2013, 10 officers serve in the Bank. Of these, 9 are employed under personal agreements, and 1 is under a service provision agreement through a management company controlled by him. The Bank has 195 authorized signatories, 94 in branches and 101 in the Head Office. For details on the appointment and retirement of officers during the reporting period, see the chapter on Senior Officers below.

Taxation

General

The bank is defined as a "financial institution" for purposes of the Value Added Tax Law 5735 – 1975, and as such is subject to payroll tax and profit tax on its activities, according to the rates determined in the VAT Act.

According to the VAT Order (Tax Rate on Non-Profit Organizations and Financial Institutions) (Amendment), 5773-2013, ratified by the Knesset in May 2013, the payroll tax that applies to financial institutions will stand at 18%, effective from June 2013.

In accordance with the provisions, the payroll tax rate in the months of January – May of 2013 will stand at 17%, and beginning in June, at 18%. The weighted profit tax rate for all financial institutions in 2013 will be 17.58%.

On August 8, 2013, the Knesset passed the Law for Change in the Tax Burden (Legislative Amendments) 5772-2013 (hereinafter: the "Law"). As part of the Law, the corporate tax rate will be increased to 26.5% beginning in 2014 and later.

Below are the statutory tax rates that apply to financial institutions, including the Bank:

Year	Corporate tax rate	Profit tax rate	Comprehensive tax rate
		%	
2010	25.0	16.00	35.34
2011	24.0	16.00	34.48
2012	25.0	16.33(*)	35.53
2013	25.0	17.58(*)	36.22
2014 and later	26.5	18.00	37.71

(*) Weighted rate

On December 15, 2013, the acquisition of the companies Clal Batucha and Brokerage was completed (for details, see above the chapter on Events in the Reporting Year), and on December 31, 2013, the merger of these companies with the Bank was completed.

In September 2013, the Bank contacted the Tax Authorities in order to receive an agreed tax decision according to which, on December 31, 2013, the companies acquired would merge into the Bank (hereinafter: the "Merger"), in accordance with the provisions of Section 103b to the Income Tax Ordinance (New Version) 5721-1961 (hereinafter: the "Ordinance").

Assessments

Final assessments were issued for the Bank up to and including 2007. For two subsidiaries, final tax assessments were issued up to and including 2005 tax year. Tax assessments up to and including 2009 are considered final.

The current and deferred taxes were calculated according to the new tax rates.

Restrictions on and supervision of the activity of the banking corporation

The Bank has a bank license, in accordance with Section 10 to the Banking (Licensing) Law 5741-1981. Pursuant to the license, the following restrictions apply to the Bank: the Bank may not control and may not be an interested party in corporations of any kind, in Israel or abroad, with the exception of auxiliary corporations, without the approval of the Supervisor, for a certain corporation or kind of corporations. The above will not be applicable to corporations held by the Bank according to relevant legislation immediately prior to receipt of the license, and such holding is according to the determined conditions.

Furthermore, the appointment of the Chairman of the Board of Directors and the General Manager is subject to advanced written approval from the Supervisor of Banks.

It is clarified that the license requirements concerning control in auxiliary corporations and approval for appointing Chairman and CEO, are requirements included nowadays in the banking enactment and relate to all the banking corporations.

In addition, the Bank of Israel informed the Bank that it may carry out options and SPOT transactions between currency rates or interest rates solely for the purpose of hedging. Transactions that are not for the purpose of hedging require prior approval of the Bank of Israel.

In accordance with the announcement submitted by the Bank to the Bank of Israel, the Trust Corporation of Bank of Jerusalem Ltd, a wholly owned subsidiary, implements instructions of its customers without exercising discretion.

Licenses For Activities of Subsidiaries

Ir Shalem, a Bank's wholly owned and controlled subsidiary, has a corporation insurance agency license according to the Law for Supervision of Financial Services (Insurance), 5741 – 1981. In accordance with provisions of the Commissioner of Insurance and the Supervisor of Banks, Ir Shalem is entitled to engage only in marketing of life insurance and property insurance policies, resulting from housing loans granted by the Bank (this limitation does not apply to insurance made before January 1, 2006).

Jerusalem Investment Portfolio Management Ltd., a Bank's wholly owned and controlled subsidiary, had a license from the Securities Authority to manage portfolios, until March 24, 2013. The subsidiary's portfolio management activities were sold on January 7, 2013. Once the transfer of activities was completed, the subsidiary canceled its license. For details, see the chapter on Events in the Reporting Year.

General

The Bank is a commercial bank, a public company whose securities are traded on the Tel-Aviv Stock Exchange Ltd., a member of the Tel-Aviv Stock Exchange, a member of the Stock Exchange Clearance and the Maof Clearance, and, accordingly, is subject to all relevant legislation.

The Bank's activities are subject to laws, regulations and instructions that are partly unique for the banking system, and partly, even if not unique as mentioned, influence material sections of its activities. The Banking Ordinance, various banking laws, and proper banking management instructions that are periodically published by the Supervisor of Banks, are the legal and central basis of the Bank's activities. These determine, inter alia, the limits of activity permitted to the Bank, relationships between the Bank and its customers, usage of the Bank's assets, manner of reporting on the aforementioned activities to the Supervisor of Banks and the public, and the activities permitted to the Bank's subsidiaries and the terms of control and ownership thereof.

Besides them, the Bank is subject to extensive legislation that regulates the Bank's activities in the capital market for its customers as well as for itself (e.g. in the area of investment consultancy and management of customer portfolios, Securities Laws, and limitations on activities in the insurance area).

Bank commissions, including those of the Bank of Jerusalem, are supervised by the Bank of Israel. In addition, the Bank of Israel determined "price lists" that include a list of the services for which banks may charge commissions and the method for calculating said commissions.

Additional laws, on unique subjects, impose on banks, including the Bank, specific obligations and rules. For example, the enactment in relation to the prohibition of money laundering and the prohibition of financing terror, the law on credit data, the enactment in relation to housing loans, collateral laws, etc.

In addition to these, there is an enactment, that due to its connection to the Bank's activities, significantly affects its conduct. On this issue, inter alia, the execution proceeding office law, liquidation and receivership laws, and various tax laws should be mentioned.

The activity of the Bank is under the supervision and regulation of the Supervisor of Banks, as well as other supervisory entities in specific activity areas; for instance, Securities Authorities, Commissioner on Capital Market, Insurance and Savings at the Ministry of Finance, and the Anti-Trust Commissioner.

The Bank and its subsidiaries operate in order to comply with obligations applied on them by the provisions of law.

In the framework of the legislation, most of the laws applied on the Bank's activity allow for the possibility of imposing financial sanctions due to violations of legal instructions and secondary legislative instructions (including circulars and guidelines) issued or to be issued based on them.

Below are, in summary, details of legislative changes (including instructions by the Supervisor of Banks) relevant to the reporting period, that influence or may influence in a material manner the Bank's activity (for legislative changes relevant to the reporting period that influence or may influence the activity of activity sectors, please see reference for each sector separately):

Provisions of Proper Banking Management 311 on "Credit Risk Management"

On December 23, 2012, the Supervisor of Banks published Provision 311 on Credit Risk Management, that is primarily based on the Basel principles from September 2000. This provision defines the structure of credit risk management required from banking corporations, and the delegation of authorities pertaining to credit risk management among the various functions in a banking corporation. These requirements constitute an adoption of the approach by which in order to support adequate credit decision-making and to minimize the effects of conflicts of interests, strong involvement of an independent function is required in the business units, in particular, in the formation of credit policies, in classification of debts and in establishment of provisions for credit losses. The provision further establishes that the decisions regarding approvals of significant credit exposures will be made with reference to the opinion of the risk management function. The provision applies since January 1, 2013. The bank is implementing the provision.

Provision of Proper Banking Management 350 on "Operating Risk Management"

On December 23, 2012, the Supervisor of Banks published an update to Provision 350 on Operating Risk Management, that is primarily based on the Basel Committee directives from June 2011. This provision updates the previous Provision 350 with regards to the applicability of Proper Banking Management Provision 310. The provision establishes ten basic principles for managing operating risk, and refers to the framework for operating risk management and the principles that were established primarily address corporate governance issues and the operating risk management environment. The provision will apply beginning on January 1, 2014. The bank is implementing the provision.

Provision of Proper Banking Management 331 on "Dividend Distribution by Banking Corporations"

On January 15, 2013, the Bank of Israel amended the Proper Banking Management Provision 331 on dividend distribution by banking corporations. The provision amends references to certain profits and losses of banking corporations that are recorded in other comprehensive income and not in the Profit and Loss Statement. The provision amends the existing limitations on dividend distribution by the Bank and expands them, so that the limitations on retained earnings will also include components of accumulated other comprehensive income, and limitations on net profit will be expanded to limitations on comprehensive income.

The provision applies since January 1, 2013. The Bank is implementing the provision.

Proper Banking Management Provision 314 on "Proper Assessment of Credit Risk and Adequate Measurement of Debts"

On April 30, 2013, the Supervisor of Banks published an update to Proper Banking Management Provision 314 on "Proper Assessment of Credit Risk and Adequate Measurement of Debts".

The updated provision adopts seven criteria for adequate assessment of credit risks and adequate measurement of debts and lists the appropriate ways of implementing them. Among the criteria listed in the provision is the accountability of the Board of Directors and Management for the existence of risk assessment processes. In addition, the Bank is required to maintain a reliable classification system for debts, establish in its policies a comprehensive process for the validation of internal models and adopt, while documenting it, a work method to handle credit losses. The provision further establishes that the Bank must maintain sufficient provisions to cover credit losses assessed in the credit portfolio, use discretion of experienced employees in credit and maintain a consistent risk assessment process that will provide it with consistent tools and data.

The provision will apply beginning on January 1, 2014. The bank is implementing the provision. Implementation of this provision is not expected to materially affect the Bank's financial statements.

Bank of Israel Provision on Compensation Policy

On November 19, 2013, the Supervisor of Banks published the Proper Bank Management provision regarding compensation policies in a banking corporation (hereinafter: the "Provision"). The Provision established rules designed to ensure that the compensation arrangements in banking corporations in Israel will be consistent with the risk management framework and with the banking corporation's long-term goals.

In accordance with the Provision, the banking corporation must adopt a compensation policy that will apply to all employees of the banking corporation and that will address all forms of compensation given to employees. The compensation policy will be prepared on a multi-year basis, will take into account organizational considerations, and will require approval of the Board of Directors at least once every three years.

The Provision further established that the banking corporation must define which employees are "key employees" in the banking corporation, whose actions might materially affect the banking corporation's risk profile, including officers in the banking corporation. The Provision includes requirements that will apply to all of the employees of the banking corporation, and requirements that will specifically apply to "key employees."

The Provision established that the variable compensation for key employees must depend on compliance with predetermined criteria, and must be based on a combination of the performance of the employee, the business unit and the entire banking corporation. The maximum variable compensation will not exceed 100% of the compensation fixed for every employee, subject to exceptions set forth in the Provision. The variable compensation is also subject to rejection arrangements set forth in the Provision. The Provision further established rules regarding the granting of shares and share-based instruments, including a demand that at least 50% of the total variable compensation for one calendar year be granted in the form of shares and share-based instruments, and a prohibition on granting variable compensations that are not performance-contingent, with the exception of a signing bonus. The Provision established that payment to key employees (with the exception of the directors) will be paid directly and not by way of corporation or any entity.

The Provision establishes instructions regarding control, documentation and audit in respect of policies, arrangements and mechanisms for compensation in a banking corporation, as well as provisions for compensating employees working in risk management, audit and control.

In addition, the Provision includes transitional provisions in which the requirements in accordance with these provisions will apply to the compensation policies to be set forth as from the date of publication of the Provision and no later than June 30, 2014, and provisions regarding existing compensation agreements. The Bank is prepared to implement the Provision and is in the process of formulating a compensation policy for officers in the bank. For more details, see chapter on Human Resources in this report.

Bank of Israel Draft on Employee Rights

On January 30, 2014, the Supervisor of Banks distributed draft amendments to the instructions for reporting to the public, that were designed to update the requirements for recognition, measurement and disclosure on employee benefits according to the GAAP in banks in the United States.

The draft cancels the temporary order that establishes the capitalization rate for calculating reserves to cover employee rights, and establishes that the capitalization rate will be based on the market yields for government debentures in Israel, and that the banking corporation will establish policies and procedures that detail how government debentures used to calculate the capitalization rate will be selected.

The date of implementation of the instruction was established for January 1, 2015 and will include a retrospective amendment of the comparison data for the periods beginning on January 1, 2013 and henceforth.

In the financial statements of the banking corporations that will be published by such date, disclosure will be given regarding the expected quantitative effect of first-time adoption of these rules on the banking corporation's capital and liabilities.

Based on the Bank's initial assessment, implementation of the draft will not have a material effect on the Bank's results.

The Law to Promote Competition and Reduce Concentration 5774-2013

On December 9, 2013, the Knesset passed the Law to Promote Competition and Reduce Concentration, 5774-2013 (the "Law"), which is based on the recommendations of The Committee on Increasing Competitiveness in the Economy. The rationale behind the law is that the supra-sector centralized structure of the Israeli economy has sparked concerns of harm to the soundness of the financial system and to competition, and that a competitive, efficient market must be promoted by simplifying the structure of the business groups operating in the Israeli economy, while decentralizing control over it.

The Law includes three significant chapters:

(a) The government's obligation to consider economy-wide concentration and industry-wide competitiveness when allocating rights in "vital infrastructures" to an entity that has been classified as a "centralized entity".

(b) Restricting control in multi-layer business groups (pyramid structure in the words of the Law), i.e. a structure that includes several "layer companies". The core principle established by the Concentration Law is the prohibition of a pyramid structure of companies, that includes more than two layers of reporting corporations. The Law went into effect immediately upon its publication, but includes transitional provisions with regards to pyramid structures created prior to the effective date of the Law. Control of a company while violating the Law will result in the appointment of a trustee for the Company, who will be granted the instruments of control in the Company for the purpose of their sale.

    To the best of the Bank's knowledge, the Association of Banks contacted the Ministry of Justice, with a request to except the issuing companies of the banking corporations (the "pipe companies") from the provisions of the law regarding pyramid structures, similar to the exemption granted to pipe companies in the Companies Regulations (Easements for Certain Types of Debenture Companies) 5772-2012, from certain provisions set forth in the Companies Law.

    As part of this chapter, the Law imposes amendments of various corporate governance provisions in the Companies Law, that are valid as at January 10, 2014 and that apply to all public companies and debenture companies, regardless of whether or not they are layer companies, including:

    (1) Requiring the audit committee to maintain a "competitive process or other processes", prior to any engagement with a controlling shareholder or in a transaction in which the controlling shareholder has a personal interest. In addition, the Audit Committee is required to establish the method by which transactions with controlling interests which are not negligible must be approved.

(2) To the extension of the tenure of a serving external director for an additional period, while neutralizing the voting power of the controlling shareholder, a new condition was added, according to which the external director cannot be a related shareholder or a competitor, or a relative of them or associated with them on the date of the appointment or in the preceding two years.

(3) The wording of Section 270 to the Companies Law was amended in a manner which determines that it is not enough that transactions with interested parties and officers do not harm the company, but they must benefit the company (positive stipulation). Furthermore, the Law stipulates that the Minister of Finance and the Governor of the Bank of Israel will establish within a maximum of two years, provisions regarding restrictions on credit given to corporations or to a business group by financial entities, on an accumulated basis, taking into account, among other things, the liabilities of each corporation or the total liabilities of the business group, according to the matter.

(c) Separation of ownership and management between significant financial entities and significant non-financial entities. The Committee is expected to publish a list of significant non-financial and financial entities.

The main limitations imposed by the Law on said corporations include:

(1) A significant non-financial corporation or its controlling interest will not hold over 10% of a certain type of means of control in a significant financial corporation (or 5% if the financial corporation has no controlling interest).

(2) The holder of more than 5% of a certain type of means of control in a significant non-financial corporation will not control a significant financial entity.

(3) An insurer and company that manages provident funds will not hold more than 10% of a certain type of means of control in a significant non-financial corporation and a company that manages a mutual fund will not hold more than 10% of the listed value of securities (that are not debentures) issued by a significant non-financial corporation.

(4) A banking corporation will not hold more than one percent of a certain type of means of control in a significant non-financial corporation or in an insurer that is a significant financial entity (with certain exceptions).

(5) The controlling interest in a banking corporation that is a significant financial entity will not control an insurer that is a significant financial entity. Implementation of the said limitations in accordance with this Chapter will occur by the end of 6 years from the date of publication of the Law, subject to exceptions. In addition, the Law establishes limitations on the cross-service of corporate officers (including controlling shareholders and/or their relatives) in accordance with the transition provisions established in the Law.

Legislative Bills

From time to time, draft legislation amendments are brought before the Knesset pertaining to various issues, some of which might affect the business of banking corporations, including the Bank. In addition, from time to time, various regulatory authorities, such as the Supervisor of Banks, the Securities Authority, etc. distribute draft provisions and directives, for the public comments. As of the date of the Financial Statements, there are several draft laws in various stages of legislation, as well as several drafts that were distributed by the Supervisor of Banks. These draft laws and draft provisions are designed to increase regulation and supervising of a bank's relationship with customers, to arrange various aspects in bank activity, to arrange the activity of public companies in various areas, etc. At the same time, as of the date of the Financial Statements, these drafts are in various stages of legislation or regulation, might be amended and there is no certainty of when they will be completed or when they will eventually become legislative provisions or binding regulatory provisions.

Material agreements

For a summarized description of the material agreements, not in the regular course of business of the Bank, as well as relevant cooperation agreements for activity sectors, that were signed and/or that are valid for the reporting year, please see details in each of the sectors.

Providing liability for indemnity of officers at the Bank and its subsidiaries

In January 2012, the Bank's General Assembly of Shareholders approved a decision, according to which the Bank will grant to those serving from time to time as officers at the Bank and its subsidiaries, an indemnification liability for monetary responsibility imposed on any of them and for reasonable litigation expenses related to the list of events attached as an appendix to the liability note (hereinafter: "Letter of Liability for Indemnity"). Provision of the indemnity depends on the existence of the conditions specified in the Letter of Liability and the cumulative maximum indemnification amount to officers of the Bank and its subsidiaries shall not exceed 25% of the Bank's equity.

In October 2013, the General Assembly of the Bank's shareholders ratified the updates to the Letter of Liability for Indemnity of Officers in the Bank and its Subsidiaries, and accordingly, to the Letter of Indemnity was added reference to other laws to enable indemnity, in permitted cases by the law, by virtue of these laws as well. In addition, a basket section was added that might enable indemnification (for legal expenses and payments to those injured by the violation), if said indemnity is permitted according to the additional laws. For details concerning the update of the Letter of Liability for Indemnity, see the immediate report of the Bank of September 3, 2013 (reference no.: 2013-01-136176).

Legal procedures

For information on the issue of legal procedures see Note 19c to the Financial Statements.

Risks and risk management

Discussion of risk factors

The activity of the Bank as a financial intermediary exposes it to a variety of financial risks, including credit risks, market risks and liquidity risks. In addition, the Bank is exposed to related risks, that are not financial risks, derived mainly from operating risks, from legal risks and from strategic risks. The risk management policy in the various areas is used for supporting the achievement of business objectives, while limiting the risk exposure involved in various activities.

The activity and profitability of the Bank are exposed to changes in the business environment and affected by the economic situation, by developments in real estate and capital markets, by technological developments and by regulatory changes. An economic slowdown or potential crisis in the real estate market and/or in the capital market might affect Bank activity, in general, and its activity in the housing loan and real estate sectors, in particular.

The following are the main changes in the business environment that could affect the activities of the Bank and its profitability:

1. The development of a financial crisis in Israel and a deepening of the economic slowdown, might affect the repayment capability of the Bank's borrowers, increase the scope of arrears of borrowers due to deterioration of their repayment capability and affect the Bank's ability to raise capital and the margins of its banking activity.

2. Incorrect forecasts and faulty estimations, unexpected responses from factors (customers, competitors and more) operating in the Bank's business environment, late recognition of market trends, changes in consumer preferences and/or conduct, changes in the banking system and/or its regulation and the effect of the above on the sector's competitive structure, lack of monitoring the realization of multi-year objectives – realization of each of the above differently than expected in the assessments underlying the Bank's strategic plan, might harm the Bank's profitability and business plans.

3. Significant changes in the residential real estate market might cause both a decrease in the value of collateral for credit provided by the Bank and an increase in the provision for credit losses, as well as affect the volumes of credit provided to households against a lien on their housing. These changes might affect the credit available for projects overseen by the Bank.

4. Tangible damage to real estate assets used by the Bank as collaterals for credit provided by it, for example, damage to settlements as result of war or destruction of buildings as a result of a natural disaster, might, in case of lack of full insurance coverage, diminish the repayment capability and cause an increase in the extent of problematic debts. Extensive damage as aforementioned might result in the development of an economic crisis and the deepening of the recession.

5. Change in the paths to recovery from the crisis in global financial markets and/or its deepening, might affect the repayment capability of foreign resident borrowers, reduce demand for new credit to finance the purchase of residential property in Israel, and affect the ability to raise funding to finance foreign currency activity.

6. A slowdown in the capital market might affect the Bank's possibilities for raising funds for the Bank by means of negotiable issuances. In addition, a slowdown in this market might influence the Bank's activities in the area of the capital market.

7. An increase in interest rates might increase the repayment of the borrowers burdened with loans with variable interest and might therefore affect the insolvency probability of these borrowers.

8. Future realization of the economy's macroeconomic forecasts in a manner different than the Bank's assessments concerning these forecasts (for example an exceptional and unexpected increase in the real interest rate) may affect the results of the financial management sector and the fair value of the Bank's securities portfolio.

9. Material, sudden and unexpected deviation from the macro data (e.g., explosion of uncontrolled inflation, increase in exchange rate of the dollar at an exceptional rate) may cause an unexpected increase of risk assets, and prevent the Bank from implementing its work plans.

10. Changes in regulatory provisions and also possible results of legal procedures may affect the banking system's scope of activity, the competitive structure therein, and/or the Bank's profitability.

11. Damage to the Bank's image and decline in the Bank's credit rating may damage the Bank's profitability due to curtailment in its activity scope and increase capital recruitment cost and liquidity because of a rating decline.

12. Operating risks, that may be expressed, inter alia, in failure of information systems that do not have proper control, or an embezzlement and fraud event, as well as damage to information security, because of the increase in the scope of electronic business, refinement of financial activity and complexity of products and technologies.

13. Increased threats to information security in relation to computer technology and primarily cybernet incidents that might occur from an intentional attack or unintentional events.

All or some of the information detailed in this paragraph on "future facing information" might not occur, or might occur differently from expectations. This information is based on estimates of bank management concerning future realization of industry forecasts and macro-economic forecasts in accordance with the bank's preliminary estimates. These estimates may not be realized, among others, as a result of economic events, political/security-related events, changes in customer preferences and increased competition.

The Bank's risk management is implemented continuously, according to provisions from the Bank of Israel and according to the rules determined in the second tier instructions of Basel II. In this framework, the Bank appointed a Risk Manager for each of the material risks as listed below, and a Chief Risk Officer (CRO), serving as Vice President and Manager of the Risk Division.

The Supervisor of Banks published various directives in the framework of Proper Banking Management on the issue of risk management by banks, including Basel II instructions. The bank integrated a work framework for risk management and control, and adjusts the policy of the bank for managing various risks to the principles appearing in the instructions of Basel.

Factors involved in risk management

Risk management in the bank is spearheaded by the Chief Risk Officer who is a management and the Bank's Risks Division Manager. For each of the various risks, a management array is determined, that includes a supervision circle and three control circles, according to the details of the following entities below:

The supervisory tier contains supervisory entities – Board of Directors, designated Board of Directors committees, and senior management.

Board of Directors – has the responsibility for determining the Bank's business strategy, including in risk management and securing the Bank's capital. The Board of Directors is responsible for determining the risk tolerance and the Bank's appetite for risk, inter alia, through defining the scope of the Bank's exposure limitation to risks and risk management policy. In addition, the Board of Directors is responsible for verifying the functional adequacy of the Bank's risk management; to approve principle internal methodologies of recognition, valuation and management of risks, and for the calculation of the required capital; performing control and supervision on applying policies determined by it.

Once every quarter, the Board of Directors discusses the main risks exposure document presented by the Bank's Chief Risk Officer.

The Board of Directors appointed a Board of Directors Risk Management Committee whose functions include discussions and recommendations to the Board of Directors on everything related to plotting and approving of the Bank's policy in risk management; review of risk management procedures, and the level of adjustments to the policy framework approved by the Board of Directors; supervision over implementation of risk management policies determined by the Bank's Board of Directors, including receiving reports on deviations from policies or limitations determined by the Bank's Board of Directors. In addition, the Board of Directors committee discusses and approves new significant products and/or procedures at the Bank according to the recommendations by the relevant internal forums headed by the Bank's CEO.

Management– committed to risk management according to policies, appetite for risk, and the limitations determined by the Board of Directors. Management, headed by the CEO, is responsible for the implementation of the risk management policies, realization of controls, supervision over quality of risk management, and adequate risk measurement and assessment. In addition, management is responsible for creating an effective system for risk management and their control. Management operates through designated committees for management of various risks, as well as through the Risk Division headed by the Chief Risk Officer.

Description of Control Circles

First Control Circle – This circle includes the risk-takers and managers, which constitutes the business and operational function, making business decisions involving risk-taking. The controls implemented under the framework of the ongoing activity, by the business factors, include a variety of activities, including: compliance with policies and procedures, complying with limitations, and reporting to the senior management and the Board of Directors.

Below are details of risks and management members and department managers serving as risk managers:

Type of risk	Manager of risk
Credit	Retail Division Manager
Business credit in the real estate area	Real Estate Sector Manager
Market	Finance Division Manager
Liquidity	Finance Division Manager
Operating	Risks Division Manager
Operating – Information Systems	Resources Division Manager
Strategic	CEO
Legal	Legal consultant
Regulatory	Legal consultant
Reputation	Retail Division Manager
Compliance	Chief Compliance Officer
Money Laundering and Terrorism Financing	Person in charge of implementing the Prohibition of Money Laundering and Terrorism Financing Law
Clearance and counterparty	Finance Division Manager
Environmental	Real Estate Sector Manager
Human Resources	Resources Division Manager
Administrative enforcement	Risks Division Manager

Second control circle – this circle includes the risk management functions used as control factor of the management and is non-contingent on risk creators, as well as the credit and financial risk controls headed by the Chief Risk Officer. The processes involved in this circle of control include, among others: outlining risk management policy (in conjunction with the business function), identification and independent measurement of levels of exposure to risk, examination of the existence of proper work processes, validation of the models, examination of compliance with the limitations set forth in the various policy documents and reporting if levels of exposure, as well as deviations from the policies of the Bank and managers to the relevant parties.

Chief Risk Officer – According to the instructions by the Bank of Israel, and according to the framework outlined in the second tier of Basel II, the Bank appointed a Chief Risk Officer for the Bank (CRO). As of August 1, 2011, Mr. Michael Ben-Ischai serves as manager of the Bank's Risks Division and as Chief Risk Officer. The role of the Risks Management Division is to strengthen the Bank's capability to understand the total risks the Bank faces and ensuring their cautious management. The instructions of the Bank of Israel define the operating principles for the Chief Risk Manager and risk management functions, and specifies their position, their function, and areas of responsibility.

The purpose of the CRO's function is to create a wide and cross-organization view of the overall risks inherent in the Bank's activities, among others, through creating a risk management culture influencing all the Bank's activities.

Under the responsibility of risk management functions and its head, is to provide, directly and indirectly, to the Board of Directors and its senior managers, all the relevant data for the proper supervision of the Bank's risk profile in such a manner that it assists in directing the Bank's activities.

The third control circle – this circle includes, inter alia, the internal audit that examines the validity of the activity and processes that are being carried out by the bank, its subsidiaries and its auxiliary corporations, including: A review and assessment of the due diligence and effectiveness of the internal control framework and the manner in which the offices and authorities are performing their roles. A review of transactions as well as a review of the activity and role of specific processes in internal control. A review of implementation and effectiveness of the risk management procedures and risk assessment methodology. A review of the resources for protecting the Bank's assets. A review of the various information systems, including: business and operating information systems, information systems used for managerial and financial purposes, as well as reporting systems. Electronic information systems and communications banking services. A review of due diligence of internal control frameworks in the financial reporting generation process. A review of the precision and reliability of the accounting records and financial reporting. A review of the reliability and timing of the reports to regulatory authorities and other authorities. A review of the systems to ensure compliance with laws, regulatory requirements and behavioral rules as well as implementation of Bank policies and procedures. An audit of current implementation of the decisions of the Board of Directors and management as well as senior management activity. A review of capital assessment vis-à-vis assessment of the risks entailed in the banking corporation activities. Implementation of tests and special investigations.

Capital Adequacy

The Bank of Israel published on June 20, 2010, Proper Banking Management provisions dealing with capital measurement and adequacy. The provisions define the method for calculating capital adequacy and are based on the Basel committee recommendations on the issue of International Convergence of Capital Measurement and Capital Standards (Basel II) that were published in June 2006.

The Basel II recommendations are divided into three pillars:

First Pillar – Minimum capital requirements for credit risk, market risk and, for the first time, also for operating risk.

Second Pillar – The ICAAP process and the supervising review process (SREP).

Third Pillar – Market compliance.

The first pillar enables, for purposes of calculating minimum capital requirements, several approaches to measurement of risk components for credit risks, market risks and operating risks: the Standardized Approach or more sophisticated approaches, based on internal models of customer rating and estimation of operating risks. The sophisticated approaches are subject to specific approval by the Supervisor of Banks. In these reports, similar to all banking system, the capital adequacy data were reported according to the principles of the Standardized Approach in Basel II, as integrated in the Proper Banking Management provisions 201-211.

The second pillar emphasizes integrative risk management. In this framework, banks are required to establish methodologies, processes and procedures intended to ensure long-term capital adequacy, including a review of all significant risks to which each bank is exposed. The banks are required to prove implementation of the required methodologies for ensuring capital adequacy. The Supervisor of Banks is required to evaluate these processes, and to levy supervisory means insofar as required and according to the evaluation results.

The third pillar relates to the level of transparency and disclosure requirements in reporting to the public by banking corporations, to supplement the second pillar. These requirements are intended to assist entities utilizing the financial statements to evaluate the bank's capital adequacy and the additional data regarding the bank's capital, as presented in the reports, the exposure to various risks and the evaluation processes.

In June 2011, the Basel committee published recommendations on the issue of "A Global Regulatory Framework for More Resilient Banks and Banking Systems" that received the name Basel III. Inter alia, the recommendations include the requirement to gradually increase the ratio of the minimum tier 1 (core capital) equity from 2% up to 7% (4.5% minimum capital ratio and additional 2.5% cushion for capital preservation) in 2019. The recommendations also include new requirements in the area of liquidity risk management (in January 2013, the Basel Committee updated the recommendations on liquidity), defining additional capital cushions (counter-cyclical cushion and specific cushion against systematic risk), requirement for leverage ratio management, and more. The Committee further recommended that capital instruments in Tier 1 be required to include a mechanism for absorbing losses, and that instruments that do not comply with the new conditions will be gradually reduced from the capital.

On May 30, 2013, the Bank of Israel published an updated Proper Banking Procedure that adopts the

Basel II and Basel III recommendations in the banking system in Israel (Proper Banking Procedures 201-211).

The banking procedure establishes that banking corporations and credit companies must:

- Comply with a ratio of minimum Tier 1 equity (core capital) to weighted risk assets of 9% for the entire banking system, beginning on January 1, 2015, and for a banking corporation whose total balance sheet assets on a consolidated basis equal to or exceed 20% of the total balance sheet assets in the banking system, to comply with a minimum total capital ratio of 10% as of January 1, 2017.

- To comply with a ratio of minimum total capital to weighted risk assets of 12.5% for the entire banking system, as from January 1, 2015, and for a banking corporation whose total balance sheet assets on a consolidated basis equal to or exceed 20% of the total balance sheet assets in the banking system, to comply with a minimum total capital ratio of 13.5%, as of January 1, 2017.

In addition, criteria were established for the eligibility of Tier 1 equity, additional Tier 1 capital and Tier 2 capital. Furthermore, temporary provisions were established that refer to supervisory adjustments and deductions from capital, as well as capital instruments that are not eligible for inclusion in the supervisory capital, in accordance with the new established criteria.

The main adjustments conducted by the Bank following the transition to the Basel III provisions:

- Deferred taxes receivable that were created as a result of timing differences – will be subject to a risk weight of 250%, instead of 100% that had been applied under the Basel II regime.

- Group provision for credit losses – eligible for inclusion as Tier 2 capital. Correspondingly, the provision will not be deductible in the calculation of risk assets.

- Deferred liability notes – the balance recognized for inclusion as Tier 2 capital as at January 1, 2014 will be limited to a ceiling of 80% (first year according to the transitional provisions) of the balance of recognized liability notes eligible for the purpose of the Basel II instructions.

Below is a table that summarizes the main adjustments conducted by the Bank following the transition to Basel III instructions:

Section	Risk assets	Core capital	Tier 2 capital
		in millions of NIS	
Deferred taxes receivable resulting from timing differences	69.5	-	-
Group provision for credit losses	77.9	-	84.7
Deferred liability notes	-	-	(68.2)

The ICAAP and SREP Processes.

On May 9, 2013, the Bank's Board of Directors approved the Internal Capital Adequacy Assessment Process – ICAAP as at December 31, 2012 (hereinafter: **TheICAAPProcess for 2012"**). (It should be noted that the ICAAP is an ongoing process, by which the Bank recognizes and handles risks embedded in its activity, examines the capital required to support these risks and verifies that the available capital complies with this requirement. Building this process at the Bank is a central part in the preparation of the Bank for the Basel II requirements and the requirements of the Bank of Israel for the implementation of the second pillar instructions of these instructions).

Simultaneous to the ICAAP process, the Supervisor of Banks performs the SREP – Supervisory Review and Evaluation Process, under which the Supervisor is required to determine the capital adequacy of a banking corporation and the appropriateness of the ICAAP process of a banking corporation in relation to its exposures to risk (risk profile), taking into consideration the bank's corporate governance framework.This process will help the Supervisor formulate an opinion regarding the appropriate level of capital, the supervisory measures and additional risk-reducing activities with regards to a bank's capital adequacy.

In the framework of the ongoing discussions between the Bank of Israel and the Bank regarding issues that arise from the ICAAP process for 2012 and the SREP process, designed to establish said capital adequacy ratios, both in meetings and in exchange of letters (the last one received by the Bank on December 15, 2013), the comments of the Supervisor of Banks were discussed and their position on the need for the Bank to make a decision concerning the long-term core capital objective, at a higher ratio than that proposed by the Board of Directors in its decision as part of the ICAAPprocess for 2012.

At the time of publication of the Financial Statements, these discussions are ongoing. It is hereby emphasized that as of the date of publication of the Financial Statements, the Bank's core capital ratio exceeded the target set by the Bank's Board of Directors as part of the ICAAP process for 2012.

The Supervisor of Banks issued an interim instruction on application of the disclosure requirements of pillar 3 of the Basel instructions. Below is a table of relationships between the disclosure requirements in the aforementioned instruction and the sections of the Board of Directors' Report or the Note to the Financial Statements in which the required information is included, except for the requirements that are not relevant to the Bank (such as the securitization issue):

Table number	Subject	Location	Page numbers
Table 1	Scope of Implementation	Capital Adequacy	108-111
Table 2	Capital Structure	Capital Adequacy Note 16	112 308-309
Table 3	Capital Adequacy	Capital Adequacy Note 16b	112-114 309

Table 4	Credit Risk- General Disclosure Requirements	Credit Risks Appendix E to Management Review Note 5 Note 18	114-133 203-205 281-291 314-317
Table 5	Credit Risk – Disclosure about Portfolios treated according to the Standard Approach	Capital Adequacy Credit exposures to foreign financial institutions	112-114 128
Table 7	Credit Risk Reduction	Capital Adequacy	114
Table 8	Counterparty Credit Risk	Note 20c Clearance risks and counterparty risks	328 132-133
Table 10	Market Risk	Market risks	133-143
Table 12	Operating Risk	Operating Risks	143-146
Table 13	Positions in Shares in the Banking Portfolio	Note 4	276-280
Table 14	Interest Rate Risk in the Banking Portfolio	Interest rate risk	136-139

Below is the calculation of the capital ratio according to Basel II instructions (for details on the calculation of the capital ratio according to the Basel III instructions, see Note 16b):

Capital for the purpose of calculating capital ratio

	December 31,	
	2013	**2012**
	Millions of NIS	
Tier 1 capital, after deductions	694.5	693.0
Tier 2 capital, after deductions	341.4	338.0
Total	**1,035.9**	**1,031.0**

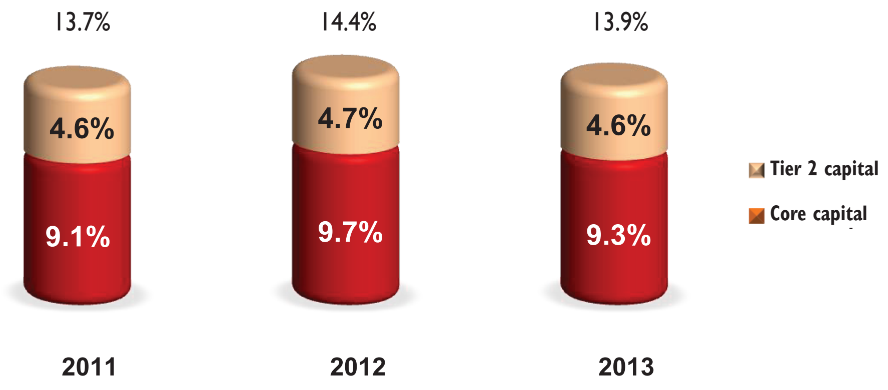
B. Weighted balance of risk assets

Credit risk	6,674.1	6,452.3
Market risks	49.3	148.2
Operating risk	705.5	553.3
Total	**7,428.9**	**7,153.8**

C. Capital to risk components ratio

	In percentages	
Tier 1 capital to risk components ratio	9.3	9.7
Comprehensive capital to risk components ratio	13.9	14.4
Minimum comprehensive capital ratio required by the Supervisor of Banks	13.0	13.0

Below are the ratios of capital to risk components, by years:



Below are the balances of the Bank's risk assets pursuant to the first pillar, as at December 31, 2013 (millions of NIS):

Credit risk	Risk assets	Capital requirements
Exposures of sovereignties	25.0	2.2
Exposures of the public sector	0.7	0.1
Exposures of banking corporations	65.3	5.9
Exposures of corporations	1,484.4	133.6
Exposures in commercial real estate security	39.6	3.6
Retail exposures to individuals	915.5	82.4
Exposures of small businesses	147.3	13.3
Exposures from housing mortgages	3,751.6	337.6
Exposures from other assets	244.7	22.0
Total credit risk	**6,674.1**	**600.7**
Market risk	**49.3**	**4.4**
Operating risk	**705.5**	**63.5**
Total	**7,248.9**	**668.6**

Below is the composition of exposures(1) pursuant to the first pillar (millions of NIS):

Risk weight	Before reduction	After reduction
0%	3,144.9	3,144.9
20%	114.1	114.1
35%	3,822.8	3,821.0
50%	458.4	467.4
75%	4,186.1	4,037.5
100%	2,857.9	2,722.7
150%	99.4	99.4
Total	**14,683.6**	**14,407.0**

(1) Before conversion to credit of off-balance sheet exposures

Below is the composition of exposures(1) and balances covered by collateral and guarantees pursuant to the first pillar, as at December 31, 2013 (millions of NIS):

	Gross credit exposure	Risk exposure covered by proper financial guarantee	Amounts subtracted in respect of guarantees	Amounts added in respect of guarantees	Net credit exposure
Debts of sovereignties	3,142.9	-	-	-	3,142.9
Debts of public sector entities	1.4	-	-	-	1.4
Debts of banking corporations	179.4	-	-	9.3	188.7
Debts of corporations	1,943.2	(125.8)	(9.3)	-	1,808.2
Debts in commercial real estate security	39.6	-	-	-	39.6
Retail exposures to individuals	1,472.0	(47.2)	-	-	1,424.7
Loans to small businesses	301.3	(100.5)	-	-	200.8
Housing mortgages	7,317.7	(3.1)	-	-	7,314.6
Other assets	286.1	-	–	-	286.1
Total	**14,683.6**	**(276.6)**	**(9.3)**	**9.3**	**14,407.0**

Credit Risks

General

Credit risk is the risk of damaging the Bank's value resulting from the potential that a borrower or other counter-party of the Bank fails to meet his obligations in relation to the agreed terms or due to worsening of borrowers quality and the value of the collaterals provided by them.

Credit risk is the Bank's main risk. The significance of this risk is compatible with the Bank's core business. The risk is expressed mainly in the activity with retail customers, but also with business customers and in the nostro activity. In order to manage the credit risk, the Bank defined a credit risk management policy and a credit policy that are approved annually by the Board of Directors.

The credit risk management policy describes the functions that create, manage and control this risk, the principles of risk management, its reduction, and risk management control tools. Moreover, the process of determining authority, orderly reporting process, and reporting of irregularities are also described in it.

An additional document is the credit policy document approved by the Bank's Board of Directors, outlining the policy of the Bank for providing credit, and specifying the principles for providing credit, limitations, and collaterals. In the framework of the policy, principles and rules are determined with respect to management and supervision of the credit portfolio, that refer to households, as well as to business customers, according to their industry classification.

The activity of credit to the public is managed in a number of principal sectors differing between them in customer characteristics and their required banking services, as well as in the organizational unit responsible for handling each of the customer types:

- The household sector, the customers of the international activity and the commercial customers are under the responsibility of the Retail Division.

- Business customers, mainly in the area accompanying real estate projects, are under the responsibility of the Real Estate Sector Department which is subject to the Bank's CEO.

In the credit provision process, transaction data are examined in accordance with the criteria that were established in the Bank's procedures. The underwriting and credit approval mechanism is hierarchical, from the branch level and up to the level of senior management, according to the authority ranking that was approved by the Board of Directors.

The Bank operates in a number of levels in order to monitor and to reduce credit risk as much as possible, starting from the credit underwriting stage, its approval, the required collaterals according to the credit policy and relevant procedures, and until the monitoring and regular controls implemented in the business units, which constitute the first control circle and in the designated control units. The Bank dedicates a great deal of effort towards improving the professionalism and expertise of those dealing with credit provision and its management, and also in developing computerized tools that will facilitate effective management.

Measurement and monitoring systems – The Bank uses a number of computerized systems for credit risk management and control. Computer systems provide control tools for the first control circle and also for the second and third circle, for credit risk detection.

Main systems include, among others, the commercial credit system, the mortgage management system, and supporting systems for making retail credit decisions.

The Bank has a number of internal systems for rating borrowers, for supporting the credit decision making process: in the project oversight area, the system integrates parameters from the projects exposure reports, such as examination of rate of completion, liquidity status, profitability erosion, inventory value, and more. In retail credit, the customer is rated according to the Bank’s existing rating model. The Bank completed the development of the customer rating system in consumer credit that is incorporated in this credit underwriting system.

Bank management continues to improve the measuring, reporting, and control tools for obtaining more comprehensive information that facilitates credit risk management.

Reduction of credit risk – For the purpose of reducing credit risk, the Bank operates in accordance with policy, processes, and work procedures for obtaining and managing collateral, reliance rates on collateral, collateral recording, and so forth.

Collaterals – The principal collateral provided to the Bank is a mortgage on rights to a real estate asset. In addition, the Bank receives other collateral: liens on vehicles, checks, deposits and securities, third-party bank guarantees, personal guarantees by debt guarantors, and more. The rules for reliance on each of the types of collateral, according to the collateral characteristics, its negotiability, realization rate, and the collateral's legal status, are determined by the Bank's policy. The collaterals are adjusted to the loan circumstances.

The rules for management of collaterals and update of their value are determined in the Bank's procedures.

The examining units in the second control circle, credit control, as well as the internal audit, examine the collateral portfolios, in addition to the business factors in the first circle.

In calculating the capital adequacy, the Bank operates according to the instructions 201-211 to the Proper Banking Management provisions from the Supervisor of Banks, concerning capital measurement and adequacy, and offsets from the credit to the public only deductible collateral according to the mentioned instruction.

In this calculation, according to provision 203, the Bank refers to two central CRM instruments, according to the Basel II guidelines, clarifications by the Bank of Israel, and legal opinions. The first is deposits and savings that were established and are managed at the Bank, and the second is third party guarantees to secure the exposures of bank customers.

Deposits and savings that may be used to secure credit are deposits that are marked in the Bank system as mortgaged, where the owner of the deposit is also the exposed, as well as deposits that are recorded in the Bank system and mortgaged in favor of the Bank, where the mortgages are also recorded in the Register of Mortgages or the Company Register, as applicable. Offsetting of deposits and savings from the total credit to the public is implemented according to compliance of the collateral with the aforementioned instructions.

Description of the active functions creating, managing and controlling the credit risk:

The Bank adopted a work framework for risk management and control, based on a supervision circle and 3 "control circles":

The Supervising Entities

Board of Directors – The Board of Directors and its committees have the ultimate responsibility for determining the Bank's business strategy, including in the risk management area, and securing the Bank's capital. Furthermore, the Board of Directors approves the business policy and the Bank's work plan for each year, and examines the risk asset allocation to business factors. The Board of Directors approves the credit risk exposure limitations, which is a credit risk management policy document; conducts periodical follow-up of credit risks exposure developments; discusses the required changes in limitations, in order to ensure that the determined limitations enable ongoing operations, while complying with the determined risk appetite. The Board of Directors examines the credit risk characteristics embedded in new relevant activities or products.

Board of Directors Risk Management Committee – Its role is to examine the Bank's risk management procedures and the level of their compatibility with the policy framework that was approved by the Board of Directors, and the reporting systems and lines of responsibility and authority. Its functions and authorities will include, inter alia: discussion on the Bank’s exposure policy for various risks and on the exposures document, and making recommendations to the Board of Directors; discussion of suggestions of new products or activities and making recommendations to the Board of Directors.

The Board of Directors Credit Committee – The Board of Directors Credit Committee holds preliminary and individual discussions on subjects of establishment of credit policies in the Bank, as well as other issues, according to the Board of Directors decision, that from time to time, require delving into, and accordingly, makes recommendations to the Board of Directors.

Audit Committee – This committee, inter alia, serves as the Board of Directors Problematic Debt Committee, which discusses problematic borrowers and makes decisions regarding their handling and issues of classification and provisions. The Committee receives regular reports on the progress in handling these debts.

Management – Through its committees, among others, is responsible for establishing an effective system of risk management and control, including: formulation of an annual work plan for the Bank and credit policy, formulation of the Bank’s annual risk management policy, definition of the levels of exposure to credit risks and definition of the actual desired levels, establishment of procedures related to detection, measurement, monitoring and control of the exposure to credit risk and assurance of the effectiveness of this risk management process through established processes and through control functions in the Risks Division.

Risk Takers and Managers – Circle I

Internal credit committee – in which senior management having financial and legal skills, are members, some of whom are Bank Credit Departments managers, and headed by the Bank's CEO. The committee discusses requests for providing/renewing credit to borrowers/groups of borrowers in the amounts determined and according to the collateral mix as defined in the Bank procedures that were approved by the Board of Directors. As part of the program to curtail the involvement of the Board of Directors in credit approval, and to increase the powers of the internal credit committee, the Chief Risk Officer, or a representative on his behalf, has been added as an observer at the credit committee meetings. The Chief Risk Officer will report at his discretion on a particular credit to the Chairman of the Board of Directors/Chairman of the Risk Management Committee.

Credit Authorizers – Their function is to approve credit requests according to criteria that have been determined in the credit policy approved by the management and the Board of Directors and the Bank's procedures.

Retail Credit Division Manager – responsible for implementing Bank policies, and formulating an overall work framework for retail and commercial credit risk management in the Bank's institutions. The retail division manager confirms an action in accordance with the credit-provision-based process by establishing criteria for granting credit that are well established and defined. The Retail Credit Division includes all retail credit activity and commercial credit activity handled by the retail and commercial credit department and branch operations, sales department, collections department, customer call center, marketing unit and the business process planning and current account products department.

The credit and branch operations department – operates as part of the retail division and is responsible for retail and commercial credit underwriting and procedures in underwriting as well as branch operations management.

Collection Department – operates as part of the retail division and is responsible for enforcing the collection of problematic debts. The Collection Department deals with classification, regulation and collection and measurements of provisions for doubtful debts in the retail, business and commercial credit area.

Real Estate Sector – The manager of the Real Estate Sector is responsible for implementing Bank policies and formulation of an overall work framework for business credit risk management and its approval in the Bank's institutions. The Real Estate Sector focuses on the financial oversight system (closed oversight). This method reduces the exposure to risks in credit provision, since it includes regular monitoring of the financed projects, while cutting off the financed project from business risks entailed in the entrepreneur's – borrower's other activity.

The retail division manager and the real estate sector manager manage the Bank's credit concentration risk. As part of their jobs, they are responsible for effectiveness and compliance with the concentration limitations established in the credit policy. The chief risk officer is responsible for quarterly monitoring of compliance with this limitations.

Risk Management Function – Circle II

Chief Risk Officer – The Chief Risk Officer is responsible for the independent control circles and his job is to ensure the overall efficiency of the risk management and control system. Furthermore, the CRO ensures regular, reliable and relevant risk reporting, and periodically checks compliance with the delegation of authorities and limitations on exposure that were established.

Risk Control Unit – The Risk Control Unit serves as an independent function, while its role, inter alia, is to provide information to management and the Board of Directors about credit risks, issue an independent opinion on credit risk exposures, develop models for credit provision (established and statistically validated) and develop tools and methodologies (Best Practice) for credit risk management. This assessment process by the unit is independent of the functions that approve credit, since credit control is not involved in decisions concerning credit provision and its terms. A credit controller operates in the unit, whose area of responsibility covers several fields:

Assessment of the quality of specific borrowers and the quality of the Bank's credit portfolio as a whole, coverage of main borrowers, and review and control of borrowers. In addition, the unit prepares a quarterly report on credit exposures trends, that is submitted to the credit risk management forum, the risk management committee, and the Board of Directors. The report includes review of credit risks measurements, business as well as retail, compared by periods and to other banks (as much as possible).

Credit Risk Management Forum – Its purpose is to review reports received from credit takers and risk managers in relation to the Bank's exposure situation to credit risks, as well as to discuss policy before submitting it for approval. Furthermore, the forum discusses the monthly exposure estimates, the quarterly trend report, and the issues arising during the work of the credit risk management unit or credit control, conclusions of the review, reviewing collection in addition to additional issues as necessary.

Central Examination Unit – Examines the mortgages portfolios according to criteria determined by Bank management prior to actual implementation, as well as reviewing of vehicle loans prior to implementation. The examination system is a part of the Resources division, and thus there exists a managerial separation between the credit approval process and transferring of documents for examination.

Credit Risk Review and Analysis Unit (CRA)– The unit was set up under the preparations for Basel II, with the purpose of separating between the level that creates the credit risk (that brings the transaction to the Bank), the one that prepares the credit request, and the one that approves it. The unit has two main functions:

1. Examining credit portfolios and analyzing credit risks. Under the second control circle, the unit deals with examining credit portfolios and borrower collateral (from the real estate sector and from the commercial banking division), prior to credit provision, as well as during the current credit life.

2. Receipt of credit application before their transfer for approval, and review of whether the transaction structure as specified in the credit request complies with the Bank's credit policy and risk appetite policy. The CRA unit is subordinated to the Risks Division manager, and reports directly to him about its activity.

The manager of the CRA unit issues his opinion on the credit transaction brought for approval at the Bank's institutions in a separate and independent document (hereinafter: "CRA Document").

Applications for credit are not discussed in the credit committees without the CRA document that is submitted at the same time as the application.

The CRA unit is subordinated to the Risks Division manager, and reports directly to him about its activity.

Credit and Guarantees in Securities controller – is required to supervise compliance with the instructions of the Stock Exchange regulations on the issue of credit provision (as part of securities activity), securities requirements and short sales, as well as compliance with the instructions by the Board of Directors on these issues. The control includes a review of barriers and alerts, custodian activity, control on special accounts, as well as additional examinations. In case of irregularities, the controller will report to the relevant functions at the Bank, according to the level of irregularity, and if necessary, will also report to the Chairman of the Board of Directors. In addition, the Bank will continuously monitor credit irregularities, Short securities in securities transactions.

Extreme scenarios team – The team determines the various extreme scenarios which include extreme holistic scenarios, including adhesive effects occurring between the markets and according to Basel II guidelines, and examines their results. If necessary, the team will advise the management on required preparedness for realization of extreme scenarios.

Control Entities – Circle III

Internal auditor / internal auditing – The internal auditing is responsible for the examination of activity and procedures implemented by the Bank, and mainly: integrity of activity performed by the Bank and its employees, the Bank's compliance with regulatory instructions and internal procedures, implementing decisions of the Board of Directors and management, management of assets and liabilities, amendment of deficiencies discovered in the auditing reports, and examination of the Bank's risk management procedures.

The Monetary Division – The function of this division is responsibility for accounting recording and subsequently for all the financial information used for risk management. In addition, the division provides specific information with regards to capital composition, capital items and capital and risk assets forecasts for the coming 3 years. Additionally, the division is responsible for composing reports on first pillar issues and on monitoring the ongoing compliance with capital adequacy outline, as determined in the annual work plan, including risk assets allocation for the activity area.

Internal Committee for Defective Debts – In which preliminary discussions are held for borrowers/ groups of borrowers on amounts that are determined by the policy prior to the discussion by the Board of Directors Committee.

Independent Auditor – performs accounting audits and reviews with reference to the Bank's Financial Statements.

Concentration

Concentration risk is the risk deriving from the lack of spread in the credit portfolio. Aiming to curtail the risk of concentration deriving from the lack of spread in the Bank's credit portfolio, the Bank works to spread its credit portfolio among many borrowers in various sectors of the economy.

The Bank's credit concentration risk has a number of principle aspects:

Borrower Concentration Risk – Risk attributed to credit provided to a borrower or a number of borrowers belonging to the same borrowing group. The greater the spread of the credit portfolio among various borrowers, the smaller the risk of borrower concentration.

In the framework of the Bank's preparation for changes in the business environment and with the willingness to reduce the exposure of the bank to large borrowers, the Bank's Board of Directors has narrowed, beyond the regulatory limits, the restrictions for the single borrower, and the framework for a group of borrowers.

The Bank continuously monitors large borrowers and compliance with the limitations established by the Board of Directors.

On November 8, 2011, the Supervisor of Banks published directives concerning additional disclosure for significant exposure to a group of borrowers. Since there is no group of borrowers at the Bank (as defined in Proper Banking Management provisions № 313) whose liabilities exceed 15% of the Bank's equity, the Bank is not required to provide additional disclosure according to the aforementioned guideline.

Concentration risk of economic sectors – The risk is attributed to a large volume of credit provided to borrowers in a certain economic sector.

In order to reduce the credit risk derived from concentration in the construction sector in project oversight, the Bank cooperates with insurance companies issuing sale policies to housing purchasers and/or securities to land owners in combination transactions, which share mutual collateral with the Bank – "pari passu".

In addition, the Bank is cooperating with financial entities, in project oversight and in solar energy. These entities provide credit along with the Bank in a predetermined ratio.

The Bank complies with the limitations of the Bank of Israel concerning exposure to economic sectors.

Geographical concentration risk – The risk attributed to insolvency of borrowers who are concentrated in a certain geographic area or collaterals that are concentrated in a certain geographical area.

It is the Bank's credit policy to set limitations concerning geographic spread with the purpose of reducing this risk.

Sector concentration risk – Risk deriving from insolvency of borrowers belonging to the same population sector.

Of the Bank's 22 branches, 4 are located in areas characterized largely by a population of largely Ultra-Orthodox and 3 in areas of a mostly Arab population.

The Bank's concentration in the Ultra-Orthodox sector is beyond its estimated proportion of the population. The Bank's concentration in the Arab sector is not beyond its estimated proportion of the population. The Bank continuously examines its exposure to these populations and performs scenario analysis that indicate that the Bank is not expected to experience any unusual losses as result of the Bank's exposure to these sectors. The results of the examination are submitted to the Bank's Board of Directors as part of the quarterly credit exposures report.

The Bank's Credit Performance Process

The majority of the Bank's credit portfolio is managed by the Retail Division, the credit in project oversight, and construction financing, is managed by the Real Estate Sector Department that is directly subordinated to the CEO. In both units, there is a clear division of credit authorities: types of credit, types of customer, and amount of credit. The credit underwriting process is also defined. Each credit application is examined and approved by the appropriate level of authority according to principles approved by the Bank's Board of Directors.

The Retail Credit Division includes an underwriting center that sends each mortgage application exceeding the approval authority of the branch manager, for approval by the grade that is authorized to approve such credit.

In addition, the Bank has a central system to review the mortgage file prior to its actual implementation. The examination process focuses on a review of the credit documents and the collateral, compliance with the terms defined when the credit was approved, and all with the purpose of performing a function of monitoring the process of creating loans, to reduce exposure to operating risks in mortgage activity, and to ensure that the Bank as a whole works according to uniform and controlled standards. The review system is subject to the Resources Division and thus, there exists a managerial separation between the credit approval process and the transfer of documents and their review.

In the Real Estate Sector Department, applications for credit are prepared by the division's control and reports team and not by the referents (creating the risks), and are reviewed by the credit risk management unit (subject to the manager of the Risks Division), before being submitted for approval in the relevant credit committees, in accordance with the specified authority level.

In the framework of examining credit and collateral files, the unit also checks the existence of all required documents and collateral, before granting the credit, and approves the provision of credit to the customers by the credit teams. In the framework of analyzing credit risks, the CRA unit gives an additional opinion on the quality of the credit when it is raised for approval in the bank's institutions in a separate and independent document (hereinafter – "the CRA document"). It is emphasized that applications for credit are not discussed in the bank's institutions without the CRA document that is submitted at the same time as the application. Once a quarter, the manager of the CRA unit reports to the Risk Management Control division on the CRE documents prepared by him.

In the project oversight department, each project is provided close oversight of the building supervisor, who issues periodical progress reports. The required additional credit needed for the completion of the construction is approved only after examination of the updated exposure report of the project, in consideration with its progress rate and the conditions with which the borrower needs to comply in parameters and milestones that were established. In addition, during the life of the project, generally once per month (with the receipt of the performance report of the supervisor), the financial solidity of the project is examined by the referents of the division.

In the business credit area, requests for credit renewal are submitted at least once a year. The credit file and collateral are examined, as of the date of granting of the credit and as of the date of the renewal. Also in this area, examinations are implemented regarding the borrowers' financial stability and regarding the financial statements. In addition, daily controls are implemented regarding deviations from the credit lines and collateral.

Identification and handling of problematic credit

As part of the efforts that the Bank is making in credit risk management, there is a methodology to identify problematic debts that is being implemented in all business lines. The methodology includes a regular, organized and structured process in which the credit file undergoes a meticulous review, using criteria that constitute an early warning of the formation of a problematic debt.

As part of the review, customers with negative symptoms are located such as debt in arrear, cash flow difficulties expressed in difficulty in paying loan principal and/or interest, worsening of business activity, and so forth. and the need to provide a recommendation for a new classification for the customer or a change of classification of a customer with an existing classification.

The recommendations are presented to the problematic debts committees based on the hierarchy of authorities determined, which discuss them and make decisions regarding classification or provision making, recommendations are reported to the Accounting Department in the Monetary Division.

When the real estate sector department recognizes that a borrower is in trouble or there is suspicion that he may get into trouble, immediate discussions are held with the participation of the main parties handing the customer and immediate decisions are taken whether to transfer handling to the Bank's Collection Department, external legal treatment, imposing receivership, liquidation or preparation of a debt arrangement.

In Retail Credit – when the loan is in arrears – the branches will handle the collection up to a certain depth of arrears as determined by the procedures. Loans beyond the aforementioned depth of arrears will be passed for handling by the Collection Department. In irregular cases in which there is suspicion of forgery, fraud, or suspicion of the borrowers skipping the country, etc., the portfolio will be immediately transferred to the Collection Department regardless of the depth of the arrears.

The Collection Department centralizes all the procedures in the framework of the Bank's collection activity, and supervises the work of lawyers and subcontractors involved in the collection process.

Bank management strives to settle with the borrower whose debts to the Bank are in arrears, and continuing the current monthly payments, but only if there exists sufficient collaterals in the loan file.

If borrowers do not cooperate and/or avoid repaying the debt, receivership proceedings will be initiated as a last resort for clearing the debt.

The Bank has orderly procedures for identification, classification and handling of problematic debts and there is a mutual working relationship between the Credit Managers and the Collection Department.

Controls of significant events that might affect a group of customers or the Bank's credit portfolio – the Bank examines the effect of the event on the credit portfolio and responds accordingly. The response may be in the form of change in policy or by means of an activity with the existing borrowers.

The Board of Directors and its committees receive periodic reports regarding distribution of credit, distribution by sector, large borrowers and other parameters measuring the exposure to credit risk.

The bank has an internal system for rating borrowers that supports credit decision making. In the project oversight sector, the system integrates parameters from project exposure reports, e.g. review of the progress report, liquidity status, erosion of profitability, value of inventories, etc. In retail credit, the customer is rated according to the Bank's existing rating model.

The bank determines the provisions for credit losses on loans against mortgage of a residential housing, according to the depth of arrears formula determined in the Proper Banking Management Instructions № 314 of the Supervisor of Banks. In addition, in compliance with the Supervisor of Banks' directive, the group provision for credit losses for the balance of housing loans was calculated to not less than 0.35% of the balance of the housing loans for which no provision is held based on the depth of the arrears or the individual provision.

With the other retail credit, as well as business credit, the Bank establishes its provisions in compliance with the Supervisor of Banks' circular: "Measurement and Disclosure of Defective Debts, Credit Risks, and Provision for Credit Losses" as published on December 31, 2007. The circular is based, inter alia, on the American Accounting Standards, and on regulatory instructions of the authorities supervising banks and the SEC (Securities and Exchange Commission) in the United States.

According to the circular, the Bank establishes as a separate liability account, provision at a suitable level to cover probable credit losses related to off-balance sheet credit instruments, such as engagements to provide credit and guarantees.

The provision needed to cover expected credit losses with regards to the credit portfolio is assessed in one of two tracks: "Individual Provision" and "Group Provision".

Individual provision for credit losses – The Bank identifies, in order to examine individually each debt whose contractual balance (without deduction of write-offs that are not involved in accounting waiver, unrecognized interest, provisions for credit losses and collaterals) is NIS 1 million or more. The Bank also identifies the need for individual valuation, other debts (except housing debts concerning to which provision has been calculated according to the depth arrears formula) for which the provision for impairment is not included in a group provision. The individual provision will be recognized for every debt classified as defective. Debt will be classified as defective when according to the information and updated events, it is expected that the Bank will not be able to collect all the entitled amounts according to the debt's contractual terms. Debt is classified as defective when the debt is in arrears for 90 days or more, except if the debt is properly insured and is in collection process. In addition, a debt is classified as defective when it is reorganized as a problematic debt.

The individual provision for credit losses is estimated based on expected future cash flows, capitalized by the debt's effective interest rate, or when the debt is contingent upon collateral, or when the Bank determines that seizure of the asset is probable, according to the fair value of the collateral pledged in order to ensure that credit, less sales costs.

The provision for credit losses estimated on a group basis – is implemented for provisions for impairment of large groups of small and homogeneous debts (such as credit card debts, housing loans and consumer debt paid in installments) and for debts that were individually reviewed and found to be not defective. The specific provision for credit losses for debts estimated on group basis, except for housing loans for which provision has been calculated according to the depths arrears formula, will be calculated according to the rules determined in American Accounting Standard FAS 5: Accounting for Contingencies (hereinafter – "FAS 5"), based on the updated estimate of past loss rates for each of the homogeneous groups of debts with similar risk characteristics. The formula is based on rates of historical losses (until 2010) and on the net accounting write-off rates that were actually recorded (since 2011) in the various economy sectors, as divided between non problematic credit and problematic credit.

The required provision in relation to the off-balance sheet credit instruments are estimated according to the group provisions rate for balance sheet credit, multiplied by the expected rate of realization of off-balance sheet credit instruments. In the defective classification, the expected rate of realization is 100%. Furthermore, the instructions established various definitions and classifications of balance sheet and off-balance sheet credit risk, rules of recognition for interest income from defective debts and accounting write-off rules for problematic debts. Inter alia, the Bank operates to write-off all debts estimated on an item by item basis and considereduncollectible and which has such a low value that its remaining as an asset is unjustified or a debt for which the banking corporation conducts efforts for long-term collecting. Concerning debts estimated on a group basis, write-off rules were established based upon the arrears period (in general, when in arrears for over 150 days) and their collaterals.

As from January 1, 2011, the instruction on "Measurement and Disclosure of Defective Debts, Credit Risk and Provision for Credit Losses" is in effect. The provision adjusts the reporting principles that apply to banking corporations in Israel on this matter to those applying to banks in the United States and is based, inter alia, on American Accounting Standards and on regulatory instructions of the supervisory institutions on banks and the SEC (Securities and Exchange Commission) in the United States.

This instruction is implemented in the Financial Statements of banking corporations and credit card companies as of January 1, 2011 (in the original instruction – from January 2010). The instruction was not implemented retrospectively in the Financial Statements for previous periods.

Below is a table presenting credit risk and non-performing assets (millions of NIS):

	Balance as at December 31,					
	2013			2012		
	Credit risk[3]					
	Balance Sheet	Off-Balance Sheet	Total	Balance Sheet	Off-Balance Sheet	Total
1. Problematic credit risk[1]						
Defective credit risk	66.4	5.6	72.0	78.1	9.7	87.8
Subordinated credit risk	27.4	1.6	29.0	28.3	6.3	34.6
Credit risk under special supervision[2]	265.8	2.9	268.7	277.7	0.4	278.1
Total problematic credit risk*	**359.6**	**10.1**	**369.7**	**384.1**	**16.4**	**400.5**
* From this: non-defective debts, in arrears of 90 days or more (primarily housing)[2]	260.3	-	260.3	280.3	-	280.3
2. Non-performing assets:						
Defective debts not accruing interest income[4]	38.3	5.6	43.9	44.1	9.7	53.8
Assets received against credit that were cleared	-	-	-	-	-	-
Total non-performing assets	**38.3**	**5.6**	**43.9**	**44.1**	**9.7**	**53.8**

1. Credit risk for credit that is defective, subordinated or under special supervision.
2. Including for housing loans for which there is a provision based on the arrears depth, and for housing loans for which there is no provision based on the arrears depth, in arrears of 90 or more days.
3. Balance sheet and off-balance sheet credit risk are presented before the effect of the provision for credit losses and before the collateral effects permitted for deduction for the purpose of liability of borrower and groups of borrowers.
4. Not including debts for which recognition of interest income was done on a cash basis.

Below are details on the provision for credit losses (millions of NIS) of housing loans for which a minor provision was made for credit losses and based on the depth of the arrear, pursuant to the appendix to Proper Banking Management Provisions No. 314:

	Balance as at December 31, 2013								
	Depth of arrears of 90 days or more								
	Depth of arrears of 30 to 89 days	90 days and up to 6 months	Over 6 months and up to 15 months	Over 15 months and up to 33 months	Over 33 months	Total above 90 days	Balances in respect of loans in arrears that were refinanced(3)	Total
Past-due amount	**1.3**	4.1	3.0	3.0	27.2	**37.3**	-	**38.6**
From this: balance of provision for interest(1)	**-**	-	0.1	0.1	11.9	**12.1**	-	**12.1**
Recorded debt balance	**59.7**	112.6	56.7	20.9	30.2	**220.4**	24.2	**304.3**
Balance of provision for credit losses(2)	**-**	-	7.8	9.3	24.7	**41.8**	3.4	**45.2**
Balance due, net	**59.7**	**112.6**	**48.9**	**11.6**	**5.5**	**178.6**	**20.8**	**259.1**

1. For interest on amounts in arrear.

2. Not including balance of provision for interest.

3. Loans for which a settlement was signed for the return of arrears from the borrower, when a change in clearance schedule was made for the remaining loan that has not yet reached maturity.

Listed below is a table of the provision rates for credit risks to the public:

	December 31,	
	2013	2012
Rate of balance of defective credit to the public that does not accrue interest income, from balance of credit to the public.	0.66%	0.81%
Rate of balance of non-defective credit to the public that is in arrears of 90 days or more, from the balance of credit to the public	2.67%	2.90%
Rate of balance of provision for credit losses from credit to the public, from balance of credit to the public(1)	1.12%	0.96%
Rate of balance of provision for credit losses from credit to the public, from balance of defective credit to the public that does not accrue interest income(1)	169%	119%
Rate of problematic credit risk from the public, from total credit risk from the public	3.31%	3.60%
Rate of expenses due to credit losses, from the average balance of credit to the public(1), (2)	0.56%	0.38%
Rate of net off-writes due to credit to the public, from balance of average credit to the public	0.37%	0.38%
Rate of net off-writes due to credit to the public, from the balance of the provision for credit losses due to credit to the public(1)	33.2%	38.9%

1. The provision as at December 31, 2013 includes a one-time provision for credit losses in respect of debts that were reviewed on a group basis in the amount of NIS 19.2 million, following the Bank of Israel directive from March 21, 2013, as specified below in the chapter on Events in the Reporting Year.

2. Neutralized by the one-time provision, the rate of expenses is 0.37%.

Credit exposures to foreign financial institutions(1) on a consolidated basis as at December 31, 2013 (millions of NIS):

	Total credit exposure in millions of NIS(2) as at December 31,	
External credit rating	**2013**	**2012**
-AA until AAA	98	49
A+ until A-	14	56
Total exposure(2)	**112**	**105**

(1) Banks, holding companies of banks, investment banks and brokers.

(2) Deposits and current account balances in banks. The Bank has no off-balance sheet credit risks, balances lower than NIS 1 million are not presented.

There are no financial institutions that are classified as defective debt, inferior debt or debt under special supervision, as well as there is no provision for credit losses. The balances included in the table above primarily include institutions operating in the US, Switzerland, Germany, Denmark and Britain.

With the outbreak of the financial crisis in the year 2008, the Bank narrowed its deposits at financial institutions abroad, established restrictions on concentrated deposits and established procedures and required examinations prior the financial deposit at foreign banks abroad. The bank relies on the rating of the rating companies "Moody's" and "Standard & Poors". These ratings are relevant in relation to deposits that have been deposited at foreign banks only.

Exposure to Environmental Risks

Increase in global and Israeli awareness, expressed in regulatory extensions, for compliance with instructions concerning environmental quality requires the Bank to address the potential financial exposure deriving from environmental risks. The Bank is obligated towards its customers and shareholders to manage its business in a profitable and responsible manner. As part of this obligation, the Bank works to recognize, assess and manage the environmental risks involved in its activity and that of its customers. The appetite of the Bank for risks in this area is low and therefore the Bank operates according to conservative principles for environmental risk management in its financial activity.

The current activity of the Bank focuses on borrowers in the retail sector who do not have a high exposure to environmental risk. As a result, the Bank's exposure to this risk is not significant. Also, the activity of the Real Estate Sector in providing credit in the construction, real estate and commercial activity sectors for corporations and individuals does not expose the Bank to material environmental risks, inter alia, in light of the Bank's avoidance from providing credit to industries prone to environmental pollution.

The Bank's Board of Directors approved the policy in this area.

Housing Loans

The Bank's activity in the housing loans area is with the mid-decile and above population level and as the main target public. Therefore, the customers with the following characteristics are preferred: Customers living in the center of Israel, an asset mortgaged in loans secured by real estate located in an area defined by the Bank as preferred, the gross family income is not less than the average income in the market. Since 2011, the financing percentage in housing loans provided by the bank significantly declined so that in 2013, approximately 85% of the loans were issued with a financing rate that does not exceed 60% of the asset value.

The Bank's Average Financing Rate – The balance of the loan divided by the estimated value of the assets, as examined in relation to the existing credit portfolio at the Bank, is very low and stands at about 31% (value of the revalued assets calculated from the last assessment day, according to the Housing Price Index that the Bureau for Central Statistics publishes, distributed by geographical areas and according to the number of rooms).

The following table presents the developments in credit performances for housing:

	2013	2012	2011	2010	2009	2008
Total performance	1,364	1,476	1,489	1,996	1,179	937
From this:						
In variable interest at a frequency less than 5 years	360	328	731	1,198	743	523
In foreign currency	158	252	243	482	247	252

Below is general data on mortgage performances in NIS:

	2013	2012	2011	2010	2009	2008
Average loan period in months	215	221	226	217	203	199
Average income per capita (NIS)	4,450	4,136	3,740	3,716	3,322	3,082
Breakdown of performance amount by percentage of asset financing (LTV)						
0%-60%	85%	92%	87%	60%	61%	58%
61%-75%(1)	14%	7%	12%	37%	36%	38%
Above 75%	1%	1%	1%	3%	3%	4%
Breakdown of number of agreements by performance amount (NIS in thousands)						
0-500	70%	74%	72%	75%	82%	85%
500-1,000	21%	18%	19%	18%	14%	11%
Above 1,000(2)	9%	8%	9%	7%	4%	4%
Average loan amount	450	510	458	447	324	300

(1) Beginning in March 2013, according to Bank policy, consumer credit is not given for mortgages and as such, the percentage of the mortgage loan performance sum with a financing rate above 60% has increased in comparison with previous years.

(2) In 2013, 51 loans were granted exceeding NIS 2 million, in a total amount of NIS 159.4 million.

Below are details of various risk characteristics in the housing loans portfolio (in millions of NIS):

Balance as at December 31, 2013								
		Age of loan (time that passed since loan was granted)						
Financing rate	Rate of repayment from fixed income	Up to 3 months	Over 3 months and up to one year	1-2 years	2-5 years	5-10 years	10 years or more	Total
Up to 60%	Up to 40%	195.3	490.8	714.7	1,255.8	490.1	531.0	3,677.7
	40%-50%	40.0	108.4	147.8	230.9	95.1	51.5	673.7
	50%-80%	19.8	153.5	166.9	289.7	116.8	44.8	791.5
	Above 80%	2.3	54.9	103.6	110.4	70.2	5.9	347.3
	Total	**257.4**	**807.6**	**1,133.0**	**1,886.8**	**772.2**	**633.2**	**5,490.2**
60%-75%	Up to 40%	36.3	83.3	56.5	481.8	255.3	25.2	938.4
	40%-50%	9.9	17.3	6.8	64.9	41.7	6.2	146.8
	50%-80%	6.8	22.5	17.4	89.7	45.4	5.1	186.9
	Above 80%	–	13.7	18.6	18.9	20.6	0.8	72.6
	Total	**53.0**	**136.8**	**99.3**	**655.3**	**363.0**	**37.3**	**1,344.7**
Above 75%	Up to 40%	6.1	22.6	5.1	31.7	52.4	25.1	143
	40%-50%	1.3	3.6	1.9	4.3	12.0	6.9	30.0
	50%-80%	2.0	3.5	4.0	12.7	19.9	1.0	43.1
	Above 80%	0.4	18.5	1.0	4.1	5.7	0.2	29.9
	Total	**9.8**	**48.2**	**12.0**	**52.8**	**90.0**	**33.2**	**246.0**
Secondary lien or no lien	Up to 40%	1.1	1.8	0.7	4.4	6.8	19.2	34.0
	40%-50%	–	0.3	0.8	0.3	0.5	0.3	2.2
	50%-80%	–	0.3	–	2.9	0.4	0.2	3.8
	Above 80%	–	0.7	1.8	0.3	–	–	2.8
	Total	1.1	3.1	3.3	7.9	7.7	19.7	**42.8**
Total		**321.3**	**995.7**	**1,247.6**	**2,602.8**	**1,232.9**	**723.4**	**7,123.7**

Quality of customers:

The population of mortgage customers are mainly in their upper thirties, from the 6th decile and above, with an income higher than the economy's average income. The ratio of repayment to average income is materially lower than the minimum requirements as defined in the Bank's credit policy.

The rate of repayment from fixed income:

Fewer than 5% of the Bank's housing loans portfolio was given to customers with a ratio of repayment to income that exceeded 50% and with a financing rate higher than 60%. The rate of repayment from income in housing loans is used as an indicator of the customer's ability to repay the loan it took. In general, the bank ensures that the monthly rate of repayment of the requested loan does not exceed 35% of the household income. In loans in which the rate of repayment is higher, the credit is granted to borrowers with a high scope of assets, and whose ability to repay the loan is not solely based on the applicants' current income, or borrowers whose average available income per capita is high. Approximately 7% of the housing credit portfolio is given to customers with a ratio of repayment to income higher than 40% whose financing rate was higher than 60%.

In 2013, the average ratio of repayment to income was approx. 33%.

On August 29, 2013, the Supervisor of Banks published directives which impose limitations, with reference to housing loans, on the rate of repayment from income, on the part of the loan given at variable interest and on the final period for repayment of the loan.

For additional details about the provisions of the directives, see the chapter of Events in the Reporting Year.

Breakdown of the portfolio according to the financing rate:

In the credit policy of recent years, the Bank decided to reduce the credit risk exposure by limiting the maximum financing rate, in general to 75% of the mortgaged asset's value. Following instructions published by the Supervisor of Banks. Beginning in November 2012, the Bank began implementing the Supervisor of Banks directive concerning limitation of the financing rate in housing loans, according to which a significant percentage of loan performances will be limited to a financing rate of 50% of the value of the mortgaged property.

According to the credit policy, the Bank does not grant loans in which there is an element of deferred payment of principal and interest.

The balance of loans secured by secondary mortgages or when the Bank's collateral rights are unsecured, is not significant. There are no housing loans at the Bank on which the information is incomplete.

The bank does not grant loans for a period exceeding 30 years.

In 2013, approximately 15% of all housing credit (NIS 220 million) was granted for a period exceeding 25 years. The original loan period for 92.5% of the balance of the housing credit portfolio was for less than 25 years.

Breakdown of the portfolio according to geographical areas:

The Bank's housing loans portfolio is distributed between many borrowers, most of whom purchased assets in a centralized manner in the center of Israel. Some 53% of the portfolio is granted to assets in the Gush Dan and Greater Jerusalem area.

Housing credit provision process:

The mortgages activity mainly includes providing loans for housing against a lien on the apartment for Israeli residents, with various linkage bases and according to a variety of interest tracks; and to foreign residents in the major foreign currencies (mainly in US dollar, English Pound and Euro).

The loans are divided into two types: loans from the Bank's funds, and loans from government funds and under its responsibility for those entitled by the Ministry of Construction and Housing (hereinafter: the "budget loans"). The Bank has no credit risk on budget loans.

The credit assessment and approval process for residential housing mortgage is a structured and standardized process. The loan is approved by the branch and/or transferred to a more senior approval level, based on the authority level established by the Bank's Board of Directors.

The procedure requires separation of functions (the credit officer is not allowed to approve the application he assesses – the computer system blocks this possibility) thus, also those applications within the branch's authority may not be performed by the same officer.

Applications exceeding the authority of the branch manager are transferred for approval to an underwriting center. The role of the underwriting center is to reexamine the application, to approve or reject it. In case the credit application requires a greater authority than the underwriting center authority, the underwriting center presents its recommendation and transfers it to a senior level for approval (division manager, CEO or credit committee) according to the relevant authority.

As part of the loan granting process, credit portfolios in the framework activity of mortgages are examined by the Central Examination Unit that examines the completeness of the portfolio after approval, and reception of all the necessary documents and collaterals. The unit is subject to the back operating system in the Resources division and thus there exists a managerial separation between the credit approval process and document transfer for examination prior to implementation.

The retail credit activity is supported in a tight manner with legal guidance of lawyers from the Bank's legal department, that review, inter alia, the legal diligence of the documents and kinds of collaterals.

Clearance Risks and Counterparty Risks

The clearance risk is the risk that the other party does not fulfill its undertakings and does not transfer to the Bank on the fixed date the required amount in the clearance transaction, this although the Bank did transfer its part to the other party. The risk only exists when the exchange for the transaction is not simultaneously transferred. The exposure to clearance risk is for a short period of time and generally for less than a day.

Counterparty risk is a risk when the other party to the transaction fails to fulfill its undertakings before the final clearance of the transaction flows. The transaction's market value, which may be positive or negative for any of the parties, actually depends on the fluctuation of the market factors. Only if the transaction will have a positive fair value for the Bank and the counter party will be in lapse – an economic loss might be caused to the Bank during the lapse. The risk exposure to the counter party may be created during the transaction's entire life time.

Until September 2007, the banking system mainly cleared receivables through the central banking clearance center, in addition to the check clearing system. In addition, as of September 2007, the banking system started to operate RTGS system (Real Time Gross Settlement), which is a real-time financial transactions clearing system. The minimum transaction amount requiring transfer via RTGS was set by the Bank of Israel at NIS 1 million. These systems significantly reduce the Bank's exposure to clearance risks of financial transactions.

The main source for exposure of the Bank to clearance risk is clearance of derivative transactions which are not traded and cleared through Stock Exchanges (OTC). The Bank operates towards its customers in derivative instruments traded at the various stock exchanges, but does not operate towards them in OTC derivatives. The Bank operates in these derivatives for itself an only for risk hedging and as an additional tool it uses for the management of its assets and liabilities. In addition, the Bank is exposed to clearance risks resulting from trading in foreign securities performed with brokers through clearance processes of NON-DVP (Delivery Versus Payment) type.

Therefore, the main exposure of the Bank to counter-party risk is formed versus banks and recognized financial institutions abroad, for clearance of derivative transactions (OTC), and versus brokers and custodian service provides in securities, for clearance of transactions in foreign securities. The lines of activity with such institutions are approved at least once a year by the Board of Directors of the Bank, as part of the credit lines of the institutions. During the reviewed period, clearance risks or counterparty risks were not realized at the Bank.

Mitigation of risk – the Bank has signed ISDA agreements and CSA appendixes with some of the banks where derivative activities are implemented. These agreements allow for the offsetting of transactions value, so that the amount transferred between the transaction parties is only the net exposure amount, and thus reducing the exposure of each of the parties. CSA appendixes regulate the transfers of the funds between the transaction parties whenever the exposure reaches a certain predetermined scope, and thus reducing the counterparty risk exposure to a defined amount, regardless of the value of the transactions as derived from market fluctuations.

Market risks

General

Market risks are a group of risks whose essence is loss exposure as a result of changes in various market parameters (exogenous parameters). In this risk group, several types of specific risks are included, managed at the Bank in similar manner, based on similar work structure and through the same principle factors.

Market Risk Management

Board of Directors – Bears the ultimate responsibility for management and supervision on market risks and liquidity and creating a proper risk environment. The function of the Board of Directors, as determining the Bank's policy, is to outline the risk management characteristic and the required corporate governing structure.

Board of Director's Risk Management Committee– Its role is to examine the Bank's risk management procedures and the level of adjustments to the policy framework that was approved by the Board of Directors, and the report systems, lines of responsibility and authority. The Committee convenes preliminary discussions to the Board of Directors discussions pertaining to the market and liquidity exposure policy (including nostro policies). In addition, the Committee discusses organizational preparation for management and control of these risks. The committee also discusses every proposal for new financial activity or irregular activity by the Bank and every deliberate investment in new financial instruments, and submits, if necessary, its recommendations to the Board of Directors.

Senior management – convenes very frequently to discuss current issues. On behalf of the senior management, a number of sub-committees have been established, whose members are the relevant senior management members for issues to be discussed, handling, inter alia, the Bank's risk management.

The Assets and Liabilities Management Committee – Headed by the CEO, it convenes twice weekly, and reviews reports on all issues related to the Bank's management of assets and liabilities. The committee monitors compliance with the Bank's objectives, as defined by the work plan and after complying with the exposure limitations for market risks, as has been approved by the Board of Directors. The committee makes operative decisions on various issues and sets prices and quantitative objectives for each of the business activities.

At each meeting, the committee reviews the current parameters of the activity including quantities and prices in all sectors. These parameters are central indicators for the exposure and liquidity situation. This review includes data concerning credit performance and performance prices, raisings in current month and prices of raisings, balances of liquid assets and their components, activity in the nostro portfolio, index and foreign currency positions, Profit and Loss from index and foreign currency positions, financial forecasts, and more.

It is the responsibility of the committee to continuously monitor all the reports related to risk management and the Bank's liquidity and management of the Bank's nostro portfolio.

Financial Risk Management Forum – Convenes monthly in order to review the reports received from the risk manager in relation to the Bank's market risk exposure situation. Furthermore, the forum discusses the monthly exposure estimates, the exposures document (quarterly), issues arising during the work of the Financial Division, the Risk Management Department or controller, and additional issues as required. At each meeting the forum reviews the exposure situation in various risk and liquidity situations, among others, through monitoring all the parameters appearing in the exposure document including the model and extreme scenario results. In addition, the forum monitors events affecting the Bank's various exposures and liquidity.

Finance Division Manager – Serves as market risk and liquidity manager and responsible for implementation of the Bank's policy and to consolidate work setting including this risk management and its approval by the Bank institutions. In principle, the Division deals with the current management of market risk exposure and guidance of the various units dealing with the management of the Bank's financial instruments, and creating exposure by the various activity sectors. The Finance Division Manager even makes recommendations to management, the Board of Directors and the Board of Directors committees concerning the feasibility of creating risks through financial instruments allowed for creating and hedging risks, and all the remaining issues connected to exposure creation and management. Moreover, it has the responsibility for managing the nostro portfolio while examining the implications of the nostro activity on all the exposures.

The Risks Division headed by the Chief Risks Manager – Deals with consolidating models for market risk assessment, exposure and liquidity; development of techniques for risk management; and support current management of market risk exposure. The division also makes recommendations to the Internal Committee on issues related to the feasibility of exposure management, while considering the expected income components from these exposures and costs of exposure hedging, and the feasibility and profitability examination of new and/or existing financial products.

It is the responsibility of the division to implement and currently monitor compliance with the limitations as determined for the various exposures.

The Mode and Scope of Reporting Systems

The Bank manages its risks, inter alia, with the assistance of the ALM, the system which covers the Bank's cash flows, as derived from its various financial activities. This system enables asset and liability management – ALM – (Asset and Liability Management) and inter alia, enables quantification of market risks according to the value-at-risk VaR methodology. In addition, the system enables monitoring additional risk parameters such as: interest and underlying exposures and Stress Testing. During the first half of 2012, the ALM system underwent validation in accordance with instructions by the Bank of Israel on model validation.

The VaR measures the maximum loss expected to occur at the Bank resulting from realization of market risks in a given period of time and at a predetermined level of statistical assurance, according to previous market conditions. The calculation at the Bank is performed monthly, for a holding period of 10 days and at a statistical significance level of 99%. The system measures the comprehensive risk through the VaR of the total banking portfolio, as well as the risk exposure of the for-trade portfolio through this system. In addition to management and control through the VaR model, the Bank also uses other models for quantifying risks.

The Bank determined limitations for the value-at-risk (economic VaR): total VaR – NIS 02sA .noillim eht ,3102 ,13 rebmeceD foVaR amounted to NIS 4.1 million, compared to NIS 5.8 million as of December 31, 2012. The maximum economic VaR value (month end) amounted to NIS 7.0 million in 2013, compared to a maximum value of NIS 14.4 million in 2012.

Hedging and/or Risk Mitigation Policy

The Bank's financial risk management policy is based on exposure management for market and liquidity risks by establishing quantitative limitations. The means used for the purpose of complying with the limitations include, among others: purchase and sales of marketable securities (mainly Israeli government debentures), raising of non-negotiable deposits (from private and institutional departments), raising of negotiable deposits, and activity in derivative financial instruments.

Interest rate risk

Interest risk results from the differences between the relative sensitivity of assets and of liabilities to unexpected changes in interest rates and between this sensitivity of liability changes – that may result in erosion of the Bank's equity. The Bank's role as a financial intermediary creates exposure to this risk, and the Bank is working to reduce this. The Bank's principal exposure is in the index-linked sector, since this is the sector in which most of the assets and liabilities bear fixed long-term interest rates. In addition, the exposure in the non-linked NIS sector due to the increase in the activity scope, in the credit area, in the nostro portfolio and in funding, should be noted. This, although the main activity in this sector, except for the activities in the nostro portfolio, is made for an interest duration of up to a year. The bank monitors the development of the duration of the loans against the deposits, for the purpose of adopting measures to minimize the effect of possible change in interest rate on the value of its net financial flows. Therefore, it continuously measures the duration derived from the current new activity, and also monitors the extent of early repayments of loans that have a significant effect on the effective duration.

The Bank's policy on management of exposure to interest risk is periodically examined in consideration of expectations concerning the decrease in various interest rates, examining the costs required to curtail exposure to this risk, and taking into consideration the estimated early repayment rates on loans and factors affecting it. Estimates of early repayment rates is performed relying on past data and on the Bank's assumptions regarding several factors that affect this rate, including mainly interest rates. The assumption of early repayments by borrowers serves in the index-linked sector for calculating the duration gaps and the interest risk exposure.

According to the Bank's estimation, considering the extent of early repayments during recent years and the risk exposure in all linked sectors, the risk exposure as result of unexpected change of 1% in the interest rate was smaller, relatively to the value of the Bank's capitalized net flows. This assessment by the Bank is "forward-looking information" and may occur differently than expected in view of the fact that it is based on the scope of early repayments in recent years and the exposure in all linked sectors and the actual scope of future repayments may possibly be different.

In addition, the Bank's is exposed to risk as a result of the curtailment of the margins in the mortgages area due to the fierce competition in this sector. One of the objectives of the strategic plan in the Bank is to reduce this risk and to reduce the Bank's dependency in this area.

C. Below is a summary of various exposures due to unexpected changes in interest (in millions of Shekels before Tax):

	Potential change in fair value				Potential change in annual profit	
	December 31,					
	2013		2012		2013	2012
Effect of immediate parallel change in yield curve	**Increase of 1%**	**Decrease of 1%**	**Increase of 1%**	**Decrease of 1%**	**Increase of 1%**	**Increase of 1%**
Sector						
Unlinked	(12.1)	12.8	(6.0)	7.0	4.7	2.8
Index-linked	4.7	(5.3)	0.8	(0.4)	(1.8)	(1.7)
Foreign currency	5.2	(5.4)	2.1	(2.1)	8.7	5.9
Total	(2.2)	2.1	(3.1)	4.5	11.6	7.0
Limitation	(50.0)	(50.0)	(50.0)	(50.0)	(12.0)	(12.0)
Maximum during the period	(21.2)	22.8	(18.5)	20.8	15.6	9.4
Minimum during the period	(2.2)	2.1	(3.1)	4.5	6.7	4.9

Below is information concerning the effect of hypothetical changes in the interest rate on the fair value of the financial instruments of the Bank and its consolidated companies (in millions of Shekels):

a. Fair value of the financial instruments of the Bank and its consolidated companies, except for non-financial items (before hypothetical changes in interest rate):

	as at December 31,									
	2013					2012				
	Israeli currency		Foreign currency(2)			Israeli currency		Foreign currency(2)		
	Unlinked	Index-linked	USD	Other	Total	Unlinked	Index-linked	USD	Other	Total
Financial assets(1)	8,301.2	3,718.0	1,126.6	118.1	**13,263.9**	6,919.0	3,816.1	1,394.4	180.9	12,310.4
Amounts receivable from derivative financial instruments(3)	269.7	51.4	814.5	85.4	**1,221.0**	259.2	119.6	6.5	0.9	386.2
Financial liabilities	7,533.4	3,536.1	1,462.0	153.2	**12,684.7**	6,217.4	4,006.6	1,271.3	165.0	11,660.3
Amounts payable for derivative financial instruments(3)	678.8	51.2	435.9	45.7	**1,211.6**	243.1	50.2	78.2	10.2	381.7
Net fair value	358.7	182.1	43.2	4.6	**588.6**	717.7	-121.1	51.4	6.6	654.6

(1) Not including balance sheet balances of derivative financial instruments and fair value of off-balance sheet financial instruments.

(2) Including Israeli currency linked to foreign currency.

(3) Amounts receivable (payable) for derivative financial instruments and for off-balance sheet financial instruments, capitalized at interest rates utilized to calculate fair value.

b. The influence of hypothetical changes in interest rates on the fair value of the financial instruments of the Bank and its consolidated companies, excluding non-monetary items:

	As at December 31, 2013					
	Net fair value of financial instruments, after the effect of changes in interest rates				Change in fair value	
	Israeli currency				in millions of NIS	In percentages
Change in interest rates	**Unlinked**	**Index-linked**	**Foreign currency(2)**	**Total**	**Total**	**Total**
Immediate parallel increase of one percent	346.6	186.8	53.0	**586.4**	**-2.2**	**-0.37%**
Immediate parallel increase of 0.1 percent	357.5	182.6	48.3	**588.4**	**-0.2**	**-0.03%**
Immediate parallel decrease of one percent	371.5	176.8	42.4	**590.7**	**2.1**	**0.35%**

As at December 31, 2012						
	Net fair value of financial instruments, after the effect of changes in interest rates				Change in fair value	
	Israeli currency				in millions of NIS	In percentages
Change in interest rates	**Unlinked**	**Index-linked**	**Foreign currency**(2)	**Total**	**Total**	**Total**
Immediate parallel increase of one percent	711.7	-120.3	60.1	**651.5**	**-3.1**	**-0.48%**
Immediate parallel increase of 0.1 percent	717.1	-121.1	58.2	**654.2**	**-0.4**	**-0.06%**
Immediate parallel decrease of one percent	724.7	-121.5	55.9	**659.1**	**4.5**	**0.68%**

(1) Not including balance sheet balances of derivative financial instruments and fair value of off-balance sheet financial instruments.

(2) Including Israeli currency linked to foreign currency.

(3) Amounts receivable (payable) for derivative financial instruments and for off-balance sheet financial instruments, capitalized at interest rates utilized to calculate fair value.

Linkage basis risk

The exposure to linkage basis risk is attributed to changes in the exchange rates and in the inflation rate. The policy of the Bank is to manage the risks resulting from linkage basis exposure in a controlled manner, as part of the limitations established by the Board of Directors.

The Bank currently manages the positions in the various linkage sectors through a variety of financial instruments available to it, in accordance with consideration of changes in relevant economic data and current control of risks resulting from such exposure. The limitations were determined while maintaining the Bank's flexibility and its ability to change the various positions in short time according to the economic forecasts. In order to limit this risk exposure, the Bank's Board of Directors determined the maximum rates for each linkage sector.

Below are limitations on exposure rates in each linkage sector as determined by the Board of Directors (not necessarily an accounting exposure). The limitations are on the excess (deficit) amounts of assets over liabilities in each sector:

	In percentages from the financial capital(1)		NIS in millions as at December 31, 2013	
	Maximum amount	Minimum amount	Maximum amount	Minimum amount
Index-linked	50%	-50%	296	-296
Foreign currency and foreign currency-linked	$10M	M01-$	35	-35
Unlinked	150%	50%	888	296

(1) The financial capital is equity less non-monetary assets – consolidated.

The Bank measures its positions in various linkage bases daily through its information system. This data is reported to the units responsible for position management and its adjustment to the applicable limitations. The data on the issue of position volume is reported in a current manner at the meetings of the Assets and Liabilities Management Committee, as well as at meetings of the other forums operating in risk management.

Following is the actual economic exposure (which is not necessarily the accounting exposure) in each linkage sector (in millions of NIS):

	Exposure as at December 31, 2013	Exposure during the reviewed period (1)		
		Minimum	Maximum	Average
Index-linked	178	223	-302(2)	-89
Foreign currency and foreign currency-linked	1	13	-5	2

(1) Exposure in the index-linked sector is presented for the 15th of each month.

(2) During the exposure period, the minimum exposure limitation was NIS 303million.

Below is data about the Bank's capital sensitivity to changes in the Consumer Price Index (the theoretical change in economic value, that includes the effect of the change on the economic value of the nostro portfolio that was not included in the calculation of the position, as a result of the scenario, in millions of Shekels):

Scenario	As at December 31, 2013	Maximum 2013	Minimum 2013
Increase of 5% in Index	7.3	7.3	-6.4

Below is data about the Bank's capital sensitivity to changes in the currency exchange rates in millions of NIS (the theoretical change in the economic value as a result of the scenario, where a strengthening scenario means strengthening of the currency in question against the shekel):

	As at December 31, 2013		Maximum 2013		Minimum 2013	
	US Dollar	Other	US Dollar	Other	US Dollar	Other
Scenario						
10% strengthening	1.9	(5.0)	3.4	0.2	(4.0)	(4.2)
5% strengthening	0.9	(2.0)	1.7	0.1	(2.0)	(2.1)
10% weakening	(9.1)	0.5	0.4	2.4	(4.3)	(2.0)
5% weakening	(9.0)	0.2	0.2	1.2	(7.1)	(1.0)

As part of it's overall strategy for managing the exposure level to market risks, the Bank carries out, inter alia, transactions in derivative financial instruments to reduce its exposure to these risks. The Bank's activity in derivative financial instruments is as intermediary, trader or end-user. The Bank has derivative financial instruments like future currency swap transactions (Swap) and forward contracts for protecting exchange rates (Forward).

The transactions in derivative financial instruments are recorded at fair value and changes in fair value are regularly recorded in the Profit and Loss Statement. In addition, the Bank enters into contracts that do not constitute derivative instruments on a stand-alone basis, but that include embedded derivatives.

The policy of the Bank is to prevent, to the extent possible, the risk exposure to the exchange rate between the various foreign currencies. Inter-currency exposure is managed within a restricted framework, and within such limits as have been approved by the Bank's Board of Directors.

Liquidity Risks

Liquidity risk is the risk to the profitability of the Bank and to its stability deriving from its failure to supply liquidity needs, due to uncertainty concerning the availability of funding and the ability to raise it (without having an unusual effect upon prices) and concerning the ability to realize assets in a fixed time and at a reasonable price. The exposure results from providing long-term loans (even if provided with variable interest) financed by short-term deposits. Liquidity risk also exists when raising short-term deposits matches the period of interest changes in loans, even if by this the exposure to interest risk is reduced. This risk also exists in relation to the Bank's activity in foreign currency.

The bank is exposed to liquidity risks and to uncertainty regarding lessening of its ability to raise negotiable debt or from institutional sources, due to changes in the market, legislative changes and/or changes in preferences of depositors. In order to comply with this risk, the bank implements a policy of enlarging its depositors' base and decreasing reliance on large depositors. Also, emphasis is placed on maintaining a high level of liquidity.

The Bank's policy is to adjust, to the extent possible, the repayment periods of the sources to those of the applications in each linkage sector. The characteristics of the credit, the rates of early repayment in the various linkage sectors and the scope of recycling of short term deposits have a significant effect on the estimated exposure to this risk.

The Bank's risk management is managed similar to market risk as described above in the chapter on Market Risks.

In accordance with Bank of Israel's instructions, every banking corporation is required to establish a comprehensive policy to manage liquidity, and to maintain an information system for supervision, control, and reporting of the liquidity position and its measurement. It was also determined that the ratio of liquid assets to liquid liabilities that the Bank is required to comply with for a repayment period of up to one month (hereinafter: "the Liquid Assets Ratio") shall not be less than 1. Exposure to liquidity risk and the liquid assets ratio can be measured by using an internal model.

On January 13, 2013, the Supervisor of Banks published Proper Banking Management Provision № 342 on Liquidity Risk Management. As part of preparing to implement the Basel III instructions, the Supervisor found it appropriate, for the interim period until the full update of the instruction according to the Basel documents, to clarify and to emphasize a number of aspects of liquidity risk estimates. The date of implementation of most instructions was established for July 1, 2013. The Bank is implementing the provision.

The Bank examines its liquidity position every day through the minimum liquidity ratio model, which is the ratio between the liquidity cushion and the potential net outgoing flow in an extreme scenario. For purposes of the model, the Bank collected and continues to collect data regarding early repayment rates, timing and rate of renewal of deposits and savings. The minimum liquidity ratio is examined in four scenarios: regular business scenario, bank-specific scenario, systemic-pressure scenario and a bank-specific and systemic-pressure integrated scenario. The various scenarios differ from each other mainly in the recycle rate of the deposits and the realization ability of liquid assets. As part of the implementation of the updated Proper Banking Management Provision 342, the Bank updated the liquidity model to the minimum liquidity ratio model that appears in the aforementioned instruction and to the principles of the Liquidity Coverage Ratio (LCR) model in the Basel III instructions. In addition, the Bank is preparing to develop a stable funding ratio model based on the principles of the NSFR (Net Stable Funding Ratio) in the Basel III instructions, in accordance with the Proper Banking Management Provision 342.

The Board of Directors of the Bank established the liquidity management principles, the level of responsibility and authority and the system of information and handling regarding determined exceptions. Determination of the aforementioned limitations and restrictions, takes into account expected events at the Bank and in the business environment, and possibilities available to the Bank concerning mobilization of alternative sources insofar as required, as well as the costs of these resources.

According to the estimation of the Bank, considering the recycling rate of deposits in the last years, the mentioned exposure risk is higher, among others, because the bank diversifies its financing sources, meticulously expands the basis of the depositors and reduces the reliance on large depositors and maintain sufficient liquidity cushion expressed by a higher than required ratio of liquid assets ratio. As at the report date, the balance of total public deposits for the three large depositor groups amounted to approx. NIS 310 million.

As part of the preparation for implementation of Basel III, the Supervisor of Banks published an initial draft of Proper Banking Management Provision on "Basel III – ratio of liquidity coverage and liquidity risk monitoring tools" and a requirement to conduct a quantitative influence survey for implementing the draft (QIS). The results of the QIS will be used as a basis for making decisions on regulation of banks, including rate of implementation of the provision.

The banking system is required to submit to the Supervisor of Banks the results of the survey no later than April 3, 2013.

The Bank has prepared to submit the survey as required.

Following are the capital requirements for market risk pursuant to the first pillar (millions of NIS):

Type of risk	Capital requirement
Interest risk	*
Exchange rate risk	4.4
Total	**4.4**

* represents an amount less than NIS 0.1 million

Operating Risks

General

Operating risk is defined as the risk of loss as a result of non-diligence or failure of internal processes, people, systems, or external events. The definition of operating risk includes legal risks but does not include strategic or reputation risks.

The Bank operates in a range of financial activities and is exposed to operating risks that include, inter alia, risks of embezzlement and fraud, information technology risks, business continuity risks and information security risks.

In December 2012, the Bank approved updated policies for managing operating risks that include a definition of an operating risk management framework in the Bank, the Bank's risk appetite and an organizational framework through which the Bank's units implements the control processes to minimize risks.

Management of operating risks in the Bank relies on three lines of defense:

Responsibility for operating risk management is that of the unit management. They are the first line of defense, which also includes a function for management of information technology, information security, and business continuity. The Operating Risks Management Unit, compliance officer, legal adviser, and the SOX process that takes place in the Monetary Division represents the second line of defense. The third line of defense is the internal audit, which involves an independent review of controls, and challenge of the processes and operating risk management systems in the Bank.

Operating Risks Management relies on an ongoing process of identification, assessment, measurement, monitoring, reporting and control / reduction of risks.

The organizational structure for operating risk management:

Board of Directors – Carries the ultimate responsibility for managing and supervising operating risks, outlining and approving operating risks.

Board of Directors Committee for Risk Management – Holds advanced discussions for the deliberations by the Board of Directors on everything concerning operating risks. Discusses the process / product / new activity whose introduction exposes the Bank to material operating risks, risk management policies and limitations, risk assessment, quality of risk management and controls, capital adequacy, and risk tolerance.

Bank Management – By means of the Risk Division consistently and regularly examines the operating risks entailed in Bank activity, as well as loss or near-loss events that occurred.

Operating Risks Management Forum – A committee, headed by the Bank's CEO, which discusses the Bank's operating risk management policies before its submittal to Management and the Board of Directors for the approval of new material products and processes, the approval of relevant operating procedures related to operating risk, monitoring implementation of various audit findings concerning embezzlement and fraud, the risk profile, risk appetite, the mode and quality of risk management, as well as controls and capital adequacy.

Information Technology Manager – Manager of the Resources Division defined as the Bank's Information Technology Manager. As part of management of the division, the Division Manager is responsible for managing information systems, human resources, logistics, Back-End System, Organization and Methods.

Business Continuity Manager – Manager of the OCIOunit in the Resources Division was defined.

Information Security – Information security at the Bank is managed by the Resource Division Manager and Information Security Manager, who are responsible for updating policy and control of this issue. Once a year, the Information Security Manager examines the need to update the information security policy and is brought before management and the Board of Directors for approval.

The Operating Risks Management Unit – The unit is part of the Risks Division and constitutes an independent function for operating risks management. The unit is responsible for the formation of a comprehensive operating framework for operating risk management, planning, implementation, and updating operating risk management methodology, formulation of operating procedures to implement the operating risk management framework, recommendations to management and the Board of Directors concerning operating risk appetite, performance of operating risks surveys, defining reporting processes to various management personnel, challenging the mode of operating risk management in Bank units, receiving reports of material and broad malfunctions, creation of a framework for reporting operating risk profile to the Board of Directors and Management, and involvement in the assessment of the operating risk involved in new products and procedures.

The Bank allocates capital for operating risks in accordance with Bank of Israel's directive. The allocation, in accordance with the base indicator approach that calculates the required allocated capital for operational risk, based on the average gross income multiplied by the last three years with a factor of 15%.

In February 2012, the Bank of Israel published an PBM Provision 350 on operating risk management. The Bank implemented and assimilated the principles of the instruction in operating risk management in the Bank.

Reduction of Operating Risk:

The Bank has in recent years been preparing for the creation of a comprehensive framework of processes and methods to lower the exposure to losses resulting from operating risks. This assessment includes, inter alia, the following measures:

- Reducing operating exposure through adoption of continuous control measures, and a requirement for performing dual controls on each process in which a material operating risk exists.

- Implementing broad controls in various areas of activity according to the risk entailed in the procedure, with emphasis on procedures that lack dual control.

- Conducting an operating risk survey and reviewing embezzlement and fraud in addition to formulating plans to lower risks identified in the survey.

- Assimilation of an organizational culture for operating risk management and increase awareness of this issue among employees.

- Implementation of the approval process prior to operation of any new product / activity / process – which requires the conduction of a comprehensive risk survey, formulating a plan that is adjusted to the risk level, and approval of any new material product in the risk management forum headed by the CEO and in the Board of Directors Risk Management Committee.

- Collection of data on loss or near loss events for monitoring, improvement and drawing lessons. The Bank's Management and Board of Directors receive a report of operating events in which a loss was incurred and events that entailed a potential loss, conduct investigations and draw conclusions concerning the loss or near loss events.

- Map of operatin risks ,plans to reduce risk and reports of loss and near loss events – managed by a designated operating risk management system.

The Bank recently conducted a comprehensive operating risk survey under which operating risks were mapped, identified and evaluated, risks levels and effectiveness of controls were assessed with reference to the substantial business and operating procedures. The Bank is working to implement the plan to reduce residual risk (risks remaining after controls are activated) at a high risk level. The plan includes, inter alia, handling to reduce risks related to risks of embezzlement and fraud.

Every quarter, management and the Board of Directors receive a risks report for operational risks that includes reports of failure events that occurred during the report period, areas of risk that exist and the progress status on implementation of the reduction plan.

Insurance – In order to reduce the operating risks to which the Bank is exposed, each year the Bank purchases professional responsibility insurance, as well as property insurance. These insurances provide a response to the following principle issues: external and internal fraud risks (embezzlement), cases of theft of money and precious property, financial damage as result of fake documents such as: checks, exchange bills, deposit confirmation, Guarantee certificates, Letters of Credit, mortgage certificates, and more; damage as result of computer crimes including penetration by a hostile factor into the Bank's computer systems, and damage to physical assets. Financial damages caused to customers or a third party following hardware or software failure. The general limit of liability of the banking policy is up to USD 22 million.

Business Continuity

In order to maintain business continuity, survivability and operating continuity of the Bank following a disaster or malfunction, and in accordance with Bank of Israel instruction 355 on Business Continuity Management, the Bank is prepared for emergency situations. The Bank's computerization system is based on two computer sites – the main site in the Bank headquarters in Kiryat Sde Teufah and an alternate site in Jerusalem. Bank activity for readiness for recovery in emergency situations is composed of the following activities:

1. Technological infrastructures for information systems backup.

2. Activity and procedural plans – Over the past year, the Bank created a comprehensive procedural infrastructure to cope with and perform activity under various emergency situations including manual work and the possibility of shifting of critical activity. The Bank prepared contingency plans to cope with extreme scenarios: war, epidemic, earthquake.

3. Drills – The Bank participated a the end of 2012 in the Turning Point 6 Drill, and even conducted internal drills to test the backup sites as well as activity in several areas in accordance with Business Continuity procedures.

Information Technology Risks

Information Technology is a central component in the Bank's proper operation and management. Information technology risks are attributed to the regular activity of the Bank's information systems, broad information technology processes and the development of new activities (projects and systems). Information technology risks include also information security risks and banking risks in communications, that might affect the Bank's business and/or operational procedures. The manager of the Resource Division is responsible for the Bank's Information Technology risks.

In 2013, the Bank's Information Technology Management policy was updated and approved. A new IT Risk

Management Policy document was written. In addition, Bank procedures defined the methodological infrastructure for operating risk management in IT processes.

In 2012, the OCIO Unit was set up under the Computerization Division Manager, and its main role is to handle project risks and IT risks. Management includes mapping of existing risk and monitoring of implementation of the mitigation plans.

The Bank has implemented most of its computerization infrastructure upgrade project, including infrastructure development and automatic machines. Following the acquisition of Clal Finance, the Bank is carrying out a project for operational merger with Clal. Within these confines, there are project risks that might prevent compliance with the project goals in terms of content, budget and timetable. These risks are managed through the arranged project risk management forums and with the assistance of external consultants who accompany the IT division manager and the Chief Risks Officer (CRO). The Bank has an organized methodology for assessing and managing project risks. A mitigation plan was arranged to manage the risks of the computer infrastructure project and continuous monitoring of implementation of the mitigation plan included in the software is being carried out.

Information Security

According to Proper Banking Management Instruction Provision № 357, the Bank appointed an information security manager, subject to the Resource Division manager. The information security manager is responsible for establishing the Bank's information security policy, to develop an information security plan, monitor its implementation, as well as handling irregular events in the information security area.

Information security risk management in the Bank supports a response to threats and risks, as well as protection of the Bank's information assets and information technology systems.

Over the past two years, the Bank significantly expanded its preparation in information security in light of the increasing threats and worldwide cybernet attacks. The Bank acquired automated information security monitoring tools and even increased the number of employees in the information security unit.

Every new system or new product/process that is relevant for IT is inspected by the information security manager, including hacking reviews – and no product is operated prior to its approval by the information security manager.

Legal Risks

Definition of legal risk is – The risk resulting from potential loss and result of breach of laws, regulations, or regulatory instructions, or as a result of rights or debts of the Bank that were not based as required; the risk is also effective when there are contracts with no enforcement capability, legal procedures, or mistaken judgment, that may make it harder or harm the rights of the Bank.

The legal risk may result from poor legal or faulty infrastructure on which the Bank relied in providing service to the customers, received sufficient service and/or received guarantee from customer or from third party such as: connection that is not properly back-up by a contract, guarantee that can not be used as result of defect in its creation or recording, or because the guarantee was stolen or lost its value, etc.

In addition, legal risk at the Bank may be created as result of external factors that are not dependable on the Bank, such as: change in the legal instructions, regulations or instructions of the various supervising (instructions of the Supervisor on the Banks, instructions from the Securities Authorities, Money Laundering Prohibition Authority, etc) or new verdict of the Courts according to which the Bank is required to operate on a certain issue in a different manner then it used to operate until the verdict.

The legal risks are part of the overall operating risks the Bank is exposed to. Attorney Sarit Vistuch, Vice CEO and legal adviser, is responsible for the legal risk management of the Bank, assisted by employees from the Bank's legal department. The regulatory and legal risk is managed at the Bank is an organized and structural manner, anchored in written procedures and policies for the purpose to minimize as much as possible the realization of these risks and the minimize the damage caused to the Bank in the case this risk was indeed actual realized.

According to the policy and the procedures of the Bank any legal issue emerging in the framework of business management is transferred to the Bank's Legal Department (each in the area of responsibility). Each claim, legal procedure or lawsuit threat due to the bank's employees are transferred for handling to the legal department, every contact of a customer to an employee of the Bank with legal question is for response transferred to the legal department or legal assistance.

Reputation risk

Reputation Risk is a risk for loss deriving from damage to the Bank's good name or damage to the external assessment of its banking capabilities or to its financial strength. Such a risk may be caused as a result of factors within the Bank such as: operational failure of the Bank's systems, failure in preventing events connected to the capital core, fraud and embezzlement by employees and so forth; or as result of external factors of the Bank such as: economic crisis in Israel or worldwide, failures at other banks, class action, etc.

Reputation Risk is characterized by two principle risk factors – first grade risk and second grade risk. A first-grade risk is a pure Reputation Risk that is attributed to the realization of a risk managed in the Bank and that harms Bank profits. For instance, credit risk, that is a first grade risk, may cause loss from actual realization of the event according to which, a certain borrower does not repay his debts to the Bank. Second grade risk is risk deriving from realization of other risks. For instance, realization of operational risk from theft on a large scale may lead to decline in reputation (and this without connection to the loss from the actual theft) expressed by a decrease in the Bank's profits.

Among the risk factors are also included a number of additional risks such as operational risk, compliance risk and strategic risk.

Management of Reputation Risk is divided into two: risk prevention, and risk management after realization of the event or indications for the event's realization.

On the level of risk prevention, the Reputation Risk takes up a central place in the Bank's performance. Risk appetite, procedures, limitations, and activity areas clearly aim to curtail exposure to Reputation Risk. The Bank monitors core issues that reflect its reputation, such as media ads in the printed and electronic media, public complaints, etc.

Board of Directors – Bears the ultimate responsibility for managing and supervising Reputation Risk and creating a proper risk environment. Senior management is generally responsible for mitigating and managing Reputation Risk. The manager of the Retail Division has been defined as this risk manager. In addition, various units of the Bank are involved in risk management. The public relations unit serves as the default manager for handling all crystallizing or potential events, concentrating and reporting to the Retail Division manager. Other units involved in risk management are: unit for public complaints, legal department, compliance officer responsible for implementing the Money Laundering Prohibition Act, factors involved in risk management, Human Resources. The Bank's policy in risk management defines three types of events that might be a risk event:

1. Expected events that can be prepared for in advance.

2. "Rolling" events that might develop gradually and that might become reputation risk events.

3. Unexpected events that suddenly occur.

The handling of each risk event is managed and centralized by the Bank's spokesman in cooperation with the Retail Division manager while in relation to each of the types of the aforementioned events, operating methods and identity of additional relevant factors working with them were defined.

Compliance Risk

Compliance risk is the risk of legal or regulatory sanction corporation suffers, significant financial loss or damaging its reputation as a result of failure to comply with consumers instructions.

Consumer instructions are laws, regulations and instructions governing the banking activities on every issue regarding the relation between the Bank and its customer in the framework of the obligations applicable to the Bank versus the public and its customers, including the Money Laundering Law, 2000, prohibition on money laundering (requirements regarding identification reporting and record of banking institutions to prevent money laundering and financing terrorism), 2001, instructions of the Banking Supervision Order and Securities Authorities guidelines.

Compliance risks are managed in the Bank on all organizational levels, including branches and product management departments. To accomplish this, the Bank relies on work processes that include the principle of dual control of an editor and reviewer ("Four Eyes"). In addition, there is a structured process in which any change in consumer provisions that affect serudecorpkrowniserudecorp nidetalimissaeblliwknaBeht,in forms and ind training.The process is supported by the legal department and the organizational unit and method.

The compliance officer is responsible for implementing Bank policy and to formulate a comprehensive work framework for risk management and its approval by the Bank institutions.This framework includes planning, implementation and update of compliance risk management methodologies, conducting regular compliance surveys, defining reporting procedures for various parties in management.

The complexity and development of the banking activity, requires the Bank to be more strict on the existence of the overall obligations applicable to banking corporation, in the connections with its customers, by virtue of legislation, regulations, orders, permits and the instructions of the Bank of Israel.

Proper Banking Management Provision No. 308 – Compliance officer, requires the Bank to enforce the consumer instructions, meaning: laws, regulations, and instructions regulating the banking activity concerning the relation between the Bank and its customers, including prohibition on money laundering and prohibition on financing terrorism. According to the provision, an infrastructure survey will be performed that maps the consumer instructions, risks occurring at abnormal events along with specific instructions preventing controls.

In order to confirm that the Bank is properly implementing its obligations as derived from the consumer provisions, the Bank has an infrastructure survey it conducted in 2010. Based on the survey, a multiple-year compliance plan was established.The results of the survey were entered into the dedicated system that enables management and dynamic monitoring after the compliance risks.

As part of his job, the Compliance Officer regularly reviews the conformity of the Bank's procedures and forms with the Consumer Provisions.

The Bank is currently conducting a new compliance infrastructure survey to confirm compliance with the provisions of consumer laws that exist and that are periodically renewed. Once the results of the survey are obtained, a mitigation plan will be created to bridge any gaps that are detected.

Administrative enforcement risk

On January 27, 2011, the Streamlining of ISA Enforcement Procedures Law (Legislative Amendments) 5771-2011 was published that created for the first time a legal mechanism for the adoption of administrative enforcement procedure by the Securities Authority (alongside criminal enforcement that had primarily been adopted until that time by Securities Laws) against public companies and against individuals, for violating the Securities Laws.

The Law established that adoption of an effective internal enforcement plan by a corporation will be one of the considerations that the Securities Authority will consider when adopting administrative enforcement proceedings and may serve, in relevant cases, as protection for the corporation and even the

CEO as part of the assumption of regulatory liability over it. The Securities Authority further published, in August 2011, a document of criteria for recognition of the internal enforcement plan. The document defined the Board of Directors as having ultimate responsibility for regulating implementation of the plan and as the responsible party, to ensure that the corporation formulates, adopts and implements this enforcement plan.

Following publication of the law, the Bank of Jerusalem adopted an administrative enforcement mechanism, and the head of the Risks Division was appointed Supervisor of Internal Enforcement in the Bank and its subsidiaries. The administrative enforcement mechanism is covered by the Securities Laws and also adopted in other areas such as the capital market (insurance), labor laws, trade restrictions, privacy protection, environmental risks and use of workers in social networks.

In accordance with the principles outlined by the Securities Authority, the Bank formulated a comprehensive internal enforcement plan designed to minimize the Bank's exposure to the risk of imposition on the Bank of financial or other sanctions due to non-compliance of the Bank and/or its employees with the provisions of the applicable laws. The internal enforcement plan includes, inter alia, mechanisms for assimilating Bank procedures and compliance values by conducting a comprehensive enforcement survey for reviewing the Bank's work processes and existing procedures, to identify, map and bridge any gaps, to create suitable controls for confirming compliance with procedures, development of a training system for Bank employees and establishment of a reception and handling system for employee reports on failures in implementation of procedures and/or violations, including conducting of investigations, drawing relevant conclusions and amending work processes whenever necessary.

At the present, control is being carried out to confirm the bridging of gaps that were discovered during the enforcement survey conducted during the first quarter of the year and that were closed in its second quarter. The survey results were assimilated in the dedicated risk management system.

Money Laundering and Terrorism Financing Risks

General

Prohibition of money laundering and financing terror risks (hereinafter: "Money Laundering") are risks of imposition of significant financial sanctions on the Bank in light of failure to comply with the provisions of the Law concerning the prohibition against money laundering and against financing terrorism as well as the risk of the formation of criminal responsibility of the corporation and its employees. In addition, materialization of a violation of the provisions of the law in the area of the prohibition against money laundering and financing terror may result in materialization of reputation risk. As part of its activity, the Bank is exposed to money laundering and terrorism financing risks. This exposure focuses at the account opening stage, as well as in the process of account managing. The Bank may be exposed to parties that are interested in "exploiting" it for the purpose of money laundering which have at their source violations as defined as "predicated offenses" in the Money Laundering Prohibition Act and to finance terrorism through it.

The Bank is subject to various provisions as part of the prevention of money laundering and financing terror that includes, inter alia, the Anti-Money Laundering Law, The Law Prohibiting the Financing of Terrorism, The Injunction Prohibiting Money Laundering, Regulations Prohibiting the Financing of Terror, the provisions of Proper Banking Management 411, various circulars, etc.

Management of the Prohibition of Money Laundering and Terrorism Financing Risk

The risk management in the Bank is carried out by the party responsible for the prohibition against money laundering and financing terror, who is directly subject to the director of the Risk Management Division – CRO, who is a member of the Bank's management. The Board of Directors and the Bank's management determine the procedures and policies on the issue of Prohibition of Money Laundering and financing terrorism. The directives of the party responsible are according to and subject to the provisions of the law. His job description includes, inter alia, meticulous monitoring of Bank activity in accounts, in order to identify potentially irregular activity that smut be reported to the Anti-Money Laundering Authority, conduct controls of reports based on the type and size of activity, delivery of reports on irregular activity to the Anti-Money Laundering Authority, conduct various controls of activity in various accounts in accordance with their profile, update policies and procedures in accordance with legislative updates and provisions, provide regular advice to branches in this area, and to carry out training adapted to various employees in the Bank, based on their positions. The responsible person is updated continuously on renewals of the legislation, the orders and standards linked to the prohibition of money laundering, among others, by participating in meetings and seminars on the issue. It is his responsibility to take care of the implementation of all the implications resulting from these updating on the Bank's activity.

In order to implement the law and assimilate its provisions, the Bank appointed compliance trustees who also serve as anti-money laundering trustees in the branches and in the headquarters (hereinafter: the "Trustee"). The Trustee is selected from among Bank employees upon recommendation of the branch manager / department manager in the headquarters / party responsible for prohibition against money laundering and financing terror. The trustee is a professional party linked to the location where the transactions are implemented and provide an immediate response to questions arising at branches. His role is to help identify problems or difficulties in implementing the provisions concerning the prohibition against money laundering to the extent possible in real time and to serve as the first professional address for branch or unit employees in which they are working to prevent money laundering and financing terror.

The trustee receives increased training and seminars for the purpose of raising its level in the area and is a linking factor between the responsible person on the issue of prohibition of money laundering and the branch.

The party responsible for the prohibition against money laundering conducts symposiums for all compliance trustees and prohibition against money laundering, in conjunction with the compliance officer, convenes a conference for branch managers, regular training and instruction for all employees as part of the Bank courses. In addition, in 2012, the Bank created educational software that includes a review of the assimilation of the software content among employees that is updated in accordance with the changes and developments in the field and in the provisions of the law. Bank employees are examined in a test and their ability to successfully pass it.

On February 14, 2013, the Bank received a report conducted by the Supervisor of Banks on the prohibition against money laundering, following an audit conducted the Bank between May-December 2011 and August-December 2012. The report addressed the Bank's activities between 2008-2010 and included a list of findings, as well as requirements to implement measures concerning the prohibition against money laundering and financing terrorism. The Bank was given the right to submit its written response to the report within 30 days from the date of its receipt, while noting the fact that it would consider filing a motion to impose a financial sanction on the Bank in accordance with the authorities prescribed by law. On June 4, 2013, the Bank received a request from the Bank of Israel to impose a financial sanction on the Bank. On November 27, 2013, the Sanctions Committee in the Bank of Israel convened and was attended by Bank representatives and their lawyers. At this stage, the Bank cannot assess whether financial sanctions will be imposed on the Bank as a result of this notice and if so, the amount of said sanctions.

The Bank believes that improvements made in the Bank's performance concerning money laundering following the audit significantly reduce the Bank's exposure to the risks of money laundering.

Effect of Risk Factors on the Businesses of the Banking Corporation

The Bank is required, like all the banking corporations, to include a table with risk factors in each of the detailed categories below, and to estimate the influence of the risk factor on its business. In the framework of these evaluations the potential exposure or the damage as result of the occurrence of a certain event as well as the probability that such an event may occur, should be estimated. In addition, the adequacy of the control to the risk environment, as other activity performed by the Bank, for purposes of risk management affects the level of risk exposure. Therefore, the estimates detailed in the following table are the Bank's subjective evaluation of the effect of the residual risk on its business.

Effect of Risk Factors on the Businesses of the Banking Corporation

	Risk factor	Risk effect
1	**Total effect of credit risks** The risk results from the borrower's non-fulfillment of liabilities to the Bank according to the agreement. Deterioration of borrowers' stability and/or ability to repay the credit may affect negatively the value of the Bank's assets and its profitability. Risk exposure is managed, among others, through the Bank's credit policy and exposure limitations concerning various kinds of borrowers in different sectors of activity.	**Moderate**
1.1	**Risk due to quality of borrowers and collateral** The risk results from deterioration of the quality of the borrowers and/or the value of the collateral provided as security to the Bank, which may affect negatively the chances of collecting the credit and therefore, the value of the Bank's assets and its profitability. Risk exposure is managed, among others, through clear definition of credit policies, appropriate underwriting and limitation of activity to specific kinds of borrowers in the various sectors of activity and products.	**Low**
1.2	**Risk due to sector concentration** The risk results from a large volume of credit provided to borrowers in a certain economic sector, relative to the credit portfolio. Deterioration in operating results in the same sector may harm repayment ability and/or the value of the collateral provided by part of the borrowers in the sector and, as a result, might negatively impact the value of the Bank's assets and its profitability. Risk exposure is managed, among others, through restrictions of the Bank of Israel in this regard and limitations determined by the Board of Directors regarding maximum exposure to various sectors. The Bank does not go beyond the mentioned restrictions.	**Moderate**
1.3	**Risk due to concentration of borrowers/group of borrowers** The risk results from deterioration in the situation of a large borrower or a large group of borrowers (relative to the credit portfolio), that might negatively impact the chances for collecting the credit and the value of the Bank's assets and its profitability. Risk exposure is managed, among others, through restrictions of the Bank of Israel in this regard and limitations determined by the Board of Directors regarding maximum exposure to a borrower and to a group of borrowers. A current control also exists regarding compliance with these restrictions. The Bank does not go beyond the mentioned restrictions.	**Low**

	Risk factor	Risk effect
2	**Total effect of market risks** The risk results from changes in prices or changes in financial market rates or other economic parameters, which influence the value of the Bank's assets or liabilities, and that might result in erosion of its capital or damage of its profitability. Risk exposure is managed for each risk separately, as detailed below, and also centralized through the VaR model.	**Low**
2.1	**Interest risk** The risk derived from the difference between the sensitivity of assets value to unexpected changes in interest rates, and between this sensitivity in respect of liabilities – changes that may cause erosion in the Bank's capital. As a result of the exposure to interest in the various linkage bases, future decrease (during assets life or liabilities life) may occur in financial income. Risk exposure is managed, among others, according to estimates of market variables and subject to restrictions on sensitivity from net capitalized financing flow of the Bank to a scenario of a change in Shekel interest and index-linked interest curves. The exposure limitations are being controlled continuously.	**Low**
2.2	**Inflation risk** The risk results from changes in the rate of inflation that may result in a loss in the value of the economic difference between assets and liabilities (active financial capital) in the index-linked sector. Risk exposure is managed, among others, subject to limitations concerning the amount of the active financial capital, while considering changes in relevant economic data in accordance with market conditions. The exposure limitations are being controlled continuously.	**Low**
2.3	**Exchange rate risk** The risk results from changes in the rate of inflation that may result in a loss in the value of the economic difference between assets and liabilities (active financial capital) in the foreign currency and foreign currency-linked sectors. Risk exposure is managed, among others, subject to limitations concerning the amount of the active financial capital, while considering changes in relevant economic data in accordance with market conditions. The policy of the Bank is to prevent, to the extent possible, the risk exposure to the exchange rate between the various foreign currencies. The exposure limitations are being controlled continuously.	**Low**

	Risk factor	Risk effect
2.4	**Shares and debentures price risk** The risk results from an impairment in the value of shares and debentures held by the Bank. The Bank's securities portfolio includes mostly Government debentures and a small part in corporate debentures. The Bank's policy does not enable significant activity in shares (not for purposes of investment and not for purposes of trading). The percentage of the Bank's holding (including indirect holding) in shares and share-linked securities is negligible. Risk exposure is managed through limitations on the amount of investments, their characteristics, marketability, duration of the portfolio, and the amount of expected loss from these investments. The limitations are managed through the VaR model and through stress scenarios.	**Low**
3	**Liquidity risk** The risk results from uncertainty concerning availability of funding and ability to raise it (without extremely affecting prices), and concerning the ability to realize assets in limited time and at a reasonable price. Extreme "supply and demand" circumstances in financial markets, may create unexpected costs of funding that may affect financing income. Risk exposure is managed, among others, through expanding the depositor base and decreasing reliance on large depositors, extension of the sources duration, and maintaining a high level of liquidity. The Bank has a system of controls based on an internal model that examines a number of scenarios. Moreover, over time, the Bank examines behavior of its customers that may affect exposure to this risk.	**Low**
4	**Operating risk** The risk of loss as a result of non-diligence or failure of internal processes, people, systems or external events. Risk exposure is managed, among others, through operating risks survey, procedures writing, implementation of controls, and integration of systems for issues affecting risk exposure, such as human resources, information security, processes, etc. The Bank maintains an organized process for approval prior to the operation of any new product / activity / process, including a review of risks and implementation of adequate controls. The Bank monitors operating loss and near-loss events, in order to draw conclusions and improve control.	**Moderate**

	Risk factor	Risk effect
5	**Information technology risks** Risk resulting from a failure in the current activity of the Bank's information systems, which include the work procedures implemented in the various computer units, or in the current activity of an infrastructure system and/or component of hardware or software. Such risk includes also information security risks and banking risks in communications, that might affect the Bank's business and/or operational processes. The Bank is in late stages of implementation of a project for improving its computer systems, as part of the project called "New World." The project's risks are managed through arranged forums for project risk management, and the assistance of external consultants supporting the Information Technology department manager and the Chief Risk Officer (CRO). In addition, an arranged reduction plan was created for managing the project's risk, and continuous monitoring is performed of the implementation of the risks reduction plan included in the plan.	**Moderate**
6	**Information security risks** Risk of damaging information that exists in the organization, particularly through harming technological assets and the physical environment of the computerized systems. Information security risk management in the Bank supports a response to threats and risks, as well as protection of the Bank's information assets and information technology systems. The Bank does not allow its customers to carry out transactions through digital means, such as website, cell phone. Exposure to risk therefore is not high.	**Moderate**
7	**Legal risk** The risk resulting from unexpected events, such as legal claims, including class action suits, inability to enforce agreements, or judicial rulings against the Bank, that might harm the Bank's profitability. Risk exposure is managed, among others, through legal controls and internal and external legal consultancy system. Past experience ascertains that such events did not expose the Bank to significant losses.	**Low**

	Risk factor	Risk effect
8	**Regulatory risk** Regulatory risk is an existing or prospective risk on the Bank's income and capital, that may arise from regulatory or legislative changes, which can have significant effect on the Bank's activity and obligations imposed upon it The Bank, as a banking corporation and as a public company, is subject to many regulatory instructions expressed by legislation, secondary legislation, policies and operative instructions of various authorities and supervising entities. Risk exposure is managed, inter alia, through existence of ongoing monitoring of proposals and legislative memorandums, legislative instructions, and drafts and instructions from the various regulators (the Supervisor of Banks, Securities Authority, Money Laundering Prohibition Authority, the Authority for Information and Technology of the Ministry of Justice, etc.). In addition, monitoring is implemented after new verdicts by the various legal systems in Israel. In order to verify completeness of the instructions that are being monitored, the legal department has subscriptions to current professional publications of a number of leading law firms in Israel in the areas of banking, capital market, real estate, Labor Law, etc.	**Low**
9	**Reputation risk** The risk results from damage to the Bank's image as a stable reliable financial institution, as a result of publications, correct or incorrect, as perceived by customers, investors and/or regulatory authorities. Damage to reputation may result in transfer of customers' activity to other providers of financial services, harming the Bank's activity and profitability. Management of reputation risk is divided into two: risk prevention, and risk management after occurrence of an event or indications of such an event occurrence.	**Moderate**
10	**Strategic risk** The strategic risk results from mistaken business decisions, improper implementation of decisions or lack of response to sector, economical or technological changes. The risk results also, among others, from entrance to new areas, expansion of existing services and increase of infrastructure investment for realization of business strategy. This risk is a function of the harmony between the strategic objectives of the Bank, business plans developed for obtaining these objectives, resources allocated to comply with these objectives and quality of the implementation. Risk exposure management is implemented, among others, through building an organized strategic process, receiving external professional advice in the area, and additional activities for reducing the risk.	**Moderate**

	Risk factor	Risk effect
11	**Compliance risk** Compliance risk is attributed to a failure to comply with consumer instructions, legal directives, directives of the Supervisor of Banks, and other relevant regulatory instructions. Consumer obligations that apply to the Bank are cross-organizational and pertain to a wide range of activities, processes, and products. Proper Banking Management Provision 308 requires banks to comply with consumer directives that apply to the Bank's relationship with its customers. Risk exposure is managed at all levels of the organization, from compliance officer, compliance trustees in the branches and headquarters, to the product management departments, and is implemented in accordance with a structured process according to which, each change in consumer instructions affecting the Bank will be integrated into the Bank's procedures, work processes, forms, and training.	**Low**
12	**Prohibition of Money Laundering and Terrorism Financing Risk** Prohibition of money laundering and financing terror risks are risks of imposition of significant monetary sanctions on the Bank in light of failure to comply with the provisions of the Law concerning the prohibition of money laundering and financing terrorism, as well as the risk of the formation of criminal liability of the corporation and its employees. In addition, materialization of a violation of the provisions of the law in the area of the prohibition of money laundering and financing terrorism might result in materialization of reputation risk. In order to minimize the exposure to the risk, a party responsible for the prohibition of money laundering was appointed, to be responsible for implementing the provisions of the law in this area and its assimilation, including training to all Bank employees in this area. In addition, the Bank appointed compliance trustees who also serve as anti-money-laundering trustees in the branches and in the headquarters.	**Low**
13	**Administrative enforcement risk** Administrative enforcement risk is the risk of imposition of significant monetary sanctions and/or anti-trust sanctions on any of the Bank's employees, for failure to comply with the Securities Laws. The Bank is preparing to reduce the risk by appointing the manager of the Risks Division to the position of Supervisor of Internal Enforcement in the Bank and its subsidiaries, establishment of an Internal Enforcement Department within the Risks Division, formulation of an internal enforcement plan based on the principles established by the Securities Authority, conducting a survey to map gaps in the area and handling the bridging of the gaps, conducting training and assimilation activities, and ongoing handling of events that might be considered as violations, including drawing the relevant conclusions.	**Moderate**

Internal auditor

General

Mr. Ron Sagy has been serving as the Bank's internal auditor since March 20, 2012. He has a BA in Economics from The Hebrew University of Jerusalem. Mr. Ron Sagy has banking experience. Between 2003-2010, served as VP and director of Banking Operations and Infrastructure and since December 2010 and until his appointment as the Bank's internal auditor, served as Acting and Deputy Internal Auditor.

The Internal Auditor complies with the conditions determined under paragraph 3 (a) Internal Audit Law; the instructions of section 146 (b) of the Companies Law 5759 – 1999, as well as paragraph 8 of the Internal Audit Law, 5752 – 1992. The Internal Auditor is no family member to any of the senior officers or parties of interest at the Bank; he has no material business relations with the Bank and does not indirectly hold Bank securities. The Internal Auditor is also responsible for the Public Ombudsman Unit, does not serve any additional function besides his position as the Bank's Internal Auditor. In addition, the Internal Auditor does not serve in any function outside the Bank that creates or might create a conflict of interest with his position as Internal Auditor.

The internal auditing employees comply with the instructions of paragraph 8 of Banking Regulations (internal auditing), 5752 – 1992, and Proper Banking Management Provision 307 – the Internal Audit Function and are only appointed with the approval of the Internal Auditor.

The person responsible for the Internal Auditor is the Chairman of the Bank's Board of Directors.

The Internal Auditor's scope of employment and the staff subject to him during 2013, averaged 9 positions annually (including preparation of the internal audit through external professionals to an average of 1.5 positions). The scope of average position in the area of public inquiries, in 2013, was one position.

The Audit Plan

The internal audit in the Bank operates according to the annual work plan based on the multi-year auditing work plan, consisting of an ongoing annual work plan and a work plan for the next three years.

The multi-year work plan refers to most of the audit subjects including: the Bank's organizational units, subsidiaries and associated corporations, work processes, products marketed, and computerized systems. In addition, the internal audit covers the Bank's exposure management procedures to the various risks, such as: credit, financial, operating (including fraud and embezzlement risks), compliance risks and so forth. Furthermore, the internal audit monitors the correction of significant deficiencies disclosed in the audit work of the Internal Auditor, of the independent auditor and of the Supervisor of Banks at the Bank of Israel. An annual summary report is submitted once a year to the Chairman of the Board of Directors, the CEO of the Bank, and members of the Audit Committee.

The work plans, annual and multi-year, are arranged according to the Internal Audit Law, 5752 – 1992, according to the Banking rules (Internal Audit) 5752 – 1992 and according to the Proper Banking

Management provisions.

The annual and multi-year work plans are derived from the systematic methodology of risk assessment and controls, according to which the audit frequency for each issue are determined. In the second half of 2009, with the assistance of an external company, a comprehensive survey of risks was carried out for all the Bank's divisions. In 2011, the internal audit performed a comprehensive updating of the multi-year work plan of the internal audit, from which the annual work plans for 2013 were derived, after making the necessary adjustments.

In the second half of 2013, with the assistance of an external company, a comprehensive risk survey was carried out using an updated methodology. The results of the survey were used to derive the multi-annual work plan of internal audit for 2014-2017. As part of the survey, the mapping of audited entities of the Bank was also updated and the frequency for examination of these entities was established according to the business and operating developments in accordance with the regulatory directives. Based on the methodology used during the preparation of the new multi-annual work plan, the frequency of audits in various entities was established based on the risk assessment. With regards to issues with higher risks, the audit frequency will be yearly and for issues with a lower risk, the audit frequency is two or four years. For information systems, the audit frequency was established at a frequency compatible with the system's risk.

The audit committee and the Board of Directors approved the 2013 work plan, including the internal auditing resources that match the requirements according to the new multi-year work plan.

As part of the integration process of the ICAAP at the Bank and according to the guidelines of the Supervisor of Banks and also the Basel II instructions, it is required that an independent factor will challenge and examine the Bank's implementation process. The Bank's internal audit was determined as the independent factor that has the task to prepare the independent review document. The independent review document reviews the risk management system that is implemented by the Bank, the ratio between risk and capital level of the banking corporation, and the methodologies developed for monitoring compliance with the internal capital policy. The independent review document includes details of the examination procedures and implemented audits, the implementing factor, as well as the main conclusion arising from the review. The document will be presented to the audit committee and the Board of Directors. For the purpose of preparing this review, the internal audit is assisted by an external professional consultant.

The annual and multi-year work plan for 2013 were discussed and approved by the audit committee on December 20, 2012, and after that by the Chairman of the Board of Directors and by the plenum of the Board of Directors at their meeting on December 27, 2012.

In 2013, the internal audit operated in compliance with this work plan. Due to changes in the business activity and in a number of significant processes in the Bank, and in accordance with the audit committee recommendation, the audit committee approved, during the year, an update of the work plan. The annual and multi-year work plan leaves to the Internal Auditor's discretion to deviate from them, subject to updating the Chairman of the Board of Directors and the Chairman of the Audit Committee in a current manner and receive their approval.

Significant transactions, if any, implemented by the Bank, are reported to the Internal Auditor and are examined by him, including the process for approving these transactions. As part of this examination, a significant transaction agreement in the area of information systems were examined, as well as the sales transaction of the Bank of Jerusalem building, was guided by the Internal Auditor.

The Internal Auditor is authorized as part of the approved budget, to be assisted through outsourcing, to perform the auditing work that requires knowledge and special expertise and/or in case of lacking a job opening.

The Internal Auditor prepares the internal audit according to accepted professional standards, and operates according to instructions and guidelines issued by the Supervisor of Banks.

During 2011, an external assessment was performed on the internal audit activity of the Bank and its compliance in preparation of the audit reports according to the accepted professional standards was examined. The findings of the examination, that the internal audit of the Bank operated according to accepted professional standards, has been presented to the Audit Committee and the Board of Directors. Every year, the internal audit conducts an internal process of assessing the quality of the internal audit function work whose findings are presented to the Audit Committee.

The Internal Auditor has free and complete access to information and data as stated in section 9 of the Internal Audit Law, 5752 – 1992, and according to Section 30 of Proper Banking Management Provision 307 – The Internal Audit Function, including free and complete access to the Bank's data systems including financial data derived from these systems and data from subsidiaries.

Reference to corporations that constitute material holdings

The Internal Auditor also serves as Internal Auditor of all subsidiaries of the Bank. The subsidiaries are included in the long-term work program and are audited according to the frequency determined in accordance with risk estimates as specified in the above section.

Audit Reports and Discussions Thereon

According to the Audit Committee's work procedure and the work Internal Auditor's procedure derived from it; each audit report is submitted in writing to the auditing factor, the CEO, the Chairman of the Board of Directors and to the Chairman of the Audit Committee. For every audit report there is a discussion with those audited and also a concluding discussion is held with the responsible managers and the Bank's CEO on the findings and material recommendations. The audit reports are also presented for discussion to the audit committee and this after receiving suitable reference to the report's findings from the auditing factor and the Bank's CEO.

The summary of the internal audit activity for the first half of 2013 was discussed by the Audit

Committee on July 25, 2013. The annual report summarizes the internal audit activity during all of 2013, also including monitoring implementation of the annual work plan, and was discussed at the meeting by the Audit Committee held on January 28, 2014.

Internal audit also reports quarterly to the Audit Committee, on the manner and level of implementation of the internal audit recommendations that arose from the audit reports that were held in the Bank's various activity areas.

If any particularly serious findings are discovered, an immediate report is sent to the CEO, Chairman of the Audit Committee and Chairman of the Board of Directors.

The reports on the summary of internal audit activity and on the manner and level of implementation of the internal audit recommendations are also submitted to the Chairman of the Board of Directors and the Bank's CEO.

Compensation of the Internal Auditor

The salary of the internal auditor amounted in the reporting year to NIS 991 thousand.

Evaluation of the Board of Directors

Annually, the audit committee holds a meeting alone with the internal auditor. This meeting took place on December 17, 2013.

Based on the current reports submitted by the internal auditor and in accordance with the work procedures of the internal audit function, the Audit Committee expresses its opinion concerning the internal auditor's compliance with professional standards, according to which the audit reports on the Bank's various activities were prepared. In addition, the Audit Committee conducted a survey of the function of the internal audit carried out by an external party in accordance with the provisions of Proper Banking Management 307 The Internal Audit.

The Audit Committee and the Board of Directors believe that the salary and the payments that have been provided to the Internal Auditor have no effect on the Auditor's professional discretion.

The Board of Directors and the audit committee believe that the scope, nature, continuity of activity and work program of the internal auditor are reasonable in the existing circumstances, and they address and meet the objectives of the Bank's internal audit.

Disclosure regarding the process of approval of the Financial Statements

The bodyat the Bank responsible for the ultimate control) as defined in Proper Banking Management Instruction303 .№) is the Bank's Board of Directors. The names of the Board of Directors' members and their accounting and financial skills are specified in chapter "The Board of Directors, the management and the salaries of senior officers" below.

Principle issues related to disclosure are provided in the Financial Statements, discussed in the Disclosure Committee headed by the CEO with the participation of the Chief Accountant, legal adviser, other members of management, the Bank Secretary, the Manager of the Accounting Department and the Manager of the Financial Statements Unit. The meeting was attended by observers of the Internal Auditor and external accountant. As part of the discussions, the committee included issues that materially affect the Financial Statements, issues of public interest, developments that must be reported to the public, and any issue the committee finds necessary to discuss before transferring the reports to the Audit Committee.

Prior to approval of the Financial Statements by the Board of Directors, drafts of the financial reports, directors' report, and the annual periodic report are transferred to the Audit Committee. The Bank authorized the Audit Committee to serve also as a committee for examining the Financial Statements. The committee consists of the following members of the Board of Directors: Chairman of the Committee, Mr. Shmuel Eshel (external director); Mr. Adiv Baruch (external director); Mr. Ira Sobel (external director in accordance with Provision 301 and an independent director), Mr. Ram Harmelech and Ms. Ester Friedman (external directors).

The committee discusses the Financial Statements' format and decisions are made for recommending approval of the Financial Statements by the Board of Directors.

After reaching an agreement regarding such recommendation, the draft financial statements, draft directors' report and draft annual periodic report are transferred for review by members of the Board of Directors, several days prior to the date of the meeting fixed for approval of the reports (the draft is occasionally sent to the directors simultaneous with their delivery to the Audit Committee members).

During the meeting of the Board of Directors, the financial results, the financial position are reviewed, and information regarding the Bank's activity is presented and directors' questions are answered.

The Bank's external accountant also participates in the meeting in order to express a professional opinion concerning the financial statements and accounting issues relating to the financial statements. After conclusion of the discussion, the Board of Directors decides on approval of the financial statements.

Miscellaneous

Circular on the issue of "Management Responsibility on Internal Control over Financial Reporting – SOX Act 404"

On December 5, 2005 the Supervisor of Banks issued a memorandum detailing instructions for application of requirements of Paragraph 404 of the SOX Act. In section 404, the SEC and the Public Company Accounting Oversight Board (PCAOB) established provisions regarding management responsibility on internal control over financial reporting.

The Supervisor's instructions in the said circular establishe:

- Banking corporations will implement the requirement of Section 404 and the SEC regulations published thereunder.

- Appropriate internal control requires the existence of a control system according to a clear defined framework and the model of the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") fulfills the requirements and may be utilized for purposes of evaluation of internal control.

- Application of requirements obligates upgrading and/or establishment of an infrastructure system of internal controls at the Bank and the process of development of such systems requires the Bank to implement preparations and to determine intermediate stages and objectives until comprehensive implementation.

In the framework of implementation of the instructions, the Bank performed, in cooperation with an independent accounting firm, identification of business accounts and procedures relating to financial reporting and due disclosure. In these processes, documentation was prepared and risks and controls were evaluated, including review of existing internal controls and risks at the level of processes, procedures and transactions.

In addition, the Bank completed an evaluation of the effectiveness of the controls, including documentation of control effectiveness, and analysis of existing differences relative to the internal control model.

Bank management, under the supervision of the Board of Directors, evaluated the effectiveness of the internal control of the Bank over financial reporting as at December 31, 2013, based on the criteria that has been determined in the internal audit model of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, management believes that as at December 31, 2013 the internal control of the Bank over financial reporting was effective.

In accordance with the approval of the Supervisor of Banks from February 2, 2014, management's evaluation regarding the effectiveness of the internal control over financial reporting does not include the components of internal control over financial reporting pertaining to the "Clal Finance Batucha Investment Management Ltd." operation, whose acquisition by the Bank was completed on December 15, 2013, and that was merged into the Bank on December 22, 2013.

The effectiveness of the Bank's internal control over financial reporting as at December 31, 2013 was audited by the independent auditors of the Bank, "Kost Forer Gabbay & Kasierer", as is stated in their report on page 218, in which an unqualified opinion was included concerning the effectiveness of the Bank's internal control over financial reporting as at December 31, 2013. It should be noted that their audit did not address the components of internal control over financial reporting pertaining to the "Clal Finance Batucha Investment Management Ltd." activity.

Evaluation of Controls and Procedures Concerning Disclosure in the Financial Report

Bank Management, in cooperation with the CEO and Chief Accountant, as of the end of the period covered by the report, evaluated the effectiveness of the Bank's controls and procedures relating to the Bank's disclosure. Based on this evaluation, the Bank's CEO and Chief Accountant concluded that as of the end of the reporting year the Bank's controls and procedures relating to disclosure are effective in order to record, process, summarize and report on data the Bank is required to disclose in the quarterly report in accordance with the public reporting requirements of the Supervisor of Banks, as of the date determined in these requirements.

This evaluation did not address the components of internal control over financial reporting pertaining to the "Clal Finance Batucha Investment Management Ltd." activity.

Ethical Code

The Bank has an ethical code that was approved by the management in 2009 whose purpose is to express the Bank's policy in the area of professional ethics of its employees and establish the level of ethical standards according to which its employees are required to operate.

The Bank insists on the fulfilling the law and the instructions of various authorities, and these are anchored it is procedures. The Bank's ethical code is intended to add a value-based infrastructure to its procedures in order to ensure a valued and qualitative work environment for its employees.

At the base of the ethical code are a number of principles: personal honesty, fairness, reliability, professionalism, responsibility, as well as loyalty to the Bank and its customers.

Donations

The bank's donation policy is performed according to the decision of the management and in the framework of the Bank's budget. This policy includes criteria for the selection of institutes and/or associations. In 2013, the Bank donated NIS 446 thousand (2012 – NIS 537 thousand) to associations and public institutions.

Transactions with a Controlling Shareholder

1.1 According to the Securities Regulations (Periodic and Immediate Reports), 1970, a corporation that must report pursuant to these regulations will submit an immediate report and in the periodic report details "regarding every transaction entered into by the corporation with the controlling owner or where the controlling owner has a personal interest in its approval". Inter alia, the reporting corporation is required to include "details of the identity of the parties to the transaction, its content and qualitative and quantitative features, the personal interest of the controlling owner, the date of approval, and details of the entity that approved the transaction".

1.2 The aforementioned will not apply in the case of a "negligible" transaction as the term is defined in Regulation 64(3)(d)(1) of the Securities Regulations (Preparation of Financial Reports), 5753 – 1993; i.e., a transaction answering to "the types and characteristics of the transactions" that the corporation views as negligible. The Association of Banks contacted the Securities Authority in order to determine the reporting format applying to banks in this context. Further to this contact by the Association of Banks and the discussions between the Bank and the Securities Authority with its controlling interest or with another person where the controlling interest has a personal stake, on the division into banking transactions and non banking transactions, will be as follows:

a. For banking transactions – the Bank will determine criteria for exceptional banking transactions for which the Bank will publish an immediate report on their occurrence. However, banking transactions that are not exceptional will be specified cumulatively in the framework of the annual reports (see the table below), even though according to the Securities Regulations (Periodic and Immediate Reports) 1970, the Bank is required to submit an immediate report also for transactions that are not exceptional.

b. For non-banking transactions – the Bank will establish criteria for classifying such transactions that are "negligible", and they will be subject to the provisions regarding reporting of transactions with a controlling owner that apply to other reporting corporations (i.e. that are not banks).

Proper Banking Management provisions (312) from the Supervisor of Banks (hereinafter: "PBM 312") determines that as a rule the Bank shall not make a transaction with a "related person" (as this term is defined in the mentioned instructions) on better terms than those under which it makes similar transactions with others, excluding a "related person" that is a corporation fully owned by the Bank and that does not give any credit or other service to anyone outside the Bank group.

1.3 Below are details of the criteria defined as mentioned at the meeting of the Board of Directors Audit Committee of February 18, 2010 and ratified in the Audit Committee meeting of January 16, 2014, in the division of banking and non-banking transactions:

1.3.1 "Exceptional" banking transactions:

Banking transactions that meet the following criteria will be deemed exceptional:

a. On the matter of "liability" transactions – a liability transaction will be deemed exceptional if following its implementation the total liability of the controlling owner's group will be more than 5% of the bank's capital, within the meaning of this term in Appendix A of the Proper Bank Management Provisions (311), as reported in the financial reports last published before the date of the transaction (hereinafter: "regulatory capital") or if the growth in liability of an individual borrower from the controlling owner's group following the transaction is more than 2% of the regulatory capital at the time of the transaction.

   If the Bank learns of liability transactions in which the controlling owner has a personal interest and to which PBM 312 does not apply because they are not made with a "related person", as this term is defined in PBM 312, the Bank shall bring them for approval as determined in the said PBM 312. For these transactions, the Bank will submit information cumulatively in the framework of the annual reports in the format shown in the tables below (separate tables for these transactions and for transactions to which PBM 312 applies). In this context it should be clarified that the criteria for an exceptional liability transaction with a controlling owner, or in which a controlling owner has a personal interest, will apply whether or not Provision 312 applies to it.

   In addition, any specific provision for doubtful debts or write-off of a particular amount for the liability of a controlling owner or a corporation linked to him shall be deemed a significant transaction.

b. Regarding "deposit" transactions – the deposit of money in a deposit of any kind shall be deemed an exception transaction if as a result the total deposits of a controlling owner's group is greater than 2% of the total public deposits, as reported in the last financial reports published by the Bank before the transaction date. Receiving a deposit from a company that is a "related person" for the controlling owner (as the term is defined in PBM 312) which is not one of the companies that are controlled by the controlling owner shall be deemed exceptional if as a result the total deposits of that "related person" are greater than 2% of the total public deposits, as reported in the last financial reports published by the Bank before the transaction date.

c. With regards to securities transaction or foreign currency transaction (that is not a debt transaction or deposit transaction as specified above) – transaction in securities or transaction in foreign currency will be considered as extraordinary if the yearly commission collected is equal or exceeds 4% of the annual total of operating income of the Bank (with deduction on income from investment in shares) according to the last annual financial reports of the Bank.

d. Any other banking transaction, of the type that the Bank usually carries out with the public, providing that it does not involve granting of credit by the Bank, where the amount of such transaction exceeds 0.1% of the regulatory capital at the transaction date.

A negligible temporary deviation from the extents specified in paragraphs (a) to (d) above, and for a period of no more than 30 days, shall not lead to a change of classification of the transaction as a "transaction that is not exceptional", and such exceptions shall be disclosed in the framework of the annual report. It should be clarified that any change to an exceptional transaction is, in itself, an exceptional transaction for which an immediate report shall be submitted.

1.3.2 Non-banking transactions:

The following transactions shall be deemed negligible transactions:

a. A transaction to purchase services from a controlling shareholder or where the controlling shareholder has a personal interest, provided that it is not an arrangement with a controlling shareholder or his relative regarding the terms of his service and employment, which is in the normal course of business, and on market terms, and whose scope is no more than the sum of NIS 250,000, providing that the total number of transactions of this type in one calendar year does not exceed 0.1% of the regulatory capital.The mentioned total shall not include individual transactions whose value of each is less than NIS 25,000.

b. Transactions concerning the hire of space from a controlling shareholder or where the controlling shareholder has a personal interest, that were approved in one calendar year, in the normal course of business, and on market terms, and whose scope does not exceed 0.1% of the regulatory capital.

c. Bearing the costs of a controlling shareholder, in the normal course of business, and on market terms, for the purpose of participating in representative events and conferences of customers and subsidiaries of the Bank at their invitation – expenses up to a total of NIS 250,000 per year.

d. Any other transaction in the normal course of business, and on market terms, and whose scope is no more than the sum of NIS 250,000, providing that the total of such transactions in one calendar year will not exceed 0.1% of the regulatory capital. The mentioned total shall not include individual transactions whose value of each is less than NIS 25,000.

Definitions:

For the purposes of the above decisions, with all their sections, the following terms shall have the following meanings:

(1) "Liability" – as this term is defined in Proper Banking Management Provision 312 of the Supervisor of Banks.

(2) "Market conditions" – conditions that are not better than the conditions on which similar transactions of the same type are made by the Bank with people or with corporations that are not controlling shareholders of the Bank or with people with whom the controlling shareholder has no personal interest in the transaction with them. Market conditions with respect to banking transactions are examined in comparison to the terms under which transactions of the same type and of similar size are made, as accepted when examining transactions with related people pursuant to Proper Bank Management Provision 312, with customers of the Bank who are not related people or with entities where the controlling shareholder has a personal interest in the transaction with them; market terms in respect of transactions that are not banking transactions will be examined in relation to transactions of that type that the Bank enters into with suppliers and/or in relation to offers of other suppliers who were examined before a decision was made about the transaction. In cases where the Bank has no transaction of this type, the market conditions will be examined in relation to transactions of that type made in the economy, on condition that the transaction is in the normal course of business and that the transaction of this type has a market in which similar transactions are made.

(3) "The controlling shareholder's group" – the controlling shareholder together with the private companies related to him within the meaning of the term "related person" in Proper Banking Management Instruction 312, and together with his relatives and private companies related to them, including family members living with him or supported by him; the definition of "relative" according to the provisions of the Banking Act (Licensing) include brother, parent, issue, spouse's issue, and the spouse of each of these.

Below are details of the balances of the controlling shareholder's group and of others in which the controlling shareholder has a personal interest in their dealings with the Bank, (NIS in thousands):

	Balance as at December 31, 2013			The highest balance during 2013		
Type of balance	**Group of the controlling shareholder**	**Relatives of the controlling shareholder**	**Export Investments Company Ltd.**	**Group of the controlling shareholder**	**Relatives of the controlling shareholder**	**Export Investments Company Ltd.**
Credit	298.3	0.1	-	597.7	0.2	0.1
Unutilized credit line	134.7	-	-	137.9	-	-
Deposits	(8,368.0)	(687.4)	(78.9)	(10,323.0)	(712.0)	(2,988.3)

	Balance as at December 31, 2012			The highest balance during 2012		
Type of balance	**Group of the controlling shareholder**	**Relatives of the controlling shareholder**	**Export Investments Company Ltd.**	**Group of the controlling shareholder**	**Relatives of the controlling shareholder**	**Export Investments Company Ltd.**
Credit	49.2	-	0.1	252.0	-	0.1
Unutilized credit line	107.2	-	-	145.8	-	-
Deposits	(7,685.2)	(637.2)	(196.5)	(13,469.9)	(641.9)	(196.5)

Below are details of income from commissions for transactions in securities and/or transactions in foreign currency (that are not liability transactions or deposit transactions) paid by the controlling shareholder's group or by others where the controlling shareholder has a personal interest in their dealings with the Bank, (NIS in thousands):

	Balance as at December 31, 2013			Balance as at December 31, 2012		
Type of balance	**Group of the controlling shareholder**	**Relatives of the controlling shareholder**	**Export Investments Company Ltd.**	**Group of the controlling shareholder**	**Relatives of the controlling shareholder**	**Export Investments Company Ltd.**
Revenues from commissions	618.4	0.9	1.3	156.2	1.8	4.1

1.3.3 Below are details of non-banking transactions with a controlling shareholder or where the controlling shareholder has a personal interest, for the year ended December 31, 2013 (NIS in thousands) and where there are no "negligible" transactions as defined above:

(1) Senior Officers Insurance Policy (O&D):

On October 13, 2012, the General Assembly of the Bank's shareholders (following approval of the Board of Directors on September 12, 2013, the Audit Committee on September 10, 2013 and the Compensations Committee, on September 10, 2013) the Bank's agreement with the its directors and senior officers (including subsidiaries), as may be from time to time, according to the matter in regards to the life insurance policies of senior officers (O&D), as specified below:

Pursuant to the decision of the General Assembly of Bank Shareholders from September 7, 2010, following the Bank's engagement with the directors and officers (including subsidiaries), as will be from time to time regarding the terms of their employment or term, as the case may be, with regards to the acquisition of officers insurances(O&D), as specified below:

The insurance coverage will be in the limit of liability of US$ 25 million per event and US$ 50 million for the period and this for the period of 18 months, beginning on 1.10.13 and until 31.3.15.

The yearly premium the Bank will pay for the purchasing of a senior officer policy will not exceed a sum of US$ 102,000 for 18 months and the deductible for the officers insurance policy will not exceed US$ 25,000 for the Bank.

The insurance policy for the directors and the senior officers may be renewed or changed periodically (whether by extending the existing insurance policy validity and whether connection into another policy, including with another insurer), with the approval of the Audit committee and the Board of Directors, and only if the following conditions will exist: a. The limits of liability in the insurance will not exceed the mentioned amount; b. The Bank's Compensation Committee and Board of Directors will establish that the yearly premium will be as the market conditions; c. The last renewal by the power of this decision will be made for the insurance period ending no later than 6 years from the date of the decision of the General Assembly.

(2) Letters of Indemnity

On January 29, 2012 the general assembly of the Bank's shareholders approved providing letters of liability for reimbursement of senior officers in the formula as attached to appendix C of the immediate report on invitation of the general assembly from December 22, 2011, as has been amended in the immediate report of January 19, 2012 (hereinafter: "the immediate report"), and this (a) for the senior officers of the Bank serving and/or have served at the Bank from time to time and for the senior officers in another company, as defined in the immediate report serving and/or have served from time to time as per request of the Bank, as senior officer at another company, except for senior officers who as controlling shareholders may be considered party of personal interest in providing these letters of liability for reimbursement. (b) For senior officers whose controlling shareholders may be considered a third party with personal interest in providing them liability letters for reimbursement, serving and/or will serve at the Bank from time to time, and also for senior officers as aforementioned that serve or will serve from time to time per request of the Bank, as senior officers at another company. For details concerning reimbursements, see the immediate report of the Bank of January 19, 2012 [reference № 2012-01-020319].

On October 9, 2013, the General Assembly of Bank Shareholders ratified the updates to the Letters of Liability to Indemnify Officers in the wording attached as Appendix C of the Immediate Report on the convening of a General Assembly from September 3, 2013, for officers as aforementioned. For details concerning the update of the Letters of Liability to Indemnify Officers, see the immediate report of the Bank of September 3, 2013 [reference № 2013-01-136176].

The Board of Directors, the Management and the salary of senior officers

Names of the members of the Board of Directors and their occupation:*

Name of Director	Primary occupation
Zev Guttman	Chairman of the Bank's Board of Directors
Dr. Zalman Shoval	Chairman of the Board of Directors of Export Investments Company Ltd. (the parent company); co-Chairman of the Faire Foundation.
Shmuel Eshel	Business adviser and consultant
Moshe Bauer	CEO and director of C.F.C. Comprehensive Financing Corporation Ltd.
Oved Ben-Ozer	Company manager
Adiv Baruch	Partner Manager and Director in Signum Ltd.
Ram Harmelech	CEO and owner of Marneg Cranes Ltd. and director in companies
Pinchas Volovelsky	Lawyer, partner in a law firm
Ira Sobel (began serving on 18.2.13)	CPA, economic adviser to companies and director in public companies
Ester Friedman (began serving on 9.10.13)	Adviser and financial consultant
Dr. Nurit Krausz	CEO and founder of Redstart Services for Modeling And Consulting Ltd.
Gideon Shoval	CEO and Deputy Chairman of the Board of Directors of Export Investments Corporation Ltd.

* Additional details on the members of the Bank's Board of Directors, including the dates they started serving, their membership on Board of Director Committees, the terms in other Boards of Directors, whether they are Bank employees, or of its subsidiaries, its consolidated companies or if an interested party and whether they are family of other interested parties, are presented in the periodical report of the Bank for 2013.

Report on directors with accounting and financial expertise

In accordance with the instructions of the Companies Law 5749 – 1999 (hereinafter: "Companies Law") and the Companies Regulations (Conditions and Examination of the Director with Accounting and Financial Expertise), 5765 – 2005, at least two directors will have accounting and financial expertise as the term is defined in the aforementioned Companies Law (hereinafter: "having accounting and financial expertise"). At least two of the external directors will have accounting and financial expertise. According to the Proper Banking Management Provision 301 at least five of all the members of the Board of Directors will have accounting expertise. According to Instruction 630 of the Public Report instructions from the Supervisor of Banks, the required minimum number of directors with accounting and financial expertise will be specified in the report of the Board of Directors, as determined by the Board of Directors, and the reasons of the Board of Directors for its decision as specified in the aforementioned instruction. In addition, the minimum number of directors with accounting and financial expertise should be specified, as determined by the Bank what will be appropriate for the Board of Directors Audit Committee as well as in each of the other committees of the Board of Directors, that are authorized to discuss the Financial Statement. In addition, the above mentioned instruction 630 determines that in the report of the Board of Directors will be detailed the number of directors that have accounting and financial expertise at the date of reporting.

In accordance with the decision of the Bank's Board of Directors (which is anchored in the Board of Directors work procedure), the minimum number of directors with accounting and financial expertise will be as determined in the Proper Banking Management Provision 301 and Companies Law, that is: (a) at least five of all of the members of the Board of Directors will have accounting and financial expertise, provided that at least two of the directors will have accounting and financial expertise and at least two from the external directors will have accounting and financial expertise; (b) at least two members of the Audit Committee will have accounting and financial expertise.

This is for the reasons specified below: (a) By the Board of Directors assessment, the above minimum number will enable the Board of Directors and the Audit Committee to comply with the obligations imposed on them according to the provisions of law and the corporate documents; in particular for their responsibility to examine the Bank's financial status and the evaluate the Financial Statements; (b) the above minimum number considers the size of the Bank, the complexity of its activity, and variety of involved risks.

At the time of reporting, all the members of the Board of Directors of the Bank have accounting and financial expertise according to their education, skills and experience, as detailed below:

Zev Guttman:

Education: Accounting Studies, College of Management (non-degree), MBA, Herriot – Watt Edinburgh.

Skills and Experience:

- Current occupation – Chairman of the Board of Directors at the Bank; director, manager and controlling shareholder in Ze'ev Gutman Management and Consulting Ltd.; member of associations as stipulated in the Bank's periodic report for 2013.

- Served in various management positions at the Bein-Leumi HaRishon Bank Ltd., member of management, Vice CEO, as follows: Chief Group Risk Officer (CRO), head of Risk Management Division [from October 2010 until August 18, 2011)] Chief Financial Risk Officer, head of Division of Financial Management and Risk Management. [From March 2007 to October 2010]; Department head of Capital Market and Foreign Currency Market [from 2000 until March 2007]; served as director in the following Board of Directors: Magal Issuance Ltd.; Panka Ltd.) FIBI Bank Ltd) Switzerland; First International Underwriting Ltd.; Stokopin (Israel) Ltd.; HIGHTRADE; Tel-Aviv Stock Exchange Ltd.; Maof Clearing House; Chairman of the Board of Directors at Bank Otsar Hahayal; Maalot; Bein-Leumi Insurance Agencies (2005) Ltd.; U-Bank Ltd.

Dr. Zalman Shoval:

Education: B.A. in International Relations from University of California, Berkeley; MAin International Relations, Economics and Political Science from the University of Geneva; Ph.D. in International Relations and Political Science from Pacific University.

Skills and Experience:

- Current occupation – Chairman of the Board of Directors of Export Investments Company Ltd.; co-Chairman of the Faire Foundation; Chairman or Director in the Board of Directors listed in the Bank's Periodic Report for 2013.
- In the past, served as CEO of Bank of Israel's exports, Israel's ambassador to the U.S., Chairman of the Bank of Jerusalem, member of the Knesset Finance Committee, member of the Knesset Foreign Affairs and Defense Committee.

Shmuel Eshel:

Education: B.A. in Political Science and Labor Studies, Tel-Aviv University

Skills and Experience:

- Current occupation – Business adviser and consultant.
- Served as Vice CEO of the Union Bank in the mortgages area (2004-2009); member of the management of the Union Bank, Vice CEO, Head of business department of the Union Bank (1998 – 2004); additional positions at the Union Bank starting from the year 1977. Until June 2009 served as director at Liblov Agencies and Insurance and at Carmel – Union Mortgages and Investments Ltd. In addition, served as Chairman of the Union Leasing Corporation Ltd, and director in the Planus Loans Fund (1998 – 2004).

Moshe Bauer:

Education: High school education.

Skills and Experience:

- Current occupation – CEO and director of C.F.C. Comprehensive Financing Corporation Ltd. Deputy Chairman of the Board of Directors of Export Investments Company Ltd., and director in the corporations listed in the Bank's periodic report for 2013.
- Former Manager of the Foreign Currency Department in Bank Elran, Secretary General of Bank Elran, and afterwards Secretary General of the Export Bank.

Oved Ben-Ozer:

Education: B.A. and M.A. in Political Science from Paddington School of Political Science.

Skills and Experience:

- Current occupation – Manager of Companies. Director in the corporations listed in the Bank's periodic report for 2013.

- Served as CEO of Unitrust Investment Company Ltd. and as Chairman of the Association of Members of the Stock Exchange in Tel Aviv. Served as a member of the Board of Directors of Maalot and its Rating Committee, and until 2010, as director of Jerusalem Portfolio Management Limited.

Adiv Baruch

Education: Bachelors Degree in Industrial Engineering and Management, Technion Haifa.

Skills and Experience:

- Current occupation – partner manager and director in Signum Ltd., a company that specializes in investment management and recovery of companies in: information systems, communications, software, internet and civilian protection technology systems; director in corporations listed in the Bank's periodic report for 2013.

- Formerly served as Venture partner in Infinity-I-China; served as president and CEO of BOS; served as senior VP of Business Development and president of Ness Ventures in Ness Technologies Ltd.

Ram Harmelech

Education: B.A. in Statistics and Geography from Tel-Aviv University; M.B.A. in Business Administration from Tel-Aviv University.

Skills and Experience:

- Current occupation – CEO of Marneg Cranes Ltd. and director in the companies listed in the Bank's periodic report for 2013.

- Served as deputy to the CEO, director of the Business Division and Director of Credit Risk in Mercantile Discount Bank (between 1998-5/2012); served as CEO of Maalot The Israel Securities Ratings Company between 1994-1998.

Adv. Pinchas Volovelsky:

Education: B.A. in Economics and International Relations from The Hebrew University of Jerusalem, M.Jur. from The Hebrew University of Jerusalem.

Skills and Experience:

- Current occupation – lawyer, partner in a law firm. Member of the Board of Directors as listed in the Bank's periodic report for 2013.
- Former Chairman of the Board of Directors of the Bank.

Accountant Ira Sobel:

Education: CPA, B.A. in Business Administration / Accounting, College of Management, Rishon Le-Zion; M.B.A.in Business Administration for Executives, Tel-Aviv University and Northwestern University, Chicago, USA.

Skills and Experience:

- Current occupation: CPA, economic adviser to companies and director in public companies. Member of the Board of Directors as listed in the Bank's periodic report for 2013.
- Between 1994-2002, senior audit manager in banking at KPMG Somekh-Chaikin; assistant to the firm's CEO.

Ester Friedman (serving since 9.10.13):

Education: BA in Economics, The Hebrew University of Jerusalem; M.B.A. in Business Administration, The Hebrew University of Jerusalem.

Skills and Experience:

- Current occupation: Financial consultant and oversight; director in corporations as listed in the Bank's periodic report for 2013;
- Served as CEO of Clal Credit and Finance Ltd. (between 2005-2013).

Dr. Nurit Krausz:

Education: B.Sc., Aerospace Engineering, Technion, Haifa; M.Sc., Physics, Technion, Haifa; D.Sc., Physics, Technion, Haifa.

Skills and Experience:

- Current occupation – Director and Founder of Redstart Services for Modeling And Consulting Ltd. dealing in consulting and development of models.

- Former Head of Model Validation and Head of Comprehensive Risk at Bank Leumi (between 2006-2011); Director of Trading Algorithms – Schonfeld Securities, USA (between 2000 – 2006).

Gideon Shoval:

Education: L.L.B. Law, University of Buckingham; L.L.M. in Law, Columbia University; M.B.A. in Business Administration, IMD Business School.

Skills and Experience:

- Current occupation – Managing Director and Acting Chairman of the Board of Directors of Export Investments Company Ltd.

Board of Directors

During 2013, and until the report's publication date, the following changes were made to the composition of the Board of Directors:

In a special general assembly that convened on February 18, 2013, Mrs. Ira Sobel was appointed external director according to Provision 301 of the Proper Banking Management Provisions and as an independent director in accordance with the Companies Law for a period of three years.

In a special general assembly that convened on February 18, 2013, Mr. Advi Baruch's term as external director in the Bank was approved in accordance with the Companies Law 5759-1999; in accordance with the approval procedure established in Section 5 of the Companies Regulations (Matters that Do Not Constitute a Connection) 5767-2006.

On July 25, 2013, Prof. Shalom Hochman ended his term (second) as external director in the Bank in accordance with the Companies Law.

In a special general assembly that convened on October 9, 2013, Ms. Ester Freidman was appointed external director in the Bank in accordance with the Companies Law for a period of three years.

In the annual General Assembly that convened on December 25, 2013, the decision was made to elect and appoint for an additional term the incumbent directors in the Bank (who are not external directors) – Mr. Ze'ev Gutman (Chairman); Gideon Shoval; Pinchas Volovelsky; Moshe Bauer; Oved Ben Ozer and Ram Harmelech. Furthermore, it was decided in the said General Assembly to ratify the appointment of Ms. Ester Friedman as external director in the Bank in accordance with the approval procedure established in Section 5 of the Companies Regulations 5767-2006.

As of the date of publication of the report, the Bank's Board of Directors appointed 12 directors, 5 of whom are external directors (3 external directors according to the Companies Law and 2 external directors according to Provision 301 of the Provisions for Proper and Independent Banking according to the Companies Law).

On October 14, 2014, the Supervisor of Banks contacted the Bank's Board of Directors, as part of the review of the function of the Board of Directors and its structure, to establish rules regarding the composition of the Board of Directors and the ratio between external directors and other directors. As an extension, the composition of the Bank's Board of Directors in the ratio between external directors and other directors complies with the agreement with the Supervisor of Banks (5 external directors of the 12-13 directors).

During 2013, and until the report's publication date, the following changes were made to the composition of the Committees of the Board of Directors:

On February 18, 2013, Ms. Sobel was appointed member of the Audit Committee.

On July 25, 2013, and with the end of his second term as external director in the Bank, Prof. Hochman ceased to serve as member of the Audit Committee, Compensations Committee, Committee for Capital Planning and Strategy Committee, Board of Directors Credit Committee and Risk Management Committee.

On August 1, 2013, Mr. Eshel was appointed member of the Risk Management Committee.

On October 9, 2013, Ms. Friedman was appointed member of the Audit Committee and Compensation Committee;

On October 24, 2013, Ms. Sobel was appointed member of the Board of Directors Credit Committee and Compensation Committee and Ms. Friedman as member of the Capital Planning and Strategy Committee;

As of the date of publication of the report, the following committees of the Board of Directors are operating:

Audit Committee: Shmuel Eshel (Chairman) (external director), Adiv Baruch (external director), Ms. Ira Sobel (external director in accordance with Provision 301 and independent director according to the Companies Law), Mr. Ram Harmelech and Ms. Ester Friedman (external directors).

Risk Management Committee: Ze'ev Gutman (Chairman), Shmuel Eshel (external director), Nurit Krausz (external director in accordance with Provision 301 and independent director according to the Companies Law) and Ram Harmelech.

Capital Planning and Strategy Committee: Gideon Shoval (Chairman), Ze'ev Gutman, Ester Friedman (external director), Nurit Krausz (external director according to Provision 301 and independent director according to the Companies Law), and Ram Harmelech.

Compensation Committee: Adiv Baruch (Chairman) (external director), Shmuel Eshel (external director), Ester Friedman (external director), Ira Sobel (external director according to Provision 301 and an independent director according to the Companies Law) and Oved Ben Ozer.

Credit Committee of the Board of Directors: Moshe Bauer (Chairman), Oved Ben Ozer, Pinchas Volovelsky, Ira Sobel (external director according to Provision 301 and independent director according to the Companies Law), and Shmuel Eshel (external director).

In 2013, there were 22 meetings of the plenum of the Board of Directors and 43 meetings of its committees.

Senior officers

Mr. Danny Nahum ceased serving as Information Technology Manager on February 15, 2013. Mr. Michael Tier, who serves as manager of the Resources Division, is currently serving in the position of Information Technology Manager of the Bank beginning on said date.

Mr. Israel Boker was appointed manager of the Retail Division and began serving in his position on March 12, 2013.

Mr. Arik Zwilli ended his term as Manager of the Retail Credit Division on June 30, 2013.

Ms. Dina Promovitz ended her term as Manager of Branching Division on October 1, 2013.

Mr. Nissan Levi ended his term as Manager of the Finance Division on November 30, 2013.

Mr. Moshe Omer was appointed Manager of the Finance Division and began serving in this capacity on December 15, 2013.

Mr. Arnon Zayit ended his term as Manager of the Financial Division and Chief Accountant on January 15, 2014.

Mr. Alex Zaltsman was appointed Manager of the Financial Division and Chief Accountant on January 16, 2014.

Members of Bank Management as of December 31, 2013

Uriel Paz	CEO
Israel Boker	Deputy CEO, Manager of the Retail Division
Arnon Zayit	Deputy CEO, Manager of the Financial Department (ceased serving on January 15, 2014)
Michael Taier	Deputy CEO, Manager of the Resources Division
Michael Ben-Ischai	Vice CEO, Manager of Risk Division (C.R.O.)
Moshe Bauer	Vice CEO, Manager of Finance Division
Sarit Weistuch	Vice CEO, legal consultant
Ron Sagy	Vice CEO, Internal auditor, member of Management

Senior officers who are not members of Management

Carmel Florentz	Secretary of the Bank
Ayelet Rusk	Manager of the Real Estate Sector Department

Additional information on senior officers at the Bank is presented in the Bank's Periodic Report for 2013, and on the Magna website of the Securities Authority at the address http//www.magna.isa.gov.il

Salaries of senior officers

See below in Appendix A.

Salary of independent auditor

See below in Appendix A.

The Bank's Board of Directors thanks the management of the Bank and it employees for their dedicated work and contribution to the Bank's business advancement.

February 27, 2014

Zeev Gutman
Chairman of the Board of Directors

Uriel Paz
CEO

Principal data from the consolidated financial statements for the year ended December 31, 2013

Reported amounts

Appendix A to the Board of Directors Report

	Rate of change in %	For the year ended on December 31, 2013	2012
A. Profits and profitability			
		In percentages	
1. Net profit yield to average capital[(1)]		**2.5%**	5.4%
		in millions of NIS	
2. Interest income, net	11%	**257.2**	230.9
3. Expenses from credit losses[(1)]	52%	**(54.7)**	(36.0)
4. Interest income, net after expenses from credit losses	4%	**202.5**	194.9
5. Non-Interest income	-6%	**106.5**	113.4
6. Operating and other expenses	13%	**(286.4)**	(254.5)
7. Profit before taxes	-58%	**22.6**	53.8
8. Provision for taxes	-69%	**(5.4)**	(17.7)
9. Net profit[(1)]	-52%	**17.2**	36.1

	Rate of change	as at December 31, 2013	2012
B. Principal financial ratios			
		In percentages	
10. Ratio of expenses from credit losses for the period to total net credit to the public (including weighted off-balance sheet credit risk)[(1)]		**0.57%**	0.37%
11. Ratio of core capital to risk components (BaselI)		**9.3%**	9.7%
12. Ratio of capital to risk components (BaselI)		**13.9%**	14.4%
		in millions of NIS	
C. Balance sheet – principal items			
13. Total balance sheet	9%	13,412	12,292
14. Cash and deposits at banking corporations	108%	2,833	1,361
15. Securities	-42%	677	1,163
16. Credit to the public	0.5%	9,627	9,581
17. Deposits from the public	13%	11,071	9,814
18. Debentures and deferred liability notes	-11%	1,406	1,581
19. Shareholders' equity	0.4%	697	694
20. Capital for purposes of ratio of capital to risk components (BaselI)	0.5%	1,036	1,031
D. Off-balance sheet items			
21. Balance of loans from deposits based on collectability	-15%	1,703	1,997
22. Balance of guarantees	-15%	165	195

(1) In 2013, one-time expenses were included following application of a group provision for housing at a rate of 0.35%, in accordance with the Bank of Israel directives on this matter from March 21, 2013, in the amount of NIS 19.2 million. The ratio of expenses for credit losses for 2013, to the net total credit to the public, while neutralizing the aforementioned one-time expense is 0.37%.

Principal data on the Bank and its consolidated companies for the year ended on December 31, 2013

Appendix A (continued) to the Board of Directors Report
E. List of compensations to senior officers (NIS in thousands)

	For the year ended on December 31, 2013								
	Details of the compensation receiver			**Compensation for services**				**Other compensations**	**Total**
Name	Function	Position Scope	Holding rate in the corporation's equity	Wage(1)	Management fees(2)	Bonus(3)	Benefit from share-based payment(4)	Interest(5)	
Zev Guttman(6)	Chairman of the Board of Directors	Partial	–	–	1,492	–	–	–	1,492
Uri Paz(7)	CEO	Full	–	–	2,157	–	349	2	2,508
Dinah Promovitz(8)	Vice CEO, Branching Division Manager	Full	–	924	–	873	(12)	1	1,786
Arnon Zayit(9)	Deputy CEO, Manager of Financial Department	Full	–	1,213	–	266*	(16)	4	1,467
Michael Taier(10)	Deputy CEO, Manager of the Resources Division	Full	–	1,147	–	–	81	–	1,228
Nissan Levi(11)	Deputy CEO, Manager of the Finance Division	Full	–	1,059	–	177**	(24)	3	1,215

Appendix A (continued) to the Board of Directors Report
E. List of compensations to senior officers (NIS in thousands)

	For the year ended on December 31, 2012									
	Details of the compensation receiver			Compensation for services				Compensations		Total
Name	Function	Position Scope	Holding rate in the corporation's equity	Wage(1)	Management fees(2)	Bonus(3)	Benefit from share-based payment(4)	Interest(5)		
Zev Guttman(6)	Chairman of the Board of Directors	Partial	–	–	1,397	–	–	–		1,397
Uriel Paz(7)	CEO	Full	–	–	2,059	–	711	3		2,773
Asher Ben David(12)	Deputy CEO, Manager of the Retail Division	Full	–	–	1,176	30	(10)	4		1,200
Nissan Levi(11)	Deputy CEO, Manager of the Finance Division	Full	–	1,112	–	–	24	3		1,139
Michael Taier(10)	Deputy CEO, Manager of the Resources Division	Full	–	1,083	–	–	24	–		1,107
Michael Ben Ischai(13)	Vice CEO, Manager of Risks Division	Full	–	1,043	–	–	–	4		1,047

* As of the date of publication of the report, the Bank's Board of Directors discussed a draft resolution (that it has not yet finally approved) for payment of a bonus of NIS 266 thousand beyond the severance pay release and 100% completion during the period between the start of his work and until June 30, 2008, and afterward and until the end of his employment for purposes of release of severance pay in accordance with Section 14 of the Severance Pay Law. Payment of the bonus is subject to final approval of the Bank's Board of Directors, as well as approval of the General Assembly.

** As of the date of publication of the report, the Bank's Board of Directors discussed a draft resolution (that it has not yet finally approved) for payment of a bonus of NIS 177 thousand beyond the amount that accrued for severance pay in the senior officers insurance policies / pension funds on his behalf. Payment of the bonus is subject to final approval of the Bank's Board of Directors, as well as approval of the General Assembly.

Appendix A (continued) to the Board of Directors Report

(1) Including provisions for severance pay, compensations, training funds, National Insurance and vacation, as well as salary-related conditions, but not including wage tax. Included in Profit and Loss in the Salaries and Related Expenses item.

(2) Including payment of monthly management fees and related benefits, but not including VAT. Included in Profit and Loss in the Salaries and Related Expenses item.

(3) Including bonus provided for in the reporting year and not yet paid (excluding wage tax). Included in Profit and Loss in the Salaries and Related Expenses item

(4) For details, see Note 22a to the Financial Statements. Included in Profit and Loss in the Salaries and Related Expenses item

(5) Including interest benefit from loans granted under benefit conditions. Included in Profit and Loss in the Profit from Financing Activity before Expenses from Credit Losses item.

(6) Mr. Ze'ev Gutman – Chairman of the Board of Directors of the Bank – is employed in the Bank for an average of 4 days per week as of October 18, 2011, according to the agreement from November 6, 2011 through a company controlled by him, "Ze'ev Gutman Management and Consultancy Ltd.", for an unlimited period. For more information, see Note 22. Following the Immediate Report dated July 14, 2013 (Reference No: 2013-01-091584) with regards to the implementation of a streamlining plan, the Chairman of the Bank's Board of Directors announced his consent to reduce the monthly management fees paid to him through a company wholly owned by him, by 3.4%, beginning on November 1, 2013. The reduction in management fees will remain valid for a fixed period of time and will end upon the occurrence of certain events, as specified in the Bank's Immediate Report dated November 17, 2013 (Reference No.: 2013-01-192759). The monthly compensation of Mr. Ze'ev Gutman is linked to the Consumer Price Index. Each of the parties may terminate the agreement while giving early announcement of three months in advance and subject to the terms set forth in the agreement. For more information, see Note 22.

(7) Mr. Uriel Paz – The Bank's CEO, has been providing management services to the Bank since April 8, 2010, in accordance with an agreement for the provision of management services through a company controlled by him, "Uriel Pal Consultancy Ltd.", for a period of 4 years. For more information, see Note 22 and Note 22a. Pursuant to the immediate report dated July 14, 2013 (Reference No: 2013-01-091584) with regards to the implementation of a streamlining plan, the Bank's CEO announced his consent to lower the management fees paid to him through a company wholly owned by him (Hereinafter: the "Management Company"), by 5% as from August 1, 2013, and also that the management fees will not be updated for the Consumer Price Index as from January 1, 2013. The reduction in management fees will remain valid for a fixed period of time and will end upon the occurrence of certain events, as specified in the Bank's Immediate Report dated November 17, 2013 (Reference No.: 2013-01-192759). Mr. Uriel Paz has a credit line with benefit terms. The balance as at December 31, 2013 totaled NIS 29 thousand.

(8) Ms. Dinah Promovitz – served as manager of the Branching Division until September 30, 2013. Ms. Promovitz was employed at the Bank starting on July 23, 1989 under a personal employment contract, for an unlimited period of time and her salary was linked to the Consumer Price Index. The Bank's Board of Directors approved payment of NIS 873 thousand for increased severance pay beyond the amount accrued for severance pay that accrued in insurance policies / pension funds under her name and an adjustment bonus. Ms. Promovtiz was allocated, as part of the options plan for senior managers, 79,938 class A option units and 39,969 class B options units, that expired upon end of her term (for information regarding the options plan for senior managers, see Note 22a and for information on the compensation plan, see within the chapter "Human Capital" in the Financial Report.) Ms. Promovtiz has a credit line with benefit terms. The balance as at December 31, 2013 totaled NIS 32 thousand.

Principal data on the Bank and its consolidated companies for the year ended on December 31, 2013

Appendix A (continued) to the Board of Directors Report

(9) Mr. Arnon Zayit served as Manager of the Financial Division until January 15, 2014. Mr. Zayit was employed at the Bank starting on April 2, 2000 in accordance with a personal employment contract, for an undefined period of time. The monthly compensation of Mr. Arnon Zayit is linked to the Consumer Price Index. As of the date of publication of the report, the Bank's Board of Directors discussed a draft resolution (that it has not yet finally approved) for payment of a bonus of NIS 266 thousand beyond the severance pay release and 100% completion during the period between the start of his work and until June 30, 2008, and afterward and until the end of his employment for purposes of release of severance pay in accordance with Section 14 of the Severance Pay Law. Payment of the bonus is subject to final approval of the Bank's Board of Directors, as well as approval of the General Assembly. Mr. Arnon Zayit was allocated, under the options plan for senior managers, 103,426 class A option units and 51,713 class B option units, that expired upon end of his term (for information regarding the options plan for senior managers, see Note 22a and for information on the compensation plan, see within the chapter "Human Capital" in the Financial Report.) Mr. Arnon Zayit has a credit line with benefit terms. The balance as at December 31, 2013 totaled NIS 217 thousand.

(10) Mr. Michael Taier – Manager of the Resources Division, has been employed at the Bank since June 18, 2011, in accordance with a personal agreement, for an unlimited period. The monthly compensation of Mr. Taier is linked to the Consumer Price Index. Each of the parties to the employment agreement may terminate the engagement while giving early announcement of three months in advance. Furthermore, upon termination of his employment, Mr. Michael Taier will be entitled to a release by the Bank of all the accumulated amounts on his behalf in various funds. Mr. Tier was allocated, under the options plan for senior managers, 155,139 class A option units and 77,569 Class B option units, that expired upon end of his term (for information regarding the options plan for senior managers, see Note 22a and for information on the compensation plan, see within the chapter "Human Capital" in the Financial Report.)

(11) Mr. Nissan Levi ended his term as Manager of the Finance Division on November 30, 2013. Mr. Levi was employed at the Bank starting on July 1, 1999 in accordance with a personal employment contract, for an undetermined period of time and his monthly salary was linked to the Consumer Price Index. As of the date of publication of the report, the Bank's Board of Directors discussed a draft resolution (that it has not yet finally approved) for payment of a bonus of NIS 177 thousand beyond the amount that accrued for severance pay in the senior officers insurance policies / pension funds on his behalf. Payment of the bonus is subject to final approval of the Bank's Board of Directors, as well as approval of the General Assembly. Payment of the bonus is subject to approval of the Bank's General Assembly. Mr. Nisan Levi was allocated, under the options plan for senior managers, 155,139 class A option units and 77,569 Class B option units, that expired upon end of his term (for information regarding the options plan for senior managers, see Note 22a and for information on the compensation plan, see within the chapter "Human Capital" in the Financial Report). Mr. Nisan Levi has a credit line with benefit terms. The balance as at December 31, 2013 totaled NIS 53 thousand.

(12) Mr. Asher Ben David – served as manager of the Retail Division, beginning on May 1, 2010 and until December 12, 2012, in accordance with an agreement to provide management services through a company controlled by him, "Yak Asset Management Ltd.". In accordance with the addendum to said agreement, Mr. Asher Ben David provided consulting services to the Bank beginning on December 12, 2012 and until March 20, 2013, on which date the management agreement ended. The monthly management fees of Mr. Asher Ben David were linked to the Consumer Price Index. In addition, in accordance with the management agreement, the Bank paid full management fees for a 3-month adjustment period from the end of the management agreement. Mr. Nissan Levi was allocated, under an options program for senior managers, 564,142 class A option units, as well as 282,070 class B option units, that expired upon end of his term (for information regarding the options plan for senior managers, see Note 22a and for information on the compensation plan, see within the chapter "Human Capital" in the Financial Report.)

Appendix A (continued) to the Board of Directors Report

(13) Mr. Michael Ben Ischai – Manager of the Risks Division, has been employed at the Bank since January 1, 1998, in accordance with a personal employment agreement, for an unlimited period. The monthly compensation of Mr. Ben Ischai is linked to the Consumer Price Index. Each of the parties to the employment agreement may terminate the engagement while giving early announcement of three months in advance. Furthermore, upon termination of his employment, Mr. Ben Ischai will be entitled to a release by the Bank of all the accumulated amounts on his behalf in various funds. Mr. Michal Ben Ischai has a credit line with benefit terms. The balance as at December 31, 2013 totaled NIS 60 thousand.

Principal data on the Bank and its consolidated companies for the year ended on December 31, 2013

Appendix A (continued) to the Board of Directors Report

	For the year ended on December 31,	
	2013	**2012**
f. Data on the organizational structure		
1. Number of Bank branches(1)	**21**	17
2. Number of employees including subsidiaries (including personnel under outsourcing regime)	**550**	509
3. Number of positions with overtime (monthly average)	**6**	19
4. Number of meetings of the Board of Directors plenum	**22**	20
5. Number of meetings of Board of Directors Committees	**43**	40

g. Compensation to the independent auditor(2,3,4) NIS in Thousands

	Consolidated		The Bank	
	For the year ended on December 31,			
	2013	**2012**	**2013**	**2012**
For audit activities(5)				
Independent auditor	**1,445**	1,215	**1,279**	1,054
For audit-related services(6)				
Independent auditor	**289**	35	**265**	–
For tax services(7)				
Independent auditor	**424**	95	**424**	95
For other services				
Independent auditor	**352**	106	**352**	106
Total compensation to independent auditors	**2,510**	1,451	**2,320**	1,255

(1) After the balance sheet date, another branch was opened. As of the date of publication of the balance sheet, the number of Bank branches is 22.

(2) Report of the Board of Directors to the annual general assembly on the compensation to the independent auditor for auditing activities – services in addition to the audit, according to paragraphs 165 and 167 of the Companies Law, 5759 – 1999

(3) The compensation to the independent auditor includes payments to partnerships and corporations under their control, and also includes payments pursuant to the VAT Law.

(4) Including paid compensation and accumulated compensation.

(5) Audit of annual financial statements and review of interim reports.

(6) Audit-related fees, including primarily: prospectus and audit of businesses acquired during the year.

(7) Ongoing tax services and preparation of reports for tax authorities.

Management Review

Annual Report for 2013

Bank of Jerusalem Ltd. and consolidated companies

Management Review of the Bank's business position and results of operations

Multi-period data and various details relating to the Financial Statements that provide a broader picture of the Bank's financial position and results of operations, are included in the appendices detailed below:

Consolidated Balance Sheets – Multi-period data as at the end of the years 2009 – 2013

Reported amounts in millions of Shekels

Appendix A

	December 31,				
	2013	**2012**	**2011**	**2010**	**2009**
Assets					
Cash and deposits at banks	**2,833.4**	1,360.6	792.3	652.3	765.1
Securities	**676.6**	1,163.0	1,490.7	1,314.9	1,083.2
Credit to the public [(1)]	**9,735.5**	9,672.1	9,148.8	8,158.4	7,481.1
Provision for credit losses[(1)]	**(108.9)**	(90.7)	(91.0)	(121.5)	(131.8)
Credit to the public, net	**9,626.6**	9,581.4	9,057.8	8,036.9	7,349.3
Buildings and equipment	**150.4**	117.9	79.7	56.7	52.4
Intangible assets and goodwill	**2.4**	–	-	–	-
Assets for derivative instruments	**21.7**	20.9	7.2	23.9 [(2)]	23.6 [(2)]
Other assets	**100.5**	47.7	54.9	41.0 [(2)]	27.8 [(2)]
Total assets	**13,411.6**	12,291.5	11,482.6	10,125.7	9,301.4
Liabilities and shareholders' equity					
Deposits from the public	**11,071.1**	9,813.7	9,064.6	7,407.8	7,115.7
Deposits from banks	**51.5**	63.3	76.2	86.5	103.9
Government deposits	**0.7**	-	0.8	4.9	5.4
Securities that were lent or sold as part of a repurchase agreement	**27.5**	-	-	–	-
Debentures and deferred liability notes	**1,406.0**	1,581.0	1,611.9	1,921.1	1,391.8
Liabilities for derivative instruments	**12.3**	16.4	15.0	10.7 [(2)]	11.0 [(2)]
Other liabilities	**145.3**	123.0	69.5	61.5 [(2)]	67.7 [(2)]
Total liabilities	**12,764.4**	11,597.4	10,838.0	9,492.5	8,695.5
Shareholders' equity	**697.2**	694.1	644.6	633.2	605.9
Total liabilities and shareholders' equity	**13,411.6**	12,291.5	11,482.6	10,125.7	9,301.4

(1) On January 1, 2011, the Bank adopted for the first time the instructions of the Supervisor of Banks concerning "Measurement and disclosure of defective debts, credit risk and provision for credit losses". The comparative data for previous periods were not restated. Therefore, the data as at December 31, 2013, 2012 and 2011 are not comparable to the data for previous periods. For additional details concerning the effect of the instruction's first adoption, see the Note on Accounting Policies.

(2) Reclassified.

Consolidated Profit and Loss Statements – Multi-period data for the years 2009-2013

Reported amounts in millions of Shekels

Appendix B

	For the year ended on December 31,				
	2013	**2012**	**2011**(1)	**2010**(1)	**2009**(1)
Interest income	543.2	555.7	559.0	426.7	486.2
Interest expenses	286.0	324.8	384.2	302.1	370.1
Interest income, net	257.2	230.9	174.8	124.6	116.1
Expenses from credit losses(2)	54.7	36.0	15.1	(2.6)	(1.3)
Interest income, net after expenses from credit losses	**202.5**	**194.9**	**159.7**	**127.2**	**117.4**
Non-interest income					
Non-interest financing income	14.2	22.6	6.1	24.5	50.5
Commissions	91.4	90.2	91.9	98.9	97.9
Other income	0.9	0.6	25.5	0.6	0.1
Total non-interest income	**106.5**	**113.4**	**123.5**	**124.0**	**148.5**
Operating and other expenses					
Salaries and related expenses	146.1	137.8	134.1	120.7	105.8
Maintenance and depreciation of buildings and equipment	58.2	46.9	37.6	29.4	27.9
Other expenses	82.1	69.8	51.4	53.0	39.9
Total operating and other expenses	**286.4**	**254.5**	**223.1**	**203.1**	**173.6**
Profit before taxes	22.6	53.8	60.1	48.1	92.3
Provision for taxes	5.4	17.7	14.6	14.0	33.6
Net profit	**17.2**	**36.1**	**45.5**	**34.1**	**58.7**
Earnings per share (in NIS)					
Basic and diluted net earnings per share (NIS)	**0.24**	**0.51**	**0.65**	**0.48**	**0.83**

(1) The comparative data in this Statement were re-classified and re-sorted following the instruction issued by the Supervisor of Banks concerning adoption of the new format for the Profit and Loss Statement. For details see Note on Accounting Policies. It should be noted that in 2011, the Other Income item included a gain of NIS 25.4 million from the sale of the Bank's administrative building, and the Tax Expenses item, an amount of NIS 4.6 million. For details, see Note 8 – Buildings and Equipment

(2) On January 1, 2011, the Bank adopted for the first time the instructions of the Supervisor of Banks concerning "Measurement and disclosure of defective debts, credit risk and provision for credit losses". The comparative data for previous periods were not restated. Therefore, the data for the years ended on December 31, 2013, 2012 and 2011 are not comparable to the data of the previous years. For additional details concerning the effect of the instruction's first adoption, see Note 2 – Accounting Policies.

Interest Income and Expenses Ratios – of the Bank and its Consolidated Companies[1] and Analysis of Changes in Interest Income and Expenses

Appendix C

Chapter A – Average balances and interest rates – assets

Reported amounts

	For the year ended on December 31,								
	2013			2012			2011		
	Average balance[2]	Interest income	Income rates	Average balance[2]	Interest income	Income rates	Average balance[2]	Interest income	Income rates
	NIS in Millions		Percentage	NIS in Millions		Percentage	NIS in Millions		Percentage
Interest-bearing assets									
Credit to the public [3]	9,695.2	509.4	5.25	9,384.9	510.1	5.44	8,643.0	495.2	5.73
Deposits at banks	190.5	0.6	0.31	88.5	0.7	0.79	204.8	5.2	2.54
Deposits at central banks	1,302.0	16.8	1.29	363.7	8.2	2.25	323.4	9.8	3.03
Debentures available for sale[4]	701.5	11.6	1.65	1,227.0	29.9	2.44	1,204.9	43.1	3.58
Debentures for trade[4]	299.5	4.8	1.60	230.4	6.1	2.65	146.0	4.7	3.22
Other assets	–	–	–	4.5	0.7	15.56	3.7	1.0	27.03
Total interest-bearing assets	**12,188.7**	**543.2**	**4.46**	11,299.0	555.7	4.92	10,525.8	559.0	5.31
Accounts receivable from non-interest-bearing credit cards	30.5	–	–	26.3	–	–	23.4	–	–
Other non-interest-bearing assets[5]	357.3	–	–	340.5	–	–	223.6	–	–
Total assets	**12,576.5**	**543.2**	**4.32**	11,665.8	555.7	4.76	10,772.8	559.0	5.19

Notes at the end of Appendix C.

Interest Income and Expenses Ratios – of the Bank and its Consolidated Companies[1] and Analysis of Changes in Interest Income and Expenses (continued)

Appendix C

Chapter B – Average balances and interest rates – liabilities and shareholders' equity

Reported amounts

	For the year ended on December 31,								
	2013			2012			2011		
	Average balance[2]	Interest expenses	Expense rates	Average balance[2]	Interest expenses	Expense rates	Average balance[2]	Interest expenses	Expense rates
	NIS in Millions		Percentage	NIS in Millions		Percentage	NIS in Millions		Percentage
Interest-bearing liabilities									
Deposits from the public	9,693.6	204.4	2.11	8,578.9	241.0	2.81	7,572.2	262.3	3.46
Deposits from banks	60.8	3.4	5.59	76.4	3.8	4.97	79.2	5.0	6.31
Debentures	1,484.2	78.2	5.27	1,484.6	80.0	5.39	1,815.0	116.9	6.44
Total interest-bearing liabilities	**11,238.6**	**286.0**	**2.54**	10,139.9	324.8	3.20	9,466.4	384.2	4.06
Non-interest-bearing deposits from the public	531.4	–	–	772.4	–	–	616.0	–	–
Other non-interest-bearing liabilities[7]	111.8	–	–	81.4	–	–	67.6	–	–
Total liabilities	**11,881.8**	**286.0**	**2.41**	10,993.7	324.8	2.95	10,150.0	384.2	3.79
Total capital resources	**694.7**			672.1			622.8		
Total liabilities and capital resources	**12,576.5**		**–**	11,665.8		–	10,772.8		–
Interest gap			**1.91**			1.72			1.25
Net return[8] on interest-bearing assets	**12,188.7**	**257.2**	**2.11**	11,299.0	230.9	2.04	10,525.8	174.8	1.66

Notes at the end of Appendix C.

Interest Income and Expenses Ratios – of the Bank and its Consolidated Companies(1) and Analysis of Changes in Interest Income and Expenses (continued)

Appendix C

Chapter C – Average balances and interest rates – additional data on interest-bearing assets and liabilities attributed to the activity in Israel

	For the year ended on December 31,								
	2013			2012			2011		
	Average balance(2)	Interest income/ (expenses)	Income/ (expense) rates	Average balance(2)	Interest income/ (expenses)	Income/ (expense) rates	Average balance(2)	Interest income/ (expenses)	Income/ (expense) rates
	NIS in Millions		Percentage	NIS in Millions		Percentage	NIS in Millions		Percentage
Non-linked Israeli currency									
Total interest-bearing assets	7,077.5	286.4	4.05	6,350.2	316.3	4.98	5,967.4	209.4	3.51
Total interest-bearing liabilities	6,251.7	(106.0)	(1.70)	5,590.9	(147.7)	(2.64)	5,085.4	(76.8)	(1.51)
Interest gap			**2.35**			**2.34**			**2.00**
Index-linked Israeli currency									
Total interest-bearing assets	3,701.5	219.6	5.93	3,543.1	197.4	5.57	3,332.1	218.7	6.56
Total interest-bearing liabilities	3,759.7	(172.6)	(4.59)	3,559.1	(165.8)	(4.66)	3,282.6	(220.9)	(6.73)
Interest gap			**1.34**			**0.91**			**(0.17)**
Foreign currency (including Israeli currency linked to foreign currency)									
Total interest-bearing assets	1,409.7	37.2	2.64	1,405.7	42.0	2.99	1,226.3	130.9	10.67
Total interest-bearing liabilities	1,227.2	(7.4)	(0.6)	989.9	(11.3)	(1.14)	1,098.4	(86.5)	(7.88)
Interest gap			**2.04**			**1.85**			**2.79**
Total activity in Israel									
Total interest-bearing assets	12,188.7	543.2	4.46	11,299.0	555.7	4.92	10,525.8	559.0	5.31
Total interest-bearing liabilities	**11,238.6**	**(286.0)**	**(2.54)**	**10,139.9**	**(324.8)**	**(3.20)**	**9,466.4**	**(384.2)**	**(4.06)**
Interest gap			**1.92**			**1.72**			**1.25**

Notes at the end of Appendix C

Interest Income and Expenses Ratios – of the Bank and its Consolidated Companies[1] and Analysis of Changes in Interest Income and Expenses (continued)

Appendix C

Chapter D – Analysis of changes in interest income and expenses

Reported amounts in millions of Shekels

	For the year ended on December 31, 2013 compared to the year ended on December 31, 2012			For the year ended on December 31, 2012 compared to the year ended on December 31, 2011		
	Increase (decrease) due to the change[9]		Net change	Increase (decrease) due to the change[9]		Net change
	Quantity	Price		Quantity	Price	
Interest-bearing assets						
Credit to the public in Israel	16.3	(17.0)	(0.7)	40.3	(25.4)	14.9
Other interest-bearing assets in Israel	4.7	(16.5)	(11.8)	2.9	(21.1)	(18.2)
Total interest income	**21.0**	**(33.5)**	**(12.5)**	**43.2**	**(46.5)**	**(3.3)**
Interest-bearing liabilities						
Deposits from the public in Israel	23.5	(60.2)	(36.7)	28.3	(49.6)	(21.3)
Other interest-bearing Liabilities	(0.9)	(1.2)	(2.1)	(17.9)	(20.2)	(38.1)
Total interest expenses	**22.6**	**(61.4)**	**(38.8)**	**10.4**	**(69.8)**	**(59.4)**

(1) Data after the effect of hedging derivative instruments.

(2) Based on beginning-of-month balances (in the non-linked Israeli currency sector – based on daily balances).

(3) Before deduction of the average balance sheet balance of provisions for credit losses. Including defective debts not accruing interest income

(4) The average balance of debentures for trade and debentures available for sale is presented after deduction/addition of the average balance of non realized profits/losses from fair value adjustments of debentures for trade and profits/losses from debentures available for sale, that are included in Shareholders' Equity under Other Comprehensive Income in the "Adjustments from the presentation of securities available for sale at fair value" item for the years 2013, 2012 and 2011 totaling (1.2), 19.3 and (4.3), respectively.

(5) Including derivative instruments and other non-interest-bearing assets, and less provision for credit losses.

(6) Commissions totaling NIS 12.3, 13.9 and 14.4 million were included in interest income in the years 2013, 2012 and 2011, respectively.

(7) Including derivative instruments.

(8) Net return – net interest income divided by total interest-bearing assets.

(9) The change attributed to the change in quantity is calculated by multiplying the new price by the change in quantity. The change attributed to the change in price is calculated by multiplying the old quantity by the change in price.

Exposure of the Bank and Consolidated Companies to Changes in Interest Rates as at December 31,

Appendix D

Reported amounts	2013				
	On demand up to one month	Over one month up to 3 months	Over 3 months up to one year	Over one year up to 3 years	Over 3 years up to 5 years
			Millions of NIS		
Non-linked Israeli currency					
Financial assets	6,233.2	415.8	1,192.2	132.8	210.8
Derivative financial instruments (excluding options)	69.6	19.1	89.9	91.0	–
Total fair value	6,302.8	434.9	1,282.1	223.8	210.8
Financial liabilities	(5,710.2)	(836.6)	(682.4)	(228.1)	(65.5)
Derivative financial instruments (excluding options)	(553.2)	(73.1)	(52.2)	(0.3)	–
Total fair value	(6,263.4)	(909.7)	(734.6)	(228.4)	(65.5)
Financial instruments, net					
Exposure to changes in interest rates in the sector	39.4	(474.8)	547.5	(4.6)	145.3
Cumulative exposure in the sector	**39.4**	**(435.4)**	**112.1**	**107.5**	**252.8**
Index-linked Israeli currency					
Financial assets	52.8	135.4	630.0	1,266.9	1,229.6
Derivative financial instruments (excluding options)	–	–	51.4	–	–
Total fair value	52.8	135.4	681.4	1,266.9	1,229.6
Financial liabilities	(139.0)	(231.5)	(797.0)	(1,014.5)	(872.4)
Derivative financial instruments (excluding options)	–	–	(51.2)	–	–
Total fair value	(139.0)	(231.5)	(848.2)	(1,014.5)	(872.4)
Financial instruments, net					
Exposure to changes in interest rates in the sector	(86.2)	(96.1)	(166.8)	252.4	357.2
Cumulative exposure in the sector	**(86.2)**	**(182.3)**	**(349.1)**	**(96.7)**	**260.5**
Foreign currency(2)					
Financial assets	921.7	27.4	89.1	52.3	114.4
Derivative financial instruments (excluding options)	697.9	194.4	6.1	–	1.5
Total fair value	1,619.6	221.8	95.2	52.3	115.9
Financial liabilities	(913.9)	(156.5)	(505.5)	(38.9)	(0.4)
Derivative financial instruments (excluding options)	(215.6)	(138.5)	(40.7)	(86.1)	(0.5)
Total fair value	(1,129.5)	(295.0)	(546.2)	(125.0)	(0.9)
Financial instruments, net					
Exposure to changes in interest rates in the sector	490.1	(73.2)	(451.0)	(72.7)	115.0
Cumulative exposure in the sector	**490.1**	**416.9**	**(34.1)**	**(106.8)**	**8.2**
Total exposure to changes in interest rates					
Total assets	7,207.7	578.6	1,911.3	1,452.0	1,554.8
Derivative financial instruments (excluding options)	767.5	213.5	147.4	91.0	1.5
Total fair value	7,975.2	792.1	2,058.7	1,543.0	1,556.3
Total liabilities	(6,763.1)	(1,224.6)	(1,984.9)	(1,281.5)	(938.3)
Derivative financial instruments (excluding options)	(768.8)	(211.6)	(144.1)	(86.4)	(0.5)
Total fair value	(7,531.9)	(1,436.2)	(2,129.0)	(1,367.9)	(938.8)
Financial instruments, net					
Exposure to changes in interest rates	443.3	(644.1)	(70.3)	175.1	617.5
Cumulative exposure	**443.3**	**(200.8)**	**(271.1)**	**(96.0)**	**521.5**

(1) The "Without repayment period" column shows balance sheet balances.

(2) Local activity, including Israeli currency linked to foreign currency.

Exposure of the Bank and Consolidated Companies to Changes in Interest Rates as at December 31, (continued)

2013							2012		
Over 5 years up to 10 years	Over 10 years up to 20 years	Over 20 years	Without repayment period[1]	Total	Internal rate of return	Average Duration Duration	Total fair value	Internal rate of return	Average Duration Duration
		Millions of NIS			%	Years	Millions of NIS	%	Years
106.7	(0.2)	(0.1)	10.0	8,301.2	3.50	0.28	6,875.5	3.70	0.38
0.1	–	–	–	269.7		0.90	259.2	–	0.44
106.8	(0.2)	(0.1)	10.0	8,570.9	3.50	0.30	7,134.7	3.70	0.38
(10.6)	–	–	–	(7,533.4)	1.79	0.18	(6,217.4)	2.13	0.29
–	–	–	–	(678.8)		0.13	(243.1)	–	0.61
(10.6)	–	–	–	(8,212.2)	1.79	0.18	(6,460.5)	2.13	0.30
96.2	(0.2)	(0.1)	10.0	358.7	1.71	0.12	674.2	1.57	0.08
349.0	**348.8**	**348.7**	**358.7**	**358.7**					
276.6	121.5	5.2	–	3,718.0	3.60	2.92	3,816.1	3.13	3.00
–	–	–	–	51.4		0.62	119.6	–	0.58
276.6	121.5	5.2	–	3,769.4	3.60	2.89	3,935.7	3.13	2.93
(481.1)	(0.6)	–	–	(3,536.1)	1.60	2.57	(4,006.5)	1.50	2.47
–	–	–	–	(51.2)		0.32	(50.2)	–	1.62
(481.1)	(0.6)	–	–	(3,587.3)	1.60	2.54	(4,056.7)	1.50	2.46
(204.5)	120.9	5.2	–	–	2.00	0.35	(121.0)	1.63	0.47
56.0	**176.9**	**182.1**	**182.1**	**182.1**					
29.3	10.5	–	–	1,244.7	3.40	0.87	1,575.4	3.82	0.44
–	–	–	–	899.9		0.11	7.4	–	–
29.3	10.5	–	–	2,144.6	3.40	0.87	1,582.8	3.82	0.44
	–	–	–	(1,615.2)	1.00	0.24	(1,436.3)	0.90	0.18
(0.2)	–	–	–	(481.6)		0.49	(88.4)	–	–
(0.2)	–	–	–	(2,096.8)	1.00	0.30	(1,524.7)	0.90	0.17
29.1	10.5	–	–	47.8	2.40	0.57	58.1	2.92	0.28
37.3	**47.8**	**47.8**	**47.8**	**47.8**					
412.6	131.8	5.1	10.0	13,263.9	**3.52**	1.07	12,310.4	3.14	1.20
0.1	–	–	–	1,221.0		0.31	386.2		0.47
412.7	131.8	5.1	10.0	14,484.9	**3.52**	1.01	12,696.6	3.14	1.18
(491.7)	(0.6)	–	–	(12,684.7)	**1.64**	0.85	(11,660.2)	1.85	1.02
(0.2)	–	–	–	(1,211.6)		0.28	(381.7)	–	0.60
(491.9)	(0.6)	–	–	(13,896.3)	**1.64**	0.80	(12,041.9)	1.85	1.01
(79.2)	131.2	5.1	10.0	588.6	**1.88**	0.21	654.7	1.29	0.17
442.3	**573.5**	**578.6**	**588.6**	**588.6**					

Exposure of the Bank and Consolidated Companies to Changes in Interest Rates as at December 31,

Comments

a. Additional information regarding the exposure to changes in interest rates by sector and according to balance sheet items will be provided by request.

b. In this table, the data by periods present the present value of future flows that were capitalized based on the interest rate that discounts them to the fair value that is included, in respect of the financial instrument, in the Note concerning Items Measured at Fair Value on a Recurring Basis, consistently with the assumptions according to which the fair value of the financial instrument was calculated. For more details regarding the assumptions that were used to calculate the fair value, see Note concerning Items Measured at Fair Value on a Recurring Basis.

c. The internal rate of return is the interest rate that discounts the projected cash flows from a financial instruments to the fair value thereof as included in the Note concerning Items Measured at Fair Value on a Recurring Basis.

d. The effective duration of a group of financial instruments constitutes a proximity to the change (%) in fair value that will result from a small change in the internal rate of return of each of the financial instruments.

Comprehensive Credit Risk to the Public by Economic Sectors – Consolidated

Reported amounts in millions of Shekels

Appendix E

	December 31, 2013								
	Comprehensive credit risk(1)		Debts (2) and off-balance sheet credit risk (excluding derivatives) (3)						
							Credit losses(4)		
	Total	Problematic (5)	Total*	of which*			Expenses due to credit losses	Accounting write-offs, net	Outstanding provision for credit losses
				Debts(2)	Problematic (5)	Defective			
Public – Commercial									
Agriculture	1.2	0.1	1.2	0.7	0.1	–	–	–	–
Industry	5.9	0.5	5.9	4.5	0.5	–	–	–	0.1
Construction and Real Estate – Construction(7)	1,633.2	67.8	1,633.2	1,026.8	67.8	42.9	(0.6)	0.2	7.1
Construction and Real Estate – Activity in Real Estate	418.3	15.3	418.3	398.4	15.3	4.0	2.6	0.3	2.4
Electricity and Water	0.9	-	0.9	0.9	-	-	-	-	-
Commerce	22.3	6.9	22.3	21.5	6.9	6.9	1.3	1.4	0.5
Hotels, Accommodation Services and Food	1.3	-	1.3	1.2	–	-	(1.3)	(1.3)	-
Transportation and Storage	36.8	0.6	36.8	36.4	0.6	0.3	-	-	0.4
Communication and Computer Services	0.5	-	0.5	0.5	-	-	-	-	-
Financial Services	33.0	-	32.6	31.0	-	-	-	-	0.2
Business and Other Services	55.6	1.1	55.5	37.0	0.4	0.1	0.1	0.1	0.2
Public and Community Services	14.2	0.1	13.0	10.9	0.1	0.1	-	-	0.1
Total Commercial	**2,223.2**	**92.4**	**2,221.5**	**1,569.8**	**91.7**	**54.3**	**2.1**	**0.7**	**11.0**
Private Individuals – Housing Loans	7,458.7	244.6	7,458.7	6,990.3	244.6	1.4	21.1	11.7	69.9
Private Individuals – Other	1,502.4	33.4	1,502.4	1,175.4	33.4	10.7	31.5	23.8	30.5
Total Public – Activity in Israel	**11,184.3**	**370.4**	**11,182.6**	**9,735.5**	**369.7**	**66.4**	**54.7**	**36.2**	**111.4**
Banks in Israel	23.5	-	-	-	-	-	-	-	-
Israeli Government	1,059.9	-	399.1	399.1	-	-	-	-	-
Total Activity in Israel	**12,267.7**	**370.4**	**11,581.7**	**10,134.6**	**369.7**	**66.4**	**54.7**	**36.2**	**111.4**
Banks abroad	4.2	–	-	-	-	-	-	-	-
Total	**12,271.9**	**370.4**	**11,581.7**	**10,134.6**	**369.7**	**66.4**	**54.7**	**36.2**	**111.4**

Comprehensive Credit Risk to the Public by Economic Sectors – Consolidated (continued)

Reported amounts in millions of Shekels

Appendix E (continued)

	December 31, 2012								
	Comprehensive credit risk(1)		Debts (2) and off-balance sheet credit risk (excluding derivatives) (3)						
							Credit losses(4)		
	Total	Problematic (5)	Total*	of which* Debts(2)	of which* Problematic (5)	of which* Defective	Expenses due to credit losses	Accounting write-offs, net	Outstanding provision for credit losses
Public – Commercial									
Agriculture	5.1	-	5.1	2.7	-	–	(0.1)	0.1	–
Industry	22.1	0.7	22.1	16.0	0.7	–	0.2	0.2	0.1
Construction and Real Estate – Construction(6)	1,798.7	79.7	1,798.7	1,167.0	79.7	57.2	1.8	1.1	7.9
Construction and Real Estate – Activity in Real Estate	421.1	19.5	421.1	377.1	19.5	13.0	0.1	–	0.1
Electricity and Water	0.9	–	0.9	0.9	–	–	–	–	–
Commerce	30.9	4.7	30.9	26.8	4.7	4.6	0.8	0.5	0.6
Hotels, Accommodation Services and Food	2.6	0.1	2.6	2.1	0.1	–	(0.2)	0.2	–
Transportation and Storage	52.6	0.5	52.6	51.9	0.5	–	0.2	0.3	0.4
Communication and Computer Services	4.2	–	1.1	1.0	–	–	–	–	–
Financial Services	45.8	–	45.4	38.0	–	–	0.2	–	0.2
Business and Other Services	36.6	1.1	35.3	31.3	0.1	–	0.3	0.2	0.2
Public and Community Services	14.7	0.2	13.3	10.4	0.2	0.2	–	–	0.1
Total Commercial	**2,435.3**	**106.5**	**2,429.1**	**1,725.2**	**105.5**	**75.0**	**3.3**	**2.6**	**9.6**
Private Individuals – Housing Loans	7,389.9	261.6	7,389.9	6,882.7	261.6	–	(1.8)	7.6	60.5
Private Individuals – Other	1,315.6	33.3	1,315.6	1,064.2	33.3	3.1	34.5	25.9	22.5
Total Public – Activity in Israel	**11,140.8**	**401.4**	**11,134.6**	**9,672.1**	**400.4**	**78.1**	**36.0**	**36.1**	**92.6**
Banks in Israel	177.9	–	141.8	141.8	–	–	–	–	–
Israeli Government	1,364.0	–	223.8	223.8	–	–	–	–	–
Total Activity in Israel	**12,682.7**	**401.4**	**11,500.2**	**10,037.7**	**400.4**	**78.1**	**36.0**	**36.1**	**92.6**
Banks abroad	24.5	–	23.1	23.1	–	–	–	–	–
Total	**12,707.2**	**401.4**	**11,523.3**	**10,060.8**	**400.4**	**78.1**	**36.0**	**36.1**	**92.6**

Comprehensive Credit Risk to the Public by Economic Sectors – Consolidated (continued)

(1) Balance sheet credit risk and off-balance sheet credit risk, including derivative instruments. Including: Debts – NIS 10,134.6 million, Debentures – NIS 672.9 million, Assets for derivative instruments – NIS 17.3 million and Credit risk in off-balance sheet financial instruments as calculated for purposes of the limits on the liability of a single borrower – NIS 1,447.1 million. (As at December 31, 2012: Debts – NIS 10,060.8 million, Debentures – NIS 1,163.0 million, Assets for derivative instruments – NIS 20.9 million and Credit risk in off-balance sheet financial instruments as calculated for purposes of the limits on the liability of a single borrower – NIS 1,462.5 million).

(2) Credit to the public, credit to governments, deposits in banks and other debts, excluding debentures and securities that were borrowed or purchased as part of repurchase agreements.

(3) Credit risk in off-balance sheet financial instruments as calculated for purposes of the limits on the liability of a single borrower, other than in respect of derivative instruments.

(4) Including credit losses in respect of off-balance sheet credit instruments (presented in the balance sheet in the Other Liabilities item).

(5) Balance sheet and off-balance sheet credit risk that is defective, subordinated or under special supervision, including in respect of housing loans for which a provision based on the depth of the arrears exists, and housing loans for which a provision based on the depth of the arrears doesn't exist, which are in arrears of 90 days or more.

(6) Balances lower than NIS 0.1 million are not presented in this Appendix.

(7) Including housing loans, that were provided to certain buying groups that are in the construction stage, of NIS 133.4 million (as at December 31 2012, NIS 157.8 million and NIS 192.8 million, respectively).

Consolidated Balance Sheets – Multi-quarter data as at the end of each quarter in the years 2012 and 2013

Reported amounts in millions of Shekels

Appendix F

	2013				2012			
	Quarter 4	Quarter 3	Quarter 2	Quarter 1	Quarter 4	Quarter 3	Quarter 2	Quarter 1
Assets								
Cash and deposits at banks	2,833.4	1,909.8	2,109.9	1,140.1	1,360.6	1,054.4	762.5	433.7
Securities	676.6	910.1	782.8	1,353.3	1,163.0	1,150.1	1,390.2	1,883.9
Credit to the public, net	9,626.6	9,683.2	9,608.1	9,650.4	9,581.4	9,487.9	9,441.4	9,166.7
Buildings and equipment	150.4	129.6	123.2	116.5	117.9	102.3	93.7	83.7
Intangible assets and goodwill	2.4	–	–	–	–	–	–	–
Assets for derivative instruments	21.7	19.4	19.3	15.4	20.9	12.3	4.9	11.4
Other assets	100.5	68.2	66.2	76.7	47.7	41.6	45.3	54.0
Total assets	**13,411.6**	**12,720.3**	**12,709.5**	**12,352.4**	12,291.5	11,848.6	11,738.0	11,633.4
Liabilities and shareholders' equity								
Deposits from the public	11,071.1	10,402.2	10,348.9	9,958.9	9,813.7	9,605.2	9,533.5	9,283.5
Deposits from banks	51.5	58.2	59.6	61.1	63.3	71.1	72.8	73.5
Government deposits	0.7	–	2.2	0.3	–	–	1.3	1.9
Securities that were lent or sold as part of repurchase agreements	27.5	–	–	–	–	–	–	–
Debentures and deferred liability notes	1,406.0	1,434.1	1,485.5	1,509.2	1,581.0	1,400.8	1,369.4	1,538.2
Liabilities for derivative instruments	12.3	14.0	11.7	21.5	16.4	13.1	19.2	5.0
Other liabilities	145.3	120.9	107.9	102.9	123.0	72.2	67.7	71.4
Total liabilities	**12,714.4**	**12,029.4**	**12,015.8**	**11,653.9**	11,597.4	11,162.4	11,063.9	10,973.5
Shareholders' equity	697.2	690.9	693.7	698.5	694.1	686.2	674.1	659.9
Total liabilities and shareholders' equity	**13,411.6**	**12,720.3**	**12,709.5**	**12,352.4**	12,291.5	11,848.6	11,738.0	11,633.4

Consolidated Profit and Loss Statements – Multi-quarter data for the years 2012 and 2013

Reported amounts in millions of Shekels

Appendix G

	2013				2012			
	Quarter 4	Quarter 3	Quarter 2	Quarter 1	Quarter 4	Quarter 3	Quarter 2	Quarter 1
Interest income	113.0	165.1	143.5	121.6	102.7	154.7	170.4	127.9
Interest expenses	46.8	98.1	78.9	62.2	42.9	95.6	112.7	73.6
Interest income, net	**66.2**	**67.0**	**64.6**	**59.4**	**59.8**	**59.1**	**57.7**	**54.3**
Expenses from credit losses	7.7	9.3	29.1	8.6	15.8	10.7	6.3	3.2
Interest income, net after expenses from credit losses	**58.5**	**57.7**	**35.5**	**50.8**	**44.0**	**48.4**	**51.4**	**51.1**
Non-interest income								
Non-interest financing income	4.1	(0.4)	8.5	2.0	5.4	3.2	10.2	3.8
Commissions	24.7	22.1	22.3	22.3	21.9	22.3	22.7	23.3
Other income	0.2	–	–	0.7	0.2	0.2	0.1	0.1
Total non-interest income	**29.0**	**21.7**	**30.8**	**25.0**	**27.5**	**25.7**	**33.0**	**27.2**
Operating and other expenses								
Salaries and related expenses	35.4	36.6	36.7	37.4	36.1	33.9	35.4	32.4
Maintenance and depreciation of buildings and equipment	15.8	15.0	14.2	13.2	12.9	11.6	11.6	10.8
Other expenses	23.3	20.4	21.1	17.3	20.0	15.3	16.7	17.8
Total operating and other expenses	**74.5**	**72.0**	**72.0**	**67.9**	**69.0**	**60.8**	**63.7**	**61.0**
Profit before taxes	**13.0**	**7.4**	**(5.7)**	**7.9**	**2.5**	**13.3**	**20.7**	**17.3**
Provision for taxes	4.6	1.0	(2.5)	2.3	(0.1)	5.1	6.6	6.1
Net profit	**8.4**	**6.4**	**(3.2)**	**5.6**	**2.6**	**8.2**	**14.1**	**11.2**
Earnings per share (in NIS)								
Basic and diluted net earnings per share (NIS)	**0.12**	**0.09**	**(0.05)**	**0.08**	**0.51**	**0.12**	**0.20**	**0.16**

Certification

I, Uriel Paz, hereby declare that:

1. I reviewed the annual report of the Bank of Jerusalem Ltd. (hereinafter: the "Bank") for the year 2013 (hereinafter: the "Report").

2. Based on my knowledge, the Report neither includes any misrepresentation of any material fact, nor omits any representation of any material fact required so that the representations included in it, in view of the circumstances under which such representations were included, would not be misleading in respect of the period covered in the Report.

3. Based on my knowledge, the Financial Statements and other financial information included in the Report, present fairly, in all material respects, the Bank's financial position, results of operations, changes in shareholders' equity and cash flows for the dates and the periods presented in the Report.

4. I am, along with others in the Bank making this statement, responsible for the establishment and implementation of controls and procedures with regards to disclosure and for the internal control of the Bank over financial reporting. Additionally:

    a. We established such controls and procedures, or caused the establishment under our supervision of such controls and procedures, designed to ensure that material information pertaining to the Bank, including its consolidated corporations, is brought to our knowledge by others in the Bank and in said corporations, particularly during the preparation of the Report;

    b. We established such internal control over financial reporting, or caused the establishment under our supervision of such internal control over financial reporting, designed to provide reasonable assurance regarding the reliability of the financial reporting, and that the Financial Statements for external purposes are prepared in compliance with generally accepted accounting principles and the instructions of the Supervisor of Banks and the directives thereof;

    c. We evaluated the effectiveness of the controls and procedures with regards to the disclosure of the Bank and presented in the Report our conclusions in respect of the effectiveness of the controls and procedures with regards to disclosure; as at the end of the period covered in the Report based on our evaluation; additionaly

    d. We disclosed in the Report any change in the Bank's internal control over financial reporting that occurred in quarter 4 that impacted materially, or that is reasonably expected to significantly impact, the Bank's internal control over financial reporting; additionaly

5. As generally accepted and with the approval of the Supervisor of Banks from February 2, 2014, my evaluation and the evaluation of others in the Bank who are making this statement regarding the effectiveness of the internal control over financial reporting do not include the components of internal control over financial reporting pertaining to the "Clal Finance Batucha Investment Management Ltd." operation, whose acquisition by the Bank was completed on December 15, 2013, and that was merged into the Bank on December 22, 2013. The assets and revenues of Clal Finance Batucha Investment Management Ltd. constitute approximately 2.79% and approximately 0.3%, respectively, of the total assets and revenues in the Consolidated Financial Statements as at December 31, 2013 and for the year then ended.

6. I and others at the Bank who are making this statement disclosed to the independent auditor, to the Board of Directors and to the Board of Directors Audit Committee of the Bank, based on our latest evaluation with regards to the internal control over financial reporting:

   a. All significant deficiencies and material weaknesses in the establishment or implementation of the internal control over financial reporting that are reasonably expected to adversely impact the Bank's ability to record, process, sum-up and report financial information; as well as

   b. Any deception, material or immaterial, involving the management or other employees whith a significant role in the Bank's internal control over financial reporting.

Nothing in the foregoing shall derogate from my responsibility or from the responsibility of any other person, under any law.

Uriel Paz

CEO

February 27, 2014

Certification

I, Alexander Zaltsman, hereby declare that:

1. I reviewed the annual report of the Bank of Jerusalem Ltd. (hereinafter: the "Bank") for the year 2013 (hereinafter: the "Report").

2. Based on my knowledge, the Report neither includes any misrepresentation of any material fact, nor omits any representation of any material fact required so that the representations included in it, in view of the circumstances under which such representations were included, would not be misleading in respect of the period covered in the Report.

3. Based on my knowledge, the Financial Statements and other financial information included in the Report, present fairly, in all material respects, the Bank's financial position, results of operations, changes in shareholders' equity and cash flows for the dates and the periods presented in the Report.

4. I am, along with others in the Bank making this statement, responsible for the establishment and implementation of controls and procedures with regards to disclosure and for the internal control of the Bank over financial reporting. Additionally:

    a. We established such controls and procedures, or caused the establishment under our supervision of such controls and procedures, designed to ensure that material information pertaining to the Bank, including its consolidated corporations, is brought to our knowledge by others in the Bank and in said corporations, particularly during the preparation of the Report;

    b. We established such internal control over financial reporting, or caused the establishment under our supervision of such internal control over financial reporting, designed to provide reasonable assurance regarding the reliability of the financial reporting, and that the Financial Statements for external purposes are prepared in compliance with generally accepted accounting principles and the instructions of the Supervisor of Banks and the directives thereof;

    c. We evaluated the effectiveness of the controls and procedures with regards to the disclosure of the Bank and presented in the Report our conclusions in respect of the effectiveness of the controls and procedures with regards to disclosure; as at the end of the period covered in the Report based on our evaluation; additionaly

    d. We disclosed in the Report any change in the Bank's internal control over financial reporting that occurred in quarter 4 that impacted materially, or that is reasonably expected to significantly impact, the Bank's internal control over financial reporting; additionaly

5. As generally accepted and with the approval of the Supervisor of Banks from February 2, 2014, my evaluation and the evaluation of others in the Bank who are making this statement regarding the effectiveness of the internal control over financial reporting do not include the components of internal control over financial reporting pertaining to the "Clal Finance Batucha Investment Management Ltd." operation, whose acquisition by the Bank was completed on December 15, 2013, and that was merged into the Bank on December 22, 2013. The assets and revenues of Clal Finance Batucha Investment Management Ltd. constitute approximately 2.79% and approximately 0.3%, respectively, of the total assets and revenues in the Consolidated Financial Statements as at December 31, 2013 and for the year then ended.

6. I and others at the Bank who are making this statement disclosed to the independent auditor, to the Board of Directors and to the Board of Directors Audit Committee of the Bank, based on our latest evaluation with regards to the internal control over financial reporting:

    a. All significant deficiencies and material weaknesses in the establishment or implementation of the internal control over financial reporting that are reasonably expected to adversely impact the Bank's ability to record, process, sum-up and report financial information; as well as

    b. Any deception, material or immaterial, involving the management or other employees whith a significant role in the Bank's internal control over financial reporting.

Nothing in the foregoing shall derogate from my responsibility or from the responsibility of any other person, under any law.

Alexander Zaltsman

Vice CEO, Manager of Financial Department
and Chief Accountant

February 27, 2014

Report of the Board of Directors and management concerning the internal control over financial reporting

The Board of Directors and management of the Bank of Jerusalem Ltd. (hereinafter: the "Bank") are responsible for the establishment and implementation of adequate internal control over financial reporting (as the definition thereof in the provisions for reporting to the public concerning the "Board of Directors Report". The Bank's internal control system was designed to provide reasonable assurance to the Bank's Board of Directors and management with regards to the adequate preparation and presentation of financial statements published in accordance with generally accepted accounting principles and the provisions and directives of the Supervisor of Banks. Regardless of the nature of their level of planning, every internal control system has built-in limitations. Subsequently, even if the determination is made that these systems are effective, they can only provide a reasonable degree of assurance with regards to the preparation and presentation of a financial statement.

Management, under the supervision of the Board of Directors, maintains a comprehensive system of controls designed to ensure that transactions are carried out in compliance with management's authorizations, that assets are protected, and that accounting records are reliable. Furthermore, management, under the supervision of the Board of Directors, adopts measures to ensure that the channels of information and communication are effective and monitor perfomce, including performance of internal control procedures.

The management of the Bank, under the supervision of the Board of Directors, evaluated the effectiveness of the Bank's internal control over financial reporting as at December 31, 2013, based on the criteria that were determined in the internal control model of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, management believes that as at December 31, 2013, the Bank's internal control over financial reporting is effective.

In accordance with the approval of the Supervisor of Banks from February 2, 2014, management's evaluation regarding the effectiveness of the internal control over financial reporting does not include the components of internal control over financial reporting pertaining to the "Clal Finance Batucha Investment Management Ltd." operation, whose acquisition by the Bank was completed on December 15, 2013, and that was merged into the Bank on December 22, 2013.

The effectiveness of the Bank's internal control over financial reporting as at December 31, 2013 was audited by the independent auditors of the Bank, "Kost Forer Gabbay & Kasierer", as is stated in their report on page 218, in which an unqualified opinion was included concerning the effectiveness of the Bank's internal control over financial reporting as at December 31, 2013. It should be noted that their audit did not address the components of internal control over financial reporting pertaining to the "Clal Finance Batucha Investment Management Ltd." operation.

February 27, 2014

Zeev Gutman	Uriel Paz	Alexander Zaltsman
Chairman of the Board of Directors	CEO	Vice CEO, Manager of Financial Department and Chief Accountant

Financial Statements

Financial Statement for 2013

Bank of Jerusalem Ltd. and its consolidated companies

Financial Statements

Kost Forer Gabbay & Kasierer.
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Independent Auditor's Report to the Shareholders of the Bank of Jerusalem Ltd. - Annual Financial Statements

We have audited the accompanying balance sheets of the Bank of Jerusalem Ltd. (hereinafter - the Bank) as at December 31, 2013 and 2012, and the consolidated balance sheets as at the same dates and the Statements of Profit and Loss, the Statements of Comprehensive Income, the Statements of Changes in Shareholders' Equity, and the Statements of Cash Flows – of the Bank and consolidated – for each of the three years in the period ended on December 31, 2013. These financial statements are the responsibility of the Bank's Board of Directors and Management. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in Israel, including those prescribed by the Israeli Auditors (Auditor's Mode of Performance) Regulations 5733-1973 and certain auditing standards whose application in the auditing of banking corporations was set forth in the instructions and guidelines of the Supervisor of Banks. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and information in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Bank's Board of Directors and Management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the aforementioned financial statements present fairly, in all material respects, the financial position - of the Bank and consolidated – as at December 31, 2013 and 2012 and the results of operations, changes in shareholders' equity and cash flows - of the Bank and consolidated - for each of the three years in the period ended on December 31, 2013, in accordance with generally accepted accounting principles in Israel (Israeli GAAP). Moreover, in our opinion, the aforesaid financial statements are prepared in accordance with the instructions and guidelines of the Supervisor of Banks.

We have also audited, in accordance with the standards of the American Public Company Accounting Oversight Board (PCAOB) concerning the audit of internal control over financial reporting, as adopted by the Institute of Certified Public Accountants in Israel, the Bank's internal control over financial reporting as at December 31, 2013, based on criteria that were established in the Integrated Framework for Internal Control published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 27, 2014 included an unqualified opinion on the effectiveness of the Bank's internal control over financial reporting.

Kost Forer Gabbay & Kasierer.
Accountants

Tel Aviv,
February 27, 2014

Kost Forer Gabbay & Kasierer.
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Tel Aviv 67067

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Independent Auditor's Report to the Shareholders of Bank of Jerusalem Ltd. - In accordance with the Instructions for Reporting to the Public of the Supervisor of Banks concerning Internal Control over Financial Reporting

We have audited the internal control over financial reporting of the Bank of Jerusalem Ltd. and subsidiaries (hereinafter together: the Bank) as at December 31, 2013, based on the criteria that were determined in the Integrated Framework for Internal Control published by the Committee of Sponsoring Organizations of the Treadway Commission (hereinafter: COSO). The Board of Directors and Management of the Bank are responsible for the existence of effective internal control over financial reporting, and for their assessment of the effectiveness of internal control over financial reporting, as included in the accompanying Report of the Board of Directors and Management on the Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Bank's internal control over financial reporting, based on our audit.

As pointed out in the assessment of the effectiveness by the Board of Directors and Management, said assessment does not refer to components of internal control over financial reporting in Clal Finance Batucha Investment Management Ltd., which was acquired on December 15, 2013 and whose assets and revenues constitute approx. 2.79% and approx. 0.3%, respectively, of the total assets and revenues in the consolidated financial statements as at December 31, 2013 and for the year then ended. Accordingly, our audit too did not refer to components of internal control over financial reporting in Clal Finance Batucha Investment Management Ltd.

We conducted our audit in accordance with the standards of the American Public Company Accounting Oversight Board (PCAOB) concerning the audit of internal control over financial reporting, as adopted by the Institute of Certified Public Accountants in Israel. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and examining and assessing the effectiveness of the design and operation of internal control based on the assessed risk. Our audit also included the application of other procedures we deemed necessary according to the circumstances. We believe that our audit provides a reasonable basis for our opinion.

The Bank's internal control over financial reporting is a process designed to provide reasonable assurance concerning the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and the instructions and directives of the Supervisor of Banks. A Bank's internal control over financial reporting includes those policies and procedures that: (1) relate to the maintenance of records that, with reasonable detail, accurately and fairly reflect the Bank's transactions and transfers of assets (including the disposition thereof); (2) provide reasonable assurance that transactions are recorded as necessary in order to enable preparation of financial statements in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and in accordance with the instructions and directives of the Supervisor of Banks, and that receipts and expenditures of the Bank are made only in accordance with authorizations the Bank's Board of Directors and Management; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or transfer (including disposition) of the Bank's assets that could materially affect the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Moreover, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become unsuitable due to changes in circumstances or that the degree of compliance which the policies or procedures may deteriorate.

In our opinion, the Bank maintained, in all material respects, effective internal control over financial reporting as at December 31, 2013, based on the criteria that were established in Integrated Framework for Internal Control published by COSO.

We have also audited, in accordance with generally accepted auditing standards in Israel, and certain auditing standards whose application in the auditing of banking corporations was set forth in the instructions and guidelines of the Supervisor of Banks, the balance sheets – of the Bank and consolidated – as at December 31, 2013 and 2012, and the statements of income, the statements of comprehensive income, the statements of changes in shareholders' equity and the statements of cash flows – of the Bank and consolidated - for each of the three years in the period ended on December 31, 2013, and our report from February 27, 2014 included an unqualified opinion on those financial statements.

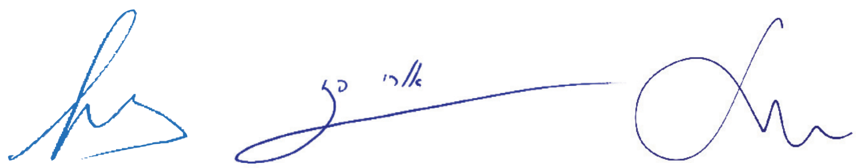
Tel Aviv,
February 27, 2014

Kost Forer Gabbay & Kasierer.
Accountants

Balance Sheets

Reported amounts in millions of Shekels

		Consolidated		Bank	
		December 31,			
	Note	2013	2012	2013	2012
Assets					
Cash and deposits at banks	3	**2,833.4**	1,360.6	**2,833.4**	1,359.9
Securities (1)	4	**676.6**	1,163.0	**680.5**	1,184.7
Credit to the public		**9,735.5**	9,672.1	**9,735.5**	9,672.1
Provision for credit losses		**(108.9)**	(90.7)	**(108.9)**	(90.7)
Credit to the public, net	5	**9,626.6**	9,581.4	**9,626.6**	9,581.4
Investments in investee companies	7	**-**	–	**380.6**	364.7
Buildings and equipment	8	**150.4**	117.9	**18.2**	19.5
Intangible assets and goodwill	8a	**2.4**	–	**2.4**	–
Assets for derivative instruments	20	**21.7**	20.9	**21.7**	20.9
Other assets	9	**100.5**	47.7	**91.0**	43.0
Total assets		**13,411.6**	12,291.5	**13,654.4**	12,574.1
Liabilities and shareholders' equity					
Deposits from the public	10	**11,071.1**	9,813.7	**12,196.8**	11,189.2
Deposits from banks	11	**51.5**	63.3	**51.5**	63.3
Government deposits		**0.7**	–	**0.7**	–
Securities that were lent or sold as part of repurchase agreements		**27.5**	–	**27.5**	–
Debentures and deferred liability notes	12	**1,406.0**	1,581.0	**541.8**	498
Liabilities for derivative instruments	20	**12.3**	16.4	**12.3**	16.4
Other liabilities (2)	13	**145.3**	123.0	**126.6**	113.1
Total liabilities		**12,714.4**	11,597.4	**12,957.2**	11,880.0
Shareholders' equity	16a	**697.2**	694.1	**697.2**	694.1
Total liabilities and shareholders' equity		**13,411.6**	12,291.5	**13,654.4**	12,574.1



Zeev Gutman	**Uriel Paz**	**Alexander Zaltsman**
Chairman of the Board of Directors	CEO	Vice CEO, Manager of Financial Department and Chief Accountant

Date of approval of the Financial Statements: February 27, 2014

(1) Out of which, as at December 31, 2013 and December 31, 2012, NIS 40.9 million and NIS 169.5 million, the Bank and consolidated respectively, were encumbered to lenders. For details on securities measured at fair value, see Note on Securities.

(2) Out of which, as at December 31, 2013 and December 31, 2012, NIS 2.5 million and NIS 1.9 million, the Bank and consolidated respectively, are a provision for credit losses in respect of off-balance credit instruments.

The Notes to the Financial Statements are an integral part thereof.

Statements of Profit and Loss

Reported amounts in millions of NIS

		Consolidated			Bank		
		For the year ended on December 31,					
	Note	**2013**	**2012**	**2011(1)**	**2013**	**2012**	**2011(1)**
Interest income	23	**543.2**	555.7	559.0	**546.4**	562.0	564.5
Interest expenses	23	**286.0**	324.8	384.2	**293.1**	337.8	398.2
Interest income, net		**257.2**	230.9	174.8	**253.3**	224.2	166.3
Expenses from credit losses	5	**54.7**	36.0	*15.1	**54.7**	36.0	*15.1
Interest income, net after expenses from credit losses		**202.5**	194.9	159.7	**198.6**	188.2	151.2
Non-interest income							
Non-interest financing income	24	**14.2**	22.6	6.1	**13.7**	22.1	6.8
Commissions	25	**91.4**	90.2	91.9	**82.3**	81.3	81.9
Other income	26	**0.9**	0.6	25.5	**-**	0.1	0.1
Total non-interest income		**106.5**	113.4	123.5	**96.0**	103.5	88.8
Operating and other expenses							
Salaries and related expenses	27	**146.1**	137.8	134.1	**131.0**	123.2	122.6
Maintenance and depreciation of buildings and equipment		**58.2**	46.9	37.6	**35.7**	33.6	27.4
Other expenses	28	**82.1**	69.8	*51.4	**119.1**	98.8	*67.8
Total operating and other expenses		**286.4**	254.5	223.1	**285.8**	255.6	217.8
Profit before taxes		**22.6**	53.8	60.1	**8.8**	36.1	22.2
Provision for taxes	29	**5.4**	17.7	14.6	**2.9**	15.0	8.0
Profit after tax		**17.2**	36.1	45.5	**5.9**	21.1	14.2
Bank's share in profits of investee companies, net of tax effect		**-**	–	–	**11.3**	15.0	31.3
Net profit		**17.2**	36.1	45.5	**17.2**	36.1	45.5
Earnings per share (in NIS)							
Basic and diluted net earnings per share (NIS)		**0.24**	0.51	0.65	**0.24**	0.51	0.65

(1) The comparative data for the year 2011 in this Statement were re-classified and re-sorted following the instruction issued by the Supervisor of Banks concerning adoption of the new format for the Profit and Loss Statement. For details, see Note on Accounting Policies, section aa. It should be noted that in the year 2011, the Other Income item included a gain from the sale of the Bank's administrative building in the amount of NIS 25.4 million, and the Tax Expenses item included an amount of NIS 4.6 million. For details, see Note 8 – Buildings and Equipment

* Reclassified

The Notes to the Financial Statements are an integral part thereof

Consolidated Statement of Comprehensive Income

Reported amounts in millions of NIS

	For the year ended on December 31,		
	2013	**2012**	**2011**
Net profit	**17.2**	36.1	45.5
Other comprehensive income:			
Adjustments due to the presentation of securities available for sale at fair value, net	**(1.2)**	19.3	(4.3)
Related tax effect	**0.4**	(6.6)	1.6
Other comprehensive income (loss) after taxes	**(0.8)**	12.7	(2.7)
Total comprehensive income	**16.4**	48.8	42.8

The Notes to the financial statements are an integral part thereof.

Statement of Changes in Shareholders' Equity

Reported amounts in millions of NIS

		Capital reserves					
	Outstanding share capital	From premium	From benefit from share-based payment transactions	Total outstanding share capital and capital reserves	Cumulative other comprehensive income (loss)	Accumulated retained earnings	Total shareholders' equity
Balance as at January 1, 2011	127.3	95.3	–	222.6	(8.9)	419.5	633.2
The after-tax cumulative effect of the first time implementation, on January 1, 2011, of the instruction concerning measurement of defective debts and provision for credit losses.						(9.5)	(9.5)
Net profit	–	–	–	–	–	45.5	45.5
Dividend	–	–	–	–	–	(25.0)	(25.0)
Adjustments and changes resulting from:							
Benefit from share-based payment transactions	–	–	3.1	3.1	–	–	3.1
Other comprehensive income, net of tax effect	–	–	–	–	(2.7)	–	(2.7)
Balance as at January 1, 2012	127.3	95.3	3.1	225.7	(11.6)	430.5	644.6
Net profit	–	–	–	–	–	36.1	36.1
Adjustments and changes resulting from:							
Benefit from share-based payment transactions	–	–	0.7	0.7	–	–	0.7
Other comprehensive income, net of tax effect	–	–	–	–	12.7	–	12.7
Balance as at January 1, 2013	**127.3**	**95.3**	**3.8**	**226.4**	**1.1**	**466.6**	**694.1**
Net profit	**–**	**–**	**–**	**–**	**–**	**17.2**	**17.2**
Dividend	**–**	**–**	**–**	**–**	**–**	**(13.7)**	**(13.7)**
Adjustments and changes resulting from:							
Benefit from share-based payment transactions	**–**	**–**	**0.4**	**0.4**	**–**	**–**	**0.4**
Other comprehensive income, net of tax effect	**–**	**–**	**–**	**–**	**(0.8)**	**–**	**(0.8)**
Balance as at December 31, 2013	**127.3**	**95.3**	**4.2**	**226.8**	**0.3**	**470.1**	**697.2**

The Notes to the Financial Statements are an integral part thereof.

Statements of Cash Flows

Reported amounts in millions of NIS

	Consolidated			Bank		
	For the year ended on December 31,					
	2013	2012	2011	2013	2012	2011
Cash flows from operating activities						
Net profit	**17.2**	36.1	45.5	**17.2**	36.1	45.5
Adjustments:						
The banking corporation's share in undistributed profits of investee companies.	**-**	-	-	**(11.3)**	(15.0)	(31.3)
Depreciation of buildings and equipment	**26.8**	17.7	13.0	**2.1**	2.3	2.4
Expenses from credit losses	**54.7**	36.0	15.1	**54.7**	36.0	15.1
Loss (profit) from sale of securities available for sale	**(19.0)**	(41.3)	(36.8)	**(15.5)**	2.2	(46.3)
Realized and unrealized profit from fair value adjustments of securities for trade	**(9.2)**	(20.2)	(7.7)	**(9.4)**	(21.8)	(7.7)
Gain from sale of buildings and equipment	**-**	-	(20.8)	**-**	-	-
Expenses resulting from share-based payment transactions	**0.4**	0.7	0.8	**0.4**	0.7	0.8
Deferred taxes, net	**(11.3)**	(18.4)	(4.0)	**(11.3)**	(17.6)	(4.4)
Severance pay – increase in excess of reserve over fund (increase in excess of fund over reserve)	**0.5**	(5.7)	4.7	**1.0**	(5.8)	5.0
Net change in current assets:						
Credit to the public	**(90.3)**	(559.6)	(1,052.1)	**(90.3)**	(559.6)	(1,052.1)
Assets for derivative instruments	**(0.8)**	(13.7)	16.7*	**(0.8)**	(13.7)	16.7*
Securities for trade	**199.2**	(72.0)	(181.9)	**205.1**	(72.0)	(184.1)
Other assets	**(17.8)**	19.0	(6.3)*	**(17.6)**	5.9	(5.2)*
Net change in current liabilites:						
Deposits from banks	**(11.8)**	(12.9)	(10.3)	**(11.8)**	(12.9)	(10.3)
Deposits from the public	**1,249.8**	749.1	1,656.8	**1,000.0**	672.2	1,429.6
Government deposits	**0.7**	(0.8)	(4.1)	**0.7**	(0.8)	(4.1)
Securities that were lent or sold as part of repurchase agreements	**13.4**	-	-	**13.4**	-	-
Liabilities for derivative instruments	**(4.1)**	1.4	4.3*	**(4.1)**	1.4	4.3*
Other liabilities	**57.2**	92.2	102.7*	**11.1**	37.1	30.8*
Net cash from operating activities	**1,455.6**	207.6	535.6	**1,133.6**	74.7	204.7

* Reclassified

The Notes to the Financial Statements are an integral part thereof.

Statements of Cash Flows (Continued)

Reported amounts in millions of NIS

	Consolidated			Bank		
	For the year ended on December 31,					
	2013	2012	2011	2013	2012	2011
Cash flows from investing activities						
Acquisition of securities available for sale	**(2,417.5)**	(2,423.4)	(1,260.3)	**(2,023.5)**	(2,205.0)	(1,372.3)
Consideration from the sale of securities available for sale	**2,408.2**	2,877.3	1,190.3	**2,003.2**	2,676.4	1,148.0
Consideration from the redemption of securities available for sale	**337.4**	26.6	116.3	**357.0**	26.6	144.1
Acquisition of Clal Batucha operation (Appendix A)	**(12.4)**	–	–	**(12.4)**	–	–
Acquisition of buildings and equipment	**(44.4)**	(48.7)	(45.3)	**-**	–	(1.2)
Consideration from sale of buildings and equipment	**-**	–	34.7	**-**	–	–
Net cash from investing activities	**271.3**	431.8	35.7	**324.3**	498	(81.4)
Cash flows from financing activities						
Issuance of debentures and deferred liability notes	**60.6**	296.9	104.3	**60.6**	78.7	104.3
Redemption of debentures and deferred liability notes	**(301.0)**	(368.0)	(510.6)	**(31.3)**	(83.3)	(62.7)
Dividends paid to shareholders	**(13.7)**	–	(25.0)	**(13.7)**	–	(25.0)
Net cash from financing activities	**(254.1)**	(71.1)	(431.3)	**15.6**	(4.6)	16.6
Effect of fluctuations in exchange rates on cash balances	**5.3**	(7.4)	0.9	**5.3**	(7.4)	0.9
Increase in cash and deposits at banking corporations	**1,467.5**	575.7	139.1	**1,468.2**	575.5	139.0
Balance of cash and deposits at banking corporations at the beginning of the year	**1,360.6**	792.3	652.3	**1,359.9**	791.8	651.9
Balance of cash and deposits at banking corporations at the end of the year	**2,833.4**	1,360.6	792.3	**2,833.4**	1,359.9	791.8
Interest and taxes paid and/or received:						
Interest received	**784.5**	833.4	797.8	**784.5**	833.4	797.8
Interest paid	**441.0**	329.2	346.7	**441.0**	329.2	346.7
Income taxes paid	**14.8**	10.3	25.4	**10.9**	10.3	25.4
Taxes received	**10.2**	7.7	5.1	**9.0**	7.7	5.1

The Notes to the Financial Statements are an integral part thereof.

Statements of Cash Flows (Continued)

Reported amounts in millions of NIS

	Consolidated			Bank		
	For the year ended on December 31,					
	2013	2012	2011	2013	2012	2011
Appendix A – Acquisition of subsidiaries that were consolidated for the first time						
Assets and liabilities, and cash flows for the acquisition of Clal Batucha operation as at the day of the acquisition:						
Cash acquired	(244.5)	-	-	(244.5)	-	-
Identified assets (excluding cash and cash equivalents)	(99.2)	-	-	(99.2)	-	-
Liabilities	87.2	-	-	87.2	-	-
Identified assets and liabilities	**(256.5)**	-	**-**	**(256.5)**	**-**	**-**
Goodwill	(0.4)			(0.4)		
Total cost of acquisition	**(256.9)**	-	-	**(256.9)**	-	-
Consideration paid in cash	(256.9)	-	-	(256.9)	-	-
Less – cash acquired	244.5			244.5		
Total inflow of cash from the acquisition of the operation	(12.4)	-	-	(12.4)	-	-

Appendix B – Non-cash investment activities during the reporting period						
Acquisition of fixed assets on credit	**14.4**	7.2	-	**-**	-	-

The Notes to the Financial Statements are an integral part thereof.

Notes on Financial Statements

Annual Report for 2013

Bank of Jerusalem Ltd. and consolidated companies

Note 1 – General

Bank of Jerusalem Ltd. (hereinafter: the "Bank") is a commercial bank that engages primarily in granting housing credit and other retail credit, financing housing construction projects, as well as in raising time deposits, activities in the capital market, current account management, and provision of private banking services to foreign residents.

The Bank is a subsidiary of Export Investment Corporation Ltd. (hereinafter: "Export") and its shares are listed for trade on the Tel-Aviv Stock Exchange.

The Financial Statements of the Bank are prepared in accordance with generally accepted accounting principles in Israel (Israeli GAAP), and in accordance with the instructions and guidelines of the Supervisor of Banks concerning the preparation of a bank's annual financial report.

Note 2 – Accounting Policies

The significant accounting policies that are implemented during the the preparation of the Financial Statements in a consistent manner and in accordance with the instructions and guidelines of the Supervisor of Banks are:

1. Reporting Base of the Financial Statements

1. In the past, the Bank prepared its Financial Statements on the basis of the historical cost adjusted to the Consumer Price Index. The adjusted amounts, as aforementioned, which were included in the Financial Statements as at December 31, 2003, were used as a starting point for nominal financial reporting effective as of January 1, 2004. Additions made after the transition date were included in nominal values. According to Accounting Standard Number 12 concerning "Discontinuance of Adjustment of Financial Statements," the adjustment of the Financial Statements for inflation was discontinued as at December 31, 2003, and from such date the Bank begun to report in reported amounts. The amounts of non-monetary financial assets do not necessarily represent realization values or current economic values, but only the reported amounts of such assets.

   In these Financial Statements, the meaning of "cost" is cost in reported amounts.

   A summary of the Bank's data in historical nominal values for tax purposes is provided in Note 32.

2. Principles of Consolidation

Note 2 – Accounting Policies (continued)

a. The Bank's consolidated Financial Statements include the financial statements of companies over which the Bank has control. Inter-company balances and transactions between the Bank and its subsidiaries were canceled in the consolidated Financial Statements. In the Bank's separate Financial Statements, investments in investee companies are presented by the equity method of accounting.

b. Business combinations:

A business combination occurs when a banking corporation acquires for the first time control over a subsidiary or separate operation. The Bank accounts for business combinations by the acquisition method. According to this method, the Bank identifies the acquirer, sets the acquisition date and recognizes the identifiable assets that were acquired and the liabilities that were assumed based on their fair value, apart from certain exceptions. All components of rights that do not grant control of the acquired entity are measured on the date of acquisition at fair value as at the date of acquisition, unless another measurement basis is required according to International Financial Reporting Standards.

The Bank recognizes goodwill on the date of acquisition as the excess of the total consideration that was transferred and the amount of rights that do not grant control, over the net amount as at the acquisition date of identifiable assets that were acquired and of liabilities assumed. In consecutive periods, goodwill is measured at cost less accumulated losses from impairment. If a gain must be recognized from an acquisition at opportunity cost, based on the gap between the net amount on the acquisition date of the identifiable assets that were acquired and of liabilities assumed (apart from certain exceptions), and the total consideration that was transferred and the amount of rights that do not grant control, the Bank must contact the Supervisor of Banks to obtain preliminary instructions.

The Bank measures the consideration that was transferred based on the fair values of assets that were delivered, liabilities that were assumed (apart from certain exceptions) and capital instruments that were issued. Any costs that can be attributed to the business combination are recognized as an expense during the period in which they were incurred, with the exception of costs for issuing capital or debt instruments of the Bank.

The Bank recognized the fair value of the assets that were acquired and the liabilities that were assumed as part of the business combination based on a provisional measurement. As of the date of approval of the Financial Statements, the final appraisal had not been received from the external value appraiser with regards to the fair value of the identified assets that were acquired and the liabilities that were assumed. The fair value of the assets and liabilities that were acquired are subject to final adjustment up to 12 months from the date of acquisition. According to International Reporting Standard Number 3 regarding Business Combinations, on the date of the final measurement, the adjustments are made by way of restatement of the comparative data that were reported in the past based on the provisional measurement.

3. Functional Currency and Presentation Currency

The functional currency and presentation currency of the Bank and of its subsidiaries is the New Israeli Shekel.

2. Foreign currency and linkage

Assets and liabilities in foreign currency or that are linked to foreign currencies and those that are linked to the Consumer Price Index are included in the Financial Statements as follows:

1. Those that are linked to the Consumer Price Index are presented according to the known index on the balance sheet date.

2. Those that are in foreign currency or that are linked to a foreign currency are presented according to the representative exchange rates published by the Bank of Israel as at the balance sheet date, except when otherwise prescribed by the terms of the agreement.

Below are the details on the Consumer Price Index and representative exchange rate of the US dollar and the rate of their increases (decreases):

	As at December 31,			Rate of increase (decrease) in the year		
	2013	2012	2011	2013	2012	2011
				In percentages		
Exchange rate of the US Dollar (NIS)	3.471	3.733	3.821	-7.0	-2.3	7.7
Consumer Price Index – Basis 1993 (points):						
November	223.6	219.4	216.3	1.9	1.6	2.5
December	223.8	219.8	216.3	1.8	1.4	2.2

Note 2 – Accounting Policies (continued)

3. Principles for preparing the Financial Statements:

Accounting Standard Number 29 – "Adoption of International Financial Reporting Standards IFRS"

In June 2009, the Supervisor of Banks published a circular on "Reporting of Banking Corporations and Credit Card Companies in Israel in accordance with International Financial Reporting Standards (IFRS)", that established the expected mode of adoption of the International Financial Reporting Standards (IFRS) by banking corporations and credit card companies.

According to the circular, the target date for reporting of banking corporations and credit card companies in accordance withIFRS standards is:

1. On matters that are not the Bank's core business, as of January 1, 2011, the Bank has been implementing the followingIFRSstandards, subject to the directives of the Supervisor regarding their implementation:

Reporting Standard	Subject
IFRS 2	Share-Based Payment
IFRS 3	Business Combinations
IFRS 5	Non-Current Assets Held for Sale and Discontinued Operations
IAS 7	Statements of Cash Flows
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events After the Balance Sheet Date
IAS 12	Taxes on Income
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures
IAS 27	Consolidated and Separate Financial Statements
IAS 28	Investments in Associates
IAS 29	Financial Reporting in Hyper-Inflationary Economies
IAS 31	Interests in Joint Transactions
IAS 33	Earnings per Share
IAS 34	Financial Reporting for Interim Periods
IAS 36	Impairment of Assets
IAS 38	Intangible Assets
IAS 40	Investment Property

See Sections 28(1) and 29(2) below regarding the directives of the Supervisor of Banks on the adoption of accounting principles in the US, as well as pertaining to the directives of the

Supervisor of Banks on the adoption of accounting principles in the US on employee rights.

2. On matters pertaining to the Bank's core business – the final decision will be determined taking into account the timetable to be established in the US and progress in the convergence of international and American accounting standards entities.

   In addition, it is hereby clarified that following completion of the reconciliation of the provisions to the international standards, the authority of the Supervisor of Banks will remain to establish the binding clarifications with regards to implementation of the requirements in the international standards, and to establish additional provisions whenever necessary in light of the requirements of regulatory authorities in developed countries in the world or in matters that have not been addressed in the international standards. Furthermore, the Supervisor of Banks will retain his authority to establish requirements for disclosure and reporting.

3. The International Financial Reporting Standards detailed above will be adopted in accordance with the following principles (unless otherwise determined by the Supervisor of Banks):

   - In cases in which there is no specific reference in the standards or interpretations of material issues or if there are several options for handling a material issue, the banking corporation will act in compliance with the specific implementation directives established by the Supervisor;

   - In cases when a material issue arises that is not addressed in the international standards or in the implementation provisions by the Supervisor, the banking corporation will handle the issue in compliance with the generally accepted accounting principles in banks in the US that specifically apply to these issues;

   - In cases where an international standard makes reference to another international standard that was adopted in the provisions for reporting to the public, the banking corporation will act in compliance with the provisions of the international standard;

   - In cases where an international standard makes reference to another international standard that was not adopted in the provisions for reporting to the public, the banking corporation will act in compliance with the provisions for reporting and in compliance with generally accepted accounting principles in Israel;

- In cases where an international standard includes a reference to a definition of a term defined in the provisions for reporting to the public, a reference to the definition in the provisions will be introduced instead of the original reference.

Since January 1, 2011 and afterwards, the Bank has been regularly updating the accounting treatment of issues that are handled in the circular in compliance with the new International Financial Reporting Standards that will be published in these areas and in compliance with the principles of adoption and clarifications of the Supervisor of Banks.

4. Offsetting of financial assets and liabilities

1. Assets and liabilities derived from the same counterpart are presented in the balance sheet in a net amount pursuant to the cumulative conditions being met:

   - For said liabilities, there is a legally enforceable right to offset the liabilities from the assets;

   - There is an intent to repay the liabilities and realize the assets on a net and/or simultaneous basis.

   - The Bank and the counterpart owe each other determinable amounts.

2. Assets and liabilities with two different counterparts are presented in the balance sheet based on the net amount pursuant to all of the cumulative conditions listed above being met, and pursuant to there being an agreement between the three parties that clearly anchors the Bank's right with respect to said liabilities for offsetting.

3. The Bank reviews the existence of legal restrictions in order to establish that the offsetting right is enforceable. In order for there to be a legally enforceable right, the Bank examines whether the offsetting right will be valid in case of bankruptcy or other liquidation.

4. Deposits whose repayment to the depositor depends on the collection from credit, were offset from the credit granted from these deposits, when the Bank has no risk of credit loss. The margin in said activity was included in the "Commissions" item.

5. Securities

1. Debentures held to maturity are presented according to their amortized cost on the reporting date.

Note 2 – Accounting Policies (continued)

2. Securities available for sale are presented in the balance sheet based on fair value. The fair value is based on the quoted price for securities that have a quoted price or on revaluation data obtained from external sources regarding debentures that have no rate. Profit or loss less the provision suitable for tax is presented in a separate section as part of equity known as "Adjustments for Presentation of Available for Sale Securities based on Fair Value".

3. Securities for trade are presented based on fair value. Profits or losses from adjustments to fair value are charged to the Profit and Loss Statement, in the Non-interest financing income item.

4. Classification of income (expenses) in the Profit and Loss Statement:

   - Income from interest on a cumulative basis on debentures held to maturity, available for sale and held for trade will be recognized in the "Interest income" item.

   - Profits (losses) that were realized and that have not yet been realized from adjustments to fair value of debentures held for trade are presented in the "Non-interest financing income from activity for purposes of trading" item.

   - Profits (losses) from the sale of debentures held to maturity and available for sale (including impairment losses) are presented in the "Non-interest financing income from activity that is not for purposes of trading" item.

5. The Bank examines during every reporting period the need to record a provision for impairment of securities that is not of a temporary nature. The Bank has defined criteria for tracking securities and the mentioned examination. These criteria are based, among others, on the following factors:

   - Change in rating of securities by rating agencies.

   - The length of time during which the security is traded at high yield.

   - Exceptional cases such as irregular impairment.

   In addition, the Bank established criteria according to which immediate provision for impairment will be performed. These criteria are based, among others, on the following factors:

   - The current rating of a security by the rating agencies.

   - A current exceptional yield at which the security is traded.

- The length of time at which the securities were traded at exceptional yield.

- Significant negative indications within the financial statements.

In addition, criteria were established for implementing the provision for impairment for an impairment that is not temporary in nature, pursuant to two cumulative conditions being met:

1. A 40% decline in the value of the security as compared to the amortized cost.

2. A decrease for nine consecutive months.

6. Transfers and service of financial assets and settlement of liabilities

The Bank implements the measurement and disclosure principles as determined by the American accounting standard ASC 860-10 (FAS 140), the transfer and service of financial assets and settlement of liabilities, as amended by ASC 860-10, transfer and service of financial assets (FAS 166), for the purpose of handling transfers of financial assets and settlement of liabilities. According to these principles, the transfer of a financial asset will be accounted for as a sale, if and only if, all of the following conditions exist: (1) the financial asset that has been transferred was isolated from the transferring entity, also in a bankruptcy situation or other receivership; (2) each receiver (or, if the receiver is an entity whose sole designation is to deal in securitization or in asset-backed financing activity, and such entity is not allowed to mortgage or exchange the financial assets it received, then any third party holding rights of beneficiary) may mortgage or exchange the assets (or the beneficiary rights) it received, and there are no conditions that also limit the receiver (or third party that holds the beneficiary rights) from exploiting the right to mortgage or exchange, and also grants the transferor a larger benefit than a trivial benefit; (3) the transferor, or consolidated companies included in its Financial Statements, or its agents, do not preserve active control over the financial assets or the beneficiary rights referring to these transferred assets.

In addition, in order for a transfer of part of a financial asset be considered a sale, the transferred part must comply with the definition of participating rights. Participating rights must comply with the following criteria: a right must represent proportional rights in relation to the full financial asset; all the cash flows received from the assets are divided between the participating rights in a manner proportional to their part in ownership; the rights are not subordinated rights in relation to other rights; there is no return right to the transferor of others holding the participating rights (except in case of violation of representations or liabilities, current contractual liabilities for service at the financial asset in whole and management of transfer contract and contractual liabilities for sharing the offset of any benefits that has been received by any holder of participating rights); and the transferor and the holder of participating rights have no right to mortgage or replace the financial asset as whole, except if all the holders of participating rights agree to mortgage or replace the financial asset in whole.

Note 2 – Accounting Policies (continued)

In case the transaction complies with the conditions for handling the transaction as a sale, the financial assets being transferred are deducted from the Bank's balance sheet. In case the sales conditions are not met, the transfer is considered a secured debt. The sale of part of a financial asset that is not a participating right is handled as a secured debt, that is, the transferred assets continue to be recorded in the Bank's balance sheet and the consideration from the sale will be recognized as the Bank's liability.

Securities that have been sold are not deducted from the balance sheet and are presented in the "Securities" section and against them the deposit for securing the repayment of which the securities were pledged, is presented in the "Securities that were lent or sold as part of repurchase agreements" section. Purchased securities are recorded according to their value on the implementation day of the transaction in the "Securities that were borrowed or purchased as part of repurchase agreements" section.

The Bank monitors the fair value of securities that were lent or borrowed, as well as securities that were transferred in repurchase and resale agreements on a daily basis and collateral requirements are implemented in suitable cases. Interest received or paid for the aforementioned securities is reported as financial income or expenses, respectively.

According to the instructions of the Supervisor, securities lending transactions that are performed as "regular" credit transactions in which the bank lends securities against the collateral portfolio and the borrower does not transfer to the banking corporation a safety margin specifically referring to the securities lending transaction, are presented as credit to the public according to market value and are added to the borrower's liability. The changes in value of the aforementioned securities on an accrual basis are charged to the Profit and Loss Statement in the section "Revenue from credit to the public," and the adjustment to market value is attributed to Adjustments for available for sale securities based on fair value.

The Bank deducts a liability if and only if the liability was settled, meaning one of the following conditions existed: (a) the Bank paid the lender and is released from its obligation because of the liability, or (b) the Bank legally was released through legal proceedings or in agreement with the lender from being the main debtor because of the liabilities.

ASU 2011-03Reconsideration of effective control for repurchase agreements (hereinafter: "the Amendment"):

In April 2011, the FASB published an amendment whose objective is to improve and simplify the accounting treatment of repurchase transactions (repos) and similar transactions. The change applies transversely to financial assets that have been transferred as part of repo transactions and

Note 2 – Accounting Policies (continued)

to other agreements that provide as well as require the transferor to repurchase or redeem the financial assets before the contractual maturity date.

According to the update, the manner in which the existence of effective control by the transferor in repurchase transactions is assessed must be changed. Assessment of existence of effective control will focus on the transferor's contractual rights and contractual liabilities, and therefore (1) criterion that requires that the transferor will have the ability to purchase securities that have been transferred, also in case of failure by the transferee, will not be considered; and also, (2) guidelines on the subject of collateral requirements in relation to said criterion. Additional criteria for examining the existence of effective control have not been changed by the ASU.

The amendment will be applied as of January 1, 2012, on transfers of assets that are valid after that, or on existing transactions in which a change was applied after the starting date.

7. Measurement and disclosure of defective debts, credit risk and provision for credit losses

According to the instruction of the Supervisor of Banks on the subject of measurement and disclosure of defective debts, credit risk and provision for credit losses, the Bank implements, as of January 1, 2011, the American Accounting Standards on the subject (ASC 310) and the positions of the banks supervisory authorities in the US and the American SEC (Securities and Exchange Commission), as adopted in the Public Reporting Instructions.

The main changes in the accounting policies following the instruction are:

A banking corporation is required to maintain a provision for credit losses at the suitable level in order to cover expected credit losses relating to its credit portfolio, including for off-balance sheet credit risk. Provisions for credit losses will include:

- The individual provision for credit losses – The provision is implemented based on measurement of impairment of the debt based on the current value of expected future cash flows, capitalized by the debt's effective interest rate, or when the debt is contingent upon collateral, or when the Bank determines that seizure of the asset is probable according to the fair value of the collateral pledged in order to ensure that credit (tsoc selas gnitcuded retfa). The need for individual provision is examined for each debt whose contractual balance (noitcuded tuohtiw: write-offs that do not involve a legal waiver, unrecognized interest, provisions for credit losses, and collaterals) is NIS 1 million or more and for any other debt that has been recognized for the purpose of individual examination by the banking corporation.

Note 2 – Accounting Policies (continued)

- The group provision for credit losses – are applied for large groups of small and homogeneous debtsyllaudividni neeb evah taht stbed rof sa llew sa , examined and have not been found defective.Measurement of credit lossesecnalab tiderc fo esuaceb , tiderc tsap fo noitamitse na no desab si ,stnemurtsni tiderc teehs ecnalab-ffo dna steehs .scitsiretcarahc ksir ralimis htiw stbed fo spuorg suoenegomoh eht fo hcae rof setar ssol ehTgroup provision rates for credit losses are based on historical loss rates between 2009 and 2010, and the rate of net write-offs that were actually recorded in the various market branches from 2011, as divided between non-problematic credit and problematic credit between 2009 and 2013.Inaddition,the Bankreviewsgnitroper yreve icepsdnarehtoeht foecnalab ehtnahtsselton sinoisivorppuorgfoecnalabeht rehtehwetad knaBreporPeht nodesabdetaluclacsi tahtetadtahtrofstbedluftbuodrofnoisivorplarenegla gnidrager513noitcurtsnitnemeganaMgni“Provision for Doubtful Debts, gross form tax. The assessed provision on a group basis for off-balance-sheet credit instruments is based on provision rates that have been determined for balance-sheet credit, while considering the realization rate of the expected credit of off-balance-sheet credit risk. The realization rate for credit is calculated by the Bank based on conversion factors for credit as specified in the Proper Banking Management instructions number 203, Measurement and capital adequacyksir tiderc – – the standard approachniatrec htiw , ecneirepxe roirp sah knaB eht hcihw ni sesac ni stnemtsujda indicating the credit realization rate.

New types of problematic debts have been determined, including:

- Defective debt – credit that the banking corporation expects that it might not collect all the amounts, according to contractual conditions of the debt agreement, and the provision for credit losses related to it is measured in the individual provision track. The aforementioned classification should be applied, also on credit found in arrears for over 90 days except if it is well-secured and is in collection stages, and on problematic debts that have been reorganized which as part of the reorganization the Bank granted the debtor concession, while in other conditions it would not have considered to grant it. Debt that is classified as defective debt will be assessed on an item by item basis for the purpose of implementing credit loss provisions or accounting write-offs. In view of the fact that the debt for which re-organization of the problematic debt has been implemented, will not be repaid according to the original contractual condition, the debt will continue to be classified as a defective debt even after the debtor returns to the repayment track according to the new conditions. Despite the aforementioned, the problematic debts in re-organization will return to accrue interest as the debt is being paid in accordance with the terms of the arrangement for a period of at least 6 consecutive months. The projected credit payment is supported by an established credit assessment. Classification of a problematic debt as "defective" will be canceled if the cumulative terms are fulfilled: (a) the debt is well secured and in collection proceedings. (b) The debt does not include "arrears components" (including write-offs) and the Bank believes that the original balance will be paid in full.

- Inferior credit risk – is defined as insufficiently protected credit by current established value and the payment capability of the debtor or of the guaranteed collateral. Balance sheet credit risk that is classified as specified, there is a well defined weakness or weaknesses that endanger realization of the debt. Credit for which a provision for credit losses is recognized on a group basis will be classified as inferior when it becomes a debt in arrears for over 90 days. No interest revenue is to be recorded for defective debts. Regarding debts that are examined and allocated on a group basis while in arrears for 90 days or more, the Bank continues to accumulate interest income. During collection of a cash-based defective debt, if there is any doubt regarding collection of the remaining recorded balance of the debt – the receipt will be used to reduce the recorded balance to the degree required to remove this doubt. If there is no doubt about the collection of the remaining recorded balance of the debt – the receipt will be recognized as cash-based income from interest.

The instructions for write-offs of problematic debts became more stringent. Among others, it was determined by this instruction that:

- Write-offs should be made for all debts that are considered impossible to collect or debts for which Bank's collection efforts were long-term.

- Write-offs should be done immediately against credit loss provision of each part of surplus debt on collateral value that has been recognized as non-collectible.

- Write-offs of debt that has been assessed for individual provision of credit loss should not be deferred. Debts should be written off within two years from the date on which the debt was first classified as a defective debt, unless specific events exist that are sufficient to defer the write-off.

- Problematic debts for which the provision is measured based on group provision for credit loss should be written off when the arrears period is more than 150 days.

- Once the debt has been partially or fully written off, a new cost basis for the debt is created that cannot be increased in consecutive periods except on an actual collection basis and based on the collection arrangement.

Note 2 – Accounting Policies (continued)

- At the first time of implementation, the Bank was, among others, required to:

  – Write-off each debt which at this date had met write-off conditions.

  – Classify by classification for special supervision, inferior, or defective, each debt that meets the aforementioned classification conditions.

  – Cancel all interest income accumulated at the implementation date of the instruction and not yet actually collected for each debt which at this date meet the referred conditions.

  – The differences accumulated at the date of first application of the new guidelines, between the balance of the provision for credit losses, according to the existing guidelines, and their calculated balance according to the new guidelines, are reflected in Section "Surplus in Equity".

  – The additional provision is only used as a marker concerning the group provision, so that in case the total group provision is lower than the additional and general provision, provision should be implemented according to the highest of the two calculations.

Furthermore, the Bank is implementing Accounting Standard ASU 2011-02 on the subject of decision by the credit provider whether re-organization of debt is a re-organization of problematic debt:

During April 2011, the FASB published an update of Accounting Standard ASU 2011-02, on the subject of a decision by the credit provider whether re-organization of debt is a re-organization of problematic debt. According to the American standard on this subject (ASC 310), debt reorganized as problematic debt is a debt that was subject to formal re-organization, in the framework of which – for economic or legal circumstances related to financial difficulties of the debtor – the Bank granted a waiver to the borrower. The update provides additional directives to the Bank, clarifying when the re-organized debt will be considered as re-organization of problematic debt in the framework of which a waiver was granted by the credit provider. In particular, clarifications have been included relating to the manner in which the waiver test in effective interest is implemented. Furthermore, directives have been included for determining whether a waiver has been granted in the re-organization of a debt, in the framework of which the contractual interest is greater according to the new conditions than the original contractual interest, but still less in comparison to the market interest for loans with similar risk characteristics and taking into consideration the total conditions determined as part of the re-organization. Furthermore, it is clarified that in situations in which the debtor has no capability to recruit debt with similar risk characteristics in market conditions, the Bank will be required to examine the composite of other conditions of re-organization to determine whether to grant the waiver. Additionally, according to the existing standard, an insignificant postponement of payments will not be a waiver. The ASU provides a list of characteristics that may indicate that the delay is not significant, such as: the amount of the payment that has been re-organized is insignificant in relation to the balance of the debt that has not been paid, or in relation to the security value, as well as the postponement is not significant in relation to the payment frequency (monthly, quarterly, and so forth), the original contractual repayment date and the original probable average duration of the debt. According to ASU, the credit provider is required to consider the cumulative effect of the debt re-organization that was implemented in the past during implementation of an assessment whether the postponement is significant.

In addition, the ASU determines a list of disclosure requirements concerning re-organization activity of problematic debt.

If re-organization of the problematic debt was implemented in which the Bank received assets as full or partial repayment of the debt, for example rights to equity, third party debtors or other assets that will be sold later, said assets will be recognized according to the fair value of the assets on the date of seizure. If the assets received constitute full repayment of the debt and on the date of seizure the registered balance due on the fair value of the assets increases, the Bank recognizes the loss and the provision for credit losses. In any case, if the assets that were received were sold a short time following their seizure (largely up to 90 days), as long as no material change occurred in the estimated fair value, the Bank replaces the estimated fair value with the price received for the sale less the sale costs and adjusts the provision for credit losses.

8. Provision for Credit Losses for Housing Loans

As of January 1, 2006, the Bank implements the guidelines from the Supervisor of Banks for implementing Proper Banking Management instructions on the issue of "Provisions for doubtful debts for housing loans" (hereinafter – "Supervisor's Directives"). The Supervisor's directives refer to a number of principle types of topics in relation to the manner of calculating provisions for doubtful debts for housing loans, including the general calculation for individuals for determining the minimum provision for housing loans, while the arrears depth in them increases over six months (the provision is calculated at a rate between 8% to 80% from the past-due debt balance, according to arrears depth). that were implemented by the Bank in the past, except for those listed below:

Provision for loans in arrangements and reorganization:

a. Loans in arrangements – A loan where an arrangement is implemented without change in the clearance timetable for the loan balance. Calculation of arrears depth is performed while considering the arrears balance and before the original monthly charge. Cancellation of provision will be implemented if the loan still meets the loan repayments during the period of two years as of the arrangement date or if half of the remaining period of the loan has passed during which arrears have been created, whatever comes first.

b. Loan in reorganization – A loan whose clearance table has changed. For these losses, the provision will be frozen according to the arrears depth and an idealistic arrears balance will be recorded comparing the arrears balance and all by the arrangement date. Freezing of the provision and the balance of the notional arrears will be for a period of half a year while at its end the Bank will be entitled to reduce the notional arrears balance during two years in a straight line.

Furthermore, the Bank's policy is to write off housing loans that were provided for loss, but as a result of collection proceedings there are no collateral balance to realize the debt against it.

As noted in Section 28(2), the Bank will implement the Supervisor's directives regarding a group provision for housing loans that will not be less than 0.35%.

9. Property, Plant and Equipment

- Recognition and measurement

Buildings and equipment are presented according to cost, less accumulated depreciation and losses from impairment. The cost includes costs that can be directly attributed to fixed assets and that bring it to a position and condition necessary for its operation.

When material parts of the fixed assets have different duration, they are handled as separate items of fixed assets. Buildings for sale are presented by cost or their realizable value, whatever is lower.

- Subsequent costs

Cost for replacing part of the fixed asset item is recognized as part of the value on the books for the same item if it is expected that the future embedded economic benefits in the replaced part will flow to the Bank and if their costs can be measured in a reliable manner. The value of the replaced part in the books – is deducted. The current maintenance costs for fixed asset items are reflected in Profit and Loss with their occurrence.

Note 2 – Accounting Policies (continued)

- Software costs

  Purchased software is measured according to cost, less accumulated depreciation and losses from impairment.

  Costs related to development of computer programs or adjustments for the purpose of personal use are capitalized only if: the depreciation cost can be measured in a reliable manner; the program can be implemented from a technical and commercial aspect; future economic benefits are expected; the Bank intends and has sufficient resources to complete the development and to use or sell the program. Capitalized costs include direct costs and overhead expenses that may relate directly to preparing the program for its designated use. These costs are measured according to cost, less accumulated depreciation and losses from impairment. Other costs of fixed asset items are reflected in Profit and Loss with their occurrence.

  Subsequent costs are recognized as intangible assets only if they increase the embedded future economic benefits of the asset for which they have been expended. Other costs are reflected in Profit and Loss with their occurrence.

- Depreciation

  Depreciation is calculated from the cost, according to the estimated usage period, according to straight-line method applied from the date the asset was ready for use in relation to original costs. Improvements in the rented are depreciated for the duration of the lease contract including the option that it reasonably will be realized, or throughout their useful duration, according to the shortest period. The estimates concerning the duration of usage and remaining value are reexamined from time to time.

  Amortization of intangible assets is reflected in the Profit and Loss Statement according to straight-line method over the useful life estimate of intangible assets, including program assets, applied from the date on which assets are available for use.

  Intangible assets that are created at the Bank (such as: software under development) are not systematically amortized as long as they are not available for use according to management's decision. Therefore, impairment for these intangible assets is examined at least once a year, until the date they become available for use according to management's decision.

- Derogation

  The book value of fixed assets was deducted during realization or when no realization of future economic benefits were expected or realized. The difference between the net exchange from the realization, if any, and between the book value of the subtracted asset, is reflected in the Profit and Loss Statement in the section "Other Income".

  For detailed reference on the subject, see Note 8 below.

10. Intangible Assets and Goodwill

This section includes intangible assets that were acquired separately or as part of a business combination, intangible assets that were developed in a banking corporation with the exception of software development costs for own use that was included in the Section "Buildings and Equipment", service assets and goodwill.

An intangible asset is a non-cash, identifiable asset that lacks any physical being. The identifiable criteria in the intangible assets definition will be in effect if the asset can be separated or the asset is derived from contractual rights or from other legal rights, without taking into account whether these rights can be assigned or separated from the Bank or from other rights and obligations.

Intangible asset is first recognized at cost, including costs that can be directly attributed to the acquisition of the intangible asset. The cost of the intangible asset is a sum equivalent in value to the cash price on the recognition date. An expenditure for an intangible item that was first recognized as an expense will not be recognized as part of the cost of the intangible asset on a later date.

An intangible asset that was acquired in a business combination is first recognized at fair value on the acquisition date.

Goodwill that was created internally in the Bank will not be recognized as an intangible asset. With regards to goodwill resulting from the acquisition of a held company, see Note 2(a)2(b).

With regards to software development costs for own use and its depreciation, see Note 2(i).

In the period after first recognition, an intangible asset is presented based on the cost less the accrued amortization and less the accrued losses from impairment.

The Bank will assess whether the useful duration of each intangible asset is defined or undefined.

The amortization sum of an intangible asset with a defined useful life span is systematically allocated over the course of the useful life. The Bank amortizes using the straight line method. Amortization expenses for the entire period are recognized in the Profit and Loss Statement.

The Bank reviews the useful life span and the amortization method used at the end of every fiscal year, at minimum. Changes are handled as change in accounting estimate.

Goodwill is defined as an asset with no defined lifespan and that is not systematically amortized. The Bank is required to examine the need to sisablaunnananolliwdoognwod-etirw.

Regarding impairment of intangible assets, see Note 2(k) below.

11. Impairment of Non-Financial Assets

The Bank examines, at each reporting date, the need for recording a provision for impairment of non-financial assets (such as: buildings and equipment and non-tangible assets including goodwill) when there are signs, as result of events or circumstantial changes, indicating that its assets in the balance sheets are presented in amounts greater than their recoverable amount.

The recoverable amount of the asset or the cash-generating is higher from between the net sales price and the usage value. The usage value is the current value of the future cash flow estimate, capitalized at the interest rate before tax, that is expected to be generated from use of the asset and its realization. For the purpose of examining the impairment, the assets that cannot be examined individually are grouped together into the smallest assets group that generates cash flow from continuous use, while independent in principle from assets and from other groups ("Cash Generating Unit"). When the book value of the assets exceeds the recoverable amount, the Bank recognizes the impairment at the gap height between the book value of the asset and the recoverable value. The aforementioned recognized loss will be canceled only if changes are applied to the estimates used for recoverable amount of the asset from the date of recognition of last loss of impairment, except for loss from impairment of goodwill that is not insignificant.

12. Sector Reporting

An activity sector is a line of business in the banking corporation that is involved in activities from which it may generate income and bear expenses. Its activity results are regularly examined by the management and the Board of Directors for the purpose of decision-making concerning the allocation of resources and to assess their implementation, as well as maintaining separate financial information on it. The format for reporting the Bank's activity sectors is determined by the Supervisor of Banks' instructions.

For detailed reference on the subject, see Note 30 below.

Note 2 – Accounting Policies (continued)

13. Issue Expenses

Issue expenses of debentures and directly attributable transaction costs, liability notes and deferred liability notes are depreciated relative to the principal's balance in the turnover according to the effective interest rate method.

14. Deferred Expenses

Issue and distribution expenses of debentures and expenses for recruitment of deposits are presented based on the cost and are depreciated during the maturity period of the liabilities according to the effective interest method.

15. Taxes on Income

Taxes on income in the Profit and Loss Statement include current and deferred taxes. Current and deferred taxes are reflected in the Profit and Loss Statement, unless the tax derives from the transaction or event that is directly recognized in equity. In these events, tax expenses on income are reflected in equity. The current tax is the amount of tax expected to be paid (or received) on taxable income per annum, that is calculated according to tax rate applicable under the enacted law or in fact is being enacted on the balance sheet date, including changes in tax payments relating to previous years.

The provision for taxes on the Bank's income and its consolidated companies that are financial institutions for the purpose of VAT, includes profit tax imposed on the income according to the VAT Law. VAT imposed on salary in financial institutions is included in the Profit and Loss Statement in Section "Salaries and Related Expenses."

Deferred taxes are calculated for differences when including income and expenses in the time between the financial reporting and recognition for the purpose of income tax, as well as for adjusting of non-financial assets for gaps between the adjusted value and between the highest value for deduction purposes of income tax. Deferred taxes are calculated according to tax rates expected to be applied when using the reserve or realizing the tax benefit, based upon the tax law that is valid at the date of the balance sheet.

Deferred taxes for losses carried forward are recognized during a business combination in accordance with the instructions of International Financial Reporting Standard 3, and particularly, if chargeable income is expected against which the losses can be used for tax purposes that have not yet been used.

The calculation of the deferred tax does not take into account the taxes that would have been applied in the realization of investments in the held companies so long as there is an assumption of continuous holding of these investments. The dividend distribution policy in the held companies will not cause an additional tax charge in the Bank.

The Bank reviews the deferred tax assets in every reporting period. If no chargeable income is expected in sufficient amounts that would allow the use of deferred tax assets, amortization is carried out for the book value of these deferred tax assets.

In accordance with the instructions of the Supervisor of Banks, the Bank implements accounting process set forth in the interpretations FIN48 – Uncertainty on Income Taxes(ASC 740-10 – Income Taxes) on uncertain tax positions with the tax authorities.

These positions affect deferred or current tax assets in the form of amortization of a tax asset, deferred recognition of tax income or in any change with regards to the manner of realization of a deferred tax asset. In accordance with the interpretations, in such an event, the Bank implements this two-stage approach: in the first stage, recognition in the books only for tax positions thatmore likely than not will be received based on their technical facts alone (in accordance with the tax laws, regulatory directives and adopted practice, if any). If the Bank complies with the terms of the first stage, a deferred tax asset will be recognized based on the largest accrued sum that is more likely than notexpected to be recognized.

For detailed reference on the subject, see Note 29 below.

16. Derivative Financial Instruments

In accordance with the instructions of the Supervisor of Banks, the banking corporation should recognize all the derivative instruments, including certain derivative instruments embedded in other contracts, as assets or liabilities in balance sheets and measure them according to fair value. The change in fair value of derivative instrument is reported in the Profit and Loss Statement, according to the manner in which the derivative instrument is designated. Changes in the fair value of derivatives, that determine the exposure to change in fair value of an asset, liability or a firm agreement, will be regularly recognized in the Profit and Loss Statement, as well as changes in fair value of a defined item, that may be attributed to the defined risk.

The accounting process for a change in the fair value of derivatives, which determines the exposure to changes of cash flow from an asset, from liabilities or from a forecast transaction depends on the effectiveness of the hedging ratios.

The effective part of the change in fair value of the derivative, designated for hedging cash flow, is initially reported in equity and after that, when the forecast transaction affects the Profit and Loss Statement, it is reclassified for the Profit and Loss Statement.

Note 2 – Accounting Policies (continued)

The non-effective part of the change in fair value of the designated derivative as aforementioned, is immediately recognized in the Profit and Loss Statement.

The Bank enters into contracts that do not entirely meet the definition of a derivative instrument – these contracts may include embedded derivative instruments. An embedded derivative instrument will be separated from the host contract and handled as a derivative instrument if the following three conditions exist – jointly: the economic characteristics of the embedded derivative are not clearly related and close to those of the host contact; the involved instrument is not re-measured according to fair value in accordance with accepted accounting regulations, while reporting on changes in fair value in the Profit and Loss Statement during their creation, and the separate instrument with the same conditions as an embedded instrument would maintain the definition of the derivative instrument. Being identified as the embedded derivative, it is separated from the host contract and handled as a derivative on its own. An embedded derivative that has been separated is presented in balance sheet together with the host contract. The separated embedded derivatives in the Bank are derived from granting credit linked to foreign currency including a floor for linkage basis and recruitment of savings plans with identical characteristics.

Profit or loss from a derivative that is not designated as a hedging instrument is regularly recognized in the Profit and Loss Statement. The transactions in derivative instruments are part of the Bank's management system of assets and liabilities. The fair value of derivative instruments is presented in the balance sheet as assets for derivatives or other liabilities, according to the matter, and the transaction results in derivative instruments deriving from their recording based on fair value are included in the Profit and Loss Statement as part of the Section "Financing Income Not from Interest."

17. Basis for Recognition of Income and Expenses

Income and expenses are recognized on an accrual basis, including income for off-balance-sheet financial instruments, with the exception of:

1. Completion of interest arriving at the Bank from the government for certain housing loans, is reflected in the Profit and Loss Statement according the effective interest embedded in cash flows deriving from the loan agreement and from the interest completion agreement.

2. Commissions from early repayment of housing loans are reflected in the Profit and Loss Statement at equal rates for three years, except for the part related to the financial capital that is reflected in the Profit and Loss Statement upon its receipt.

Note 2 – Accounting Policies (continued)

3. Management fees due to loans that were sold are reflected in the Profit and Loss Statement over the remainder of the loan and repayment period relative to their balance.

4. Interest arrears for housing loans are reflected in the Profit and Loss Statement only upon collection.

5. Income from dividend is reflected in the Profit and Loss Statement on the eligibility date for their receipt.

6. Income and expenses from marketable securities and derivative instruments are recognized based on changes in fair value.

7. Interest for problematic debts that were classified as non-income bearing debts are recognized as cash-based income when there is no doubtregarding the collection of the registered remaining balance of the defective debt. Under these circumstances, the sum that is collected at the expense of interest that will be recognized as interest income, is limited to the sum that accrued during the report period on the registered remaining balance of the debt based on the contractual interest rate. Interest cash-based income is classified in the Profit and Loss Statement as interest income in the relevant section. When there is doubt regarding collection of the registered remaining balance, all payments that were collected are used to reduce the principle of the loan.

8. Credit allocation commissions as well as commissions from financing transactions are recognized in the Profit and Loss proportional to the transaction periods.

9. Income from commissions for service provision is charged to Profit and Loss upon provision of the service.

18. Employee Rights

1. Because of all the liabilities of employer-employee relations, there are appropriate reserves by law, agreement, management's custom and expectation. Future liabilities for jubilee grants are calculated by an actuarial expert in evaluating methods of accrued benefits and considering the probabilities based on past experience when the salary increase rate is based on past experience and varies according to the age of the employee.

2. The reserve for severance pay is calculated on the basis of their last salary and the employee's work period, and, in accordance with the law, the terms of the employment

agreement, as well as managerial practice and expectations. The amount for severance pay included in the balance sheet includes accrued profits.

3. Directives and clarifications concerning strengthening of internal auditing on financial reporting on the subject of employee rights.

   On March 27, 2011, directives from the Supervisor of Banks were published concerning strengthening of internal auditing on financial reporting on the subject of employee rights. The directives set forth several clarifications concerning the assessment of liability for employee rights and directives concerning internal auditing of the financial reporting process on the subject of employee rights while requiring the collaboration of a certified actuary, identification and screening of liabilities for employee rights, existence of internal auditing for the purpose of relying on the actuary's assessment and validation in addition to certain disclosure requirements. On May 23, 2011, the Supervisor of Banks published a clarification according to which the first time application of the above mentioned directive was postponed to April 1, 2011.

   The directives sets forth, inter alia, that a banking corporation that expects that it will have to pay its employees, upon their leaving, benefits for contractual terms, will take into consideration the number of employees expected to leave and the benefits the Bank expects that it will be required to pay for the benefits beyond the contractual terms, for early retirement of employees.

   The circular's implications on measuring liabilities and on the internal auditing process on the subject of employees rights are not material.

   Regarding the directives of the Supervisor of Banks on the adoption of accounting principles in the US, See Section 28(3) below.

   For detailed reference on the subject, see Note 14 below.

19. Contingent Liabilities

According to the directives of the Supervisor of Banks, American Accounting Standard ASC 450 has been adopted with their accompanying instructions concerning the accounting process issue of pending legal claims; except for rare cases, such as class action suits in which there is no possibility by the Bank and its legal advisers to assess their results. Based on its legal advisers concerning the probability of realization of exposure to risks from claims, the Bank management's assessment is determined on the basis of three areas of probability, as follows:

1. Risk is expected – The probability of realization of the exposure to risk is more than 70%. For claims included in this risk group, suitable provisions are included in the Financial Statements.

2. Risk is probable – The probability of realization of the exposure to risk is between 20% and 70%. For claims included in this risk group, no provisions are included in the Financial Statements, but only disclosure is given.

3. Risk is weak – The probability of realization of the exposure to risk is less than or equal to 20%. For claims included in this risk group no provisions are included in the Financial Statements and no disclosure is given.

When the expected exposure is realized, a provision is included in the Financial Statements for the full exposure amount, as estimated by the Bank's management. In case of probable exposure, a provision is not included in the Financial Statements, but disclosure is given for the amount of exposure. In case of weak exposure, there is no need to implement the provisions and/or provide disclosure. For claims for which the exposure to them is weak, but the liability or maximum possible loss might place the continuing activity of the Bank in doubt, disclosure is provided.

For detailed reference on the subject, see Note 19 below.

20. Share-based Payment Transactions

The Bank recognizes share-based payment transactions according to International Financial Reporting Standard IFRS 2, as adopted by the Supervisor of Banks. A benefit due to share-based payment transactions that are cleared in capitalized instruments, is measured on the date the benefit (grant day) is provided, based on an acceptable options pricing model. The value of the benefit is regularly attributed to expenses against capital reserve, over the maturity period.

The cost of a transaction cleared in cash is measured according to fair value on the grant date, through use of an acceptable options pricing model. See additional details in Note 22a. Fair value is recognized as expense over the maturity period, and correspondingly, a liability is recognized. Liabilities are measured again in each reporting period according to the fair value until clearance, while changes in fair value are reflected in Profit and Loss.

When the company performs changes in the conditions of the grant cleared in capitalized instruments, the additional expense is recognized beyond the original expense that was calculated for every change that increases the total fair value of the granted benefit or that it benefits with the employer/the other service provider according to fair value at the time of the change.

Note 2 – Accounting Policies (continued)

When changes are being implemented in a share-based payment plan, the banking corporation recognizes the influence of the changes that increase the total fair value of the plan during the remaining maturity period, and in addition to the affects on changes that change the nature of the plan from liability to capital, or vice versa.

21. Use of Estimates in the Preparation of Financial Statements

Preparation of the Financial Statements, in accordance with GAAP in Israel and the Supervisor of Banks' instructions and directives, requires use of estimates, assessments and discretion by the management, that affect the reported amounts of the assets and liabilities, on disclosure referring to contingent assets and contingent liabilities, as well as on income and expenses amounts for the reporting period. It should be clarified that the actual results might differ from these estimations.

During the implementation of the accounting estimates used in the preparation of the Bank's Financial Statements, the Bank's management is required to make assumptions for such circumstances and events involving significant uncertainty. In its discretion in determining the estimates, Bank management relies on past experience, various facts, external factors and on reasonable assumptions according to the suitable circumstances for each estimation.

The estimations and assumptions on which they are based are subject to ongoing reviews. Changes in the accounting estimates are recognized in the period in which the estimates are amended and in future periods that are affected.

22. Earnings per Share

Earnings per share are calculated by dividing the net profit attributable to shareholders of the company by the weighted number of ordinary shares in existence during the period.

The basic earnings per share includes only shares that actually exist during the period.

Potential ordinary shares (convertible securities, for example, convertible debentures, option notes and options for employees) are only included in the calculation of diluted earnings per share whose affect dilutes the earning per share so that the conversion reduces the per share earning or increases the per share loss from continuing operations. In addition, potential ordinary shares that were converted during the period are included in diluted earning per share only until the conversion date, and from that moment are included in the basic earning per share.

Note 2 – Accounting Policies (continued)

23. Comparison Numbers

A number of comparison numbers that were reclassified were mentioned in the Financial Statements. For this matter, see also Section Z below.

24. Statements of Cash Flows

The statement was prepared in accordance with the instruction of the Supervisor of Banks and International Accounting Standard 7 (IAS7) regarding Statement of Cash Flows. Cash flows from assets and liabilities are presented net, except for housing credit activity, non-monetary items in motion, non-negotiable securities and debentures and deferred liability notes. Cash also includes deposits in banks whose original period from their deposit date is up to three months.

25. Measurement of Fair Value and Alternative for Fair Value

1. On April 28, 2011, the Supervisor of Banks published a circular on the subject of measurements of fair value and alternative fair value. The circular adopts, inter alia:

   1.1 Measurement of Fair Value – American Accounting Standard ASC820-10(FAS 157) hereinafter "ASC 820-10."

   ASC 820-10 defines fair value and establishes a consistent work framework for measurement of fair value by defining the techniques for fair value appraisal concerning assets and liabilities and determining the level of fair value and specified implementation directives.

   The circular distinguishes between two types of data that are used to determine fair value:

   Observable inputs represent information available in the market that is obtained from independent sources and data for unobservable inputsreflecting the assumptions of the banking corporation. These types of data create a hierarchy of fair value as specified below:

   Level 1 Data: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

   Level 2 Data: Quoted prices for similar assets and liabilities in active markets; quoted prices for identical assets or liabilities in non-active markets; prices that are derived from assessment models where all the data that is material (significant inputs) are observable in the market or are supported by observable market data.

Level 3 Data: Unobservable data for asset or liability derived from assessment models where one or more material data (significant inputs) in them are unobservable.

Furthermore, ASC 820-10 expands the disclosure requirements for measurement of fair value. Implementation of the regulations set forth in ASC 820-10 requires discontinuation of the usage of the blockage factor in the calculation of the fair value, as well as replacing the directives that prohibit recognition in day one profits and requires the determination of fair value of non-negotiable derivative instruments in the active market based on the transaction price. In addition, ASC820-10 requires the banking corporation to reflect the Bank's credit risk and other risks through fair value measurements of debt, including derivatives, that were issued by it and that were measured according to fair value.

820-10 ASC became valid as of January 1, 2011 and henceforth, except for a number of financial instruments for which implementation is in the limited format of retrospective application on the date of the first-time adoption date. The difference between the balance sheet balances of certain financial instruments and the values of the fair value of the same instruments is recognized as an accrued influence for the opening balance of retained earnings on January 1, 2011, that is presented separately.

The banking corporation is required to re-examine the assessment method it implements to assess the fair value in consideration of the relevant circumstances for different transactions, including the latest transaction prices in the market, indicative prices for evaluation services, and results of backwards examination (back-testing) of similar types of transactions.

In January 2010, the FASB published an update of the accounting standard on the subject of improving disclosure for measurement of fair value. According to the update, amounts of material transitions from measurement of fair value according to level 2 to measurement according to level 1, and vice versa require disclosure, as well as including explanations for these transitions. It is required to provide disclosure concerning the gross amounts of changes in measurement of fair value according to level 3 deriving from acquisition, sales, issuance, and repayment.

1.2 Alternative fair value for financial assets and financial liabilities – American Accounting Standard ASC 825-10)FAS 159) hereinafter "ASC 825-10".

The purpose of ASC 825-10 is to enable a reduction of the fluctuations in reported profits that are derived from measurement of hedged assets and liabilities, and hedged derivative instruments according to various measurement bases.

ASC 825-10 enables the banking corporation to select defined dates, for measuring fair value of financial instruments and certain other items (valid items), that according to the Public Reporting Instructions do not require measurement at their fair value. The profits and losses that have not yet been realized for changes in fair value of items for which an alternative fair value is chosen, are reported in the Profit and Loss Statement in each consecutive reporting date. In addition, costs and prepaid fees related to items for which an alternative fair value is chosen are recognized in Profit and Loss at the time of their formation and are not deferred. The choice for implementation of alternative fair value as aforementioned is implemented separately for each instrument (instrument-by-instrument) and cannot be canceled. In addition, ASC 825-10 sets forth a requirement for presentation and disclosure that are designed to facilitate a comparison between the banking corporations that choose different measurement bases for similar types of assets and liabilities. Despite the aforementioned, it is clarified by the Supervisor of Banks that the banking corporation will not chose an alternative to fair value, except if the banking corporation developed in advance knowledge, systems, procedures, and controls at a high level that would allow it to measure the item with a high level of reliability Therefore, a banking corporation will not chose an alternative to fair value concerning any asset suitable for classification at level 2 or level 3 in the hierarchy of fair value, or regarding any liability, except if it received advanced approval from the Supervisor of Banks. The standard is effective as of January 1, 2011 and henceforth.

2. ASU 2011-04 – Measuring Fair Value (hereinafter: 'the Amendment"):

In May 2011, the FASB published an amendment concerning ASC 820 Measurement and Disclosure of Fair Value. The new disclosure does not change the existing requirements considerably, but clarifies them. The amendment presents several changes. Among them, the main market in which the measurement will be implemented will be considered the market with the main volume and level of activity for said asset or liability, and not the market perceived by the entity that reflects the said volume or level. Use of the holding size factor is prohibited not only for negotiable instruments classified as Level I fair value, as currently determined, but also concerning the remaining instruments in Levels 2 and 3, with the exception of situations in which the premium or discount were taken into account when calculating the measurement of the fair value by participants in the market in the absence of Level I data. The amendment provides directives for measuring fair value in portfolios of financial instruments. Furthermore, the amendment establishes new disclosure requirements, including classification for levels in the fair value hierarchy for items that are not measured according to fair value in the balance sheet but within the confines of the Notes, disclosure concerning fair value is required. Regarding items included in Level 3, information regarding assessment that is implemented by the reporting entity and disclosure regarding sensitivity analysis of the measurement of fair value for changes in material unobservable data and the mutual relationship between unobservable data, if there exists. Any transition of measurement of fair value from Level 2 to Level I or vice versa, including a listing of the reasons for the transition.

The amendment will become valid as of January 1, 2012 from hereon in. First-time adoption did not have any material affect on the Bank's financial statements, with the exception of a representative change of the new disclosure requirements.

For detailed reference on the subject, see Note 21 below.

26. Instructions regarding the format of the Profit and Loss Statement for a banking corporation and adoption of GAAP in banks in the United States on measurement of income from interest.

In December 2011, the Supervisor of Banks issued an instruction regarding adoption of a new format for the Profit and Loss Statement designed to adapt the manner of presentation of the Profit and Loss Statement to the standard presentation of banking corporations around the world and in the United States, while maintaining the level of specification that exists in the instructions for reporting to the public.

As result of the adoption of the new format for the Profit and Loss Statement, the section "Profit from Financing Activity" was replaced by three sections: "Income from Interest", "Interest Expenses" and "Income from Financing that is not from Interest". Moreover, the section "Profit from Extraordinary Operations After Tax" was canceled.

In addition, in accordance with the Supervisor's instructions, the definition of the term interest was amended to clarify that interest will also include index-linked differences for the principal.

On the issue of implementing the instruction on the subject of "measurement and disclosure of impaired debts, credit risk and the provision for credit losses," the banking corporation is required to cancel the index-linked differentials that accumulated from January 1, 2012, for the debt inventory and not yet been paid for the principal, only for debts that have been classified as defective as of January 1, 2012.

The bank implemented the instructions regarding the format for the Profit and Loss Statement beginning on January 1, 2012 retroactively. The first-time adoption had no effect other than a representative change.

Listed below is a list of reclassifications that were carried out:

a. The financing profit components listed below were classified to the section on Financing Income that is Not From Interest for activities that are not for commercial purposes:

   – Profits or Losses from the sale of available for sale debentures.

   – Income/expenses for derivative instruments used for ALM activity.

   – Rate differences with the exception of rate differences on interest that were included as part of the Interest Income or Expenses.

b. The financing profit components listed below were classified to the section on Financing Income that is Not From Interest for activities that are for commercial purposes:

   – Profits or losses realized from fair value adjustments of negotiable securities

   – Dividends for Shares Held For Trade.

   – Income / Expenses for other derivative instruments.

c. The financing profit components listed below were classified to the Commissions section:

   – Income from conversion commissions

   – Income from Maof commissions.

   – Income from guarantee commissions.

   As a result of the change in classifications as stipulated above, income (expenses) that were included in the profit from financing activity totaled NIS 6.8 million, and NIS 6.1 million in the Bank and consolidated, respectively, for the year ending on December 31, 2011, were classified as specified.

Income (expenses) that were included in the profit from financing activity totaled NIS 14.5 million in the Bank and consolidated for the year ending December 31, 2011, were classified in the "Commissions" section.

d. Profits (losses) that were included in the past as part of the "Profits (Losses) from Net Investment in Shares" section were reclassified and included as part of the Financing Income Not from Interest section. The sums that were classified are not material.

The section, "Profit from Irregular Activity" was canceled and the approach used in the US was adopted regarding classification of an event or transaction as a special item, in which a special item is an item that is "irregular" and "uncommon". In light of this, the banking corporation will be entitled to classify an event or transaction as a special item only with the approval of the Supervisor of Banks. Profits (losses) that were included in the past as part of the "Profit (Loss) from Irregular Activity, after Taxes" section were reclassified as follows:

Profits (Losses) from Realization of Buildings and Equipment were classified to the "Other Income" section.

As a result of said change in classification, "Profit from Irregular Activity after Taxes" that was derived from realization of buildings and equipment totaling NIS 20.9 million in the year ending December 31, 2011, was recognized in the "Other Income" section at a sum of NIS 25.5 million, and in the Provision for Taxes section at a sum of NIS 4.5 million.

27. The Supervisor of Banks' instructions on actions between a banking corporation and controlling shareholder, and between a company controlled by the banking corporation.

In December 2006, the Israeli Institute published Accounting Standard Number 23 concerning "Accounting Treatment for Transactions Between an Entity and its Controlling Shareholder" (hereinafter: "Standard 23"). According to Standard 23, assets and liabilities for which a transaction is performed between the entity and the controlling shareholder will be measured on the transaction date according to the transaction's fair value, while the difference between fair value and the consideration will be imputed to equity. The debit difference is in essence the dividend and therefore it will be recognized as a reduction in the balance of retained earnings. The credit difference is in fact the investment of owners and therefore it will be presented in a separate section in equity called capital reserve from a transaction between an entity and a controlling shareholder. The standard discusses three issues pertaining to transactions between an entity and its controlling shareholder, as follows:

- Transfer of an asset to an entity from the controlling shareholder or, alternatively, transfer of an asset from the entity to the controlling shareholder.

- Assumption of the entity's liability to a third party, in full or in part, by the controlling shareholder; indemnity of the entity by the controlling shareholder for an expense; waiver by the controlling shareholder of all or part of a debt owed to it by the entity.

- Loans granted to the controlling shareholder or loans received from the controlling shareholder.

In addition, the Standard sets forth the disclosure that must be provided in the financial statements regarding transactions between the entity and its controlling shareholder. Therefore, the treatment instructions as determined in Public Reporting Instructions on the issue of transactions with controlling shareholders or with a company controlled by a banking corporation were canceled. Nevertheless, the guideline concerning continuous agreement with a different consideration was left intact.

28. First-time adoption of Accounting Standards, Accounting Standards Update and Instructions from the Supervisor of the Banks:

Beginning from the reporting periods that begin on January 1, 2013, for the first time, the Bank is implementing the accounting standards and instructions as detailed below:

1. Update of the disclosure instructions on credit quality of debts and provision for credit losses.

2. Update of directives on residential real estate.

3. Restrictions on granting of loans for housing.

4. Instruction on Statement of Comprehensive Income.

5. Instruction on disclosure of deposits.

6. Instruction on offsetting of assets and liabilities

7. Circular from the Supervisor of Banks on the another provision for doubtful debts.

8. Instructions from the Supervisor of Banks on Assets and Liabilities based on Linkage Bases and based on Period of Repayment.

9. Update of Accounting Standard as specified below:

9.1 New standards:

IFRS 10- Consolidated financial statements

IFRS 11- Joint Arrangements

IFRS 12-Disclosure of Interests in Other Entities

9.2 Amendment of Existing Standards:

ISA27R(amended 2011) – Separate Financial Statements

IAS 28R (amended 2011) – Investments in Associates and Joint Transactions.

Listed below is a description of the nature of the changes adopted in the accounting policies in the condensed consolidated annual financial statements and the effect of first-time adoption:

1. Update of the disclosure instructions on credit quality of debts and provision for credit losses (hereinafter – "The Instruction")

On March 25, 2012, the Supervisor of Banks published an instruction regarding an update of disclosure of credit quality of debts and a provision for credit losses based on the 10-2010 update of the FASB for disclosure requirements in the United States regarding credit quality of debts and for the provision for credit quality losses. The instructions in this matter are based on disclosure requirements of the FASB (Article 310-10 in the Codification), the disclosure requirement that exists in call report and the disclosure actually provided by banks in the USA. In light of the aforementioned, the instructions for reporting to the public were updated and the phrases "Credit Sector", "Groups of Debts", and "Indication for Credit Quality" were defined.

The requirements expand the quantitative and qualitative disclosure for every Group of Debts as defined in the instruction, on quality of its debts to the banking corporation, including:

- Description of the indication for credit quality.
- The registered balance due of debts, in accordance with the indication for credit quality.

- For every indication for credit quality, the date or range of dates on which the information was updated regarding this indication.

Movement in the Provision for Credit Losses.

Beginning from the report dated March 31, 2013 and onwards, the banking corporation presents other disclosures with regards to reorganization of problematic debts, inter alia, disclosure on the way in which the problematic debts were reorganized during the presented periods, including a description of the changes made in the debts and the financial effects of the changes, for some of the problematic debts that were reorganized information on the types of debts that failed and the sum of the debts that failed was provided in accordance with the instructions of the circular.

The instruction was applied from the report for 2012, with the report to the public for 2012 including only balance sheet disclosures. Beginning from the public report dated March 31, 2013 and onwards, every disclosure required in accordance with this instruction was provided.

The adoption did not materially affect the Bank's financial statements or results, with the exception of a representative change.

2. Update of directives on residential real estate (hereinafter:"The Directives").

On March 21, 2013, in light of the accelerated growth in the banking system in residential credit in recent years parallel to an increase in housing prices, the Supervisor of Banks published an update of directives concerning residential credit and realty, on the allocation of capital and provision for doubtful debts for housing loans and change in the risk weight of guarantee in accordance with the Sales Law (draft directives that were supposed to have first been published on February 21, 2013).

Below are the key points of the guidelines:

1. In order to calculate the capital adequacy ratios, the housing loan is weighted at 35%, with the exception of a leverage housing loan that includes a variable interest component, that since October 2010 has been weighted at 100%. In accordance with the new draft directive, capital for housing loans will be allocated based on the following weighted rates:

    - Housing loans in which the financing rate is up to 45% will be weighted at 35% – remains unchanged.

- Housing loans whose financing rate is higher than 45% and up to 60%, will be weighted at 50% instead of 35%.

- Housing loans whose financing rate is higher than 60%, will be weighted at 75% for capital requirement purposes instead of 35% or at 100%.

- Correspondingly, the requirement (from October 2010) to weight 100% loans whose financing rate exceeds 60% and a sum that exceeds NIS 800 thousand and whose variable interest rate exceeds 25%, will be canceled and will be replaced, as previously mentioned, by a weighted rate of 75%.

2. The guidelines set forth that the balance of the group provision for credit losses held for housing loans will be at a minimal rate of 0.35% of the balance of said loans beginning from the reports to the public in the second quarter of 2013. This will not apply to housing loans for which a provision is held based on the depth of the arrears or private provision.

3. Furthermore, the guidelines set forth a reduction in the allocation of capital required for Sales Law guarantees in the event that the apartment had already been delivered to the tenant. These guarantees will be weighted with a conversion coefficient for credit of 10% instead of 20%. This move constitutes a relief in the capital allocation requirements and may increase the supply of bank credit in the construction and real estate industry.

   The bank has been implementing these directives since the second quarter reports of 2013. As a result of implementation of the guidelines, the provision for credit losses increased in the second quarter of 2013 for debts that were reviewed on a group basis totaling NIS 19 million gross before tax and NIS 12 net after tax.

   In addition, as a result of the update of the risk weights of the housing loans, in 2013, the Tier 1 capital ratio decreased for risk components at a rate of approximately 0.1%.

3. Restrictions on granting of housing loans.

On August 29, 2013, a circular was published on Restrictions on the Granting of Housing Loans. The circular imposes restrictions on granting of housing loans. by banking corporations. The purpose of the circular is to lower the risk to banking corporations as a result of the public taking mortgages, under conditions that might endanger their future ability to repay the mortgage.

Below are the key points of the guidelines in the circular:

- A banking corporation will not approve and will not grant a housing loan whose repayment rate from income exceeds 50%.

- Housing loans in which the monthly repayment rate from income exceeds 40%, will be weighted at 100% for the purpose of calculating the capital adequacy ratio.

- A banking corporation will approve and grant housing loans only if the following two conditions are met:

  – The ratio between the share of the housing loan in variable interest and the total loan does not exceed 66.66%.

  – The ratio between the share of the housing loan in variable interest that bears an interest that might change within five years from the date of approval of the loan, and the total loan does not exceed 33.33%.

- A banking corporation will not approve and will not grant a housing loan whose repayment period exceeds 30 years.

- A banking corporation will not approve and will not grant a refinancing of the housing loan if as a result of the refinancing, a deviation occurs in one of the aforementioned restrictions, or if the exception that existed prior to the refinancing was increased.

The Bank has been implementing the loan guidelines for which it granted principle approval since September 1, 2013.

4. Instruction on Statement of Comprehensive Income.

On December 9, 2012, a circular was published concerning the Statement of Comprehensive Income. The purpose of the circular is to adapt the manner of presentation of the Statement of Comprehensive Income to the GAAP in the USA (ASU2011-05,ASU2011-12). The circular changes the manner of presentation of the items of Other Comprehensive Income in Financial Statements so that the items of Other Comprehensive Income will be reported separately in a "Statement of Comprehensive Income" that will be presented after the Profit and Loss Statement.

In addition, an itemization of the composition and movement of Accumulated Other Comprehensive Income will be presented in a new Note on Accumulated Other Comprehensive Income.

The amendments in this instruction will apply to first quarter reports of 2013 and later, and will be adopted retrospectively.

The adoption did not materially affect the Bank's financial statements or results, with the exception of a representative change.

5. Instruction on disclosure of deposits.

On January 13, 2013, the Bank of Israel published a circular regarding changes in the instructions on reporting to the public on disclosure of deposits.

The amendments to the instructions for reporting to the public were designed to adapt the requirement for disclosure of deposits to the standard disclosure requirements in financial statements of banking corporations in the USA.

The main changes in the instructions for reporting to the public:

- Definitions of terms were added;
- Disclosure requirements (in activity sectors, and liquidity status) were added;
- A separate disclosure requirement was added for deposits recruited in Israel from deposits recruited overseas, subject to its materialness, in the Notes on public deposits, deposits from banks and deposits from the government;
- In the Note on Public Deposits: A separate disclosure requirement was added on the balance of interest-bearing deposits, from the balance of non-interest bearing deposits. The disclosure requirement for deposits in savings plans and other deposits was canceled; a requirement for size-based reporting based on brackets was added; a requirement for reporting identity of depositors in Israel was added.
- In Note "Assets and Liabilities based on Linkage-bases and Period of Repayment": A disclosure requirement for contractual dates of payment of credit to the public and public deposits was added; the lines referring to dates of payment for non-cash items were deleted.

The instructions that were set forth in accordance with this contract will be implemented retrospectively beginning from the report to the public in 2013, and thereafter, with the exception of disclosure of balance of deposits from institutional entities that were included in the public deposits that were recruited in Israel, whose application will begin from the financial statement for the first quarter of 2013.

6. **Instruction on offsetting of assets and liabilities.**

On December 12, 2012, a circular was published on offsetting of assets and liabilities. The purpose of the circular is the adaptation of the instructions in this area to the GAAP in the United States. The circular sets forth that a banking corporation will consider whether the conditions for disposition of existing assets and liabilities prior to considering whether the assets and liabilities should be offset. Furthermore, certain considerations that the banking corporation is required to take into account when reviewing the existence of the conditions for offsetting were clarified. Disclosure requirements were added pertaining to the offsetting of assets and liabilities, including new disclosures with regards to derivative instruments that were presented in net or for which exist net accounting agreements or similar agreements. In addition, the disclosure requirements pertaining to derivative instrument activities were updated as were the disclosure requirements for credit-risk-lowering instruments that were not offset in the balance sheet.

The instructions that were set forth in accordance with this circular were implemented retrospectively beginning from the financial statement for the first quarter of 2013.

The first-time adoption does not materially affect the financial statements of the bank and its results.

7. **Circular from the Supervisor on Banks on Provision for Doubtful Debts.**

On May 30, 2013 the Supervisor on Banks published a circular on the additional provision for doubtful debts. The circular updates Banking Management Instructions No. 315 "Additional Provision for Doubtful Debts" following the update of Banking Management Instructions No. 313 on Restrictions on Liability of a Borrower and of Groups of Borrowers that was also updated in the circular published on May 30, 2013.

According to the circular, a banking corporation, as of May 30, 2013, is required to update the limitation rate for the liabilities of a group of borrowers to 25% instead of 30%. In addition, the banking corporation is required to update the limitation rate for the total large borrower liability to 120% of all large borrowers, instead of 135% for the six largest borrowers.

The adoption of this instruction does not materially affect the financial statements of the bank.

8. **Instructions from the Supervisor of Banks on Assets and Liabilities according to index linked basis and according to repayment period.**

On September 30, 2013, the Supervisor of Banks published a circular on Assets and

Liabilities according to index-linked basis and according to the repayment period. The circular is designed to adapt the disclosure requirements to the presentation of cash flows for assets and liabilities, differentiating between Israeli currency not linked, index-linked Israeli currency, foreign currency – local activity and foreign currency – foreign operation. The purpose of the circular is to allow the reader of the report to better understand the liquidity risk to which the banking corporation is exposed. Main changes:

1. Instead of presentation on a currency basis or that is linked to the Consumer Price Index, and distinction in foreign currency and local activity and foreign activity, the banking corporation is required to present cash flows for assets and liabilities distinguishing between Israeli currency (including foreign currency-linked Israeli currency) and foreign currency.

2. The statements of cash flows for cleared derivative instruments net in accordance with Section 22.b.d.(1) of the Instructions for Reporting to the Public will change and will be as follows: the expected contractual cash flows net for derivative instrument will be classified for Israeli currency or foreign currency based on the currency in which the clearance is made. The banking corporation will not report off-balance sheet amounts of derivative instruments as specified.

The instructions that were set forth in accordance with this circular were implemented retrospectively beginning with the report to the public for 2013, and afterwards. The comparison numbers for previous years will be reclassified in accordance with the new format.

The adoption of these disclosure requirements do not materially affect the financial statements of the bank.

9. Update of Accounting Standards as specified below:

Certain International Financial Reporting Standards (IFRS) and interpretations of International Financial Reporting Interpretations Committee (IFRIC) referring to the implementation of these standards, as stipulated below:

9.1 In May 2011, the IASB published three new standards:

- IFRS 10 – Consolidated Financial Statements
- IFRS11 – Joint Arrangements
- IFRS12 – Disclosure of Interests in Other Entities

The new standards will be retrospectively applied as of the Financial Statements for annual periods starting January 1, 2013, or later The standards included transition instructions with certain reliefs during first time application.

Below are the principle instructions for the aforementioned standards:

IFRS 10 – Consolidated Financial Statements

According to IFRS 10 (hereinafter:"Standard 10"), in order to establish control, the existence of power is required and exposure or rights to variable returns from the invested company. Power is the ability to influence and direct the activities of the invested company, that significantly affect the investor's yield. Standard 10 determines that during the examination of the existence of control, potential voting rights should only be considered if they are veritable.

In addition, Standard 10 determines that the investor can control even if he holds less than the majority of the voting rights in the held company (effective control), and this in contradiction with the existing IAS 27 that allowed a choice between two models for consolidation – the effective control model and the legal control model.

Standard 10 will be applied retrospectively beginning from the Financial Statements for annual periods from January 1, 2013.

The adoption of this standard will not materially affect the Bank's results.

IFRS 11 – Joint Arrangements

IFRS 11 (Hereinafter – Standard 11) replaces IAS 31 concerning the accounting process of rights in joint transactions and SIC13 regarding interpretation of accounting treatment for "non-financial" investments by entities in joint control. In addition, the standard amends some of the directives of IAS28regarding investment in associates.

Standard 11 defines joint arrangements as contractual arrangements according to which two parties or more have joint control.

Standard 11 divides the arrangements into two types:

– Joint transactions (joint ventures), in which the parties to the arrangement have joint control of the rights in net assets of the joint transaction and that will be treated only in accordance with the book value method.

– Joint activities (joint operations), in which the parties to the arrangement have joint control over the rights to the assets of the joint operations and joint obligations for the liabilities of the joint operations, and therefore will be consolidated in the financial statements based on their relative share in this operation as to be determined in the joint arrangement, similar to the currently existing accounting treatment.

Standard 11 will be applied retrospectively beginning from the Financial Statements for annual periods from January 1, 2013.

The adoption of this standard will not materially affect the bank's financial position or results.

IFRS 12 – Disclosure of Interests in Other Entities

IFRS 12 (hereinafter: "Standard 12") determines the disclosure requirement concerning the Bank's held entities, including subsidiaries, joint arrangements, consolidated companies and structured entities. Standard 12 expands the disclosure requirement concerning considerations and guidelines used by the management in determining the existence of control, joint control or significant influence in held entities, as well as determining the type of joint arrangement. Standard 12 also includes disclosure requirements concerning material held entities.

The purpose of the new disclosure requirements is to allow users of the financial statements to understand the nature and risks resulting from the reporting corporation's interests in other entities, as well as to understand the effect of said interest on the reporting corporation's financial position. This purpose is reflected in the expanded and comprehensive disclosure requirements, inter alia: discretion and significant discounts that are reflected in determination of the nature of the entities and in the arrangements, rights in subsidiaries, rights in joint arrangements and in associated companies as well as rights in structured entities.

The suitable disclosures will be included in the Financial Statements of the Bank with the standard's first time adoption on January 1, 2013.

The adoption of this standard will not materially affect the bank's financial position or results.

9.2 In May 2011, the IASB published an amendment to two existing standards:

• ISA 27R (amended 2011) – Separate Financial Statements

• IAS 28R (amended 2011) – Investments in Associates and Joint Transactions.

IAS 27R – Separate Financial Statements

IAS 27R replaces IAS 27 and deals only with separate financial statements.

The existing guidelines concerning separate financial statements remained without changes as part of the amended Standard 27.

IAS 28R – Investments in Associates and Joint Transactions

IAS 28R (hereinafter: amended Standard 28) replaces IAS28. The main changes included in it, compared to IAS 28, refer to the accounting treatment according to the equity method in investments in joint transactions, as a result of the publication of IFRS 11 and the transition from implementation of relative consolidation method to equity method in these investments.

Standard 28 will be applied retrospectively beginning from the Financial Statements for annual periods from January 1, 2013.

The adoption of this standard will not materially affect the Bank's financial results and position.

29. New accounting standards and instructions of the Supervisor of Banks in the period prior to their implementation:

1. Instructions of the Supervisor of Banks on Reporting of Banking Corporations and Credit Card Companies in Israel according to GAAP in the United States.

On January 27, 2014, the Supervisor of Banks distributed a draft on Reporting of Banking Corporations and Credit Card Companies in Israel according to GAAP in the United States.

No target date has yet been set for the transition to full reporting.

From the transition date to the adoption of full reporting according to GAAP in the United States, banking corporations will be required to regularly update the accounting treatment on these issues, in accordance with the transition instructions for new updates to the GAAP in the United States that will be published on these matters, and in accordance with clarifications that will be delivered by the Supervisor of Banks.

The banking corporation will review the expected effect of adoption of the rules on the financial statements. At this stage, the effects cannot be estimated.

2. **Supervisor of Banks' instructions concerning the Profit and Loss Statement format for a banking corporation, and adoption of GAAP by banks in the USA for measurement of interest:**

   Adoption of ASC 310-20 concerning "Non-Refundable Commissions and Other Costs":

   On December 29, 2011, the Supervisor of Banks published a circular aimed at adapting the instructions for reporting to the public for the purpose of adopting the rules set forth as part of the accepted accounting standards in the US regarding non-refundable commissions and other costs. The instructions set forth rules for treating commissions from the creation of loans and direct costs in the creation of loans. The qualifying commissions and costs in accordance with the criteria set forth in the instruction will not be immediately recognized in the Profit and Loss Statement but will be taken into account in calculating the loan's effective interest rate. In addition, the instruction changes the treatment of the commissions and costs related to the credit allocation liabilities, including credit card transactions. Furthermore, the instruction sets forth rules pertaining to the treatment of changes in the terms of the debt that do not constitute reorganization of the problematic debt, treatment of early repayment of the debts, as well as treatment of other credit provision transactions such as syndication transactions.

   The amendments related to adoption of the issue of measuring interest incomes will be implemented as of January 1, 2014, and henceforth.

   According to the bank's estimates, the affect of implementation of the instructions for 2014 is not expected to be material.

3. **Instructions of the Supervisor of Banks on the adoption of GAAP in the US on employee rights**

   On January 30, 2014, the Supervisor of Banks distributed draft amendments to the instructions for reporting to the public that were designed to update the requirements for recognition, measurement and disclosure on employee benefits according to the GAAP in the United States.

   The draft nullifies the temporary order in the existing instructions that establishes the capitalization rate for calculating reserves for covering employee rights. In accordance with the GAAP in the United States, the capitalization rate will be based on the market yields for government debentures in Israel. A banking corporation will establish policies and procedures that detail how government debentures used to calculate the capitalization rate will be selected.

   The date of implementation of the instruction was established for January 1, 2015 and will include a retroactive amendment of the comparison numbers for the periods beginning on January 1, 2013 and henceforth.

In the financial statements of the banking corporations that will be published by this date, disclosure will be given regarding the expected quantitative effect of first-time adoption of these rules on the banking corporation's capital and liabilities.

Based on the bank's initial assessment, implementation of the draft will not have a material effect on the Bank's results.

4. Instructions of the Supervisor of Banks on Disclosure Requirements of Basel pertaining to the capital composition

On August 29, 2013, the Supervisor of Banks circular was published on Basel requirements pertaining to the capital composition and various disclosure requirements. Pursuant to the adoption of Basel III by the Supervisor of Banks, the instructions for reporting to the public were amended. Below are the key points of the changes:

- The definition of Tier 1 equity was changed.
- New deductions from capital were established.
- Qualifying criteria for recognized capital instruments were changed.
- Expansion of disclosure on the main characteristics of capital instruments that were issued and on regulatory capital components.
- Establishment of a format to present the correlation between the balance sheet in the published financial statements and the regulatory capital components.

The instructions will apply beginning on January 1, 2014. At the same time, as part of the audited Note on capital adequacy according to the instructions of the Supervisor of Banks on December 31, 2013, disclosure on the effect of the adoption of Basel III was provided. Furthermore, the Board of Directors' report from December 31, 2013 included quantitative and qualitative reference to main factors that are expected to be subject to change due to adoption of Basel III, in capital for capital adequacy purposes and in the weighted balances of risk assets.

As a result of the transition to the instructions of Basel III, risk assets increased by approximately NIS 163 million, Tier 1 capital increased by NIS 0.3 million and Tier 2 capital increased by approximately NIS 16.6 million.

5. Instructions of the Supervisor of Banks on the reporting of sums that were reclassified outside accumulated other comprehensive income.

On September 30, 2013, the Supervisor of Banks published a circular on reporting of sums that were reclassified outside accumulated other comprehensive income. The circular aims to adapt the disclosure requirements for sums that were reclassified outside accumulated other comprehensive income, to the update requirements and accepted method of disclosure of sums as specified in the financial statements of banking corporations in the United States. Main Changes:

1. Added to the Note on Accumulated Other Comprehensive Income (Loss) is a disclosure requirement for sections in the Statement of Profit and Loss that include sums that were reclassified from Accumulated Other Comprehensive Income to the Statement of Profit and Loss.

2. In the Note on Financing Income Not from Interest, a footnote was added that clarifies which sections in the note were reclassified from Accumulated Other Comprehensive Income.

The instructions that were set forth in this circular will be implemented retrospectively beginning with the report to the public for the first quarter of 2014, and henceforth.

The bank estimates that the adoption of this disclosure requirement will not materially affect the bank's results and financial position.

Note 3 – Cash and Deposits in Banks

Reported amounts in millions of Shekels

	Consolidated		Bank	
	December 31,			
	2013	2012	2013	2012
Cash and deposits in the Bank of Israel	**2,701.5**	1,030.6	**2,701.5**	1,030.5
Cash and deposits in commercial banks	**131.9**	330.0	**131.9**	329.4
	2,833.4	1,360.6	**2,833.4**	1,359.9
From this: cash, deposits in banks and deposits in the Bank of Israel for an original period of up to 3 months	**2,833.4**	1,360.6	**2,833.4**	1,359.9

Note 4 – Securities – Consolidated

Reported amounts in millions of Shekels

	December 31, 2013				
			Accumulated other comprehensive income		
	Balance sheet value	Amortized cost (in shares – cost)	Earnings	Losses	Fair value(1)
Available-for-sale securities -					
Debentures					
of the Israeli Government	477.8	477.3	1.0	0.5	477.8
of financial institutions in Israel	10.1	10.0	0.1	–	10.1
of others in Israel	1.7	1.5	0.2	–	1.7
Total debentures	489.6	488.8	1.3	0.5	489.6
Shares	3.7	3.7	–	–	3.7
Total available-for-sale securities	**493.3**	**492.5**	**1.3**(2)	**0.5**(2)	**493.3**

	Balance sheet value	Amortized cost (in shares – cost)	Unrealized earnings from fair value adjustments	Unrealized losses from fair value adjustments	Fair value(1)
Securities for trade -					
Debentures					
of the Israeli Government	183.0	181.9	1.3	0.2	183.0
of financial institutions in Israel	0.3	0.3		–	0.3
Total securities for trade	183.3	182.2	1.3(3)	0.2(3)	183.3
Total securities	**676.6**	**674.7**	**2.6**	**0.7**	**676.6**

(1) Fair value data is generally based on stock exchange rates that are not necessarily reflected in the prices obtained from sale of securities on a large scale.

(2) Included in equity in section "Adjustments for presentation of available-for-sale securities at fair value".

(3) Charged to Profit and Loss Statement.

For an itemization of expenses from investment activity in debentures – see Notes on interest income and expenses and non-interest financing income.

Note 4 – Securities (continued) – Consolidated

Reported amounts in millions of Shekels

	December 31, 2012				
			Accumulated other comprehensive income		
	Balance sheet value	Amortized cost (in shares – cost)	Earnings	Losses	Fair value(1)
Available-for-sale securities -					
Debentures					
of the Israeli Government	786.2	784.5	3.4	1.7	786.2
of financial institutions in Israel	10.0	10.0	-	-	10.0
of others in Israel	3.0	2.8	0.2	-	3.0
Total debentures	799.2	797.3	3.6	1.7	799.2
Shares	1.1	1.1	-	-	1.1
Total available-for-sale securities	**800.3**	**798.4**	**3.6** (2)	**1.7** (2)	**800.3**

	Balance sheet value	Amortized cost (in shares – cost)	Unrealized earnings from fair value adjustments	Unrealized losses from fair value adjustments	Fair value(1)
Securities for trade -					
Debentures					
of the Israeli Government	354.0	345.1	8.9	-	354.0
of financial institutions in Israel	6.6	6.6	-	-	6.6
of others in Israel	2.1	2.2	-	0.1	2.1
Total securities for trade	362.7	353.9	8.9 (3)	0.1 (3)	362.7
Total securities	**1,163.0**	**1,152.3**	**12.5**	**1.8**	**1,163.0**

(1) Fair value data is generally based on stock exchange rates that are not necessarily reflected in the prices obtained from sale of securities on a large scale.

(2) Included in equity in section "Adjustments for presentation of available-for-sale securities at fair value".

(3) Charged to Profit and Loss Statement.

For details on results of investment activity in debentures – see Notes: Interest Income and Expenses and Non-Interest Financing Expenses

Note 4 – Securities (continued) – The Bank

Reported amounts in millions of Shekels

Fair value and unrealized losses, by impairment length of time and rate, of available-for-sale securities in unrealized loss position

	December 31, 2013							
	Less than 12 months (1)				12 months or more (2)			
	Fair value	Unrealized losses 0-20%(3)	Unrealized losses 20-40%(4)	Unrealized losses Total	Fair value	Unrealized losses 0-20%(3)	Unrealized losses 20-40%(4)	Unrealized losses Total
Debentures								
of the Israeli Government	–	–	–	–	123.1	0.5	–	0.5
of financial institutions in Israel	–	–	–	–	-	-	–	-
of others in Israel	–	–	–	–	-	-	–	-
Total debentures	**–**	**–**	**–**	**–**	**123.1**	**0.5**	**–**	**0.5**
Shares	**–**	**–**	**–**	**–**	**-**	**-**	**–**	**-**
Total available-for-sale securities	**–**	**–**	**–**	**–**	**123.1**	**0.5**	**–**	**0.5**

	December 31, 2012							
	Less than 12 months (1)				12 months or more (2)			
	Fair value	Unrealized losses 0-20%(3)	Unrealized losses 20-40%(4)	Unrealized losses Total	Fair value	Unrealized losses 0-20%(3)	Unrealized losses 20-40%(4)	Unrealized losses Total
Debentures								
of the Israeli Government	6.9	-(5)	–	–	385.8	1.7	–	1.7
of financial institutions in Israel	9.1	-(5)	–	–	–	-	–	-
Total debentures	16.0	-(5)	–	–	385.8	1.7	–	1.7
Shares	-	–	–	–	–	-	–	-
Total available-for-sale securities	**16.0**	-(5)	**–**	**–**	**385.8**	**1.7**	**–**	**1.7**

(1) Investments that were in a continuous unrealized loss position lasting less than 12 months.

(2) Investments that were in a continuous unrealized loss position lasting 12 months or more.

(3) Investments in respect of which the unrealized loss constitutes up to 20% of their amortized cost.

(4) Investments in respect of which the unrealized loss constitutes over 20% and up to 40% of their amortized cost.

(5) Amount less than NIS 0.1 million.

Note 4 – Securities (continued) – The Bank

Reported amounts in millions of Shekels

	December 31, 2013				
			Accumulated other comprehensive income		
	Balance sheet value	Amortized cost (in shares – cost)	Earnings	Losses	Fair value(1)
Available-for-sale securities -					
Debentures					
of the Israeli Government	286.1	286.0	0.6	0.5	286.1
of financial institutions in Israel(4)	213.4	213.3	0.1	–	213.4
of others in Israel	1.7	1.5	0.2	–	1.7
Total debentures	501.2	500.8	0.9	0.5	501.2
Shares	3.7	3.7	–	–	3.7
Total available-for-sale securities	**504.9**	**504.5**	**0.9** (2)	**0.5** (2)	**504.9**

	Balance sheet value	Amortized cost (in shares – cost)	Unrealized profits from adjustments to fair value Earnings	Unrealized losses from adjustments to fair value Losses	Fair value(1)
Securities for trade -					
Debentures					
of the Israeli Government	175.3	174.2	1.3	0.2	175.3
of financial institutions in Israel	0.3	0.3	–	–	0.3
Total securities for trade	175.6	174.5	1.3 (3)	0.2 (3)	175.6
Total securities	**680.5**	**679.0**	**2.2**	**0.7**	**680.5**

(1) Fair value data is generally based on stock exchange rates that are not necessarily reflected in the prices obtained from sale of securities on a large scale.

(2) Included in equity in section "Adjustments for presentation of available-for-sale securities at fair value".

(3) Charged to Profit and Loss Statement.

(4) From this, balance sheet value of NIS 203.3 million (NIS 222.9 million in 2012) in respect of debentures of consolidated companies.

For details on results of investment activity in debentures – see Notes: Interest Income and Expenses and Non-Interest Financing Expenses

Note 4 – Securities (continued) – The Bank

Reported amounts in millions of Shekels

	December 31, 2012				
			Accumulated other comprehensive income		
	Balance sheet value	Amortized cost (in shares – cost)	Earnings	Losses	Fair value[1]
Available-for-sale securities -					
Debentures					
of the Israeli Government	587.0	585.5	3.2	1.7	587.0
of financial institutions in Israel[4]	232.9	232.9	–	–	232.9
of others in Israel	3.0	2.8	0.2	–	3.0
Total debentures	822.9	821.2	3.4	1.7	822.9
Shares	1.1	1.1	–	–	1.1
Total available-for-sale securities	**824.0**	**822.3**	3.4 [2]	1.7 [2]	**824.0**

	Balance sheet value	Amortized cost (in shares – cost)	Unrealized profits from adjustments to fair value Earnings	Unrealized losses from adjustments to fair value Losses	Fair value[1]
Securities for trade -					
Debentures					
of the Israeli Government	352.0	343.1	8.9	–	352.0
of financial institutions in Israel	6.6	6.6	–	–	6.6
of others in Israel	2.1	2.1	–	–	2.1
Total securities for trade	360.7	351.8	8.9 [3]	– [3]	360.7
Total securities	**1,184.7**	**1,174.1**	**12.3**	**1.7**	**1,184.7**

(1) Fair value data is generally based on stock exchange rates that are not necessarily reflected in the prices obtained from sale of securities on a large scale.

(2) Included in equity in section "Adjustments for presentation of available-for-sale securities at fair value".

(3) Charged to Profit and Loss Statement.

(4) From this, balance sheet value of NIS 222.9 million (NIS 260.7 million in 2011) in respect of debentures of consolidated companies.

For details on results of investment activity in debentures – see Notes: Interest Income and Expenses and Non-Interest Financing Expenses

Note 5 – Credit Risk, Credit to the Public and Provision for Credit Losses on a Consolidated Basis

Reported amounts in millions of Shekels

A. Debts[1] and off-balance sheet credit instruments

	December 31, 2013					
	Credit to the public				Banks and governments	Total
	Commercial	Housing	Other private	Total		
1. Movement in balance of provision for credit losses						
Balance of provision for credit losses at the start of the year	9.6	60.5	22.5	92.6	–	92.6
Expenses from credit losses	2.1	21.1	31.5	54.7	-	54.7
Accounting write-offs	(4.0)	(11.8)	(31.6)	(47.4)	–	(47.4)
Collection of accounting write-off debts from previous years	3.3	0.1	7.8	11.2	–	11.2
Net accounting write-offs	(0.7)	(11.7)	(23.8)	(36.2)	–	(36.2)
Other	–	–	0.3	0.3	–	0.3
Balance of provision for credit losses at the end of the year (*)	11.0	69.9	30.5	111.4	-	111.4
(*) From this: in respect of off-balance sheet credit instruments	1.4	0.7	0.4	2.5	–	2.5
2. Additional information on the method for calculating the provision for credit losses for debts[1] and on debts[1] for which it was calculated:						
Recorded balance of debts due[1]:						
Examined on individual basis	1,183.4	1.4	236.2	1,421.0	–	1,421.0
Examined on group basis(**)	386.4	6,988.9	939.2	8,314.5	399.1	8,713.6
Total debts[1]	1,569.8	6,990.3	1,175.4	9,735.5	399.1	10,134.6
(**) From this: for which the provision was calculated according to the depth of the arrears	–	6,805.8	–	6,805.8	–	6,805.8
Provision for credit losses from debts						
Examined on individual basis	7.9	0.1	1.2	9.2	–	9.2
Examined on group basis(***)	1.7	69.1[2]	28.9	99.7	–	99.7
Total provision for credit losses	9.6	69.2	30.1	108.9	–	108.9
(***) From this: for which the provision was calculated according to the depth of the arrears	–	44.3	–	44.3	–	44.3

(1) Credit to the public, credit to governments, deposits in banks and other debts, with the exception of debentures and securities that were borrowed or purchased as part of reverse repo agreements.

(2) Includes balances of provision beyond what is required according to the depth of the arrears that was calculated on an individual basis for a sum of NIS 0.3 million, and that was calculated on a group basis for a sum of NIS 24.5 million.

Note 5 – Credit Risk, Credit to the Public and Provision for Credit Losses on a Consolidated Basis (continued)

Reported amounts in millions of Shekels

A. Debts(1) and off-balance sheet credit instruments (continued)

	December 31, 2012					
	Credit to the public				Banks and governments	Total
	Commercial	Housing	Other private	Total		
1. Movement in balance of provision for credit losses						
Balance of provision for credit losses at the start of the year	8.9	69.9	13.9	92.7	–	92.7
Expenses from credit losses	3.3	(1.8)	34.5	36.0	–	36.0
Accounting write-offs	(3.4)	(7.6)	(31.3)	(42.3)	–	(42.3)
Collection of accounting write-off debts from previous years (3)	0.8	–	5.4	6.2	–	6.2
Net accounting write-offs	(2.6)	(7.6)	(25.9)	(36.1)	–	(36.1)
Balance of provision for credit losses at the end of the year(*)	9.6	60.5	22.5	92.6	–	92.6
(*)From this: in respect of off-balance sheet credit instruments	1.7	–	0.2	1.9	–	1.9
2. Additional informationon the method for calculating the provision for credit losses for debts(1) and of debts(1) for which it was calculated:						
Recorded balance of debts due(1):						
Examined on individual basis	1,190.6	–	374.8	1,565.4	–	1,565.4
Examined on group basis(**)	534.6	6,882.7	689.4	8,106.7	388.7	8,495.4
Total debts(1)	**1,725.2**	**6,882.7**	**1,064.2**	**9,672.1**	**388.7**	**10,060.8**
(**)From this: for which the provision was calculated according to the depth of the arrears	–	6,602.6	–	6,602.6	–	6,602.6
Provision for credit losses from debts						
Examined on individual basis	7.2	–	1.8	9.0	–	9.0
Examined on group basis(***)	0.7	60.5(2)	20.5	81.7	–	81.7
Total provision for credit losses	**7.9**	**60.5**	**22.3**	**90.7**	**–**	**90.7**
(***)From this: for which the provision was calculated according to the depth of the arrears	–	53.1	–	53.1	–	53.1

(1) Credit to the public, credit to governments, deposits in banks and other debts, with the exception of debentures and securities that were borrowed or purchased as part of repurchase agreements.

(2) Including balances of provision that were calculated on a group basis for a sum of NIS 7.4 million.

(3) Reclassified

Note 5 – Credit Risk, Credit to the Public and Provision for Credit Losses on a Consolidated Basis (continued)

Reported amounts in millions of Shekels

B. Debts[1]

1. Credit quality and arrears

	December 31, 2013					
		Problematic[2]			Non-defective debts additional information	
Borrowers Activity in Israel Commercial Public	**Non-problematic**	**Non-defective**	**Defective[3]**	**Total**	**In arrears of 90 or more days[4]**	**In arrears of 30 to 89 days [5]**
Construction and Real Estate – Construction	968.6	15.3	42.9	1,026.8	2.8	0.2
Construction and Real Estate – Activity in Real Estate	383.1	11.3	4.0	398.4	3.6	2.5
Financial Services	31.0	-	–	31.0	-	-
Commercial – Other	105.1	1.1	7.4	113.6	0.4	0.4
Total Commercial	**1,487.8**	**27.7**	**54.3**	**1,569.8**	**6.8**	**3.1**
Private Individuals – Housing Loans	6,745.7	243.2[6]	1.4	6,990.3	243.2	59.7
Private Individuals – Other	1,142.4	22.3	10.7	1,175.4	10.3	14.1
Total Public – Activity in Israel	**9,375.9**	**293.2**	**66.4**	**9,735.5**	**260.3**	**76.9**
Banks in Israel	-	-	–	-	-	-
Israeli Government	399.1	-	–	399.1	-	-
Total Activity in Israel	**9,775.0**	**293.2**	**66.4**	**10,134.6**	**260.3**	**76.9**
Banks Abroad	-	-	–	-	-	-
Total	**9,775.0**	**293.2**	**66.4**	**10,134.6**	**260.3**	**76.9**

(1) Credit to the public, credit to governments, deposits in banks and other debts, with the exception of debentures and securities that were borrowed or purchased as part of reverse repo agreements.

(2) Credit risk that is defective, inferior or under special supervision, including for housing loans for which there is a provision based on the arrears depth, and housing loans, for which there is no provision based on the arrears depth, in arrears by 90 or more days.

(3) In general, defective debts do not accrue interest income. For information about certain defective debts that were reorganized under a reorganization of problematic debts, see Note 5.b.2.c. below.

(4) Classified as problematic debts that are not defective. These debts accumulate interest income.

(5) These debts accumulate interest income. Debts in arrears between 30 and up to 89 days, totaling NIS 9.0 million, were classified as problematic debts that are not defective.

(6) Including balance of housing loans of NIS 109.4 million with a provision based on the arrears depth, for which a settlement was signed for the return of arrears from the borrower, when a change in clearance schedule was made for the remaining loan that has not yet reached maturity.

Note 5 – Credit Risk, Credit to the Public and Provision for Credit Losses on a Consolidated Basis (continued)

Reported amounts in millions of Shekels

B. Debts[1]

1. Credit quality and arrears (continued)

	December 31, 2012					
		Problematic(2)			Non-defective debts Additional information	
Borrowers Activity in Israel Commercial Public	Non-problematic	Non-defective	Defective(3)	Total	In arrears of 90 or more days (4)	In arrears of 30 to 89 days (5)
Construction and Real Estate – Construction	1,099.5	10.3	57.2	1,167.0	5.2	0.7
Construction and Real Estate – Activity in Real Estate	357.6	6.5	13.0	377.1	3.4	-
Financial Services	38.0	-	-	38.0	–	-
Commercial – Other	137.3	1.0	4.8	143.1	0.3	0.9
Total Commercial	**1,632.4**	**17.8**	**75.0**	**1,725.2**	**8.9**	**1.6**
Private Individuals – Housing Loans	6,621.1	261.6 (6)	-	6,882.7	261.6	62.7
Private Individuals – Other	1,034.5	26.6	3.1	1,064.2	9.8	17.7
Total Public – Activity in Israel	**9,288.0**	**306.0**	**78.1**	**9,672.1**	**280.3**	**82.0**
Banks in Israel	141.8	-	-	141.8	-	-
Israeli Government	223.8	-	-	223.8	-	-
Total Activity in Israel	**9,653.6**	**306.0**	**78.1**	**10,037.7**	**280.3**	**82.0**
Banks Abroad	23.1	-	-	23.1	-	-
Total	**9,676.7**	**306.0**	**78.1**	**10,060.8**	**280.3**	**82.0**

(1) Credit to the public, credit to governments, deposits in banks and other debts, with the exception of debentures and securities that were borrowed or purchased as part of reverse repo agreements.

(2) Credit risk that is defective, inferior or under special supervision, including for housing loans for which there is a provision based on the arrears depth, and housing loans, for which there is no provision based on the arrears depth, in arrears by 90 or more days.

(3) In general, defective debts do not accrue interest income. For information about certain defective debts that were reorganized under a reorganization of problematic debts, see Note 5.b.2.c. below.

(4) Classified as problematic debts that are not defective. These debts accumulate interest income.

(5) These debts accumulate interest income. Debts in arrears between 30 and up to 89 days, totaling NIS 9.3 million, were classified as problematic debts that are not defective.

(6) Including balance of housing loans of NIS 102.3 million with a provision based on the arrears depth, for which a settlement was signed for the return of arrears from the borrower, when a change in clearance schedule was made for the remaining loan that has not yet reached maturity.

Note 5 – Credit Risk, Credit to the Public and Provision for Credit Losses on a Consolidated Basis (continued)

Reported amounts in millions of Shekels

B. Debts[1](continued)

2. Additional information on defective debts

A. Defective debts and individual provision borrower activity in Israel

	December 31, 2013				
	Balance[2] of defective debts for which an individual provision exists [3]	Balance of individual provision [3]	Balance[2] of defective debts for which no individual provision exists [3]	Total balance[2] of defective debts	Balance of contractual principal of of defective debts
Commercial Public					
Construction and Real Estate – Construction	35.5	1.9	7.4	42.9	51.2
Construction and Real Estate – Activity in Real Estate	-	–	4.0	4.0	5.1
Financial Services	-	–	–	–	–
Commercial – Other	2.8	0.5	4.6	7.4	7.8
Total Commercial	**38.3**	**2.4**	**16.0**	**54.3**	**64.1**
Private Individuals – Housing Loans	1.4	0.1	–	1.4	1.4
Private Individuals – Other	10.7	2.4	–	10.7	14.8
Total Public – Activity in Israel	**50.4**	**4.9**	**16.0**	**66.4**	**80.3**
Banks in Israel	-	–	–	–	–
Israeli Government	-	–	–	–	–
Total Activity in Israel	**50.4**	**4.9**	**16.0**	**66.4**	**80.3**
Banks Abroad	-	–	–	–	–
Total	**50.4**	**4.9**	**16.0**	**66.4**	**80.3**
From this:					
Measured according to present value of cash flows	30.2	1.7	9.2	39.4	49.3
Debts in reorganization of problematic debts	40.8	1.8	11.8	52.6	53.7

(1) Credit to the public, credit to governments, deposits in banks and other debts, with the exception of debentures and securities that were borrowed or purchased as part of reverse repo agreements.

(2) Recorded balance of debt.

(3) Individual provision for credit losses.

Note 5 – Credit Risk, Credit to the Public and Provision for Credit Losses on a Consolidated Basis (continued)

Reported amounts in millions of Shekels

B. Debts[1](continued)

2. Additional information on defective debts (continued)

A. Defective debts and individual provision borrower activity in Israel (continued)

	December 31, 2012				
	Balance[2] of defective debts for which an individual provision exists [3]	Balance of individual provision [3]	Balance[2] of defective debts for which no individual provision exists [3]	Total balance[2] of defective debts	Balance of contractual principal of defective debts
Commercial Public					
Construction and Real Estate – Construction	29.5	2.5	27.7	57.2	65.5
Construction and Real Estate – Activity in Real Estate	–	–	13.0	13.0	14.0
Financial Services	–	–	–	–	–
Commercial – Other	3.0	0.3	1.8	4.8	4.8
Total Commercial	**32.5**	**2.8**	**42.5**	**75.0**	**84.3**
Private Individuals – Housing Loans	–	–	–	–	–
Private Individuals – Other	3.1	0.7	–	3.1	7.5
Total Public – Activity in Israel	**35.6**	**3.5**	**42.5**	**78.1**	**91.8**
Banks in Israel	–	–	–	–	–
Israeli Government	–	–	–	–	–
Total Activity in Israel	35.6	3.5	42.5	78.1	91.8
Banks Abroad	–	–	–	–	–
Total	**35.6**	**3.5**	**42.5**	**78.1**	**91.8**
From this:					
Measured according to present value of cash flows	35.6	3.5	25.3	60.9	70.3
Debts in reorganization of problematic debts	35.6	3.5	10.9	46.5	55.8

(1) Credit to the public, credit to governments, deposits in banks and other debts, with the exception of debentures and securities that were borrowed or purchased as part of reverse repo agreements.

(2) Recorded balance of debt.

(3) Individual provision for credit losses.

Note 5 – Credit Risk, Credit to the Public and Provision for Credit Losses on a Consolidated Basis (continued)

Reported amounts in millions of Shekels

B. Debts[(1)] (continued)

2. Additional information on defective debts (continued)

B. Average balance and interest income

	For the year ended on December 31, 2013		
	Average balance of defective debts	Interest income that was recorded [(2),(3)]	From this: Recorded on a cash basis
Borrowers Activity in Israel			
Public – Commercial			
Construction and Real Estate – Construction	49.4	1.8	1.8
Construction and Real Estate – Activity in Real Estate	8.2	0.2	0.2
Commercial – Other	8.2	–	–
Total Commercial	65.8	2.0	2.0
Private Individuals – Other	7.0	0.1	0.1
Total	**72.8**	**2.1**	**2.1**

	For the year ended on December 31, 2012
Average recorded debt balance of defective credit to the public in reporting period	54.4
Total interest income that was recorded in the reporting period in respect of this credit in the time period in which it was classified as defective*	0.2
Total interest income that would have been recorded in the reporting period, had these debts accumulated interest according to the original conditions	3.1
*From this: interest income that was recorded on a cash basis accounting method	0.2

(1) Credit to the public, credit to governments, deposits in banks and other debts, with the exception of debentures and securities that were borrowed or purchased as part of reverse repo agreements.

(2) Accumulates interest income.

(3) Included in defective debts.

Note 5 – Credit Risk, Credit to the Public and Provision for Credit Losses on a Consolidated Basis (continued)

Reported amounts in millions of Shekels

B. Debts[(1)] (continued)

2. Additional information on defective debts (continued)

C. Problematic debts in reorganization Borrower Activity in Israel

	As at December 31, 2013				
	Recorded debt balance				
	not accumulating interest income	Accumulating[(2)] in arrears of 90 or more days	Accumulating[(2)] in arrears of 30 and up to 89 days	Accumulating[(2)] not in arrears	Total
Commercial Public					
Construction and Real Estate – Construction	34.5	–	–	–	**34.5**
Construction and Real Estate – Activity in Real Estate	3.4	–	–	–	**3.4**
Financial Services	–	–	–	–	**–**
Commercial – Other	4.6	–	–	0.1	**4.7**
Total Commercial	**42.5**	**–**	**–**	**0.1**	**42.6**
Private Individuals – Housing Loans	0.8	–	–	–	**0.8**
Private Individuals – Other	7.5	–	–	1.7	**9.2**
Total	**50.8**	**–**	**–**	**1.8**	**52.6**

	As at December 31, 2012				
Construction and Real Estate – Construction	29.5	–	–	7.8	**37.3**
Construction and Real Estate – Activity in Real Estate	3.1	–	–	–	**3.1**
Financial Services	–	–	–	–	**–**
Commercial – Other	3.0	–	–	–	**3.0**
Total Commercial	**35.6**	**–**	**–**	**7.8**	**43.4**
Private Individuals – Housing Loans	–	–	–	–	**–**
Private Individuals – Other	3.1	–	–	–	**3.1**
Total	**38.7**	**–**	**–**	**7.8**	**46.5**

(1) Credit to the public, credit to governments, deposits at banks and other debts, with the exception of debentures.

(2) Accumulates interest income

(3) Included in defective debts

As at December 31, 2013, the bank has no obligations to provide additional credit to debtors for which problematic debt was reorganized, during which changes were made to the credit terms.

Note 5 – Credit Risk, Credit to the Public and Provision for Credit Losses on a Consolidated Basis (continued)

Reported amounts in millions of Shekels

B. Debts[1](continued)

2. Additional information on defective debts (continued)

C. Problematic debts in reorganization Borrower Activity in Israel (continued)

	As at December 31, 2013		
	Recorded debt balance		
	Number of contracts	Recorded debt balance before reorganization	Recorded debt balance after reorganization
Commercial Public			
Construction and Real Estate – Construction	–	–	–
Construction and Real Estate – Activity in Real Estate	–	–	–
Commercial – Other	6	3.4	3.4
Total Commercial	6	3.4	3.4
Private Individuals – Housing Loans	–	–	–
Private Individuals – Other	250	7.4	7.4
Total	**256**	**10.8**	**10.8**

2. Additional information on defective debts	Reorganizations that were performed and failed[2] for the year ended December 31, 2013	
C. Problematic debts in reorganization Borrowers Activity in Israel	Number of contracts	Recorded debt balance
Commercial Public		
Construction and Real Estate – Construction	–	-
Construction and Real Estate – Activity in Real Estate	–	-
Commercial – Other	2	-[3]
Total Commercial	**2**	-[3]
Private Individuals – Housing Loans	–	-
Private Individuals – Other	72	1.6
Total	**74**	**1.6**

(1) Credit to the public, credit to governments, deposits at banks and other debts, with the exception of debentures.

(2) Debts that in the reporting year became debts in arrears of 30 days or more, that were reorganized in a reorganization of problematic debts in the 12 months that preceded the date on which they became debts in arrears.

(3) Balance less than NIS 0.1 million.

Note 5 – Credit Risk, Credit to the Public and Provision for Credit Losses on a Consolidated Basis (continued)

Reported amounts in millions of Shekels

B. Debts[(1)](continued)

3. Additional information on housing loans

Balance as at the end of the year based on the financing rate (LTV)(1), type of reimbursement and type of interest

		December 31, 2013			
		Balance of Housing Loans			Off-balance sheet credit risk
		Total[(1)]	From this: bullet and balloon[(1)]	From this: variable interest[(1)]	Total
First lien: financing rate	Up to 60%	5,490.2	149.0	4,593.9	552.4
	Over 60%	1,590.7	34.8	1,421.8	69.2
Secondary lien or no lien		42.8	1.6	23.0	3.8
Total		**7,123.7**	**185.4**	**6,038.7**	**625.4**

		December 31, 2012			
First lien: financing rate	Up to 60%	5,332.7	123.6	4,352.0	638.6
	Over 60%	1,662.2	20.1	1,483.2	56.9
Secondary lien or no lien		45.6	0.9	20.9	4.5
Total		**7,040.5**	**144.6**	**5,856.1**	**700.0**

(1) The ratio between the approved credit line during the granting of the credit line and the value of the asset, as approved by the bank when providing the credit line.

(2) Including housing loans provided to certain acquisition groups that are under construction, for a total of NIS 133.4 million in 2013, and NIS 157.8 million in 2012.

Note 5 – Credit to the public and provision for credit losses on a consolidated basis (continued)

Reported amounts in millions of Shekels

C. Credit to the public and off-balance sheet credit risk according to the amount of the borrower's credit

		December 31, 2013			December 31, 2012		
Credit ceiling in thousands of NIS		Number of borrowers(1)	Credit(2)	Off-balance sheet credit risk(2)(3)	Number of borrowers(1)	Credit(2)	Off-balance sheet credit risk(2)(3)
			Millions of NIS			Millions of NIS	
	Up to 10	**4,715**	**26.7**	**17.2**	3,545	19.3	2.5
Over 10	up to 20	**6,070**	**82.2**	**11.3**	5,554	79.7	9.9
Over 20	up to 40	**10,439**	**301.6**	**15.9**	9,173	265.5	21.3
Over 40	up to 80	**8,920**	**466.1**	**21.6**	8,375	435.2	32.4
Over 80	up to 150	**4,257**	**427.0**	**42.3**	4,827	516.4	29.0
Over 150	up to 300	**4,901**	**1,013.3**	**50.9**	5,032	1,058.8	53.6
Over 300	up to 600	**4,716**	**1,840.5**	**135.5**	4,617	1,816.4	159.3
Over 600	up to 1,200	**2,391**	**1,744.9**	**179.1**	2,244	1,673.5	170.4
Over 1,200	up to 2,000	**733**	**958.3**	**124.1**	695	957.2	97.1
Over 2,000	up to 4,000	**393**	**956.9**	**103.6**	385	880.4	169.5
Over 4,000	up to 8,000	**133**	**590.0**	**156.4**	132	610.3	115.0
Over 8,000	up to 20,000	**71**	**599.9**	**247.9**	78	677.5	254.0
Over 20,000	up to 40,000	**22**	**461.8**	**192.3**	24	460.7	183.9
Over 40,000	up to 60,000	**8**	**266.3**	**149.0**	7	221.2	164.6
		47,769	**9,735.5**	**1,447.1**	44,688	9,672.1	1,462.5

(1) Number of borrowers according to total credit and off-balance sheet credit risk.

(2) Credit and off-balance sheet credit risk are presented before the effect of the provision for credit losses and before the collateral effects permitted for deduction for the purpose of the liability of the borrower and groups of borrowers.

(3) Credit risk in off-balance sheet financial instruments as calculated for the purpose of single borrower's liability limitations.

Note 6 – Credit to the Government (consolidated and the Bank)

Reported amounts in millions of Shekels

	December 31,	
	2013	**2012**
Credit as part of interest completion arrangements for the entitled of the Ministry of Construction and Housing	**1.1**	1.4
Less – interest completion in advance from the government	**(1.1)**	(1.4)
Total credit to the government	**-**	-

According to the agreement between the government of Israel and the Bank, the government undertook to complete to the Bank, due to certain housing loans that have been provided to those entitled to support according to the directives of the Ministry of Construction and Housing, the interest gap between the average low interest rate that was custom at the mortgage banks, according to an agreed formula, and between the actual interest rate on aforementioned loans. Completion of interest as mentioned, in advance for the whole loan period, where the loan is capitalized according to an annual interest rate of 2%, was granted as a deposit in favor of the Bank with the Accountant General, carrying interest at an identical rate.

Note 7 – Investment in investee companies

Reported amounts in millions of Shekels

a – Investment composition

	Consolidated		The Bank	
	December 31,			
	2013	2012	2013	2012
Consolidated companies				
Investment in shares according to the equity method	–	–	**380.6**	364.7
From this: profits accumulated from acquisition date	–	–	**285.2**	274.5
Items accumulated in equity from the acquisition date				
Adjustments due to the presentation of securities available for sale at fair value, net	–	–	**0.2**	0.1

b – The Bank's share in profits or losses of investee companies

	Consolidated			The Bank		
	2013	2012	2011	2013	2012	2011
The Bank's share in profits of investee companies	–	–	–	**14.0**	18.6	38.1
Provision for taxes						
Current taxes	–	–	–	**2.2**	3.3	6.9
Deferred taxes	–	–	–	**0.5**	0.3	(0.1)
Total provision for taxes	–	–	–	**2.7**	3.6	6.8
The Bank's share in profits of investee companies, after tax effect	–	–	–	**11.3**	15.0	31.3

Note 7 – Investment in Investee Companies (Continued)

Reported amounts

c – Details on Investee Companies(10)

Company name	Details on the Company	Share in capital that entitles to receive profits and voting rights	Investment in shares based on value as per the equity method as at December 31,		Contribution to net income from regular activities on December 31,	
			2013	**2012**	***2013**	***2012**
		%	Millions of NIS			
Tomer Jerusalem Ltd.	(1)	100	**159.9**	157.4	**2.6**	6.6
Ir Shalem Insurance Agency (1996) Ltd.	(2)	100	**155.5**	148.0	**7.4**	7.7
Jerusalem Investment Portfolio Management Ltd.	(3)	100	**35.0**	34.7	**0.3**	(0.1)
Jerusalem Capital Markets Funds Management (1980) Ltd.	(4)	100	**1.6**	1.5	**–**	–
Jerusalem Underwriting and Issuances Ltd.	(5)	100	**6.5**	6.5	**–**	–
The Trust Company of Bank of Jerusalem Ltd.	(6)	100	**0.5**	0.4	**–**	–
Jerusalem Financing and Issuances (2005) Ltd.	(7)	100	**21.6**	16.2	**0.4**	0.8
Jerusalem Financial Operations (2005) Ltd.	(8)	100	**–**	–	**–**	–
Clal Finance Batucha Investment Management Ltd.	(9)		**-**	-	**0.6**	–

(1) The principle activity of Tomer Jerusalem Ltd. (hereinafter: "Tomer") is to serve as the Bank's asset company and to grant computer services to the Bank. See the Buildings and Equipment Note with regards to the sale of the administrative building.

(2) Ir Shalem Insurance Agency (1996) Ltd. operates as an insurance agency providing services in relation to asset insurance and life insurance for the Bank's borrowers.

(3) Jerusalem Investment Portfolio Management Ltd. deals with providing consultant services and management of investment portfolios, with regards to Company's activity, see Note on Material Events during the Reporting Period.

4) Jerusalem Capital Markets Funds Management (1980) Ltd., dealt in trust funds management. In 2006, the trust funds activity was sold.

(5) Jerusalem Underwriting and Issuances Ltd., dealt in the area of underwriting and issuances. The company decided to cease its activity as underwriter, and switched its underwriting registry status to "Not active".

(6) The Trust Company of Bank of Jerusalem Ltd., engages in holding accounts and financial assets of foreign residents and others in trust.

(7) Jerusalem Finance and Issuances (2005) Ltd. (a subsidiary fully owned and controlled by the Bank), operates to raise funds by way of issuing debentures and deferred liability notes to the public. In 2013, the company raised approximately NIS 60 million by issuing liability certificates, and in 2012 – NIS 194 million. For details, see Note on debentures and deferred liability notes.

(8) Jerusalem Financial Operations (2005) Ltd., serves as an agent for performing activities in the debentures series offered to the public by Jerusalem Financing and Issuances (2005) Ltd. As of 2007, the company is not active. The Bank has begun the company's liquidation process.

(9) Clal Finance Batucha Investment Management Ltd. (hereinafter: "Clal Batucha") – On December 15, 2013, the acquisition of the company was completed and on December 22, 2013, the company was merged into the Bank. For details, see Note 33 Events in the Report Year, Section e below.

(10) The Bank or its subsidiaries, as the case may be, hold (100% of) companies found in voluntary liquidation, as follows: Unitrust Future Financial Instruments Ltd.; Jerusalem Financial Operations (2005) Ltd.; Mabat Currency Trade 2007 Ltd.; Mabat Currencies Ltd; Ilanot Batucha Capital Ltd.; Magen TA 25 Trade Ltd.; Magen Financial Products Ltd.; Tsuot Mutual Funds Management (1993) Ltd.; Moment Investment Products Ltd.; Batucha Mutual Funds Management Ltd.; Ilanot – Batucha Capital Ltd.; Moment Investment and Trade Ltd.; Cleel Investment Products Ltd.; Magen Dollar Trade Ltd.

Note 7 – Investment in Investee Companies (Continued)

d – Purchase of liability certificates issued by a subsidiary

As at the balance sheet date, the Bank holds liability certificates of the subsidiary in a total nominal value of NIS 206,162 thousand (Series A, F and H). Concerning Series A – The Bank is entitled to receive interest according to the certificates, but may waive its right. Concerning series F and H, the Bank is not entitled to receive interest. In 2012, the Bank held liability certificates of a subsidiary in a total nominal value of NIS 226,493 thousand.

In July 2012, the Bank sold to outsiders its holdings in Series B totaling a nominal value of NIS 79.5 million, in consideration for approx. NIS 104.4 million.

e – Details on companies that were consolidated for the first time

As previously mentioned, on December 15, 2013, Clal Batucha was fully (100%) consolidated in the Bank's financial statements, and on December 22, was merged into the Bank. For details, see Note 33 Events in the report year. The Bank recognized the fair value of the assets that were acquired and the liabilities that were assumed in the framework of a business combination, based on a provisional measurement, since the bank has yet to receive preliminary approval from the Tax Authority with regards to the tax implications of the merger. As of the date of approval of the Financial Statements, a final appraisal had not been received from the external value appraiser with regards to the fair value of the identified assets that were acquired and the liabilities that were assumed. The fair value of the assets and liabilities that were acquired are subject to final adjustment up to 12 months from the date of acquisition. According to International Reporting Standard Number 3 regarding Business Combinations, on the date of the final measurement, the adjustments are made by way of restatement of the comparison numbers that were reported in the past based on the provisional measurement.

Below are details on the Company's assets and adjustments as at the date of acquisition:

	Millions of NIS
Total assets in the company's books	372.8
Equity in the company's books	254.3
Adjustments to capital	2.7
Customer relations(1)	2.0
Contingent liabilities(2)	(4.6)
Indemnification asset(2)	2.3
Others	(0.1)
Goodwill	0.4
The company's net income recorded in the Bank's books in 2013	0.6
The company's loss that would have been recorded in the Bank's books in 2013 had the merger taken place on January 1, 2013	(26.0)

(1) For details, see Note 8a

(2) For details, see Note 19d5

Note 8 – Buildings and Equipment

Reported amounts in millions of Shekels

	Consolidated				The Bank			
	Buildings and property (1)(3)(6)	Equipment, furniture and vehicles	Software costs(4)(5)	Total	Buildings and property(1)	Equipment, furniture and vehicles	Software costs	Total
Cost of assets(2)(4)								
Balance as at December 31, 2011	61.6	47.7	74.6	183.9	45.6	29.7	–	75.3
Additions	4.9	3.7	47.3	55.9	–	–	–	–
Disposals	0.6	2.7	–	3.3	–	–	–	–
Balance as at December 31, 2012	**65.9**	**48.7**	**121.9**	**236.5**	**45.6**	**29.7**	**–**	**75.3**
Additions	3.3	1.1	54.1	58.5	–	–	–	–
Additions from business combinations	–	–	0.8	0.8	–	–	0.8	0.8
Disposals	0.3	2.0	–	2.3	–	–	–	–
Balance as at December 31, 2013	**68.9**	**47.8**	**176.8**	**293.5**	**45.6**	**29.7**	**0.8**	**76.1**
Depreciation and impairment losses								
Balance as at December 31, 2011	31.6	31.3	41.3	104.2	29.3	24.2	–	53.5
Depreciation for the year	3.3	4.6	9.8	17.7	1.3	1.0	–	2.3
Disposals	**0.6**	**2.7**	**–**	**3.3**	**–**	**–**	**–**	**–**
Balance as at December 31, 2012	34.3	33.2	51.1	118.6	30.6	25.2	–	55.8
Depreciation for the year	2.9	4.4	19.5	26.8	1.2	0.9	–	2.1
Disposals	0.3	2.0	–	2.3	-	-	–	–
Balance as at December 31, 2013	**36.9**	**35.6**	**70.6**	**143.1**	**31.8**	**26.1**	**–**	**57.9**
Depreciated balance								
As at December 31, 2013	**32.0**	**12.2**	**106.2**	**150.4**	**13.8**	**3.6**	**0.8**	**18.2**
As at December 31, 2012	31.6	15.5	70.8	117.9	15.0	4.5	–	19.5
As at December 31, 2011	30.0	16.4	33.3	79.7	16.3	5.5	–	21.8
Average weighted depreciation rate in % as at December 31, 2013	**7.42**	**15.27**	**23.54**		**5.71**	**8.78**		
Average weighted depreciation rate in % as at December 31, 2012	8.72	18.15	24.82		5.78	8.93		

Note 8 – Buildings and Equipment (Continued)

(1) Including leasehold improvements.

(2) Bank and subsidiaries-owned property the cost of which is NIS 88.1 million – consolidated, and NIS 39.9 million – the Bank (2012 – NIS 77.2 million and NIS 37.2 million, respectively), fully depreciated and still in use.

(3) In 2011, Tomer Jerusalem Ltd. (a Bank's fully owned and controlled subsidiary) signed a sale agreement for the sale of the Bank's management building at 2 Herbert Samuel Street, Jerusalem, in consideration for approx. NIS 35 million plus VAT. The gain recognized in the financial statements for 2011 from the building's sale is NIS 20.8 million. As part of the sale, the subsidiary undertook to rent from the purchasers part of the area of the sold asset, and to rent out the remainder of the asset to third parties, according to a rental lease signed with the purchaser, in such a manner ensuring the purchaser fixed consideration for the asset at an agreed rate for a period of 10 years.

(4) Including capitalized expenses for work wages and outsourcing for a total of NIS 30.7 million (2012 – NIS 11.2 million).

(5) Including costs for materials and services used, related to software development.

(6) The Bank does not have rights that have not been registered with the Lands Registry Bureau.

Note 8a – Intangible Assets and Goodwill (consolidated and the bank)

Reported amounts in millions of Shekels

	Goodwill	Customer relations(2)	Total
		Millions of NIS	
Cost			
Balance as at December 31, 2012	-	-	-
Acquisitions as part of business combinations (see Note 7e)	0.4	2.0	2.4
Balance as at December 31, 2013	**0.4**	**2.0**	**2.4**
Amortizations			
Balance as at December 31, 2012	-	-	-
Amortization for the year	–	–	–
Balance as at December 31, 2013	-	-	-
Amortized balance			
As at December 31, 2013	**0.4**	**2.0**	**2.4**
As at December 31, 2012	-	-	-
As at December 31, 2011	-	-	-

(1) On December 15, 2013, the Bank acquired from Clal Finance Ltd. all of its holdings in Clal Batucha, as specified below in the Note Material Events in the Report Year.

The Bank recognized the fair value the assets that were acquired and the liabilities that were assumed as part of the business combination, based on a provisional measurement, since the Bank has yet to receive preliminary approval from the Tax Authority with regards to the tax implications of the merger. As of the date of approval of the Financial Statements, a final appraisal had not been received from the external value appraiser with regards to the fair value of the identified assets that were acquired and the liabilities that were assumed. The fair value of the assets and liabilities that were acquired are subject to final adjustment up to 12 months from the date of acquisition. According to International Reporting Standard Number 3 regarding Business Combinations, on the date of the final measurement, the adjustments are made by way of restatement of the comparison numbers that were reported in the past based on the provisional measurement.

(2) The fair value of customer relations acquired in this transaction was calculated through capitalization of the cash flows, after tax, expected to be generated from the company's customer relations acquired, and less the imputed expenses for the use of the business's assets. Customer relations are amortized in an equal manner for a period of 5 years.

Note 9 – Other assets

Reported amounts in millions of Shekels

	Consolidated		The Bank	
	December 31,			
	2013	2012	2013	2012
Deferred taxes receivable, net (see Note 29)	**46.3**	35.0	**47.6**	36.3
Payroll tax receivable	**14.2**	–	**14.2**	–
Funds deposited in trust	**8.4**	–	**8.4**	–
Receivables for securities	**7.6**	–	**7.6**	–
Prepaid expenses	**5.4**	4.3	**4.3**	4.1
Issuance expenses for debentures(1)	**5.2**	5.4	**–**	–
Indemnification asset(2)	**2.3**	–	**2.3**	–
Excess of advances over provision	**2.3**	–	**–**	–
Revenues receivable	**1.3**	0.9	**0.4**	0.1
Other accounts receivable and debit balances	**7.5**	2.1	**6.1**	2.5
Total Other Assets	**100.5**	47.7	**90.9**	43.0

(1) Issue expenses of debentures amortized using the effective interest method.

(2) On August 6, 2013, the Bank of Jerusalem acquired all the shares of Clal Batucha from Clal Finance Ltd., which held 100% of Clal Batucha shares. In accordance with the acquisition agreement, the Bank is also responsible for the liabilities and debts of Clal Batucha for its past activity, if any, and including any existing claims against Clal Batucha that were estimated for the purpose of attributing the acquisition cost in a total amount of NIS 5 million. This (capitalized as at 31.12.13 – NIS 4.6 million) subject to the undertaking by Clal Finance to indemnify the Bank for damages resulting from events that occurred at Clal Batucha prior to the date of the sale, should said total damages exceed NIS 2.5 million (capitalized as at the acquisition date – NIS 2.3 million).

Note 10 – Deposits from the Public

Reported amounts in millions of Shekels

A. Types of deposits according to type of depositor (in Israel)

	Consolidated		The Bank	
	December 31,			
	2013	2012	2013	2012
In Israel				
By request				
Non-interest-bearing	899.4	778.4	920.5	791.6
Interest-bearing	181.0	137.0	181.0	137.0
Total deposits by request	1,080.4	915.4	1,101.5	928.6
Fixed-term	9,990.7	8,898.3	11,095.3	10,260.6
Total deposits from the public*	**11,071.1**	**9,813.7**	**12,196.8**	**11,189.2**
*From this:				
Deposits of private individuals	8,888.4	8,113.5	8,888.4	8,113.5
Deposits of institutional entities	785.7	809.5	785.7	809.5
Deposits of corporations and others	1,397.0	890.7	2,522.7	2,266.2

B. Deposits from the public according to size on a consolidated basis

Deposit ceiling in millions of NIS	December 31,	
	2013	2012
Up to 1	**7,243.0**	6,364.4
Over 1 and up to 5	**2,436.6**	2,261.2
Over 5 and up to 10	**542.2**	518.3
Over 10 and up to 15	**331.0**	317.1
Over 15 and up to 20	**184.2**	218.4
Over 20 and up to 50	**279.4**	134.3
Over 50 and up to 100	**54.7**	-
Total	**11,071.1**	**9,813.7**

Note 11 – Deposits from Banks

Reported amounts in millions of Shekels

	Consolidated		The Bank	
	December 31,			
	2013	2012	2013	2012
Fixed-term deposits from commercial banks	**51.5**	63.3	**51.5**	63.3

Note 12 – Debentures and Deferred Liability Notes

Reported amounts

a – Composition

	Duration Average Duration(2)	Internal rate of return(2)	Consolidated		The Bank	
			December 31,			
			2013	2012	2013	2012
	years	%	Millions of NIS			
Debentures and deferred liability notes that cannot be converted into shares:						
Non-linked Israeli currency	3.07	2.25%	**589.5**	746.5	**118.0**	120.4
Index-linked Israeli currency	3.22	3.99%	**816.3**	834.0	**423.6**	377.1
USD-linked Israeli currency	3.15	2.94%	**0.2**	0.5	**0.2**	0.5
Total debentures and deferred liability notes			**1,406.0**	1,581.0	**541.8**	498
From this: deferred liability notes			**536.7**	491.2	**537.6**	491.2

b – Additional details

(1) a. On December 24, 2012, the Jerusalem Financing and Issuances Company issued, according to a shelf offering report from December 24, 2012, that was published based on a shelf prospectus from August 31, 2011, debentures (Series H) in a par value of NIS 122,421 thousand debentures in consideration for NIS 122,421 thousand, and deferred liability notes (Series 10) in a par value of NIS 71,761 thousand, in consideration for NIS 71,761 thousand.

b. On August 28, 2013, Jerusalem Finance and Issuances (2005) Ltd. (a subsidiary fully owned and controlled by the Bank) published a shelf prospectus for the issuance of debentures and deferred liability notes.

c. On December 24, 2013, Jerusalem Finance and Issuances issued, in a private issuance to classified investors, deferred liability notes (Series 10), from the listed series, with a par value of NIS 58,790 thousand at a price of NIS 1,031 per NIS 1,000 par value. The terms of the liability notes will be identical to the terms of the liability notes as described in the shelf offering report published by the Company on December 24, 2012.

The liability notes will be listed on the stock exchange, but will be subject to the barrier restrictions set forth in Section 15c of the Securities Law 5728-1968 and its subsequent regulations. The deferred liability notes were issued through a shelf offering report without discount. The adjusted value of the liability notes as at December 24, 2013 is NIS 1,019 per NIS 1,000 par value, and therefore, the liability notes are issued in a private issuance with a premium and without a discount.

Note 12 – Debentures and Deferred Liability Notes (continued)

d. Jerusalem Financing has an agreement with the Bank, under which it was determined that the proceeds from the issuance of deposit certificates according to the prospectus, will be deposited at the Bank in a deposit bearing interest, that will have repayment terms identical to those of the deposit certificates, and interest terms identical to those of the deposit certificates or preferable, as will be agreed from time to time with the Bank. The deposit will be for the Bank's use, at its discretion, and with a repayment level equal to other deposits at the Bank.

e. On May 30, 2013, Maalot announced that after monitoring the Bank's rating with Maalot's updated methodology for rating banks (as published on November 9, 2011), it was leaving the Bank's rating of ilA+ in place and was updating the rating forecast to stable from negative.

   This rating is also the rating of the debentures (except for the deferred liability notes as specified below) that were issued by Jerusalem Financing and Issuance, a subsidiary owned and fully controlled by the Bank, that isilA+. Deferred liabilities notes that were issued by Jerusalem Financing and Issuance are rated at one rating level lower than the Bank's rating, in accordance with the rating agency's methodology. Therefore, their rating is ilA. On December 22, 2013, Maalot announced that it set a rating of ilA+ for a private expansion of the series of deferred liability notes (Series 10).

(2) Internal rate of return is the interest rate that discounts the expected payment flows to balance-sheet balance included in the financial statements. The duration is the average payment periods as weighted in the capitalized cash flow by the internal rate of return.

(3) Concerning the Bank's purchasing of liability certificates issued by Jerusalem Financing and Issuances (2005) Ltd., see Note 7d. As part of the issuances to the public of liability certificates by Financing and Issuances, the Bank undertook towards Financing and Issuances and the trustee for those issuances, to comply with all the terms of the liability certificates that were issued by it and that will be held by the public.

Note 13 – Other Liabilities

Reported amounts in millions of Shekels

	Consolidated		The Bank	
	December 31,			
	2013	**2012**	**2013**	**2012**
Advances	**39.0**	35.4	**39.0**	35.4
Accounts payable for credit card activity	**34.4**	33.2*	**34.4**	33.2*
Accrued expenses	**18.5**	9.0	**15.3**	6.5
Accounts payable for fixed assets	**14.4**	7.2	**–**	–
Salaries and related expenses payable	**14.3**	14.6	**13.5**	13.4
Contingent liabilities(1)	**4.6**	–	**4.6**	–
Provision for credit losses from off-balance sheet items (See Note 19a)	**2.5**	1.9	**2.5**	1.9
Excess of reserve for severance pay over fund (see Note 14a)	**2.0**	1.5	**2.1**	1.1
Excess of current liabilities for income tax over paid advances	**–**	16.3	**-**	18.1
Other accounts payable and credit balances	**15.6**	3.9*	**15.2**	*3.5
Total other liabilities	**145.3**	123.0	**126.6**	113.1

* Reclassified

(1) On August 6, 2013, the Bank of Jerusalem acquired all the shares of Clal Batucha from Clal Finance Ltd., which held 100% of Clal Batucha shares. In accordance with the acquisition agreement, the Bank is also responsible for the liabilities and debts of Clal Batucha for its past activity, if any, and including any existing claims against Clal Batucha that were estimated for the purpose of attributing the acquisition cost in a total amount of NIS 5 million. This (capitalized as at 31.12.13 – NIS 4.6 million) subject to the undertaking by Clal Finance to indemnify the Bank for damages resulting from events that occurred at Clal Batucha prior to the date of the sale, should said total damages exceed NIS 2.5 million (capitalized as at the acquisition date – NIS 2.3 million).

Note 14 – Employee Rights

a – Severance Pay

The reserve for severance pay included in the balance sheet, together with payments for insurances policies, covers the liabilities for severance pay payment to employees, based on their last salary and their period of employment at the Bank and its subsidiaries. The amounts deposited by the Bank and its subsidiaries in insurance companies as part of a personal plan for senior employee insurance are not included in the balance sheet, since they are not controlled by the Bank. Withdrawal of designated funds is subject to compliance with the provisions of the Severance Pay Law. Below are the reserve and fund amounts:

	Consolidated		The Bank	
	December 31,			
	2013	2012	2013	2012
	Millions of NIS			
Amount of reserve	**61.0**	59.3	**58.3**	56.3
Amount of fund	**59.0**	57.8	**56.2**	55.2
Excess of reserve for severance pay over fund (included in "Other Liabilities" section)	**2.0**	1.5	**2.1**	1.1

b – Reserve for Jubilee Grants

Employees of the Bank and its subsidiaries are entitled, when reaching a certain seniority, to a special grant ("Jubilee Grant"). According to the instructions of the Supervisor of Banks, the reserve for this liability has been calculated since 2007 on an actuarial basis and is presented at its present value. The capitalization rate established by the Supervisor of Banks is 4%, and taking into account future increases in salaries. Provisions for the Jubilee Grants were included in the Financial Statements and their balance is: consolidated – NIS 2.7 million (2012 – NIS 2.6 million), the Bank – NIS 2.4 million (2012 – NIS 2.3 million), in the "Salaries and Related Expenses Payable" item as part of the "Other Liabilities" section.

c – Vacation

Employees of the Bank and its subsidiaries are entitled, by law and employment agreements, to annual vacation days. The provision for vacation is calculated based on the last salary of the employees and the vacation days accumulated in their favor with addition of related obligatory expenses. The balance of the provision for vacation as at the balance sheet date totaled NIS 5.1 million – consolidated, and NIS 4.6 million – the Bank (2012 – NIS 6.2 million – consolidated, and NIS 5.5 million – the Bank), and was included in the Financial Statements under "Salaries and Related Expenses Payable" item as part of the "Other Liabilities" section.

Note 14 – Employee Rights (continued)

d – Description of Employee Compensation Plans

On December 12, 2012, Amendment No. 20 to the Companies Law 5773-2012 went into effect, in which public companies are required to formulate a compensation policy with regards to the terms of service and employment for officers (hereinafter: "Amendment 20"). On November 19, 2013, the Supervisor of Banks published the Instruction on Proper Bank Management A301, regarding compensation policies in a banking corporation (hereinafter: "PBM301A"). This instruction contains additional requirements, inter alia, regarding compensation of officers in banking corporations. During the year 2010, the Bank of Jerusalem formulated a compensation plan for the employees of the Bank, based on the document published by the Supervisor of Banks on this issue, with the purpose of determining a clear and predetermined formula connecting the yield of the Bank with the height of the yearly distributed grant, and this while long-term examining the goals of the Bank and with consideration of the existing level of risk in achieving such yield. Distribution of the grant among bank employees will be differential and will be based on quantitative and qualitative performance indicators and other parameters. Should the Bank meet the threshold for bonus payments, as set by the plan, the employees, including management members, will be entitled to an annual bonus payment according to brackets, as follows (data in thousands of NIS):

Calculated yield	Bonus to employees		Bonus to management members		Total bonus	
	from	up to	from	up to	from	up to
8.5%-9%	1,200	1,200	-	-	1,200	1,200
9%-10%	2,900	4,500	400	700	3,300	5,200
10%-11%	4,500	6,000	700	950	5,200	6,950
11%-12%	6,000	7,250	950	1,500	6,950	8,750
12%-13%	7,250	8,500	1,500	2,000	8,750	10,500
13%-14%	8,500	11,000	2,000	2,700	10,500	13,700
14%-15%	11,000	13,000	2,700	3,300	13,700	16,300
15%-16%	13,000	15,000	3,300	4,500	16,300	19,500

e – Other Rights

In general, Bank employees, including members of the Management (with the exception of the CEO) are not entitled to adjustment grants and increased compensation during retirement. For information regarding the terms of employment for the CEO and the Chairman of the Board of Directors, see Note on Stakeholders and Related Parties, "Stakeholders and related parties" item, below.

f – Share-Based Payment

For information regarding share-based payment transactions, see Note on Stakeholders and Related Parties, "Share-based payment transactions" item, bellow.

Note 15 – Liens and Restricted Terms

a – According to the bylaws of Maof Clearing House Ltd. (hereinafter: the "Maof Clearing House"), the Bank, as a member of the Maof Clearing House, is required to deposit liquid collaterals for the full exposure in respect of its activity in derivatives and for its part in the risk fund. For this purpose, the Bank encumbered in favor of the Maof Clearing House its rights in the following accounts:

1. An account with the Stock Exchange Clearing House under the name of Maof Clearing House, in which government debentures are deposited amounting to the entire securities requirement from the Bank's customers and for the Bank's part in the risk fund (hereinafter: the "Securities Account"). The value of the deposited debentures as at December 31, 2013 amounted to NIS 116.6 million.

2. An account at Bank Leumi L'Israel Ltd. under the name of the Moaf Clearing House, where funds shall be deposited amounting to at least 25% of the Bank's part in the risk fund, and where funds shall be deposited amounting to the gains from the securities that have been deposited in the securities account of the Bank. As at December 31, 2013, the Bank deposited NIS 4.4 million in this account. The accounts specified above are mortgaged in a floating pledge in favor of the Maof Clearing House, as well as mortgaged in a fixed charge in favor of the Maof Clearing House.

b – As a member of the Stock Exchange, the Bank is required to deposit liquid collaterals to secure fullfilment of all of the liabilities of the Bank's customers towards the Stock Exchange Clearing House, for transactions performed in the Stock Exchange Clearing House and for securing their part in the Stock Exchange Clearing House risk fund. For this purpose, the Bank mortgaged in favor of the Stock Exchange Clearing House, in fixed first charge, its rights in the following accounts:

1. An account with the Stock Exchange Clearing House under the name thereof and which is managed for the Bank, in which government debentures are deposited amounting to the entire securities requirement from the Bank's customers and for the Bank's part in the risk fund. The value of the deposited debentures as at December 31, 2013 amounted to NIS 6.6 million.

2. An account at Bank Leumi L'Israel Ltd. under the name of the Stock Exchange Clearing House, where funds shall be deposited amounting to at least 25% of the Bank's part in the risk fund, and where funds shall be deposited amounting to the gains from the securities that have been deposited in the securities account of the Bank. As at December 31, 2013, NIS 14.8 million were deposited in this account.

c – For the purpose of securing credit provided or to be provided by the Bank of Israel to the Bank, as part of the Bank's activity in the RTGS System, the Bank mortgaged in favor of the Bank of Israel, according to an agreement from January 24. 2011, debentures held by the Bank which are deposited or will be deposited in a designated account on the Stock Exchange under the name of the Bank of Israel. The lien amount is unlimited. The value of the deposited debentures as at December 31, 2013 amounted to NIS 40.9 million.

Details of securities that have been mortgaged for lenders

	Consolidated and the Bank	
	2013	**2012**
	Millions of NIS	
Available-for-sale securities	**164.0**	225.3

Note 16a – Equity

a – The Bank's registered share capital as at December 31, 2013 is composed of 100,250,000 ordinary shares of NIS 1 each (as at December 31, 2012 – similar). The issued and paid-up capital as at December 31, 2013 – 70,517,741 shares listed on the Tel Aviv Stock Exchange (as at December 31, 2012 – similar).

b – On August 29, 2013, the Bank's Board of Directors decided to adopt a dividend distribution policy of up to 30% of the Bank's net income every year.

On August 29, 2013, the Bank's Board of Directors decided to distribute interim dividends in cash in the amount of NIS 11 million (gross), based on the Bank's accumulated earnings. The dividend was paid on September 23, 2013, to shareholders who held the Bank's shares on September 10, 2013 (the determining date).

On November 28, 2013, the Bank's Board of Directors decided to distribute interim dividends in cash in the amount of NIS 2.7 million (gross), based on the Bank's accumulated earnings. The dividend was paid on December 17, 2013, to shareholders who held the Bank's shares on December 5, 2013 (the determining date).

In 2012, there was no distribution of dividends.

On March 31, 2011, the Bank's Board of Directors decided to distribute interim dividends in cash in the amount of NIS 25 million. This dividend was distributed on April 27, 2011.

The distribution of the dividends is implemented in accordance with the provisions of the Companies Law 5759 – 1999, and the instructions of the Supervisor of Banks.

Note 16b – Equity – Capital adequacy according to instructions of the Supervisor of Banks

Reported amounts in millions of Shekels

Calculated according to the Proper Banking Management Instructions number 201-211 and Instruction number 299 concerning "Measurement and Capital Adequacy".

A. In consolidated data

	December 31,		January 1,
	2013	2012	2014
a – Capital for the purpose of calculating the capital ratio			
Tier 1 capital, after deductions	694.5	693.0	694.8
Tier 2 capital, after deductions	341.4	338.0	357.7
Total comprehensive capital	1,035.9	1,031.0	1,052.5
b – Weighted balances of risk assets			
Credit risk	6,674.1	6,452.3	6,831.5
Market risks	49.3	148.2	55.1
Operating risk	705.5	553.3	705.5
Total weighted balances of risk assets	7,428.9	7,153.8	7,592.1
c – Capital to risk components ratio (in percentages)			
Tier 1 capital to risk components ratio	9.3	9.7	9.2
Comprehensive capital to risk components ratio	13.9	14.4	13.9
Minimum comprehensive capital ratio required by the Supervisor of Banks	13.0	13.0	13.0

B. Capital components for the purpose of calculating capital ratio

a – Tier 1 capital			
Shareholders' equity	**697.2**	694.1	697.2
Less – net gains from adjustments to fair value of available-for-sale securities	**(0.3)**	(1.1)	-
Less – intangible assets and goodwill	**(2.4)**	-	(2.4)
Total Tier 1 capital	**694.5**	693.0	694.8
b – Tier 2 capital			
Upper tier capital:			
45% of the net gains, before the effect of the referring tax, from adjustments to fair value of available-for-sale securities	**0.2**	0.9	-
Bottom Tier 2 capital:			
Deferred liability notes	**341.2**	337.1	273.0
Group provision for credit losses	–	–	84.7
Total Tier 2 capital	**341.4**	**338.0**	**357.7**

Note 17 – Assets and Liabilities by Linkage Basis – Consolidated

Reported amounts in millions of Shekels

	December 31, 2013					
	Israeli currency		Foreign currency[1]			
	Unlinked	Linked to the CPI Prices	US dollar USA	Other	Non-monetary items Money	Total
Assets						
Cash and deposits at banks	2,702.4	–	90.1	40.9	–	2,833.4
Securities	583.5	89.0	0.4	–	3.7	676.6
Credit to the public, net	4,939.0	3,582.9	981.7	123.0	–	9,626.6
Buildings and equipment	–	–	–	–	150.4	150.4
Intangible assets and goodwill	–	–	–	–	2.4	2.4
Assets for derivative instruments	14.6	0.5	4.1	2.5	–	21.7
Other assets	90.1	2.3	–	–	8.1	100.5
Total assets	**8,329.6**	**3,674.7**	**1,076.3**	**166.4**	**164.6**	**13,411.6**
Liabilities						
Deposits from the public	6,856.6	2,603.3	1,219.4	391.8	–	11,071.1
Deposits from banks	–	47.2	4.3	–	–	51.5
Government deposits	0.5	0.2	–	–	–	0.7
Securities that were lent or sold as part of repurchase agreements	27.5	–	–	–	–	27.5
Debentures and deferred liability notes	589.5	816.3	0.2	–	–	1,406.0
Liabilities for derivative instruments	10.3	–	1.9	0.1	–	12.3
Other liabilities	101.7	–	–	–	43.6	145.3
Total liabilities	**7,586.1**	**3,467.0**	**1,225.8**	**391.9**	**43.6**	**12,714.4**
Difference	743.5	207.7	(149.5)	(225.5)	121.0	697.2
Non-hedge derivative instruments						
Derivative instruments (with the exception of options)	(413.4)	(0.4)	263.3	150.5	–	–
Total general	**330.1**	**207.3**	**113.8**	**(75.0)**	**121.0**	**697.2**

(1) Including linkage to foreign currency.

Note 17 – Assets and Liabilities by Linkage Basis (continued) – Consolidated

Reported amounts in millions of Shekels

	December 31, 2012					
	Israeli currency		Foreign currency[1]			
	Unlinked	Linked to the CPI Prices	US dollar USA	Other	Non-monetary items Money	Total
Assets						
Cash and deposits at banks	1,017.3	–	293.0	50.3	–	1,360.6
Securities	969.5	189.7	2.7	–	1.1	1,163.0
Credit to the public, net	4,881.9	3,474.7	1,097.4	127.4	–	9,581.4
Buildings and equipment	–	–	–	–	117.9	117.9
Assets for derivative instruments	11.6	–	5.5	3.8	0	20.9
Other assets	40.5	2.5	–	–	4.7	47.7
Total assets	**6,920.8**	**3,666.9**	**1,398.6**	**181.5**	**123.7**	**12,291.5**
Liabilities						
Deposits from the public	5,367.3	3,011.8	1,065.3	369.3	–	9,813.7
Deposits from banks	–	52.4	10.9	–	–	63.3
Government deposits	–	–	–	–	–	–
Debentures and deferred liability notes	746.6	833.9	0.5	–	–	1,581.0
Liabilities for derivative instruments	14.0	–	2.0	0.4	–	16.4
Other liabilities	87.6	–	–	–	35.4	123.0
Total liabilities	**6,215.5**	**3,898.1**	**1,078.7**	**369.7**	**35.4**	**11,597.4**
Difference	705.3	(231.2)	319.9	(188.2)	88.3	694.1
Non-hedge derivative instruments						
Derivative instruments (with the exception of options)	19.2	69.0	(280.8)	192.6	–	–
Total general	**724.5**	**(162.2)**	**39.1**	**4.4**	**88.3**	**694.1**

(1) Including linkage to foreign currency.

Note 17 – Assets and Liabilities by Linkage Basis (continued) – the Bank

Reported amounts in millions of Shekels

	December 31, 2013					
	Israeli currency		Foreign currency[1]			
	Unlinked	Linked to the CPI Prices	US dollar USA	Other	Non-monetary items Money	Total
Assets						
Cash and deposits at banks	2,702.4	–	90.1	40.9	–	2,833.4
Securities	585.3	91.1	0.4	–	3.7	680.5
Credit to the public, net	4,939.0	3,582.9	981.7	123.0	–	9,626.6
Investment in consolidated companies	22.0	–	–	–	358.6	380.6
Buildings and equipment	–	–	–	–	18.2	18.2
Intangible assets and goodwill	–	–	–	–	2.4	2.4
Assets for derivative instruments	14.6	0.5	4.1	2.5	–	21.7
Other assets	83.9		–	–	7.1	91.0
Total assets	**8,347.2**	**3,674.5**	**1,076.3**	**166.4**	**390.0**	**13,654.4**
Liabilities						
Deposits from the public	7,586.2	2,999.4	1,219.4	391.8	–	12,196.8
Deposits from banks	–	47.2	4.3	–	–	51.5
Government deposits	0.5	0.2	–	–	–	0.7
Securities that were lent or sold as part of repurchase agreements	27.5	–	–	–	–	27.5
Debentures and deferred liability notes	118.0	423.6	0.2	–	–	541.8
Liabilities for derivative instruments	10.3	–	1.9	0.1	–	12.3
Other liabilities	83.0	–	–	–	43.6	126.6
Total liabilities	**7,825.5**	**3,470.4**	**1,225.8**	**391.9**	**43.6**	**12,957.2**
Difference	521.7	204.1	(149.5)	(225.5)	346.4	697.2
Non-hedge derivative instruments						
Derivative instruments (with the exception of options)	(413.4)	(0.4)	263.3	150.5	–	–
Total general	**108.3**	**203.7**	**113.8**	**(75.0)**	**346.4**	**697.2**

(1) Including linkage to foreign currency.

Note 17 – Assets and Liabilities by Linkage Basis (continued) – the Bank

Reported amounts in millions of Shekels

	December 31, 2012					
	Israeli currency		Foreign currency[1]			
	Unlinked	Linked to the CPI Prices	US dollar USA	Other	Non-monetary items Money	Total
Assets						
Cash and deposits at banks	1,016.6	–	293.0	50.3	–	1,359.9
Securities	988.2	192.7	2.7	–	1.1	1,184.7
Credit to the public, net	4,881.9	3,474.7	1,097.4	127.4	–	9,581.4
Investment in consolidated companies	13.7	–	–	–	351.0	364.7
Buildings and equipment	–	–	–	–	19.5	19.5
Assets for derivative instruments	11.6	–	5.5	3.8	–	20.9
Other assets	38.5	–	–	–	4.5	43.0
Total assets	**6,950.5**	**3,667.4**	**1,398.6**	**181.5**	**376.1**	**12,574.1**
Liabilities						
Deposits from the public	6,267.9	3,486.7	1,065.3	369.3	–	11,189.2
Deposits from banks	–	52.4	10.9	–	–	63.3
Debentures and deferred liability notes	120.4	377.1	0.5	–	–	498
Liabilities for derivative instruments	14.0	–	2.0	0.4	–	16.4
Other liabilities	77.7	–	–	–	35.4	113.1
Total liabilities	**6,480.0**	**3,916.2**	**1,078.7**	**369.7**	**35.4**	**11,880.0**
Difference	470.5	(248.8)	319.9	(188.2)	340.7	694.1
Non-hedge derivative instruments						
Derivative instruments (with the exception of options)	19.2	69.0	(280.8)	192.6	–	–
Total general	**489.7**	**(179.8)**	**39.1**	**4.4**	**340.7**	**694.1**

(1) Including linkage to foreign currency.

Note 18 – Assets and Liabilities by Linkage Basis and by Repayment Period – Consolidated[(1)]

Expected contractual future cash flows

Reported amounts in millions of Shekels

	On demand and up to one month	Over one month and up to 3 months	Over 3 months and up to one year	Over one year and up to two years	Over two years and up to 3 years
As at December 31, 2013					
Israeli currency (including foreign currency-linked)					
Assets*	3,129.8	370.5	1,639.7	1,179.7	975.0
Liabilities**	2,776.5	837.7	2,149.9	3,095.3	1,057.4
Difference	353.3	(467.2)	(510.2)	(1,915.6)	(82.4)
Derivative instruments (with the exception of options)	(479.1)	(55.5)	34.7	86.1	–
Difference after effect of derivative instruments	(125.8)	(522.7)	(475.5)	(1,829.5)	(82.4)
Foreign currency[(3)]					
Assets*	123.1	0.3	105.7	98.8	100.3
Liabilities**	901.4	147.6	476.1	38.9	–
Difference	(778.3)	(147.3)	(370.4)	59.9	100.3
From this: difference – in USD	(665.2)	(121.9)	(311.6)	48.5	88.7
From this: difference – for foreign operation	–	–	–	–	–
Derivative instruments (with the exception of options)	479.1	55.5	(34.7)	(86.1)	–
Difference after effect of derivative instruments	(299.2)	(91.8)	(405.1)	(26.2)	100.3
Total					
Assets*	**3,252.9**	**370.8**	**1,745.4**	**1,278.5**	**1,075.3**
Liabilities**	**3,677.9**	**985.3**	**2,626.0**	**3,134.2**	**1,057.4**
Difference	**(425.0)**	**(614.5)**	**(880.6)**	**(1,855.7)**	**17.9**
*From this: credit to the public	333.7	362.4	1,501.8	1,223.3	1,042.7
**From this: public deposits	3,518.0	914.3	2,457.0	2,822.2	772.1
As at December 31, 2012					
Israeli currency (including foreign currency-linked)					
Assets*	1,493.3	615.2	1,499.1	1,155.6	963.1
Liabilities**	2,750.5	822.4	2,399.3	1,673.2	965.5
Difference	(1,257.2)	(207.3)	(900.2)	(517.5)	(2.4)
Derivative instruments (with the exception of options)	(0.9)	18.7	33.5	36.9	–
Difference after effect of derivative instruments	(1,258.1)	(188.6)	(866.7)	(480.6)	(2.4)
Foreign currency[(3)]					
Assets*	311.4	1.5	114.1	109.7	109.1
Liabilities**	939.2	218.1	238.2	5.2	0.0
Difference	(627.8)	(216.7)	(124.1)	104.5	109.1
From this: difference – in USD	(487.0)	(174.7)	(62.4)	82.6	95.7
From this: difference – for foreign operation	–	–	–	–	–
Derivative instruments (with the exception of options)	0.9	(18.7)	(33.5)	(36.9)	–
Difference after effect of derivative instruments	(626.9)	(235.4)	(157.6)	67.6	109.1
Total					
Assets*	**1,804.7**	**616.6**	**1,613.2**	**1,265.3**	**1,072.2**
Liabilities**	**3,689.7**	**1,040.5**	**2,637.5**	**1,678.4**	**965.5**
Difference	**(1,885.0)**	**(423.9)**	**(1,024.3)**	**(413.1)**	**106.7**
*From this: credit to the public	378.5	275.2	1,582.7	1,219.8	1,032.8
**From this: public deposits	3,596.7	959.3	2,410.1	1,402.2	649.6

(1) In this Note, expected contractual future cash flows are presented for assets and liabilities sections by currencies, according to the remaining contractual repayment periods of each cash flow. The data is presented after deducting the effect of accounting write-offs and provisions for credit losses.

(2) Assets without a repayment period include assets in the amount of NIS 6.3 million whose repayment time has passed (NIS 3.7 million as at 31.12.2012).

Note 18 -Assets and Liabilities by Linkage Basis and by Repayment Period – Consolidated[(1)](continued)

Expected contractual future cash flows

Reported amounts in millions of Shekels

						Balance sheet balances[(4)]		
Over 3 years and up to 4 years	Over 4 years and up to 5 years	Over 5 years and up to 10 years	Over 10 years and up to 20 years	Over 20 years	Total cash flows	Without period of repayment[(2)]	Total	Contractual yield rate[(5)]
759.0	758.8	2,687.0	2,530.7	411.6	14,441.8	170.9[(2)]	12,377.1	3.92%
705.6	494.3	780.5	14.0	–	11,911.2	43.6	11,151.0	1.73%
53.4	264.5	1,906.5	2,516.7	411.6	2,530.6	127.3	1,226.1	
–	–	–	–	–	(413.8)	–	–	
53.4	264.5	1,906.5	2,516.7	411.6	2,116.8	127.3	1,226.1	
100.5	96.3	405.5	360.0	0.5	1,391.0	–	1,034.5	3.46%
–	0.2	0.2	–	–	1,564.4	–	1,563.4	0.82%
100.5	96.1	405.3	360.0	0.5	(173.4)	–	(528.9)	
88.1	85.4	359.5	327.7	0.5	(100.3)	–	–	
–	–	–	–	–	–	–	–	
1.0	–	(0.2)	–	–	414.6	–	–	
101.5	96.1	405.1	360.0	0.5	241.2	–	(528.9)	
859.5	**855.1**	**3,092.5**	**2,890.7**	**412.1**	**15,832.8**	**170.9**	**13,411.6**	**3.88%**
705.6	**494.5**	**780.7**	**14.0**	**–**	**13,475.6**	**43.6**	**12,714.4**	**1.80%**
153.9	**360.6**	**2,311.8**	**2,876.7**	**412.1**	**2,357.2**	**127.3**	**697.2**	
846.9	738.3	2,843.4	2,890.7	412.1	12,195.3	6.3	9,626.6	3.96%
516.0	374.6	376.5	–	–	11,750.7	–	11,071.1	1.73%
776.8	715.1	3,223.1	2,532.4	333.3	13,307.0	153.5[(2)]	10,805.1	4.11%
674.0	635.9	685.2	18.9	–	10,624.8	35.4	10,197.2	2.70%
102.8	79.2	2,537.9	2,513.5	333.3	2,682.2	118.1	607.9	
–	–	–	–	–	88.2	–	–	
102.8	79.2	2,537.9	2,513.5	333.3	2,770.4	118.1	607.9	
108.0	106.6	439.9	401.8	1.0	1,703.0	4.6	1,486.4	3.20%
–	1.5	–	–	–	1,402.3	–	1,400.2	1.30%
108.0	105.1	439.9	401.8	1.0	300.7	4.6	86.2	
94.6	92.0	384.8	367.2	1.0	393.8	–	–	
–	–	–	–	–	–	–	–	
–	–	–	–	–	(88.2)	–	–	
108.0	105.1	439.9	401.8	1.0	212.5	4.6	86.2	
884.8	**821.8**	**3,663.0**	**2,934.2**	**334.3**	**15,010.0**	**158.1**	**12,291.5**	**4.00%**
674.0	**637.4**	**685.2**	**18.9**	**–**	**12,027.2**	**35.4**	**11,597.4**	**2.53%**
210.8	**184.3**	**2,977.8**	**2,915.3**	**334.3**	**2,982.9**	**122.7**	**694.1**	
829.7	726.2	2,878.2	2,902.4	334.3	12,159.8	34.4	9,581.4	4.20%
386.4	442.8	230.8	0.6	–	10,078.5	–	9,813.7	2.42%

(3) Excluding foreign currency-linked Israeli currency.

(4) As included in Note "Assets and Liabilities by linkage basis", including uncleared off-balance sheet amounts for derivatives, net.

(5) The contractual yield rate is the interest rate that discounts the expected contractual future cash flows presented in this Note for a monetary item, to its balance-sheet balance.

Note 18 – Assets and Liabilities by Linkage Basis and by Repayment Period – the Bank[1] (continued)

Expected contractual future cash flows

Reported amounts in millions of Shekels

	On demand and up to one month	Over one month and up to 3 months	Over 3 months and up to one year	Over one year and up to two years	Over two years and up to 3 years
As at December 31, 2013					
Israeli currency (including foreign currency-linked)					
Assets*	3,135.9	371.4	1,445.8	1,232.9	1,026.1
Liabilities**	2,788.6	706.8	2,133.1	2,994.1	990.0
Difference	347.3	(335.4)	(687.3)	(1,761.2)	36.1
Derivative instruments (with the exception of options)	(479.1)	(55.5)	34.7	86.1	–
Difference after effect of derivative instruments	(131.8)	(390.9)	(652.6)	(1,675.1)	36.1
Foreign currency[3]					
Assets*	123.1	0.3	105.7	98.8	100.3
Liabilities**	901.4	147.6	476.1	38.9	–
Difference	(778.3)	(147.3)	(370.4)	59.9	100.3
From this: difference – in USD	(665.2)	(121.9)	(311.6)	48.5	88.7
From this: difference – for foreign operation	–	–	–	–	–
Derivative instruments (with the exception of options)	479.1	55.5	(34.7)	(86.1)	–
Difference after effect of derivative instruments	(299.2)	(91.8)	(405.1)	(26.2)	100.3
Total					
Assets*	**3,259.0**	**371.7**	**1,551.5**	**1,331.7**	**1,126.4**
Liabilities**	**3,690.0**	**854.4**	**2,609.2**	**3,033.0**	**990.0**
Difference	**(431.0)**	**(482.7)**	**(1,057.7)**	**(1,701.3)**	**136.4**
*From this: credit to the public	333.7	362.4	1,501.8	1,223.3	1,042.7
**From this: public deposits	3,551.3	851.5	2,552.9	2,940.8	901.5
As at December 31, 2012					
Israeli currency (including foreign currency-linked)					
Assets*	1,520.1	557.7	1,522.7	1,180.0	1,017.3
Liabilities**	2,784.5	824.9	2,444.4	1,691.7	1,015.6
Difference	(1,264.4)	(267.2)	(921.7)	(511.7)	1.7
Derivative instruments (with the exception of options)	(2.2)	18.8	35.3	38.6	–
Difference after effect of derivative instruments	(1,266.6)	(248.4)	(886.4)	(473.1)	1.7
Foreign currency[3]					
Assets*	274.6	2.9	115.0	109.7	109.1
Liabilities**	939.5	218.4	238.3	5.2	0.0
Difference	(664.9)	(215.6)	(123.3)	104.5	109.1
From this: difference – in USD	(487.0)	(174.7)	(62.4)	82.6	95.7
From this: difference – for foreign operation	–	–	–	–	–
Derivative instruments (with the exception of options)	7.4	(17.4)	(31.8)	(37.8)	–
Difference after effect of derivative instruments	(657.5)	(233.0)	(155.1)	66.7	109.1
Total					
Assets*	**1,794.7**	**560.6**	**1,637.7**	**1,289.7**	**1,126.4**
Liabilities**	**3,724.0**	**1,043.3**	**2,682.8**	**1,696.9**	**1,015.6**
Difference	**(1,929.4)**	**(482.8)**	**(1,045.1)**	**(407.2)**	**110.8**
*From this: credit to the public	378.5	275.2	1,582.7	1,219.8	1,032.8
**From this: public deposits	3,622.4	1,025.6	2,632.1	1,613.8	924.2

(1) In this Note, expected contractual future cash flows are presented for assets and liabilities sections by currencies, according to the remaining contractual repayment periods of each cash flow. The data is presented after deducting the effect of accounting write-offs and provisions for credit losses.

(2) Assets without a repayment period include assets in the amount of NIS 6.3 million whose repayment time has passed (NIS 3.7 million as at 31.12.2012).

Note 18 – Assets and Liabilities by Linkage Basis and by Repayment Period – the Bank[1] (continued)

Expected contractual future cash flows

Reported amounts in millions of Shekels

						Balance-sheet balances(4)		
Over 3 years and up to 4 years	Over 4 years and up to 5 years	Over 5 years and up to 10 years	Over 10 years and up to 20 years	Over 20 years	Total cash flows	Without period of repayment(2)	Total	Contractual yield rate(5)
791.3	802.6	2,716.4	2,530.7	411.6	14,464.7	396.3(2)	12,619.9	3.93%
612.9	468.9	601.4	14.0	–	11,309.8	–	11,393.8	1.83%
178.4	333.7	2,115.0	2,516.7	411.6	3,154.9	396.3	1,226.1	
–	–	–	–	–	(413.8)	–	–	
178.4	333.7	2,115.0	2,516.7	411.6	2,741.1	396.3	1,226.1	
100.5	96.3	405.5	360.0	0.5	1,391.0	–	1,034.5	3.46%
–	0.2	0.2	–	–	1,564.4	–	1,563.4	0.82%
100.5	96.1	405.3	360.0	0.5	(173.4)	–	(528.9)	
88.1	85.4	359.5	327.7	0.5	(100.3)	–	–	
–	–	–	–	–	–	–	–	
–	–	–	–	–	413.8	–	–	
100.5	96.1	405.3	360.0	0.5	240.4	–	(528.9)	
891.8	**898.9**	**3,121.9**	**2,890.7**	**412.1**	**15,855.7**	**396.3**	**13,654.4**	**3.89%**
612.9	**469.1**	**601.6**	**14.0**	**–**	**12,874.2**	**–**	**12,957.2**	**1.71%**
278.9	**429.8**	**2,520.3**	**2,876.7**	**412.1**	**2,981.5**	**396.3**	**697.2**	
846.9	738.3	2,843.4	2,890.7	412.1	12,195.3	6.3	9,626.6	3.96%
527.9	419.9	344.6	–	–	12,090.4	–	13,753.9	1.87%
825.5	748.4	3,293.3	2,533.0	336.1	13,534.2	405.9(2)	11,087.7	4.11%
725.7	666.0	744.9	18.2	–	10,915.9	35.4	10,479.8	2.70%
99.8	82.3	2,548.5	2,514.8	336.1	2,618.3	370.5	607.9	
(1.5)	(3.4)	–	–	–	85.6	–	–	
98.3	78.9	2,548.5	2,514.8	336.1	2,703.9	370.5	607.9	
108.0	106.7	439.9	401.8	1.0	1,668.6	4.6	1,486.4	3.20%
–	1.5	–	–	–	1,403.0	–	1,400.2	1.30%
108.0	105.2	439.9	401.8	1.0	265.6	4.6	86.2	
94.6	92.0	384.8	367.2	1.0	393.8	–	–	
–	–	–	–	–	–	–	–	
–	(1.4)	–	–	–	(81.0)	–	–	
108.0	103.8	439.9	401.8	1.0	184.6	4.6	86.2	
933.5	**855.1**	**3,733.2**	**2,934.8**	**337.1**	**15,202.8**	**410.5**	**12,574.1**	**4.00%**
725.7	**667.5**	**744.9**	**18.2**	**–**	**12,318.9**	**35.4**	**11,880.0**	**2.53%**
207.7	**187.5**	**2,988.4**	**2,916.6**	**337.1**	**2,883.9**	**375.1**	**694.1**	
829.7	726.2	2,878.2	2,902.4	334.3	12,159.9	34.5	9,581.4	4.20%
637.5	580.7	507.5	0.6	–	11,544.4	–	11,189.2	2.44%

(3) Excluding foreign currency-linked Israeli currency.

(4) As included in Note "Assets and Liabilities by linkage basis", including uncleared off-balance sheet amounts for derivatives, net.

(5) The contractual yield rate is the interest rate that discounts the expected contractual future cash flows presented in this Note for a monetary item, to its balance-sheet balance.

Note 19 – Contingent Liabilities and Special Agreements

Reported amounts in millions of Shekels

a – Off-balance sheet financial instruments (consolidated and the Bank)

	Contractual balances[1]		Balance of provision for credit losses	
	as at December 31,			
	2013	2012	2013	2012
Transactions in which the balance represents credit risk:				
Irrevocable undertakings to provide credit that was approved but not yet granted	**1,066.4**	1,038.5	**1.3**	0.7
Guarantees to housing purchasers	**16.8**	32.9	**0.2**	0.2
Guarantees for credit assurance	**65.8**	81.4	**0.2**	0.3
Other guarantees	**82.4**	80.5	**0.5**	0.5
Credit lines of credit cards that were not utilized	**156.2**	134.4	**0.3**	0.2
CLA lines and other credit lines in accounts on demand that were not utilized	**71.2**	80.1	**–**	–
Total	**1,458.8**	1,447.8	**2.5**	1.9

(1)Contractual balances or their face amounts at the end of the year, before the effect of the provision for credit losses.

b – Off-balance sheet agreement for activity according to collection level(1) as at the end of the year (consolidated and the Bank)

	as at December 31,	
	2013	2012
Balance of credit from deposits based on the collection level[2]		
Non-linked Israeli currency	**1,651.5**	1,936.7
Index-linked Israeli currency	**51.2**	59.7
Foreign currency	**0.3**	0.4
Total	**1,703.0**	1,996.8

Information on loan granting during the year

	for the year ended on December 31,	
	2013	2012
Loans from deposits by collection level	**2.6**	4.8
Standing loans	**3.5**	1.8

(1) Credit and deposits from deposits whose return to the depositor is subject to credit collection with a collection fee.
(2) Standing loans and government deposits provided for them, in the amount of NIS 219 million (2012 – NIS 301 million), were not included in this Note.

Note 19 – Contingent Liabilities and Special Agreements (continued)

Reported amounts in millions of Shekels

b – Off-balance sheet agreements for activity according to collection level(1) as at the end of the year (continued)

Flows from collection fees and interest margins for activity according to collection level(2)

	December 31,						
	2013						2012
	Up to one year	Over one year up to 3 years	Over 3 up to 5 years	Over 5 up to 10 years	Over 10 up to 20 years	Total	Total
Future contractual flows	**13.7**	**26.6**	**26.0**	**41.8**	**7.2**	**115.3**	137.4
Capitalized expected flows(3)(4)	**13.4**	**25.0**	**23.3**	**34.8**	**5.3**	**101.8**	120.7

(1) Credit and deposits from deposits whose return to the depositor is contingent upon collection of the credit with a collection fee.

(2) Including the foreign currency sector and the unlinked NIS sector that does not exceed 10% of the total deposits according to collection level.

(3) Capitalization was performed according to a rate of 2.51% (2012 – 2.4%).

(4) The data do not take into account an estimate of early repayments.

c – Claims

1. General

   During the regular course of business, various lawsuits were filed against the Bank. Based on the opinion of the legal advisers concerning the chances of the claims, including requests for approval of class action suits, adequate provisions were included in the Financial Statements in accordance with GAAP, for expected losses resulting from these pending claims against the Bank.

2. Pending motions for class action suits against the Bank are as detailed below:

   a. On July 12, 2010, a claim was filed against the Bank in the Jerusalem District Court, as well as a motion to recognize this claim as a class action suit for an overall amount of NIS 10,692 thousand for the entire represented group. The claim alleges that the Bank failed to remove all records of liens listed in its name to secure loans already entirely cleared by the borrowers. Therefore, it is demanded that the Bank remove these records and compensate customers who removed these records at their own expense. Arbitration on this case is currently being conducted.

According to the Bank's management opinion, relying on the opinion of its legal advisers, the chances that the Bank will be required to make payments in the framework of the class action (with the exception of the Plaintiff's lawyer's retainer) is slight.

b. On September 17, 2013, a claim was filed with the Jerusalem District Court (inter alia) against the Bank, and a motion was filed to recognize this claim as a class action suit, in which the Bank has allegedly misled its customers who are disabled (at 40% or more) and is in violation of the law in its failure to inform them of their rights in accordance with the law to receive discounts from certain commisions. The remedies that were demanded in the motion to approve the claim as a class action suit are restitution of the difference between the commisions collected from the disabled customers and the payment that would have been actually charged had they been granted the discounts. As well as, issuing of a mandatory injunction for the Bank to inform its customers about the discount to disabled customers. The Plaintiff estimated that the amount of damage caused to the entire Group with regards to the Bank of Jerusalem amounts to approx. NIS 784 thousand.

To the extent that it is possible to assess at this initial and preliminary stage, the Bank has adequate counter claims, and therefore, the Bank's management estimates, relying on the opinion of the legal advisers, that the chances that the motion will be granted are slight.

c. On April 1, 2007, a statement of claim and a motion to approve the claim as a class action suit were filed with the Tel-Aviv District Court against Clal Batucha Investment Management Ltd. (hereinafter: "Clal Batucha"), as well as against other banks and investment houses.

The Petitioners are claiming that they own participating units in various mutual funds that were previously managed by the banks' subsidiaries, including by Clal Finance Mutual Funds Ltd. (formerly Ilanot Discount Ltd., hereinafter: "Ilanot Discount"), which was sold to Clal Batucha. The subject matter of the claim and the motion for approval focuses on the brokerage fees that, according to the Petitioners, Clal Finance Mutual Funds (which had during a part of the period relevant to the claim, been controlled by Clal Batucha), as manager of the mutual funds, used to pay to Bank Discount and Clal Batucha for operations of purchase and sale of securities and/or foreign currency that Bank Discount and/or Clal Batucha, as members of the Stock Exchange, use to perform for it.

According to the Petitioners, some of the Defendants unlawfully charged the mutual funds that were managed by their subsidiaries fees in higher rates than the rates charged from their other customers. The Petitioners further claim that the reason for the continued charging of the high fees was various agreements reached between Clal Batucha and Bank Discount in the framework of the sale of the control in Ilanot Discount. The Petitioners claim that with these actions, Clal Batucha violated the provisions of the Joint Investment Trust Law 5754-1994. Furthermore, the Petitioners claim that Clal Batucha violated the fidelity duty towards holders of the participating shares in the fund, violated the contract between it and investors in the mutual fund, misled investors and took advantage of their ignorance. The amount of damage claimed for the Group is estimated by the Petitioners for the period since January 1, 2004, against all Defendants, in an amount of approx. NIS 386.15 million. The Petitioners claim that of this amount, Clal Batucha is liable for approx. NIS 50.3 million, where for part of the said amount, it is being sued on its own and for some of the amount, it is being sued jointly and severally with Bank Discount. The remedy being claimed in the suit is to charge all Defendants to refund the exceeding fees allegedly collected since the beginning of 2004, as well as a mandatory injunction ordering the Defendants to change the way they practice with regards to collection of fees.

On February 15, 2010, Clal Batucha filed a response to the motion for approval. On January 9, 2011, the Petitioners filed a response to Clal Batucha's response. On April 17, 2012, the first pre-trial hearing took place in the suit, in which it was determined that the broadening the scope claims would be discussed as part of the final ruling on whether to approve the class action suit. Furthermore, the court sent the material in the file to the Securities Authority, which, on July 8, 2012, filed its position in this case, and on September 12, 2012, Clal Batucha filed its response to the Authority's position. The parties, at the recommendation of the court, went to arbitration, which began in February 2013. The arbitration proceeding failed and the file returned to the court and is currently being heard in the economic court.

On August 6, 2013, the Bank of Jerusalem acquired all shares of Clal Batucha from Clal Finance Ltd., which held 100% of Clal Batucha shares. In accordance with the acquisition agreement, the Bank is also responsible for the liabilities and debts of Clal Batucha in respect of this clain, should there be any. This, subject to the undertaking by Clal Finance to indemnify the Bank for damages resulting from events that occurred at Clal Batucha prior to the date of the sale, including payment according to a ruling issued in this claim, if any, should the total of said damages exceed NIS 2.5 million (capitalized to the report date NIS 2.3 million). For more information, see Note 7e.

Note 19 – Contingent Liabilities and Special Agreements (continued)

Reported amounts in millions of Shekels

According to the opinion of the Bank's management, relying on the opinion of the legal advisers, the Bank (formerly – Clal Batucha) has good defense arguments against the claim and against the motion for approval, and the court is not expected to accept the motion and the Plaintiff's demand.

d – Other contingent liabilities

1. In January 2012, the Bank's General Assembly of Shareholders approved a decision, according to which the Bank will grant to those serving from time to time as senior officers at the Bank and its subsidiaries, an indemnification liability for monetary responsability imposed on any of them and for reasonable litigation expenses related to the list of events attached as an appendix to the liability note. Provision of the indemnity depends on the existence of the conditions specified in the liability note and the cumulative maximum indemnification amount to senior officers of the Bank and its subsidiaries shall not exceed 25% of the Bank's equity.

2. As part of the establishment of Jerusalem Financing Issuances (2005) Ltd., a subsidiary fully controlled by the Bank (hereinafter: "Financing and Issuances"), the Bank undertook to indemnify Financing and Issuances for all its liabilities, and this in order to meet the requirements of the instructions of the Supervisor of Banks on the subject of minimum capital ratio (Section 4 of Instruction 311 of the Proper Banking Management Instructions).

   As part of the issuances to the public of liability certificates by Financing and Issuances, the Bank undertook towards Financing and Issuances and the trustee for those issuances, to comply with all the terms of the liability certificates issued by it and held by the public. As at the report date, the balance of the Bank's liability is NIS 30 million par value of Deposit Certificates (Series A), NIS 182 million par value of Deposit Certificates (Series B), NIS 150 million par value of Deferred Liability Notes (Series C), NIS 315 million par value of Debentures (Series F), NIS 360 million par value of Debentures (Series G), NIS 122 million par value of Debentures (Series H), NIS 100 million par value of Deferred Liability Notes (Series N) and NIS 131 million of Deferred Liability Notes (Series 10), that were issued by Financing and Issuances. In June 2013, the final date for redeeming a liability certificate (series E) arrived and thus the balance of the principal was redeemed for a total of NIS 68 million par value. The aforementioned undertaking of the Bank cannot be revoked or changed since the rights of the owners of the deposit certificates depend on it.

Note 19 – Contingent Liabilities and Special Agreements (continued)

Reported amounts in millions of Shekels

3. On June 4, 2013, the Bank received a notice regarding the filing of a motion with the Committee to Impose Financial Sanctions on Banking Corporations, to impose on the Bank a financial sanction in accordance with the Anti-Money Laundering Law 5760-2000, for alleged violations of said law. The motion, which does not specify the requested amount of the sanction, refers to alleged violations mentioned in the audit report from February 2013, that was prepared by the Supervisor of Banks with regards to the period between 2007 and until 2010. The Bank responded to the motion and presented in its response its position according to which, it acted in compliance with the provisions of the Law, and following the Bank's response to the audit report itself, and the detailed treatment outline presented by the Bank in the framework of said response, which reflects, to the best of its understanding, a culture of proper compliance, and compliance by all levels with the provisions of the law.

   At this stage, the Bank cannot assess whether financial sanctions will be imposed on the Bank as a result of this notice and if so, the amount of said sanction.

4. The Bank undertook to allow depositors and savers to receive loans for purchasing an apartment or a vehicle at the height of their deposits, at a lower interest than the nominal interest that will be customary at the bank when providing the loan. This entitlement will be available to them as from the end of one year following the beginning of the deposit term and on condition that they will comply with the conditions customary at the Bank concerning providing loans; additionally, the funds will be deposited at the dates determined under the plan's terms.

Listed below is the composition of the liability sums for providing credit:

	Rate of reduction from nominal interest	Maximum undertaking to grant loans as at December 31,	
		2013	2012
Details of savings	%	Millions of NIS	
Savings plans (monthly or one-time deposit)	0.25%	**1,829.2**	2,218.3
Savings plans with monthly deposit	0.4%	**1,116.2**	991.2
Savings plans with one-time deposit	0.5%	**21.1**	34.8
Total		**2,966.5**	3,244.3

* Reclassified

It should be noted that the effect of the discounts mentioned above and the actual rate of utilization thereof are not material.

Note 19 – Contingent Liabilities and Special Agreements (continued)

Reported amounts in millions of Shekels

5. On August 6, 2013, the Bank of Jerusalem acquired all the shares of Clal Batucha from Clal Finance Ltd., which held 100% of Clal Batucha shares. In accordance with the acquisition agreement, the Bank is also responsible for the liabilities and debts of Clal Batucha for its past activity, if any, and including any existing claims against Clal Batucha that were estimated for the purpose of attributing the acquisition cost in a total amount of NIS 5 million. This (capitalized as at 31.12.13 – NIS 4.6 million) subject to the undertaking by Clal Finance to indemnify the Bank for damages resulting from events that occurred at Clal Batucha prior to the date of the sale, should said total damages exceed NIS 2.5 million (capitalized as at the acquisition date – NIS 2.3 million).

   In addition, the Bank, as a result of the acquisition transaction, is also responsible for the undertakings to indemnify various entities that purchased variuos operations from Clal Batucha prior to the date of the sale. This, subject to the undertaking by Clal Finance to indemnify the Bank for damages resulting from events that occurred at Clal Batucha prior to the date of the sale, should such total damages exceed NIS 30 thousand.

e – Agreements

The Bank and a consolidated company entered into long term lease contracts that include an extension option. The payable rent for the coming years for the aforementioned agreements is as follows:

	Consolidated		The Bank	
	December 31,			
	2013	2012*	2013	2012
First Year	**16.0**	14.7	**2.4**	2.4
Second Year	**18.4**	14.0	**2.4**	2.0
Third Year	**15.1**	16.3	**2.3**	1.8
Fourth Year	**13.3**	12.5	**1.5**	1.8
Fifth Year onward	**115.0**	114.0	**3.3**	4.6
Total long-term lease contracts	**177.8**	171.5	**11.9**	12.6

* Reclassified

Note 20 – Activity in Derivative Instruments – Scope, Credit Risks and Repayment Dates (consolidated and the Bank)

A. Implementation of the instructions of the Supervisor concerning derivative instruments and hedging activities

The activity of the Bank as a financial intermediary exposes it to a variety of risks, including market risks. Market risks include, inter alia, underlying risks, interest risks, exchange rates fluctuation risks, and inflation rate risks. As part of the Bank's overall strategy for managing the level of exposure to market risks, as mentioned above, the Bank performs, inter alia, transactions in derivative financial instruments in order to reduce its exposure to market risks. The Bank's activity in derivative financial instruments is as intermediary, trader or end-user. The Bank has derivative financial instruments, like future transactions for exchange between currencies (Swaps), future contracts for protecting currency rates (Futures, Forwards).

The transactions in derivative financial instruments are recorded at fair value, and changes in fair value are regularly recorded in the Statement of Profit and Loss.

The Bank enters into contracts that do not constitute derivative instruments on a stand-alone basis, but that include embedded derivatives. For each contract, the Bank assesses whether the economic characteristics of the embedded derivative are clearly and closely related to those of the host contract, and determines whether a separate instrument with the same conditions as the embedded instrument would fulfill the definition of a derivative instrument. Once it is determined that an embedded derivative has economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, and that a separate instrument with the same conditions would be considered a derivative instrument, the embedded derivative is separated from the host contract and accounted for as a stand-alone derivative instrument. An embedded derivative that has been separated is presented in the balance sheet together with the host contract.

Note 20 – Activity in Derivative Instruments – Scope, Credit Risks and Repayment Dates (consolidated and the Bank) (continued)

Reported amounts in millions of Shekels

B. Scope of activity

1. Nominal amount of derivative instruments

	December 31, 2013				
	Interest rate contracts		Foreign currency contracts	Contracts for shares	Total
	NIS – Index	Other			
A. ALM [1][2] derivatives					
Futures contracts	–	21.6	–	–	21.6
Forwardcontracts	–	–	995.8	–	995.8
Swaps	100.0	202.9	-	–	302.9
Total	**100.0**	**224.5**	**995.8**	**–**	**1,320.3**
From this, interest rate swap contracts (swaps) in which the banking corporation agreed to pay a fixed interest rate	50.0	188.1	–	–	238.1
B. Other derivatives [1]					
Option contracts traded on the Stock Exchange					
Written options	–	–	24.4	687.1	711.5
Purchased options	–	–	24.4	687.1	711.5
Total	**–**	**–**	**48.8**	**1,374.2**	**1,423.0**
C. Credit derivatives and spot foreign-currency swaps					
Spot foreign-currency swaps	–	–	110.9	–	110.9
Total nominal amount	**100.0**	**224.5**	**1,155.5**	**1,374.2**	**2,854.2**

2. Gross fair value of derivative instruments

	NIS – Index	Other	Foreign currency contracts	Contracts for shares	Total
A. ALM [1][2] derivatives					
Gross positive fair value	0.5	1.7	15.1	–	17.3
Gross negative fair value	0.8	0.9	6.2	–	7.9
B. Other derivatives[1]					
Gross positive fair value	–	–	0.2	4.2	4.4
Gross negative fair value	–	–	0.2	4.2	4.4
Total positive fair value	**0.5**	**1.7**	**15.3**	**4.2**	**21.7**
Total negative fair value	**0.8**	**0.9**	**6.4**	**4.2**	**12.3**

(1) Except for credit derivatives and SPOT foreign-currency swaps.

(2) Derivatives which are part of the Bank's Asset and Liability Management (ALM) system, and are not designated for hedging.

Note 20 – Activity in Derivative Instruments – Scope, Credit Risks and Repayment Dates (consolidated and the Bank) (continued)

Reported amounts in millions of Shekels

B. Scope of activity

1. Nominal amount of derivative instruments

	December 31, 2012				
	Interest rate contracts		Foreign currency contracts	Contracts for shares	Total
	NIS – Index	Other			
A. ALM [1][2] derivatives					
Forwardcontracts	–	–	649.0	–	649.0
Swaps	170.0	320.8	-	–	490.8
Total	**170.0**	**320.8**	**649.0**	**–**	**1,139.8**
From this, interest rate swap contracts (swaps) in which the banking corporation agreed to pay a fixed interest rate	120.0	320.8	–	–	440.8
B. Other derivatives [1]					
Option contracts traded on the Stock Exchange					
Written options	–	–	32.8	610.7	643.5
Purchased options	–	–	32.8	610.7	643.5
Total	**–**	**–**	**65.6**	**1,221.4**	**1,287.0**
C. Credit derivatives and spot foreign-currency swaps					
Spot foreign-currency swaps	–	–	65.5	–	65.5
Total nominal amount	**170.0**	**320.8**	**780.1**	**1,221.4**	**2,492.3**
2. Gross fair value of derivative instruments					
A. ALM [1][2] derivatives					
Gross positive fair value	0.4	0.1	15.9	–	16.4
Gross negative fair value	2.0	6.4	3.5	–	11.9
B. Other derivatives [1]					
Gross positive fair value	–	–	0.3	4.2	4.5
Gross negative fair value	–	–	0.3	4.2	4.5
Total positive fair value	**0.4**	**0.1**	**16.2**	**4.2**	**20.9**
Total negative fair value	**2.0**	**6.4**	**3.8**	**4.2**	**16.4**

(1) Except for credit derivatives and SPOT foreign-currency swaps.

(2) Derivatives which are part of the Bank's Asset and Liability Management (ALM) system, and are not designated for hedging.

Note 20 – Activity in Derivative Instruments – Scope, Credit Risks and Repayment Dates (consolidated and the Bank) (continued)

Reported amounts in millions of Shekels

C. Credit risk for derivative instruments by the counterparty to the contract

	December 31, 2013		
	Stock exchanges	Banks	Total
Balance-sheet balance of assets for derivative instruments (2)	4.4	17.3	21.7
Gross amounts that were not offset in the balance sheet:			
Reduction of credit risk for cash securities that were received	–	–	–
Net amount of assets for derivative instruments	**4.4**	**17.3**	**21.7**
Net off-balance sheet credit risk for derivative instruments (1)	7.6	33.5	41.1
Total credit risk for derivative instruments	**12.0**	**50.8**	**62.8**
Net amount of liabilities for derivative instruments	**4.4**	**8.0**	**12.4**

	December 31, 2012		
	Stock exchanges	Banks	Total
Balance-sheet balance of assets for derivative instruments (2)	4.5	16.4	20.9
Balance-sheet balances of assets deriving from derivative instruments	4.5	16.4	20.9
Off-balance sheet credit risk for derivative instruments (1)	5.9	55.6	61.5
Total credit risk for derivative instruments	**10.4**	**72.0**	**82.4**
Net amount of liabilities for derivative instruments	**3.5**	**10.8**	**14.3**

(1) The difference is positive, between the total amounts for derivative instruments (including derivative instruments with a negative fair value) that were included in the borrower's liabilities, as calculated for the purpose of restrictions on the borrower's liabilities, prior to reducing the credit risk, and the balance-sheet balance of assets for the borrower's derivative instruments.

(2) Of this, a balance-sheet balance of stand-alone derivative instruments amounting to NIS 21.7 million (as of 31.12.12 – NIS 20.9 million) that is included in the Assets for Derivative Instruments section.

D. Details of repayment dates (amounts in nominal value)

	Up to 3 months	Over 3 months and up to one year	Over one year and up to 5 years	Over 5 years	Total
as of December 31, 2013 –					
Interest contracts (NIS – Index)	-	100.0	-	-	100.0
Interest contracts (other)	21.6	-	175.8	27.1	224.5
Foreign currency contracts	1,027.9	40.8	86.8	-	1,155.5
Contracts for shares	1,374.2	-	-	-	1,374.2
Total	2,423.7	140.8	262.6	27.1	2,854.2
As at December 31, 2012 –					
Interest contracts (NIS – Index)	70.0	–	100.0	–	170.0
Interest contracts (other)	–	–	320.8	–	320.8
Foreign currency contracts	556.8	186.0	37.3	–	780.1
Contracts for shares	1,221.4	–	–	–	1,221.4
Total	**1,848.2**	**186.0**	**458.1**	**–**	**2,492.3**

Note 21 – Balances and Estimates of Fair Value of Financial Instruments (consolidated)

a – Fair value of financial instruments

The information included in this Note refers to the assessment of fair value of financial instruments.

Most of the financial instruments at the Bank cannot quote "market price" because an active market in which they trade does not exist. Therefore, the fair value is assessed through accepted pricing models, such as present value of future cash flow capitalized by a discount interest rate that reflects the risk level embedded in the financial instrument. The estimation of fair value through future cash flow assessment and the determination of the discount interest rate are subjective. Therefore, for most of the financial instruments, the above mentioned assessment of fair value is not necessarily an indication of the realization value of the financial instrument on the reporting day. The assessment of the fair value was carried out according to the valid interest rates on the reporting date, and does not take into account the fluctuation of the interest rates. Under the assumption of other interest rates, the fair value amounts to be obtained may be significantly different. The aforesaid primarily concerns financial instruments at fixed interest or not bearing any interest. In addition, upon determining the fair value amounts, the commissions that will be obtained or paid for the business activity are not taken into account and also do not include the tax effect.

It should be noted that it is plausible that the gap between the balance-sheet balance and the fair value balance will not be realized, since in most cases the Bank may hold the financial instruments until repayment. For all these, it should be emphasized that the data included in this Note do not indicate the value of the banking corporation as a going concern. Furthermore, caution should be adopted when comparing the amounts of fair value between various banks, because of multiple assessment techniques and estimates that can be implemented during the fair value assessment.

b – The method and principal assumptions for estimating the fair value of financial instruments

Deposits in banks, non-negotiable debentures and loans and credit to the government – by the capitalization of future cash flows method, based on the interest rates at which the Bank made similar transactions at the reporting date.

Negotiable securities – at market value, non-negotiable securities – by revaluation data obtained from external sources.

Credit to the public – the fair value of the balance for credit to the public is estimated using the present value of future cash flows method, discounted by suitable discount rates. The credit balance was split into categories based on the main types of population, and divided according to linkage and credit sectors and fixed and variable interest rates. Cash flows (principal and interest) were capitalized at

Note 21 – Balances and Estimates of Fair Value of Financial Instruments (consolidated) (continued)

interest rates that are identical to the average interest rates at which similar transactions were being carried out at the Bank on the reporting date. Early credit repayments were not taken into account during the calculation of fair value, when their effect is not unambiguous. The fair value of debit balances in current accounts was assessed based on the balance-sheet balances.

The fair value of problematic debts was calculated using discount interest rates that reflect the high credit risk embedded in them. These discount rates were not lower than the highest interest rate used by the Bank for its transactions on the reporting date. Future cash flows for problematic debts are calculated after the write-offs and provisions for credit losses are deducted. Early credit repayments were not taken into account during the calculation of fair value, when their effect is not unambiguous.

Deposits, debentures and deferred liability notes – by the capitalization of future cash flows method, based on the interest rate at which the Bank raises similar deposits or issues similar debentures and deferred liability notes on the reporting day, except for debentures listed on the Stock Exchange that are presented according to market value. The fair value of credit balances in current accounts and deposits without repayment date was estimated based on the balance-sheet balance.

With regards to off-balance sheet financial instruments in which the balance represents a credit risk – the fair value was estimated according to the present value of future cash flows capitalized at an interest rate that reflects the interest level at which a similar transaction would have been carried out on the reporting date. Derivative instruments for which there is an active market were assessed at market value, and derivative instruments not negotiable in an active market were assessed based on models used by the Bank in its current operations, and that take into account the risks embodied in the financial instrument.

Financial instruments having an original term of up to three months and a variable market interest rate – the balance-sheet balance constitutes an approximation of the fair value, subject to changes in credit risks and in the Bank's margin for transactions with variable interest.

Note 21 – Balances and Estimates of Fair Value of Financial Instruments (consolidated) (continued)

Reported amounts in millions of Shekels

	December 31,									
	2013					2012				
	Balance in balance sheet	Fair value				Balance in balance sheet	Fair value			
		Level 1[(1)]	Level 2[(1)]	Level 3[(1)]	Total		Level 1[(1)]	Level 2[(1)]	Level 3[(1)]	Total
Financial assets										
Cash and deposits at banks	2,833.4	2,833.4	-	-	2,833.4	1,360.6	971.9	-	388.7	1,360.6
Securities[(2)]	676.6	671.6	1.3	3.7	676.6	1,489.6	1,157.9	4.0		1,161.9
Credit to the public, net[(3)]	9,626.6	-	-	9,713.4	9,713.4	9,581.4			9,744.9	9,744.9
Assets for derivative instruments	21.70	4.4	17.3	–	21.7	20.9	4.5	16.4	–	20.9
Other financial assets	40.30	-	-	40.3	40.3	43.0	-	-	43.0	43.0
Total	**13,198.6**	**3,509.4**	**18.6**	**9,757.4**	**13,285.4**	**12,495.5**	**2,134.3**	**20.4**	**10,176.6**	**12,331.3**
Financial liabilities										
Deposits from the public	11,071.1	-	-	11,125.0	11,125.0	9,813.7	-	-	9,865.8	9,865.8
Deposits from banks	51.5	-	-	59.5	59.5	63.3	-	-	72.8	72.8
Government deposits	0.7	-	-	0.7	0.7	–	-	-	–	–
Debentures and deferred liability notes	1,406.0	-	-	1,424.3	1,424.3	1,581.0	1,029.7	-	604.3	1,634.0
Liabilities for derivative instruments	12.3	4.40	7.90	-	12.3	16.4	4.5	11.9	–	16.4
Other financial liabiilties	75.0	-	-	75.0	75.0	87.6	-	-	87.6	87.6
Total	**12,616.6**	**4.4**	**7.9**	**12,684.5**	**12,696.8**	**11,562.0**	**1,034.2**	**11.9**	**10,630.5**	**11,676.6**

(1) Level 1 – Fair value measurements using quoted prices in an active market. Level 2 – Fair value measurements using other significant observable inputs. Level 3 – Fair value measurements used in other significant observable inputs.

(2) For more information about the balance-sheet balance and fair value of securities, see Note on Securities.

(3) From this: defective credit whose collection is contingent on collateral as at December 31, 2013 and December 31, 2012 in the amount of NIS 8.1 million and NIS 31.6 million, respectively.

(4) From this: assets whose balance-sheet balance is identical to the fair value (instruments presented in the balance sheet according to fair value) or that constitutes an approximation of the fair value (instruments for an original term of up to 3 months for which use was made of the balance-sheet balance as an approximation of fair value) as at December 31, 2013 and December 31, 2012 in the amount of NIS 3,528 million and NIS 2,328 million, respectively. Liabilities whose balance-sheet balance is identical to the fair value (instruments presented in the balance sheet according to fair value) or that constitutes an approximation of the fair value (instruments for an original term of up to 3 months for which use was made of the balance-sheet balance as an approximation of fair value) as at December 31, 2013 and December 31, 2012 in the amount of NIS 1,229.0 million and NIS 801.1 million, respectively. For more information about instruments that were measured at fair value on a recurring basis and on a non-recurring basis, see Note 21a.

(5) For items that were measured at fair value as part of the attribution of the acquision costs of Clal Batucha, see Note 7e.

Note 21a – Items Measured at Fair Value on a Recurring Basis (consolidated)

Reported amounts in millions of Shekels

	December 31, 2013			
	Fair value measurements using -			
	Prices quoted in an active market (Level 1)	Other significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total Fair value
	Millions of NIS			
Assets				
Available-for-sale securities:				
Israeli Government Debentures	477.8	–	–	477.8
Other corporate debentures	10.5	1.3	3.7	15.5
Total available-for-sale securities	**488.3**	**1.3**	**3.7**	**493.3**
Securities for trade purposes:				
Debentures – of the Israeli Government	183.0	–	–	183.0
Other corporate debentures	0.3	–	–	0.3
Total securities for trade	**183.3**	**–**	**–**	**183.3**
Assets for derivative instruments:				
NIS – Index interest contracts	–	0.5	–	0.5
Interest contracts – other	–	1.7	–	1.7
Foreign currency contracts	0.2	15.1	–	15.3
Share contracts	4.2	–	–	4.2
Total assets for derivative instruments	**4.4**	**17.3**	**–**	**21.7**
Total financial assets	**676.0**	**18.6**	**3.7**	**698.3**
Liabilities				
Liabilities for derivative instruments:				
NIS – Index interest contracts	–	0.8	–	0.8
Interest contracts – other	–	0.9	–	0.9
Foreign currency contracts	0.2	6.2	–	6.4
Share contracts	4.2	–	–	4.2
Total liabilities for derivative instruments	**4.4**	**7.9**	**–**	**12.3**
Total financial liabilities	**4.4**	**7.9**	**–**	**12.3**

Note 21a – Items Measured at Fair Value on a Recurring Basis (consolidated)

Reported amounts in millions of Shekels

	December 31, 2012			
	Fair value measurements using -			
	Prices quoted in an active market (Level 1)	Other significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total Fair value
Assets				
Available-for-sale securities:				
Israeli Government Debentures	783.9	2.3	–	786.2
Other corporate debentures	11.3	1.7	1.1	14.1
Total available-for-sale securities	**795.2**	**4.0**	**1.1**	**800.3**
Securities for trade purposes:				
Debentures – for trade	362.7	–	–	362.7
Total securities for trade	362.7	**–**	**–**	362.7
Assets for derivative instruments:				
NIS – Index interest contracts	–	0.4	–	0.4
Interest contracts – other	-	0.1	–	0.1
Foreign currency contracts	0.3	15.9	–	16.2
Share contracts	4.2	-	–	4.2
Total assets for derivative instruments	**4.5**	**16.4**	**–**	**20.9**
Total financial assets	**1,162.4**	**20.4**	**1.1**	**1,183.9**
Liabilities				
Liabilities for derivative instruments:				
NIS – Index interest contracts	–	2.0	–	2.0
Interest contracts – other	–	6.4	–	6.4
Foreign currency contracts	0.3	3.5	–	3.8
Share contracts	4.2	–	–	4.2
Total liabilities for derivative instruments	**4.5**	**11.9**	**–**	**16.4**
Total financial liabilities	**4.5**	**11.9**	**–**	**16.4**

Note 22 -Stakeholders and Related Parties [1](consolidated)

Reported amounts in millions of Shekels

a – Balances

	Stakeholders								Related parties	
	Shareholders						Key management personnel(6)		Others(7)	
	Controlling shareholders(4)		with material influence(5)		Others					
	2	3	2	3	2	3	2	3	2	3
As at December 31, 2013										
Assets										
Credit to the public	0.3	0.6	–	–	–	–	0.6	0.7	–	–
Provision for credit losses	–	–	–	–	–	–	–	–	–	–
Credit to the public, net	0.3	0.6	–	–	–	–	0.6	0.7	–	–
Liabilities										
Deposits from the public	8.4	10.5	0.2	0.2	1.5	2.0	2.2	2.9	0.5	0.5
Other liabilities – Accounts payable and credit balances	–	–	–	–	–	–	1.6	1.6	–	–
Shares (included in equity)(8)	603.5	603.5	–	–	35.0	35.0	–	–	–	–
As at December 31, 2012										
Assets										
Credit to the public	–	0.2	–	–	–	–	0.7	5.4	–	–
Provision for credit losses	–	–	–	–	–	–	–	–	–	–
Credit to the public, net	–	0.2	–	–	–	–	0.7	5.4	–	–
Liabilities										
Deposits from the public	7.9	13.6	0.2	0.2	2.0	2.0	2.8	5.1	0.6	0.6
Other liabilities – Accounts payable and credit balances	–	–	–	–	–	–	0.8	0.8	–	–
Shares (included in equity)(8)	600.9	600.9	–	–	34.8	34.8	–	–	–	–

(1) Stakeholder – as defined in Section 80d to the Instructions on Reporting to the Public.

Related party – as defined in International Accounting Standard 24 Disclosures regarding a related party which is not a stakeholder

(2) Balance as at the balance sheet date.

(3) The highest balance during the year – and this based on balances at the end of each month.

(4) Controlling shareholder – as defined in the Securities Law.

(5) Shareholders with significant influence– in accordance with Section 80.d(2) to the Instructions on Reporting to the Public.

(6) Key management personnel – in accordance with Section 80.d(4) to the Instructions on Reporting to the Public.

(7) In accordance with Section 80.d(5) to the Instructions on Reporting to the Public.

(8) The holdings of stakeholders and related parties in the banking corporation's capital.

(9) Amounts less than NIS 0.1 million are not presented in this Note.

Note 22-Stakeholders and Related Parties (consolidated) [(1)] (continued)

Reported amounts in millions of Shekels

b – Summary of business results with stakeholders and related parties

	Stakeholders				Related parties
	Shareholders			Key management personnel(6)	
	Controlling shareholders(4)	with material influence(5)	Others		Others(7)
For the year ended on December 31, 2013					
Interest income, net**	(0.1)	–	–	(0.1)	–
Expenses from credit losses	–	–	–	–	–
Non-interest income	0.3	–	–	–	–
Operating and other expenses***	0.1	0.1	0.1	16.7	0.5
Total	**0.1**	**(0.1)**	**(0.1)**	**(16.8)**	**(0.5)**
For the year ended on December 31, 2012					
Interest income, net**	(0.1)	–	–	–	–
Expenses from credit losses	–	–	–	–	–
Non-interest income	(0.2)	–	–	–	–
Operating and other expenses***	0.1	0.1	0.1	15.0	0.5
Total	**(0.4)**	**(0.1)**	**(0.1)**	**(15.0)**	**(0.5)**
For the year ended on December 31, 2011					
Interest income, net**	(0.2)	–	–	(0.1)	–
Expenses from credit losses	–	–	–	–	–
Non-interest income	(0.3)	–	–	–	–
Operating and other expenses**	0.1	0.1	0.1	15.4	0.5
Total	**(0.6)**	**(0.1)**	**(0.1)**	**(15.5)**	**(0.5)**

* Amounts less than NIS 0.1 million are not presented in this Note

** Details in Table D – Interest income, net in transactions of the banking corporation and its consolidated companies with stakeholders and related parties

*** Details in Table C – Compensation and any other benefit to stakeholders (from the banking corporation and investee companies).

Note 22-Stakeholders and Related Parties (consolidated) [(1)] (continued)

Reported amounts in millions of Shekels

c – Compensation and any other benefit to stakeholders (from the banking corporation and investee companies).

	Stakeholders							
	Shareholders						Key management personnel(6)	
	Controlling shareholders (4)		with material influence(5)		Others			
	Total benefit	Number of parties receiving benefits	Total benefit	Number of parties receiving benefits	Total benefit	Number of parties receiving benefits	Total benefit	Number of parties receiving benefits
For the year ended on December 31, 2013								
Stakeholder employed by or for a corporation	**–**	**–**	**–**	**–**	**–**	**–**	**14.8***	**14**
Director who is not employed by or for a corporation	**0.1**	**1**	**0.1**	**1**	**0.1**	**1**	**1.9**	**11**
*From this: share-based payment of NIS 0.4 million.								
For the year ended on December 31, 2012								
Stakeholder employed by or for a corporation	–	–	–	–	–	–	13.2*	12
Director who is not employed by or for a corporation	0.1	1	0.1	1	0.1	1	1.8	12
*From this: share-based payment of NIS 0.8 million.								
For the year ended on December 31, 2011								
Stakeholder employed by or for a corporation	–	–	–	–	–	–	12.6*	11
Director who is not employed by or for a corporation	0.1	1	0.1	1	0.1	1	2.8	13
*From this: share-based payment of NIS 0.8 million, post-employment benefits of NIS 1.1 million.								

d – Interest income, net in transactions of the banking corporation and its consolidated companies with stakeholders and related parties

	Consolidated		
	For the year ended on December 31,		
	2013	2012	2011
A. From assets			
From credit to the public	-	0.2	0.1
B. From liabilities			
On public deposits	0.2	0.3	0.4
Total interest income, net	(0.2)	(0.1)	(0.3)

Note 22-Stakeholders and Related Parties (consolidated) [1] (continued)

e – CEO Employment Terms

On April 13, 2010, Mr. Uriel Paz (hereinafter: "Mr. Paz" or the "CEO") began his tenure as CEO of the Bank, after receiving approval from the Bank of Israel for his appointment. A detailed immediate report of the Bank in relation to the employment terms of the CEO was issued on March 15, 2010. The CEO's employment terms, as detailed below, were approved by the Audit Committee and the Board of Directors of the Bank on March 14, 2010, as required in relation to an extraordinary transaction with a senior officer.

Below are the principles of the management service provision agreement between the Bank and Uriel Paz Consultancy Ltd., a company owned and fully controlled by the CEO (hereinafter: the "Management Company"), as of October 10, 2010 (hereinafter: the "Management Agreement") (this agreement replaced the work agreement that was signed with the CEO on April 8, 2010), as follows:

1. The Management Company is entitled to a consideration of NIS 120,000 gross per month ("monthly payment") during the management agreement period, linked to the CPI as published on February 15, 2010 for January 2010. Pursuant to the immediate report dated July 14, 2013, with regards to the implementation of a streamlining plan, the Bank's CEO announced his consent to lower the management fees paid to him through a company wholly owned by him, by 5% as from August 1, 2013, and that the management fees will not be updated for the Consumer Price Index as from January 1, 2013. The reduction in the management fees will remain valid for an allotted time and will end upon the occurrence of certain events.

2. The term of the engagement, according to the management agreement from April 8, 2010, is 4 years, but each of the parties may terminate the engagement period by issuing written notice six months in advance. In addition, the Bank will be entitled to bring the agreement to an end, immediately, without compensation, and this in each of the following events: (a) the CEO was convicted of a flagrant offense related to providing services to the Bank or of another offense of a criminal type; (b) the court ruled that the CEO caused a grave betrayal of Bank's trust, or embezzled Bank funds or intentionally harmed the Bank or any of its employees by causing significant damage to the Bank and/or any of its employees; and (c) under such circumstances that permit to deprive the CEO of severance pay, in whole or in part, had he been employed as a Bank employee.

3. Following the approval of the above employment terms of the CEO on March 14, 2010 and the management agreement, the Board of Directors of the Bank decided on February 27, 2011, after receiving the approval of the Bank's Audit Committee on February 21, 2011, to adopt an options plan for the allocation of options units to

the Management Company at a volume and under such terms as determined by the plan. According to the options plan, 2,115,530 options units of class A and 1,410,355 options units of class B were registered and allocated to the Management Company. For additional details concerning the options plan, see the Bank's Immediate Report dated March 7, 2011 (reference number: 2011-01-071295), and Note 22a to the Financial Statements.

4. One-time grants

The plan determines the Management Company entitlement to two one-time bonuses, for a maximum amount of NIS 240 thousand each, and this depending, for one of the bonuses, on a performance formula of the Bank's share at the Stock Exchange in the period between the plan's approval and until April 13, 2011. Concerning the other one-time bonus, it is dependent upon a capital issuance by the Bank at a price that will reflect a certain premium rate on the equity, as determined in the one-time bonus formula. It should be mentioned that until April 13, 2011, the conditions as aforementioned were not met, and therefore, the Management Company is not entitled to the grants specified in this Section.

5. Yearly bonus

The Management Company will be entitled to a yearly bonus, according to the yearly bonus plan that is an integral part of the management agreement ("Yearly Bonus Plan").

According to the yearly bonus plan, the Management Company will be entitled to a yearly bonus derived from the "calculated yield", as defined below, and as limited to a maximum of 24 gross monthly payments (that is, NIS 2,880 thousand) (hereinafter: "Yearly Bonus"). The yearly bonus will start at the height of three monthly gross payments (that is, NIS 360 thousand) (at an average equity yield and increase in equity of 9%) and until a maximum of 24 monthly gross payments as aforementioned (at an average of 15%).

It should be mentioned that the bonus amount is listed in the plan as multiple monthly payments paid to the Management Company. Derived from this, since the monthly amounts are linked as specified above, the minimum and maximum amounts of the bonus are index-linked.

Each annual bonus will be paid in stages over 3 years (50% in the first year and 25% in the second and third years), while the payment of each part of the annual bonus is contingent upon continued compliance with the targets during the year determined for payment.The actual payment of the annual bonus depends therefore on the year in which the payment should be performed, that there will be no regulatory limitation and/or capital adequacy limit on dividend distribution at a rate of at least 33% of the net profit in the payment year to the Bank's shareholders.As far as the aforementioned limitation applies to the dividend distribution, the bonus payment will be deferred, in whole or in part, to a date on which the aforementioned limitation is removed. In the event of the ability to make only a partial payment of the dividend, the dividend will be paid to the shareholders and the bonus, pro-rata, for the aforementioned limitation rate, and the payment of the balance of the bonus will be deferred to a date on which the regulatory and/or capital adequacy limitation is removed. It should be mentioned that the Bank of Israel expressed its reservations in relation to the aforementioned section that reflects the correlation between inability to pay a dividend due to regulatory limitations and/or capital adequacy and payment of the bonus.The Chairman of the Board of Directors, in his letter to the Bank of Israel from August 11, 2011, notified the Bank of Israel that the aforementioned reservations were noted, and that the Board of Directors of the Bank will operate in accordance with the position of the Bank of Israel on this issue, and, if necessary, will contact them. It is clarified that no actual such change was made to the agreement.

Calculated yield means "reported yield" as per the definition below, excluding the effect of the project as mentioned hereinafter.

"Reported yield" is defined as the average between the annual yield (net) on equity as reported in the Bank's audited annual Financial Statements, and the growth rate in the Bank's equity as reported in the Bank's audited annual Financial Statements. A dividend announced and paid during the year, and capital issuances, if there were any, will be neutralized for the purpose of calculating the growth in equity (meaning, they will not be taken into account for the purpose of calculating the equity growth rate).

In the calculation of the annual yield, one-time profits (it was defined that financial profits such as nostro will not be considered one-time), as well as capital gains (with the exception of potential capital gain from the sale of certain real estate property defined in the plan, and that wasn't excluded from the calculation of the yield) shall be neutralized. In calculating the growth in equity, capital issues will be neutralized. The manner in which these elements will be neutralized will be reviewed by an external, independent reviewer whose identity was defined in the plan.

A venture was defined in the plan, for establishing and operating a new retail banking for the Bank ("the Project"), and it was decided that during the period between the project's approval by the Board of Directors and until the date when the project activity will be profitable from an accounting aspect, the project implications will be neutralized from the bonus formula components (the captive project capital will be neutralized from the denominator of capital yield formula; income and expenses related to the project, as well as the tax shield created by it, will be neutralized from the numerator when calculating the capital yield for the purpose of determining the bonus amount). Implementation of the formula will be controlled and examined by the independent entity as mentioned above.

f – Employment terms of the Chairman of the Board of Directors

On October 3, 2011, the General Assembly approved the appointment of Mr. Ze'ev Gutman (hereinafter: "Mr. Gutman" or the "Chairman") as director at the Bank, as well as the employment terms as the Bank's designated Chairman of the Board of Directors, following approval of the terms of the engagement, approval of the Audit Committee in their meeting of June 20, 2011, and later by the Board of Directors in their meeting on July 17, 2011, was obtained.

On October 27, 2011, the Bank's Board of Directors decided to appoint Mr. Gutman as Chairman of the Bank's Board of Directors. An Immediate Report regarding the terms of the engagement with the Chairman of the Board of Directors was given as part of the Immediate Report on the summons of the General Assembly from September 4, 2011, and its amendment from September 26, 2011.

Below are the principle terms of the engagement:

1. The services will be provided to the Bank by the Chairman in the framework of an engagement between an ordering party and an independent contractor, and this through a company controlled by the Chairman. Based on such framework, the consideration was determined for these services to the Bank. There will be no employer-employee relationship between the Chairman and the Bank.

   In the event in which instructions will be given on this issue by the Bank of Israel and/or any other authorized authority prohibiting the provision of services by a management company, the terms of this engagement will be terminated and at the same time the Chairman will be employed for all purposes as a Bank employee. In this event, the employment terms will be adjusted so that the economic position of the Chairman will not change positively or negatively following this change. So far as there will be no agreement on this issue, the terms of his employment as a Bank employee will be determined by an accountant agreed upon by the parties.

2. The consideration for the services will be as follows: a fixed monthly amount of NIS 108,340 (one hundred and eight thousand, three hundred and forty New Shekels),

with addition of VAT by law (hereinafter: the "Monthly Consideration"). Pursuant to the Immediate Report dated July 14, 2013, with regards to the implementation of a streamlining plan, the Chairman of the Bank's Board of Directors announced his consent to reduce the monthly management fees paid to him through a company wholly owned by him by 3.4%, beginning on November 1, 2013. The reduction in management fees will remain valid for a fixed period of time and will end upon the occurrence of certain events. The monthly consideration will be updated monthly according to the change in the CPI, as specified in the terms of the engagement.

Should it be that for a given fiscal year, the Bank's annual net profit according to its annual audited financial statements, will exceed NIS 61 million, the monthly consideration will increase by 10%. It is clarified that if after the above mentioned update in any tax year, the net annual profit of the Bank will be less than NIS 61 million – the monthly consideration will be reduced by 10%. The increase or decrease in the monthly consideration will be implemented one month after publication of the Bank's audited annual Financial Statements, and will be applied from that period onwards, without retroactive effect. In any case, the monthly consideration will not be less than the monthly consideration prescribed in the above section, and will not exceed 10% of the updated monthly consideration (for the purpose of clarification – if during two consecutive years the annual net profit of the Bank according to its annual audited financial statements will exceed NIS 61 million, the monthly consideration will increase by 10% only once). This update mechanism will be applied starting from the publication of the bank's audited financial statements for 2012.

3. Vacation extending up to 30 days for each full calendar year, as well as absence due to illness of up to 30 days during a full calendar year, will not cause a decrease of the monthly consideration.

4. The Bank will bear all current expenses involved in providing the services, and against presentation of receipts (when they do not come directly to the Bank), including provision of vehicle and telephone.

5. The Chairman will be entitled to be included in the compensation plan for members of Management, which establishes parameters and thresholds for receiving a yearly bonus, that was approved by the Bank's Board of Directors on November 25, 2010 (hereinafter: the "Plan").

   In accordance with the terms of the engagement, all the terms of the Plan shall apply to him, subject to the parameters and designated brackets established for the Chairman, as detailed below.

Should the Bank comply with the threshold for bonus payments, as established in the Plan, the Chairman will be entitled to an annual bonus payment according to brackets, as follows:

"Calculated Yield"*	Bonus amount (in NIS)
Up to 9% (not inclusive)	-
9% and up to 10%	100,000
Above 10% and up to and including 11%	120,000
Above 11% and up to and including 12%	140,000
Above 12% and up to and including 13%	170,000

g – Terms of Employment of the Chairman of the Board of Directors (continued)

Should the Bank comply with the threshold for bonus payments, as established in the Plan, the Chairman will be entitled to an annual bonus payment that is contingent on a minimum calculated yield of 9%. The annual bonus shall be from a level of NIS 100,000 + VAT (upon a calculated yield of 9% and higher) and up to a maximum amount of NIS 530,000 + VAT per calendar year, and this also in the event that according to the Bank's business results, the Chairman is entitled to payment of a larger bonus.

The bonus will be paid on the dates and in the terms established in the Plan. It should be mentioned that, according to the Plan, the bonus for bank managers will be paid in stages over three years from the date of eligibility (60% for the eligible year and 20% for one and two years after the date of eligibility), while the payment of each part of the annual bonus is contingent upon continuous compliance with the goals during the year established for payment.

The actual payment of the annual bonus shall occur if in the year in which the payment should be performed there will be no regulatory limitation and/or capital adequacy limit on dividend distribution at a rate of at least 33% of the net profit in the year of the payment to the Bank's shareholders. As far as any aforementioned limitation applies to the dividend distribution, the bonus payment will be deferred, in whole or in part, to a date on which the aforementioned limitation is removed. In the event of the ability to make only a partial payment of the dividend, the dividend will be paid to the shareholders and the bonus, pro-rata, for the aforementioned limitation rate, and the payment of the balance of the bonus will be deferred to a date on which the regulatory and/or capital adequacy limitation is removed.

At this stage, and according to the Plan, the instructions of the above section will not be implemented, due to objections by the Bank of Israel to the paragraph expressing the correlation between inability to pay a dividend due to regulatory and/or capital adequacy limitation and between payment of a bonus given in relation to the terms of employment of the Bank's CEO (see details on the aforementioned objections and the letter from the Chairman of the Board of Directors of August 11, 2010, to the Bank of Israel, describing the CEO's employment terms).

Note 22-Stakeholders and Related Parties (consolidated) [1] (continued)

6. The Chairman will also be entitled to a special bonus – in addition to the yearly bonus as said in Section (E) above, and without derogating from it, if, according to the Bank's annual audited financial statements, the annual yield (net) of the Bank on equity will be at least 9% – then accordingly, and subject to the required approvals according to the provisions of the law, the Chairman will be paid a special bonus and this in consideration of his special contribution to the Bank's profitability. The scope of the special bonus is at the sole discretion of the Bank's Board of Directors, and approval of the General Assembly, and will be paid on the date of the yearly bonus payment.

7. Each party may terminate the agreement at any time, pursuant to having issued written notice three months in advance. At the end of the term of the agreement, the Chairman will be subject to various limitations for the periods and under the conditions as specified in the terms of the engagement. Should an announcement of termination of the agreement be given before 12 months have passed from the start of the agreement period, then for two months following the end of the period of the early announcement, the Chairman shall not be employed by any other bank in Israel, pursuant to the Bank continuing to make full payments owed to the Management Company in accordance with the agreement between the parties.

Note 22a – Share-Based Payment Transactions

1. CEO

a. The CEO is entitled to two classes of options – units of class A and units of class B. The quantity of units of class A options will change according to the yield of the Bank's shares as specified below: starting from 70,518 units for each batch, in case that the yield of the Bank's share from the employment starting date until the option unit exercise date reflects an annual yield of up to and including 6.5% above a basic share price of NIS 8.6 per share, and up to 423,106 units per batch, in the event that the yield of the Bank's share from the employment starting date until the exercise date of the option unit reflects an annual yield of more than 9% above a basic share price of NIS 8.6 per share. The quantity of options units of type B will be 282,071 units per batch.

b. The options will mature and will be exercisable in 5 yearly batches, with the first one maturing on the employment starting date of the CEO in the Bank, and the fifth maturing 4 years after the employment starting date of the CEO in the Bank. The options may be exercised for a period of 72 months from the maturity date of each batch, subject to the provisions of the agreement.

c. The exercise increment for each option unit of class A will be in the range between NIS 8.6 for the first batch up to NIS 10.8 for the fifth batch, bearing a compound interest at an annual rate of 4% from the maturity date and until the exercise date; and the exercise increment for each option unit of class B will be in the range between NIS 10.3 for the first batch and up to NIS 12.5 for the fifth batch, bearing a compound interest at an annual rate of 3% from the maturity date and up to the exercise date, all subject to the adjustments specified in the Agreement.

d. Each option unit provides the CEO the right to receive, after exercise, a consideration that reflects the difference between the average price of the Bank's share during the 30 business days prior to the exercise date and between the exercise increment.

e. In the event of termination of employer-employee relationship between the Bank and the CEO, the matured options may be exercised within 180 days from the termination date of the employer-employee relation, otherwise they will expire.

f. In the Financial Statements of the Bank as at December 31, 2013, proceeds were recorded from options to the Bank CEO in the amount of NIS 0.4 million (2012 – NIS 0.7 million). The estimated economic value of the options that was calculated by an external appraiser while using the binomial model, was approx. NIS 4.2 million. On the granting date, and until February 27, 2011, the Bank's Board of Directors had not yet decided on the manner for granting the options to the Bank's CEO, whether as part of a plan settled in equity instruments, with a cash settlement alternative, or as part of a cash settlement plan. As a result thereof, and since the Bank's Board of Directors is not able to determine that the settlement of the options will be made through equity instruments, the Bank has accounted for the aforementioned grant as a grant settled in cash, as defined in International Financial Reporting Standard Number 2. As a result, the Bank measured in each reporting period the fair value of the liabilities, while the changes were reflected in the Profit and Loss Statement and this taking into consideration the maturity period. On February 27, 2011 the Bank's Board of Directors decided that the options granted to the CEO of the Bank will be settled with equity instruments. Therefore, on the same day the Bank classified the liabilities for the options of the CEO as equity, and this according to the fair value as at that date.

The calculation of the estimated economic value as at the aforementioned date was based on the following main parameters:

Standard deviation of annual yield: between 27% to 30%.

Risk-free interest rate: between 4.5% to 5.1%.

Share price: NIS 6.56.

2. Senior managers

a. Senior managers of the Bank for whom, on November 29, 2011, was approved by the Board of Directors of the Bank, an allocation of phantom units (hereinafter: the "Managers") will be entitled to phantom units of two classes – units of class A and units of class B. The quantity of units of class A options will change according to the yield of the Bank's shares as specified below: starting from 58,765 units for each batch, in case that the yield of the Bank's share from the employment starting date until the option unit exercise date reflects an annual yield of up to and including 6.5% above a basic share price of NIS 8.84 per share, and up to 352,589 units per batch, in the event that the yield of the Bank's share from the employment starting date until the exercise date of the option unit reflects an annual yield of more than 9% above a basic share price of NIS 8.84 per share. The quantity of options units of class B will be 176,294 units per batch.

b. The phantom units will mature and will be exercisable in 4 yearly batches, with the first one maturing on November 29, 2012 and the forth maturing 3 years after such date. The phantom units may be exercised for a period of 48 months from the maturity date of each batch, subject to the provisions of the options plan.

Note 22a – Share-Based Payment Transactions (continued)

c. The exercise increment for each phantom unit of class A will be in the range between NIS 9.37 for the first batch up to NIS 11.16 for the forth batch, bearing a compound interest at an annual rate of 4% from the maturity date and until the exercise date; and the exercise increment for each phantom unit of class B will be in the range between NIS 11.14 for the first batch and up to NIS 12.9 for the forth batch, bearing a compound interest at an annual rate of 3% from the maturity date and up to the exercise date, all subject to the adjustments specified in the Agreement.

d. The units are granted without any consideration.

e. The units may not be transferred, except in case of death or in case of legal incompetency.

f. The options plan provides a protection provision for the beneficiary during the exercise period, in case of distribution of bonus shares, distribution of securities through rights, changes in the Bank's organizational structure, as well as at any time in which a dividend is announced.

d. Each phantom unit provides the managers the right to receive, after exercise, a consideration that reflects the difference between the average price of the Bank's share during the 30 business days prior to the exercise date and between the exercise increment.

e. In the event of termination of the employer-employee relationship between the Bank and the managers for reasons other than death, the matured options may be exercised within 30 days from the date of termination of the employer-employee relationship, otherwise they expire.

i. In the Financial Statements of the Bank as at December 31, 2013, income from options for the Bank's managers was recorded in the amount of NIS 29 thousand (2012– NIS 108 thousand). The estimated economic value of the options that was calculated by an external appraise while using the binomial model, is assessed as at December 31, 2013 in approx. NIS 0.1 million.

The calculation of the estimated economic value was based on the following main parameters:

Standard deviation of annual yield: between 24% to 29%.

Risk-free interest rate: between 2.3% to 3.2%.

Share price: NIS 4.96.

Note 23 – Interest Income and Expenses

Reported amounts in millions of Shekels

	Consolidated			The Bank		
	For the year ended on December 31,					
	2013	2012	2011	2013	2012	2011
Interest income						
From credit to the public	**509.4**	510.1	495.2	**509.4**	510.1	495.2
From deposits in the Bank of Israel and from cash	**16.8**	8.2	9.8	**16.8**	8.2	9.8
From deposits at banks	**0.6**	0.7	5.2	**0.6**	0.7	5.6
From debentures	**16.4**	36.0	47.8	**19.6**	42.5	52.9
From other assets	**–**	0.7	1.0	**–**	0.5	0.9
Total interest income	**543.2**	555.7	559.0	**546.4**	562.0	564.4
Interest expenses						
On public deposits	**204.4**	241.0	262.3	**266.7**	309.8	357.5
On deposits from banks	**3.4**	3.8	5.0	**3.4**	3.8	5.0
On liability certificates and deferred liability notes	**78.2**	80.0	116.9	**23.0**	24.2	35.6
On other liabilities	**–**	–	–	**–**	–	–
Total interest expenses	**286.0**	324.8	384.2	**293.1**	337.8	398.1
Total interest income, net	**257.2**	**230.9**	**174.8**	**253.3**	**224.2**	**166.3**
Details of the net effect of hedging derivative instruments on interest income and expenses						
Interest expenses	**–**	(1.2)	–	**–**	(1.2)	–
Details of interest income on a cumulative basis, from debentures						
available for sale	**11.6**	29.9	43.1	**14.8**	36.6	48.2
for trade	**4.8**	6.1	4.7	**4.8**	5.9	4.7
Total included in interest income	**16.4**	36.0	47.8	**19.6**	42.5	52.9

Note 24 – Non-Interest Financing Income

Reported amounts in millions of Shekels

	Consolidated			The Bank		
	For the year ended on December 31,					
	2013	2012	2011	2013	2012	2011
A. Non-interest financing income from activities not for trade purposes						
1. From activities with derivative instruments						
Net income from ALM derivative instruments(1)	**(2.7)**	15.6	(15.2)	**(2.7)**	15.6	(15.2)
2. Exchange differentials, net (without the effect of derivatives)	**1.2**	(15.3)	17.4	**1.2**	(15.3)	17.4
3. From investment in debentures						
Profits from the sale of available-for-sale debentures(2)	**9.5**	20.5	4.5	**9.0**	19.7	4.5
Losses from the sale of available-for-sale debentures(2)	**(1.3)**	(8.7)	(6.4)	**(1.3)**	(8.4)	(5.7)
Total from investment in debentures	**8.2**	**11.8**	**(1.9)**	**7.7**	**11.3**	**(1.2)**
4. Losses from investment in shares						
Impairment provision for available-for-sale shares(2)	**(0.3)**	(1.5)	-	**(0.3)**	(1.5)	0
Total from investment in shares	**(0.3)**	(1.5)	-	**(0.3)**	(1.5)	-
5. Other financing income	**-**	1.0	3.9	**-**	1.0	3.9
Total from activities not for trade purposes	**6.4**	11.6	4.2	**5.9**	11.1	4.9
B. Non-interest financing income from activities for trade purposes						
Net income from other derivative instruments	**1.1**	(3.8)	(0.4)	**1.1**	(3.8)	(0.4)
Realized and unrealized gains from fair value adjustments of debentures for trade, net(3)	**6.7**	14.8	2.3	**6.7**	14.8	2.3
Total from activities for trade purposes	**7.8**	11.0	1.9	**7.8**	11.0	1.9
Total non-interest financing income	**14.2**	22.6	6.1	**13.7**	22.1	6.8

(1) Derivative instruments which are part of the Bank's ALM system and are not designated for hedging relations. From this: in respect of ALM derivatives exchange differences as at December 31, 2013, December 31, 2012, and December 31, 2011, the Bank and consolidated, NIS (2.2) million, NIS 15.6 million, NIS (20.3) million, respectively.

(2) Reclassified from accumulated other comprehensive income

(3) From this: the part of the profits and losses related to debentures for trade, that are still being held as at the balance sheet date in the Bank and consolidated, as at December 31, 2013, December 31, 2012, and December 31, 2011, in the amount of NIS 1.1 million, NIS 8.8 million and NIS 1.8 million, respectively.

Note 25 – Commissions

Reported amounts in millions of Shekels

	Consolidated			The Bank		
	For the year ended on December 31,					
	2013	**2012**	**2011**	**2013**	**2012**	**2011**
Credit processing	**18.2**	20.5	19.5	**18.2**	20.5	19.5
Net income from credit portfolio service	**15.5**	17.0	18.4	**15.5**	17.0	18.4
Project oversight commissions	**17.9**	13.4	9.8	**17.9**	13.4	9.8
Commissions from life insurance	**9.8**	10.5	11.1	**5.6**	6.4	7.4
Conversion differences*	**9.6**	9.4	9.6 *	**9.6**	9.4	9.6 *
Activity in securities	**9.8**	7.8	10.0	**8.0**	6.6	8.2
Commissions from financing businesses*	**3.4**	3.9	4.9 *	**3.4**	3.9	4.9 *
Commissions from property insurance	**3.1**	3.5	4.5	**–**	–	–
Commissions from distribution of financial products*	**2.0**	1.5	1.4 *	**2.0**	1.5	1.4 *
Credit cards	**0.8**	0.7	0.9	**0.8**	0.7	0.9
Account management	**0.3**	0.3	0.3	**0.3**	0.3	0.3
Foreign trade activity	**0.1**	0.1	0.1	**0.1**	0.1	0.1
Other commissions*	**0.9**	1.6	1.4 *	**0.9**	1.5	1.4 *
Total commissions	**91.4**	90.2	91.9	**82.3**	81.3	81.9

* Reclassified

Note 26 – Other Income

Reported amounts in millions of Shekels

	Consolidated			The Bank		
	For the year ended on December 31,					
	2013	**2012**	**2011**	**2013**	**2012**	**2011**
Capital gain from the sale of buildings and equipment(1)	**–**	–	25.4	**–**	–	–
Other	**0.9**	0.6	0.1	**–**	0.1	0.1
Total other income	**0.9**	0.6	25.5	**–**	0.1	0.1

(1) For details – see Note 8.

Note 27 – Salaries and Related Expenses

Reported amounts in millions of Shekels

	Consolidated			The Bank		
	For the year ended on December 31,					
	2013	2012	2011	2013	2012	2011
Salaries	**103.1**	95.1	92.1	**91.6**	83.6	83.8
National Insurance and Payroll Tax	**23.4**	21.5	19.4	**22.5**	20.7	18.6
Severance pay, benefits, study funds and vacation	**18.3**	19.7	21.0	**16.1**	17.5	18.8
Expense derived from share-based payment transactions*	**0.4**	0.8	0.8	**0.4**	0.8	0.8
Other related expenses	**0.9**	0.7	0.8	**0.4**	0.6	0.6
Total salaries and related expenses	**146.1**	137.8	134.1	**131.0**	123.2	122.6

* From this: NIS 0.4 million in 2013 (2012 – NIS 0.7 million, 2011 – NIS 0.8 million) are an expense deriving from transactions treated as share-based payment transactions and cleared in equity instruments.

Note 28 – Other Expenses

Reported amounts in millions of Shekels

	Consolidated			The Bank		
	For the year ended on December 31,					
	2013	2012	2011	2013	2012	2011
Computer	**27.6**	21.8	16.1	**66.4**	52.8	34.8
Professional services	**9.7**	10.1	8.2	**8.7**	9.4	7.2
Marketing and advertisement	**14.0**	12.2	5.9	**14.0**	12.2	5.8
Vehicle maintenance	**4.4**	4.6	4.5	**4.3**	4.0	3.9
Telephone call center	**8.2**	3.4	–	**8.2**	3.4	–
Training and professional courses	**2.7**	3.2	3.0	**2.6**	3.2	3.0
Communications (mail, telephone, deliveries, etc.)	**3.0**	3.0	3.1	**3.0**	2.8	3.0
Commissions	**2.2**	2.2	1.8	**1.8**	2.0	1.6
Salary of members of the Board of Directors who are not employed by the Bank	**1.9**	1.9	1.7	**1.8**	1.8	1.6
Office	**2.8**	1.8	1.6	**2.9**	1.7	1.6
Insurance	**1.4**	1.4	1.5	**1.3**	1.4	1.4
Other	**4.2**	4.2	4.0	**4.1**	4.1	3.9
Total other expenses	**82.1**	69.8	51.4	**119.1**	98.8	67.8

Note 29 – Provision for Taxes on Profit

Reported amounts in millions of Shekels

a – Composition of provision for taxes on profit

	Consolidated			The Bank		
	For the year ended on December 31,					
	2013	2012	2011	2013	2012	2011
Current taxes -						
For the accounting year	**18.7**	35.8	12.2	**15.6**	32.5	4.7
For previous years	**(1.1)**	(0.1)	-	**(1.1)**	-	-
Total current taxes	**17.6**	35.7	12.2	**14.5**	32.5	4.7
Deferred taxes – (deduction)/addition						
For the accounting year	**(12.2)**	(11.7)	2.4	**(11.6)**	(11.2)	3.3
For previous years	**-**	(6.3)	-	**-**	(6.3)	-
Total deferred taxes	(12.2)	(18.0)	2.4	(11.6)	(17.5)	3.3
Provision for taxes on income	**5.4**	17.7	14.6	**2.9**	15.0	8.0

b – Reconciliation between the theoretical tax amount that would have applied had the profit been taxable according to the statutory tax rate applicable in Israel for the Bank, and the provision for taxes on profit as reflected in the Profit and Loss Statement:

	Consolidated			The Bank		
	For the year ended on December 31,					
	2013	2012	2011	2013	2012	2011
Profit before tax	**22.7**	53.8	60.1	**8.7**	36.1	22.2
Statutory tax rate applied on a Bank in Israel	**36.22%**	35.53%	34.48%	**36.22%**	35.53%	34.48%
Tax amount based on statutory tax rate	**8.2**	19.1	20.7	**3.2**	12.8	7.7
Tax (tax savings) for:						
General and additional provision for credit losses	**-**	-	(0.5)	**-**	-	(0.4)
Other unrecognized expenses	**1.1**	0.9	0.7	**1.1**	0.9	0.7
Exempt income and income subject to a limited tax rate	**(0.7)**	(1.1)	(4.6)	**-**	-	-
Taxes for previous years	**1.1**	(0.1)	-	**1.1**	-	-
Changes in deferred taxes balance following a change in the tax rate	**(2.1)**	(0.5)	(1.5)	**(2.1)**	(0.5)	(1.6)
Income of subsidiaries in Israel	**(1.4)**	(1.8)	(1.1)	**-**	-	-
Other differences	**(0.8)**	1.2	0.9	**(0.4)**	1.8	1.6
Provision for taxes on income	**5.4**	17.7	14.6	**2.9**	15.0	8.0

c – Assessments

Final assessments were issued for the Bank until and including the year 2007. For two subsidiaries, final tax assessments were issued until and including the 2005 tax year. Tax assessments up to and including the year 2009 are considered final.

The current and deferred taxes were calculated according to the new tax rates.

Note 29 – Provision for Taxes on Profit (continuation)

Reported amounts

d – Balances of deferred taxes receivable and reserve for deferred taxes

	Consolidated				The Bank			
	For the year ended on December 31,							
	2013	2012	2013	2012	2013	2012	2013	2012
	in millions of NIS		Average tax rate		in millions of NIS		Average tax rate	
Deferred taxes receivable:								
For timing differences:								
Provision for vacation and jubilee bonus	**2.8**	3.1	36.9%	35.2%	**2.6**	2.8	37.7%	35.9%
Excess of reserve for severance pay over fund	**0.5**	0.6	38.4%	36.1%	**0.5**	0.4	37.7%	35.9%
Securities	**–**	–	–	–	**2.3**	2.2	37.7%	35.9%
Liability certificates and deferred liability notes	**0.9**	0.6	37.7%	35.9%	**–**	–	–	–
From the provision for credit losses	**40.2**	25.4	37.7%	35.9%	**40.2**	25.4	37.7%	35.9%
From interest that was not charged to the year's revenue	**0.6**	0.8	37.7%	35.9%	**0.6**	0.8	37.7%	35.9%
From adjustment of non-monetary and other assets	**1.3**	4.5	37.6%	30.4%	**1.4**	4.7	37.7%	35.9%
Total deferred taxes receivable	**46.3**	35.0	32.0%	35.0%	**47.6**	36.3	37.7%	35.9%

Note : The realization of the net receivable deferred taxes is based on a forecast, according to which there will be in the future taxable revenue in suitable amounts.

e – Tax rates applied on the Bank and its subsidiaries

The Bank is defined as a "financial institution" for purposes of the Value Added Tax Law 5736-1975 and as such, its activities are subject to wage tax and profit tax in accordance with the rates determined in the VAT Law.

a. In June 2013, the Value Added Tax Order (Tax Rate on NPOs and Financial Institutions) (Amendment) 5773-2013 was published. The order established that the wage tax rate that applies to financial institutions will be 18% of the wages paid for work in June and afterwards, and the profit tax will stand at 18% of the profits generated. The provision regarding the profit tax in the 2013 tax year will apply to the relative share of the profit for this year.

b. On July 30, 2013, the Knesset ratified on the second and third calls the economic plan for 2013-2014 (The Budget Law), which includes, inter alia, fiscal changes whose primary goal is to broaden tax collection for said years. Said changes include, inter alia, increasing the corporate tax from 25% to 26.5%, beginning on January 1, 2014.

Note 29 – Provision for Taxes on Profit (continuation)

Reported amounts

c. Below are the statutory tax rates that apply to financial institutions, including the Bank, as a result of said changes:

Year	Corporate companies	Profit tax rate	Comprehensive tax rate
2012	25%	16.33%*	35.53%
2013	25%	17.58%*	36.22%**
2014 and later	26%	18.00%	37.71%

* Weighted rate

** Compared to a tax rate of 35.90% on the eve of the publication of the amendment.

d. The balance of deferred taxes included in the financial statements as at December 31, 2013 are calculated based on the new tax rates, whose legislation was essentially completed as of the balance sheet date and as such, include the said changes. Said changes in the aforementioned tax rates have resulted in an increase in net profit of NIS 1.9 million in 2013, and a reduction in other comprehensive income of NIS 0.1 million.

Note 30 – Activity Sectors (consolidated)

a – General

The Bank operates through the Bank headquarters, its branches and subsidiaries. The activity sectors of the Bank are classified according to the directives of the Supervisor of the Banks, according to types of customers included in each of the sectors, and do not necessarily match the organizational structure of the Bank.

The Bank operates and provides various banking services in four main activity sectors. Below are details on the reported activity sectors:

Household sector

The customers in this sector are households and small businesses with characteristics similar to those of households.

Private Banking sector

This sector includes customers with a medium to high level of financial wealth, and services to them are provided through a branch specializing in private banking, mainly for foreign residents (mostly from North America, England and France).

Business sector

Customers in this sector include construction and real estate companies, business customers, corporations and associations.

Financial Management sector

This sector includes management of the Bank's available financial capital and positions, management of the Bank's nostro portfolio, activity with banks in Israel and abroad, as well as performance of transactions with derivative financial instruments.

Non-allocated amounts and adjustments

Including investment in trust funds and capital gain from the sale of property, plant and equipment, if any. Furthermore, the sector includes a provision for impairment of fixed assets, if any. In 2011, a capital gain from the sale of a building was recorded in the amount of NIS 20.8 million.

Note 30 – Activity Sectors (consolidated) (continuation)

b – Principal rules implemented in the distribution of the results of operations between the various sectors:

Interest income, net

Margin resulting from the difference between the interest on the credit provided to the sector's customers, and the price of money (economic transfer price that matches the linkage sector and the credit duration).

The margin includes cross-sector financing expenses – charging the sector providing the loan and crediting the sector that raises the deposit, at transfer prices (accordingly, income in the sector that raises the deposits is increased, while income in the sectors using the credit is reduced).

Non-interest income

Income not from interest is directly charged to the sector in which the customers' activity is classified.

Expenses for credit losses

The provision was attributed to the activity sector in which the customer's activity is classified, for which the provision was made. In a similar way, collection from a provision that was made, or the reduction of it, is attibuted to the sector in which the customer's activity is classified.

Operating and other expenses

Identifiable direct expenses were specifically attributed to the activity sectors. The balance of indirect expenses or direct expenses that were not accurately identifiable was attributed according to a model, by which these expenses are attributed according to the number of direct work positions in that sector relative to the Bank's total work positions, for each of the activity sectors.

Taxes on income

Taxes were calculated according to the effective tax rate and attributed accordingly to each sector.

Capital yield

The allocation of capital for purposes of calculating the capital yield in each of the activity sectors was based on the average risk assets in each sector. The yield for each sector was calculated according to the equity that, as aforementioned, was attributed to the sector.

Note 30 – Activity Sectors (consolidated) (continued)

Reported amounts in millions of Shekels

	For the year ended on December 31, 2013					
	Households	Private banking	Business	Financial management	Non-allocated amounts and adjustments	Total
Interest income, net:						
From externals	198.2	20.0	39.9	(0.9)	–	257.2
Inter-sectoral	(6.4)	(1.0)	(2.2)	9.6	–	–
Non-interest income – from externals	53.9	11.0	27.4	14.2	–	106.5
Total income	**245.7**	**30.0**	**65.1**	**22.9**	**–**	**363.7**
Expenses from credit losses	(53.0)	(0.5)	(1.2)	–	–	(54.7)
Operational and other expenses, with the exception of depreciation and amortization:	(198.7)	(27.7)	(26.6)	(6.4)	–	(259.4)
Depreciation and amortization	(20.6)	(3.2)	(2.9)	(0.3)	–	(27.0)
Profit (loss) before taxes	**(26.6)**	**(1.4)**	**34.4**	**16.2**	**–**	**22.6**
Provision for taxes on profit	12.6	0.6	(12.7)	(5.9)	–	(5.4)
Net profit (loss)	**(14.0)**	**(0.8)**	**21.7**	**10.3**	**–**	**17.2**
Capital yield (percentage of net profit from average equity)	**(3.1%)**	**(1.4%)**	**15.6%**	**25.2%**	**–**	**2.5%**
Average balance of assets	7,273.2	1,160.3	1,397.2	2,745.8	–	12,576.5
Average balance of liabilities	7,269.8	1,016.6	3,485.9	109.5	–	11,881.8
Average balance of risk assets	4,675.4	654.0	1,454.5	412.3	–	7,196.2
Average balance of securities	2,369.4	271.8	251.5	–	–	2,892.7
Average balance of other assets under management	1,855.8	-	-	-	–	1,855.8
Margin from credit granting activity	160.2	15.2	32.0	(4.6)	–	202.8
Margin from deposit receiving activity	16.1	3.8	5.7	–	–	25.6
Other	15.5	–	–	13.3	–	28.8
Total interest income, net	**191.8**	**19.0**	**37.7**	**8.7**	**–**	**257.2**

Note 30 – Activity Sectors (consolidated) (continued)

Reported amounts in millions of Shekels

	For the year ended on December 31, 2012*					
	Households	Private banking	Business	Financial management	Non-allocated amounts and adjustments	Total
Interest income, net:						
From externals	185.8	21.2	36.9	(13.0)	–	230.9
Inter-sectoral	(12.4)	(2.1)	(4.3)	18.8	–	–
Non-interest income – from externals	56.6	11.6	22.6	22.6	–	113.4
Total income	**230.0**	**30.7**	**55.2**	**28.4**	**–**	**344.3**
Expenses from credit losses	(33.4)	(0.6)	(2.0)	–	–	(36.0)
Operational and other expenses, with the exception of depreciation and amortization:	(178.1)	(24.1)	(28.8)	(5.6)	–	(236.6)
Depreciation and amortization	(13.5)	(2.1)	(2.1)	(0.2)	–	(17.9)
Profit before taxes	**5.0**	**3.9**	**22.3**	**22.6**	**–**	**53.8**
Provision for taxes on profit	(1.5)	(1.3)	(7.3)	(7.6)	–	(17.7)
Net profit	**3.5**	**2.6**	**15.0**	**15.0**	**–**	**36.1**
Capital yield (percentage of net profit from average equity)	**0.7%**	**4.1%**	**9.9%**	**31.8%**	**–**	**5.4%**
Average balance of assets	7,028.7	1,192.6	1,311.9	2,132.6	–	11,665.8
Average balance of liabilities	6,292.4	1,119.7	3,405.1	176.5	–	10,993.7
Average balance of risk assets	4,380.2	653.1	1,527.4	509.2	–	7,069.9
Average balance of securities	1,476.0	263.7	247.8	–	–	1,987.5
Average balance of other assets under management	2,310.0	–	72.7	–	–	2,382.7
Margin from credit granting activity	136.6	13.1	28.2	(13.6)	–	164.3
Margin from deposit receiving activity	17.0	6.0	5.3	–	–	28.3
Other	19.8	–	(0.9)	19.4		38.3
Total interest income, net	**173.4**	**19.1**	**32.6**	**5.8**	**–**	**230.9**

* Reclassified

Note 30 – Activity Sectors (consolidated) (continued)

Reported amounts in millions of Shekels

	For the year ended on December 31, 2011*					
	Households	Private banking	Business	Financial management	Non-allocated amounts and adjustments	Total
Interest income, net:						
From externals	161.6	17.7	39.6	(44.1)	–	174.8
Inter-sectoral	(20.7)	(3.0)	(8.3)	32.0	–	-
Non-interest income – from externals	61.8	10.0	20.1	6.2	25.4	123.5
Total income	**202.7**	**24.7**	**51.4**	**(5.9)**	**25.4**	**298.3**
Expenses from credit losses	(20.4)	2.7	2.6	-	–	(15.1)
Operating and other expenses from externals, with the exception of depreciation and amortization	(152.6)	(20.6)	(32.5)	(4.4)	–	(210.1)
Depreciation and amortization	(9.7)	(1.3)	(1.9)	(0.1)	–	(13.0)
Profit before taxes	**20.0**	**5.5**	**19.6**	**(10.4)**	**25.4**	**60.1**
Provision for taxes on profit	(5.8)	(1.6)	(5.6)	3.0	(4.6)	(14.6)
Net profit (loss)	**14.2**	**3.9**	**14.0**	**(7.4)**	**20.8**	**45.5**
Capital yield (percentage of net profit from average equity)	**4.3%**	**7.4%**	**7.4%**	**(19.8%)**	**–**	**7.3%**
Average balance of assets	6,608.9	982.7	1,165.8	2,015.4	–	10,772.8
Average balance of liabilities	5,505.7	835.0	3,728.2	81.2	–	10,150.0
Average balance of risk assets	3,552.4	556.0	1,969.2	389.2	–	6,466.8
Average balance of securities	1,539.0	227.9	318.9	–	–	2,085.8
Average balance of other assets under management	2,601.6	–	125.9	–	–	2,727.5
Margin from credit granting activity	101.3	9.3	24.2	(33.1)	–	101.7
Margin from deposit receiving activity	17.7	5.4	7.1	–	–	30.2
Other	21.9	–	-	21.0	–	42.9
Total interest income, net	**140.9**	**14.7**	**31.3**	**(12.1)**	**–**	**174.8**

* Reclassified

Note 31 – Cumulative Other Comprehensive Income (Loss)

Reported amounts in millions of Shekels

	Reconciliations for the presentation of securities available for sale at fair value	Total
Changes in cumulative comprehensive income (loss) for the years ending December 31, 2013, 2012 and 2011 (controlled)		
Balance as at January 1, 2011	(8.9)	(8.9)
Net change during the period	(2.7)	(2.7)
Balance as at January 1, 2012	(11.6)	(11.6)
Net change during the period	12.7	12.7
Balance as at January 1, 2013	1.1	-
Net change during the period	(0.8)	(0.8)
Balance as at December 31, 2013	0.3	(0.8)

	For the year ended on December 31,								
	2013			2012			2011		
	Controlled								
	before tax	the tax effect	after tax	before tax	the tax effect	after tax	before tax	the tax effect	after tax
Reconciliations for the presentation of securities available for sale at fair value									
Net profits (losses) that have not yet realized from fair value reconciliations	6.7	(2.4)	4.3	29.6	(10.1)	19.5	(6.2)	2.1	(4.1)
Net (profits) losses that were reclassified for the Profit and Loss Statement[1]	(7.9)	2.8	(5.1)	(10.3)	3.5	(6.8)	1.9	(0.5)	1.4
Total net change during the year	**(1.2)**	**0.4**	**(0.8)**	**19.3**	**(6.6)**	**12.7**	**(4.3)**	**1.6**	**(2.7)**

(1) The amount before tax is reported in the Profit and Loss Statement in the Non-interest financing income section. For more information, see Note 24 – Non-interest financing income

Note 32 – Information on the Bank's Nominal Database

	December 31,	
	2013	2012
Total assets	**13,653.3**	12,752.9
Total liabilities	**12,957.2**	11,880.0
Shareholders' equity	**696.1**	692.9

	For the year ended December 31	
	on December 31,	
	2013	2012
Net profit	**17.4**	36.3

Note 33 -Events in the Reporting Year (continued)

1. On January 7, 2013, Jerusalem Investment Portfolio Management Ltd., a wholly owned subsidiary (hereinafter: the "subsidiary"), entered into an agreement with a third party not related to the Bank, for the sale of the portfolio management activity, as defined in the Regulation of Investment Advice, Investment Marketing and Portfolio Management Law 5755-1995, that it had managed. On March 21, 2013, the transfer of the subsidiary's portfolio management activity to a third party not related to the Bank was completed, in accordance with the agreement between the parties. It should be noted that the income generated for the subsidiary from said sale, as well as the consideration from said sale, are of an amount that is not material to the Bank.

2. On March 21, 2013, the Supervisor of Banks published directives regarding the allocation of capital and provision for doubtful debts for housing loans and change in the risk weight of guarantees in accordance with the Sales Law. For details, see Note 2 – Accounting Policies, section ab2.

3. On June 4, 2013, the Bank received notice regarding the filing of a motion with the Committee to Impose Financial Sanctions on Banking Corporations, to impose on the Bank a financial sanction in accordance with the Anti-Money Laundering Law 5760-2000, for alleged violations of said law. The motion, which does not specify the requested amount of the sanction, refers to alleged violations mentioned in the audit report from February 2013, that was prepared by the Supervisor of Banks with regards to the period between 2007 and until 2010. The Bank responded to the motion and presented in its response its position, according to which it acted in compliance with the provisions of the Law, and following the Bank's response to the audit report itself, and the detailed treatment outline presented by the Bank in the framework of said response, which reflects, to the best of its understanding, a culture of proper compliance, and compliance by all levels with the provisions of the law.

   At this stage, the Bank cannot assess whether financial sanctions will be imposed on the Bank as a result of this notice and if so, the amount of said sanction.

4. On July 14, 2013, the Bank announced that due to changes in the capital requirements and other regulatory requirements, and their effect on the Bank, a decision was made to implement a streamlining program in the Bank, in order to reduce the expenses.

5. On August 6, 2013, the Bank entered into an agreement with Clal Finance Ltd. ("Clal Finance") and with the stock exchange member of Clal Finance Ltd. – Clal Finance Batucha Investment Management Ltd. ("Clal Batucha"), to purchase all of Clal Finance's holdings in Clal Batucha (the "Agreement"). In accordance with the Agreement, the Bank acquired, on the date of completion of the transaction, December 15, 2013, all of Clal Finance's holdings in Clal Batucha, for a consideration that was paid and that is not contingent on the amount equivalent to Clal Batucha's adjusted equity on said date

Note 33 -Events in the Reporting Year (continued)

of NIS 257 million. On October 10, 2013, the Bank's Board of Directors decided to merge the Bank with Clal Finance Batucha Investment Management Ltd. and Clal Finance Batucha Brokerage Ltd., as specified in the immediate reports dated October 16, 2013 and October 21, 2013. Clal Finance undertook to indemnify the Bank for a series of events listed in the Agreement, regarding damage or liability for the period preceding the date of completion of the Agreement, including for breach of representations, for a liability due to Clal activity during the period preceding the date of completion of the agreement, for tax liabilities, for liabilities resulting from work relations and other events set forth in the Agreement, pursuant to the Bank informing Clal of the occurrence of the indemnifying event no later than 84 months from the date of completion, or no later than 36 months from the date of completion (with regards to a liability due to past activity and breach of representations). The maximum amount of reimbursement (with the exception of past activity, for which the amount of reimbursement is not limited), will not exceed NIS 190 million, and NIS 250 million with regards to the additional events. Clal Insurance Enterprises Holdings Ltd., which wholly owns Clal Finance, assumed jointly and severally with Clal Finance, all of Clal Finance's obligations for reimbursement. On February 25, 2013, the Bank received a valuation of Clal Batucha's significant intangible assets, through an external accounting firm. The valuation of Clal Batucha's significant intangible assets was performed in compliance with International Financial Reporting Standard 3, Business Combinations (IFRS3), and in accordance with American Financial Accounting Standard ASC820-10 (FAS157). A copy of the valuation accompanies this report. For details on the assets and liabilities created as part of the valuation, see Note 7e.

The Bank recognized the fair value of the assets that were acquired and the liabilities that were assumed in the framework of the business combination, based on a provisional measurement, since the Bank has yet to receive preliminary approval from the Tax Authority with regards to the tax implications of the merger. As of the date of approval of the Financial Statements, a final appraisal had not been received from the external value appraiser with regards to the fair value of the identified assets that were acquired and the liabilities that were assumed. The fair value of the assets and liabilities that were acquired is subject to final adjustment up to 12 months from the date of acquisition. According to International Reporting Standard Number 3 regarding Business Combinations, on the date of the final measurement, the adjustments are made by way of restatement of the comparison numbers that were reported in the past based on the provisional measurement.

6. On August 29, 2013, the Supervisor of Banks published a directive imposing restrictions on the granting of housing loans by banks. For details, see Note 2 on Accounting Policies, section ab3.

Note 33 -Events in the Reporting Year (continued)

7. On December 9, 2013, the Knesset passed the Law to Promote Competition and Reduce Concentration, 5774-2013 (the "Law"), which is based on the recommendations of The Committee on Increasing Competitiveness in the Economy. The rationale behind the law is that the supra-sector centralized structure of the Israeli market has sparked concerns of harm to the soundness of the financial system and to competition, and that a competitive, efficient market must be promoted by simplifying the structure of the business groups operating in the Israeli economy while decentralizing control over it.

   The Law includes three significant chapters:

   (a) The government's obligation to consider economy-wide concentration and industry-wide competitiveness when allocating rights in "vital infrastructures" to an entity that has been classified as a "centralized entity".

   (b) Restricting control in multi-layer business groups (pyramid structure in the words of the Law), i.e. a structure that includes several "layer companies".

   The core principle established by the Concentration Law is the prohibition of a pyramid structure of companies, that includes more than two layers of reporting corporations. The Law went into effect immediately upon its publication, but includes transitional provisions with regards to pyramid structures created prior to the effective date of the Law. Control of a company while violating the Law will result in the appointment of a trustee for the Company, who will be granted the instruments of control in the Company for the purpose of their sale. To the best of the Bank's knowledge, the Association of Banks contacted the Ministry of Justice, with a request to except the issuing companies of the banking corporations (the "pipe companies") from the provisions of the law regarding pyramid structures, similar to the exemption granted to pipe companies in the Companies Regulations (Easements for Certain Types of Debenture Companies) 5772-2012, from certain provisions set forth in the Companies Law. As part of this chapter, the Law imposes amendments of various corporate governance provisions in the Companies Law, that are valid as at January 10, 2014 and that apply to all public companies and debenture companies, regardless of whether or not they are layer companies, including: (1) requiring the audit committee to maintain a "competitive process or other processes", prior to any engagement with a controlling shareholder or in a transaction in which the controlling shareholder has a personal interest. In addition, the Audit Committee for Classification must establish the method by which transactions with controlling interests which are not negligible must be approved. (2) To the extension of the tenure of a serving external director for an additional period, while neutralizing the voting power of the controlling shareholder, a new condition was added, according to which the external director cannot be a related shareholder or a competitor, or a relative of them or associated with them on the date of the appointment or in the preceding two years. (3) The wording of Section 270 to the Companies Law was amended in a binding manner that it is not enough that transactions of interested parties and officers do not harm the company, but they must benefit the company (positive stipulation). Furthermore, the Law stipulates that the Minister of Finance and the Governor of the Bank of Israel will establish within a maximum of two years, provisions regarding restrictions on credit given to corporations or to a business group by financial entities, on an accumulated basis, taking into account the liabilities of each corporation or the total liabilities of the business group, according to the matter.

(c) Separation of ownership and management between significant financial entities and significant non-financial entities. The Committee is expected to publish a list of significant non-financial and financial entities. The main limitations imposed by the Law on corporations as previously mentioned are: (1) a significant non-financial corporation or its controlling shareholder will not control or hold more than 10% of a certain type of means of control in a significant financial corporation (or 5% in a financial entity that has no controlling core); (2) the holder of more than 5% of a certain type of means of control in a significant non-financial corporation will not control a significant financial entity; (3) an insurer and company that manages provident funds will not hold more than 10% of a certain type of means of control in a significant non-financial corporation and a company that manages a mutual fund will not hold more than 10% of the listed value of securities (that are not debentures) issued by a significant non-financial corporation; (4) a banking corporation will not hold more than one percent of a certain type of means of control in a significant non-financial corporation or in an insurer that is a significant financial entity (with certain exceptions); (5) the controlling interest in a banking corporation that is a significant financial entity will not control an insurer that is a significant financial entity. Implementation of the said limitations in accordance with this Chapter will occur by the end of 6 years from the date of publication of the Law, subject to exceptions. In addition, the Law establishes limitations on the cross-service of corporate officers (including controlling shareholders and/or their relatives) in accordance with the transition provisions established in the Law.

Bank Branches and subsidiaries

Central Management
2 HaNegev Street, Airport City
Postal address: 2 Herbert Samuel Street, Jerusalem 91022

Business Department
HaNegev Street, Airport City

Private banking branch
18 Keren HaYesod Street , Jerusalem 992149

Jerusalem branch
2 Herbert Samuel Street, Jerusalem 91022

Geula branch
10 Yacov Meir Street, Jerusalem 95513

Tel Aviv branch
21 Ehad Ha'Am Street, Tel Aviv 65251

Be'er Sheva branch
90 Hadassah Street, Be'er Sheva 84221

Haifa branch
9 Pal-Yam Street (Zim House), Haifa 33095

Bnei Barak branch
2 Hazon Ish Street, Bnei Barak 51512

Ashkelon branch
5 Herzl Street, Ashkelon 78601

Ashdod branch
118 Shavi Zion Street, Ashdod 77273

Rishon LeZion branch
63 Herzl Street, Rishon LeZion 75267

Holon branch
28 Sokolov Street, Holon 58256

Petah Tikwah branch
10 HaHaganah Street, Petah Tikwah 49591

Netanya branch
45 Herzl Street, Netanya 42401

Mode'in Elite branch
18 Avnei Nezer, Mode'in Elite

Pisgat Zeev Branch
Moshe Dayan Blvd. 164, Jerusalem

Kiryon branch
195 Dereh Akko, Kiryat Bialik 27000

Nazareth branch
6092/50 El Riad Center, Nazareth 16000

Sakhnin Branch
Sakhnin Mole Shopping Center, Sahknin Main Road

Karmiel branch
5 Ma'ale Kamon St., Hutsot Karmiel Mall, Karmiel

Umm al fahm branch
Alharam Mall, Main road, Umm al fahm

Bat Yam branch
Bat Yam Mall, 92 Yoseftal st., Bat Yam

Elad Branch
94 Rabi Yehuda Hanassi st., Elad

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Bank of Jerusalem

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