ISRAEL DISCOUNT BANK

'05 ANNUAL REPORT 2005

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

'05

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[BOARD O]F DIRECTORS

SHLOMO ZOHAR Chairman, the Bank; Mercantile Discount Bank Ltd.; Israel Credit Cards Ltd.; Israel Discount Capital Markets & Investments Ltd.; The Provident Fund of the Staff of Israel Discount Bank Ltd. Vice Chairman, Israel Discount Bank of New York. Director, Discount Bancorp, Inc.; S. Zohar Consulting & Management Ltd.

GAD ARBEL Economic Financial Consultant. Director, Discount Bancorp, Inc.; Israel Discount Bank of New York. Outside Director, Nitsba Holdings 1995 Ltd. Member, Board of Trustees and Chairman, Audit Committee, The College of Management and Academic Studies. Member, Administrative Committee, The Veteran Pension Funds.

BETZALEL EIGER Chairman & CEO, Dorea Investments & Development Ltd. Chairman, Liberty Properties Ltd. Director, Comsec. Ltd.

ITTAMAR GIVTON Managing Director, Automotive Equipment Group. Director, Automotive Equipment Ltd.; Moto Parts Ltd.; Israel Automobile Corporation Ltd.; Automotive Equipment & Vehicles (2004) Ltd.; Metive Ltd.; Automotive Industries Ltd.; Advanced Vehicles C.R.M Ltd.; M.S.Y. Sport Cars Israel Ltd.; Metropolitan Public Transport Ltd.; Metrodan Be'er Sheva Ltd. Member of Management Committee, Buxenbaum-Neta Fund (private fund). Member of Management, Sheba Fund (Endowment).

BEN-ZION GRANIT Management Consultant. Member of Management, Ilan-Israel Foundation for Handicapped Children.

GENE KLEINHENDLER Attorney-at-Law and Partner in Law Offices of Gross, Kleinhendler, Hodak, Halevy, Greenberg & Co. Director, K.H. Trustees Ltd.; Kleinhendler & Halevy Trustees Ltd.; Law Firm of Gene Kleinhendler; Trust for Employment Benefits Ltd.; Gross, Kleinhendler, Hodak, Halevy, Greenberg Trustees Ltd.; Jerack Inc.

DR. ARIE OVADIA Companies Consultant. University Lecturer. Chairman, The Israel Phoenix Assurance Co. Ltd.; Giron Development & Building Ltd. Director, Strauss-Elite Ltd.; Israel Petrochemical Industries Ltd.; Carmel Ulpinim Ltd.; Hadar Ltd.; Mehadrin Ltd.

TSIPPI SAMET (Outside Director) Outside Director, Hazera Genetics Ltd.; Mivtahim Pension Funds Ltd; Menorah Mivtahim Gemel Ltd.; Sinai Insurance Holdings (1993) Ltd. Chair, Investment Committee, Avner-Motor Vehicle Accident Victims Insurance Ltd. President, Adif College for Insurance, Pension and Financial Studies. Director, Merav—Yaniv Pension Consultants Ltd.

TIDA SHAMIR Attorney-at-Law and Director, Law Firm of Tida Shamir. Outside Director, Gazit Globe Ltd. Director, Dikla Insurance Co. Ltd.; G.M.S.L. Ltd.

PROF. EYTAN SHESHINSKY Professor of Public Finance, Hebrew University, Jerusalem.

JOSEPH SINGER (Outside Director) Director & Managing Partner, Giza Singer & Even Ltd. Director, Singer & Even Ltd.; Midroog Ltd.; Midroog Holdings Ltd; Giza Singer & Even Finance Ltd.; Singer, Even & Kraizberg Holdings Ltd. Outside Director, Edmond de Rothschild Mutual Funds Management Ltd. and Chairman of its Investment Committee.

ZVI STREIGOLD Attorney-at-Law and Director, Law Firm of Zvi Streigold.

ZEEV VUREMBRAND CEO, Clalit Health Services. Chairman, Mor Institute for Medical Data Ltd.; Shila Ltd; Clalit - Medical Engineering Ltd.

JORGE ZAFRAN Director and CEO, Power Phone Marketing Ltd.; Power Dialing Ltd.; Inter-American Marketing Services Ltd.; Cadillac Properties and Building Company Ltd.; Israel Learning Systems Ltd. Joint Managing Director, T.M. Intertrom Ltd.

PROF. BEN-ZION ZILBERFARB Professor of Economics, Bar-Ilan University. Edmond de Rothschild Professor of Global Assets Management, School of Banking and Capital Markets, Netanya Academic College. Outside Director, Fundtech Ltd.; Brimag Digital Age Ltd.; Clal Provident Fund and Education Fund Financing Ltd. Director, Prof. Ben-Zion Zilberfarb Economics and Management Consultant Ltd.

[MANAGE]MENT

GIORA OFFER President & Chief Executive Officer. **RONIT ABRAMSON ROKACH** Executive Vice President \ Legal Adviser \ Legal Advisory Group. **NISSIM ALAGEM** Executive Vice President \ Commercial Banking Division. **LINDA BENSHOSHAN** Executive Vice President \ Asset Management Division. **JOSEPH BERESSI** Executive Vice President \ Chief Accountant \ Accounting Group. **ISRAEL DAVID** Executive Vice President \ Retail Banking Division. **AMNON GIDEON** Executive Vice President \ Human Resources Group. **NOAM HANEGBI** Executive Vice President \ Operations & Information Systems Division. **RONY HIZKIYAHU** Executive Vice President \ Corporate Banking Division \ from January - March 2006, temporary Risk Manager, in place of Dr. Goldschmidt, who retired at the end of 2005. **ELI HOTER** Executive Vice President \ Marketing & Strategic Planning Division.

SHLOMO PITCHON Senior Executive Vice President \ Internal Auditor.
RUTH MOSHKOVITZ Corporate Secretary.

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The Board of Directors, on March 28, 2006, approved and authorized for publication the consolidated financial statements of the Bank and its subsidiaries for the year ended December 31, 2005.

MAIN DEVELOPMENTS IN THE ISRAELI ECONOMY IN 2005

PRINCIPAL ECONOMIC DEVELOPMENTS

The Gross Domestic Product increased in 2005 at a rate of 5.2%, a rate higher than the growth rate in 2004 which stood at 4.4%. The business product increased by 6.6%, compared with an increase of 6.3% in 2004. The export of goods and services increased by 7%, compared with an increase of 17.4% in 2004, and the import of goods and services increased by 4.4%, compared with an increase of 11.8% in 2004. As for domestic uses, private consumption increased by a rate of 4%, compared with an increase at the rate of 5% in 2004. Investment in fixed assets increase by 1%, as compared with a decrease of 0.2% in 2004, and public consumption increased by 2.7%, compared with a decrease of 2.4% in 2004.

The average unemployment rate stood at 9.1% in 2005, compared with an average rate of 10.4% in 2004. The number of employee positions in the market increased in the first eleven months of the year at an annual rate of 2.5%, reaching a monthly average of 2.54 million positions, of which 0.81 million positions in the public sector and 1.73 million positions in the business sector.

Industrial production expanded in 2005 at an annual rate of 3.8%, reflecting a slowdown compared with the annual rate of 6.6% registered in 2004. Turnover in the commercial and services sectors expanded in 2005 by an annual rate of 7.4%, following an increase of 7.9% in 2004.

The hotel industry continued to register improved activity with a number of bed/nights in tourist hotels in 2005 higher by 12.5% over that of 2004, reaching 19 million bed/nights due to an increase of 43% in the number of tourist bed/nights.

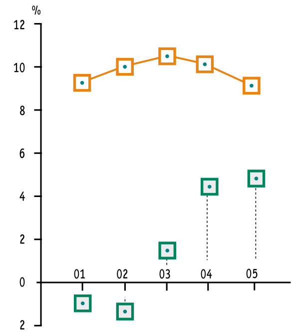
In the construction industry construction of 29,640 residential units began in 2005 – an increase of 2.2% over the corresponding period last year. At the same time, on the demand side there was almost no material change in 2005 as compared with 2004.

The State's budget performance data in 2005 indicate a deficit of NIS 10.8 million, compared with a deficit of NIS 20.1 billion in 2004. The low accumulated deficit in 2005 stems mostly from reduced Government spending, which was NIS 7.7 billion lower than budgeted, of which NIS 3.2 billion representing interest payments. Revenues in 2005 amounted to approximately NIS 199.4 billion compared with NIS 185.5 billion in 2004, higher by NIS 1 billion than the forecasted income in the budget proposal.

ECONOMIC DEVELOPMENTS IN THE PERIOD JANUARY – MARCH 2006

The Israeli currency was devalued against the US Dollar by 1.4% in the period from the beginning of January 2006 to the middle of March. The Bank of Israel increased the interest rate at he end of January 2006 by 0.25% to a level of 4.75%. The Bank of Israel noted that the increase in the interest rate is based on anticipated continued increases in interest rates in the world at large and in the United States in particular, and on the fact that the reduction in the interest rate gap between the Israeli Shekel and the US Dollar is to affect the exchange rate thus affecting inflation.

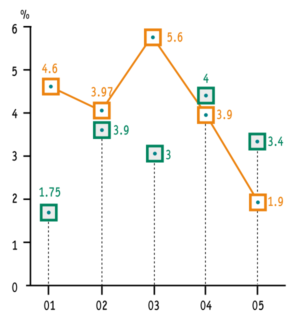
A cumulative surplus in the State budget of NIS 5.8 billion was recorded in January-February 2006.



GROWTH AND UNEMPLOYMENT IN ISRAEL

REAL CHANGE IN THE GROSS DOMESTIC PRODUCT

AVERAGE RATE OF UNEMPLOYMENT



GOVERNMENT DEFICIT

OVERALL DEFICIT (LAW)

ACTUAL OVERALL DEFICIT

The Consumer Price Index fell in January 2006 by 0.3% and rose in February 2006 by 0.6%. On the background of rising inflation, the Federal Reserve in the United States increased the interest rate on January 31, 2006 by 0.25% to a rate of 4.5%

As from the beginning of January to the middle of March 2006 the price per barrel of Brent crude oil increased by 11%.

PRICE INDICES AND CURRENCY EXCHANGE RATES

The Consumer Price Index (CPI) rose in 2005 by 2.4%. This rate is within the targeted annual inflation rate of the Bank of Israel, which stood at 1% to 3%, and is twice the rate of increase in the CPI in 2004. The sub-indices of the CPI also rose. The CPI excluding fruits and vegetables and housing rose during 2005 by 1.8%, compared with a rise of 2.1% in 2004, whereas the housing index (comprising 22% of the CPI and which is significantly affected by developments in the US Dollar exchange rate) rose by 5.9%, compared with a drop of 2.5% in 2004. The wholesale price index of industrial output for the domestic market rose by 5.2%, following a rise of 7.6% in 2004.

The main factors that contributed to the rise in the CPI in 2005 were the rising prices of oil in the world, which brought about an increase of 6.9% in energy prices in Israel, and the strengthening of the US Dollar as against the NIS at an approximate rate of 7%, which caused an increase of 6.8% in the cost of freehold housing services and an increase of 3.9% in housing rent. The price increases in 2005 encompassed most of the main consumption fields. Especially noted were the increases in the housing (5.9%) and housing maintenance (5.1%) items. These were setoff by the sharp decrease of 9.6% in fruit and vegetable prices and in the continued long-term trend of decrease in prices of clothing, footwear and household furniture and equipment, resulting from increased competition and the continued exposure to imports.

The NIS exchange rate was devalued against the US Dollar in 2005 by 6.2% (December 2005 average compared with December 2004 average), compared with a revaluation of 1.2% in 2004. The NIS exchange rate against the currency basket was devalued in 2005 at a rate of 1.6%, compared with a devaluation of 1.8% in 2004. The devaluation against the US Dollar occurred on the background of the gradual reduction, particularly during the first nine months of 2005, in the interest rate gap as against foreign interest rates and the equalization of the tax rate applying to investment income in Israel and abroad, which came into effect at the beginning of 2005, and is explained, among other things, by the strengthening of the US Dollar against most of the currencies worldwide.

INFLATION

— INFLATION IN THE LAST TWELVE MONTHS

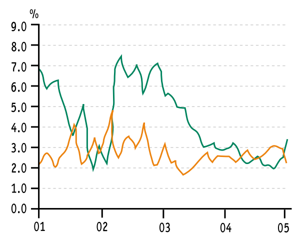
— INFLATION TARGET

MONETARY DEVELOPMENTS AND THE MONEY MARKET

The Bank of Israel interest rate steadied itself in the period from February to September 2005 at 3.5%, following a decrease of 0.2% at the end of January 2005. From the end of September to the end of the year the Bank of Israel increased the interest rate by 1% to a level of 4.5%. The increases in the interest rate took place on the background of the Bank of Israel's assumptions of the continued existence of pressures on prices. Among other things, these pressures were the result of the devaluation of the NIS against the Dollar, the continued rapid growth of the economy, the continued growth trend in inflation rates worldwide, entailing increases in interest rates by central banks over the world as well as the political uncertainty.

The money supply (the M1 total of cash and bank current accounts held by the public), which increased in 2004 by 18%, continued to grow in 2005 by an additional 23.6%, reaching a total of NIS 48.1 billion at the end of December 2005.

Investments in Israel by foreign residents amounted in 2005 to US$8.7 billion, compared with US$7.3 billion in 2004. Most of the foreign investments were made in the first and last quarters of the year. Of the amount of US$8.7 billion, an amount of US$5.7 billion represented direct foreign investments and US$4.2 billion represented investments in



PUBLIC'S INFLATION EXPECTATION* AND REAL EFFECTIVE INTEREST RATE**

* Public's inflation expectations for the next 12 months is defined as the difference between the nominal annual yield on unindexed Treasury Bills and gross annual yield on one-year CPI-indexed bonds.

** Real effective interest rate is defined as the difference between the annual effective interest rate of the Bank of Israel's monetary tender and the public's expectation of inflation for the next 12 months.

marketable securities, while other investment decreased by an amount of US$1.2 billion. On the other hand, overseas investments by Israeli residents amounted in 2005 to US$14.3 billion.

The average effective return on the total non-linked Shekel funds applications at the seven major banks increased during 2005 from a rate of 6.32% in December 2004 to 6.64% in December 2005.

The average effective cost of the total non-linked Shekel funds resources at the seven major banks increased during 2005 from a rate of 3.21% in December 2004 to 3.38% in December 2005.

The financial margin, including management fees, in the non-linked Shekel segment at the seven major banks remained unchanged during 2005 at a rate of 3.7% in December 2004 and in December 2005.

THE CAPITAL MARKET

Securities prices on the Tel-Aviv Stock Exchange strengthened in 2005 and the general share prices index increased in real-terms by 29.7%, compared with a real-term increase of 16.2% in 2004. The average daily trading turnover stood at NIS 1 billion, compared with NIS 658 million in 2004. The increase in share prices in 2005 covered most of the sectors. The “TA 25” Index rose by 30.1% in real-terms, compared with a real-term rise of 26.1% in 2004., and the “TA 100” Index rose by 26.4% in real-terms, compared with a real-term rise of 17.6% in 2004. On the other hand, the “TelTech” Index dropped 7% in real-terms, compared with a real-term rise of 14.6% in 2004

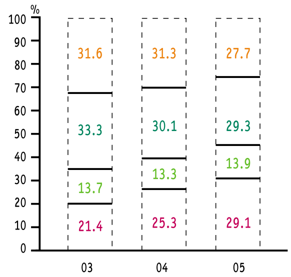
The market value of shares and convertible securities reached NIS 564 billion at the end of 2005, compared with NIS 397 billion at the end of 2004. Net investments in mutual funds during the year amounted to NIS 16.3 billion, compared with NIS 14.1 billion in 2004. Investments in mutual funds specializing in bonds and in foreign investments amounted to NIS 22.8 billion and NIS 4.4 billion, respectively. On the other hand mutual funds specializing in shares and in Shekel investments recorded a negative investment which totalled NIS 0.9 billion and NIS 10 billion, respectively.

The vigorous trading activity in options on the “TA 25” Index continued in 2005, and the daily trading turnover numbered 258 thousand contracts, compared with 153 thousand contracts in 2004.

During the year the bond market registered price increases and declining returns in all segments and in all periods to redemption and the general bond index covering all types of bonds recorded a real-term return of 3.5%, compared with a real-term return of 4.1% in 2004.

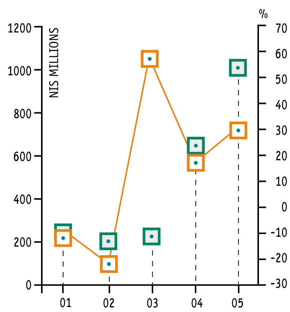
CPI linked Government bonds registered a return of 4%, compared with a return of 3.9% in 2004. Bonds with a period to maturity of up to two years showed a return of 0.6%, compared with a return of 2.5% in 2004. Bonds with periods to redemption of two to five years showed a return of 0.4%, compared with a return of 4.9% in 2004, and with periods to redemption of seven to ten years a return of 5.9%, compared with a return of 4.4% in 2004.

The non-linked Government bonds recorded a return of 5.4%, compared with a return of 5.6% in 2004. The fixed interest bonds of the “Shachar” class registered an overall return of 5.7%, and the variable interest Government bonds of the “New Gillon” class showed an overall return of 4.8%, compared with 4.5% in 2004. The short-term Treasury notes (MAKAM) showed a return of 1.3% in 2005, compared with 3.9% in 2004.



ASSET PORTFOLIO OF THE PUBLIC

- NON-LINKED
- CPI-LINKED
- FOREIGN CURRENCY-LINKED
- SHARES



STOCK MARKET

- REAL RATE OF CHANGE IN GENERAL SHARE INDEX
- TRADING VOLUME IN NIS MILLIONS (CURRENT PRICES)

’30

1932: The fifth immigration wave. Within six years the number of jews in Israel will double.
1935: Leon Recanati, president of the jewish community in Thessaloniki, immigrates to pre-state Israel, followed by many members of his community. He establishes a bank here. Within a decade, this becomes the second largest bank in Israel.

Europe is in turmoil in the 1930s. Purging in Russia, pogroms in Poland. Persecution. Adolph Hitler is appointed chancellor in Germany. The Jewish community in Thessaloniki starts to feel the threat. Community president Leon Recanati decides to immigrate to pre-state Israel with his four sons. Many of the community follow him. Recanati purchases a small shop on Yehuda Halevi Street in Tel Aviv and opens a bank. There are sixty private banks in the town at that time, but Palestine Discount Bank is not only intended for business executives. It also caters to the average citizen. It excels in personal attention and a warm relationship with its customers-new immigrants and natives alike.

With its reliability, cautious policy and, in particular, the service quality provided by its employees, Discount becomes Israel's second largest bank within a decade.

The Staff: Daniel Recanati, son of the bank's founder, with the bank's first employees. Standing, right to left: Shmuel Molcho, Alfred Ezrati, Peppo Romano, Emmanuel Gorali, Yaakov Zarfati, Albert Molcho. Sitting, right to left: Rachel Linkovsky (Hasid), Azriel Raveno, Daniel Recanati, Henri Burla, Greta Tabuch.

THE DISCOUNT GROUP - GENERAL OVERVIEW AND STRUCTURE OF THE GROUP

Israel Discount Bank Ltd. (hereinafter – "the Bank") was incorporated in Palestine in 1935, as a public company under the Companies Ordinance. The Bank was founded by Mr. Leon Recanati. The Bank is a banking corporation having a banking license under the provisions of the Banking Law (Licensing) 1981.

During the seventy years of its operation the Bank has developed a chain of branches and a wide variety of commercial banking activities in all banking spheres. The Discount Group is the third largest banking group in Israel

DOMESTIC OPERATIONS

The Bank is a universal bank, which grants its customers comprehensive banking services in all areas of financial activity, through 124 branches in Israel. The Bank also offers its customers a variety of direct banking, on-line banking and Internet services.

The Bank is an "authorized dealer" entitled to conduct foreign currency operations in accordance with the Control of Foreign Exchange Law, 1978.

The Bank is active in receiving deposits of foreign residents, in providing credit to foreign residents and in an array of foreign currency services, both to Israeli and foreign residents.

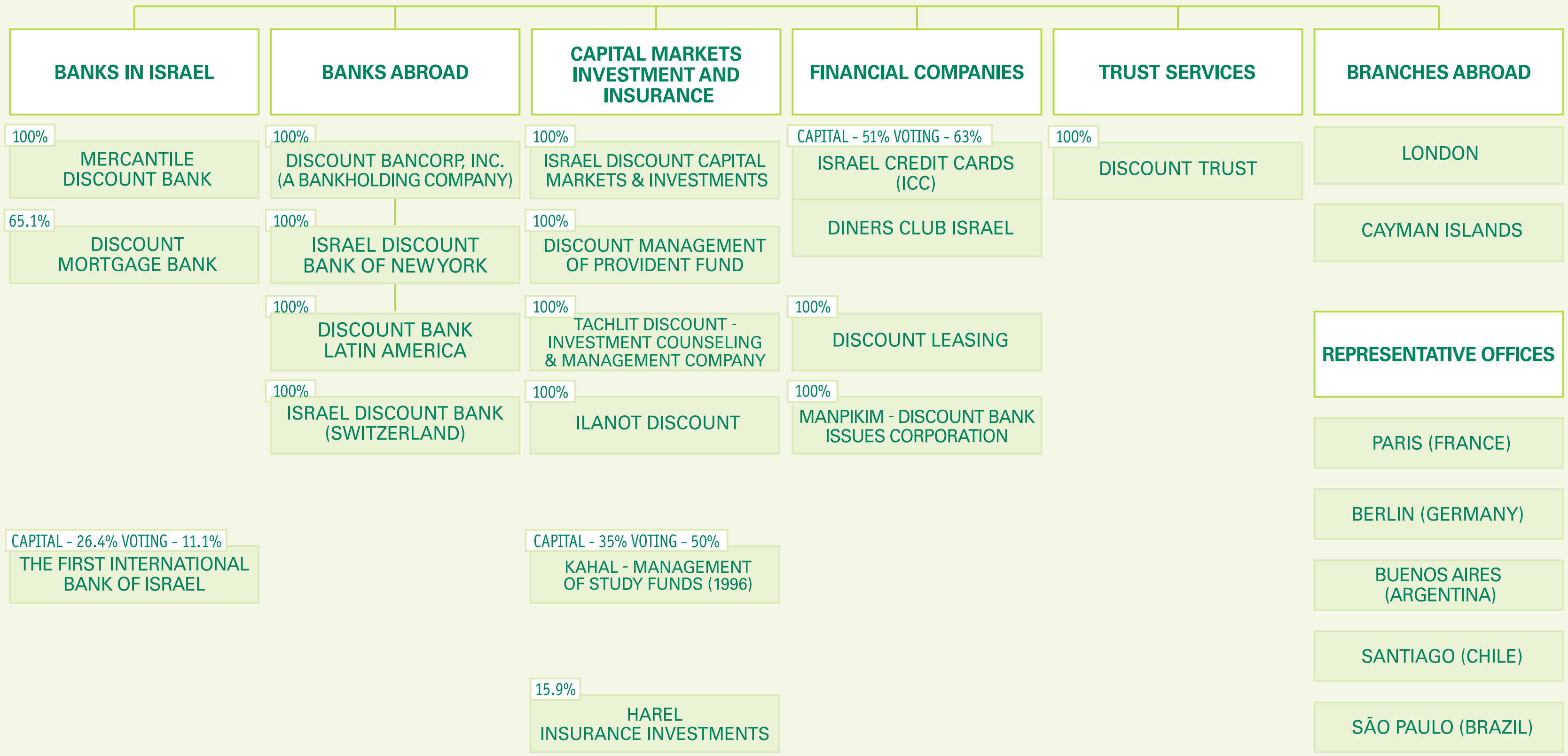
The Bank is a member of the Tel-Aviv Stock Exchange (hereinafter – "the Exchange") and acts, among other things, as a securities dealer and broker for its customers, including for companies of the Group and for provident funds managed by it. The Bank has two banking subsidiaries in Israel – Mercantile Discount Bank Ltd. – a commercial bank serving customers in all fields of financial activity through 63 branches, and Discount Mortgage Bank Ltd., serving as the main arm of the Group in the mortgage loan field. In addition, the Bank has an affiliated company, The First International Bank of Israel Ltd., also being one of the five major banking groups in Israel.

Additional areas of activity in Israel are:

- Credit cards – The Bank controls Israel Credit Cards Ltd. ("ICC") and Diners Club Israel Ltd. ("Diners"), which issue and market "VISA", "Diners" and "MasterCard" credit cards, both for domestic and overseas use.
- Mutual investment trust funds – The Bank controls Ilanot Discount Ltd., a company marketing a variety of mutual funds.
- Securities portfolio management – The subsidiary, Tachlit Discount – Investment Counseling & Management Co. Ltd., which manages securities investment portfolios for private customers, corporations, not-for-profit organizations and institutional bodies.
- Underwriting, investments and venture capital funds – The subsidiary, Israel Discount Capital Markets and Investments Ltd., engages in securities issuance underwriting and management, in investment banking, as well as investing in venture capital funds together with foreign institutional bodies.
- Provident funds – The subsidiary, Discount Management of Provident Fund, manages a variety of provident funds.
- Trustee services – The subsidiary, Discount Trust Ltd., provides various trust services.
- Advanced training funds – Kahal – Management of Study Funds (1996) Ltd. and Kahal – Employees' Supplementary Training Fund Ltd. are affiliated companies engaged in the field of advanced training savings.
- Leasing – Discount Leasing Ltd. is a subsidiary providing a variety of leasing services.
- The raising of secondary capital for the Bank – effected by Manpikim – Discount Bank Issues Corporation Ltd.
- Harel Insurance Investments Ltd., is an affiliated company of the Bank, engages in varied insurance and investment fields.

The Bank's activity in Israel is facing significant changes due to the implementation of the

DISCOUNT GROUP STRUCTURE



legislation passed in the wake of the Bachar Committee recommendations. These changes include the sale of shares of Ilanot Discount Ltd., the sale of the operations of the provident funds, decrease in the holdingds in Harel Insurance Investments Ltd. and the entry into the pension consultancy field. For details see hereunder "Operations in the capital market" under "Further details as to activity in certain products", "Legislation and supervision" and Notes 6 F and 33 to the financial statements.

OVERSEAS EXTENTIONS OF THE BANK

The major part of the Bank's operations abroad is conducted by Discount Bancorp, Inc., which owns Israel Discount Bank of New York. IDB New York is the largest of all Israeli banks operating abroad. Discount Bank (Latin America) operates as a commercial bank in Montevideo, Uruguay. Israel Discount Bank (Switzerland) S.A., located in Geneva, focuses on private banking. The Bank operates a London branch, which provides commercial and private banking services. The Bank has an additional branch in the Cayman Islands.
In addition, the Bank has representative offices in Paris, Berlin, Buenos Aires, Santiago and São Paulo.

FORWARD-LOOKING INFORMATION

Some of the information detailed in the directors' report, which does not relate to historical facts, comprises forward-looking information, as defined in the Securities Law, 1968.
Actual results of the Bank might differ materially from those indicated in the forward-looking information due to a large number of factors, including, among other things, macro-economic changes, changes in the geo-political situation, regulatory changes and other changes not under the control of the Bank, and which may result in the non-realization of the estimates and/or in changes in the business plans of the Bank.
Forward-looking information is typified by terms and words like: "believe", "anticipate", "estimate", "intends", "prepares to...", "might" and similar expressions, in addition to nouns such as: "desire", "anticipation", "intention", "expectation", "assessment", "forecast", etc. Such forward-looking expressions involve risks and uncertainties as they are based on evaluations by management as to future events, which include, among other things, evaluations as to the state of the economy, public preferences, domestic and foreign interest rates, inflation rates, etc. as well as regarding the effects of new legislative and regulatory provisions relating to the banking industry and the capital market and to other fields that have an impact on the activity of the Bank and on the environment in which it operates, and that by the nature of things, their realization is uncertain.
The information presented below relies, among other things, on information in the hands of the Bank, inter-alia, publications by other entities such as the Central Bureau of Statistics, the Ministry of Finance, the Bank of Israel, the Ministry of Housing and other entities that publish data and assessments as to the Israeli and global financial and capital markets.
The above reflects the point of view of the Bank and its subsidiaries at the time of preparation of the financial statements as to future events, based on evaluations that are uncertain. The evaluations and business plans of the Bank and its subsidiaries are derived from such data and assessments. As stated above, actual results might differ materially and impact the realization of the business plans or bring about changes in these plans.

DISCONTINUATION OF THE ADJUSTMENT OF FINANCIAL STATEMENTS TO THE EFFECT OF INFLATION

Starting January 1, 2004, the Bank discontinued the adjustment of the financial statements to inflation, which are now presented in reported amounts. Up to December 31, 2003, the financial statements were prepared in inflation adjusted terms (for details as to the discontinued adjustment of the financial statements in accordance with Accounting Standard 12 of the Israeli Accounting Standards Board and the instructions of the Supervisor of Banks, see Note 1 B to the financial statements).

In view of the materiality that the Supervisor of Banks attaches to income and expenses from financial instruments included in the business results of banking corporations, and in order to enable users of their financial statements, to examine the data included in the financial statements for 2004, in comparison to the data of 2003, special instructions were determined in respect of the comparative figures which refer to 2003. Accordingly, the comparative figures for income and expenses in 2003 included in the income statement up to and including the item “operating income before taxes” in reported amounts, are stated in reported amounts, when the discontinued adjustment to the effect of inflation in respect thereto was made according to the CPI for December 2002. The difference in the comparative figures for 2003 between the income before taxes in reported amounts as stated above, and the income before taxes as adjusted on the basis of the CPI for December 2003, is stated in the item “erosions and adjustments”. This form of presentation allows a fair comparison between the said items in the reported period and in the report for 2004 with the comparative figures for 2003.

In contrast, the comparative figures for income statement items for 2003 appearing after the line item “operating income before taxes” are stated, as said, in amounts adjusted for the effect of inflation based on the CPI for December 2003. Care should therefore be taken when comparing such items in the reported period and in 2004 with the comparative figures relating to them in 2003. The same applies to the data calculated on their basis, such as “Income per share” and “Return on equity”.

INCOME AND PROFITABILITY

The Group’s Net Income in 2005 totalled NIS 458 million, compared with NIS 556 million in the preceding year, a decrease of 17.6%.

Net income of the Bank Group for 2005, disregarding the provision for early retirement and a provision in respect of the arrangement that IDB New York signed with the regulatory authorities in the United States, amounted to NIS 693 million, compared with earnings, desregarding a provision for early retirement, of NIS 659 millions in 2004, an increase of 5.2%.

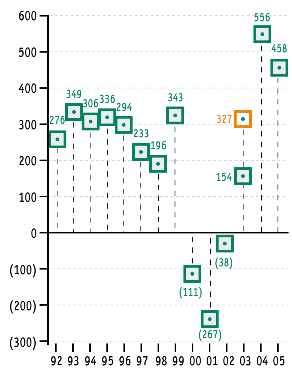
The Bank alone had a loss from ordinary operations after taxes amounting to NIS 228 million in 2005, compared with income from ordinary operations after taxes of NIS 104 million in the previous year.

Disregarding a provision for early retirement of employees, the Bank would have recorded in 2005 operating loss after taxes of NIS 56 million, compared with operating earnings after taxes of NIS 204 million in 2004.

Disregarding the hedging of the investment of the Bank in overseas extensions and without the provision for early retirement, the Bank would have recorded in 2005 operating income after taxes of NIS 29 million, compared with income of NIS 185 million in 2004.

Return on shareholders’ equity for 2005 was 7.2%, compared with 9.3% in the preceding year.

The return on equity for 2005, disregarding the provision for early retirement and the provision in respect of the arrangement signed by IDB New York with the regulatory authorities in the United States, reached a rate of 10.9%, compared with a return on equity, disregarding the provision for early retirement, for 2004 at a rate of 11.1%.



NET INCOME (LOSS)
IN NIS MILLIONS

NET INCOME (LOSS)

DISREGARDING THE PROVISION FOR IMPAIRMENT IN VALUE OF FIBI

Net earnings per NIS 1 par value of the share capital amounted in 2005 to NIS 4.67, compared with NIS 5.67 in the preceding year.

Following are the main factors, having a possitive effect on the business results of the Group in 2005, as compared with 2004:

(a) An increase of 6.4% in income from financing activities before provision for doubtful debts.

(b) A decline of 21.5% in the provision for doubtful debts, which resulted mainly from a decline at the rate of 24.2% in the provision for doubtful debts in the Bank.

(c) An increase of 7.9% in operating and other income, caused mainly by an increase of 53.4% in other income primarily from the increase in gains from severance pay funds and an increase of 4.9% in operating commissions, partly setoff by a decline of NIS 100 million in net income from investments in shares.

(d) An increase of 28.9% in the Bank's share in income from affiliated companies. The share in earnings of affiliates in 2005 is stated net of a provision for taxes of NIS 22 million, in respect of the Bank's holdings in Harel, net of dividends received (see Note 33 to the financial statements).

On the other hand, the following factors offset the said positive effects:

(a) An increase of 17.4% in operating and other expenses, effected mostly by an increase of 15.2% in payroll and related expenses resulting from the wage agreement signed by the Bank, employee bonuses and the program for the encouragement of early retirement, an increase of 32.5% in other expenses stemming primarily from the increase in computer expenses at the Bank and from the provision in respect of the arrangement signed by IDB New York with the regulatory authorities in the United States, and an increase in buildings and equipment maintenance and depreciation expenses at the rate of 5.4%.

(b) A decline of NIS 20 million in net gain from extraordinary items, net of taxes.

The results for the fourth quarter of 2005. In the fourth quarter of 2005 the Bank Group recorded a loss of NIS 111 million, compared with net income of NIS 217 million in the third quarter of 2005 and net income of NIS 134 million in the corresponding period last year. The results for the fourth quarter of 2005 were affected mostly by the provision for the program for the encouragement of employee early retirement of NIS 196 million (compared with an expense of NIS 30 million in the fourth quarter of 2004) and by a provision of NIS 113 million in respect of the arrangement signed by IDB New York with the regulatory authorities in the United States. Disregarding the said effects and their relating tax, the net income for the fourth quarter of 2005 would have been NIS 124 million, compared with net income of NIS 217 million in the third quarter of 2005 and net income of NIS 160 million in the corresponding period last year.

DEVELOPMENTS IN INCOME AND EXPENSES

Income from financing activities before provision for doubtful debts amounted to NIS 3,697 million in 2005, compared with NIS 3,473 million in the preceding year, an increase of 6.4%.

Income from financing activities before provision for doubtful debts was influenced by the following factors:

(a) An increase of 2.9% in the average outstanding balance of financial assets generating financing income.

(b) An increase in the overall financial margin (including the effect of derivative financial instruments), which in 2005 reached a rate of 1.76%, compared with 1.72% in 2004.

(c) Gains net on sale of available-for-sale bonds and a provision for the decline in value of available-for-sale bonds in 2005, totaling NIS 30 million compared with NIS 98 million in 2004.

(d) Realized and non-realized gains on adjustment to fair value of trading bonds, net, amounted to NIS 2 million in 2005, compared with a loss of NIS 29 million in 2004.

As to the loss of NIS 47 million recognized on the write-off of the balance of the fair value of a forward transaction in respect of a property lease agreement that had been cancelled, see "Acquisition of office space in the "Discount Tower" on Yehuda Halevi Street" under "Miscellaneous" hereunder.

INCOME FROM FINANCING ACTIVITY BY LINKAGE SEGMENTS

Below is the composition of income from financing activity by linkage segments (including the effect of derivative financial instruments which may be allocated to segments of activity - ALM):

	For the year ended December 31						
	2005			2004			
	Contribution to profit			Contribution to profit			Changes in contribution in NIS millions
	Volume of activity* in%	in NIS millions	in %	Volume of activity* in %	in NIS millions	in %	
Israeli Currency	29.8	1,508	40.8	28.9	1,384	39.8	124
Unlinked shekels	12.2	460	12.4	13.6	434	12.5	26
CPI-linked shekels	58.0	1,378	37.2	57.5	1,208	34.8	170
Foreign Currency	100.0	3,346	90.4	100.0	3,026	87.1	320
Options		(16)	(0.4)		48	1.4	(64)
Other derivative financial instruments (not including hedged derivatives and ALM)	-	-	-		-	-	-
Financing commissions		138	3.7		120	3.5	18
Other financing income (expenses), net		229	6.3		279	8.0	(50)
Total		3,697	100.0		3,473	100.0	224

* According to the average balance of the assets.

For further details of earnings from financing operations according to linkage terms, see "Financing income and expense ratios" in Schedule C in the Management Review hereunder.

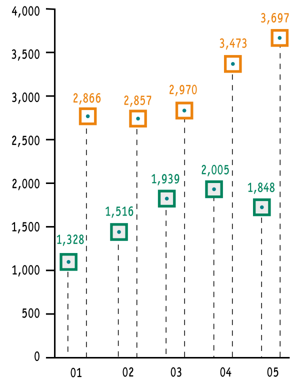
Effect of Non-Performing Debts. One of the factors that considerably affected the income from financing activities was the volume of non-performing debts. The balance of such debts, as at December 31, 2005, was NIS 2.75 billion, compared with NIS 2.86 billion in the preceding year. (The average rate of return on credit in the different linkage segments in 2005 was between 7.11% and 11.35%).

BELOW ARE PARTICULARS ON NET INTEREST INCOME ACCORDING TO LINKAGE SEGMENTS (INCLUDING ALM):

In the non-linked shekel segment, net interest income totalled NIS 1,508 million in 2005, compared with NIS 1,384 million in the preceding year, an increase of 9.0%. Income from this segment constituted 40.8% of total net interest income in 2005, compared with 39.8% in the preceding year.

In 2005, assets exceeded liabilities in this segment by NIS 1,552 million, compared with 2004, where assets exceeded liabilities by NIS 1,465 million, contributing to the increase in earnings from financing operations in this segment.

The average balance of assets in this segment increased in 2005 by 6.1% compared with the preceding year.



INCOME FROM FINANCING ACTIVITIES BEFORE PROVISION FOR DOUBTFUL DEBTS THE BANK/CONSOLIDATED
IN NIS MILLIONS

CONSOLIDATED

THE BANK

In 2005 the interest margin reached 2.77% compared with 2.67% in the previous year.

In the CPI-linked shekel segment, net interest income totalled NIS 460 million in 2005, compared with NIS 434 million in the preceding year, a rise of 6.0%. Its proportion of total net interest income in 2005 was 12.4%, compared with 12.5% in the previous year.

The average asset balance in this segment in 2005, fell by 7.4% compared with the preceding year.

The interest margin in 2005 reached the rate of 1.51%, compared with a rate of 1.49% in the preceding year.

In the foreign currency segment, which includes activities in the foreign currency-linked shekel segment, net interest income amounted to NIS 1,378 million in 2005, compared with NIS 1,208 million in the preceding year, an increase of 14.1%. Its proportion of all net interest income was 37.2% in 2004, compared with 34.8% in the preceding year.

In 2005, the average balance of assets in this segment increased by 3.7% compared with the preceding year.

The interest margin in this segment in 2005 was 1.31%, compared with 1.23% in the preceding year.

Other net financing income totalled NIS 367 million in 2005, compared with NIS 399 million in the preceding year.

Total interest margin in 2005 was 2.08%, compared with 2.14% in the preceding year (including the effect of hedge transactions).

The interest margin, including the effect of other derivatives (in hedge transactions and ALM), reached a rate of 1.76% in 2005, compared with a rate of 1.72% in the preceding year.

Provision for doubtful debts totalled NIS 691 million in 2005, compared with a provision of NIS 880 million in the preceding year, a decrease of 21.5%. In 2005, the provision constituted 18.7% of the income from financing activities before provision for doubtful debts, compared with 25.3% of this income in the preceding year. (For details in rexpect of a material provision recorded in 2004, see "Completion of the provision for doubtful debts in respect of a certain borrower" hereunder).

The annual provision for doubtful debts, as a ratio of credit to the public, not including off-balance sheet credit risk, was 0.77% in 2005 (0.48% - including off-balance sheet credit risk), compared with 1.06% (0.70% - including off-balance sheet credit risk) in 2004.

The balance of the provision for doubtful debts, which includes the specific provision, the general provision, the supplemental provision and the special provision, but not including provision for off-balance sheet credit risk, totalled NIS 5,769 million in 2005 (NIS 5,903 million - including provision for off-balance sheet credit risk). The balance of this provision constitutes 6.43% of the credit to the public (4.11% - including off-balance sheet credit risk), compared with a balance of the provision in the amount of NIS 5,540 million, not including provision for off-balance sheet credit risk (NIS 5,663 million - including provision off-balance sheet credit risk), constituting 6.67% of the credit to the public (4.48% - including off-balance sheet credit risk) at the end of the preceding year.

The specific provision for doubtful debts amounted to NIS 642 million in 2005, compared with NIS 845 million in the preceding year, a decrease of 24.0%.

The specific provision was made on a conservative basis, in accordance with management's assessment of expected losses in the credit portfolio, based on an examination and monitoring of the condition of debtors and their business activity, an assessment of the risks related to their financial condition and in relation to the type and value of the collateral.

The main part of the expense recorded by the Bank (in Israel) for the specific provision for doubtful debts in 2005 relates to the following industries: construction and real estate industries 29.2% in 2005, compared with 41.4% in 2004; hotel industry 3.2% in 2005, compared with 0.9% in 2004; communications and computer services 8.5% in 2005, compared with 20.1% in 2004; commercial sector 19.2% in 2005, compared with 8.1% in 2004; various industrial sectors 18.9% in 2005, compared with 12.2% in 2004.

The Bank's specific provision (in Israel) for major sectors - The Bank's specific provision for the construction and real estate sector, as a ratio of credit to the public in this sector was 1.1% in 2005, compared with 2.2% in 2004.

The Bank's specific provision for the hotel sector, as a ratio of credit to the public in this sector, was 0.5% in 2005, compared with 0.2% in 2004.

The Bank's specific provision for the commercial sectors, was 1.2% in 2005, compared with 0.8% in 2004.

The Bank's specific provision for the various industrial sectors, was 0.8% in 2005, compared with 0.7% in 2004.

The Bank's specific provision for the communications and computer services, was 1.3% in 2005, compared with 4.6% in 2004.

The specific provision in the Bank, in respect of all other economic sectors, as a ratio of the credit granted to such sectors, was 0.5% in 2005, compared with 0.6% in 2004.

(It should be noted that the comparative figures for 2004 were reclassified).

The supplemental provision for doubtful debts of the Bank and the banking subsidiaries in Israel, in 2005, totalled NIS 23 million, compared with a supplemental provision of NIS 6 million in the previous year. (For details as to the provision in respect of deviation from limitations relating to indebtedness of a group of borrowers and the indebtedness of the six large borrower groups, see "Legislative restrictions, regulations and special constraints applicable to the segment" in the "Corporate banking segment" hereunder).

The total of the said amount included, in 2005, an additional provision in respect of prior years, in the amount of NIS 11 million, compared with NIS 6 millions in 2004. (see hereunder regarding the accumulation of the required provision until the final target is gradually reached over several years, as required by the amendment to the directive,).

The supplemental provision for doubtful debts is based on the quality of the credit portfolio in accordance with risk factors, as determined by the directives for proper banking procedures. In respect of these risk factors, the initial directive determined annual provision rates and final targeted rates for each of the risk factors.

In February 2002, the said directive was amended. The annual provision rates were abolished, and it was determined, effective immediately, that banks have to reach the final target of the supplemental provision with respect to problem debts in the same quarter in which a debt has been classified as problematic.

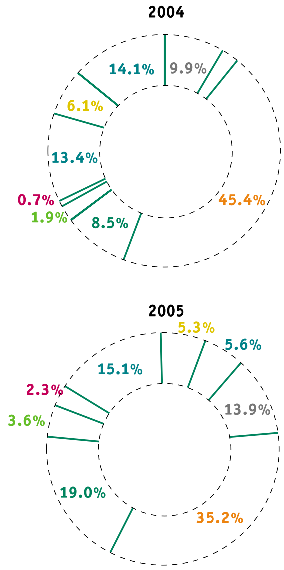
The Bank had implemented this amendment with respect to debts classified as problematic in the last quarter of 2001, and thereafter. As to the required final target of the balance of the provision relating to debts so classified up to September 30, 2001, the Bank obtained the approval of the Supervisor of Banks to accrue it up to the end of 2005. Mercantile Discount Bank and Discount Mortgage Bank obtained the approval of the Supervisor to record the said provision over five consecutive quarters ending on December 31, 2002.

Directive regarding a certain loan. The Bank and Mercantile Discount Bank have granted a loan as part of a consortium of banks. As the borrower did not abide by the terms of the loan and did not settle the periodic interest payments, the court, at the request of the consortium, appointed a receiver to realize shares of "Bezeq" pledged as collateral for the loan.

At June 30, 2003, the market value of the proportionate share of the Bank and Mercantile Discount Bank in the said collateral exceeded the outstanding balance of the loan, net of existing provisions as of that date.

On July 10, 2003, the Supervisor of Banks directed that in view of the financial position of the borrower and the terms of the loan, the outstanding balance thereof should no longer be considered as credit granted.

Accordingly, the Supervisor of Banks issued, on July 15, 2003, a directive stating that the balance of the said loan as of June 30, 2003, should be treated as an "investment in shares"



PROVISION FOR DOUBTFUL DEBTS BY ECONOMIC SECTORS

- CONSTRUCTION AND REAL ESTATE
- COMMERCE
- OTHER BUSINESS SERVICES
- HOTELS
- INDIVIDUALS
- OTHERS
- COMMUNICATIONS
- INDUSTRY

classified as "available-for-sale securities", based on the market value of the proportionate share of the Bank and Mercantile Discount Bank in the said collateral.

The Bank and Mercantile Bank have made the classification according to the directive, based on the market value of their share in the collateral as of June 30, 2003, which amounted to NIS 324 million. As from that date, changes in market value are taken to the capital reserve in respect of the presentation of available-for-sale securities at fair value.

It should be noted, that consistent with the said directive, the Bank has also been instructed to classify the said balance as part of the non-monetary investments of the Bank.

In accordance with the said directive, the supplementary provision recorded up to June 30, 2003, in respect of this problematic loan, which until then was classified as a non-performing loan, was not cancelled and was included in "Other liabilities". Only towards the publication of the financial statements for December 31, 2005, the Supervisor of Banks allowed the Bank to reverse the said supplemental provision. Whereas the said approval was received towards the end of February 2005, the provision included in the books of Mercantile Discount Bank was reversed only in the first quarter of 2005.

Augmenting the provision for doubtful debts in respect of a certain borrower (2004). The Supervisor of Banks informed the Bank in November 2004, that it will be required to augment the provision in respect of a certain borrower, based upon the value of the collateral derived from the market value per subscriber, as evaluated by the Supervisor, in accordance with an indicative examination performed on the basis of the data provided by the Bank to the Supervisor, and in accordance with a review of a wide range of scenarios and assumptions in relation to various parameters of the valuations provided by the Bank. In accordance with a directive of the Supervisor of Banks, the Bank provided in its financial statements as of September 30, 2004, an amount of NIS 97 million in this respect (the said directive also resulted in an estimated decrease of NIS 12 million in the Bank's share in earnings of the First International Bank).

As from September 30, 2004, the Bank updates the provision according to the format directed by the Supervisor. The total provision in respect of this borrower amounted in 2005 to NIS 25 million, compared with NIS 111 million in 2004.

Income from financing activities after provision for doubtful debts amounted to NIS 3,006 million in 2005, compared with NIS 2,593 million in the preceding year, an increase of 15.9%.

Non-financing income in 2005 amounted to NIS 2,401 million, compared with NIS 2,226 million in the preceding year, an increase of 7.9%.

Commissions totalled NIS 1,858 million in 2005, compared with NIS 1,771 million in the preceding year, an increase of 4.9%. The increase results, mainly, from income from credit cards, payment order system services, income from securities transactions, handling of credit and drafting of contracts and foreign trade and foreign currency special services activity which result from the expansion of activity by Bank customers.

The Group's income from credit card activity derives from both operating and financing activities.

Income from credit card operating activities amounted to NIS 565 million in 2005, compared with NIS 519 million in 2004, an increase of 8.9%. Interest income on credit to customers via credit cards amounted to NIS 57 million in 2005, compared with NIS 56 million in 2004.

Gains on investment in shares, net, amounted to NIS 3 million in 2005, compared with NIS 103 million in 2004. The gains in 2004 include dividend income of NIS 5 million, received on shares of Israel Credit Cards Ltd. designated for sale.

Other income in 2005 totalled NIS 540 million, compared with NIS 352 million in the preceding year, an increase of 53.4%. This increase derives mainly from a decline in profits of severance pay funds, which amounted to NIS 160 million in 2005, compared with NIS 29 million in 2004.

Following are the main components comprising non-financing income:

	2005	2004	2003
	%	%	%
Revenue from management fees	11.2	12.9	13.1
Payment order system services	18.3	19.8	19.9
Revenue from credit cards	23.6	24.4	22.4
Revenue from capital market activities	23.9	23.3	18.1
Profits of the severance pay fund	6.7	1.4	8.7
Computerized services, information and confirmations	1.8	2.0	2.1
Foreign trade activity	3.3	3.5	3.0
Margins and collection fees on loans out of deposits refundable according to collection	0.8	0.9	1.0
Other	10.4	11.7	11.6
Total	100.0	100.0	100.0

Non-financing expenses totalled NIS 4,724 million in 2005, compared with NIS 4,023 million in 2004, an increase of 17.4%.

Salaries and related expenses amounted to NIS 2,891 million in 2005, compared with NIS 2,510 in the preceding year, an increase of 15.2%.

In 2005, the Bank continued encouraging early retirement of employees, while directing it towards employee populations with defined characteristics, where focused efforts are being made to encourage early retirement at beneficial terms. The financial statements for 2005, include an expense of NIS 196 million in respect of early retirement (2004: NIS 121 million).

Within the framework of the wage agreement signed with the employees in January 2006, the management of the Bank agreed to grant the employees an additional award in respect of 2004, equal to one monthly salary (hereinafter – "the additional award"). The expense in respect of the additional award, in the amount of NIS 61 million, was recognized in 2005.

Payroll expenses for 2005 include for the first time a payroll tax expense of NIS 49 million, in respect of the amended definition of wages in the Value Added Tax Law (see Note 27 to the financial statements and "Taxation" hereunder).

Payroll expenses in 2005 also include a provision of NIS 12 million in respect of the change in mortality tables used in actuarial computations, on the basis of which the Bank computes a part of the liability for employee benefits (for additional details see Note 16 to the financial statements).

Salaries and related expenses exlcuding expenses for encouraging early retirement, the additional bonus, payroll tax due to the change in the legal definition and a provision in respect of a change in the mortality tables amounted to NIS 2,573 million in 2005, compared with NIS 2,389 million in 2004, an increase of 7.7%, deriving mainly from the wage agreement signed by the Bank for the years 2004 and 2005.

Salaries expenses, excluding related expenses, amounted in 2005 to NIS 1,845 million, compared with NIS 1,638 million in 2004, an increase of 12.6%.

Salary and related expenses in the Bank alone amounted to NIS 1,958 million in 2005, compared with NIS 1,671 million in the preceding year, an increase of 17.2%. The increase derives mainly from the provision for program for encouraging early retirement, from the wage agreement signed at the Bank, from provisions in respect of employee bonuses regarding the earnings of the Bank in the years 2004 and 2005, and from payroll expenses in respect of the change in the definition of wages in the Value Added Tax Law.

Payroll and related expenses of the Bank, excluding early retirement expenses, the additional award and payroll tax in respect of the changes in the definition of the law and the effect of the change in the mortality tables, amounted in 2005 to NIS 1,645 million, compared with NIS 1,554 million in 2004, an increase of 5.9%.

Salary expenses, excluding related expenses, in the Bank alone, amounted to NIS 1,162 million in 2005, compared with NIS 1,017 million in the preceding year, an increase of 14.3%.

Salary related expenses in the Bank alone, amounted in 2005 to NIS 600 million, compared with NIS 537 million in 2004, an increase of 11.7%, mainly in respect of supplementing provisions for related expenses following the wage agreement.

For details as to the effect of the wage agreement signed by the Bank on the business results for the first quarter of 2006, see hereunder.

Program for the encouragement of early retirement (2005). In January and February 2006, the board of directors approved a plan for the encouragement of early retirement, at beneficial terms, of employees of 50 years of age and over, employed at head offices and branches. The financial statements as of December 31, 2005, include a provision of NIS 196 million in respect of the said plan.

Program for the encouragement of early retirement (2004). In May and October 2004, the Board of Directors approved plans for the encouragement of early retirement of employees. The plans were focused on an employee population having defined characteristics, in respect of which a special effort was made to encourage their early retirement under improved terms. The financial statements, as of December 31, 2004, included an expense of NIS 60 million in respect of the these plans. In addition, an additional expense of NIS 57 million was recorded in 2004, in respect of encouraging the retirement of employees.

See the section on “Human Resources” below, for details of employee retirement in 2000-2005.

Depreciation and maintenance of building and equipment totalled NIS 666 million in 2005, compared with NIS 632 million in the previous year, an increase of 5.4%, mainly due to an increase in depreciation expenses in the Bank which derived primarily from the amortization of software development costs for in-house use, the development of which had been completed.

Other expenses totalled NIS 1,167 million in 2005, compared with NIS 881 million in the preceding year, an increase of 32.5%. The increase results mainly from an increase in computer expenses of the Bank and a provision in respect of an arrangement that IDB New York signed with the regulatory authorities in the United States (see “Discount Bancorp, Inc.” under “Main investee companies” and Note 6 D to the financial statements hereunder).

The ratio of non-financing income to non-financing expenses reached 50.8% in 2005, compared with 55.3% in the preceding year.

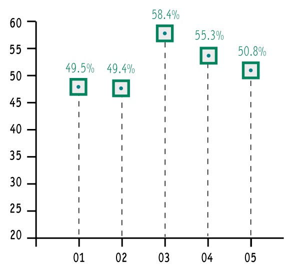
Operating income before taxes totalled NIS 683 million in 2005, compared with NIS 796 million in the preceding year, a decrease of 14.2%.

Provision for taxes on operating income totalled NIS 324 million in 2005, compared with NIS 342 million in the preceding year.

Final tax assessments have been issued to the Bank for the years up to and including the tax year 2002. Finalizing the assessments for tax years 2001 and 2002 resulted in the reduction in the tax expense in 2004, in the amount of NIS 41 million.

No income was recorded in 2005 from deferred tax assets in respect of current losses for tax purposes and timing differences in the amount of NIS 47 million compared with 2004 in which the Bank did not record a current tax expense in respect of taxable current income of NIS 51 million due to the utilization of carry forward tax losses in respect of which no deferred tax assets had been recorded in the past. (For details concerning the balance of tax losses and deductions carried forward as well as net timing differences in respect of which no deferred tax assets have been recorded, see Note 29 to the financial statements).

In view of the amendment to the Income Tax Ordinance in 2004 and the expected gradual reduction in the corporate tax rate, the amounts stated in respect of deferred tax expenses,



RATIO OF NON-FINANCING INCOME TO NON-FINANCING EXPENSES CONSOLIDATED

net (deferred tax assets) were recalculated in accordance with the tax rates applying in the periods in which the deferred taxes are expected to materialize. The updating of the deferred taxes as above, increased the tax expense of the Group for 2004 by an amount of NIS 4 million. (The said amount is comprised of NIS 48 million, being the net effect of the reduction in the tax rate on the outstanding balance of deferred taxes as of January 1, 2004, less NIS 44 million, being deferred tax assets recorded in respect of the change in net timing differences in 2004).

The Knesset enacted, on July 25, 2005, an amendment to the Income Tax Ordinance Law providing for further reduction in the corporation tax rate. The provisions for deferred taxes in the financial statements of 2005 have been updated accordingly.

The net effect of the decrease in the tax rate on the balance of deferred taxes as of January 1, 2005, amounts to NIS 37 million as opposed deferred tax assets in respect of the net change in timing differences in 2005 in the amount of NIS 60 million recorded by the Group. (For additional details see "Taxation" hereunder and Note 29 to the financial statements).

Operating income after taxes totalled NIS 359 million in 2005, compared with NIS 454 million in the preceding year, a decrease of 20.9%.

The Bank's share in operating income of affiliated companies after taxes totalled in NIS 174 million in 2005, compared with NIS 135 million in the preceding year, an increase of 28.9%. The share in earnings of affiliates in 2005 is stated net of a provision for taxes,of NIS 22 million, in respect of the Bank's holdings in Harel, less dividends received (see Note 33 to the financial statements).

Net operating income totalled NIS 458 million in 2005, compared with NIS 533 million in the preceding year, a decrease of 14.1%.

The ratio of operating income before taxes to shareholders' equity, including minority interest, was 12.4% in 2005, compared with a ratio of 15.3% in the preceding year.

The ratio of operating income after taxes to shareholders' equity, including minority interest, was 6.5% in 2005, compared with a ratio of 8.7% in the preceding year.

Net earnings from extraordinary operations, after taxes, amounted, in 2005, to NIS 4 million, mostly due to additional building rights realized in the "Discount Tower" (for additional details see "The acquisition of office space in the "Disount Tower" on Yehuda Halevi street under "Miscellaneous" and Note 19 C 20 to the financial statements). The corresponding period last year reflected net earnings from extraordinary operations, after taxes, of NIS 24 million. This mainly comprises a gain on realization of an investment in an investee company (NIS 32 million) and the reversal of a provision for taxes recorded in previous years in respect of Mercantile Discount Bank (NIS 33 million), which were partly offset by a loss on the sale of the building in Ramat-Gan and by provisions for impairment in value recorded prior to the sale (NIS 32 million). For additional details, see Note 30 to the financial statements.

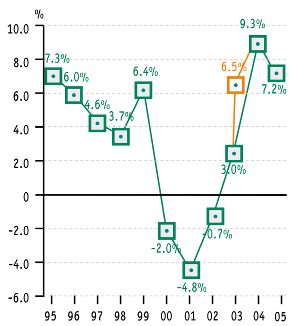
Net income in 2005 amounted to NIS 458 million, compared with of NIS 556 million in the preceding year, a decrease of 17.6%.

Return on shareholders' equity reached a rate of 7.2% in 2005, compared with a rate of 9.3% in the preceding year.

Net earnings per NIS 1 par value of the share capital amounted in 2005 to NIS 4.67, compared with a loss of NIS 5.67 in the preceding year.

An estimate of the effect of the Bank's wage agreements and the sale bonus on the business results for the first quarter of 2006. The wage agreement signed for the year 2006 will increase the wage base for computing the provisions for severance pay, vacation pay and long service award by a rate of 5%. Accordingly, the Bank will include in its financial statements for the first quarter of 2006, the full increase in the provisions for wage related liabilities, in the estimated amount of NIS 98 million.

In view of the completion of the transaction for the sale of a controlling interest in the Bank, the financial statements for the first quarter of 2006, will also include an expense of



RETURN ON EQUITY

ACTUAL

DISREGARDING THE PROVISION FOR IMPAIRMENT IN VALUE OF FIBI

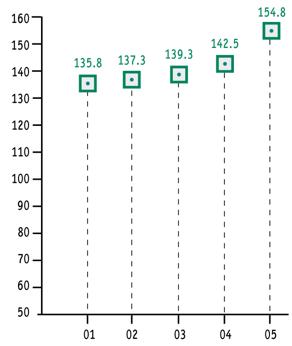
NIS 57 million in respect of the balance of the bonus awarded by the Bank to the employees, in accordance with the "Employee Agreement" (for further details see "Employee Agreement" in the Chapter "Control of the Bank" hereunder). In addition, the said financial statements will include an expense in respect of the State bonus to the employees in the amount of NIS 175 million, recorded against a capital reserve, in accordance with the position of the Supervisor of Banks that the payment of this bonus constitutes a "transaction with a controlling party".

DEVELOPMENT OF ASSETS AND LIABILITIES

Total assets as at December 31, 2005 amounted to NIS 154,798 million, compared with NIS 142,510 million at the end of the preceding year, an increase of 8.6%.

Following are the developments in the principal balance sheet items:

	December 31		Rate of
	2005	2004	change
		In NIS millions	in %
Assets			
Cash and deposits with banks	20,586	17,751	16.0
Securities	42,188	40,068	5.3
Credit granted to the public	83,890	77,518	8.2
Liabilities			
Deposits from the public	130,300	121,974	6.8
Deposits from banks	6,518	4,806	35.6
Debentures and subordinated capital notes	5,342	4,809	11.1
Shareholders' equity	6,718	6,386	5.2

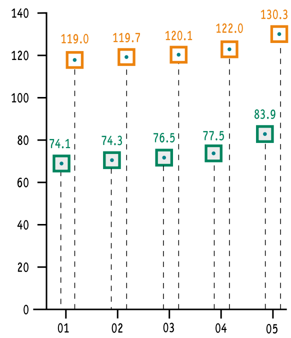


TOTAL ASSETS – CONSOLIDATED
IN NIS BILLIONS

Credit granted to the public as at December 31, 2005, totalled NIS 83,890 million, compared with NIS 77,518 million on December 31, 2004, an increase of 8.2%. The ratio of credit granted to the public to total assets reached 54.2% at the end of 2005, compared with 54.4% at the end of 2004.

Following are data on the composition of credit granted to the public by linkage segments:

	December 31, 2005		December 31, 2004		
	In NIS millions	% of total credit to public	In NIS millions	% of total credit to public	Rate of changes in %
Non-linked shekels	31,786	37.9	27,451	35.4	15.8
CPI-linked shekels	19,196	22.9	18,768	24.2	2.3
Foreign currency and foreign currency-linked shekels	32,908	39.2	31,299	40.4	5.1
Total	83,890	100.0	77,518	100.0	8.2



CREDIT TO THE PUBLIC AND DEPOSITS FROM THE PUBLIC - CONSOLIDATED
IN NIS BILLIONS

DEPOSITS FROM THE PUBLIC
CREDIT TO THE PUBLIC

A directive concerning the treatment of credit facilities in current accounts. On February 8, 2005, the Supervisor of Banks issued a directive with regards to credit facilities granted within the framework of creditory and debitory current accounts. The directive was amended on August 17, 2005. The directive is intended to stop the practice, prevalent in Israel, of having current accounts that often, and for long periods, show overdrawn balances over and above the approved credit facilities.

The directive provides, inter alia, that:

- Banks have to determine credit facilities in accordance with the needs of the customer, his repayment ability and the collateral provided by him, based on a documented analysis performed for the purpose of approving the credit facility by the authorized credit officer at the bank;
- Determination of the credit facility in an educated manner can be achieved also according to characteristics of groups of customers, and the bank may fix different threshold amounts for groups of customers in respect of which general criteria are to be defined for the documented analysis of credit requirements;
- The credit facility would be established in a written agreement specifying both parties' obligations – the customer and the Bank – to transact business within the limits of the credit facility, only, without any deviation therefrom;
- The bank may grant to a customer having an approved credit facility (that has been determined in a written agreement with him) or to a group of such customers, an additional unilateral credit line, for a limited time, provided that the bank informs the customer accordingly. Such unilateral credit line shall not carry a commission charge, and the rate of interest in respect thereof shall not be in excess of the interest rate in respect of the most recent credit line agreed in writing with the customer and signed by him;
- In cases where the customer asks the bank to honor a charge to his account that would result in him exceeding the approved credit facility, and the bank consents to such request, an appropriate credit facility, even though temporary, shall be agreed in advance and in writing, in line with the requested additional credit;
- Charging the customer with an excessive interest rate and with special commissions in respect of an account that has exceeded the credit limits, shall be permitted only in cases where the bank had been unable to prevent the account from being overdrawn, and, even in this case, only with respect to accounts classified by the bank as problematic debts (in default);
- No interest income is to be recognized in respect of overdrawn amounts in accounts classified as problematic, until such income is in fact collected (and the overdraft settled). (This item will come into effect on July 1, 2006);
- A credit facility agreement may be signed at a branch of the bank, at the customer's home or via the Internet.

The new directive become effective on January 1, 2006; however, the Bank will be entitled to grant a customer a unilateral credit facility, even without a written agreement, at an interest rate charged by the Bank to similar customers, until January 1, 2007. Until July 1, 2006, the Bank will be permitted to allow an overdraft on current accounts and to charge exceptional interest in respect thereto. In respect of current account credit facilities in foreign currency the directive will come into effect on January 1, 2007.

It should be noted that prior to the issue of the directive the Bank had already taken steps regarding conversion of overdrafts to loans and regulating credit facilities in order to reduce the level of overdrawn client accounts.

The Bank is preparing to implement the directive, among other things, by converting the overdrafts into loans, adjusting the credit facilities to the needs of the customer and its activity, offering loans at attractive prices, conducting seminars for customers on the subject of managing the family budget etc. As part of the above, in September 2005, the bank sent a letter to its customers concerning the directive of the Bank of Israel. The letter explained the principles of the directive, and its meaning and implications on managing the customer's account. Customers were requested to stop in at the Bank's branches in order to adjust their credit facilities to their activities and needs as well as to receive advice and solutions as to compliance with the approved credit facilities (loans, "The family as a business" seminar).

The Bank estimates that difficulties might arise in the implementation of the Directive in view of the fact that this matter involves a major change in behavior and consumption patterns of private customers and also due to the fact that some of the customers might refuse to cooperate and refrain from settling their credit facility arrangements in time, despite requests by the Bank.

Following are data as to the overall credit risk at the responsibility the Group as regards problematic borrowers[1] net of provision for doubtful debts (in NIS millions):

	December 31	
	2005	*2004
Non-performing debts	2,740	2,859
Reorganized debts[2]	457	360
Debts due for reorganization[3]	92	84
Debts temporarily in arrears	555	615
Debts under special supervision[4]	4,034	4,403
Total balance sheet credit to borrowers	7,878	8,321
Off-balance sheet credit risk regarding problematic borrowers[5]	728	525
Debentures of problematic borrowers	68	42
Other assets in respect of derivative instruments of problematic borrowers	1	8
Total overall credit risk concerning problematic borrowers	8,675	8,896

* Reclassified

(1) Not including problem debts for which the collateral received is available for set-off with respect to the limitations on indebtedness of a single borrower or of a group of borrowers (Proper Banking Procedures No. 313).

(2) Credit reorganized during the current year as well as credit reorganized in prior years with waiver of income.

(3) Credit to borrowers, which per Management decision is to be reorganized, but which reorganization has not yet been implemented.

(4) Of which: debts of NIS 1,592 million, presented net of specific provision made thereof, and housing loans of NIS 202 million, in respect of which a provision according to the period of default exists (December 31, 2004: NIS 1,730 million and NIS 199 million, respectively).

(5) As computed for the purpose of limitations on indebtedness of a single borrower or of a group of borrowers, except for guarantees granted by a borrower to secure a third party indebtedness.

The major part of the growth in credit risk (including in respect of problematic debts) is in the hotel, communications, computer services and the industrial sectors, which was partly offset by the decrease in other economic sectors.

Arrangement with Creditors regarding the "Tevel" group. In accordance with the various regulatory approvals granted in the matter of the arrangement with creditors relating to the "Tevel" group, the banks participating in the arrangement, including the Bank, (hereinafter in this section – "the banks") are required to sell all their shares in "Tevel" within two years from date of the arrangement, namely, by the end of 2005. During 2005, the banks conducted intensive negotiations with the shareholders of the TV cable companies for the merger of these companies, on the background of preparations made by the banks towards the start of a public process for the sale of the shares in "Tevel".

The banks and the shareholders of the TV cable companies have recently concluded the main principles for the merger of the cable companies, except for the financing terms for the merged company, which is still in dispute. The banks are expected to hold the shares of the merged company separately from one another and at a cumulative rate, which will not

exceed 30% (the Bank is expected to hold about 2.7% of the shares in the merged company).
As part of the merger, MATAV will absorb the activities of the other cable companies and will issue to the shareholders of the other cable companies shares in the merged company, in accordance with the proportionate number of subscribers of each of the companies. Prior to the merger, Tevel is expected to sell to MATAV subscribers at a price reflecting a gross value of US$1,350 per subscriber.
The agreement in principle between the parties is subject, among other things, to the signing of final agreements by the parties, to an agreement regarding the issue of financing, to approval of the relevant organs of the entities involved, to the approval of the shareholders of MATAV, as well as various regulatory approvals. The trustee for the creditor arragnegment is acting to receive the required regulatory approvals in order that Tevel shares will continue to be jointly held by the banks, and this in order to enable the parties to complete the merger proceedings.
A draft of a directive regarding the "Measurement and disclosure of problematic debts and provision for doubtful debts in financial statements of banking corporations". On February 8, 2004, the Supervisor of Banks delivered to the banks a preliminary draft of a directive regarding the "Measurement and disclosure of problematic debts and provision for doubtful debts in financial statements of banking corporations".
The principal subject of this directive, which is intended to replace the existing directive, is the adjustment of the set of terms and definitions customary in Israel to those accepted by the banking industry in the world, and in particular in the United States, as well as to the recommendations of the Basel International Committee on Supervision of Banks.
Inter-alia, the draft directive addresses the following issues:
- The provision for doubtful debts regarding large debts will be based on the discounted value of future cash flows expected to be derived from such debts or, under certain circumstances, on the basis of the market value of the collateral at hand.
- In respect of each delinquent debt (as defined in the draft instruction) the banking corporation would be entitled to recognize income only in respect of actual cash collected.
- The provision for doubtful debts in respect of consumer debts will be based on group risk coefficients in accordance with borrower characteristics.

Following receipt of the draft directive the Bank has begun to study and analyze it, including attempts to assess its effect upon the Bank. In March 2005 a draft of "Questions & Answers" was published regarding this issue.
The preliminary draft presents a completely new model for the definition and measurement of problematic debts, which raises questions of interpretation and implementation, and many more questions will probably emerge in the process of incorporating the provisions of the new instruction into the process of treatment of problematic debts at the Bank.
These questions will probably require, on the one hand, clarifications and further guidelines by the Supervisor of Banks, and on the other hand, internal processes of policy determination, both as to interpretation and implementation. It should be mentioned that the proposed model assuems the completion of the anticipated change in the management of credit lines in accordance with the directives of the Supervisor of Banks in this respect (see above).
In addition, the existing information and measurement systems are based upon the existing model, which, as stated, is very different from the proposed model, and therefore the Bank is not able, at this stage, to provide the relevant information necessary to assess the effects of the implementation of the new model.
In view of the above, it is not possible, at this stage, to evaluate the effect of the implementation of the new model on the volume of problematic debts of the Bank and on the volume of the doubtful debt expense. Nonetheless, it is already clear that the

implementation of the new instruction will increase the volume of debts in respect of which interest income would not be currently recognized but only upon actual collection, as a result of their being defined as delinquent debts. This relates, inter-alia, to debts defined at present as partly doubtful but income bearing, and to debts defined at present as temporarily in arrears.

THE FOLLOWING IS A REVIEW OF THE DEVELOPMENT OF CREDIT TO THE PUBLIC BY ECONOMIC SECTORS:

Balance sheet credit risk for the construction and real estate sector totalled NIS 15.2 billion as at December 31, 2005, compared with NIS 14.6 billion on December 31, 2004, an increase of 4%, which constituted about 17.1% of the total balance sheet credit risk to the public, compared with 17.9% on December 31, 2004. Off-balance sheet credit risk for the construction and real estate sector (mostly sales guarantees and non-utilized credit lines) amounted to NIS 9.1 billion as at December 31, 2005, compared with NIS 7.6 billion on December 31, 2004, and it constituted 16.8% of the off-balance sheet credit risk, compared with 17.5% as at December 31, 2004.

Off-balance sheet credit risk for this sector, as at December 31, 2005, includes NIS 3.9 billion in respect of non-utilized credit lines.

Total credit risk for the construction and real estate sector constituted 17.0% of the total credit risk to the public as at December 31, 2005, compared with 17.8% on December 31, 2004.

Total credit risk for the industrial sectors totalled NIS 27.2 billion as at December 31, 2005, compared with NIS 23.4 billion at December 31, 2004, an increase of 16%, and it constituted 19% of the total credit risk to the public under the Group's responsibility, compared with 18.7% as at December 31, 2004. Credit to industry is extended to a large number of customers in various industrial sectors.

Included within the framework of credit to industry is credit to the diamond industry with a small spread. The Bank's total credit risk to the diamond industry as at December 31, 2005 totalled NIS 3.9 billion, compared with NIS 3.6 billion as at December 2004.

Total credit risk for the commercial sector amounted to NIS 19.5 billion as at December 31, 2005, compared with NIS 15.9 billion as at December 31, 2004, an increase of 23%, and it constituted 13.7% of the total credit risk to the public, compared with 12.7% the preceding year.

Total credit risk to individuals was NIS 29.6 billion as at December 31, 2005, compared with NIS 26.9 billion as at December 31, 2004, a decline of 10%, and it constituted 20.7% of the total credit risk to the public, as compared with 21.5% as at December 31, 2004.

(It should be noted that the comparative figures relating to 2004 were reclassified).

THE FOLLOWING IS A REVIEW OF DEVELOPMENTS IN CREDIT TO THE PUBLIC, INCLUDING OFF-BALANCE SHEET CREDIT RISK BY BORROWER SIZE:

Approximately 99% of borrowers were granted credit of less than NIS 1.2 million. Credit to this group constituted 27.5% of total credit to the public as at December 31, 2005, compared with 29.2% as at December 31, 2004.

The credit bracket between NIS 1.2 million and NIS 200 million constitutes about 59.4% of all credit as at December 31, 2005, compared with 58.6% as at December 31, 2004.

The 50 largest borrowers, in the credit bracket between NIS 200 million and NIS 1,200 million, were granted credit constituting 13.1% of total credit as at December 31, 2005, compared with 36 borrowers that were granted credit constituting 12.2% of the total credit as at December 31, 2004.

Credit granted to the Government - totalled NIS 92 million as at December 31, 2005, compared with 271 million as at end of 2004, a decrease of NIS 179 million (66.1%).

Securities totalled NIS 42,188 million as at December 31, 2005, compared with NIS 40,068 million at the end of 2004, an increase of 5.3%.

Following is the composition of the securities portfolio by linkage segments:

	December 31		Rate of
	2005	2004	change
	(in NIS millions)		in %
Non-linked shekels	15,089	12,784	18.0
CPI-linked shekels	708	1,978	(64.2)
Foreign currency and foreign currency-linked shekels	25,328	24,401	3.8
Shares - non-monetary items	1,063	905	17.5
Total	42,188	40,068	5.3

In accordance with directives of the Supervisor of Banks, securities have been classified into three categories: held-to-maturity bonds portfolio, available-for-sale securities portfolio, and trading securities portfolio.

Following is the composition of investments in securities according to the above categories:

	December 31, 2005			December 31, 2004		
	Net adjusted cost	Fair value	Book value	Net adjusted cost	Fair value	Book value
	In NIS millions					
Bonds						
Held-to-maturity	5,833	5,784	5,833	5,566	5,559	5,566
Available-for-sale	32,657	32,617	32,617	30,649	30,891	30,891
Trading	2,659	2,675	2,675	2,677	2,706	2,706
Shares						
Available-for-sale	994	1,060	1,060	883	894	894
Trading	4	3	3	10	11	11
Total Securities	42,147	42,139	42,188	39,785	40,061	40,068

Deposits from the public as at December 31, 2005, totalled NIS 130,300 million, compared with NIS 121,974 million at the end of the preceding year, an increase of 6.8%.

Following is data on the composition of deposits from the public by linkage segments:

	December 31, 2005		December 31, 2004		
	In NIS millions	% of total deposits from public	In NIS millions	% of total deposits from public	Rate of change in %
Non-linked shekels	46,236	35.5	45,415	37.2	1.8
CPI-linked shekels	12,947	9.9	14,872	12.2	(12.9)
Foreign currency and foreign currency-linked shekels	71,117	54.6	61,687	50.6	15.3
Total	130,300	100.0	121,974	100.0	6.8

The ratio of total credit to the public to deposits from the public was 64.4 % at the end of 2005, compared with 63.6% at the end of the previous year.

FIXED ASSETS AND INSTALLATIONS

BUILDINGS AND EQUIPMENT

At the end of 2005, the investment in buildings and equipment amounted to NIS 2,268 million, compared with NIS 1,978 million at he end of 2004, a decrease of 14.7%.

Most of the premises on which the business of the Bank is conducted in Israel are owned directly by the Bank or by its auxiliary corporations.

The total office space at the Bank's disposal at December 31, 2005, was 131 thousand square meters, compared with 138 thousand square meters at the end of 2004. Of this area, 85 thousand square meters were freehold property and 45 thousand square meters leasehold property (2004: 87 thousand square meters were freehold property and 51 thousand square meters leasehold property). At the end of 2005, some 68 thousand square meters served the Bank's branches and the balance served the head office, compared with 71 thousand square meters in 2004.

For details as to the Bank's investments in buildings and equipment, see Note 7 to the financial statements.

THE ACQUISITION OF OFFICE SPACE IN THE "DISCOUNT TOWER" ON YEHUDA HALEVI STREET

In July 2005, the Bank entered into an agreement with Meshulam Levinstein Buildings (1986) Ltd. (hereinafter – "the Company") for the purchase from the Company of office space of 12.5 thousand square meters, basement and parking areas with regard to the "Discount Tower" which is being constructed on Yehuda Halevi Street.

Upon the signing of the said agreement, the commitment of the Bank, pursuant to an agreement dated June 2002, for the lease for a period of thirteen years of an office space of about 11.6 thousand square meters, basement and parking areas (hereinafter – "the Lease Agreement") was cancelled. For additional details as to the Lease Agreement, see Notes 19 C and 22 A to the financial statements.

The Bank has also entered into an agreement with Meshulam Levinstein Contracting Ltd. and Engineering (the parent company of the Company) to supply construction services in respect of an additional 4 thousand square meters in the "Discount Tower".

The total cost of the area, which the Bank will receive in the Tower, including betterment levy, acquisition tax and value added tax, amounts to US$67 million.

According to the Lease Agreement, the lease payments would have been translated from US Dollars into Shekels at the Dollar exchange rate at date of delivery, and would have been linked to the CPI as of that date. In accordance with the provisions of FAS-133, the Bank has treated the Lease Agreement as a combined agreement comprised of a Shekel lease agreement (the host agreement) and a forward transaction (embedded derivative instrument). In view of the said annulment of the Lease Agreement, a loss of NIS 47 million was recognized in the financial statements, resulting from writing off the balance of the fair value of the said forward transaction.

In addition, and further to the said agreement of June 2002, the Bank and the Company have settled the scope of the building rights attached to the property to be acquired, which would enable the construction of 8.8 thousand square meters in the Discount Tower (deriving from the new Urban Planning Regulations published in March 2005 for taking effect), and also settled the accounts between them in respect of the adaptation of the areas.

In respect of the above, the Bank recognized a gain of NIS 11 million.

COMPUTER SYSTEM

The data processing system at Discount Bank is a central system comprised of mainframe computers (hereinafter: "MF") at the Bank's computer center and workstations at the branches and at the head office units.

The central system is presently based on Unisys computers that operate in conjunction with IBM computer. The Bank is currently in the midst of a project for the conversion of the banking data systems from Unisys computers to IBM computers (see "Conversion of the central computer system" hereunder). Until this project is completed, the computers will operate in co-existence.
The MF systems of the Bank are installed in two different locations, the primary system in Tel-Aviv, and the secondary system in Rishon Le'Zion. The secondary system was moved to Rishon Le'Zion three years ago creating a distance between the two systems in order to increase the survival of the Bank's data systems.
The Bank's back-up system policy ("hot back-up") is characterized by the two computers being simultaneously updated with the movements effected at the branches of the Bank (monetary movements), and accordingly, in case of a breakdown at the main computer location, the secondary location takes over without losing even a single movement.
The two computer sites of the Bank's, in Tel-Aviv and in Rishon Le'Zion, are inter-connected by optical fibers in two separate channels.
In these locations are also found the EMC disc systems, cassette robots, central printers and other peripheral equipment required for the operations of the Bank. It is needless to note that this equipment has also a back-up at the two locations.
The branches and the head office units are connected to the computer center by way of two communication lines. Both lines operate simultaneously and provide a bandwidth of 3MB. In the event of a breakdown, one line provides back up for the active applications on the other line, and vice versa.
Direct banking services are provided by the Bank through a wide range of means: Internet, information stations (information kiosks), automatic teller machines, computerized vocal response and others. These services interface with the central computer for obtaining and updating data, by way of designated servers using advance technology for data security.
Serving the customers of the Bank, are over 400 information stations providing information and allowing customer initiated transactions in a wide range of services ("Mashov Discount"). The Bank is preparing to replace these stations in the course of 2006, with modern and advanced automatic stations of their kind.
The abovementioned systems serve both Discount Bank and Mercantile Discount Bank.
It should be noted that some 6,000 work stations (PC's) are installed at the branches of the Bank and at head office units as well as about 400 servers, which provide services to both internal and external customers.

CONVERSION OF THE CENTRAL COMPUTER SYSTEM

BACKGROUND

In the 1970's the Bank decided to base its electronic data processing (EDP) systems on the computers of the Burroughs Company (which later merged with Unisys). It should be mentioned that at that time and at points of decision in the 1980's, all other banks in Israel decided to base their EDP systems on IBM computers.
Over the years since the 1970's, various processes have taken place in EDP in general and in bank EDP in particular, which changed considerably the status and concept of EDP as well as the status of equipment suppliers.
Following are the main changes:
EDP systems at banks became the backbone on which the activity of banks is based. The basic systems turned into the "system core" on which were based hundreds of additional systems located on the central computer or on subsidiary computers, all these systems being inter-connected for the transfer of data.

a. Differences in the implementation concept for the different systems as well as the technology, accompanied by the "aging" of the basic systems and the increasing

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14 May 1948, Dizengoff House, Tel Aviv.
David Ben Gurion declares the establishment of the state of Israel.
Discount Bank gets ready to serve the new state and its residents.

One day after the declaration of the establishment of the nascent state, the War of Independence breaks out. A heavy price is paid for political independence. Achieving economic independence is no easier.

The young country is faced with difficult tasks: many factories are destroyed; many workers are mobilized and removed from the production cycle. The war effort has to be funded and there are hundreds of thousands of new immigrants to absorb.

Israel Discount Bank joins the effort: it helps to recruit funds from foreign parties by opening branches abroad, encourages its customers to purchase national loans, invests in government treasury bills, participates in development of industrial projects to generate more jobs, and opens branches in the three large cities to serve the country's growing population.

Partnership, belonging, responsibility. These values continue to guide the bank today.

The National Loan Calls. The first Discount Bank administration building on Yehuda Halevi Street in Tel Aviv.


המלוה הלאומי
קורא לך!

shortage of skilled staff with expertise in the systems, turned the EDP system of the Bank over the years into a most complex system as far as understanding and maintenance were concerned. As difficulties and complexities increased so did human resources involved in operating the system (implementation staff, operation/infrastructure systems staff, computer operators, development staff, organization and systems staff, user assistance staff, data security staff, EDP audit staff, quality assurance staff, acceptance tests staff, etc.). As a result, the process of introducing changes to existing systems or introducing new systems at the Bank became a very long one, extremely expensive and requires maximum attention, in order that the change would not destroy the texture of the systems and the delicate and fragile equilibrium existing among them. The cost of maintenance of the EDP systems also increased over the years.

b. The number of large business entities that based their EDP systems on Unisys computers declined gradually. At the present day, the Bank remained the only place in Israel where business activity is based on Unisys computers.

c. IBM established itself as the principal supplier in the world for mega-computers supporting large enterprises, where some 90% of the major banks in the world use IBM computers.

THE CONDITION OF THE EDP SYSTEMS AT THE BANK

Over the years, the Bank has developed effective, efficient and stable EDP solutions for all fields of its activity. The solutions developed compete well with solutions developed by other banks in Israel. These systems may continue and serve the Bank for many more years, provided the necessary maintenance measures are applied.

DECISION OF THE BANK TO DEPART FROM UNISYS

At the end of the 1990's only a few large enterprises in Israel remained with Unisys computers, one of which had already decided at the beginning of the 90's to change to another main computer.

The belief that the Bank is to remain the only customer of this technology in Israel, a matter that in itself presents a risk, induced the Board of Directors, still in 1998, to adopt a strategic resolution of changing from Unisys to IBM.

Electing the IBM computers stemmed rather from the lack of another practical alternative, considering also that this alternative serves all the major banks in Israel.

THE PROJECT OF CONVERTING THE BANK'S SYSTEMS TO IBM

A consolidated subsidiary of the Bank – "Badal" Computer and Management Services Ltd. – entered, into an agreement on May 26, 1998 with IBM Israel Ltd. ("IBM") whereby Badal would purchase IBM computers and peripheral equipment, and that IBM would convert the central computer system of the Bank to IBM computers, on a "turnkey project" basis.

The consideration for this engagement was US$18 million (excluding VAT), of which US$8 million had been paid by June 30, 1999.

The project was supposed to automatically convert the systems of the Bank to the IBM platform, using a system by which the systems would be converted "as is", with no change in their behavior or in the data they manage. This was unsuccessful, and in June 1999, the consolidated subsidiary of the Bank informed IBM of the termination of the engagement between them as the format for executing the conversion was found to be inapplicable.

BIRTH OF THE OFEK PROJECT

Following the failure of the trial to convert to IBM computers, the Bank has formed a workplan for the execution of a project, the essence of which is the renovation of the Bank's central EDP system infrastructure, while replacing the existing operating system with that

of IBM's operating system. In this respect, the Bank has completed the process of identifying a "software package" that would replace, subject to the necessary modifications, most of the existing banking software.
The Bank went through a systematic and orderly process of identifying alternatives and the election of a product that will serve as a basis for conversion, being assisted by Gartner, Tower Group and Data Monitor consulting companies.
After examining several alternatives, the Bank elected to base the conversion on the Alta Mira product, which at the time was in operation at about 80 banks all over the world, with the assistance of Accenture Consulting Company, which specializes in projects of this nature, for the execution of the project itself.
The Alta Mira project has been defined as a basic product, on which modifications are to be made by the "Buy and build" method.
In October 2001, the Bank entered into an agreement with Accenture Ltd. (an Israeli corporation) and with Alnova Technologies Corporation SL, both of the Accenture International Group, for the purchase of the "Core Banking" system for the providing of services, and for the modification of the system to the needs of the Bank as well as for its absorption at the Bank.

THE OFEK PROJECT

The Ofek Project was started at the end of 2001, relying on the work methods of Accenture. The first stage in the development of the system acquired was the definition of the modification processes required for its adaptation to the Bank (PDP). In this respect and alongside the detailed examination of the different modules, the required software changes, the order of development and the solutions for the "co-existence" period have been defined. Based on the differences that had been mapped, and the experience of Accenture in conducting similar projects in other countries, a work plan was devised for the whole project, including principal milestones, as well as a budgetary framework for the execution of the project. Management and the Board of Directors have approved the result of the PDP process as well as the work plan and the budgetary framework. The original budgetary framework stood at US$116 million (excluding VAT).
Besides Accenture, which leads the project together with the Bank, several leading Israeli software companies participate in the project, amongst which are: Matrix, Ness Technologies, Teldor, Tescom, TessNet and IBM.

THE FIRST ROLL OUT

The first stage of the project has been defined as a pioneer stage, at the end of which a conclusion will be drawn regarding the manner of execution of the project and the work plan will be updated accordingly.
The execution of this stage – roll out No.1 – met with many difficulties, both because of external factors (the Intifada and the Iraq War) and because of the difficulty of the Bank to come to grips with such an enormous and complex project (professional, administrative and other difficulties).
The first roll out included infrastructure systems and the customer management system. At the end of October 2003, the first stage of the system was installed in all branches of the Bank and is operating successfully.
The difficulties described above caused a delay of five months in the launching of the first stage of the project (even though, as stated, it was very successfully launched), and the delay appearing with respect to future roll outs was getting longer.
The conclusions drawn from the first roll out. Following the delay in the time schedule, as well as the increase in costs, the Bank executed at the end of 2003 a process of inquiry and the drawing of conclusions.
Following this process, the Bank has made organizational changes for the execution of the

project; certain adaptations were made to the contents of the project, while increasing the contents in certain areas and reducing it in other areas. The Board also approved an expansion of the budgetary framework of the project as well as a delay in the time schedule for completing the project, which, at the time, was estimated at one additional year (namely, completion of the project by the end of 2006). Following the update, the budget for the project has increased to US$155 million (excluding VAT). This budget includes the direct cost of the project, but not indirect expenses in respect of the project and in respect of its effect on the current conduct of the Bank. In addition, the project was divided into seven stages instead of ten.

SECOND ROLL OUT

During the second half of 2004, additional systems were installed within the framework of the second roll out, including a significant system concerning deposits that was launched successfully in December 2004. Following the launching of this system, several failures have been discovered (most of them repaired), including the non-presentation of data relating to deposits in foreign currency at the automatic service machines (though this data was recorded in the central EDP system), and a failure as a result of which notices to customers have not been issued in time regarding deposits entries made and notices as to future maturities of deposits.

Towards implementation of the second stage in which, as stated, the leading system was the deposit management system at the Bank, the Bank upgraded the professional and administrative abilities of the project, and indeed, as stated, the second stage was launched successfully in December 2004. However, this stage was also not implemented according to the set time schedules (as updated) and also deviated from the updated budget.

The conclusions drawn from the second roll out. Examination of the reasons for the deviation from the time schedule and from the budget utilization shows that the deviations stemmed from two main reasons:

a. Increasing the demands from the system well in excess of those mapped at the PDP stage (this increase in demands resulted mostly from new regulatory requirements that demanded EDP preparations)
b. A professional difficulty, greater than expected in executing such a large and complex project (this stage handled for the first time the core banking systems, therefore only then was the whole complexity and fragility inherent in banking systems exposed in full).

As a result of the conclusions drawn from the second roll out, the third roll out has been re-planned (as was the execution of all projects relating to the fourth roll out). Following this, Management of the Bank has prepared an update of the budget required for the second roll out (based on the actual cost) and of the budgets for the third and fourth roll outs. An update for the fifth roll out will be made, if necessary, with the progress of the project and the preparation of a detailed planning of these roll out.

This budgetary update was discussed in March 2005 by the Computerization Committee of the Board, which decided to recommend to the Board that the budget be increased to US$185 million, excluding VAT (namely: US$216 million including VAT). The Board of Directors approved the said increase in April 2005.

An amount of US$127 million has been invested in the project by December 31, 2005, excluding VAT (for details of software development costs that were capitalized, and the amortization of costs so capitalized in respect of systems put into operation, see Note 7 to the financial statements).

As of the end of 2005, the implementation and use at Discount Bank and at Mercantile discount Bank of about 40% of the Ofek Project has been completed. The third roll out system is undergoing tests, and the fourth roll out system is at various stages of installation and implementation. Concurrently work has begun on various systems from fifth roll out and onwards.

According to the plan, third roll out is to be completed in 2006, including its installation and implementation at Discount Bank and at Mercantile Discount Bank. Once the implementation of the third roll out is completed, approximately 70% of the Ofek Project will be completed.

TAXATION

GENERAL

The provisions of the Income Tax Law (Adjustments for inflation), 1985, apply to the Bank. The Bank is considered a financial institution under the Value Added Tax Law, 1975, and as such it is chargeable to payroll tax and to profit tax at the rate of 17% of the payroll expense and of the profit, respectively.
The carry forward losses and deductions for tax purposes and the net timing differences (including in respect of earnings or losses, as the case may be respectively, that were taken to a capital reserve in respect of available-for-sale securities), in respect of which no deferred tax assets have been recorded as of December 31, 2005, were NIS 878 million for the Bank and NIS 959 million consolidated (December 31, 2004: Bank – NIS 1,029 million, consolidated – NIS 1,069 million).

THE VALUE ADDED TAX LAW AMENDMENT – 1975 – AMENDMENT OF THE DEFINITION OF THE TERM "WAGES"

The Economic Policy Law for the fiscal year 2005 (Legislation Amendments) – 2005, passed the second and third readings by the Knesset on March 29, 2005, in which the definition of wages, in respect of the payment of payroll tax by financial institutions, was expanded to also include all the benefits that a financial institution pays its employees, such as: a grant payable upon retirement or death, excluding an award paid by a provident fund, or paid out of funds that had been deposited with a provident fund and later withdrawn by the employer for the purpose of payment of the award and any amount paid by an employer to a supplemental education fund or to a provident fund on the employee's behalf even if they are exempt from tax upon transfer to the fund (and where no employee benefit value has been charged in their respect in accordance with Section 3 of the Ordinance). The Amendment is effective commencing January 1, 2005.
The said amendment has an effect on the payment of payroll tax in respect of amounts payable by the Bank to its employees, and on the increase in the payroll expense of the Group. The Bank and its subsidiaries recorded in 2005 an expense of NIS 49 million in respect of the above.

REDUCTION IN TAX RATES

On July 25, 2005, the Knesset passed the Income Tax Ordinance Amendment Law (No.147 and Temporary Provision) – 2005 (hereinafter – "the Amendment"). The Amendment provides for a gradual reduction in the rate of company tax, as follows: a rate of 31% for 2006, a rate of 29% for 2007, a rate of 27% for 2008, a rate of 26% in 2009 and a rate of 25% for 2010 and thereafter.
The provision for taxes on the Bank's earnings and of subsidiaries that are considered "financial institutions", includes profit tax under the Value Added Tax Law. Accordingly, the statutory tax rate applying to the Bank and the said consolidated subsidiaries in 2006 is 41.03%, in 2007 – 39.32%, in 2008 – 37.61%, in 2009 – 36.75% and as from 2010 a tax rate of 35.90% will apply.
For details regarding the effect of the change on the outstanding balances of deferred taxes as of December 31, 2005, see Note 29 to the financial statements.

CAPITAL RESOURCES

COMPONENTS OF CAPITAL

The Bank's capital resources as at December 31, 2005, including minority interest, totalled NIS 7,185 million, compared with NIS 6,835 million at the end of the preceding year, an increase of 5.1%.

Shareholders' equity as at December 31, 2005, totalled NIS 6,718 million, compared with NIS 6,383 million at the end of the preceding year, an increase of 5.2%.

The increase in shareholders' equity in 2005, resulted, inter-alia, from an increase of NIS 134 million in the component representing the net adjustments to fair value of available-for-sale securities, net of the tax effect.

The ratio of shareholders' equity, including minority interest, to total assets as at December 31, 2005, stood at 4.6%, compared with 4.8% at the end of the preceding year.

Ratio of primary capital to risk assets as of December 31, 2005, reached a rate of 6.66%, compared with 6.88% at the end of the preceding year.

The ratio of capital to risk assets stood at 9.38% on December 31, 2005, compared with 9.76% at the end of 2004.

Tier II Capital - According to Bank of Israel directives, Tier II Capital serves as a component of total capital for the purpose of calculating the ratio of capital to risk assets. Tier II Capital is composed of, inter alia, subordinated capital notes and the general provision for doubtful debts.

The Bank's Tier II capital totalled NIS 3,796 million as at December 31, 2005, including NIS 3,539 million of subordinated capital notes and NIS 254 million of general provision for doubtful debts.

During 2005, the Group issued certificates of deposit - subordinated capital notes totalling NIS 644 million, partly with the aim of improving its capital adequacy ratio and partly for the purpose of replacing capital notes deducted from the Tier II capital.

The extent of subordinated capital notes is limited to 50% of the primary capital. At December 31, 2005, the Bank exhausted the said limitation (December 31, 2004 – 50.0%).

Tier III Capital – According to the directives of the Bank of Israel, the Tier III capital serves as part of the capital components for the purpose of calculating the ratio of capital to risk assets, but which may be related to market risk only. As of December 31, 2005, capital notes amounting to NIS 37 million, which were deducted from the Tier II capital, were defined as Tier III capital, with the approval of the Bank of Israel.

ISSUE OF SUBORDINATE CAPITAL NOTES

Issue of subordinate capital notes – March 2004. On March 18, 2004, Manpikim – Discount Bank Issues Corporation Ltd. ("Manpikim"), completed an issue of NIS 236 million of subordinate capital notes (series "A"). The proceeds of the issue was deposited in full with the Bank, which is obligated towards the nots holders for the payment in full of the principal, interest, and linkage increments on the capital notes.

The major part of the subordinate capital notes was issued to replace capital notes issued in the past, and which according to direcives of the Bank of Israel will be removed from the second tier capital of the Bank in the course of 2004. The Supervisor of Banks approved the said subordinate capital notes as second tier capital of the Bank.

Additional capital notes in the amount of NIS 264 million, were issued to a subsidiary of Manpikim immediately prior to the publishing of the prospectus. Such capital notes were listed for trading on the stock exchange, and were gradually sold by the said subsidiary, in accordance with the needs of the Bank.

Issue of subordinate capital notes – November 2004. On November 10, 2004, Manpikim successfully concluded an issue of deferred capital notes (series B) in the amount of NIS 73 million. Additional deferred capital notes (series B) in the amount of NIS 227 million, were issued prior to the publication of the Prospectus to a subsidiary of Manpikim and were registered for trading on the stock exchange.

Near to that date, deferred capital notes (series A), in a total amount of NIS 300 million, were registered for trade (these were added to deferred capital notes (series A) of a par value of NIS 500 million that were already traded) of which NIS 40 million were issued to institutional investors, and the balance to a subsidiary of Manpikim.

The deferred capital notes series A and B that were issued to a subsidiary of Manpikim are gradually sold by it, in accordance with the needs of the Bank. The balance of the subordinated capital notes that had not yet been sold by the subsidiary of Manpikim as of December 31, 2004 was NIS 472 million. The proceeds of the issue were deposited with the Bank, which has accepted responsibility towards the note holders for the repayment in full of the principal, interest and linkage increments of all the capital notes.

Most of the said deferred capital notes were issued to replace capital notes that had been issued in the past and which, in accordance with the Bank of Israel directives are to be deducted from the second tier capital of the Bank in the course of the years 2004 – 2005. The Supervisor of Banks approved the said subordinate capital notes as second tier capital of the Bank.

Issue of subordinate capital notes – Mercantile Issues Ltd. On August 23, 2005, Mercantile Issues Ltd., a subsidiary of Mercantile Discount Bank, completed issuing NIS 200 million of deferred capital notes (series A), out of a series of a total of NIS 300 million. which were listed for trading on the Tel-Aviv Stock Exchange.

Mercantile Discount Bank received the approval of the Supervisor of Banks to have the said capital notes included as Mercantile discount Bank's second tier capital. (Accordingly, the said captial notes are considered second tier captial for the purpose of calculating the Bank's capital ratio).

Up to December 31, 2005, Mercantile Discount Bank raised additional secondary capital, out of the same series, of NIS 57 million.

Issue of subordinate capital notes – Discount Mortgage Issues Ltd. On November 23, 2005, Discount Mortgage Issues Ltd., a subsidiary of Discount Mortgage Bank, published a prospectus for issuing of NIS 125 million deferred capital notes (Series "A"), out of a total series of NIS 300 million. Discount Mortgage Bank received the approval of the Supervisor of Banks for inclusion of the said capital notes as part of Discount Mortgage Bank's secondary capital (Accordingly, the said capital notes are considered secondary tier capital for the purpose of calculating the Bank's capital ratio).

Issuance of Capital Notes in 2006. An amount of NIS 439 million of capital notes issued in the past will be deducted in the course of 2006 from the secondary capital of the Bank, used in calculating the ratio of capital to risk assets.

The issuing of such notes requires, among other things, the prior approval of the Bank of Israel. In the estimate of the Bank, maintenance of the capital ratio at its present level would require the issuance of new capital notes in a similar amount.

RATING THE BANK'S LIABILITIES

Ma'alot – The Israeli Securities Rating Company Ltd., has rated the liabilities of the Bank an "AA-" rating. This rating will also apply to all of the Bank's liabilities, including other subordinated debt notes and deposits, all the deposits with the Bank as well as subordinated capital notes issued by Manpikim Discount Bank Issues Corporation.

Midroog Ltd. rated the Bank with an "Aa2" rating with respect to deposits with the Bank and subordinated capital notes issued by the Bank, directly and through Manpikim.

Moody's rated the Bank, based on public information, with an "A2" rating with respect to long-term deposits, and with a "P1-" rating with respect to short-term deposits. Moody's also rated the Bank with a "D+" rating for the financial stability parameter. S&P rated the Bank, based on public information, with a "BBpi" rating.

DIVIDENDS

In recent years, the Bank did not distribute dividends to its shareholders, except on the Cumulative Preference Shares of the Bank, in an annual amount of £24 thousand (see Note 13 B to the financial statements), which the Bank distributes regularly.

The main limitation affecting the ability of the Bank to distribute a dividend in the past two years was the capital base limitation.

For details as to the limitation on the distribution of a dividend out of gains from a possible future sale of IDB New York, see the Section "Agreement with the employees" under "Control of the Bank" hereunder. As to details regarding a limitation set by the Governor of the Bank of Israel in the permit issued to the Bronfman-Schron Group for the acquisition and holding of means of control in the Bank, see "The Governor of the Bank of Israel's permit for the control and holding of means of control in the Bank" under "Control of the Bank" hereunder and Note 32 B to the financial statements.

LIQUIDITY AND THE RAISING OF SOURCES IN THE BANK

GENERAL

The year 2005 has been characterized, among other things, by the continued growth trend of the economy while maintaining financial stability.

Following are the principal factors that affected the asset portfolio held by the public in 2005:

- The Bank of Israel interest rate: in the first quarter of 2005, the interest rate was reduced from 3.9% to a rate of 3.5%. In the second and third quarters of the year the interest rate remained unchanged at 3.5%. In the last quarter of the year the Bank of Israel increased the interest rate to a level of 4.5%. In February 2006, the interest rate increased to 4.75%.
- The weakening of the Shekel against the US Dollar: in line with the strengthening of the US Dollar worldwide it also gained strength against the Shekel
- The devaluation of the Shekel against the Dollar and the rise in oil prices resulted in an increase in inflation. The Consumer Price Index (CPI) rose in 2005 by 2.4%, compared with 1.2% in 2004.
- The improvement in world economy as well as in the domestic economy and the relatively low interest environment brought about the continued trend of rising share prices and long-term (non-linked and CPI linked) bond prices.
- A consecutive gradual increases in monetary interest in the United States.
- 2005 saw the continued decrease in the volume of Government borrowings on the local bond market, following the decrease in the State's budget deficit and the increase in Government income from privatization.

Following the above described developments, the following changes in the asset portfolio of the public were recorded:

- A significant increase in the weight of shares (in Israel and abroad) in the asset portfolio, from a level of 25.3% at the end of 2004 to a level of 29.7% at the end of 2005. The increase stems for the most part from a rise in the weight of shares in Israel.
- A decrease in the weight of non-linked assets, from a level of 31.3% at the end of 2004 to a level of 27.8% at the end of 2005.
- A moderate decrease in the weight of assets likned to the CPI, concurrently with a slight increase in the weight of assets linked to foreign currency. The total weight of these assets stands at about 43%.
- An increase in the weight of medium and long-term assets and a decrease in the weight of short-term assets. About 60% of the assets held by the public at the

end of 2005 were medium term assets, some 23% were short-term assets and 17% were long-term assets.

- An increase in public preference for securities traded on the Stock Exchange, the price of which increased during the year at a high rate compared with bank deposits. A sharp increase was recorded in 2005 in the volume of corporation bond issues. These changes first began in 2004 and continued even more forcefully in 2005.

THE BANK

During the whole of 2005, the Bank maintained a relatively high level of liquidity, both in Israeli and in foreign currency. During the whole of the year, the Bank maintained liquid assets in a volume greater than the total of its liquid liabilities.

Public preference and the raising of resources by the Bank in 2005 were affected, among other things, by the relatively low level of monetary interest rates during most of the year, concurrently with a drop in the return on bonds and the continued trend of increase in share prices.

The developments described above, brought about a change in the liquidity mix of the Bank during 2005: an increase in the liquidity level in foreign currency as against a drop in the liquidity level in Israeli currency.

The non-linked segment. The volume of non-linked deposits of the public with the Bank reached at the end of 2004 an amount of NIS 37.4 billion, compared with NIS 36.8 billion at the end of 2004, an increase of 1.9%.

The volume of interest earning non-linked Shekel deposits of the Bank with the Bank of Israel decreased in 2005, in continuation of the trend that started in the preceding year, from an amount of NIS 0.6 billion at the beginning of the year to a negligible level of NIS 0.1 billion at its end. This drop reflects the change in the resources mix of the Bank's customers.

The CPI linked segment. The total of CPI linked financial resources amounted to NIS 9.7 billion at the end of 2005, compared with NIS 10.9 billion at the end of 2004, a decline of 10.8%. The demand by the public in 2005 for CPI linked deposits was affected by the decline in interest rates, following the decline in the return on bonds and from the transition to marketable assets.

The foreign currency and foreign currency linked segment. The total of deposits of the public in or linked to foreign currency increased in 2005 by 6.6% and reached an amount of US$7.2 billion at the end of the year. The preferences of the public in this sector were affected, among other things, by the increase in the short-term dollar interest rate and by the worldwide strengthening of the US Dollar.

Raising of secondary capital. For details regarding the issuance of secondary capital in 2005 see "Capital resources" above.

Changes in monetary tools. On August 16, 2005, the Bank of Israel advised of changes in the monetary tools for operating the current interest policy. Starting September 1, 2005, the previous system of monetary loan quotas was terminated and in its stead the Bank of Israel began providing the banks with a "monetary loan window" at the rate of 1% above the Bank of Israel interest rate. Concurrently, the Bank of Israel offers the banks a new monetary tool, "deposit window", with the Bank of Israel at a rate of 1% below the Bank of Israel rate. The said tools create an "interest-rate corridor" of a width of 2%, the middle of which being the Bank of Israel interest rate.

EXPOSURE TO RISKS AND RISK MANAGEMENT

GENERAL

The Bank's activity as a financial broker engaged in all fields of financial activities involving risk taking, the principal of which are: credit risks, market risks and liquidity risks. Such risks are accompanied by financial risks resulting from operational and legal risks.

Risk management policy is intended to support the achievement of the Bank's business targets, while evaluating the damage which may result from exposure to such risks and limiting the losses at the various levels of risk.

This policy is based on various forecasts and assessments as to the development of various economic and capital and money markets indices.

The market risks management is performed within the framework of Proper Banking Management Directive No. 339 – "risks management", issued by Bank of Israel in respect of the management and control of financial risks.

The Bank has a committee of risk managers headed by the risk manager of the Bank. The committee's members are the following members of Management:

Mr. Rony Hizkiyahu –	Credit risk manager; As from the beginning of 2006, he serves temporarily also as Risk Manager of the Bank, Market and Liquidity Risk Manager and as Chairman of the Committee (in place of Dr. Amnon Goldschmidt who retired from the Bank at the end of 2005);
Mr. Noam Hanegbi –	Operational risk manager;
Mrs. Ronit Abramson-Rokach –	Legal risk manager.

This committee is engaged in forming the risk management policy of the Bank in the various areas, in identifying new risk areas and risk centers and the ways of treating them, and in initiating changes required in the risk management policy. The committee was also defined as the supreme steering committee in the matter of the preparations of the Bank for the implementation of the "Basel II" guidelines.

The Finance Division, with its risk evaluation department, is responsible for the day to day risk management.

DESCRIPTION OF EXPOSURE TO AND MANAGEMENT OF MARKET RISKS

Market risk – The risk to business results, to equity, to cash flows or to the value of the Bank deriving from changes in interest rates, foreign exchange rates, inflation, prices of securities, product prices, the fluctuations in these parameters and in other economic indices, which have an effect on the assets or liabilities of the Bank.

Management of market risks is mainly intended to manage the economic exposure of the Bank to these risks (principally base risk, interest rates risk and options risk), not all of which are reflected in the financial statements (for example: options imbedded in shekel savings schemes linked to the CPI).

The extent of the exposure to which the Bank wishes to be subject and the decision parameters in this respect, are determined mainly according to evaluations made by the Bank as to the various market characteristics, while complying with the limitations set out by the board of directors.

(1) BASE RISK EXPOSURE

The exposure to base risk is reflected in the loss which may incur as a result of changes in inflation and in exchange rates, due to the difference between amounts of assets and liabilities, including the effect of forward transactions. This exposure is measured in each of the linkage segments: the CPI linked segment, the foreign currency and shekels linked thereto segment and the non-linked shekel segment. The measurement also takes into consideration the effect of options embedded in the base exposure.

The following is a summary of the net linkage balances of the Bank (in NIS millions):

	Non-linked shekels	CPI linked shekels	Foreign currency(*)	Non-monetary asset	Total
	As at December 31, 2005				
Assets	39,251	14,508	34,652	8,513	96,924
Liabilities	41,103	13,259	35,771	73	90,206
Balance sheet difference	(1,852)	1,249	(1,119)	8,440	6,718
Derivatives	2,180	(728)	(1,452)	-	-
Options	159	91	(250)	-	-
Total Difference	487	612	(2,821)	8,440	6,718
	As at December 31, 2004				
Assets	35,082	15,579	32,994	7,418	91,073
Liabilities	38,537	14,520	31,563	67	84,687
Balance sheet difference	(3,455)	1,059	1,431	7,351	6,386
Futures contracts, net	3,343	184	(3,527)	-	-
Options	529	50	(579)	-	-
Total Difference	417	1,293	(2,675)	7,351	6,386

(*) Including foreign currency-linked shekels.

The follow-up of exposure to base risks in the Bank is performed by a daily review of the economic positions of the various linkage bases (as different from the accounting positions) based on unprocessed data.

The policy relating to base risk exposure is being implemented, inter-alia, using derivative financial instruments, which may have a considerable effect on exposure to the various linkage bases.

It is the policy of the Bank to avoid significant exposure to foreign currencies other than to the US dollar. Exposure to these currencies is permitted within the limits approved by the board of directors of the Bank.

Following is the actual exposure at the level of the Bank (not consolidated) as compared to the limitations (The limitations and exposures are stated in relation to the available capital):

Segment of operations	Limitations	December 31, 2005	December 31, 2004	Maximum exposure for the period January - December 2005
Non-linked Shekel	140%-(30%)	99%	42%	110%
CPI linked Shekel	120%-(40%)	1%	48%	49%
Foreign currency	50%-(50%)	0%	10%	9%

The Bank complied with the limitations during 2005.

The maximum linkage based exposure in the current year used for market risks management, reached NIS 799 million in the CPI linked segment, NIS 1,973 million in the non-linked segment, and US$150 million in the foreign currency segment. This is in comparison to NIS (1,035) million in the CPI linked segment, NIS 1,775 million in the non-linked segment, and US$37 million in the foreign currency segment in 2004.

The Boards of Directors of the banking subsidiaries have each determined their policies with respect to the subsidiaries' maximum exposure to base risks.

(2) INTEREST RISK EXPOSURE

Interest risk derives from the exposure to future changes in interest rates and their effect on the present value of assets and liabilities of the Bank. Such changes may adversely affect the earnings and equity of the Bank.

Management of interest risk exposure is performed for each of the linkage segments separately, and is based on various assumptions as to the maturity dates of assets and liabilities.

The interest rate risk, in practice, is managed on the basis of economic exposures, computed on the basis of all the Bank's positions and based on various behavioral assessments as to redemption dates of the assets and liabilities. Among other things, the policy of the Bank is to spread part of the current account balances in the non-linked segment in a uniform quarterly manner over a period of between one and seven years.

The limitation on exposure to interest rate risk in the various linkage segments relates to the maximum loss permitted in a scenario of a 1% parallelogram movement on the yield curve for each segment.

Following is the actual exposure at the level of the Bank (non consolidated) as compared to the limitations:

Segment of operations	Limitations Setout by the Board of Directors	December 31, 2005	December 31, 2004(1)	Maximum exposure for the period January - December 2005
		(In NIS million)		
Non-linked Shekel	180	107	23	109
CPI linked Shekel	180	31	10	33
Foreign currency	100	3	(2)(4)	14
Total segments	320	141	29	156

Note:

(1) The limitations, as of December 31, 2004, were: NIS 120, 180, 60 and 290 million for the non-linked segment, the CPI linked segment, the foreign currency segment and total segments, respectively.

(2) Exposure to reduction in interest.

The Bank complied with the limitations during 2005.

The analysis of exposure of the Bank (non-consolidated) to economic interest rates, presents the following findings:

In the CPI linked segment – In determining the interest rate exposure, the Bank's policy is to include the effect of premature redemptions of savings deposits, in accordance with a model used by the Bank (see hereunder).

The non-linked segment – A high average maturity of assets was maintained in this segment during the year, in comparison to the average maturity of liabilities, with an increase of the interest rate risk in the segment.

In determining the interest rate exposure, the Bank's policy is to consider a part of current account deposit balances in Israeli currency as a liability for a longer period in accordance with a model used by the bank (see hereunder). In contrast, Schedule "D" reflects the current account balances in accordance with directives of the Bank of Israel, under "demand deposits and up to one month".

In the foreign currency segment (including foreign currency linked) – The Bank's policy is to maintain a relatively lower interest rate exposure. Most of the activity is on the basis of variable interest rates. The availability of varied financial instruments in international markets enables the reduction of exposure.

The following is a summary of the Bank's and its consolidated subsidiaries' exposure to fluctuations in interest rates, including the internal rate of return (IRR) and the average maturity, as per the various linkage segments (in NIS millions):

	As at December 31, 2005			As at December 31, 2004		
	Non-linked shekels	CPI linked shekels	Foreign currency[1]	Non-linked shekels	CPI linked shekels	Foreign currency[1]
Total Assets	49,431	21,345	79,063	44,578	22,321	71,282
Total Liabilities	50,669	19,021	77,796	47,997	20,017	67,565
Average maturity (years):						
Assets	0.61	4.08	1.49	0.50	3.79	1.38
Liabilities	0.32	3.64	0.79	0.32	3.45	1.02
Average maturity gap	0.29	0.44	0.70	0.18	0.34	0.36
IRR gap	3.35	1.13	1.30	2.66	1.27	0.93

(1) Including foreign currency-linked shekels.

The data in the Bank's and its consolidated subsidiaries' report on their exposure to fluctuations in interest rates indicates that:

- In the non-linked shekel segment, a gap existed as at December 31, 2005, between the average maturity of liabilities and the average maturity of assets, amounting to 0.29 years, compared with an average maturity gap on December 31, 2004 of 0.18 years.
- In the CPI-linked shekel segment, the average maturity gap between assets and liabilities as at December 31, 2005, was 0.44 years (about 5 months), compared with 0.34 years (about 4 months) on December 31, 2004. Calculation of the average maturity gap includes the effect of early redemption and withdrawals at exit points of savings deposits, based on a model which serves the Bank (see hereunder).
- In the foreign currency segment, including activity in shekels linked to foreign currency, the gap between the average maturity of liabilities and average maturity of assets as at December 31, 2005, was 0.7 years, compared with a gap of 0.36 years on December 31, 2004. The exposure to interest rates in this segment is affected also by the manner in which the Bank finances its investments abroad from the foreign currency sources of the Bank.

(3) OPTION RISKS

Option risks relate to a possible loss deriving from changes in the parameters affecting the value of options, including standard deviation.

The board of directors of the Bank has set out guidelines regarding the permitted activity in options, including also limit on the options activity of the Bank both as regards overall volume and as regards the maximum loss in extreme scenarios and in moderate scenarios. The scenarios relate to simultaneous changes in exchange rates and in the volatility of base assets. Furthermore, the Bank has set out limits on sensitivity indices ("GREEKS") for changes in the value of the foreign currency/shekel options portfolio, managed by the dealing room. The board of directors has also set limitations as to the volume and as to the market risk exposure of activity in foreign currency options.

(4) ACTIVITY IN DERIVATIVE FINANCIAL INSTRUMENTS

The board of directors has determined the mode of operation of the Bank in derivative financial instruments, volume of activity and the range of financial instruments in which the Bank may engage (whether on behalf of customers or for the bank itself). The transactions of the Bank in derivative financial instruments are made partly with banking institutions or Tel-Aviv Stock Exchange members, who are subject to capital adequacy requirements or

compliance with the level of security required by the Tel-Aviv Stock Exchange, and partly with other customers of the Bank, who provide security in accordance with the Bank's procedures.
Such transactions are being made either on behalf of customers or for the Bank itself, both for hedging and for other purposes. The trading desk makes the transactions, inter-alia, for management of the Bank's assets and liabilities as well as for trading. Subject to the limitations setout by the Board of Directors, further internal limitations were fixed for the dealing room with regard to this area of operations.
The Bank is active in a wide range of derivative financial instruments both in shekels and in foreign currency, and acts also as a market maker for some of which. A large part of the transactions are made "over the counter" (OTC) in accordance with customer needs. The price determination for these transactions is based on returns and prices of base assets using accepted pricing models and taking into account market competition.
The exposure created both with regard to linkage base and with regard to interest as a result of this activity, is included in the limitations set by the board of directors on exposure to linkage base, interest and options.

Following are data as to the volume of operation in derivative financial instruments of the Bank and its consolidated subsidiaries (in millions of NIS):

	As at December 31, 2005	As at December 31, 2004
Hedging derivatives	4,483	4,605
ALM derivatives	40,301	32,190
Other derivatives	56,824	38,566
Credit derivatives and SPOT foreign currency	3,423	2,921

Accounting aspects. The accounting policy with regard to the measurement of the value of derivative financial instruments and the results thereof is stated in Note 1(m) and 20 to the financial statements.
According to the said directives of the Supervisor of Banks, most of the transactions in derivative financial instruments made by the Bank for managing market risks resulting from its financial base assets (ALM) are classified as "other transactions" and not as "hedging transactions". In terms of the said directives more stringent criteria have to be complied with so that transactions in derivative financial instruments could be considered as "hedging transactions".
The majority of base assets, the exposure of which to market risk, as stated, was hedged by derivative financial instruments, are not marketable. Income and expenses generated by such assets are recognized on the accrual basis while the results of the transactions in derivative financial instruments defined as "other transactions" are computed, due to the absence of a market, according to "fair value". Accordingly, no correlation exists between the recording of the base assets and the results they produce in accordance with generally accepted accounting principles and the transactions in derivative financial instruments in respect of those base assets, which are classified as "other transactions". The effect of the above was an increase in the earnings from financing operations by NIS 15 million in 2005, compared with a decrease of NIS 16 million in earnings from financing operations in 2004. Details of financing income from derivative financial instruments are presented in Note 23 to the financial statements.
Activity in the Ma'of market. The Bank operates in the Ma'of share index market only on behalf of customers, while maintaining the security level required by the Tel-Aviv Stock Exchange. The Bank operates in options on the dollar exchange rates in the Ma'of market both on customers' behalf and on behalf of the Bank itself. The Bank permits selected customers to operate on credit in the Ma'of market while monitoring closely, on an ongoing basis, the risk involved in the portfolio as compared with security received.

Credit risk involved in financial instruments. The Bank's activity in derivative financial instruments involves special risk factors including credit risks. The credit risk relating to such transactions is derived from the fact that the stated value of the transaction does not necessarily reflect the credit risk involved therein. This risk is measured according to the maximum amount of the loss, which the Bank may incur in case the other party to the transaction will not honor its obligations, net of the effect of enforceable setoff agreements. The credit risk during the period of the engagement is assessed according to the cost of engagement in a similar transaction, had this been entered into at the reporting date with the same customer and for the remaining period until its expiration.

The Bank's policy as to the required security for customer activity in derivative financial instruments is similar to its policy in respect of other credit, except for customer activity in the Ma'of market. The required security may be of different kinds. Furthermore, the Bank may grant the customer a credit line without security, as the case may be. Additional risk factors deriving from transactions of the Bank in derivative financial instruments, is the market liquidity risk resulting from the fact that it is not always possible to eliminate the exposure swiftly, particularly in low trading markets.

The Bank continuously monitors the credit risk inherent the derivative financial instrument activity of major customers.

Considering the fact that the risk involved in derivative financial instrument activity is not market risk only, the board of directors approves a monetary framework for each of these instruments in addition to other limitations applying to the activity in specific instruments.

(5) LIQUIDITY RISK

Liquidity risk is defined as a risk to the profitability of the Bank and its equity resulting from the inability to provide its liquidity requirements. This risk stems from the uncertainty, which may exist as to the availability of liquid sources, the possible necessity to raise funds quickly and unexpectedly as well as from the difficulty arising in a situation where a material realization of assets may be required at a given time and at a reasonable price. The measurement of liquidity risks is intended to provide decision makers with indicators for the identification of situations in which the level of this risk rises. Management of liquidity risks is intended to ensure that the Bank will have sufficient sources of funds to enable it to honor in due time all its obligations without having to incur material costs or losses in the process.

Proper Banking Management Directive regarding liquidity risk management. Proper Banking Management Directive No.342 – "Liquidity risk management", which is effective as of December 31, 2004, requires a banking corporation to determine a comprehensive policy for the management of liquidity risks, quantitative targets, limitation on the liquidity gap and a system for handling deviations. The directive requires that the liquidity gap should be defined according to maturity periods and that sufficient liquid means to cover its liquidity requirements for the coming month be guaranteed, as well as liquidity ratio of assets to liabilities (for a period of up to one month), not be lower than 1, according to the internal model..

The policy document that regulates the management and measurement of the liquidity risk at the Bank was approved during 2004, as required by Directive 342. Several updates were made to the internal model in 2005.

The format for managing and measuring the liquidity risks include, among other things:

- Separation between short-term and long-term liquidity;
- Management of the liquidity risks in the shekel segment (including the CPI linked segment) and in the foreign currency and foreign currency linked segment;
- Differentiation between different types of depositors;
- Computation of the liquidity risk indices determined for each segment, examination of the changes therein and comparing them to the minimum levels fixed.

Management of liquidity risks. The Bank performs an ongoing and organized follow-up of its liquidity positions and of indications as to changes in its liquidity risk. In this regard the Bank applies an internal model, to assess the liquidity risk, the principles of which are as follows: (1) Determination of scenarios in respect of the level of reliance on assets as a source for liquidity and (2) Assumptions as to the possible need for liquidity as a result of the non-recycling of liabilities: withdrawals from current accounts and premature redemption of savings and other deposits.

The limitations define the ratio of liquidity as the total of liquid sources divided by the total possible liquidity requirement (in extreme scenario terms and in more moderate scenario terms). This ratio is to be maintained at over one. A drop in the ratio to below 1 indicates the need for a close examination of the liquidity situation and the adoption of measures to improve it.

In addition the Bank conducts a daily and weekly model comprising an early warning system for exceptional developments in the liquidity risk. The object of the model is to monitor various data, the fluctuations of which may indicate a change in the liquidity situation of the Bank.

During 2005 the Bank maintained a relatively high liquidity level.

(6) THE MAIN CHANGES OCCURRING IN 2005 IN RISK MANAGEMENT POLICY AND PROCEDURES:

- Changes in operating procedures of the risk managers committee;
- Changes in the current account balances spread model;
- Changes in the interest risk limitations of the Bank;
- Increase in the volume of facilities for foreign currency/Shekel options operations and exotic options of types previously approved;
- Changes in the parameters of the internal model for assessing liquidity risks at the Bank.

MEANS OF CONTROL AND APPLICATION OF THE POLICY

(1) ATTITUDE OF THE BOARD OF DIRECTORS TO MARKET RISK MANAGEMENT ISSUES

During the year, the board of directors, the risk management committee of the Board and the audit committee of the Board discussed various issues regarding market risk.

(2) BANK MECHANISM RELATING TO MARKET AND LIQUIDITY RISKS MANAGEMENT ISSUES

The asset and liability management committee of the Bank headed by the President & CEO, which meets once a month, discusses, reports and controls the market and liquidity risk management policy of the Bank. The committee discusses the policy of the Bank relating to market and liquidity risks, subject to the limitations and guidelines set out by the Board.

The exposure to market and liquidity risks position of the Bank is examined and discussed once a week in the Financial Forum headed by the Head of the Finance Division. This forum makes decisions as to short-term exposure which the Bank may face.

Exposure to market risks is reported in the quarterly exposure document submitted to the Board. This document relates also to the other types of exposure as well as to exposure of the principal subsidiaries of the Bank.

The Bank has established in its procedures a mechanism which requires officers taking a risk and the controlling entities to report to the Head of the Finance Division any exceptional events such as a loss which exceeds the determined limit, or a deviation from the limits set. The Head of the Finance Division decides how to deal with such deviations as well as how to react to exceptional developments in the various markets. Deviations, if any, are also brought to the attention of the Board.

(3) INTERNAL CONTROL MECHANISM REGARDING THE PREVENTION OF DEVIATION FROM THE POLICY OF EXPOSURE TO MARKET AND LIQUIDITY RISKS AND ITS MANAGEMENT

The Bank operates control mechanisms for the prevention of deviation from the market and liquidity risks management policy.

The Risk Manager and the various forums for market and liquidity risks management receive periodic reports as to the state of exposure to market risks (VAR, BPV, Stress tests and more) and to liquidity risks (compliance with the limitations of the model, trends, etc.). Deviations are reported to the market and liquidity risk manager.

The Middle Office Unit of the Finance Division performs a general control over the activity of the trading desk, including a measurement and independent reporting of income and compliance with determined risk limitations. Any deviation from the limits is reported to the Risk Manager.

The department for risk evaluation of the Finance Division reports on a monthly basis on the exposure position of the Bank to market risk (in VAR and stress test terms) and on deviations from the determined limits or policy.

The Risk Controller and the Internal Audit Department also perform procedures intended, inter-alia, to identify failure in the risk management process and deviations from policy.

No material deviations were recorded in 2005 in the implementation of the risk policy of the Bank.

(4) MANAGEMENT OF POSITIONS IN THE TRADING PORTFOLIO

Limitations on trading activities are defined in the framework of Board procedures. The limitations relate to portfolio size, types of risks to which the Bank may be exposed, the permitted instruments, factors of management and control.

The trading activity is conducted while measuring, on a daily basis, the compliance with limitations by the person managing the portfolio and periodic control of compliance with the limitations and of the profitability by an independent controller.

The activity in the trading portfolios is performed subject to a daily measurement of compliance with the set limits, made by the portfolio manager, and a monthly control of compliance with the limits and of the performance of the portfolios, made by an independent control factor.

MEASUREMENT OF MARKET AND LIQUIDITY RISKS

(1) MODELS USED FOR MEASURING MARKET AND LIQUIDITY RISKS

Premature redemptions of savings deposits model. Actual management takes into consideration estimates of the Bank as to the amount of premature redemption of savings deposits. The Bank applies a model, which estimates the rate of expected premature redemptions of savings deposits, based upon a long series of historical data, which the Bank maintains. For this purpose, all savings deposits with the Bank were divided into several groups having similar characteristics, and the computations in respect of each such group is made after exclusion of extraordinary effects, and by using a moderating factor giving greater weight to the “decay factor”. The rates of premature redemption are computed as from the end of two years of the life of the deposit and at each exit date until the final date of redemption of the savings deposit.

Background assumptions on which the model is based:

- There is a relationship exists between age of the savings deposits and the rate of premature redemptions thereof.
- It is possible to estimate the rates of withdrawal based on historical data of premature withdrawals from savings deposits of different ages in recent years.
- An indemnification mechanism exists in the case of withdrawal made on a date other than the determined exit dates (“breaking a deposit”).

The internal rate of return and average maturing not including the assumption of premature redemption of savings deposits (the Bank):

	December 31, 2005			December 31, 2004		
	Non-linked	CPI linked	Foreign currency(1)	Non-linked	Foreign currency(1)	CPI linked
Internal rate of return						
Assets	5.20	5.35	3.96	4.81	5.65	3.39
Liabilities	2.11	4.40	2.34	2.54	4.54	2.49
Average maturity						
Assets	0.70	3.67	0.24	0.56	3.37	0.44
Liabilities	0.32	4.00	0.26	0.33	3.92	0.41

(1) including foreign currency - linked shekels.

Creditory current accounts spread model. The Bank assumes that a significant part of the credit balances on current accounts is not expected to be withdrawn immediately. For the purpose of computing interest exposure, the Bank considers the steady amount of these balances as a liability for periods of one to seven years.

(2) THE VALUE AT RISK (VAR)

General. According to directives of the Supervisor of Banks regarding risk management, the Bank is required to manage the exposure to market risk by means of an information system based on an internal model, which enables a current measurement of the Bank's exposure to market risk by assessing the VAR.

The VAR serves as a central indicator of the extent of exposure of the Bank to market risk. An analysis of its results and examination of the changes therein over a period of time, enables Management to receive information regarding the level of market risk involved in all operations of the Bank.

The VAR assesses the maximum damage that might be caused to the Bank as a result of market risks being materialized in a given time period and at a defined statistical security level. This damage reflects the change in the fair value of assets and liabilities and the following erosion in the value of the Bank (in fair value terms).

The VAR limitation was approved at the beginning of 2004, according to which the VAR of the portfolio of the Bank (for a forward period of ten days and at a clarity level of 99%) shall not exceed 3% of the equity capital of the Bank

Assumptions and parameters for computing the VAR. The VAR computation (at the Bank's level) is made, on a weekly basis, by the Iris/Riskpro system. This system assembles the financial data required for risk management and which relates to the variety of financial instruments transacted by the Bank, as well as to market data (such as indices, exchange rates and interest rates), their extent of volatility and the correlation between them.

The VAR computations detailed hereunder were performed by the parametric method, at a security level of 99%, and for a time period of ten days.

	2005			2004		
	At year end	Yearly average	Maximum	At year end	Yearly average	Maximum
Estimate of VAR amount (in NIS millions)	60.9	46.3	78.7	31.6	44.7	66.2

Analysis of the VAR results shows that the main risk derives from the interest rate exposure of the Bank, in the CPI linked shekel segment, and, to a lesser extent, in the non-linked shekel segment. The weight of the VAR in relation to the shareholders' equity of the Bank as of December 31, 2005, stands at 0.9%, compared with 0.5% at the end of 2004.

Limitations of the VAR model. The results produced by the VAR model do not serve as a blocking device for possible losses that may be created in various extreme circumstances. Inter-alia, the model is limited as regards the following points:

- The model assumes that the changes in risk factors are divided normally. Accordingly, a sudden and extreme change in a risk factor cannot be forecasted by the model;
- The computation of the VAR for a holding period of ten days assumes that the positions are realizable or could be terminated within that period. In certain market circumstances such an assumption may not materialize;
- The use of historic data, is by its nature, limited to events that happened in the reported time period, which may not include particularly extreme events (to overcome this limitation, the Bank is performing an analysis of the losses under stress tests, as described hereunder);
- In computing the VAR using a clear security level of 99%, losses that might be incurred at a lower level of probability, are ignored.

(3) LOSS ANALYSIS IN EXTREME SCENARIOS (STRESS TESTS)

One of the objects of the risk management process is to protect the Bank against a devastating loss in the event of extreme scenarios. Even though the VAR is the most suitable measurement tool for assessing market risk, it does not provide information as to losses that may occur in "abnormal" market situations, which exceed the clear levels which had been determined.

Stress tests enable the examination if the possible implications of remote events that are not envisioned in statistical models, but which are still possible. Such events may be related to an economic crisis, such as war, political instability, natural disasters, and reflected in significant changes in interest rates, exchange rates, and others. Evaluation of the loss potential in such circumstances will provide the Bank with data concerning the extent of its exposure to market risks in extreme situations.

The Bank has established a stress test forum that examines, at least once in every quarter, extreme scenarios. The forum meets in accordance with determined procedures and its members are the Chief Economist, representatives of the ALM, risk evaluation, dealing room departments as well as the Risk Controller. The Head of the Finance Division chairs the forum. The forum reviews the results of defined scenarios and examines their effect on the portfolio of the Bank. The forum also suggests changes in scenarios and additional extreme scenarios, which should be examined.

The stress tests used by the Bank were updated in 2005.

(4) THE NET INTEREST INCOME (NII) MODEL AND THE EARNINGS AT RISK (EAR) INDEX

In 2004, the Bank began calculating a dynamic simulation of the net interest income of the Bank for the next two years, in order to examine the effect of various strategies of asset and liability management of the Bank on its future interest income.

The Bank assesses the sensitivity to changes in market yields of the forecasted interest income by way of the EAR index. This index serves as an additional risk index to that of the VAR, which measures the market risk in terms of the possible effect on the economic value of the Bank.

(5) INTERNAL MODEL – LIQUIDITY RISK

The object of the internal model used for liquidity risk management is to provide decision makers with an additional indicator to identify situations in which the liquidity risk increases.

In the internal model, the Bank classifies its assets and liabilities in accordance with the maturity period on an economic basis, while adjusting assets and liabilities, as follows:

- Assets serving as a reliable source of cash inflow are added to the balance of assets in the maturity period.
- Payments that would bring the balance of liabilities to the amount expected to be redeemed, based on estimate of the Bank, are added or deducted from the balance of liabilities.

The parameters for the classification of assets are based on the assessments of the Bank regarding the quality of borrowers, on the Bank's policy and trends in the financial markets, and the classification of liabilities is based on the rate of recycling according to historical series. In determining the parameters, the Bank takes into account the possible implications on liquidity of other risks, including credit risks, market risks and operational risks. The Bank also takes into account the Bank's goodwill and rating, size of the marketable securities portfolio and its spread, the size of the market and volatility of prices, the structure and spread of deposits, and the effect of flows that are not taken into account in computing the liquidity.

CREDIT RISKS

The Bank's policy in granting credit to the public is intended, inter alia, to secure the quality of the credit portfolio and diversify the risks thereto.

Credit risks are diversified by, inter alia, spreading the credit portfolio over a large number of borrowers, in various economic sectors, with different segments of linkage and over different geographic regions.

The policy of dispersal of the credit portfolio over a large number of borrowers is focused on the relative weight of medium and small borrowers, including expanding the credit to non-business customers in the private banking segment such as households, VIP customers and the international private banking centers.

The Bank grants credit to its customers against various types of collateral, including liquid assets, fixed assets, and various liens and guarantees. The scope and/or the quality of the collateral is derived from the level of risk which the Bank is ready to accept when granting the credit, while putting a special emphasis on the repayment ability of the borrowers. In certain cases, where circumstances justify, the Bank grants credit without collateral and/or subject to conditions of various kinds.

The policy of collateral management and determining the value for security purposes of the various types of collateral, is based on rules and principles determined as part of the Bank's procedures for granting credit.

The collateral is adapted to the type of credit it is supposed to secure, while relating to the time range, linkage base the nature of the credit and its purpose.

Determining the value of the security for collateral is derived from their quality and the ability to realize them quickly, including changes in their value as a result of slowdown or growth situations in the business sector of the borrower.

In granting credit for construction via the "project financing" method, the Bank generally relies for collateral, inter alia, on the amount of equity and on the ownership rights to the land on which the project is built.

With regard to its exposure to foreign currency credit risks, the Bank has prepared itself to minimize the risks stemming from possible fluctuations in the shekel exchange rate, inter alia, by testing the sensitivity of foreign currency borrowers to changes in exchange rates. As to borrowers who have a high exposure to changes in foreign exchange rates, the Bank takes steps, to the extent possible, to reduce the exposure by strengthening the collateral, demanding coverage and hedging transactions and by applying stricter criteria for the approval of credit denominated in foreign currency.

Credit management and the follow-up of the business condition of borrowers are performed at three different levels of activity, as detailed hereunder:

Preliminary examination and approval procedures prior to making credit decisions – The procedures of the credit committees and of the board of directors define the authority for approving credit at committee and loan officer levels, in a manner that will address the need for an effective response to customer needs.

In addition computer programs were developed with a view to improve the decision making process and make it more efficient and to maintain proper control. Furthermore, training programs at various levels are provided for the credit department staff, in order to improve the professional level of loan officers at all levels.

The use of control tools, current analysis and reporting for follow-up and identification of credit risk - The Bank makes current use of analysis and control tools with the aim of identifying quality borrowers and locating as early as possible, borrowers who may prove problematic.

The Bank operates a system for the rating of borrowers' debts, which assesses the level of risk in the liability of various categories of borrowers based on their financial performance, scope and quality of collateral, character of their business sector, their compliance with the credit terms, and others.

The system provides ratings for most of the business and commercial borrowers, which are used by Management in the credit decision making process.

Until the end of March 2006, the Bank rated some 95% of the total indebtedness, which requires rating according to proper banking management instructions issued by the Bank of Israel concerning the rating of credit granted by banks.

The Bank is developing a new indebtedness rating model, as required by the Basel II Principles. This model is intended to improve the rationalization of pricing the credit from the aspect of the relation between the level of risk and the return earned thereon.

Loan review procedures – The Bank has a credit control unit reporting to the Chairman of the Board, which performs follow-up and periodic assessments of the propriety of credit management, the level of credit risk taken, including an assessment of the reliability of the debt rating and quality of the collateral.

In addition, either currently or occasionally, the internal auditing department performs an examination as to the propriety of loan approval processes and their compliance with the various procedures.

Repayment and collection arrangements. In 2005, as in former years, special focus was directed towards the treatment of repayment arrangements and/or collection of problematic debts, with the view of reducing the volume of non-performing debts.

Credit risk in certain economic sectors. Following the deterioration in the security-political situation from the last quarter of 2000, the deepening slowdown of the Israeli economy, and the changing trends in the economy and the capital markets both in Israel and in the world, influenced by the said developments, the Bank performs periodic analysis of the said developments in the various sectors of the economy, which serve to define the proper policy in the matter. It should be noted, however, that, since the first half of 2003, a consistent and continuous improvement in most of the principal indicators in the economy has shown an improvement in the ability of borrowers in most economic sectors to repay.

Note should be made of the strengthening of means of control and follow-up over the activity of borrowers in the following economic sectors:

The communications and computer services sector: Due to the worldwide crisis in the communications sector and especially in the high-tech field, the Bank has increased control over this sector, and, where possible, the increased collateral required and has also tightened demands where new financing applications are concerned. The weight of this segment in the provision for doubtful debts has grown in the course of 2004, mostly as a result of a material provision in respect of a certain borrower, in accordance with directives of the Bank of Israel. Nevertheless, a consistent and continuous improvement has taken place as from the second half of 2003, in the domestic and global communications market, which is reflected in the increase in volume of activity of this industry and an improved repayment capability of most of the borrowers. Following this, the weight of this industry in the provision for doubtful debts decreased in 2005, in comparison to the previous year.

The hotel and related services sector: Due to the security situation in the country, a sharp deterioration has taken place since the last quarter of 2000, in the number of tourists and in the volume of hotel occupancy, and a number of hotels have even closed. The crisis in this sector adversely affected the operations of companies engaged in the sector and in related areas. The Bank has adopted measures to increase supervision, control and the monitoring of operations of companies belonging to this sector. During 2004, the industry has shown a significant improvement reflected in the number of tourists and in the country's overall occupancy rate which increased to 48%. The improvement in this sector continued in 2005, where the national occupancy rate reached 55.4%, an increase of 16% compared with the corresponding period last year. The improvement is reflected, among other things, in the low share of this sector in the provision for doubtful debts.

The industrial sector: As from the second half of 2003, there was an improvement in the volume of activity of companies belonging to the industrial sector, which was reflected in increased production, sales and imported inputs, and in an improved repayment ability of borrowers in this sector. Certain of the borrowers involved in real estate activities do not as yet enjoy improved business conditions. The improvement is reflected in this sector's low share in the provisions for doubtful debts.

The construction and real estate sector: In view of the continuous slowdown in activity in this sector, which is reflected, inter-alia, in reduced demand on the one hand and in a drop in prices on the other, the Bank strengthened control over its customers, increased the collateral where possible and tightened the demands when examining new applications for finance, although the loans in question are generally loans which have been classified as problem loans in the past. Despite the continued slowdown, this sector's share in the provision for doubtful debts was significantly reduced in 2005, compared with the corresponding period last year.

The commercial sector: the slow improvement in the volume of sales in the domestic market, including the increased competition in various commercial fields, particularly among the supermarket and electrical appliances chains, contributed to the continued low operating profit margins of companies in this sector. As a result of the above, this sector's share in the provision for doubtful debts increased in 2005, compared with the corresponding period last year.

Credit risk involved in derivative financial instruments. The control of credit risk involved in derivative financial instruments is effected in the Bank by computer systems designed to measure the exposure at transaction and customer levels. Principles and operating procedures were adopted for determining the required level of collateral for these transactions, including the procedures required to close off the exposure as regards the transaction and the customer.

BASEL II

The targets of "Basel II" are: assuring the stability of the financial system, more comprehensively addressing risks, and the development of capital requirements that would agree with the risk level of each individual bank.

The innovations in Basel II recommendations focus on improving the risk measurement by banking corporations, and in particular credit risks and operational risks and the allocation of capital in their respect. In contrast to the existing situation where capital allocation is required in respect of credit and market risks only, the Basel II recommendations require the allocation of capital also in respect of exposure to operational risks. The Basel II recommendations also allow the use of advanced models for the allocation of capital in respect of credit risk.

The recommendation is composed of three tiers:

- Tier I - minimum capital requirements – the aim is to expand and improve the existing framework of measurement determined in 1988.
- Tier II - expanding the examination process of bank supervisors – including capital adequacy of the financial institution, its management processes and risk assessment.
- Tier III - fair disclosure – by expanding public information as to the risks to which a bank is exposed.

In October 2004, the Supervisor of Banks distributed to the banks a first draft of guidelines concerning the credit rating of companies, banks and countries, which was prepared in the preparations by the Supervisor of Banks in Israel for the application of the Basel Commission principles for the supervision of banks (of June 26, 2004) – "Basel II". This document has been defined by the Supervisor of Banks as the first of a series of steps to eventually apply in Israel a framework for capital adequacy that would comply with the principles of Basel II. From the contents of this document, as well as from the publications of "Basel II", it is assumed that the implementation of the principles and requirements included in this would be a long and resource consuming process.

The draft distributed to the banks determined basic standards for the formation of borrower rating systems, their management, the assessment of risk components and the performance of validity tests as to the systems and assessments. The draft focuses on the control and supervision mechanisms over the rating systems and particularly the involvement of management and the board of directors and their responsibility for the proper operation of the rating systems and the reliability of the rating model.

Despite the uncertainty existing with regard to the exact requirements that would apply to banks in Israel and as to the timetable that would be determined for their application, the Bank already began preparations in this respect.

This preparation includes the study of the Commission's recommendations and the ways for their application. The committee of risk managers at the Bank, headed by the Finance Division Head, is in charge of the preparations, and it has established two steering subcommittees for credit risks and for operational risks. Heading the credit risks subcommittee is the head of the Corporate Division and credit risk manager of the Bank. Heading the operational risk subcommittee is the head of the Operations & Information Division Systems and manager of operational risks at the Bank. The Bank has engaged the services of an outside consulting firm to assist in the Bank's preparations in respect of the above matter. In September 2005, the Bank began the implementation of the first stage of its preparations for the implementation of the guidelines of Basel II. This stage includes the formation of an appropriate risk management strategy, a comprehensive variance analysis and preparing a project plan.

OPERATIONAL RISKS

An operational risk is defined in the directives of the Bank of Israel as a loss risk resulting from faulty data processing systems, human error and the lack of proper checks and controls. Following the publication of the "Basel II" guidelines, the Bank accelerated its inner preparations regarding operational risks. The principle guiding the Bank with respect to operational risks is that readiness to tackl§e this matter is essential, even without considering the allocation of capital for this purpose that would be required in the future. Furthermore, the application of advanced measuring systems, as required by the said guidelines, would require the assembly of extensive and sufficiently comprehensive information over a number of years.

Operational risk management policy. During 2004, the "Operational risk management policy" document was created and approved by the Bank's Management and board of directors.

In 2005 the Bank continued its preparations for the implementation of the policy, including:

- The publication of a comprehensive procedure detailing the responsibility and the method of risk management by the heads of the business units, product managers and headquarters executives;
- A detailed process characterization and information system for operational risk management has been conducted, as a derivative of business processes and operations.

The operational risks forum, headed by the operational risks manager and with the participation of divisional risk controllers met regularly during the year, discussed and approved the processes formed into a procedure and dealt the furthering and coordination of operations for the absorption of the policy in practice.

The mapping and hedging of risks. At the beginning of 2004, a comprehensive survey mapping the operational risks, prepared during 2003 by an independent entity, was submitted to Management. The findings of the review are being dealt with by the various deivision, and the processing of which is about to be concluded.

In the first half of 2005, an individual mapping of the operational risks based on the findings of the survey was accomplished. In the third quarter of 2005, plans for the management and reduction of identified material risks were prepared by the various divisions of the Bank. These plans are to be gradually implemented up to the end of 2006.

Reporting operational failure events. As from the middle of 2004, the Bank set an internal procedure requiring all units of the Bank to submit quarterly reports as to operational risks that have become realized. In this respect, the Bank endeavors to reach extensive reporting that would include also failure events that did not result in a financial loss to the Bank. The purpose of this is the establishment of a wide database that would enable future use of advanced models for operational risk evaluation.

LEGAL RISKS

A legal risk is defined in the directives of the Bank of Israel as the risk of a loss resulting from the lack of ability to enforce the performance of an agreement by legal means.

Among the principal legal risks that may affect the ability of the Bank to enforce an agreement by legal means, the following may be noted:

- Lack of authority and/or lack of legal competence of a party to the agreement;
- Absence of appropriate documents or improper documentation;
- Illegality;
- Insolvency of a party to an agreement with the Bank (a credit risk that exposes the Bank to a situation of legal risk);
- Disappearance of the base asset.

Legal risk management policy. The year 2005 was devoted to the implementation of the legal risk management policy, formed during 2004 and approved by the Bank's management and board of directors. Within this framework, an officer was appointed in charge of the assembly and coordination of information regarding legal risks and the coordination of findings relating to the handling of various matters that emerged from the reports on legal risks, as well as the formation of guidelines with respect to the treatment of agreements and engagements of the Bank, the formation of processes and the design of procedures and routine reporting has begun.

REGULATION RISKS

The Bank and its subsidiaries are exposed to frequent changes in legislation and in various regulatory directives, under which limitations are imposed on the areas of activity and sources of income, at times even retroactively (as in the "Gal Law" and in the legislation concerning local authorities). In addition, these directives may impose various obligations, the implementation of which involves significant costs.

COMPLIANCE RISKS

The activity of the Bank and of its subsidiaries is subject to legislative and regulatory directives both in the field of banking and in other areas, as detailed in the section "Legislation and supervision" hereunder. Frequent changes in legislation and the many regulatory directives that apply to the Bank and to its subsidiaries, require changes in their mode and fields of operation and expose the Bank and its subsidiaries to risks involved in the frequent changes in work procedures, to costs involved in the preparations for the implementation of the new directives and to the exposure steming from the possibility of non-compliance with the provisions of the law and the various regulatory authorities.

Within the framework of the legislation passed in recent years, and in particular the new legislation passed in the wake of the Bachar Committee (see Note 33 to the financial statements), the various regulatory authorities were granted extensive powers to order instructions and guidelines to the entities regulated by them and even impose monetary sanctions on them in case of violation. This state of affairs exposes the Bank and its subsidiaries also to the risk pf monetary sanctions in material amounts.

Procedures and supporting systems. The Bank operates according to a detailed system of procedures, intended to bring about the enforcement of compliance with the various legal and regulatory demands. The procedures are updated from time to time according to the legislative and regulatory directives. Concurrently, the systems supporting the operations are also updated and the employees are trained accordingly.

Control and supervision. Compliance with the provisions of the law and the procedures is enforced on a regular basis by means of various control and supervision systems. Some other control factors also exist, such as the internal audit, the compliance officer and the officer in charge in accordance with the Prohibition of Money Laundering Law.

The internal audit constantly and continuously examines all areas of operation of the Bank. For details of the activities of the internal audit, see the section "The internal audit in the Group" below.

The compliance officer is appointed according to Proper Banking Management Directive No. 308 with the object of assisting the board of directors and management in managing the responsibility for compliance with the instructions of the law and regulations in the consumer area. A compliance officer who reports directly to the President and CEO operates at the Bank under the Chief Legal Advisor. The compliance officer monitors the Bank's preparations for compliance with the law and regulations in the area of bank-customer relations ("consumer instructions"), including consumer instructions relating to the new activities of the Bank, as well as follows the correction of various deficiencies in the matter of compliance to consumer instructions. For the purpose of her work, the compliance officer is assisted by the coordination committee that meets once in every quarter. The compliance officer submits periodic reports to the President and CEO, as well as an annual report to the board of directors. The banking subsidiaries in Israel have also appointed compliance officers in accordance with the said instruction.

The officer in charge of money laundering prohibition was appointed in accordance with the Prohibition of Money Laundering Law and related regulations, and coordinates the activity of the Bank in this respect and in respect of the prohibition of the financing of terror. The banking subsidiaries in Israel have also appointed officers in charge of this issue as required by law. See "Prohibition of Money Laundering Law and Prohibition of the Financing of Terror Law" in the section "Legislation and supervision" below.

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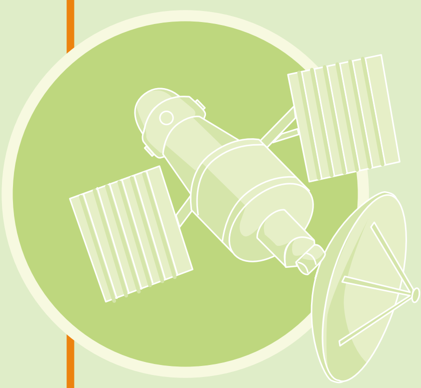
1957. Sputnik, the first satellite, is launched into space. Twelve years later, a man will walk on the moon. The small savings plan also starts with plans for the future.



The fifties are the first years of establishment and of forward thinking. Peace treaties and alliances are being forged around the world. The Superpowers are competing to break into new horizons. There are first signs of recovery in Israel's economy, following the days of war and austerity. There are waves of mass immigration from Northern Africa and Europe. To encourage the public to invest in the future, the government passes the Encouragement of Savings Law.

Israel Discount Bank continues to think about its customers and to help them plan their future. It is the first bank that offers the public a government-approved savings plan: which carries profits, is tax-free, provides benefits and credit, for the small, modest saver as well.

To lead. To plan. To think forward. This is how the breakthrough is made.

The Treasure Trunk. The Pilon Savings plan for Children encourages savings from a young age.

ACTIVITY OF THE GROUP ACCORDING TO PRINCIPAL SEGMENTS OF OPERATION

GENERAL

In December 2001, the Supervisor of Banks in Israel issued directives concerning segment information reporting in a banking corporation, which followed the approval of Accounting Standard No. 11 regarding segment reporting by the Israeli Accounting Standard Board and in view of the application abroad of accounting standards concerning segment information, and in particular the application of the US Accounting Standard FAS 131 (Disclosure about segments of an enterprise and related information), implementing certain modifications concerning the special characteristics of banking corporations, mostly on the basis of the disclosure prevalent in the US banking system.

According to the directives, a segment of operations is a component of a banking corporation having the following three characteristics:

(a) Engaged in business activities that may produce income and bear expenses (including income and expenses deriving from transactions with other components of the same banking corporation);

(b) The results of its operations are reviewed on a current basis by Management and the Board of Directors in order to make decisions as to the allocation of resources to the segment and evaluate its performance;

(c) Separate financial information exists with regard to the segment.

In addition, the directives determine the disclosure requirements and the manner of presenting the financial results of segments in the financial statements.

The Supervisor of Banks clarified in January 2002, that he expects that a banking corporation heading a banking group would include disclosure as to the following segments: corporate banking, retail banking, middle market banking, private banking, real estate and construction, mortgages, credit card operations, capital market operations, non-financial companies.

Towards the publication of financial statements for 2004, the Supervisor clarified that the retail banking segment should be split into two segments, as follows: “household segment” and “small business segment”, and the “financial management segment”, which previously appeared as part of “other operations and adjustments, should be presented separately”.

In July 2005, the Supervisor of Banks published a “Questions and Answers” file in the matter of the disclosure of segment information. The issued circular clarified that the answers appearing in the said file were to be regarded as a Statement of Opinion (SOP) of the Supervisor of Banks’ staff regarding guidelines for implementation so long as the Supervisor of Banks has not issued Directives in the matter.

In the said file the number of segments that would require disclosure in the relevant note to the financial statements were, among other things, reduced to the following: Households, Private Banking, Small Businesses, Middle Market Banking, Corporate Banking, Financial Management and Other (if relevant, on a specific basis in the reporting banking corporation). The segments relating to banking products (such as: credit cards, capital market activity and mortgage loans) are to be reflected in the relevant customer segments. Notwithstanding, it is required to include in the Directors’ Report, in respect of each segment in a separate column, a disclosure as to the banking product.

In accordance with the above, beginning with the financial statements as of December 31, 2005, the product segments, which were reported in the past as separate segments (credit cards, capital market operations, construction and real-estate activity, and mortgage loans), are reflected now in the relevant customer segments, and in addition disclosure is given in their respect in the Section “Additional details regarding activity in certain products” hereunder. Activity of the “Non financial companies” which had also been presented in the past as a separate segment is presented as a sub-segment of the “Finanical management segement”.

As the system is unable to produce data retroactively, the comparative figures for 2004 are presented, with the approval of the Supervisor of Banks, according to the previous reporting format of the Bank.

The Bank is installing a management information system to manage profit centers according to customers, products and additional profiles (the "Tomer" system). It should be noted that due to the short time that has elapsed since the system was put into operation, and since the system as a whole has not yet been completed and implemented, the use of it as a management tool has not yet begun. Furthermore, as the organizational structure of the Bank does not fully coincide with the reported segments of operations, the model used for providing the data is based on various assumptions and estimates. On the other hand, in view of the frequent changes in the definition of segments, as discussed above, together with the fact that the system is not able to provide retroactive data, a periodic series of data segmentized according to operating segments has not yet been created. In the future, once the information produced by the system is studied and analyzed over a period of time, and concurrently with the process of implementation of the system, certain changes in the said assumptions and estimates may be required.

It should be noted that in the said questions and answers file, the Supervisor of Banks requires banking corporations to consolidate the data of their subsidiaries according to quantitative characteristics determined by the parent company. Providing such data requires the maintenance of a double database for earnings and segments of subsidiaries. This involves great difficulties and at this stage the Bank is not prepared for its implementation. The Bank is preparing for implementing the said requirement, and at this stage, with the consent of the Supervisor of banks the consolidation of the segments of operations of the banking subsidiaries has been made based on the segments of operation reported by them, without adjustment for the differences, if any, that exist between the characteristics of operation of customers of the Bank and those of customers of the subsidiaries in the same segment (except for the segmentation of the data relating to the retail and middle market banking segments of Mercantile Discount Bank, which was made on the basis of an estimate, up to December 31, 2004).

ADMINISTRATIVE STRUCTURE

The Discount Group operates in Israel and overseas by way of the Bank, subsidiaries, branches and representative offices, in all areas of banking and financial services.

The business operations of the Bank are conducted by five divisions: Retail Division (previously known as the "Banking Division"), Corporate banking Division, Commercial Banking Division, Finance Division, and Asset Management Division.

The Retail Division conducts business with households, VIP customers, small companies and businesses, foreign residents and private banking customers.

The Corporate Banking Division conducts business with large and medium size companies and provides services to specific customer sectors: diamond industry, construction companies (real estate project financing) and "approved enterprises".

The Commercial Banking Division conducts business with middle market business customers and is responsible for the operations of the business centers, foreign trade department, the Tel-Aviv main branch.

The Finance Division is responsible for the Bank's financial investments and for management of the Bank's own account and liquidity.

The Asset Management Division is responsible for the securities department, the capital markets department and for subsidiaries engaged in managing customer asset.

RETAIL SEGMENT – GENERAL

This segment includes customers of the Retail Division of the Bank, except for customers of the private banking centers. In accordance with a directive of the Supervisor of Banks issued towards the preparation of the financial statements for 2004, this segment was divided into "households" and "small business" segments.

The segment also includes customers of the middle market and retail banking of Mercantile Discount Bank. The Supervisor of Banks has agreed that Mercantile Discount Bank will present in its financial statements for 2004, the said data, until it is ready to divide them into at least two segments (households and middle market segments). Until December 31, 2004, the data for this segment have been divided between the household segment and the small business segment, for the purpose of the segment data of the Israel Discount Bank Group, on the basis of an estimate. As of December 31, 2005, and for the year then ended, the segment information data of Mercantile Discount Bank has been consolidated on the basis of the segment information reported by it, after the bank has prepared the breakdown thereof as required.

Starting with the financial statements for 2005, the segment also includes the share relating to customers' activities in certain products (credit cards, capital market operations, mortgages and construction and real estate).

TARGETS AND BUSINESS STRATEGY

In order to create for the Bank a relative advantage in retail banking, the Retail Division of the Bank has conducted since 2002 several moves, which included:

- Establishing customer focused departments at the Retail Division – private customers department, small business customers department, and affluent foreign residents department.
- Allocating the business management at the regional offices and at the branches according to segments – private (households) and commercial (small businesses).
- Modification of the branch mapping – merger of branches and establishment of unique concept branches.
- Establishing indices and targets supporting the retail components – service and sales.
- Developing the consumer credit field as a clear retail need.
- Recruiting new customers, by the "Circles" activity.
- Commercializing – Modifying the appearance of branches to retail banking.
- A project intended to remove operational work from the branches in order to provide more time for new initiatives and marketing (see a more extensive discussion in "The Bank portal project" hereunder).

THE BRANCHES AS THE CENTER OF RETAIL OPERATIONS

The branches are the central link in the relations between the Bank and the retail customer, the retail experience taking place at the meeting point of the retail customer with the Bank – in the branch.

A customer visiting a branch should undergo a retail experience as a result of a combination of four major components: A pleasant appearance of the branch and its staff, quality service throughout his stay at the branch, clarity and simplicity of the products offered and messages given to him and the availability and timeliness of consumption – simple processes and efficient performance.

The Retail Division is in the midst of an advanced process of modifying the branches to a customer-focused structure, where against each group of customers the Bank provides a separate and different arrangement.

THE SEGMENT STRATEGY

The strategy that outlines a way according to which a distinct differentiation is to be made between customers in order to succeed in maintaining the customers and exhaust the potential inherent in them.

The way of applying the strategy of differentiation between segments:

- A correct segmentation of customers;
- Differentiation in service – organizational attachment to a certain team and modification of complementing channels;
- Development of customer relations with customers of the segment;
- Marketing.

CUSTOMER SEGMENTATION

Private Sector. Four principal segments of customers have been identified in the private sector: VIP customers; preferred private customers; private customers (households); the growing segment.

In recent years emphasis was put on the private sector and all its segments.

Based on the segmentation of the private sector, account channels have been established allowing the granting of structured credit facilities while offering unique channels to customers having financial wealth and/or salaried customers. These customers were offered a credit line of 30% of their net available financial wealth and/or up to three times the amount of their salary, respectively.

Modifying the credit facilities to the said population segments is achieved by initiating approach to the customer and accordingly adjusting the credit facility to the requirement of the customer, his repayment ability, and the acquaintance with him over the years as regards structured credit lines, in which the interest rate decreases gradually in line with the increasing utilization of the credit facility. This activity supports the development of the consumer credit field at the Bank, allows full compatibility with the needs of the customer and leads to a significant decline in overdrawn current accounts.

Business sector. Three main segments have been identified in the business sector: complex business; ordinary business; general business.

SERVICE CONCEPT

The service concept has been formed with the view of providing comprehensive services to the customer, deriving from the understanding that the customer is interested in receiving service from a banker who is aware of all his financial needs, and will modify the services and products in accordance with his unique characteristics.

Accordingly, the overall service concept has been formed, the principles of which are:

- One stop shop – A comprehensive service to the customer at one service point;
- Team service – provides a response for a more comprehensive service at one address at the branch;
- Deployment according to spheres – teams that specialize in the customer sphere (rather than in the product sphere);
- Humane banking – familiarity and warm and humane relations on the part of the service providers;
- Service initiative – anticipating the customer's needs and customizing products or services to such needs;
- The allocation of resources based on the customer needs and the Bank's priorities.

CUSTOMER RELATIONS WITH THE SEGMENT AND SALES

Following the segmentation of branch customers and separating the service in their respect, the implementation of the segment strategy focuses on the manner of conducting operations in respect of each arena – specialization in the arena.

The service team is required to intensify its activity with its customers: to develop customer relations with the segment served by it and conduct initiated activity.

For this purpose the following is required:

- Familiarizaion with customer characteristics (banking activity, needs and preferences);
- Customization of the professional level and the required qualifications to the needs of the customer – for this purpose the Bank has devised courses, seminars and instruction classes on various subjects for the staff of the branches. Studies are conducted both by way of self study and at the Discount college. Among other things, the subjects studied are: consumer credit, advanced business credit, deposits, foreign currency, provident funds, sales, securities, etc.
- Customizing products focused on customer needs in the investments and credit fields;
- Broadening the personal acquaintance with customers;
- Customizing the manner of approach and sales to the various customers.

Several strategic emphasis have been introduced with respect to each field of operation and its characteristics, its needs and the order of priority of the Bank.

In general, the emphasis is:

1. **VIP field** – Personal, customized, professional and prompt service. Emphasis has been put on developing the acquaintance circle with all customers as a basis for the development of activity with them.
2. **Personal Banking field** – Development of a variety of activities and the identification and handling of the "VIP customers of the future".
3. **General banking field** – Reduction in operating expenses (by means of referring customers to the direct banking services and to the use of automatic machines for conducting simple banking operations) and locating secondary customers in order to intensify activity with them.
4. **The complex and ordinary banking segment –** Professional, customized and personal service. Intensifying business activity with customers having accounts at other banks. Transferring the private bank accounts to the handling of the business team as part of the implementation of the comprehensive service concept.

COMPLEMENTING SERVICES

Direct and complementary service layouts that serve as an alternative to the services provided in the branches:

The "Bank gateway" project. Customer telephone answering service – automatic direction to direct banking for customers calling the branch switchboard (and not the direct lines of the staff). This project enables improvement of the quality of telephone reply on the one hand, and gives the branch staff more free time for developing initiative, sales and the improvement of service to the customer on the other hand.

Telebank Internet. Development and improvement of the service channel via the Internet. Encouraging customers to use this channel results in significantly lower costs as compared with the cost of identical services provided at the branches.

Investment centers. Customers having deposits of over NIS 400,000 or customers active in the capital market are entitled to receive comprehensive consultancy services regarding their funds at eleven investment centers. The account of the customer is managed at the branch, however the service is provided at the investment centers by expert investment consultants.

Business center for private banking. The center combines two concepts: the concept of a business center and the concept of an investment center. The center handles customers having a private banking profile, who manage their accounts at the branches.

SERVICE - "DISCOUNT YOUR WAY"

Three "Discount your way" branches were opened during 2005: at the "Negev" Shopping Mall, Beer-Sheva, at the "Across the Park" shopping mall in Ra'anana and at the "Giva'tayim shopping mall" in Giva'tayim. These branches, located in shopping malls, serve as service and sales points to customers of these malls, and are tailored to the retail environment of the malls.

INCORPORATING THE RETAIL CULTURE

Within the strategic framework of advancing retail banking, the Bank inaugurated, at the beginning of July 2005, a retail bainking school, the first of its kind in the banking industry – providing broad and comprehensive training in the field of retail.
The retail banking school will train managers and employees of the Bank's branches and will focus on attaining the following goals: to incorporate retailing culture into the Bank's branches, to provide management teams of the Bank's branches with tools for the implementation of the retail concept, and to train staff in a wide variety of courses.
The retail banking school operates within the framework of the Discount College and its lecturers are drawn from the field of retail activity in Israel and abroad.

THE RETAIL SEGMENT AT MERCANTILE DISCOUNT BANK

As part of the work plan for 2006, Mercantile Discount Bank set out growth targets in the retail segment.

RETAIL BANKING SECTOR – HOUSEHOLD SEGMENT

SEGMENT CUSTOMERS

This segment includes customers of the Bank's Retail Division who are private customers, who are defined as customers who are either salaried employees, possess the potential for growth, or may be viewed as VIP customers (the definition excludes customers of the private banking centers). The segment also includes the household segment customers of the Mercantile Discount Bank (Until December 31, 2004, the segment included the customers of Mercantile Discount Bank in that bank's household segment and commercial segment, on the basis of an estimate, on the basis of the relevant weighting accorded to this segment at the Discount Bank).
Starting with the financial statements for 2005, the segment also includes the share relating to customers' activities in certain products (credit cards, capital market operations and mortgages).

LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS APPLICABLE TO THE SEGMENT

The Bank operates within the framework of laws regulations and regulatory directives applicable to the banking sector in Israel as promulgated by various supervisory bodies, viz., the Supervisor of Banks, the Commissioner of the Capital Market, Insurance and Savings of the Ministry of Finance, the Commissioner of Restrictive Trade Practices, the Securities Authority etc. The principal restrictions applicable to this segment are briefly described hereunder.
Commissions. In the course of the years 2004 and 2005, various matters pertaining to commissions charged by banks appeared on the public agenda, including their rates, types and disclosure given to customers with regards thereof. In this respect, a large number of private bills have been tabled before the Knesset, concerning setting limitation on the ability to increase commission rates, setting limits on the total income from commissions, prohibiting charging a commission in respect of certain services and more, as well as a bill proposing the establishment of a Fair Trade Authority which will be responsible for various matters, including the regulation of bank/customer relations.

The matter was also examined by various professional teams who have submitted their recommendations thereon.

During the said period, efforts were made by the Knesset Economics Committee to reach a "package deal" on the subject of commissions and of the removal of obstacles regarding the transfer of private customer/household accounts from bank to bank.

The proposal of the Knesset Economics Committee included two "baskets" of commissions as follows:

"Package 18" – "the Knesset package": private customers would be entitled to receive a basket of banking services in return for the payment of NIS 18.

Composition of the Basket:

- 4 withdrawals of cash at the ATM (once weekly);
- 8 deposit and/or check withdrawal entries;
- 6 automatic information requests;
- 5 payment orders (payments to institutions).

Moreover, a customer not holding an ATM card or a credit card would be allowed:

- 2 information requests at the counter
- 2 withdrawals of cash at the counter

In respect of every deviation from one component or from the whole basket the customer would be charged with a transaction commission of NIS 1.21.

The Supervisor of Banks formed a proposal, which included:

1. The elimination of a line entry commission in private customer accounts.
2. The tariff for the services including in list of basic services included in the package deal and which are controlled (at a zero price today): ATM cash withdrawal, deposit of a check at the counter, withdrawal by way of the clearing house and a payment order – would be NIS 1.21. The banks would be entitled to charge such a commission also in respect of several services that are not under control, in respect of which a line entry commission has been charged (credit card debits and clearing credits).
3. On the one hand, the fixed ledger fees would be eliminated, while on the other hand, the banks would be entitled to charge a minimum monthly commission of NIS 10 in respect of the services mentioned in item 2 above, also from customers with a low activity that does not reach a charge of NIS 10, but shall not be entitled to charge fixed ledger fees in addition to a charge in respect of each entry.
4. A customer choosing the basic services basket at a monthly payment of NIS 18, agreed upon by the Knesset Economics Committee, shall not be entitled to the terms mentioned in 1 to 3 above.

Finally, the Supervisor of Banks and the banks reached an arrangement in July 2005, with respect to commissions charged to household customers. The Supervisor informed the Economic Committee of the Knesset of this arrangement, and on July 14, 2005, issued to the banks a letter detailing the principles for the implementation of the "package deal" in the matter of commissions pertaining to current accounts of private customers.

As stated, the banks accepted the Supervisor of Banks' proposal and informed that they would expedite the preparations for its application, so that it could be implemented as from December 1, 2005. The Bank is preparing to offer its customers the commission baskets at an earlier date, as detailed hereunder.

As from October 1, 2005, the Bank offers its customers three tracks:

- A basic track – NIS 10 basket (the Bank of Israel basket);
- An extended track – NIS 18 Basket (the Knesset Economics Committee basket);
- "Discount Fix" track.

During September 2005, the Bank sent to its private customers letters describing:

- The Bank's decision as to the implementation of the package deal;
- The three tracks offered by the Bank, details of commissions included therein and the cost of each track;

- Dates for transition from one track to another based on the customer's notice and the date of the automatic transition to the basic track in the event of no response from the customer.

A form to be completed by the customer was appended to the letter, in which the choice between the tracks is given to the customer. Customers not responding to the letter would automatically be transferred to the basic track starting on December 1, 2005.

At the beginning of November 2005, the Bank sent additional letters to customers reminding them that they must decide upon the track according to which their account would be managed and to inform the Bank accordingly, as well as informing them that no response to the letter would mean consent to the transition to the basic track.

On November 23, 2005, the Supervisor of Prices at the Ministry of Industry, Trade and Labor, issued a general permit allowing banks to charge a commission of NIS 1.21 in respect of four basic services provided to customers in current accounts: withdrawal of cash at an automatic teller machine (ATM); deposit of a check at the counter; charging a customer's account in respect of the use of a credit card; and charging an account in respect of payment orders. This permit forms an integral part to the implementation of a package deal in the matter of bank commissions.

The Bank's Management anticipates that the application of "commission baskets" would adversely affect the Bank's income from ledger fees charged to private customers, though its volume is not expected to be material.

This constitutes forward-looking information based on estimates of the management of the Bank regarding the amounts of commission charged from customers according to the package deal that were customary up to now in comparison to the amounts that would be charged under the new package deal. The realization of these estimates depends on the actual characteristics of customer activity and the channels that would be elected.

Removal of obstacles with respect to the transfer of accounts between banks. Another issue examined by the Economics Committee related to the easing of procedures for the transfer of accounts between banks.

In light of the Bank's efforts to attract new customers, the Bank has indicated its consent to this initiative. The Bank sees itself as a leader in the process of easing the procedures for the transfer of accounts between banks and even employs the services of external companies for this purpose.

The Supervisor of Banks issued, on July 14, 2005, a Proper Banking Management Directive that regularizes this issue, effective as from December 1, 2005. The Directive is intended to facilitate the transition process for customers wishing to close their accounts with one bank and transfer their business to another bank. According to the Directive, banks are required to do everything necessary in order to enable the customer to close his account or to transfer his business, while taking all possible measures to avoid unnecessary inconvenience to the customer. The banks are required to provide the customer with full information regarding his assets and liabilities at the bank so as to enable him to examine the possibilities and weigh the advisability of transferring his business from the account or closing the account, and to receive from the customer distinct instructions as to the steps to be taken regarding the assets and liabilities pertaining to his account. The Directive also includes technical relief to facilitate the transfer from one bank to another. Alongside this, the Supervisor also included in his said letter regarding commissions collected on private customers' Shekel current accounts, instructions as to commissions, which, in his opinion, constitute obstruction or impediment with regards to the transfer from one bank to another, and therefore has directed the banks to reduce such commissions or change the manner of their collection. The Bank is preparing to implement the said Directive and the contents of the Supervisor's letter.

MARKETS DEVELOPMENT

As from 2002, the Bank has been engaged in a marketing effort to attract private customers. This marketing decision is rooted in the Bank's strategy, which is to lead retail banking in Israel while focusing on the retail segment as a major source of growth and profitability.
Since the beginning of the "Circles" campaign, the Bank has attracted approximately 246 thousand new customers, mainly from the household sector.

COMPETITION

As of today, the Bank's principal competitors are the four other major banks in Israel – Bank Hapoalim, Bank Leumi, the First International Bank and Mizrachi Bank. Israel Discount Bank is third in size amongst the five banks. The Bank may be differentiated from its competitors from the point of view of both quality of service and specialization in the retail banking sector (see above).

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

As discussed above, the definition of segments was changed as from the report for 2005, so that in addition to activity in the field of banking and finance, the data for 2005 also include the activity relating to the banking products field (credit cards, operations in the capital market, mortgages, construction and real estate). The comparative figures for 2004 include only the activity in the banking and finance fields.
Net income of the segment in 2005 amounted to NIS 195 million.
The return on equity in 2005, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 19.7% in 2005.
In accordance with the directive of the Supervisor of Banks, the segment has been charged with expenses relating to the encouragement of early retirement of segment employees who have retired, and of staff members at various levels whose salaries are attributed to the segment. Disregarding these expenses, the segment's net income in 2005 would have amounted to NIS 237 million, and the return on equity in 2005 would have been 24.0%.
Provision for doubtful debts in this segment amounted in 2005 to NIS 85 million.

Following are the principal data relating to the operations of the household segment:

	Banking and financing		Credit cards	Capital market	Mortgage	Total
	2005	2004	2005	2005	2005	2005
Income from financing activities before provision for doubtful debts						
From externals -	(1,157)		111	2	217	(827)
Inter-segmental -	1,947		(36)	0	(80)	1,831
Total income from financing activities	790	1,182	75	2	137	1,004
Operating and other income	457	469	550	369	55	1,431
Total income	1,247	1,651	625	371	192	2,435
Provision for doubtful debts	39	56	14	0	32	85
Operating and other expenses	1,121	1,202	422	201	82	1,826
Income from ordinary operations before taxes	87	393	189	170	78	524
Provision for taxes on ordinary activities	62	174	81	77	29	249
Net income	25	219	55	82	33	195
Return on equity (rate)	8.0	80.2	31.8	446.0	6.8	19.7
Average balance of assets	4,842	5,592	1,846	10	9,365	16,063
Average balance of liabilitites	45,888	55,761	613	-	2,293	48,794
Average balance of risk assets	5,158	4,548	2,872	306	8,174	16,510
Average balance of provident funds and mutual funds assets	-	-	-	29,384	-	29,384
Average balance of securities	-	-	-	12,624	-	12,624
Average balance of other assets under management	-	-	-	964	2,282	3,246
Components of income from financing activities:						
Margin on credit	215	220	78	-	137	430
Margin on deposits	544	935	(3)	-	-	541
Other	31	27	-	2	-	33
Total income from financing activities	790	1,182	75	2	137	1,004

HUMAN CAPITAL

In 2005, the average number of positions in the segment amounted to 3,823 including positions of employees directly related to the segment and positions of staff members at various levels whose employment costs are charged to the segment.

RETAIL BANKING SECTOR – SMALL BUSINESSES SEGMENT

SEGMENT CUSTOMERS

This segment includes customers of the Bank's Retail Division which are defined as small companies and small businesses with borrowings of up to NIS 4 million. The segment also includes the customers of Mercantile Discount Bank in that bank's small business and commercial banking segments (Until December 31, 2004, the segment included the customers of Mercantile Discount Bank in that bank's small business and commercial banking segmetns, on the basis of an estimate, based on the relevant weighting accorded to this segment at the Discount Bank).

Starting with the financial statements for 2005, the segment also includes the share relating to customers' activities in certain products (credit cards, capital market operations, mortgages, construction and real estate).

SCALE OF OPERATIONS AND NET INCOME OF SEGMENT

As discussed above, the definition of segments was changed as from the report for 2005, so that in addition to activity in the field of banking and finance, the data for 2005 also include the activity relating to the banking products field (credit cards, operations in the capital market, mortgage, construction and real estate). The comparative figures for 2004 include only the activity in the banking and finance fields.

Net income of the segment in 2005 amounted to NIS 18 million.

The return on equity in 2005, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 3.6%.

In accordance with the directive of the Supervisor of Banks, the segment has been charged with expenses relating to the encouragement of early retirement of segment employees who have retired, and of staff members at various levels whose salaries are attributed to the segment. Disregarding these expenses, the segment's net income in 2005 would have amounted to NIS 39 million, and the return on equity in 2005 would have been 7.4%.

Provision for doubtful debts in this segment amounted in 2005 to NIS 182 million.

Following are the principal data relating to the operations of the small business segment:

	Banking and financing		Credit cards	Capital market	Construction and real estate	Mortgage	Total
	2005	2004	2005	2005	2005	2005	2005
Income from financing activities before provision for doubtful debts							
From externals -	393		-	1	143	38	575
Inter-segmental -	91		4	-	(97)	(16)	(18)
Total income from financing activities	484	462	4	1	46	22	557
Operating and other income	242	219	14	112	12	3	383
Total income	726	681	18	113	58	25	940
Provision for doubtful debts	157	118	-	-	18	7	182
Operating and other expenses	562	488	11	100	15	9	697
Income from ordinary operations before taxes	7	75	7	13	25	9	61
Provision for taxes on ordinary activities	15	37	3	8	12	2	40
Net income (loss)	(8)	38	4	4	14	4	18
Return on equity (rate)	(2.3)	10.3	123.1	140.5	11.3	5.1	3.6
Average balance of assets	7,982	11,595	60	3	2,244	1,288	11,577
Average balance of liabilitites	7,404	8,852	-	-	494	291	8,189
Average balance of risk assets	5,343	6,297	52	50	2,083	1,306	8,834
Average balance of provident funds and mutual funds assets	-	-	-	5,060	-	-	5,060
Average balance of securities	-		-	3,315			3,315
Average balance of other assets under management	-	-	-	244	-	-	244
Components of income from financing activities:							
Margin on credit	325	332	4	-	36	22	387
Margin on deposits	82	80	-	-	7	-	89
Other	77	50	-	1	3	-	81
Total income from financing activities	484	462	4	1	46	22	557

HUMAN CAPITAL

In 2005, the average number of positions in the segment amounted to 1,445 including positions of employees directly related to the segment and positions of staff members at various levels whose employment costs are charged to the segment.

SERVICE TO SEGMENT CUSTOMERS

The foreign trade department serves customers engaged in international trade. Every customer benefits from the entire range of the Bank's foreign trade services in specialist industry units that deal with all aspects of foreign trade, viz., exports, imports, financing, future financial instruments, electronic communication and relevant information on customers and suppliers. Activities of business clubs are also provided to customers of this segment. (For further information, see below, 'Middle Market Banking Segment').

SERVICE - CREDIT CENTERS

The Sharon Credit Center was recently opened, the first of five credit centers and two extensions planned to be established in the coming months. The establishment of the credit centers is the outcome of an innovative and breakthrough concept dealing with business customers (small businesses), the objective of which is to support two central values etched on the Bank's banner, namely, leadership in retail banking and humane banking service. Alongside the operational efficiency, the Bank arrived at the understanding that professionalism and specialization is required in everything connected to the handling of small businesses, which constitute the targeted arena for the Banking Division of the Bank. The credit centers will be manned by teams of professionals specializing in providing response to the characteristic needs of businesses of this kind. The staff of the credit centers will manage the credit portfolios of business customers having a credit facility in excess of NIS 400,000. The credit center will act as a service bureau, while the customer's account will remain at the respective branch.

CORPORATE BANKING SEGMENT

SEGMENT CUSTOMERS

This segment includes customers of the Bank's Corporate Division (up to December 31, 2004 – except for construction and real estate customers). This segment in the Bank includes mainly companies with annual turnovers of over NIS 150 million and/or total indebtedness exceeding NIS 40 million. The segment also includes customers of the business segment of the Mercantile Discount Bank.
Starting with the financial statements for 2005, the segment also includes the share relating to customers' activities in certain products (credit cards, capital market operations and mortgages).
As from the financial statements for 2005, the segment also includes the sub-segment of construction and real estate, reflected in the past as a separate segment. This includes customers of the various divisions of the Bank classified as belonging to the construction and real estate industry, the real estate and project financing sub-segment in Mercantile Discount Bank, the segment of loans financing the purchase or construction of commercial property and the segment of building project financing at Discount Mortgage Bank.

REVIEW OF DEVELOPEMENTS IN THE BUSINESS SECTOR IN 2005

The business sector's volume of activity continued to grow in 2005.According to estimates of the Central Bureau of Statistics, the business product grew by 6.6%, as compared with 6.3% in 2004. The growth was registered in all economic sectors with the exception of the building sector, where activity continued to decline.
The growth was reflected in the expansion in volume of activity of domestic companies as a result of the improvement in the level of domestic demand. In addition, a growth of 2.3% was registered in investments in the various economic sectors.
A significant moderation in the growth rate of export-oriented industries took place in 2005 compared with 2004. The export of goods and services increased at the rate of 7%, compared with an increase of 17.4% in 2004. The increase in exports was more balanced and was also reflected in the traditional industries, compared with 2004 where the increase was mainly reflected in the high technology industries.
The increase in volume of domestic activity and in exports contributed to improved profitability, cash flows and the repayment ability of most of the Bank's customers in the business sector.
The growth rate of the business product, the level of demand both domestic and overseas,

the volume of investments in various sectors of the economy including the building sector, all had a significant effect upon the development of the volume of activity and the business results of the business segment at the Bank.

THREATS AND OPPORTUNITIES IN THE CORPORATE BANKING SEGMENT

Threats:

- Strengthening of alternative sources of credit outside the banking industry – as from institutions, insurance companies, share and debenture issuances etc. It should be noted that, as of 2002, the rate of utilization of alternative sources of credit exceeded the rate of utilization of banking credit;
- Intensification of competition within the banking industry, as a result of the desire to increase the business and consumer credit portfolio. Competition between the banks has led to a decrease in credit margins;
- Exposure to groups of borrowers – implementation of related Bank of Israel directives (Proper Banking Management Directive No. 313), and in particular, the tightening of the provisions of the directive in the August 2003 amendment, has led to a reduction in the credit facilities made available to the large groups of borrowers, and the creation of restrictions on the financing of the country's large companies.

Opportunities:

- The trend towards economic expansion that has characterized Israel's economy since the second half of 2003. The rise in economic activity has encompassed all of the country's principal industries, with the exception of the construction and transportation industries. It is felt that, in most industries, the trend towards increased economic activity in the domestic market will continue, especially in the field of exports;
- A decrease in the credit to the GDP ratio in tandem with an improvement in companies' cash flows. The significance of these trends lies in the improved repayment capacity of the corporate sector.

The assessment provided in this paragraph constitutes forward-looking information, which is based on the Bank's evaluations as of the date on which these financial statements were prepared. External events or errors in the evaluations (as described in the next paragraph hereunder) may adversely affect the realization of these forecasts.

DEVELOPMENTS IN THE SEGMENT'S MARKETS

The significant increase in the scope of activity of the business sector in 2005, positively affected the expansion of activity by customers of the business segment of the Bank.

The said growth occurred despite repayments of credit in material amounts by large borrowers, mostly as a result of the acceleration in the raising of credit substitutes on the off-banking market.

An expansion in the credit granted to the business sector at the Bank is anticipated for 2006, mainly on the background of forecasts for the continued growth in the business product, the growth in private consumption, in the export of goods and services and the investments in the physical capital inventory of the various sectors of the economy.

However, some of the indicators show moderation in the growth rate compared with 2005. The above information constitutes forward-looking information. This information might not materialize if a decline occurs in the level of domestic demand due to a deterioration of the political-security situation, moderation in the growth rate in the domestic and global markets, a significant increase in the interest rates both in Israel and overseas and other developments in the macro-economic conditions, which are out of the Bank's control.

LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS APPLICABLE TO THE SEGMENT

The Bank operates within the framework of laws, regulations and regulatory directives applicable to the banking sector in Israel as promulgated by various supervisory bodies, viz., the Supervisor of Banks, the Commissioner of the Capital Market, Insurance and Savings of the Ministry of Finance, the Commissioner of Restrictive Trade Practices, the Securities Authority etc. The principal restrictions applicable to this segment are briefly described hereunder:

The Proper Bank Management directives contain restrictions with respect to the extent of the indebtedness allowed to any single borrower or group of borrowers, and the extent of the total indebtedness allowed to the bank's six largest borrower groups and to certain customers defined as 'related persons'. These restrictions may have adverse implications on the manner and scope of the Bank's business segment operations insofar as they relate to these customers.

Deviation from the limitations on indebtedness of a borrower and of all the six large borrower groups. Proximate to the date of publishing the financial statements for 2005, information has reached the Bank, according to which corporations that had been related to two groups of borrowers form in fact one group of borrowers.

Had the said information been in the Bank's hands, and had the Bank treated the two borrower groups as one group, then a deviation from the permitted volume of indebtedness of that group would have arisen, with the resulting requirement for the increase in the expense of the supplementary provision for doubtful debts in 2004 in the amount of NIS 5.4 million.

All the indebtedness of the said corporations were combined in the financial statements for 2005 into one group of borrowers. The total volume of the indebtedness deviates from the limitation of the indebtedness of a single borrower in an amount of NIS 441 million, and the volume of all indebtedness of the six large borrower groups at the Bank deviates from the limitation by an amount of NIS 533 million. In respect of these deviations a supplementary provision was included in the financial statements of NIS 8.4 million, as stated above. It should be mentioned that as of the beginning of March 2006, most of the deviation has been eliminated.

The limitation on "related parties". The permit granted by the Governor of Bank of Israel to the Bronfman-Schron Group determined that the members of the Bronfman Group and Mr. Schron are to reduce their indebtedness to the Bank, in order to comply with the provisions of Proper Banking Management Directive No. 312, regarding the business of a banking corporation with related parties. During January 2006, proximately prior to the receipt of the permit, the members of the Bronfman-Schron Group reduced their indebtedness and to date they do not deviate from the said limitation.

Ratio of primary capital to risk assets restricion. The Proper Bank Management directives contain restrictions with respect to the extent of a bank's risk assets in relation to any given level of capital (as defined in the directive). In recent years, this directive affected the Bank's activities and led to the introduction of a restrained credit policy. An improvement in the Bank's capital adequacy ratio in 2004 allowed the Bank to increase its credit portfolio and finance new ventures in the course of 2005.

Basel II. The Basel Commission has published new guidelines, commonly known as Basel II, which are due to enter into force in certain countries towards the end of 2006. As part of its preparations for meeting the requirements of Basel II, the Bank of Israel has, for the present, provided guidance in relation to the grading of customers (for further information on this matter, and for more general information on the Bank's plans for implementing Basel II, see 'Exposure to risks and risk management').

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

As discussed above, the definition of segments was changed as from the report for 2005, so that in addition to activity in the field of banking and finance, the data for 2005 also include the activity relating to the banking products field (credit cards, operations in the capital market, mortgage, construction and real estate). The comparative figures for 2004 include only the activity in the banking and finance fields.

Net income of the segment in 2005 amounted to NIS 56 million.

The return on equity in 2005, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 3.0%.

In accordance with the directive of the Supervisor of Banks, the segment has been charged with expenses relating to the encouragement of early retirement of segment employees who have retired, and of staff members at various levels whose salaries are attributed to the segment. Disregarding these expenses, the segment's net income in 2005 would have amounted to NIS 82 million, the return on equity in 2005 would have been 4.3%.

Provision for doubtful debts in this segment amounted in 2005 to NIS ___ million.

Following are the principal data relating to the operations of the corporate banking segment:

	Banking and financing		Capital market	Construction and real estate	Total
	2005	2004	2005	2005	2005
Income from financing activities before provision for doubtful debts					
From externals -	984	-	1	562	1,547
Inter-segmental -	(489)	-	-	(295)	(784)
Total income from financing activities	495	439	1	267	763
Operating and other income	67	112	20	16	103
Total income	562	551	21	283	866
Provision for doubtful debts	138	217	-	165	303
Operating and other expenses	389	266	17	52	458
Income from ordinary operations before taxes	35	68	4	66	105
Provision for taxes	22	30	2	33	57
Net income (loss)	12	38	2	42	56
Return on equity (rate)	1.1	2.9	225.2	5.9	3.0
Average balance of assets	17,749	19,886	11	11,263	29,023
Average balance of liabilitites	11,068	6,496	3	1,299	12,370
Average balance of risk assets	19,549	21,990	18	11,822	31,389
Average balance of provident funds and mutual funds assets	-	-	432	3	435
Average balance of securities	36		20,504	-	20,540
Average balance of other assets under management	-	-	101	-	101
Components of income from financing activities:					
Margin on credit	375	344	-	227	602
Margin on deposits	88	40	-	14	102
Other	32	55	1	26	59
Total income from financing activities	495	439	1	267	763

’60

1962. Premieres in New York: Who's Afraid of Virginia Wolff on Broadway; To Kill a Mockingbird in the cinema. An IDB branch on Fifth Avenue.

The word "globalization" is coined in 1959, in a financial article in The Economist about taxes on Italian cars.
At Israel Discount Bank, it was already clear that the stability and development of a financial system depends on its being open to the whole world and on the international ties that it creates.
And indeed, in the sixties, the bank's international breakthrough was already set in motion. One of the milestones in this process is the opening of the bank's branch on New York's Fifth Avenue, in 1962. It is symbolic that the ribbon in the opening ceremony was cut by Eleanor Roosevelt, widow of Franklin D. Roosevelt, 32nd President of the United States and patron of the economic recovery program.
Other bank branches are established around the world, and in 1964, IDB stock is traded on the New York Stock Exchange.

The First Lady. Eleanor Roosevelt, widow of former US president F.D. Roosevelt, christens the IDB branch in New York, 1962.

HUMAN CAPITAL

In 2005, the average number of positions in the segment amounted to 893, including positions of employees directly related to the segment and positions of staff members at various levels whose employment costs are charged to the segment.

SERVICE TO SEGMENT CUSTOMERS

The business segment enjoys professional banking services provided by the Corporate Division. In 2005, the division intensified its expertise in the comprehensive financial guidance, i.e., an in-depth examination of the company's needs and the adoption of creative financial solutions. Customers are provided with personal, professional and quality service that relates to all their financial needs by offering customized various banking products in the credit, exchange-rate hedging, international trade, settlement through the use of credit cards, financing, specialist capital market investments, etc.

Concurrently, solutions are also devised for meeting the financial needs of the owners of companies, and their executives and staff, who thus benefit from arrangements that afford them the status of preferred customers.

The rolling finance arrangements for the big companies are implemented through **business managers** in the corporate company department of the Corporate Division. The teams are allocated to customers by reference to the field of business activity in which the companies are engaged. The teams include a business manager, a business banker, economists and credit officers. Such a team provides the banking support for all the financial needs of the business customer.

The Diamond Exchange Branch serves diamond industry customers. The branch specializes in accounts of diamond merchants as well as in all the special services required by the diamond industry.

The Unit for Approved Enterprises works with those customers entitled to benefits from the State by providing finance for the acquisition or construction of equipment and buildings, and for the establishment or expansion of tourist and industrial projects, by virtue of the provisions of the Law for the Encouragement of Capital Investments.

The foreign trade department serves customers engaged in international trade. Every customer benefits from the entire range of the Bank's foreign trade services in specialist industry units that deal with all aspects of foreign trade, viz., exports, imports, financing, future financial instruments, and relevant information on customers and suppliers. For further information, see below, 'Middle Market Banking Segment.'

Discount Leasing Ltd. – a company wholly owned by the Bank, implements financing transactions for customers.

Deepening the current communication with segment customers is carried out by providing them with direct mailing several times a year, which include up to date banking information as well as an attractive set of offers, tailored to the needs of business people and companies.

Some of the segment's customers utilize the services of the Bank's trading desk (see below, 'Finance management segment') and the overseas offices of the Bank (see below, 'International operations segment').

CRITICAL SUCCESS FACTORS IN THE SEGMENT

The critical success factors in the segments include current communication with customers, quality service, prompt response to credit requests and to the overall related services (foreign trade operations, security investment, derivative financial instruments, banking services to corporate executives and owners, etc.).

Additional success factors are: efficient management of the credit portfolio from the aspects of measurement, costing and sophisticated risk management, focusing on credit risks, professional training of staff and improvement of the technological capabilities of the information systems.

PRINCIPLE ENTRY AND EXIT BARRIERS OF THE SEGMENT

Customers of the segment transact business concurrently with several other banks, so that the relative advantage of the segment is based on the long-term relationship with the customers, including continued satisfaction with the quality of service and providing prompt and suitable solutions to complex financing needs.

A large number of large corporations have adopted a balanced leverage policy, reflected in the use of bank financing sources together with use of off-banking means of finance, on the background of the improvement in opportunities of raising finance on the capital market and the reduction in financing costs.

Entry and exit barriers may arise as a result of the need for the appropriate allocation of capital and compliance with regulatory limitations of the Bank of Israel, which impact the manner and volume of activity vis-à-vis borrowers and groups of borrowers.

SUBSTITUTES FOR PRODUCTS AND SERVICES OF THE SEGMENT AND CHANGES THEREIN

As a substitute for bank credit to customers of the business segment, alternative financing products offered by off-banking financial institutions in general and institutional entities in particular have been developed.

These bank credit substitutes include the raising of finance by way of the issue of shares, bonds and other securities on the capital markets in Israel and abroad, including direct credit offered by such entities.

The off-banking finance constitutes an alternative financing source, mainly for long and medium term credit products, which contributes to the reduction in volume of such credit in the credit portfolio reflecting the activity of the segment.

COMPETITION IN THE SEGMENT AND CHANGES THEREIN

The business segment is exposed to ever-increasing competition from the other four large banking groups as well as from foreign banks that intensify their activity in the local market.

The level of competition on the part of institutional bodies also increased in recent years, mainly insurance companies and pension funds, which established off-banking credit departments.

The increased competition among the banks is derived mostly from improvement in capital adequacy ratios and the increase in the supply of sources on the part of the off-banking system.

The accelerated competition is contributing, as from the second half of 2004, to a continuous process of reduction in financial margins and in operating commissions that typify this segment.

DEALING WITH COMPETITION

The high level of competition in the segment is reflected in the quality of service, prompt reaction and the cost of credit and commissions

The principal means of the segment for dealing with competition include providing personal, professional and quality service and the establishment of a comprehensive system of communication with the customer, moving to an overall view of the customer's financial needs.

PRODUCTS AND SERVICES

The services offered include current financing according to customer needs, including among other things, foreign trade activity and the trading desk, financing of investments for maintaining and expanding activity, financing acquisitions of controlling interests in corporations, granting credit to capital market operators, participating in credit and/or risk offered by the large local banks or foreign financial institutions

In addition, these include related services such as deposit accepting and investment activities, derivative financial instrument activities, granting financial guarantees, advances, execution and so forth.

Alongside these, solutions are provided for the financial needs of corporation owners, executives and employees.

The year 2005 saw an increase in applications for credit to finance the acquisition of controlling interests in corporations, on the background of the many transactions in the market involving mergers and acquisitions.

TARGETS AND BUSINESS STRATEGY

- Management of the credit portfolio and the risks involved therein, recruitment of new customers and intensifying activity with existing customers.
- Improving the quality of the Bank's credit portfolio, and increasing debt and collection activity.
- Improving the quality of service, while moving to an overall view of customer need and providing overall solutions.
- Preparation for the implementation of the "Basel II" provisions.

This information is considered forward-looking information, which is based on various assumptions and forecasts available to the Bank's management, as detailed hereunder. This information might not materialize in the event that the Bank's management would adopt a business policy different than that described above, or due to changes that might occur in various influencial factors, which are not under the Bank's control.

These factors may include developments in domestic and global economic conditions, including the effect of macro-economic and geo-political conditions, developments in currency markets, capital markets, competition environment, as well as changes in legislative limitations and directives by regulatory authorities.

CORPORATE BANKING SEGMENT AT MERCANTILE DISCOUNT BANK

In its business plan for 2005, Mercantile Discount Bank has set goals for increasing the number of corporate customers, whilst simultaneously seeking to improve the quality of its credit portfolio.

MIDDLE MARKET BANKING SEGMENT

SEGMENT CUSTOMERS

This segment includes customers of the Bank's Commercial Banking Division. This segment in the Bank includes mainly companies with annual turnovers of NIS 15 – 150 million and/or total indebtedness of NIS 4 – 40 million. The segment also includes Mercantile Discount Banks commercial banking customers.

Starting with the financial statements for 2005, the segment also includes the part relating to customers' activities in certain products (credit cards, capital market operations, construction and real estate).

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

As discussed above, the definition of segments was changed as from the report for 2005, so that in addition to activity in the field of banking and finance, the data for 2005 also include the activity relating to the banking products field (credit cards, operations in the capital market, mortgages, construction and real estate). The comparative figures for 2004 include only the activity in the banking and finance fields.

Net income of the segment in 2005 amounted to NIS 22 million.

The return on equity in 2005, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 3.3% in 2005.

In accordance with the directive of the Supervisor of Banks, the segment has been charged with expenses relating to the encouragement of early retirement of segment employees who have retired, and of staff members at various levels whose salaries are attributed to the segment. Disregarding these expenses, the segment's net income in 2005 would have amounted to NIS 36 million, and the return on equity in 2005 would have been 5.4%.

Provision for doubtful debts in this segment amounted in 2005 to NIS 83 million.

Following are the principal data relating to the operations of the middle market banking segment:

	Banking and financing		Credit cards	Capital market	Construction and real estate	Mortgage	Total
	2005	2004	2005	2005	2005	2005	2005
Income from financing activities before provision for doubtful debts							
From externals -	(298)	-	4	-	520	44	270
Inter-segmental -	654	-	-	-	(487)	(38)	129
Total income from financing activities	356	190	4	-	33	6	399
Operating and other income	117	68	-	35	6	1	159
Total income	473	258	4	35	39	7	558
Provision for doubtful debts	60	42	-	-	10	13	83
Operating and other expenses	401	255	-	21	9	1	432
Income (loss) from ordinary operations before taxes	12	(39)	4	14	20	(7)	43
Provision for taxes from ordinary operations	9	(16)	-	6	9	(3)	21
Net income (loss)	3	(23)	3	8	11	(3)	22
Return on equity (rate)	0.5	(6.4)	599.7	362.6	15.4	(9.6)	3.3
Average balance of assets	8,100	6,985	11	-	1,198	535	9,844
Average balance of liabilitites	5,797	4,859	-	-	265	-	6,062
Average balance of risk assets	9,196	5,899	10	36	1,153	534	10,929
Average balance of provident funds and mutual funds assets	-	-	-	2,335	-	-	2,335
Average balance of securities	-		-	11,250	-	-	11,250
Average balance of other assets under management	1,000	705	-	507	-	-	1,507
Components of income from financing activities:							
Margin on credit	243	131	4	-	27	6	280
Margin on deposits	92	47	-	-	2	-	94
Other	21	12	-	-	4	-	25
Total income from financing activities	356	190	4	-	33	6	399

The assets of the business centers have increased at an average rate of 8% per annum during the last three years.

HUMAN CAPITAL

In 2005, the average number of positions in the segment amounted to 1,027, including positions of employees directly related to the segment and positions of staff members at various levels whose employment costs are charged to the segment.

SERVICE TO SEGMENT CUSTOMERS

The commercial banking segment enjoys professional banking services provided through the Commercial Banking Division. In 2005, the division intensified its expertise in the **comprehensive financial guidance** meaning an in-depth examination of the company's needs and the adoption of creative financial solutions. Customers are provided with personal, professional and quality service that relates to all their financial needs by offering customized various banking products in credit, exchange-rate hedging, international trade, settlement through the use of credit cards, financing, specialist capital market investments, etc.

Concurrently, solutions are also devised for meeting the financial needs of the owners of companies, and their executives and staff, who thus benefit from arrangements that afford them the status of preferred customers.

Customer service is provided at **business centers** situated in the Dan, Sharon, Tel Aviv, Southern, Jerusalem and Haifa. The service provided by the centers is most professional and integrative, provided by teams that include business bankers, economists and credit officers.

In order to adapt the service to the business customer, the customer is referred to a business-oriented branch of the Bank at which unique service teams are set up to meet customer requirements as and when they arise.

The services of the **Tel Aviv Main Branch** are also at the disposal of the customers. This branch is unique due to the large amount of assets and liabilities managed there. This branch attends to four main areas: **businesses**, including foreign currency transactions for companies, guarantees and development; **loans and development** – designated for local authorities; **foreign banks** - dealing with banks in the Palestinian Autonomous Territories and providing custodian services for foreign entities and **private customers**.

The support units for the Commercial Banking Division include the division's headquarter units, and banking business mangers for the asset and liability sides.

Segment customers are invited to join the 'business club,' a feature unique to the Discount Bank. Within the framework of this seminars are being offered to business people for the acquisition of proficiency in financial matters, such as the capital market, financial instruments and foreign trade and areas interfacing business activity such as: taxation, management, leadership, advertising, marketing, human resource management, etc.

Segment customers, who are interested in broadening their knowledge of the capital market, are invited to participate in the capital market business club, which includes a theoretical study of a wide range of subjects in the capital market field as well as practical experience in the framework of investment simulations.

Deepening the current communication with segment customers is carried out by providing them with information packets several times a year, which includes up-to-date banking information as well as an attractive set of offers, tailored to the needs of business people and companies.

The **foreign trade department** serves customers engaged in international trade (for further information, see below).

Discount Leasing Ltd., a company wholly owned by the Discount Bank, implements financing transactions for customers, in a variety of areas.

FOREIGN TRADE OPERATIONS

General. The foreign trade department operates within the framework of the Bank's Commercial Banking Division, and offers a range of services to customers from the various business segments engaged in international trade.

Scale of operations. The year 2005 was typified by levels of import and exports of goods (excluding diamonds), which were of the highest recorded until now in the Israeli economy, this being part of the general recovery in economic activity. Imports increased by 11.1% while exports increased by 7.1% as compared with 2004.

Import transactions at Discount Bank increased by 19% as compared with 2004 (an increase of 22% in the activity of the business segment, an increase of 13% in the commercial banking segment and an increase of 17% in the small business segment). The Bank's share in the total activity of the banking industry reached 10.8% in 2005, compared with 10.5% in 2004.

An increase of 16.5% was recorded in export transaction at the Bank in 2005 compared with 2004 (an increase of 16% in the activity of the business segment, an increase of 28% in the commercial banking segment and an increase of 14% in the small business segment). The Bank's share in the total activity of the banking industry stood at 8.7% in 2005, similar to 2004.

The business activity of the foreign trade department is segmented in accordance with industry specialization, which coordinates in each department all the services in the foreign trade field that the customer requires (import, export, finance, future financial instruments, etc.). The personal and direct relations with the customer are particularly emphasized alongside the current communication of the customer with his business manager at the Bank, with the view of intensifying the activity with customers.

The foreign trade department, which is responsible for the management operation of the product, provides foreign trade services by means of about 50 independent branches (including the Haifa and Jerusalem main branches), which were selected in accordance with the level of activity conducted by them.

The activities of this department were expanded during 2005, from a unit that provides professional operating services to the business units, to an active partnership that initiates business development while providing personal and professional service to customers and directing the focus to customer profitability.

Improvement of service. As part of the continuous effort for improvement of customer service quality, the "Green lane" was launched in 2005, which provides quick service in times of work pressure and according to the urgency, even after normal working hours at the branches, as well as professional advice and immediate response to customers for carrying out complex transactions within 24 hours from the time of approach, and where necessary even at the customer's home.

Activities in 2006. It is planned that in 2006, the foreign trade activity of all corporate customers who currently transact business at the various Bank branches would be transferred to the foreign trade department.

Furthermore, foreign trade operations at eleven independent branches, the volume of which does not justify maintaining the service at the branch, are to be closed down and the business of such customers will also be transferred to the foreign trade department.

These moves will enable the Bank to provide a quick and professional response to business customers.

ACCUMULATING INVESTMENTS AND SAVINGS AT BUSINESS CENTERS

Customer deposits in the middle market companies segment at the business centers comprise only 2% of total deposits with the Bank. This segment is typified by direct deposits made by the controlling shareholders of such companies who divide their investments among several banks, and not by deposits made by the companies themselves. In order to increase the Bank's share in such deposits, beginning with 2005, the Bank started to assign investment consultants to the business centers, and this move is to be completed in 2006.

COMPETITION

2005 was characterized by the decline in the business risk in the market, the continued improvement in the condition of corporations, the increase in trade and foreign trade turnovers and the growth in business activity. As a result of these changes, a continued erosion in financial margins and increased competition on the part of the two largest banks in the market was witnessed.

COOPERATION IN THE LEASING FIELD

Following the signing of cooperation agreements with non-banking leasing companies and importers of motor vehicles and equipment, a marketing activity is being conducted, in the framework of which business customers of the bank are being offered finance for purchasing vehicles and equipment through Discount Leasing Ltd. This channel constituted most of the leasing marketing operations in 2005. An effort for establishing cooperation with additional equipment suppliers will be made in 2006 with a view of expanding the product basket offered to customers through the Discount leasing operations.

PRIVATE BANKING SEGMENT

SEGMENT CUSTOMERS

This segment includes customers of the Bank's Retails Division, individuals and corporations, who maintain their accounts at private banking centers (except for customers of the construction and real estate segment).
Starting with the financial statements for 2005, the segment includes the relating activities of these customers in certain products: credit cards, capital market operations and mortgages.

STRUCTURE OF SEGMENT

The International Private Banking Division was set up at the beginning of 1999, and has since grown in the extent of its assets. At the end of 2001, the Bank embarked on a program intensifing its efforts to recruit and retain private customers. This program extended also to the domestic private banking segment, responsibility for which had been assigned to the division.
The International Private Banking Division provides services to customers foreign residents and Israeli citizens permanently residing abroad and to Israelis of considerable financial means.
In addition the Division's Global Center supports operations of the Bank's overseas extensions, working in full cooperation with them. These activities include assistance in attracting new customers, providing information regarding the overseas extensions and enhancing the awareness of branches and Head Office employees to the services of the Group.
In 2004, the Bank formed a strategic statement regarding Private Banking. Principal dilemmas have been presented, to be used as a basis for the re-evaluation of the allocation of resources and the re-positioning of the Private Banking field within the Bank and the Group. In 2005 the Bank commenced the gradual implementation of the plan and Private Banking continued to strengthen its position as a leading factor in this field and as an appropriate service layout for customers of the segment at the Bank's branches.

COMPETITION

The private banking segment comprises a competitive niche within the banking industry.

STRATEGIC EMPHASES

As mentioned above, as part of the reorganization of the retail division towards the implementation of the Bank's segment strategy, various strategic emphases have been determined. In the field of International Private Banking, emphasis has been placed on professional and specialized service, combined with a commitment to discretion and prompt response to customer requirements.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

As discussed above, the definition of segments was changed as from the report for 2005, so that in addition to activity in the fields of banking and finance, the data for 2005 also include the activities relating to banking products (credit cards, operations in the capital market, mortgages and construction and real estate). The comparative figures for 2004 include only the activities in the banking and finance fields.

Net income of the segment in 2005 amounted to NIS 35 million.

The return on equity in 2005, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 125.5% in 2005.

In accordance with the directive of the Supervisor of Banks, the segment has been charged with expenses relating to the encouragement of early retirement of segment employees who have retired, and of staff members whose salaries are attributed to the segment. Disregarding these expenses, the segment's net income in 2005 would have amounted to NIS 43 million, and the return on equity in 2005 would have been 152.6%.

Following are the principal data relating to the operations of the private banking segment:

	Banking and financing 2005	Banking and financing 2004	Credit cards 2005	Capital market 2005	Total 2005
Income from financing activities before provision for doubtful debts					
from externals -	(722)	-	-	-	(722)
Inter-segmental -	843	-	-	-	843
Total income from financing acitivites	121	87	-	-	121
Operating and other income	31	9	1	43	75
Total income	152	96	1	43	196
Provision for doubtful debts	-	-	-	-	-
Operating and other expenses	100	67	-	29	129
Income from ordinary operations before taxes	52	29	1	14	67
Provision for taxes	24	12	-	8	32
Net income (loss)	27	17	1	7	35
Return on equity (rate)	103.6	94.7	61.7	1,217.8	125.5
Average balance of assets	1,067	1,051	21	6	1,094
Average balance of liabilitites	16,575	10,271	-	-	16,575
Average balance of risk assets	444	277	18	9	471
Average balance of provident funds and mutual funds assets	-	-	-	1,069	1,069
Average balance of securities	-		-	7,713	7,713
Average balance of other assets under management	-	-	-	502	502
Components of income from financing activities:					
Margin on credit	15	13	-	-	15
Margin on deposits	106	74	-	-	106
Other	-	-	-	-	-
Total income from financing activities	121	87	-	-	121

HUMAN CAPITAL

In 2005, the average number of positions in the segment amounted to 274, including positions of employees directly related to the segment and positions of staff members whose salaries are attributed to the segment.

SERVICE TO CUSTOMERS

Segment customers enjoy the highest level of banking services in four private banking centers.

The private banking center, located in the Ayalon-Insurance Building in the Diamond Exchange area in Ramat-Gan, offers overall banking solutions, tailored to the needs of its high net worth customers, both Israelis and foreign residents, while focusing on a personal and initiating service, in investment products as well as credit and finance facilities.

At the International Private Banking centers in Tel Aviv, Jerusalem and Netanya,

specialized services are provided to foreign residents, individuals and overseas corporations including Israelis residing overseas.
In 2005, the activity of providing loans for the purchase of real estate in Israel increased, concurrently with the increase of investments in this field by foreign investors.
The Business Promotion Department operates additional service channels, "Global Centers", that enable private customers and corporations to enjoy the maximum benefit from the international network of the Bank.

INTERNATIONAL OPERATIONS SEGMENT

SEGMENT CUSTOMERS

This segment includes the overseas operations of the Discount Group. These operations are mainly carried out by the Bank's subsidiaries in the United States, South America (including the Bank's representative offices) and Switzerland, and by the Bank's branch in the U.K. The international operations are characterized by commercial business activity and by private banking.
It was clarified in a question and answer file published by the Supervisor of Banks that the Bank is required to devide the data relating to the international operations segment between the segments relating to the Group's domestic operations. In view of the fact that, at this stage, the Bank's subsidiary in New York is not in a position to provide the required information, the Supervisor has agreed that, for the time being, the Bank may continue to present international operations in the segment Note in one column.

LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS APPLICABLE TO THE SEGMENT

The principal restrictions applicable to this segment are briefly described below:
Exposure restriction with regard to overseas extensions. In accordance with the terms of a regulatory letter sent by the Supervisor of Banks, a restriction exists with respect to the extent of the exposure of the Bank in relation to the operations of its overseas extensions. The volume of the risk assets held by these extensions was determined as a risk index. The "imputed capital" in respect of the risk assets of overseas extensions is calculated in accordance with the provisions of the relevant directive, at a rate of 16% of the risk assets of the extension (calculated in accordance with the weighting determined by the Proper Banking Management Directive No. 311 which deals with the minimum capital ratio) is multiplied by the coefficient determined by reference to risk factors and the nature of the supervision in the country in which the extension is situated. In this connection, it has been determined that the coefficient shall be 1 for countries of the OECD and 4 for all other countries. The Bank's exposure with respect to the operations of its overseas extensions is calculated by multiplying the "imputed capital" by the coefficient determined by reference to risk factors and the nature of the banking supervision in the relevant country, as required by the directives.
The rate of exposure is calculated as a proportion of the calculated "imputed capital", as determined by Appendix A of directive no. 311, which deals with the ratio of capital to risk components.
In the past, the maximum exposure rate for overseas extensions was 30%. In May 2001, the Supervisor of Banks increased the maximum exposure rate to 32%.
The main overseas office is the New York subsidiary. The subsidiary's profitability and the high ratio of capital to risk components have allowed the subsidiary to continue to develop its business, which has, in turn, contributed to the increase in the calculated risk assets of the Bank's overseas extensions. In contrast to the above, however, the Bank's losses in 2000-2001 and the first half of 2002 led to an erosion of capital. The outcome of both the above processes constituted a deviation on the part of the Bank from the rules governing exposure restrictions with regard to overseas extensions.

As on December 31, 2005, the calculated rate of exposure of the Bank with respect to overseas extensions stood at 40.78%, as compared to a rate of 34.48% on December 31, 2004.

It should be noted that, in the regulatory letter from the Bank of Israel, no mention was made of sanctions to be applied in the event that the Bank were to deviate from the imposed limitation. Nevertheless, the Supervisor of Banks recently pursued the matter of changes to the Bank's calculated rate of exposure and requested that the Bank take steps to reduce the deviation. In addition, the Bank itself reviews, at monthly intervals, developments in the calculated rate of exposure regarding its activity at the overseas extensions.

The Bank has since applied to the Supervisor of Banks to agree to an increase in the restriction to a rate of 35% of the calculated capital. During the course of the year, discussions were held with the Supervisor with a view to formulating a mutually acceptable solution to this matter.

Overseas regulatory supervision. Operations of the international segment in the various countries are subject to regulatory supervision on the part of the appropriate authority in the country in question.

For details of the investigation regarding matters relating to the prohibition of money laundering, conducted at IDB New York, see "Discount Bancorp Inc." under "Main investee companies" and Note 6 D to the financial statements hereunder.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Net income of the segment in 2005 amounted to NIS 227 million, compared with 164 million in 2004, an increase of 38.4%.

The return on equity in 2005, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 16.0% in 2005, compared with 13.8% in 2004.

Provision for doubtful debts in this segment amounted in 2005 to NIS 38 million, compared with 35 in 2004, a increase of 8.6%.

Following are the principal data relating to the operations of the international operations segment:

	2005			2004		
	U.S. operations	European operations	Segment total	U.S. operations	European operations	Segment total
	In NIS millions					
Income from financing operations before provision for doubtful debts	903	45	948	766	38	804
Operating and other income	104	20	124	105	20	125
Total income	1,007	65	1,072	871	58	929
Provision for doubtful debts	34	4	38	29	6	35
Operating and other expenses	715	53	768	512	49	561
Income from ordinary operations before taxes	258	8	266	330	3	333
Net income	222	5	227	159	5	164
Return on capital	17.1	4.3	16.0	14.8	6.3	13.8
Average balance of liabilities	38,923	1,286	40,209	35,433	1,230	36,663
Average balance of assets	42,209	3,068	45,277	38,686	2,458	41,144

TAXATION

Under an agreement made with the Israeli tax authorities, the income of the Bank's overseas banking subsidiaries is added to the Bank's chargeable income, such that the Bank pays tax on the pre-tax accounting income of its overseas subsidiaries to the extent of the difference between the tax notionally payable in Israel on that income at the tax rate applicable to the Bank in Israel and the tax payable to overseas tax authorities.

HUMAN CAPITAL

In 2005, the average number of positions in the segment amounted to 863, of which 817 positions related to operations on the American continent and the rest on Europe, compared with 906 positions as aforementioned in 2004, of which 859 positions related to positions on the American continent and the rest on Europe. This segment is not charged with any employment costs of staff members in Israel.

TARGETS AND BUSINESS STRATEGY

The Bank, through Israel Discount Bank (Switzerland), is examining the possibilities of enlarging its activities in Switzerland.

SERVICE TO SEGMENT CUSTOMERS

Europe. 2005 witnessed the continuing growth of assets of customers of Israel Discount Bank (Switzerland), a wholly owned subsidiary of the Bank. Israel Discount Bank (Switzerland), located in Geneva, focuses on exclusive **private banking** operations, by which it has succeeded in attracting customers and expanding the extent of its business. The Bank's Swiss office provides advanced private banking and investment management services to existing and potential customers of the Group, both foreign residents and residents of Israel, at an international financial center.

The Bank also maintains a branch in London, which provides commercial and private banking services, and a branch in the Cayman Islands. In addition, the Bank maintains representative offices in France (Paris) and Germany (Berlin).

United States. I.D.B. New York ("IDB Bank") continues to be the largest of the Israeli banks operating overseas. This bank maintains two branches in New York, three branches in Florida, two branches in Los Angeles and one branch in the Cayman Islands. IDB Bank has an Uruguayan banking subsidiary, Discount Bank (Latin America), and representative offices situated in various centers in South America and Mexico.

SERVICES AND PRINCIPAL PRODUCTS OF IDB BANK

Credit – IDB Bank, and its leasing subsidiary, provides financing to a variety of US based corporations and also, at times, to the principals of these privately held companies.

Middle Market– In 2005, the IDB Bank loan portfolio experienced double-digit growth vis-à-vis the previous year and acted as agent in important syndications. IDB Bank has a significant niche in Middle Market Lending in a wide variety of industries, particularly in the New York Metropolitan Area, South Florida and Los Angeles; furthermore, IDB Bank recently has initiated a strong marketing effort to develop the New Jersey market. Examples of some of the industries in which IDB Bank is active are apparel and accessories, food, finance companies, retail, not-for-profit, sports and entertainment. The biggest increases have been in California (24%) and Florida (25%) with the addition of two new branches in both Los Angeles and Boca Raton.

Asset Based Lending – This includes accounts receivable financing, inventory/equipment financing, letters of credit, terms loans as well as funding for mergers and acquisitions, for middle market companies. Asset Leveraging, is the process by which IDB Bank values and leverages a client's assets to provide working capital. In 2005, the total Asset Based Lending portfolio grew by 13%. Additionally, there is optimism for continued growth in

2006 and a new development officer for ABL has been hired.
The distinction between asset-based loans and other secured loans resides in the amount of monitoring required to ensure the existence, value and integrity of the collateral. It is this constant collateral appraisal process that functionally differentiates asset based loans from other secured commercial loans. IDB Bank also began a small business program in 2003, providing services to small companies whose needs for lines of credit are between US$500 thousand and US$2 million.
Factoring – The factoring division, IDB Factors, continued to experience solid growth in 2005, with factoring volumes now at US$650 million. Since its inception just six years ago, IDB Bank has become one of the fastest growing factors in the industry. One of the Division's strengths is its ability to custom-design a factoring package to suit each client's needs. IDB Factors serves a wide range of diverse companies in many different industries. Clients are provided with a full range of services and financings, including accounts receivable management, customer credit guarantees, collections, advances against accounts receivable and inventory, seasonal over advances and import financing. It should be noted that a well known factoring executive has joined IDB Bank in Los Angeles. Factoring has seen a growth of 15% anuually in loans. The projected Factoring volume for 2006 is expected to reach US$1 billion.
Commercial Real Estate Lending – Relationships are maintained with real estate owners and investors in the New York Metropolitan Area, Florida and California. Principal products include lines and letters of credit and fixed and floating rate loans for all real estate asset classes, e.g., facilities for the acquisition and adaptive re-use of retail, office, residential and hotel properties. There are also longer term loans on stabilized projects, including participations with other U.S. financial institutions. Focus is always put on maintaining a high degree of credit quality. IDB Bank continues to be committed to help support the development and revitalization of neighborhoods.
IDB Mortgage Corp. – This is a subsidiary of IDB Bank's holding company, Discount Bancorp, Inc., through which jumbo residential mortgages have been available to IDB Bank's high net worth customers in the Tri-State New York region and Florida.
Trade & Finance – Letters of credit and related documentary collections continue to be a significant source of fee income for the Bank. IDB Bank continues to be a major issuer of documentary letters of credit in its peer group and also continues to be ranked within the top 10% of all U.S. commercial banks as reported by Documentary Credit World, out of the 300 banks on their list. IDB Bank's Automated Letter of Credit Customer Initiation System is a state-of-the-art, personalized Internet-based Letter of Credit system that connects a company's personal computer directly with IDB Bank's Amending Letter of Credit Department. The software makes issuing and amending Letters of Credit faster, easier and more accurate than ever before.
Household Banking – Offers the gamut of banking products and services, including personal and business checking accounts, money market accounts, time deposits, etc.
International Private Banking – This segment provides highly personalized service to non-U.S. clients. As in all segments of IDB Bank, building solid relationships with clients is paramount. Deposits from non-U.S. clients represent some 85% of IDB Bank's entire deposit base. The products and services of IDB Bank's broker-dealer subsidiary, IDB Capital Corp., are also available to International Private Banking customers. Officers of the International Private Banking Department are also licensed representatives of IDB Capital Corp.
U.S. Private Banking – 2005 was a year of growth, both in terms of new accounts and additional investments. Deposits made by U.S. customers in IDB Bank's innovative Structured Time Deposits with Principal Protection have doubled. Customers include personal and corporate clients alike. The products and services of IDB Bank's broker-dealer subsidiary, IDB Capital Corp., are also available to these customers.
Investment Products – The department continued to create and launch a variety of

innovative bank deposit alternatives in 2005 that provided its U.S. and international clients with compelling opportunities for upside gain, without risk to principal. Among IDB Bank's extremely popular Structured Time Deposits with Principal Protection booked last year were Step-up Rate deposits; "Bump-up", extendable deposits; and various "linked" deposits, such as "inverse floaters" and range deposits linked to LIBOR, deposits linked to capital markets such as the S&P 500 Index and Dow Jones Industrial Index, and deposits linked to a basket of indices. These Structured Time Deposits with Principal Protection, which are also adaptable for the needs of IRAs, continue to enhance the diversification of IDB Bank's deposit mix and accounted for more than one-half of IDB Bank's time deposits at year-end 2005, versus less than one-third at year-end 2003. Investments in these special deposits totaled over US$1.7 billion at the end of 2005, a US$650 million increase over the previous year's end.

Deposits – The largest part of IDB Bank's deposits, approximately 85%, are from residents of Latin America, namely, South America and Mexico. These depositors invest, principally, in short-term time deposits, step-up time deposits, equity-linked time deposits and time deposits tied to an inverse floating rate offered by a counter party, and to a lesser extent money market accounts. These same depositors vary their investment patterns between deposit based products offered by IDB Bank and investing with IDB Bank's brokerage subsidiary; dependent upon interest rates and maturities vs. opportunities in the bond and equity markets.

International Banking – This department continued in 2005 to expand IDB Bank's relationships with premier global financial institutions and highly rated corporations. In both emerging and non-emerging markets, IDB Bank dealt with financial institutions and corporations consistent with IDB Bank's conservative risk assessment policy and risk-reward criteria. Business was transacted either directly with financial institutions or by purchasing assets in the primary and secondary markets.

Branches – In addition to IDB Bank's head office at 511 Fifth Avenue, IDB Bank maintains 5 full-service branches: on Broadway in midtown Manhattan; in Miami, Aventura and Boca Raton, Florida; and two in Los Angeles, California. There is also a Grand Cayman Island Branch.

PRINCIPAL SUBSIDIARIES OF IDB BANK

IDB Leasing, Inc. – A wholly owned subsidiary of IDB Bank. The portfolio of this subsidiary grew by more than 20% in 2005, as new business increased more than 30%. While IDB Leasing's business is mainly concentrated on the East Coast, the company has achieved a national presence. The quality of the leasing portfolio remains high, consisting of middle market and investment grade businesses, including several Fortune 500 companies. Transactions are with businesses looking to lease equipment and also with other leasing entities looking for a smart source for funding. IDB Leasing discounts all types of leases and installment obligations nationwide. In March 2005, IDB Leasing acquired substantially all the assets of Fleetwood Financial Corporation, a small leasing company specializing in lender programs. They are located in South Plainsfield, New Jersey and their portfolio as of December 31, 2005 was between US$35 million and US$40 million.

Discount Bank Latin America – IDB Bank's wholly-owned subsidiary in Montevideo, Uruguay.

IDB Capital Corp. – A wholly owned broker-dealer subsidiary of IDB Bank, was established in 2001 and continues to be very successful. It has a solid foothold in various fixed income structures and markets but also provides a rich variety of choices for equity investors; for example, principal short-term notes linked to single stocks of varying sectors and markets. Non-deposit investment products offered through IDB Capital Corp.: U.S. Government Obligations; Corporate Stocks and Bonds; Offshore and Domestic Mutual Funds; Capital Market Instruments.

FINANCIAL MANAGEMENT SEGMENT

SEGMENT DEFINITION

This segment includes activities that are characterized as banking operations, but do not involve customers of the Group (except for the trading desk). These activities are mainly comprised of for their own account operations of the Bank and Mercantile Discount Bank involving securities and other banks, as well as exposure management (the Consumer Price Index and foreign exchange) and dealing room operations, including those involving derivatives. This segment also includes the Bank's share in the income of the First International Bank and its share in the income of its affiliated companies which operate in a supporting capacity.

As from the financial statements for 2005, the segment also includes the non-financial corporations sub-segment, previously reflected as a separate segment, which includes the Discount Group activity in non-financial investments. This sub-segment's main activity is the Bank's investment in Harel and investments made by the subsidiary Israel Discount Capital Markets and Investments ("DCMI") and by the Bank directly.

NEW PRODUCTS

The department that deals with the development and management of financial products has responsibility for the development of new products that are then marketed and sold by the other segments. During 2005, several new products were offered and marketed, as follows:

In the course of 2005, the Bank distributed a range of new products: structures deposits, one-time and monthly savings deposits.

Deposits of various types have been distributed in the structured deposits field: deposits securing the principal amount, deposits securing the interest but not the principal sum, deposits convertible into shares and deposits producing a return derived from share indices.

In the field of monthly savings deposits, the Bank distributed deposits in the various linkage options for short and long terms, as an alternative to monthly deposits in provident funds (5 and 18 years).

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Net loss of the segment, excluding operations in the non financial companies sub-segement, in 2005 amounted to NIS 140 million, compared with 109 million in 2004, an increase of 28.4%.

Total revenues amounted in 2005 to NIS 45 million, and they include two major components:

1. Earnings from operations in the "Nostro" portfolio in the amount of NIS 39 million, of which NIS 32 million from gains on sale of securities and from adjustments to fair value of trading securities.
2. Net earnings from the management of positions taken and from currency and financial derivatives brokerage in the amount of NIS 6 million.

The return on equity in 2005, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was a negative rate of 16.7% in 2005, compared with 13.8% in 2004.

In accordance with the directive of the Supervisor of Banks, the segment has been charged with expenses relating to the encouragement of early retirement of segment employees who have retired, and of staff members at various levels whose salaries are attributed to the segment. Disregarding these expenses, the segment's net income in 2005 would have amounted to NIS 82 million, compared with 71 million in 2004, an increase of 15.5%, and the return on equity in 2005 would have been at a negative rate of 9.7%, compared with 8.9% in 2004.

Following are the principal data relating to the operations of the financial management segment:

	2005	2004
	In NIS millions	
Loss from financing activities	(80)	(160)
Operating and other income	125	74
Total income	45	(86)
Operating and other expenses	410	285
Loss from ordinary operations before taxes	(365)	(371)
Loss	(140)	(109)
Return on equity	(16.7)	(13.8)
Average balance of liabilities	9,195	7,420
Average balance of assets	35,800	34,469
Average balance of risk assets	8,761	6,806

HUMAN CAPITAL

In 2005, the average number of positions in the segment amounted to 378, including positions of employees directly related to the segment and positions of staff members at various levels whose employment costs are charged to the segment, compared with 318 positions as aforementioned in 2004.

TRADING DESK

The trading desk attends at one location to the overall activity in the foreign currency and local currency fields, index and interest rates, derivative instruments, foreign securities traded all over the world and foreign investments as well as the liquidity management in local and foreign currencies. The trading desk responds to the needs of sophisticated and competitive customers, investors, corporations and institutions. These customers carry out by means of the trading desk transactions in complex financial products, hedging transactions against exposure risk to currency and interest rate fluctuations, and are also offered unique customized solutions. Advanced technology and a computer system connected to the major financial centers around the world provide a prompt, accurate and reliable service.

Marketing and distribution. The trading desk continues successfully to market structured products based on foreign currency interest rates, foreign share indices and foreign currency. It also handles on-call credit and trades in transactions based on local and foreign currency interest rates.

New products. The trend of the transfer of activity to sophisticated (exotic) options and structured products based on interest rates, currency or shares continues. The trading desk has commenced offering its own products of this kind.

Both the domestic and foreign financial markets showed stability in 2005, which resulted in increased activity of the trading desk and its customers in alternative markets such as emerging markets.

Market making in Shekel interest rates. The reform of the Government bond market, initiated by the Ministry of Finance, is planned to be launched at the beginning of 2006. This reform is expected to bring about a rapid development of the bond market and of complex and sophisticated derivatives based on the Shekel interest rate.

The bank complies with the basic conditions applying to the appointment of a market maker, and is of the opinion that it would be so appointed. Accordingly, the trading desk is accelerating the preparations in this matter and in the coming months the operational, professional and organizational setup will be coordinated with this new activity.

This constitutes forward-looking information, which is based on the Bank's best evaluations at the date of the preparation of these financial statements. Changes in various parameters, including changes in form and in timing of the implementation of the bond market reform, might cause the non-realization of these expectations.

NON-FINANCIAL COMPANIES SUB-SEGMENT

SUB-SEGMENT DEFINITION

This sub-segment includes the Group's operations with respect to non-financial investments. The greater part of the sub-segment's operations relate to investments of the Bank in Harel Ltd., and investments undertaken by a subsidiary, Israel Discount Capital Markets and Investments Ltd. (hereinafter: "DCMI"), as well as direct investments by the Bank itself.

LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS APPLICABLE TO THE SUB SEGMENT

The Bank operates within the framework of laws, regulations and regulatory directives applicable to the banking sector in Israel as promulgated by various supervisory bodies, viz., the Supervisor of Banks, the Commissioner of the Capital Market, Insurance and Savings, the Commissioner of Restrictive Trade Practices, the Securities Authority etc. The principal restrictions applicable to this sub segment are briefly described hereunder.

Section 23 A of the Banking (Licensing) Law, specifies that the amount of any means of control held by a banking corporation in non-financial corporations shall not exceed the following proportions of the capital of the banking corporation, as shall be determined for this purpose in rules prescribed by the Governor, after consultation with the Advisory Committee and with the approval of the Minister of Finance –

(1) Up to fifteen per cent of its capital – in any non-financial corporation;

(2) Up to a further five per cent of its capital – provided that it does not hold in corporation more than five per cent of a certain class of means of control and it is not entitled to appoint a director;

(3) Up to a further five per cent of its capital – in non-financial corporations which are foreign corporations that do not conduct any material and continuing business operations in Israel.

As of December 31, 2005, the amount of the Bank's investment in non-financial corporations was considerably less than the amount of the above restriction.

The legislation passed in the wake of the Bachar Committee recommendations included limitations on the holdings of controlling interests in non-financial corporations being an insurer or a corporation controlling an insurer or whoever holds over 25% of the equity of an insurer. For additional details, including details regarding the necessity for the Bank to reduce its holdings in Harel Insurance Investments Ltd., in view of the decision taken by the Bank to engage in pension consultation, see Note 33 to the financial statements.

SCALE OF OPERATIONS AND NET INCOME OF THE SUB SEGMENT

Net income of the sub segment in 2005 amounted to NIS 45 million, compared with 115 million in 2004, an decrease of 60.8%.

The return on equity in 2005, calculated on the capital allocated to the sector on the basis of the average balance of sub segment risk assets, was 127.9% in 2005, compared with 355.1% in 2004.

Following are the principal data relating to the operations of the non-financial company segment:

	2005	2004
	In NIS millions	
Loss from financing activities	(15)	(21)
Operating and other income	1	51
Total income	(14)	30
Operating and other expenses	4	11
Income (loss) from ordinary operations before taxes	(18)	19
Bank's equity in income of		
affiliated companies	54	66
Extraordinary income on the sale of investments	-	32
Net income	45	115
Return on equity	127.9	355.1
Average balance of liabilities	26	-
Average balance of assets	616	573
Average balance of risk assets	583	539

HUMAN CAPITAL

In 2005, the average number of positions in the sub segment amounted to 7, including positions of employees directly related to the segment and positions of staff members at various levels whose employment costs are charged to the segment, compared with 6 positions as aforementioned in 2004.

PRINCIPAL AREAS OF OPERATION IN SEGMENT

The investments of the Discount Group in non-financial companies are divided into two principal categories, as under:

- Investment in companies: the principal investment in this field is the investment in Harel Insurance Investments Ltd. (see below, 'Principal investee companies');
- Investments in venture capital funds. The greater part of the investments in this field are made through the subsidiary DCMI, through the subsidiary of Mercantile Discount Bank, and directly by the Bank itself.

REVIEW OF THE ISRAELI VENTURE CAPITAL MARKET IN THE YEAR 2005*

About 83 "exits" were effected in the course of 2005 by venture capital market companies. Of these, 32 were by way of an IPO and the others by way of mergers or acquisitions (12 of which in amounts exceeding US$100 million). The largest "exits" were those of Shopping.com Inc., which was bought by Ebay Inc.in consideration for US$634 million, and of Versity Ltd., which was bought by Cadence Design Systems Inc. for US$315 million.

During 2005 378 Israeli high-tech companies raised an amount totaling US$1.34 billion, a decrease of 8% compared with the amount raised in 2004 (an increase of some 3% in the average fund raising per company). The Israeli venture capital funds invested during 2005 an amount totaling US$655 million, a decrease of 1.5% compared with 2004. The proportionate part of these funds in the total amount invested in Israeli high-tech companies in 2005 was 49%, compared with 46% in 2004.

The communications field came first in the fund raising extent in 2005. 116 communications companies raised an amount of US$469 million, comprising about 35% of the total amount invested, in comparison with US$430 million raised in 2004, an amount that comprised 29% of the total amount invested in that year.

* The data in this item has been taken from data issued by the IVC (Israel Venture Capital) Research Institute.

The bio-science field was second in the extent of fund raising, with a total amount raised of US$284 million, comprising 21% of the total amount invested, compared with US$321 million in 2004, an amount that comprised 22% of the total amount invested in that year.
177 mid-stage companies (with income of up to US$10 million) raised 52% of the total amount invested (US$702 million), compared with 56% (US$819 million) in 2004.
52 companies at the “seed” stage raised 8% of the total amount invested (about US$110 million), similar to the extent of fund raising in 2004.

INVESTMENTS OF GROUP IN VENTURE CAPITAL FUNDS

In the field of venture capital fund management, DCMI (directly and trhough a consolidated company) participated in a number of funds, including:
First Israel Mezzanine Fund (FIMI) – in conjunction with foreign investors. The size of the fund is US$91 million. DCMI’s share in the fund will reach US$16 million, of which US$13.1 million had already been invested by December 31, 2005.
The Israel International Fund, which was established jointly by Hambros Bank (UK) (since acquired by Investec) and DCMI, specializes in export-oriented projects. Amongst the investors in the fund is a group of Japanese investors headed by the Nomura company. The size of the fund is US$50 million, and DCMI’s share is due to reach US$8.1 million. As of December 31, 2005, DCMI had invested US$7.7 million in this fund. The fund has concluded its investment program and realized holding in some of its investments.
Vertex Venture Management (III) Capital Fund (hereinafter: “the First Vertex Fund”). This fund’s size is US$35 million, and DCMI’s share is US$5 million. The fund has concluded its investment program and has realized some of the holdings obtained through its investments. The fund has repaid the entire investment amount to the investors and has now begun distributing profits.
Following the success of the First Vertex Fund, the **Vertex Israel II Venture Capital Fund** was established. The size of the fund is US$160 million, and is due to reach US$15 million. As of December 31, 2005, DCMI had invested US$11.6 million.
Vertex Israel III Fund is expected to reach a size of between US$100 and US$200 million, and DCMI’s share will reach US$13.5 million. As of December 31, 2005, DCMI had invested an amoun of US$1.4 million.
Vitalife Fund. DCMI has initiated the establishment of a venture capital fund for investment in the field of the life sciences. Following the completion of the initial capital raising, the Fund will reach a size of US$50.3 million, of which DCMI’s share will amount to US$10 million. As of December 31, 2005, DCMI had invested an amount of US$7.9 million in this fund.
DCIM, together with Foresight Ltd. established the **Golden Gate Bridge Fund,** which engages in providing bridge financing for hi-tech start-up companies. The size of the fund is US$6 million. DCMI’s share is due to reach US$2 million, of which US$1.7 million had already been invested by the end of 2005. The Golden Gate Bridge Fund is now jointly managed with the Plenus Technologies Fund.
Plenus Venture Lending II Fund. The Fund, which amounts to US$55 million, engages in the granting of bridging loans and credit facilities to technology companies. DCMI has undertaken to invest up to US$5 million in the fund. As of December 31, 2005. DCMI had invested an amount of US$1.4 million.
DCMI jointly with Bezeq and others, established the **Stage One Venture Capital Fund,** which is to invest in companies engaged in communications and information technology fields. The size of the fund is US$30 million. DCMI’s share is due to reach US$10 million, of which US$8.5 million had been invested by the end of 2005.
Alon Fund. DCMI has invested in a venture capital fund, of the Gaon Financial Management Group, which invests in late stage technology companies. The size of the fund is US$30 million, and DCMI’s share is US$2 million.

Fortissimo Capital Fund. The size of the fund stands at US$78 million. DCMI has undertaken to invest US$5 million in the fund, of which US$1.4 million had been invested by the end of 2005.
DCMI has invested in **"Menif" – Financial Services Ltd.**, together with Mivtach Shamir Finances, Clali Investments & Properties, Walter Rosenthal Ltd. and Edmond Chacheg. "Menif" engages in complementing equity capital of building contractors as required by banks financing building projects in a closed project format. Complementing the equity capital is effected by way of providing guarantees in favor of the project in consideration for a share of the profits. DCMI holds 19.6% of the share capital of "Menif" and has undertaken to provide guarantees for projects of up to US$6 million. The balance of the guarantees granted by Discount Israel Capital Markets & Investments Ltd., amounted to NIS 10.9 million as of December 31, 2005.
DCMI has invested US$1 million in **tecc-Is**, which is traded on the London AIM Exchange. tecc-Is invested in Israeli hi-tech companies. The controlling interest in the company has changed hands, and the company has, in consequence, now changed its name to Serviced Office Group (SVO). At present the company is engaged mainly in the income producing real-estate field.
During 2005, DCMI sold its holdings (70%) in Foresight Ltd., at an insignificant profit.
Additional investment in funds. In addition to the investment in funds through DCMI, the Bank has made a direct investment in additional funds.
FIMI Opportunity Fund I. The size of this fund is US$114 million. The Bank's share in the fund is due to reach US$22.8 million, of which US$14.2 million had been invested by December 31, 2005.
FIMI Opportunity II Fund. The Fund reaches a total of approximately US$293 million. The Bank's share in the Fund will reach US$50 million, of which an amount of US$0.5 million has been invested up to December 31, 2005.
FITE – First Israel Turnaround Enterprise Fund. The size of the fund is US$129 million, and the Bank's share is due to reach US$12.5 million. Up to December 31, 2005, the Bank had invested US$1.5 million in the fund.
Furthermore, Mercantile Discount Bank is committed to an investments in five venture capital funds. As of December 31, 2005, the investment of Mercantile Discount Bank in these funds amounted to NIS 8.8 million. As of December 31, 2005, the maximum commitment for the future investments in these funds amended to NIS 11 million.

FURTHER DETAILS AS TO ACTIVITY IN CERTAIN PRODUCTS

CREDIT CARD OPERATIONS

The credit card operations of the Bank's customers includes the credit-financing income from transactions carried out by credit card and various commissions relating to credit card activity. The operations are principally conducted through Israel Credit Cards Ltd.

GENERAL INFORMATION ON THE OPERATIONS

The income of Israel Credit Cards Ltd. increased by 13.7% in 2005, from NIS 95 million in 2004 to NIS 108 million in 2005. The increase in income was mainly attributable to an increase of approximately 9% in credit cards issued, and to higher credit balances.
The company's operations are concentrated in two particular areas, **issuing** and **clearing**. With regard to the company's issuing operations, credit facilities are made available to its customers.

SCALE OF OPERATIONS AND NET INCOME OF THE SEGMENT

Net income of the segment in 2005 amounted to NIS 63 million, compared with 50 million in 2004, an increase of 26%.

The return on equity in 2005, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 35.6% in 2005, compared with 38.0% in 2004.

In accordance with the directive of the Supervisor of Banks, the segment has been charged with expenses relating to the encouragement of early retirement of segment employees who have retired, and of staff members at various levels whose salaries are attributed to the segment. Disregarding these expenses, the segment's net income in 2005 would have amounted to NIS 65 million, compared with 52 million in 2004, an increase of 25%, and the return on equity in 2005 would have been 36.6%, compared with 39.0% in 2004.

Provision for doubtful debts in this segment amounted in 2005 to NIS 14 million, compared with 8 in 2004, an increase of 75_%.

Following are the principal data relating to the operations of the credit card segment in 2004:

	Households	Small businesses	Middle market banking	Private banking	Total	
	2005	2005	2005	2005	2005	2004
Income from financing activities before provision for doubtful debts						
From externals -	111	-	-	-	111	-
Inter-segmental -	(36)	4	4	-	(28)	-
Total income from financing activities	75	4	4	-	83	89
Operating and other income	550	14	0	1	565	531
Total income	625	18	4	1	648	620
Provision for doubtful debts	14	-	-	-	14	8
Operating and other expenses	422	11	-	-	433	419
Income from ordinary operations before taxes	189	7	4	1	201	193
Provision for taxes on ordinary activities	81	3	-	-	84	83
Net income (loss)	55	4	3	1	63	50
Return on equity (rate)	31.8	123.1	599.7	61.7	35.6	38.0
Average balance of assets	1,846	60	11	21	1,938	1,604
Average balance of liabilitites	613	-	-	-	613	760
Average balance of risk assets	2,872	52	10	18	2,952	2,222
Average balance of provident funds and mutual funds assets	-	-	-	-	-	-
Average balance of securities	-	-	-	-	-	-
Average balance of other assets under management	-	-	-	-	-	-
Components of income from financing activities:						
Margin on credit	78	4	4	-	86	89
Margin on deposits	(3)	-	-	-	(3)	-
Other	-	-	-	-	-	-
Total income from financing activities	75	4	4	-	83	89

REGULATIONS, LEGISLATION AND ARRANGEMENTS

Commissioner of Restrictive Trade Practices. In May 2005, the Commissioner declared IsraCard Ltd. as a monopoly in the field of clearing IsraCard and MasterCard credit card transaction vouchers. ICC is unable to assess at this stage the effect of this declaration on the clearing market (for further information, see Note 34 B to the financial statements).

Supervisor of Banks. On May 30, 2005 the Supervisor of Banks issued Proper Banking Management Directive No. 470, the purpose of which is regulating the charge card operations of credit card companies both in the field of risk management and in various consumer fields. In the risk management field, the Supervisor applied to the credit card companies additional Proper Banking Management Directives, such as "the board of directors", "risk management", "fraud and embezzlement by employees", "banking insurance" and so forth. In the consumer field the instruction relates to several principal issues, including: rules for the issue of credit cards, their delivery, their renewal and cancellation, the information provided as part of the monthly statement, rules regarding point/stars drives, rules regarding the conversion of transaction in foreign currency into Shekels, and so forth.

ICC does not believe that the directive will have any material effect on the results of its operations.

CRITICAL SUCCESS FACTORS

- The existence of recruiting platforms: banks and customer clubs (direct recruiting);
- Intelligent management of the credit field, risk management;
- The existence of sophisticated, customized computer systems.

OBSTACLES TO MARKET ENTRY

The principal obstacle to market entry is the existence of a solid, credible information system for billing management. In addition, the existence of a critical mass of customers recruited at the various recruiting platforms is crucial for success.

ALTERNATIVE PRODUCTS

The most readily available alternative products to those of ICC are checks and cash. With the growth in credit transactions, the most appropriate alternative product to credit cards is bank credit.

NEW PRODUCTS

In 2005 ICC has launched the "Active" credit card – a new and revolutionary "revolving" credit card that allows the customer complete control over his monthly expenses.

Another new product recently launched by ICC is the 'designer card'. The product allows the customer to select the design of his card from a range of different designs including personalized designs. This is an innovative and groundbreaking product designed to reinforce the image of the company in the eyes of the customer.

CUSTOMERS

The company's customers are mostly customers of the recruiting banks. In view of this fact, certain dependence exists in the relationship between ICC and the banks.

MARKETING AND DISTRIBUTION

Two avenues of distribution and marketing are open to the company: distribution through the banks to which the company is tied through a series of arrangements, and direct distribution through customer clubs (e.g., PowerCard, H&O etc.).

The reduction of the share of the banks with whom ICC is tied by a number of issuing agreements (especially the owner-banks), in the retail sector will have a direct influence on the company.

COMPETITION

In the issuing field, the company is in competition with the other credit card companies, which also initiate approaches to the banks' customers. In the clearing field, the company is in competition with LeumiCard, operating under the 'Visa' brand name.

At the present time, there are two other credit card companies operating in Israel in direct competition with ICC. Both of the competitors are wholly owned by banks:

- IsraCard Ltd., wholly owned by Bank Hapoalim, is the exclusive issuer and acquirer of the IsraCard, MasterCard and American Express credit cards. As of the end of 2005, the estimated market share of IsraCard was 44%.
- LeumiCard Ltd., wholly owned by Bank Leumi Ltd., issues and clears Visa credit cards, and, to a limited degree, also issues MasterCard credit cards. As of the end of 2005, the estimated market share of LeumiCard was 27%.

ICC issues and clears Visa and Diner's Club credit cards. The company has exclusive rights to the issuing and clearing of Diner's Club credit cards. In addition, the company issues MasterCard credit cards to a limited degree. As of the end of 2005, the estimated market share of ICC Ltd. was 29%.

DEVELOPMENTS IN THE SEGMENT

Arrangements between the First International Bank and the IsraCard Group. During the year 2000, the Bank signed agreements with several strategic partners, including an agreement from September 2000 with the First International Bank, for the sale of shares, which at date of acquisition comprised 20% of the equity and 16% of the voting rights in ICC and entitled the right to appoint directors as well as to shares in Diners.

Among other distribution agreements signed by ICC with several banks, is also an agreement signed with the First International Bank for the joint issue of VISA credit cards to customers of the First International Bank for a period of six years as from August 1, 2000, at the end of which the agreement would be renewed for an additional period of three years. However, as from February 2006, each of the parties is entitled to terminate the engagement at any time giving prior notice of six months.

In the reports of the First International Bank regarding the agreement signed recently with Bank Hapoalim for the purchase of means of control in Otsar Ha-Hayal Bank Ltd., it is stated, among other things that the parties to the agreement determined "arrangements as to the continued engagement between Otsar Ha-Hayal and the IsraCard Group and for cooperation between the bank and the IsraCard Group".

The contents of the reports of the First International Bank raise real concern regarding a violation of the commitments of the First International Bank towards ICC and towards the Bank, as well as various obligations imposed on it according to any law. A real concern exists also that the actions that are probably planned for the transfer of customers from ICC to IsraCard comprise not only the use of customers as "pawns" and as part of the payment for the acquisition of Otsar Ha-Hayal, but also damage to the customers themselves and to ICC. Whereas the reports of the First International Bank are drafted in general and vague terms and do not disclose in full the details of the transaction, the Bank approached the First International Bank demanding to receive all the documents and details pertaining to the said arrangements. Until now, the demand of the Bank has been turned down.

In the absence of details as above, the Bank is not able to assess what actions would be taken by the First International Bank in this matter, and therefore the implications, if any, on ICC.

The establishment of a new customer club and the sale of the means of control in Diners. On November 29, 2005, ICC entered into an agreement with Dor-Alon Energy in Israel (1988) Ltd. and Blue Square Israel Ltd. (hereinafter together – "the Purchasers") according to which ICC has committed to sell to the Purchasers 49% of the issued and paid share capital of Diners Club Israel Ltd. (hereinafter – "Diners") in consideration of NIS 21.3

million. Concurrently, Diners entered into an agreement with the Purchasers for the establishment of a customer club. The closing of the transaction is subject to conditions precedent, among which are regulatory and other approvals.

The consideration for the shares is to be financed by a loan to be granted to the Purchasers by ICC. The shares sold are to serve as collateral for the loan, which is to be repaid at different dates over a number of years, during which the Purchasers are entitled to decide on returning the shares to ICC instead of repayment of the loan, and ICC on its part is entitled to demand the return of the shares, all in accordance with the terms stated in the agreement for the sale of the shares.

It should be noted that to the Bank's best knowledge, some of the controlling parties amongst the Purchasers according to the above agreement, are also among the Buyers in accordance with the agreement for the sale of a controlling interest in the Bank, or are related to them (see "The Agreement for the Sale of a Controlling Interest in the Bank" in the Chapter "Sale of the Bank").

SEASONAL FACTORS

The company's operations are affected by certain seasonal factors related to patterns of consumption; in the periods immediately prior to religious festivals and during the summer months, the company experiences an increase in its operations.

GOALS AND STRATEGY

ICC has adopted the goal of continuing to work for the development of the provision of consumer off-banking credit.

EXPECTATIONS FOR DEVELOPMENT IN THE COMING YEAR

ICC expects to capture a further increase (7%-8%) of the credit card market, whilst viewing the intensification of the competition from the independent issuers (with the approaches to customers of all banks) ("Multi" by LeumiCard and "MORE" by IsraCard), and the competition in clearing operations.

This comprises forward-looking information based on the Bank's and ICC's best evaluation as of the financial statements and on past experience. Changes in economic and in private consumption growth rates might cause a reduction in the data.

OPERATIONS IN THE CAPITAL MARKET

The operations in the capital market includes securities activity (excluding activity for the Bank's own account), portfolio management, mutual funds, supplementary training funds, provident funds and severance pay funds. The operations include the activity of the Bank's securities and capital market departments, as well as the operations of specialized subsidiaries: Tachlit, Ilanot Discount, Discount Management of Provident Fund and Kahal, and the operations in the capital market of Mercantile Discount Bank.

OPERATIONAL STRUCTURE

The Asset Management Division of the Bank, which is responsible for the operations in the capital market, is comprised of the following units and investee companies:

- Securities department;
- Capital market department;
- Tachlit Discount – Investment Counseling Management Co. (subsidiary);
- Discount Management of Provident Fund (subsidiary);
- Ilanot Discount (subsidiary);
- Discount Trust (subsidiary) (the operations of this company are included in the financial management segment);
- Kahal – Employee's Supplementary Training Fund Ltd. (affiliated company).

TREND OF EVENTS AND DEVELOPMENTS IN THE MACRO-ECONOMIC ENVIRONMENT

The mutual funds market. The year 2005 experienced a growth in the mutual fund industry, which reached a record volume of NIS 124.8 billion, comprising a growth of 23.3% compared with December 2004 (two thirds of the growth stems from new money entering the market, in a total volume of approximately NIS 15.8 billion, while one third stems from an average return of approximately 6.5%).

Private brokers market share increased sharply in 2005, from 14.3% to 21.6%, reducing the banks' share in the market (including the growth in the market share of insurance companies from 1.8% to 2.7%).

The provident funds market. The provident fund market was also marked by the continuous trend of diversion of funds towards provident funds managed by private entities.

In the wake of high rates of return and quality management, Discount Bank's provident funds were successful in maintaining a market share of 17.4%.

Change of ownership. Within the framework of the advance preparations for the implementation of the legislation enacted in the wake of the Bachar Committee recommendations, the major banks have informed in the second half of 2005 of their entry into agreements for the sale of the ownership or the operations of the mutual funds and/or provident funds management companies operating within the banking group to which they belong. Ownership of most of the operations that are being sold will pass, upon the completion of the transactions, to the large insurance groups in Israel. In view of the enormity of ownership changes, the short period of time that has elapsed since the agreements in the matter were undertaken and the fact that the agreements and the ownership and activities changes therein have not yet been completed, it is not possible to evaluate their effect on the activity of the capital market in Israel.

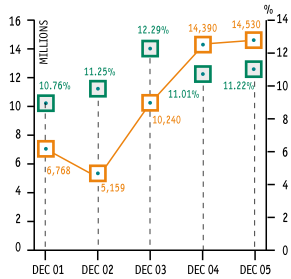
LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS APPLICABLE TO THE OPERATIONS IN THE CAPITAL MARKET

The main restrictions that are expected to affect the operations are those that will be applied to banks under the legislation enacted following the Bachar Committee recommendations. For details see "Reform in the structure of the capital market in Israel and in the activity of banks and other players in the capital market field" in the section "Legislation and regulation" hereunder, as well as Note 33 to the financial statements.

Among other things, the legislation regularized the following issues:

- The gradual detachment of provident funds and mutual funds from the banks;
- Separation of the activities of a consultant who is not connected to the entities generating the products, and the activities of a promoter who has an affinity to the entities generating the products he sells to customers;
- The gradual entry of the banks into the pension and life assurance product distribution market.

As for details regarding limitations on the deposit and withdrawal of funds with provident funds, in effect as from January 1, 2006, see "Amendment No. 3 to the Income Tax Regulations (Rules for the Approval and Management of Provident Funds)" in the Chapter "Legislation and Supervision" hereunder.



ASSET VALUE AND MARKET SHARE OF ILANOT DISCOUNT 2001-2005

▣	MARKET SHARE
▣	ASSETS

SCALE OF OPERATIONS AND NET INCOME

Net income of the operations in 2005 amounted to NIS 115 million, compared with 87 million in 2004, an increase of 32.2%.

Following are the principal data relating to the operations in the capital market:

	Households	Small businesses	Corporate banking	Middle market banking	Private banking	Other	Total	
	2005	2005	2005	2005	2005	2005	2005	2004
Income from financing activities before provision for doubtful debts	2	1	1	-	-	20	24	17
Operating and other income	369	112	20	35	43	(3)	576	485
Total income	371	113	21	35	43	17	600	502
Operating and other expenses	201	100	17	21	29	(3)	365	330
Income from ordinary operations before taxes	170	13	4	14	14	20	235	172
Provision for taxes on income from ordinary operations	77	8	2	6	8	8	109	76
Net income	82	4	2	8	7	12	115	87
Average balance of assets	10	3	11	-	6	-	30	47
Average balance of liabilitites	-	-	3	-	-	-	3	8
Average balance of risk assets	306	50	18	36	9	-	419	44
Average balance of provident funds and mutual funds assets	29,384	5,060	432	2,335	1,069	-	38,280	33,839
Average balance of securities	12,624	3,115	20,504	11,250	7,713	-	55,206	
Average balance of other assets under management	964	244	101	507	502	-	2,318	1,773

DATA RELATING TO THE SCALE OF OPERATIONS IN DIFFERENT AREAS:

- **Securities.** On December 31, 2005, the balance of securities held for customers amounted to NIS 70.2 billion, including NIS 9.6 billion of non-marketable securities, compared to NIS 58.3 billion as at December 31, 2004, including NIS 4.6 billion of non-marketable securities, an increase of 20.4%. The said balances include holdings by way of provident funds, branches, investment centers, portfolio managers, the business department of the capital market and the international private banking division. For details as to income from security activities, see Note 24.
- **Investment portfolio management.** On December 31, 2005, Tachlit was managing 1,757 investment portfolios, which together were valued at approximately NIS 1,996 million, as compared to 1,368 portfolios valued in total at approximately NIS 1,640 million as at December 31, 2004. The above data point to an increase of 28.4% in the number of portfolios managed and to an increase of approximately 21.7% in the monetary value of the managed portfolios.

  In addition, Mercantile Discount Bank, through a subsidiary of that bank, manages investment portfolios for its customers. On December 31, 2005, the total monetary value of managed portfolios was approximately NIS 510 million, an increase of approximately 19.4% in comparison with the situation as at December 31, 2004. The Bank's income from management of mutual funds totalled NIS 7 million, an increase of 40% compared with the preceding year.
- **Mutual fund management.** On December 31, 2005, Ilanot Discount was managing 60

mutual funds, as compared to 59 such funds as at the end of 2004. As of the end of 2005, the total value of mutual funds managed amounted to approximately NIS 14.0 billion, as compared to approximately NIS 12.3 billion as of the end of the previous year, an increase of approximately 13.8%. The share of Ilanot Discount in the mutual fund industry fell from approximately 12.1% as of the end of 2004 to 11.2%as at December 31, 2005.

- **Basket certificates.** Tachlit has expanded its activities in the basket certificates field, in which it operates in coordination with companies of the Michael Davis Group, and has issued additional such certificates. The total position held by Tachlit in basket certificates amounted, at the end of 2005, to NIS 1,734 million, compared with NIS 540 million at the end of 2004.
- **Provident funds.** As of December 31, 2005, the total value of provident fund assets amounted to NIS 17.6 billion, as compared to NIS 16.2 billion as of December 31, 2004, an increase of approximately 5.9%.

  The number of provident fund accounts as of December 31, 2004 was approximately 535,000, as compared to 557,000 as of the end of 2004, a decrease of approximately 4.0%.

  The provident funds managed by the Bank's subsidiary, Discount Management of Provident Fund Ltd., include:
  - Three funds for the self-employed and salaried employees – "Tamar", "Gefen", and "Rothschild-Discount Overseas". "Rothschild-Discount Overseas" is a new fund that commenced operations at the end of December 2004, and invests its funds overseas;
  - Two funds for the self-employed only – "Shikma" and "Toar". "Toar" is a provident fund that combines long-term savings with deposit insurance;
  - A general severance pay fund;
  - A multi-channel severance pay fund – "Hadas";
  - A multi-channel provident fund – "Eshkolot", for both the self-employed and salaried employees alike.

The real-term returns achieved by these provident funds in 2005 were as follows: "Tamar" – 11.09%, "Gefen" – 11.04%, "Shikma" – 11.33%, "general severance pay fund" – 9.94%, "Toar" – 11.32%.

"Hadas" affords a unique investment track for each employer, and accordingly, it is not possible to publish a return for this fund.

The multi-channel provident fund, "Eshkolot", achieved positive returns on all its investment tracks at rates ranging between 0.41% and 21.59%.

The Articles of "Tamar, "Geffen" and "General Severance Pay Fund" provident funds state that the Bank has guaranteed each of its members that the provident fund would pay the member no less than the total amount of the deposits made by the member or on his behalf. Therefor, in the event that the total amount to be received by a member from the provident fund, according to his entitlement therein is lower than the total amount deposited by him or on his behalf with the provident fund, the Bank would pay the difference to that member. A similar arrangement also exists with the "Mercantile Central Severance Pay Fund" managed by Mercantile Discount Bank. As a general rule, the amounts accumulated in the said funds significantly exceed the amounts guaranteed by the Bank and Mercantile Discount Bank. In view of the above and based on past experience, the Bank believes that the amounts that the Bank and Mercantile Discount Bank might have to pay in respect of the said guarantees are negligible.

The Articles of Association of the provident funds "Tamar" and "Gefen" and the Articles of Association of "General Severance Pay Fund" have been changed recently, determining that the guarantee of the Bank shall not apply to members joining the funds subsequent to June 30, 2006 and to accounts opened subsequent to this date.

Employees' Supplementary training funds. "Kahal" – Employees' Supplementary Training Fund Ltd. and "Kahal Maslulim" are jointly held by the Bank and Bank Leumi Le-Israel Ltd. In addition, Mercantile Discount Bank manages, both directly and through its subsidiary, eight additional provident funds, including severance pay funds and an supplementary training fund. As of December 31, 2005, total fund assets amounted to approximately NIS 3.6 billion, as compared to approximately NIS 3.1 billion as of the end of 2004, an increase of 16.5%. The number of members was approximately 113,000, a decrease of approximately 1.6% in comparison with the number of members as of December 31, 2004.

DEVELOPMENTS IN THE OPERATIONS

General. Concurrently with the legislative process in the wake of the Bachar Committee recommendations, and even more intensely, following the completion of this process, the Bank commenced the examination of the reform in the capital market, the risks faced by the Bank, and the opportunities that it presents the Bank. The Bank began to apply several moves intended to enhance its preparations for capital market activities in the post Bachar Committee era, as detailed hereunder.

Acquisition of 20% of the equity of Logos Pensionary Models and Wage Benefits Ltd. The transaction for the acquisition of 20% of the equity of Logos (including an option for an increase in ownership) was completed in April 2005. Logos is a company engaged for about four years in providing pension consultation to employers and to private individuals by means of advanced decision supporting systems.

Among its customers are corporations such as: Cellcom, Maccabi Health Services, Delta, Bezeq, Micro Swiss and more.

The acquisition of means of control in Logos Ltd. is intended to serve the Bank as a quality platform for a prompt entrance into the pension consultation market.

Acquisition of means of control in Ilanot Discount Ltd. On September 29, 2005, the Bank acquired 45% of the equity capital of Ilanot Discount Ltd, exercising the right of first refusal granted to the Bank by the shareholders' agreement in Ilanot. The shares were purchased in consideration of NIS 229.7 million, subject to adjustments. For further details, see "Ilanot Discount Ltd." in the Chapter "Main Investee Companies" hereunder and Note 6 E to the condensed financial statements.

Agreement in Principle for the sale of shares of Ilanot Discount Ltd. and the operations of Discount Management of Provident Fund Ltd. On November 7, 2005, the Bank approached several parties with respect to the possible sale of the Bank's holdings, in whole or in part, in Ilanot Discount Ltd. and in Discount Management of Provident Funds Ltd. (hereinafter: "the Provident Funds"). The said approach included certain conditions precedent. The Bank advised that it does not undertake to accept the highest offer or any particular offer of the offers, and that the Bank reserves the right to change the terms of sale, the process of sale, the determined schedules or totally discontinued the sale process.

On November 9, 2005, an agreement in principle was signed between the Bank and Clal Insurance Enterprises Holdings Ltd., whether itself or by way of a company under its control (hereinafter – "the Purchaser") for the sale of all shares of Ilanot Discount Ltd. and for the sale of the operations of Discount Management of Provident Fund Ltd., as one package, in consideration for NIS 1,310 million, subject to adjustments.

The consideration for the sale of the shares of Ilanot Discount Ltd. amounts to NIS 600 million, subject to adjustments, and the consideration for the sale of the operations of the Provident Funds amounts to NIS 710 million, subject to adjustments.

The Agreement in Principle determined, among other things, that following the consummation of the transaction, the Bank shall provide Ilanot Discount and the Provident Funds with distribution services in consideration for a distribution fee equal to the rate of fees stated in the draft regulations regarding distribution commissions payable by mutual funds and provident funds, respectively, as well as operating services and additional services.

The said Agreement in Principle is subject to the signing of detailed agreements between the Bank, the Purchaser as well as Ilanot Discount and the Provident Funds, as the case may be, the approval of their pertinent institutions as well as subject to the required approvals under any law.

At this stage, the parties have reached an understanding as to the change in the cut-off date for the sale of Ilanot Discount to January 1, 2006 (instead of October 1, 2005) so that the results of Ilanot Discount in the last quarter of 2005 would relate in full to the Bank, the reduction in the purchase price of Ilanot Discount to NIS 580 million, and the severing of the connection between the sale of Ilanot Discount and the sale of the provident funds.

The Bank anticipates that the pre-tax profit resulting from this transaction might reach NIS 1 billion subject to adjustments, if and to the extent required. The Bank is studying the tax implications of this transaction. The profit from the transaction will be recognized in the quarter in which the transaction will be concluded, which the Bank estimates to be during 2006.

Preparation for the sale of KAHAL. The Bank and Bank Leumi have recently reached an understanding regarding cooperation for the sale of all their holdings and rights in KAHAL – Employees' Supplementary Training Funds, KAHAL Channels and KAHAL Management. This following the preparation of the banks for the implementation of legislation in the wake of the Bachar Committee recommendations. In this respect several bodies have been approached in order to achieve a competitive process for the said sale. If the sale is carried out, the consideration would be divided up 65% to Bank Leumi and 35% to the Bank.

Preparations towards pension consulting. The Logos Company has been guiding the implementation and preparation of a consulting staff and computer system of the Bank for the distribution of provident and pension products. Logos employees will be integrated as a department of the Bank soon after the Bank receives a license to engage in pension consultation.

As a first step, the Bank has trained about 60 investments consultants to act as pension consultants. These consultants will be joined by Logos pension consultants, selected staff of Discount Management of Provident Fund, by additional consultants to be trained in the course of 2006, and by pension consultants to be recruited, in order to allow for a countrywide deployment of this service.

A decision supporting system, the implementation of which is being presently completed at the Bank, will serve as a basis for the consulting operations. This professional system will assist the customer in electing the most favorable pension alternative based upon his personal needs and the current solutions available in the market, taking into consideration the size of the pension or provident fund, the return it has achieved, its standard deviation and additional quantitative components

Establishment of a distribution system. In recent months, the Bank entered into distribution agreements with several leading entities for the distribution of provident fund products, supplementary education funds and mutual funds, which they manage. Among others, the Bank entered into agreements with the following entities: Infinity, APEX, D.S. Capital, Halman Aldubi, Rothschild and Mercantile Discount.

The Bank has also signed agreements with leading entities in the market for the distribution of pension funds which they manage. Among others, the Bank entered into agreements with Mivtachim, New Makefet, Halman, Aldubi, Harel and Ayalon Insurance.

The Bank is conducting advanced negotiations with many other entities for establishing distribution agreements for products, which they manage.

Concurrently, the Bank is preparing to establish an independent banking distribution system, which would answer the Bank's business needs with respect to the sale of products of various providers (provident funds, pension funds, insurance companies, etc.).

MARKETING AND DISTRIBUTION

The distribution of products and services is undertaken by segment employees through the use of the Bank's existing distribution apparatus, the branch network, investment centers, private banking centers, staff units and the Bank's subsidiary companies.
As stated above, following the new legislation for the implementation of the Bachar Committee recommendations, the Bank is to become a financial and pension consultant independent of the providers of the products, and will distribute a range of financial and pension products.

COMPETITION

In the capital market activity, the Bank competes both with other banks and with private brokers.
In the field of financial products competition exists against the consulting entities as well as against the marketing entities (the providers of the products) as regards the sale to customers of one or another financial product.
In the field of financial products the Bank plans to begin during the year pension consulting services activities. This activity requires a continued pension consulting agreement between the consultant or the marketer and the customer. Accordingly, fierce competition is expected regarding the preferences of the customer in an effort to create a long-term relationship, within its framework the Bank is committed to maintain a continuous connection with the customer.
In this respect, competition is expected against all the consulting entities on the one hand and the marketing entities as well as against the providers of the products (insurance companies, insurance brokers, pension funds, etc.) on the other hand.
For details as to the conditions required for entry into the pension-consulting field, see Note 33 to the financial statements.

GOALS AND BUSINESS STRATEGY

- Completion of the process of sale of Ilanot Discount and the provident fund activity, the sale of the holdings in KAHAL, and a reduction in the holdings in Harel, and everything in order to fulfill the terms required for receiving a pension consultant license;
- Completing the preparations for pension consulting;
- Completing the preparations for operating as a "supermarket" for financial and pension products;
- Improvement in securities trading by means of the Internet, development of the activity of arbitrage player and capital market players;
- Cultivation and distinction of the status of the consultant;
- Providing operating services to provident funds and mutual funds.

CONSTRUCTION AND REAL ESTATE ACTIVITY

This activity includes customers of the Bank's various divisions whose industry classification is construction and real estate. This activity also includes customers of the construction and real estate segment of the Mercantile Discount Bank and the loans for the purchase or building of commercial property segment at Discount Mortgage Bank and the building project finance segment at Discount Mortgage Bank.

DEVELOPMENTS IN ACTIVITY

Residential construction projects. The slowdown in the activity of the construction and real estate sector continued in 2005. The volume of investments in residential construction projects, according to assessments of the Central Bureau of Statistics, decreased by an overall rate of 2.2%, and by 7.4% in the case of non-residential construction projects.

The slowdown in activity of residential construction was evident mostly in peripheral areas, due to characteristics of low disposable income of households, relatively high unemployment rates and the decrease in grants to eligible individuals.

The increases in the price of land, in the cost of labor and a significant increase in the cost of other construction inputs during 2005, materially decreased the profit margin of the building entrepeneur/contractor. This decrease urged some of the large construction corporations to divert their business overseas, mainly to Central and Eastern Europe.

Several developments occurred in 2005 that might indicate a specific improvement in the residential property market in central Israel and in preferred peripheral areas:

An increase in the volume of investment of foreign residents in luxury apartments in Jerusalem, Tel-Aviv, Ashdod and Netanya, an increased coupled with rising prices.

An Increase in the acquisition of land in preferred areas, through cash and "combination" transactions, followed by a rise in prices.

An increase in demand for housing units in preferred central areas, particularly in the coastal cities, coupled by rising prices at an average rate of 5%, following a long standstill period.

Office and commercial income producing property. Activity in this sector is divided into the office-space and commercial fields.

The slowdown in activity in the field of office-space continued in 2005, due to excess supply of vacant office space, though moderate compared with prior years. Rental prices stabilized on a low level following erosion over several years.

The slowdown in activity continued also in the commercial property field which was reflected in the scarcity of investments in new projects. The excess supply in this field was relatively low, since investments in new projects were made only after a large part of the designated areas had been leased in advance. A significant number of large corporation diverted abroad their activity in the office-space and commercial property fields, due a relatively high rate of return on investments, obtaining a relatively higher rate of finance from the financing banks and the potential for quick capital gains.

The second half of 2005 saw an acceleration in the number of transactions for the acquisition of companies in this sector, the assets of which included income producing property, mostly commercial space.

LEGISLATIVE RESTRICTIONS, REGULATIONS AND SPECIAL CONSTRAINTS APPLICABLE TO THE ACTIVITY

The limitations described above, with respect to the business segment as a whole, also apply to the sub-segment. Furthermore, it should be noted that the Proper Banking Management Directives contain restrictions with respect to the concentration of credit by industry. This situation arises when the credit facilities provided by a bank (including off-balance sheet facilities) to a certain industry (as defined in the directive) at the bank's risk, exceeds 20% of the total credit facilities made available to the public at that bank's risk. The exposure rate with respect to total credit facilities made available to customers of the Bank's construction and real estate segment as of December 31, 2005 was approximately 15.4%.

CREDIT POLICY IN THE CONSTRUCTION REAL ESTATE ACTIVITY

The Bank's credit policy is based on the following principles:

- The greater part of the credit facilities made available to the real estate sector will be processed through a professional project finance unit;
- Future credit policy will be selective, insofar as preference will be given to the financing of projects which bear a relatively low exposure vis-à-vis the slowdown in the industry;
- The provision of credit facilities for the acquisition of land and/or construction purposes will be conditioned on minimum capital investment rates on the part of the promoters;
- The release of unutilized facilities will be subject to simultaneous compliance with rates of sales and minimum rates of performance.

The preferred areas for granting of credit facilities:

- Construction of low-grade housing projects and more improved housing units in areas of demand;
- Land is available for construction in areas of demand with respect to which the Bank is prepared to provide closed financing for construction projects;
- The provision of credit facilities to real estate companies for the purpose of financing current projects and/or investment projects. Preference will be accorded to large well-established financially sound companies, whose requirements are for medium-term credit for a period of between one and three years.

Discount Mortgage Bank's policy is to moderate is activity regarding building project financing and limiting itself to financing the purchase of commercial property.

SCALE OF OPERATIONS AND NET INCOME

Despite the continuing economic slowdown in this industry, the Bank has increased its business activity with enterprising construction companies by way of approval of new credit facilities for the purpose of land acquisition and/or the building of residential projects in preferred areas both in central and peripheral regions.

The Bank approved new credit facilities in 2005, for financing the purchase of land and residential construction projects of 1,573 residential units, compared with 1,250 units in 2004.

In addition, the business activity has been extended by way of approval of new credit facilities to finance both current and investment operations, according to the Bank's policy.

A reasonable volume and rate of sales were reported in respect of projects in the process of construction.

The shortage in equity capital and cash on the part of some of the contractors contributed to the increased trend of acquiring land through "combination transactions" or by the "vacate and build" system, where the payment for the land is only made upon the completion of the project.

Net income of the segment in 2005 amounted to NIS 67 million, compared with a loss of NIS 52 million in 2004.

The return on equity in 2005, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 7.5% in 2005, compared with a negative rate of 5.1% in 2004.

In accordance with the directive of the Supervisor of Banks, the segment has been charged with expenses relating to the encouragement of early retirement of segment employees who have retired, and of staff members at various levels whose salaries are attributed to the segment. Disregarding these expenses, the segment's net income in 2005 would have amounted to NIS 69 million, compared with a loss of NIS 49 million in 2004 and the return on equity in 2005 would have been 7.7%, compared with a negetive rate of 4.9% in 2004.

Provision for doubtful debts in this segment amounted in 2005 to NIS 193 million, compared with 326 in 2004, a decrease of 41%. In 2004, the provision was significantly affected by the increase in the provision made by Discount Mortgage Bank for this segment.

Following are the principal data relating to the operations of the construction and real estate segment:

	Small businesses	Corporate banking	Middle market banking	Total	
	2005	2005	2005	2005	2004
Income from financing activities before provision for doubtful debts					
From externals -	143	562	520	1,225	-
Inter-segmenta -	(97)	(295)	(487)	(879)	-
Total income from financing activities	46	267	33	346	259
Operating and other income	12	16	6	34	26
Total income	58	283	39	380	285
Provision for doubtful debts	18	165	10	193	326
Operating and other expenses	15	52	9	76	74
Income from ordinary operations before taxes	25	66	20	111	(115)
Provision for taxes on ordinary activities	12	33	9	54	(45)
Net income (loss)	14	42	11	67	(52)
Return on equity (rate)	11.3	5.9	15.4	7.5	(5.1)
Average balance of assets	2,244	11,263	1,198	14,705	9,708
Average balance of liabilitites	494	1,299	265	2,058	1,876
Average balance of risk assets	2,083	11,822	1,153	15,058	16,801
Components of income from					
financing activities:					
Margin on credit	36	277	27	290	218
Margin on deposits	7	14	2	23	16
Other	3	26	4	33	25
Total income from financing activities	46	267	33	346	259

CRITICAL SUCCESS FACTORS OF THE SEGMENT

The critical success factors of the segment include current communication with customers, qualitative service, continued customer satisfaction as regards the quality of service and the financing of projects that had been completed, providing prompt response to applications for credit and other related services. In addition – the offer of competitive terms as regards project financing, the volume of the equity capital required and the financing costs and commissions.

THE MAIN ENTRY AND EXIT BARRIERS OF THE SEGMENT

Segment customers conduct business with several banks at any given time, so that the relative advantage of the segment is based upon the long-term relationship of the Bank with its customers, including continued satisfaction as regards the quality of service and the financing of projects. The said close-end system of project financing is, prima facie, supposed to allow the construction company to finance each project at another bank. Nevertheless, considering the fact that surplus created in respect of projects financed by the Bank or current credit facilities allotted to promoters is being used in many cases as capital for leveraging other projects, a certain difficulty exists as regards the transfer from bank to bank, mostly with respect to the small and medium customers, a factor comprising an entry barrier to the segment.

ALTERNATIVES TO PRODUCTS AND SERVICES OF THE SEGMENT AND CHANGES THEREIN

The large and medium property companies increased in 2005 the volume of off-banking credit raised by the issuance of shares and bonds on the domestic and overseas capital markets.
Off-banking financing constitutes an alternative financing source for segment customers as to long and medium-term credit used for the financing of investments and/or the purchase of income producing property, while in building projects, customers generally prefer the use of medium-short term bridging finance for the set up period.

STRUCTURE OF THE COMPETITION PREVAILING IN THE SEGMENT AND CHANGES THEREIN

Most of the competition prevailing in the segment lies within the banking industry. The off-banking finance comprises, primarily, an alternative long-term financing source required for the construction and/or acquisition of income producing property in Israel and abroad, or as equity capital for the leverage of residential construction projects.
Insurance companies sometime participate in project financing by providing insurance policies instead of guarantees under the Sales Act, however this activity is conducted in cooperation with the banking industry.
The principal means of the segment for facing competition include the provision of a professional service and the establishment of a comprehensive and current relationship with the customers.
Intensifying the current communication with segment customers is carried out several times a year by means of an information kit for business customers, which includes up-to-date data as well as a package of attractive offers customized to the needs of corporations and business people.

SERVICE TO CUSTOMERS

The Bank's project financing department provides credit to real estate companies according to their particular needs, primarily in the following areas:

1. Financing of housing projects and/or projects involving income-producing property (mainly commercial property the majority thereof is marketed in advance);
2. Credit financing the purchase of income-producing property;
3. Credit for current financing
4. Providing guarantees under the Sales Act to purchasers of dwelling units and performance guarantees to the rights owners in land in the context of combination transactions or clearing and construction transactions

Deepening the current communication with segment customers is carried out by providing them with information packets several times a year, which include up to date banking information as well as an attractive set of offers, tailored to the needs of business people and companies.
For further information relating to services provided to segment customers, see above, 'Corporate segment.'
Discount Mortgage Bank offers its services to customers through its three branches (in Tel Aviv, Jerusalem and Haifa), as well as through 41 mortgage bank counters located in various branches of Israel Discount Bank Ltd.

Mercantile Discount Bank. The construction project financing department, providing services to customers Mercantile Discount Bank engaged in the construction field.

ORGANIZATIONAL CHANGES AT DISCOUNT MORTGAGE BANK

Discount Mortgage Bank is currently implementing changes to its organizational structure. In the current structure, there are two separate marketing and credit departments, which service respectively the business segment and the retail (mortgage) segment. Under the new structure, there will be a retail department specializing in marketing and sales, and a business department specializing in credit management.

MORTGAGE AND HOUSING LOAN ACTIVITY

SEGMENT CUSTOMERS

This segment includes the mortgage operations of the Discount Group in Israel (Mercantile Discount Bank and Discount Mortgage Bank). At this stage, housing loans made by the Bank are excluded. This segment includes the granting of loans for housing purposes (purchase, construction etc.) and the granting of business loans and loans for any purpose secured by a mortgage on a residential apartment or other property.

DEVELOPMENT IN THE MORTGAGE MARKET

An increase in the volume of credit (including re-financing) granted by mortgage banks was recorded in 2005. This amounted to NIS 26,362 million compared to NIS 22,757 million in 2004, an increase of 15.8%. The credit from bank funds (including re-financing) included in the above amounts, increased from NIS 24,022 million, compared with NIS 19,614 million in 2004, an increase of 22.5%. At the same time the credit granted from state funds decreased reaching NIS 2,340 million in 2005 (including standing loans and conditional grants of NIS 0.3 billion) compared with NIS 3,143 million in 2004 (including standing loans and conditional grants of NIS 0.2 billion) a decrease of 25.6%

The increase in the volume of credit granted as above, includes, among other things, loans repaid at one bank and taken at another bank, as well as internal recycling reported by some fo the banks of loans and changes in the terms of loans as the granting of new loans.

According to the Bank of Israel data, the volume of internal recycling of loans was NIS 5,021 million in 2005. No comparative data is available for 2004.

SECTORS OF OPERATION

Loans for the purchase or building of housing units. Loans for the purchase or building of housing units (by private individuals). The loans are generally granted to private individuals (households). These loans constitute most of the activity in the mortgage loan field.

Multi purpose loans secured by a mortgage on a housing unit. These loans are granted not in the course of purchasing or building of a housing unit but by using it as collateral. Discount Mortgage Bank offers house owners whose property is free of a mortgage or with a relatively low mortgage loan compared to the value of the property, to use the property as collateral for raising funds for use of the household, similarly to the conduct of business entities.

Providing services to the State. Discount Mortgage Bank provides entitled individuals, credit and grants out of State funds according to guidelines of the Ministry of Construction and Housing and the Accountant General at the Ministry of Finance. The volume of this operation is diminishing due to the policy of the Finance Ministry to reduce the scope and advantage of the loans to entitled individuals.

In recent years, the Accountant General reduces the commission paid to the banks for handling loans to entitled individuals. The said reduction in commission rates caused the commission income of the Group in respect of new loans from State funds to become imaterial. The agreement between Discount Mortgage Bank and the Ministry of Finance as regards loans to entitled individuals will expire on June 30, 2006. The Ministry of Finance has not as yet informed Discount Mortgage Bank whether it intends to issue a new tender in the matter or extend the existing agreement.

Discount Mortgage Bank provides rent grants out of State funds to entitled individuals according to guidelines set by the Ministry of Construction and Housing and the Accountant General at the Ministry of Finance. Discount Mortgage Bank has an agreement for providing these services until June 2006. The Ministry of Finance issued at the end of 2005 a tender for providing these services, in which non-banking entities were successful. As a consequence, Discount Mortgage Bank expects to terminate this operation in the middle of 2006. However, the entities that were successful in the tender are required to establish computer and operating systems within a relatively short time. In the event that these entities should not complete their preparations in time, the Ministry of Finance might exercise the option it has and extend the agreement with Discount Mortgage Bank for an additional period.

Discount Mortgage Bank estimates that the termination of its operation in providing the above services would reduce its operating income by an annual amount of NIS 3 million (about NIS 1.5 in 2006). This estimate is considered "forward-looking information". The above estimate is based on actual income data and estimates as to cost saving generally and in 2006 in particular. This estimate may not materialize, among other things, due to the inability to reduce costs, longer reaction times than expected and so forth.

Mortgage related insurance. As an additional security for credit granted by Discount Mortgage Bank, this bank requires its customers to purchase property insurance and in some of the cases life assurance.

On February 20, 2005, the Supervisor of Banks published a circular relating to the marketing of life assurance and property insurance policies in connection with loans taken out for housing purposes. The circular was accompanied by a joint policy declaration of the Supervisor of Banks and the Supervisor of Insurance dated February 17, 2005, which prescribes the principles for marketing life assurance and property insurance as policies by a banking corporation as security for the repayment of a housing bank loan.

According to the policy declaration, which was anchored in legislation, the above insurance policies will be marketed at unmanned sales points operated by technological means that will be separated from all other banking activities. The policies will be sold through an authorized insurance agent acting as an authorized insurance agency, whose business is quite distinct from that of the Bank, by employees of the agency who are not employees of the Bank.

A banking corporation shall be entitled to possess full ownership of the insurance agency, whose business shall be limited to the insurance policies referred to above. The agency shall have a computer system at its disposal, access to which shall be available only to agency employees. It shall be forbidden to use the information obtained by the insurance agency for any purpose other than that for which the agency was established. Collection of the premiums on the insurance policies shall be made separately from those of the loan.

Any bank interested in receiving a permit to control an insurance agency for the aforementioned activities should apply to the Supervisor of Banks.

In the above circular, the Supervisor of Banks have clarified that, as of October 1, 2005, a banking corporation shall not market insurance policies except in accordance with the procedures described in the circular. The above notwithstanding, an insurance policy entered upon before October 1, in accordance with the previous arrangements, may be continued or renewed.

For many years, Discount Mortgage Bank offered its customers to purchase insurance by means of that bank, serving as an insurance brokers for this purpose. The customer could choose using the services of that bank or of any other insurance agent. As from January 1, 2006, Discount Mortgage Bank no longer offers the sale of these insurance schemes as a broker.

Discount Mortgage Bank formed a subsidiary, **Discount Mortgage Home Insurance Agency**

(2005) Ltd., which acts as an insurance broker. This subsidiary operates independently and sells insurance through a telephone service separate from that bank's telephone service. Discount Mortgage Bank believes that this subsidiary will show operating losses in the first years of operation.

The transition of the sale of insurance from the bank to an insurance broker owned by the bank, is expected to adversely affect the operating income in the mortgage field, though it is not possible to assess the volume of such effect. Discount Mortgage Bank continues to maintain the existing customer insurance portfolio.

Some of the information given in this section is "forward-looking information". As to the meaning of this term, see above in the Section "Forward-looking information".

Net income of the segment in 2005 amounted to NIS 34 million, compared with 12 million in 2004, an increase of 183.3%.

The return on equity in 2005, calculated on the capital allocated to the sector on the basis of the average balance of segment risk assets, was 5.6% in 2005, compared with 2.6% in 2004.

Provision for doubtful debts in this segment amounted in 2005 to NIS 52 million, compared with 78 in 2004, a decrease of 33.3%. In 2004, the provision was significantly affected by the increase in the provision made by Discount Mortgage Bank for this segment.

Following are the principal data relating to the operations of the mortgage and housing loan segment:

	Households	Small businesses	Middle market	Total	
	2005	2005	2005	2005	2004
Income from financing activities before provision for doubtful debts from externals	217	38	44	299	-
Inter-segmental	(80)	(16)	(38)	(134)	-
Total income from financing activities	137	22	6	165	125
Operating and other income	55	3	1	59	57
Total income	192	25	7	224	182
Provision for doubtful debts	32	7	13	52	78
Operating and other expenses	82	9	(1)	92	65
Income from ordinary operations before taxes	78	9	(7)	80	39
Provision for taxes on ordinary activities	29	2	(3)	28	21
Net income (loss)	33	4	(3)	34	12
Return on equity (rate)	6.8	5.1	(9.6)	5.6	2.6
Average balance of assets	9,365	1,288	535	11,188	9,850
Average balance of liabilitites	2,293	291	-	2,584	2,298
Average balance of risk assets	8,174	1,306	534	10,014	7,389
Average balance of provident funds and mutual funds assets	-	-	-	-	-
Average balance of securities	-	-	-	-	-
Average balance of other assets under management	2,282	-	-	2,282	2,362
Components of income from financing activities:					
Margin on credit	137	22	6	165	124
Margin on deposits	-	-	-	-	-
Other	-	-	-	-	1
Total income from financing activities	137	22	6	165	125

MARKETING OF MORTGAGE PRODUCTS

Discount Mortgage Bank serves its customers through three branches (in Tel Aviv, Jerusalem and Haifa) and through 41 counters located inside branches of Israel Discount Bank Ltd.
Discount Mortgage Bank engages in the marketing and advertising of its many and varied products, customizing them to the changing requirements of the public, to changing economic conditions and to market trends.
Discount Mortgage Bank continues to constantly examine new and original ways of customizing its products to public needs. In this respect, for instance, Discount Mortgage Bank launched in February 2006 a campaign for the product "Buy a house at the price of paying your rent", This integrated product offers the potential customer to turn from a tenant to a house owner both as regards the variety of mortgage channels suitable to his needs during the transition as well as the arrangements made by the bank with a line of leading building companies, who offer a variety of dwelling units for sale and participate in part of the cost of the mortgage.
Alongside this, the bank expands its activity with varied populations, such as: purchase groups, foreign residents, the Jewish Orthodox sector, students, VIP's and others.

COMPETITION

Most of the banks compete in this field; both the mortgage banks, the mortgage banks that have been merged and turned into a division of a commercial bank, and the commercial banks. Some of the insurance companies also offer mortgage loans.
Competition in this market is fierce and is clearly prone to price reduction.

BUSINESS STRAGETY – DISCOUNT MORTGAGE BANK

Discount Mortgage Bank will continue providing credit in the sectors of operations in which it operated in the past. Nevertheless, Discount Mortgage Bank has moderated its operations in financing building projects and has set limits with respect to granting credit for the purchase of commercial property.
Discount Mortgage Bank sees the field of financing of housing (both credit for the purchase or building of dwelling units or the granting credit for any other purpose by a mortgage on a dwelling unit) as its principal line of operations and as the leverage for its expansion in the coming years, and most of its marketing and sales efforts are directed towards these segments.
The bank set itself a target of becoming the leading bank in the housing mortgage loan field, as regards service, innovation and as regards customizing to customer needs.
Within this framework the bank acted in 2005, both in advertising, identifying the recycling segment and conducting extensive activity in this field, and in improving the sources of funds – which enabled is to offer attractive terms to customers, as well as in the improvement of service.
The bank plans to expand these operations in 2006:

a. Products – the bank continuously examines new products;
b. Improvement of service – the bank acts to improve the service awareness;
c. Advertising and marketing – the bank will continue advertising its services according to its changing needs.

ORGANIZATIONAL CHANGES AT DISCOUNT MORTGAGE BANK

At the beginning of 2005, Discount Mortgage Bank implemented a conceptual organizational change, from a traditional structure of to separate arms – retail and business, each conducting in its own field an entire range of operations: credit, marketing and sales, to a structure of an arm specializing in marketing and sales and an arm specializing in credit management, by way of two leading operating divisions: the business division and the sales and marketing division.

ORGANIZATIONAL CHANGES AT MERCANTILE DISCOUNT BANK

Until 2005, the mortgage loan activity of Mercantile Discount Bank was part of the mortgage and construction project finance division. As from January 1, 2006, the mortgage and construction project finance division was closed down and its operations divided between the corporate division (construction project finance) and the branch head office (mortgages).

STRUCTURE OF THE BANKING GROUP

The Bank's Group is composed of commercial banks in Israel and overseas, a mortgage bank and financial services companies.

Total investment in the consolidated and affiliated companies as at December 31, 2005, amounted to NIS 6.4 billion, compared with NIS 5.9 billion on December 31, 2004.

Following is the distribution of net income (loss) by main operating segments (in NIS millions):

	Contribution to Group's results		Contribution Disregarding the effects of coverage of investment(*)	
	2005	2004	2005	2004
	In Nis Million			
Banking Activity:				
Commercial banks:				
In Israel - the Bank (including branches overseas)	(228)	104	(143)	85
- Consolidated company	114	104	114	104
- Affiliated company	122	65	122	65
Overseas - Bank offices	307	141	222	160
Mortgage Bank	17	(23)	17	(23)
Other Activities:				
Credit cards	42	33	42	33
Other financial services	84	109	84	109
Total operating (gain) loss	458	533	458	533
Income (loss) from extraordinary operations	-	23	-	23
Net gain (loss)	458	556	458	556

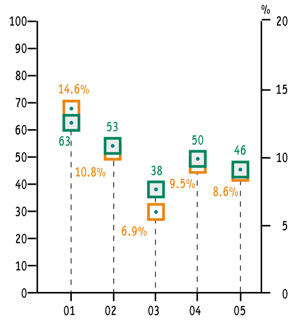
(*) The Bank in Israel created a surplus of liabilities in foreign currency, constituting coverage for the Bank's investment in Discount Bancorp, Inc., and as from May 2001 also in Israel Discount Bank (Switzerland), with the aim of preventing exposure to fluctuations in the exchange rate of the shekel against the US dollar and the Swiss Franc.
In the Statement of Income of the Bank in Israel, income and expenses arising from exchange rate differentials on the surplus of liabilities mentioned above are presented under the item "income from financing activities before provision for doubtful debts". This income and expenditure is taken into account in the calculation of provision for taxes. Income and expenses arising from exchange rate differentials on overseas investments are presented under the item "Bank's share in operating income of investee companies, net of tax effect".
This method of treatment has an effect on the presentation of the Bank's after-tax operating income and on the contribution of the overseas units to net income. In 2005, the shekel was devalued in real terms as against the US dollar by 6.8%, compared with a appreciation of 1.6% in 2004. In 2005, the shekel was appreciated in real terms against the Swiss Franc by 8.1%, compared with a devaluation of 7.2% in 2004. The said devaluation/appreciation resulted in a decrease in the Bank's net operating income after tax in Israel by NIS 85 million, compared with an increase of NIS 19 million in net operating income in 2004. Concurrently, there was a decrease/increase in the positive contribution by overseas extensions to the results of the Bank.

MAIN INVESTEE COMPANIES

At the end of 2005, 18.2% of all assets in the consolidated balance sheet were assets of consolidated companies in Israel, and 29% were assets of overseas consolidated companies and branches. The contribution to the net results by the consolidated companies in Israel totalled NIS 203 million in 2005 (2004: NIS 150 million). The contribution to the net results by overseas consolidated companies totalled NIS 307 million in 2005 (2004: NIS 141 million), and the contribution to the net results by affiliated companies totalled NIS 174 million in 2005 (2004: NIS 135 million).
The total contribution by both domestic and overseas investees companies to the net results of the Bank amounted to NIS 684 million in 2005, compared with NIS 426 million in 2004, an increase of 60.6%. The share in earnings of affiliates in 2005 is stated net of a provision for taxes of NIS 22 million, in respect of the Bank's holdings in Harel, less dividends received.
Disregarding the effect of the coverage of the investment in overseas subsidiaries, net of the tax effect, the contribution of both domestic and overseas investees to the net results of the Bank in 2005, would have been NIS 599 million, compared with 445 million in 2004, an increase of 34.6%.

DISCOUNT BANCORP, INC.

Discount Bancorp, Inc. ("Bancorp") is fully owned by the Bank. Bancorp fully owns and controls Israel Discount Bank of New York (IDB New York).
Pursuant to Bancorp's Certificate of Incorporation and By-Laws, IDB New York may not be sold by Bancorp unless the Bank has given its prior written consent thereto. A legend to this effect appears on the share certificate of IDB New York.
Total assets at the end of 2005 amounted to US$ 9,121 million, compared with US$ 8,410 million at the end of 2004, a rise of 8.5%.
Total credit at the end of 2005 was US$ 2,775 million, compared with US$ 2,481 million at the end of 2004, an increase of 11.9%.
Total deposits stood at US$ 6,613 million as at the end of 2005, compared with US$ 5,019 million at the end of 2004, an increase of 31.8%.
Shareholder's equity totalled US$ 554 million at the end of 2005, compared with US$ 537 million at the end of 2004, an increase of 3.2%.
The ratio of capital to risk assets was 11.85% as at December 31, 2005, compared with 12.5% at December 31, 2004.
Net income in 2005 totalled US$ 46 million, compared with US$ 50 million in the preceding year, a decrease of 8.0%.
Return on equity was 8.6% in 2005, compared with 9.6% in 2004.
The contribution of the Bank's investment in Bancorp to the net results of the Bank was NIS 310 million in 2005 (after deducting a provision for additional taxes of NIS 58 million that applies to the Bank in Israel), compared with NIS 138 million in 2004 (after deducting provision for additional taxes of NIS 44 million that applies to the Bank in Israel).
The said contribution is comprised of Bancorp's net income in 2005 (after deducting the provision for tax as aforesaid) of NIS 156 million with the addition of real term exchange rate differentials on the investment of NIS 151 million, compared with net income of NIS 172 million (after deducting a provision for taxes as aforesaid) and with the addition of real term exchange rate differentials on the investment of NIS 34 million in 2004.
Together with exchange rate differentials on the said investment, the Bank in Israel recorded financing expenses in 2005 and financing expenses in the preceding year, in respect of the surplus foreign currency liabilities that the Bank created as coverage for the investment in Bancorp.
In 2004, IDB New York reclassified bonds in a total amount of US$ 1,297 million from the



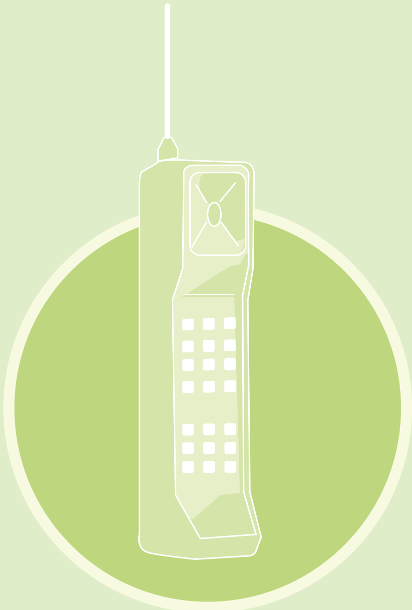
DISCOUNT BANCORP, INC.
NET INCOME AND RETURN ON EQUITY

NET INCOME - IN US$ MILLIONS

RETURN ON EQUITY

'70

1970, Invention of the diskette. 1975, The personal computer. 1978, The cell phone. 1973. A machine that issues money from the wall appears in Israel.



How would our lives look without the PC? Without the telephone? And without the cell phone?
Technological development makes our lives easier: it saves precious time, simplifies complex processes, shortens distances, promotes efficiency.
Israel Discount Bank, which emphasizes personal and direct ties with its customers, was a pioneer in adopting technological innovations for the benefit of their customers and to improve operation at its branches.
Already in the sixties, two years after the electronic computer was introduced into the bank, its operators receive the Kaplan Award for Excellence in Research. In 1973, Israel Discount Bank is the first to introduce ATMs to Israel, and its customers are able to withdraw cash at any time of the day, without standing in line. The TeleBank, the computerization, the option of performing banking transactions with the PC — these are further examples of innovation and openness which have the same objective: professionalism and service.

Please Enter Your Password. The bank is closed, but you can withdraw cash. One of the first Discount-o-Mats in action, 1973.


DISCONTOMAT

securities available for sale portfolio to the securities held to maturity portfolio.
IDB New York continues to be the largest Israeli bank operating overseas.

An investigation regarding matters relating to the prohibition of money laundering laws. The New York County District Attorney's Office conducted an investigation with respect to several banks and financial institutions, including IDB New York, regarding matters pertaining to the transfer of funds from a third country and to the conduct of the bank in matters relating to duties imposed by anti money laundering laws and regulations.

Concurrently, the Banking Department of the State of New York conducted an examination with respect to those and other matters.

An examination performed by the Superindendent of Banks of the State of New York discovered many deficiencies in the efficiency of the systems of the control and reporting relating to matters regarding the prohibition of money laundering and the prevention of financing of terror at IDB New York. Following these findings, the Superindendent of Banks of the State of New York and the FDIC issued Letters of Directives in which IDB New York was instructed, among other things, to refrain from operating according to the existing procedures, due to them being deficient, to correct deficiencies, to reinforce control and supervision processes, to establish an enforcement plan and to correct the procedures related to these matters, all in the manner and dates determined by the said Authorities.

On December 15, 2005, IDB New York confirmed that it would act in accordance with the requirement of the Letters of Directives. The Letters of Directives determined, among other things, that the board of directors of IDB New York would appoint an independent entity that would examine the actions adopted by the senior management for the correction of the deficiencies found by prior inspections; that an overall plan is to be formed, adopted and implemented to assure compliance with the provisions law and the principles governing matters of prohibition of money laundering and the financing of terror, which would relate, inter-alia, to control systems, training programs, audit program and the appointment of an executive in charge of compliance with the said laws and principles; that a compliance committee be appointed of members of the Board of IDB New York, which would monitor the implementation of the requirements stated in the Letters of Directives. In addition, IDB New York is to be charged with the payment of an amount not exceeding US$16.5 million, which is to be paid to the Superindendent of Banks of the State of New York, to the FDIC and to the FINCEN. The final amount to be paid by IDB New York has not yet been determined.

Discount Bank, as the parent company of IDB New York, has declared that it is aware of the said arrangements and that it has taken upon itself to act to the best of its ability to assure the fulfillment of the above commitments.

Concurrently and in addition, IDB New York reached an arrangement on December 15, 2005, with the District Attorney of the County of New York for the termination of the inquiry by way of a civil arrangement. In the agreement IDB New York has undertaken to cooperate with the District Attorney of the County of New York. Furthermore, IDB New York has recognized the facts relating to certain accounts, and to the fact that the internal controls and the procedures of the bank as well as its treatment of the matters relating to the prohibition of money laundering contributed to the findings of the District Attorney of the County of New York and the Civil Authorities. According to the terms of the agreement, IDB New York has undertaken to pay an amount of US$8.5 million, as well as to report to the District Attorney of the County of New York within one year, as to all the actions taken to improve the procedures of the bank and to correct the deficiencies found both by the District Attorney of the County of New York and by the Civil Authorities, as detailed in the abovementioned Letters of Directives. The District Attorney of the County of New York has agreed not to sue IDB New York and its related companies with respect to the investigation.

The Management of IDB New York has begun implementing the requirements included in the Letters of Directives and in the Cooperation Agreement with the District Attorney of the

County of New York, and these are being implemented in accordance with the schedule, as required. For this purpose IDB New York engaged the services of KPMG for the preparation of a comprehensive enforcement plan and for performing examinations in accordance with the letters of Directives. In addition, the services of PROMONTORY were also engaged in order to examine the activities of senior management with regard to the implementation of prior inspection findings.

IDB New York estimates that the remediation costs in 2006 might be material for it.

In December 2005, within the framework of the abovementioned declaration, Discount Bank decided to appoint Mr. Reuven Spigel, a Senior Vice President of the Bank, and Mr. Gad Arbel, a director of the Bank, as directors of IDB New York. Mr. Arbel was appointed member of the Audit Committee of the Board and as member of the compliance committee, which has to monitor the implementation of the requirements of the Letters of Directives.

In accordance with a resolution of the Board of Directors of IDB New York of January 2006, adopted after consultation with IDB New York's external legal counsels, the President and CEO Mr. Arie Sheer, was asked to take a paid leave of absence until a different decision is taken. During this period, Mr. Chaim Bar-Ziv, Vice President of IDB New York assumed the duties of acting President & CEO. As part of the said decision Mr. Sheer was asked to cooperate with IDB New York or whoever acts on its behalf and with the various regulatory authorities. Restrictions were also been set with respect to his entry into the premises of the bank and regarding communication with customers and employees. Mr. Sheer informed that he accepts the above decisions under protest.

On February 6, 2006, The Board of Directors of the Bank decided to recommend to the Board of Directors of IDB New York to appoint Mr. Reuven Spigel as President and CEO of IDB New York in place of Mr. Arie Sheer. On February 23, 2006, the Board of Directors of IDB New York decided to terminate the office of Mr. Arie Sher and to appoint Mr. Reuven Spigel as President and CEO of IDB New York.

The financial statements as of December 31, 2005, include a provision of NIS 120 million in respect of fines and consultation expenses.

Material deficiencies in the internal control. As reported to the Bank, the Management of IDB New York reported to the audit committee in the meeting approving the financial statements of IDB New York that no material weaknesses had been identified in the internal control, except for controls regarding the compliance with the Bank Secrecy Act (BSA) and the Anti-Money Laundering Act (AML).

In order to properly relate to control issues regarding BSA and AML, IDB New York established on December 30, 2005, a compliance committee (hereinafter – "the committee"), composed of three external directors and also appointed a new officer in charge of BSA/AML. The committee reports to the board of directors on a monthly basis and a set of rules was established for the compliance committee as well as definition of duties for the officer in charge of BSA/AML. The board of directors also approved on February 7, 2006, the compliance plan for BSA/AML and distributed it on February 23, 2006 to all employees of IDB New York. The new officer in charge of BSA/AML took office on January 16, 2006, and he also serves as a member of the compliance committee and reports to the board of directors, to the audit committee and to the president and CEO.

MERCANTILE DISCOUNT BANK LTD.

Mercantile Discount Bank Ltd. (“Mercantile Discount”) is a wholly-owned subsidiary of the Bank.

At the end of 2054, Mercantile Discount Bank operated through 63 branches, compared with 62 branches in 2004.

Total assets at the end of 2005 amounted to NIS 16,578 million, compared with NIS 15,771 million at the end of 2004, a rise of 5.1%.

Total credit granted to the public at the end of 2005 was NIS 12,784 million, compared with NIS 12,697 million at the end of 2004, a rise of 0.7%.

Total deposits from the public at the end of 2005 amounted to NIS 14,119 million, compared with NIS 13,894 million at the end of 2004, a rise of 1.6%.

Shareholder’s equity at the end of 2005 amounted to NIS 1,056 million, compared with NIS 952 million at the end of 2004, a rise of 10.9%.

The ratio of capital to risk assets was 12.2% as at December 31, 2005, compared with 10.6% as at December 31, 2004.

Net income was NIS 111 million in 2005, compared with NIS 103 million in 2004, a rise of 7.8%. The significant improvement in the business results of the Mercantile Discount Bank was mainly the result of the following factors: an increase in earnings from financing operations, an increase in operating and other earnings and a decrease in the effective tax rate. The improvement was partly mitigated by an increase in operating and other expenses and an increase in the provision for doubtful debts.

Return on shareholders’ equity in 2005 was 11.7%, compared with 11.5% in 2004.

The General Meeting of Shareholders approved on December 28, 2004, a dividend distribution of NIS 50 million, which was paid on January 3, 2005.

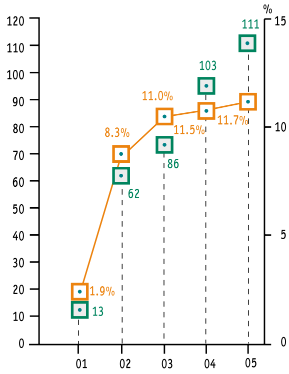
Issuance of deferred capital notes. On August 23, 2005, Mercantile Hanpakot Ltd., a subsidiary of Mercantile Discount Bank, successfully completed issuing NIS 200 million of deferred capital notes (series A), out of a series of a total of NIS 300 million. which were listed for trading on the Tel-Aviv Stock Exchange. Ma’alot rated the said capital notes as “AA-”. Mercantile Discount Bank received the approval of the Supervisor of Banks to have the said capital notes included as Mercantile Discount Bank’s second tier capital. (Accordingly, the said capital notes are considered second tier capital for the purpose of calculating the bank’s capital ratio). Up to December 31, 2005, Mercantile Discount Bank raised additional secondary capital out of the same series of NIS 57 million. In 2004, the Mercantile Discount Bank raised secondary capital of NIS 40 million, by way of an issue of subordinate capital notes.

Following cancellation of the Government decision in the matter of the sale of the shares in Mercantile Discount Bank held by the Bank there was no further need for the provision for taxes in the amount of NIS 33 million, in respect of the Bank’s share in the earnings of Mercantile Discount Bank recorded in the past. This provision was reversed in 2004.

See Note 19 C to the financial statements, article 15.2 as regards a request for approval of an action as a class action suit against Mercantile Discount Bank in the matter of a share hiking affair. As regards a motion for the approval as a class action of an action filed against Mercantile Discount Bank and against the Bank, in the matter of the method of calculating excessive interest, see Note 19 C 15.4 to the financial statements.

Investigation of suspected employee violations of the Prohibition of Money Laundering Law. On March 7, 2006, police arrived at the Ramla Branch of Mercantile Discount Bank and detained the branch manager, his deputy and another employee, on suspicion of violations of the Prohibition of Money Laundering Law. At the order of the police, the branch was cleared of its customers and staff and was closed to the public.

In coordination with the police, the branch was opened to the public on March 8, 2006, and resumed regular activity.



MERCANTILE DISCOUNT BANK
NET INCOME AND
RETURN ON EQUITY

NET INCOME - IN NIS MILLIONS

RETURN ON EQUITY

It should be noted that an undercover investigation in the matter was conducted in recent months with the knowledge of certain members of the management of Mercantile Discount Bank, who assisted the police with their investigation to the extent required. The said members of the management signed a non disclosure agreement with regard to the investigation so as to avoid disruption of its progress.
Neither the bank nor Mercantile Discount Bank have any knowledge as to the progress of the investigation and its findings. According to information given to Mercantile Discount Bank by the investigating authorities, however, no claims are being raised against Mercantile Discount Bank in this matter.

DISCOUNT MORTGAGE BANK LTD.

Discount Mortgage Bank is a subsidiary of the Bank. As of December 31, 2005, the Bank held 65.1% of its equity and of its voting rights.
Discount Mortgage Bank operates through three branches (Tel-Aviv, Jerusalem and Haifa), and through 41 counters located all over the country within branches of Discount Bank or adjacent to them (compared with 36 counters at the end of 2004).
Total assets at the end of 2005 amounted to NIS 10,355 million, compared with NIS 9,746 million at the end of 2003, an increase of 6.2%.
Total credit granted to the public amounted at the end of 2005 to NIS 10,024 million, compared with NIS 9,519 million at the end of 2004, an increase of 5.3%.
Shareholder's equity amounted to NIS 809 million at the end of 2005, compared with NIS 783 million at the end of 2004, an increase of 3.3%.
Net income totalled NIS 26 million in 2005, compared with a loss of NIS 35 million in 2004.
Return on shareholders' equity in 2005 was 3.4%, compared with a negative rate of 4.3% in 2004.
The ratio of capital to risk assets was 11.3% as at December 31, 2005, compared with 10.5% as at December 2004.
The Bank's share in the income of Discount Mortgage Bank totalled NIS 17 million in 2005, compared with a share in a loss of NIS 23 million in 2004.
On November 23, 2005, Discount Mortgage Issues Ltd., a subsidiary of Discount Mortgage Bank, published a prospectus for issuing of NIS 125 million deferred capital notes (Series "A"), out of a total series of NIS 300 million. Discount Mortgage Bank received the approval of the Supervisor of Banks to have the said notes included as Discount Mortgage Bank's second tier capital (accordingly, the said captial notes are considered second tier capital for the purpose of calculating the Bank's capital ratio).
See Notes 19 C 14.4 and 15.5 to the financial statements for details of the uncertainties relating to the Discount Mortgage Bank Ltd. in the matter of charging commission in respect of life assurance and property insurance of borrowers and in the matter of insuring property for amounts exceeding its reinstatement value.

FIRST INTERNATIONAL BANK OF ISRAEL LTD.

The First International Bank of Israel Ltd. is an affiliated company of the Bank. As of December 31, 2005, the Bank held 26.4% of its share capital and 11.1% of its voting rights.
The Bank's share in the net income of the First International Bank in 2005 totalled NIS 122 million, compared with NIS 65 million in 2004.
Return on shareholders' equity in 2005 was 12.2%, compared with 6.9% in 2004.
The ratio of capital to risk assets stood at 11.7% on December 31, 2005, compared with 11.4% at the end of 2004.
Provision for impairment in value. See Note 6 D to the financial statements for details of an opinion received by the Bank regarding the value of its investment in the First International Bank, according to which the recoverable value of this investment does not

fall below the equity value of this investment. Therefore, according to generally accepted accounting principles no provision for impairment in the value of this investment is required; and for details of the provision for impairment in value that has been recorded in accordance with an instruction of the Supervisor of Banks. The Bank received an opinion and updates thereto according to which the recoverable value of the investment does not fall below the equity value of the investment on all reporting dates since December 31, 2002. For details regarding updated opinions, according to which the recoverable value of the Bank's investment in the First International Bank does not fall below the equity value of the investment on December 31, 2004, March 31, 2005, June 30, 2005 and September 30, 2005 see Note 6 D to the financial statements.

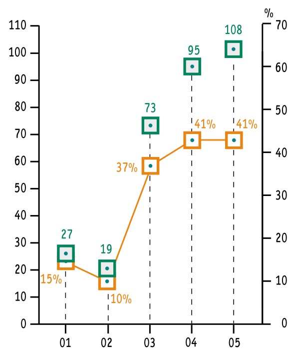
On December 22, 2004, the First international bank acquired all the holdings in UBank (formerly Investec (Israel) Bank Ltd.).

On January 24, 2006, the First International Bank signed an agreement with Bank Hapoalim Ltd. (hereinafter – "Hapoalim") according to which it will purchase the full holdings of Hapoalim in Otsar Ha-Hayal Bank Ltd. (hereinafter – "Otsar Ha-Hayal"), namely, 68% of the equity and 66% of the voting rights in Otsar Ha-Hayal, in consideration for NIS 703 million, subject to adjustments, based on the equity capital of Otsar Ha-Hayal as of December 31, 2005. The agreement determined also arrangements with respect to several issues including arrangements relating to to the credit card field (see above "Activity in the credit card field" in the section "Additional details as to operations in certain products" and Note 34 to the financial statements).

For details regarding a legal action filed against the First International Bank in the matter of life assurance commissions and property insurance in contravention of the law and regarding a request to approve it as a class actions, see Note 19 C 17 to the financial statements.

ISRAEL CREDIT CARDS LTD.

Israel Credit Cards Ltd. ("ICC") is a subsidiary of the Bank. As of December 31, 2005, the Bank owned 51% of the equity and 63% of the voting rights in ICC and in Diners. The remaining shares are held by strategic partners: The First International Bank, Fishman Networks, and Harel (for details as to the acquisition of the control in ICC, see Note 34 A to the financial statements. This Note also provides details regarding the implementation in the financial statements as of September 30, 2004 and thereafter, of the directives of the Supervisor of Banks with respect to the presentation on an equity basis also in the case of shares acquired with the intent to sell, which previously have been presented as part of available-for-sale securities).



ISRAEL CREDIT CARDS
NET INCOME AND RETURN ON EQUITY

Total assets amounted, at the end of 2005, to NIS 1,670 million, compared with NIS 1,597 million at the end of 2004, an increase of 4.6%.

Total capital resources amounted, at the end of 2005, to NIS 335 million, compared with NIS 275 million at the end of 2004, an increase of 21.8%. In 2005, ICC distributed to its shareholders a dividend amounting to NIS 50 million (2004: NIS 65 million).

The ratio of equity to risk assets at December 31, 2005, was 12.7%, compared with 9.9% at the end of 2004.

Total income amounted in 2005 to NIS 578 million, compared with NIS 532 million in 2004, an increase of 8.6%.

Net earnings amounted in 2005 to NIS 108 million, compared with NIS 95 million in 2004, an increase of 13.7%.

Return on equity reached 41.1% in 2005, compared with 40.9% in 2004.

The share of the Bank in the net earnings of ICC in 2005, amounted to NIS 47 million, compared with NIS 36 million in 2004.

ICC issues and operates "VISA", "Diners" and "MasterCard" credit cards.

For details as to the agreement for the establishment of a new customer club and as to the

sale of a part of the means of control in Diners, see "Credit Card Operations Activity" above.
In December 2003, ICC acquired 100% of the equity capital of Iatzil Finance Ltd., which is engaged in the clearing of credit card transactions of commercial firms. In August 2005, ICC served the seller with a demand for the cancellation of the Iatzil transaction due to a basic breach of the agreement between the parties.
ICC and the seller reached an agreement regarding the reduction in the consideration paid by ICC for the shares in Yatzil and for the refund of the excess payment made by ICC in eight quarterly payments, starting from March 2006.
In October 2005, ICC entered into an agreement with New Kopel Ltd. for the establishment of a joint enterprise that will engage in the purchase of vehicles and their lease to private individuals. Each party is to provide services to the enterprise, either directly or through its related companies. ICC owns approximately 20% of the shares in the enterprise.
As for details regarding changes in arrangements concerning the credit card field in Israel, see Note 34 B. to the financial statements.

HAREL INSURANCE INVESTMENTS LTD.

Harel Insurance Investments Ltd. (hereinafter – "Harel") is an affiliate of the Bank. At December 31, 2005 the Bank held a 15.89% interest in the equity and in the voting rights of Harel.
On June 16, 2004, the Bank sold on and off the market 870,500 ordinary shares of NIS 1 each of Harel, comprising 4.11% of the equity, for total consideration of NIS 128 million. The said sale contributed an amount of NIS 32 million to the income of the Group. The said reduction in the holdings in Harel does not affect the rights of the Bank in accordance with the agreement between the Bank and the Hamburger Group, which regulates the relationship between them as shareholders of Harel.
Harel is a holding company that primarily engages in the various insurance areas and in additional areas, such as the capital markets, real estate and communications. Holding means of control in Harel is a strategic investment which diversifies the Bank's sources of income.
Net earnings in 2005 amounted to NIS 483 million, compared with net earnings of NIS 406 million in 2004, an increase of 18.9%.
The return on equity in 2005 was 27.5%, compared with 28.6% in 2004.
The contribution of Harel to the net earnings of the Bank amounted in 2005 to NIS 50 million, compared with NIS 63 million in 2004. The said contribution in 2005 is presented net of the provision for deferred taxes that the Bank had recorded in the amount of NIS 22 million, in respect of its share in the profits accumulated in respect of its investment in Harel, net of dividends received (computed in respect of profits so accumulated through December 31, 2005), and this in view of the requirement to sell at least a part of the Bank's investment in Harel prior to commencing the pension consultations.
On September 15, 2005, Harel reported that it had reached an understanding with Bank Leumi Le'Israel Ltd. to sign an agreement for the acquisition of the management of the mutual funds of Leumi Pia in consideration of NIS 535 million. Harel also reports, in its statements for the third quarter, that negotiations are being conducted as to the terms of the agreement and the final purchase price.
On November 27, 2005, Harel reported that its Board of Directors approved the engagement with Bank Leumi and Leumi Gemel Ltd. in a transaction for the acquisition of the goodwill, operations, management, assets and liabilities relating to provident funds, the total assets of which amount to NIS 16.3 billion, in consideration of NIS 675 million. Execution of the transaction is subject to regulatory approval and the signing of distribution and operation agreements between Harel and Bank Leumi.
Following this, Harel reported that on December 6, 2005 it signed an agreement n principle with Bank Leumi Le'Israel and Leumi Gemel, according to which the parties are to engage

also in an operation agreement and a distribution agreement in respect of the funds to be acquired. A detailed agreement has not as yet been signed and the conditions required for the engagement to enter into effect have not yet been fulfilled.
With regard to motions for approval of actions against Harel and its consolidated subsidiary, Harel – Insurance, as class action suits, see Note 19 C, paragraphs 16.1 and 16.2 to the financial statements.
For details regarding the legislation enacted following the Bachar Committee recommendations, including directives regarding the ownership and control relationship between banks and insurance companies, see Note 33 to the financial statements.

ISRAEL DISCOUNT CAPITAL MARKETS AND INVESTMENTS LTD.

Israel Discount Capital Market and Investments Ltd. ("DCMI"), a fully owned and controlled consolidated company of the Bank, is engaged (through a subsidiary) in the underwriting and management of public offerings of securities, in investment banking and also in investment in venture capital funds together with foreign institutional entities.
Total assets as at December 31, 2005 amounted to NIS 226 million, compared with NIS 229 million at the end of 2004, a decrease of 1.3%.
Net loss in 2005 amounted to NIS 1 million, compared with net profit of NIS 20 million in 2004.
Return on equity in 2005 reached a negative rate of 0.75%, compared with positive rate of 18.2% in 2004.
During 2005, Discount Israel Capital Markets and Investments Ltd., through a subsidiary, participated in 15 public offerings of securities with a total volume of NIS 1.9 billion (5 public offerings with a total of NIS 1.9 billion – in 2004), and in 31 private placements of securities with a total volume of NIS 3 billion (31 private placements with a total volume of NIs 4.3 billion in 2004).
As to an indictment filed against DCMI and against two of its former employees, see Note 19 C, paragraph 16.4 to the financial statements.

TACHLIT DISCOUNT - INVESTMENT COUNSELING & MANAGEMENT CO. LTD.

Tachlit Discount - Investment Counseling & Management Company Ltd., a fully owned and controlled consolidated company of the Bank, is engaged in managing securities portfolios for private clients, companies, non-profit organizations and institutional investors.
As at December 31, 2003, Tachlit managed 1,757 investment portfolios with assets totaling NIS 1,9960 million, compared with 1,368 portfolios with assets of NIS 1,6406 million as at December 31, 2004.
Tachlit Worldwide Dollar Ltd. Tachlit together with Synergetica Ltd. (hereinafter: "Synergetica") established Tachlit Worldwide Dollar Ltd. (hereinafter: "Tachlit Dollar") a special purpose company (SPC), the sole purpose of which is to issue up to two series of marketable debt notes linked to foreign currency, which are convertible in accordance with the terms to be detailed in prospectuses that Tachlit Dollar will publish from time to time, on the basis of various indices of foreign currencies published by recognized bodies, as well as carrying out all the operations required for issuing the notes, their conversion and redemption, reducing the exposure of Tachlit Dollar and coverage by various assets in order to honor the liabilities of Tachlit Dollar as stated in the prospectuses. Tachlit owns 20% of the issued equity of Tachlit Dollar.
On July 13, 2004, Tachlit Dollar issued, for the first time, registered debt notes (Series "A") with a par value of NIS 1 each, which are convertible into US Dollars in cash, of a total par value of NIS 3,500,000, of which NIS 222,222 par value have been issued to the public and the balance has been issued to Ma'agar Sachar, a subsidiary of Tachlit Dollar. The units were issued to the public and sold at a price of US$100 per unit of NIS 1 par value. Tachlit Dollar

published on December 25, 2005 an additional prospectus, in the framework of which, 4,600,000 debt notes of NIS 1 par value each have been listed for trade, all of which have been issued to Ma'agar Sachar (Dollar) Ltd.

Tachlit is committed to Synergetica and Tachlit Dollar to transfer, from time to time to Tachlit Dollar, funds not to exceed a cumulative amount of US$1 million (hereinafter – "the amount of liability") to enable Tachlit Dollar to honor its liabilities towards the note holders and to cover its current operating expenses.

To secure the liabilities of Tachlit, the Bank provided a letter of indemnity in respect of the said liability of Tachlit to provide funds, by indemnifying Tachlit Dollar in respect of its liabilities towards the note holders and for covering its current operating expenses, in a total amount not to exceed the amount of the liability.

Tachlit Basket Certificates Ltd. Tachlit together with Synergetica established Tachlit basket certificates Ltd. (hereinafter – "Tachlit BC") a special purpose company (SPC), the sole purpose of which is to issue series of marketable "basket" notes based on various indices computed and published by recognized institutions, which are convertible in accordance with the terms to be detailed in prospectuses that Tachlit BC will publish from time to time, as well as carrying out all the operations required for issuing the notes, their conversion and redemption, reducing the exposure of Tachlit BC and coverage by various assets in order to honor the liabilities of Tachlit BC as stated in the prospectuses. Tachlit owns 20% of the issued equity of Tachlit BC.

On December 29, 2004, Tachlit BC issued, for the first time, "basket" notes (Series "A"), convertible into the basket of shares included in the "TA 100" Index, and "basket" notes (Series "B"), convertible into the basket of shares included in the "TA 25" Index. The notes carry interest payable in one sum in December 2029, the date on which the remaining balance of the "basket" notes of whatever series will be converted, by way of a forced conversion, into the share basket relating to the particular series. Within the framework of the prospectus, 12,317,890 basket certificates of NIS 1 par value each (Series "A") have been listed for trade, of which NIS 543,696 par value have been issued to the public and the balance has been issued to Mizbor & Sachar (Index) Ltd., a subsidiary of Tachlit BC, and 10 million basket certificates (Series "B") of NIS 1 par value each were listed for trade. 500,000 par value have been issued to Mizbor & Sachar (Index) Ltd.

Tachlit is committed to transfer to Tachlit BC, from time to time, with funds not to exceed a cumulative amount of US$1 million (hereinafter – "the amount of liability") to enable Tachlit BC to honor its obligations towards the "basket" note holders.

In addition, Tachlit, jointly with Synergetica, have committed to Tachlit BC to bear, in equal parts, without a mutual guarantee, all expenses involved in the issue of the "basket" notes according to the prospectus. The amounts so provided are to comprise shareholder loans, bearing at least linkage increments and interest at the rate of 4%.

To secure Tachlit's obligations, the Bank has provided a letter of indemnity in respect of the said commitment to provide funds, by indemnifying Tachlit BC in respect of its liabilities towards the note holders in a total amount not to exceed the amount of the commitment.

Tachlit BC published a prospectus on January 19, 2006, by which basket certificates (Series "A") of NIS 0.1 par value each in a total par value of NIS 12.5 million.

In addition, Tachlit BC issued to the public under the same prospectus, six series of basket certificates as follows:

TA Banks Index. 1,538,426 units of basket certificates (Series "C") of NIS 1 par value each, convertible into a cash amount equal to the Banks Index value as computed by the Tel-Aviv Stock Exchange Ltd., in accordance to their weight in this index and as detailed in the prospectus.

SPX Index. 312,713 units of basket certificates (Series "D") of NIS 1 par value, convertible into a cash amount equal to the value of the SPX Index, as computed by the "preparer of the Index", with the addition of proportionate part, as determined in the prospectus, of the net dividend received by Tachlit BC in respect of its holdings in the SPX Index, in accordance with their weight in this Index and as detailed in the prospectus.

NDX Index. 500,000 units of basket certificates (Series "E") of NIS 1 par value, convertible into a cash amount equal to the value of the NDX Index, as computed by the NASDAQ Exchange, with the addition of a proportionate part as determined in the prospectus of the net dividend actually received by Tachlit BC in respect of its holdings in the NDX Index, in accordance with their weight in this Index and as detailed in the prospectus.

NKY Index. 125,000 units of basket certificates (Series "F") of NIS 1 par value, convertible into a cash amount equal to the value of the NKY Index, as computed by Nihon Keizal Shinbum Inc., in accordance with their weight in this Index and as detailed in the prospectus.

SKSE Index. 98,039 units of basket certificates (Series "G") of NIS 1 par value, convertible into a cash amount equal to the value of the SKSE Index, as computed by Stoxx Limited, in accordance with their weight in this Index and as detailed in the prospectus.

NBI Index. 549,459 units of basket certificates (Series "H") of NIS 1 par value, convertible into a cash amount equal to the value of the NBI Index, as computed by the NASDAQ Exchange, in accordance with their weight in this Index and as detailed in the prospectus.

Tachlit Currencies Ltd. Tachlit together with Synergetica Ltd. established Tachlit Currencies Ltd. (hereinafter – "Tachlit Currencies") a special purpose company (SPC), the sole purpose of which is to issue up to two series of marketable debt notes linked to various indices of foreign currency, which are convertible in accordance with the terms to be detailed in prospectuses that Tachlit Currencies will publish from time to time, as well as carrying out all the operations required for issuing of the notes, their conversion and redemption, and the purchase of various assets for coverage purposes of Tachlit Currencies' liabilities in accordance with the prospectuses. Tachlit owns 20% of the issued equity capital of Tachlit Currencies.

In August 2005, Tachlit Currencies issued, for the first time, debt notes (Series "A" and "B"): Series "A" debt notes are registered notes with a par value of NIS 1 each, totaling NIS 37,500 (out of a total series of up to NIS 637,500). The notes carry interest at a variable rate computed on a daily basis, and payable once every quarter. The debt notes are convertible into cash in Pound sterling, as from date of listing for trading and until April 22, 2030, the date on which the remaining balance of the principal amount of the debt notes will be converted by way of an enforced conversion. Each unit of NIS 1 par value of the debt notes was offered to the public and sold at a price of £100 per unit less a discount of 0.3% granted by Tachlit Currencies to buyers of the notes.

Series "B" debt notes are registered notes of a par value of NIS 1 each, totaling of NIS 55,500 (out of a total series of up to NIS 1,000,000). The notes carry interest at a variable rate computed on a daily basis, and payable once in every quarter. The debt notes are convertible into cash in Euro, as from date listed for trading and up to April 22, 2030, the date on which the remaining balance of the principal amount of the debt notes will be converted by way of an enforced conversion. Each unit of NIS 1 par value of the debt notes was offered to the public and sold at a price of 100 per unit less a discount of 0.3% granted by Tachlit Currencies to buyers of the notes.

Disciplinary transgressions. In November 2005, Tachlit was requested by the Israeli Securities Authority to hand over various documents in connection with a review of disciplinary transgressions conducted by the Securities Authority. Two executives were also asked to submit statements. In January 2006, the Securities Authority informed Tachlit that the case had been closed for lack of guilt.

For details as to restrictions imposed on investment portfolio management companies and on the ownership and control thereof by banking corporations in accordance with legislation enacted in the wake of the Bachar Committee recommendations, see Note 33 to the financial statements.

ILANOT DISCOUNT LTD.

Ilanot Discount is a subsidiary of the Bank. As at December 31, 2005 the Bank owned all the equity of Ilanot Discount. Until September 29, 2005, the Bank owned 55% of the equity of Ilanot Discount, while IDB Development Company Ltd. ("IDB") and Discount Investment Company Ltd. ("DIC") held the balance of the equity in equal parts.

Ilanot Discount engages in mutual funds management. 60 mutual funds were managed by Ilanot Discount at December 31, 2005, compared with 59 mutual funds at the end of 2004. The value of the mutual funds managed by Ilanot Discount amounted to NIS 14.0 billion at the end of 2005, compared with NIS 12.3 billion at the end of 2004. Ilanot Discount's share in the mutual funds market decreased from 12.1% to 11.2% at December 31, 2005.

On August 16, 2005, IDB Development Corporation Ltd.(hereinafter: "IDB") and Discount Investment Corporation Ltd. (hereinafter: "DIC") reported an agreement they signed on August 15, 2005, with Solomon Mutual Funds Ltd., for the sale of all their holdings (22.5% each) in Ilanot Discount, in consideration of NIS 228 million. The consideration is subject to certain adjustments.

According to the shareholders' agreement in Ilanot Discount, the Bank had the right of first refusal for the purchase of the shares, under the terms specified in the Solomon Agreement, or it may join the sellers according to its share of holdings within 30 business days from date of notice. On September 8, 2005, the Bank informed IDB and DIC that it is exercising its right of first refusal. On September 29, 2005, the Bank acquired 45% of the equity capital of Ilanot-Discount Ltd. held by IDB and DIC. The shares were acquired under the terms of the provisions of the "Solomon Agreement", in consideration of NIS 229.7 million (comprising the amount of the consideration determined in the "Solomon Agreement", together with interest up to the date of payment). The "Solomon Agreement" determined, among other things, price adjustments in certain cases, including the possibility of a sale to a third party at a price exceeding that determined in this agreement, within a period of 18 months.

The said shares were acquired and held from the start with the intention of selling them. Accordingly, the said shares are presented in the financial statements, as available-for-sale securities, and the rights of the outside shareholders have been computed at 45%.

On October 6, 2005, the Supervisor of Banks sent a letter to the Bank, which included the Bank of Israel's legal advisor's opinion, according to which the acquisition of the shares of the minority shareholders in Ilanot Discount by the Bank does not comply with the directives of the law (the transitional instructions of the legislation passed in the wake of the Bachar Committee recommendations), its wording and its intent. This is contrary to the legal opinion obtained and submitted to the Supervisor of Banks prior to the acquisition, according to which no legal hindrance exists as regards the acquisition of the shares. The Supervisor's letter does not include any operative demand, apart from a request for the Bank to respond to the said legal opinion. The Bank disputes the contents of the said legal opinion of the Bank of Israel and has informed the Supervisor of Banks accordingly.

With respect to the legislation enacted following the Bachar Committee's recommendations regarding the changes in the structure of the capital market, including the matter of ownership and control relations between banks and companies managing mutual funds, see Note 33 to the financial statements.

For details with respect to the signing of an Agreement in Principle for the sale of all the shares of Ilanot Discount, see "Additional details regarding activity in certain products" and Note 6 F to the financial statements.

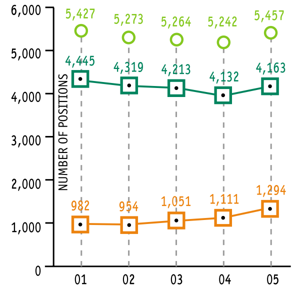
HUMAN RESOURCES

The average monthly number of employees, based on full-time positions, in the Bank in Israel (not including overseas branches) was increased from 5,180 in 2004 to 5,296 in 2005, an increase of 116 employees on a monthly average, 2.2%.
There were 5,457 employees in full-time positions in the Bank in Israel at the end of 2005, compared with 5,242 at the end of 2004, an increase of 4.1%.
The annual average direct cost per employee position in the Bank in Israel in 2005 was NIS 216 thousand, compared with NIS 193 thousand in 2004, an increase of 11.9%.
The annual average direct cost per employee position in the Bank of Israel, disregarding bonuses would have amounted to approximately NIS 189 thousand in 2005, compared with NIS 179 thousand in 2004, an increase of 5.6%.
The total annual average cost per employee position in the Bank in Israel, not including voluntary early retirement expenses, in 2005, was NIS 329 thousand, compared with NIS 297 thousand in 2004, an increase of 11.0%.
The total annual average cost per employee position in the Bank in Israel, not including voluntary early retirement expenses, bonuses, value added tax on salary relating to the change in the law and the provision relating to the change in the mortality tables in 2005 was NIs 284 thousand, compared with NIS 279 thousand in 2004, an increase of 2%/
The average monthly number of employees in full-time positions in the Group, both in Israel and abroad, at the end of 2005, was 8,712, compared with 8,544 at the end of 2004, an increase of 2.0%.
There were 8,986 full-time positions in the Group at the end of 2005, compared with 8,655 at the end of 2004, an increase of 3.8%.
The average annual overall payroll cost per employee of the Group in Israel and abroad, excluding the change in the salary tax expense, amounted in 2005 to NIS 332 thousand, compared with NIS 294 thousand in 2004, an increase of 12.9%.
The labor force of the Group and the Bank, in terms of full-time positions, appears below:

	As of December 31		Monthly average in	
	2005	2004	2005	2004
The Bank in Israel	5,457	5,242	5,296	5,180
Domestic subsidiaries	2,647	2,502	2,553	2,458
Group total in Israel	8,104	7,744	7,849	7,638
Overseas branches	28	31	29	31
Overseas subsidiaries	854	880	834	875
Group total overseas	882	911	863	906
Group total overseas and Israel	8,986	8,655	8,712	8,544

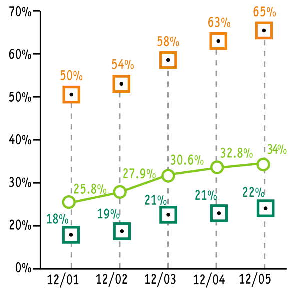
RETIREMENT OF EMPLOYEES

In the years 2000-2005, the Bank encouraged early retirement of employees, directed at an employee population having defined characteristics, in respect of which a focused effort was made to encourage their early retirement at beneficial terms.
53 employees retired during 2005, of which 3 employees took early retirement. In the period from January to March 2006 (up to March 15) 171 employees retired from the Bank, of which 165 employees took early retirement. 22 additional employees signed a retirement agreement and will retire from the Bank by the end of June 2006. 175 employees retired during 2004, of which 131 employees took early retirement. 182 employees retired during 2003, of which 142 employees took early retirement.
In total, 1,281 employees retired from the Bank in the period 2000-2006, of which 922 took early retirement.



NUMBER OF BANK POSITIONS

TENURED EMPLOYEES (INCLUDING OVERTIME)
TEMPORARY EMPLOYEES AND MANPOWER AGENCIES' EMPLOYEES
TOTAL (INCLUDING OVERTIME)

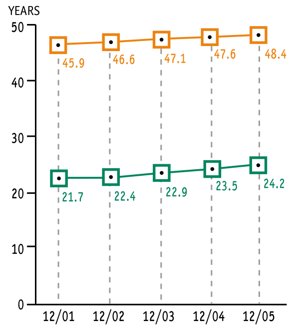


PERCENTAGE OF EMPLOYEES WITH UNIVERSITY DEGREES

MANAGERS
CLERKS
TOTAL

DEVELOPMENT OF HUMAN RESOURCES

Development of the human resources of the Bank focuses on three central levels: the personal level (hierarchic courses), the organic level and the system level.
On the personal level, the Bank laid in 2005 the foundation for the development of careers at the Bank. Development courses have been formed and approved for the temporary population (in the branches, in direct banking and in the concept branches), development course for investment consultants and career courses for the managerial level.
In addition, a management channel has been developed at the Bank by way of two classes of training: training of a reserve for fulfilling a position and training while in the position.
On the organic level, a multi-disciplinary approach is being implemented for "custom made development program" – the implementation of improvement processes and development of the human resources in order to exhaust the business potential of the unit. Professional of various disciplines (organizational consulting, managers development, tutorial and service) assist the unit manager in forming a vision for the unit (the desired situation), in diagnosing the position of the unit (the existing situation) and in the forming of unique operative development programs to bridge the gap between the desired and the existing situations.
On the system level, a general concept for multi-annual planning of the human resources has been formed and the implementation of the customer segment strategy at the branches has continued.



AVERAGE SENIORITY AND AVERAGE AGE

IMPROVEMENT OF SERVICE

Discount Bank is currently in the midst of a multi-annual process of transition to a culture that places the customer at the center of the organizational existence. Several years ago, management of the Bank etched on the Bank's banner the strategic target according to which each customer (whether internal or external) will be satisfied. For this purpose the Bank began extensive operations among the staff intended to create within the staff a developed service conviction moved by the understanding of and identification with customers. In addition the activity is directed towards providing suitable tools, including infrastructure, processes and organizational structures supporting the creation of an outstanding service experience.
The process of the cultural change relies primarily on implanting within all managers in the organization the conviction that they in fact manage service units (both internal and external). Based on a structured methodology named "Shir" (service improvement) an active absorption of the service management principles has been conducted in over 250 head office and line units, the managers and staff of which were presented with a unique and specially designed absorption process. The implementation of this culture engulfs all the course of organizational life of the staff, starting with selection and recruitment, which were redesigned so as to include the necessary component of "service awareness" as a threshold condition for acceptance. Further down the road, the "contribution" of each employee to the success of the service improvement process is measured within the framework of annual evaluation processes or feedback mechanism.
As a rule, the quality of service provided in actual fact to external and internal customers, is tested at many crossroads: telephone service, face-to-face service, handling of complaints and internal interface. The various grades received as a result of the periodic tests, feed the professional decision making process and the systems for acknowledgement and appreciation of employees, managers and organizational units. The "outstanding unit" competition, for instance, has been redesigned to include many parameters derived from service controls – and therefore provides further indication as to how critical and central this subject is.
In a dynamic organizational reality of constant changes and fierce competition, the

relationship with the customer is the key factor for survival and thriving of business entities. In an organizational environment where products and prices are generally similar, the competitive advantage exists only where it is possible to produce a significant added value. At Discount Bank, the subject of customer service is considered a component that would create such an advantage, and thus the full resources of the Bank are directed towards the continuous effort of creating a unique and unforgettable "service experience" for the customer.

INFORMATION MANAGEMENT

The information management at the Bank turned in 2005 into a central organizational activity supporting cooperation and the transfer of information among the many professional systems, and contributing to the enhancement of the professional level of the staff, advancement of the business goals and a growth leverage.

The organization portal on the Intranet turned into a central tool of information management. The portal provides infrastructure for the supply of relevant, readily available and up-to-date information. The professional sites and the information communities are connected to the core business activity and to central organizational processes, and thus support the enhancement of the professional level of staff and the satisfaction of customers. Some 15 information communities and information sites are updated by 150 substance experts, providing the general population of the Bank with the professional information required for their current operations.

An upgraded and updated system of procedures and circulars has been developed, which provides advanced retrieval and distribution possibilities, while facilitating these processes and use of computerized media only.

Additional organizational and cultural processes, such as the selection of outstanding employees, accompanied by designated sites planned to provide a response both as to current information regarding the process and as to the possibility of interactive staff operation.

Statistical data indicate the increasing use made by the staff in this channel allowing the optimal participation in professional information.

Drawing of conclusions, the transfer of duties and congruent period processes are also accompanied by designated management and information tools. Also developed are tools and forms for varied operational purposes, while emphasizing efficiency and savings aspects.

The information management operation serves an essential layer of staff professionalism management in the organization, which provides an answer to several central challenges:

- Transfer of the center of gravity of the professional information from head office to the field units by assembling knowledge and insight from the field and constructing its distribution to the entities requiring it;
- The turning of covert knowledge to overt knowledge and knowledge management through cooperation and study processes;
- Shortening of reaction time and the transfer of required knowledge in the fastest and most efficient manner;
- Presentation of an updated picture of the professional level of the organization;
- Presentation of alternatives by way of the measurement of knowledge for complying with professional goals;
- the improvement of operations and complying with the business goals of the organization.

TRAINING

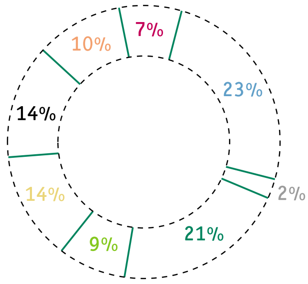
In 2005, the staff at the Bank received a widespread response to their professional requirements through extensive and focused training and guidance.

The knowledge gaps in various areas were filled in during the year according to the identification of needs conducted at the various units.
In addition, a training response was given to unplanned training requirements that arose from provisional directives and/or regulatory decisions having an impact on the banking industry, such as: the law prohibiting money laundering, management of credit facilities, etc.
In 2005 the writing of the fifth training course of the courses dealing with general banking business was completed, and an innovative guidance response is now available for the overall general banking training.
All learning processes of general banking are available on the “Knowledge” system (a distant learning system), when in 2005 the system was upgraded and many improvements were introduced thereto.
With the view of training, the new employees recruited for the branch system in a professional and speedy manner, the training and tutorship of new employees has been restructured.
One of the goals of Discount College for 2005, was the creation of learning flashes supporting staff professionalism. The learning flashes are designed to update or inform the staff at large of changes, innovations or particular emphasis relevant to their work as well as to refresh existing knowledge.
The uniqueness of learning flashes is in their ability to swiftly reach the employee’s desk and to transmit uniform and clear information to a particularly large population.
An initiated move was made in the reported year for the identification of extra-banking professional needs of the staff of the various units. These needs were addressed in courses organized by the College, as part of closed seminars for Discount Bank, which were tutored by lecturers of the first line.
Staff of all departments of the bank took part in this activity and it spanned a variety of subjects – computerization, organization, project management, bridging, etc.
In 2005, the retail training activity was launched with a view of positioning the Discount Bank as a leading bank in the retail culture in Israel, the goals of which are increased profitability and customer share, locating and recruitment of new customers, maintaining customer loyalty and preventing customers from leaving the Bank.
The number of training days in 2005 reached 25,767 compared with 25,487 training days in 2004. This data, prima facie, indicates stability in training days, however it should be remembered that this refers to training days that actually took place at the premises of the College and it does not reflect the self-study activity, which as stated, significantly expanded in 2005.

ASTD BEST AWARDS

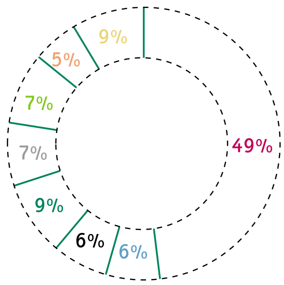
Discount Bank won the 2005 ASTD Best Award competition. The Bank won an international competition in the field of training and organizational development held annually by ASTD – American Society for Training and Development. This is the leading international and largest association of its kind in the world.
The ASTD Best Award is granted to organizations that create, support and leverage learning opportunities for business purposes and absorb a learning culture in their organization. Such organizations have to prove that:
- Learning is valued in the organizational culture;
- A connection exists between learning and performance;
- The organization leverages technology as a base for absorption of a learning culture;
- The organization invests in learning an initiation of performance.

Organizations from all over the world entered the competition. The Prize was awarded to the Bank at a ceremony held in Washington in October 2005.



TRAINING DAYS PER SUBJECT – 2005

- EXTERNAL STUDIES
- COMPUTER AND OFEK
- ORGANIZATION AND MANAGEMENT
- CREDIT AND FINANCIAL INSTRUMENTS
- MISCELLANEOUS
- INVESTMENTS
- SALES, MARKETING, SERVICE AND BEHAVIOR
- EXTENDED TELLER SERVICE



TRAINING DAYS PER SUBJECT – 2004

- EXTERNAL STUDIES
- COMPUTER AND OFEK
- ORGANIZATION AND MANAGEMENT
- CREDIT AND FINANCIAL INSTRUMENTS
- MISCELLANEOUS
- INVESTMENTS
- SALES, MARKETING, SERVICE AND BEHAVIOR
- EXTENDED TELLER SERVICE

LABOR RELATIONS

The employee representative committee submitted to the Bank's Management the employee wage demands for the years 2004-2005, and since June 2005, the parties have been negotiating the matter. On September 29, 2005, while conducting negotiations, the Histadrut declared a labor dispute and a strike in respect of "a demand to sign a wage agreement for the years 2004-2005 and for the payment of a bonus in respect of the Bank's profitability in 2004, in which the customer base of the Bank was significantly expanded thanks to the efforts of the Bank's employees and their coping with the workload imposed upon them".

On October 16, 2005, the Bank, being a party to a collective labor dispute, filed with the Regional Labor Court a plea requesting the Court to declare that the Histadrut may not declare a labor dispute and a strike at the Bank until after the transaction for the sale of a controlling interest in the Bank has been completed and thus in view of the clause in the Employees Agreement with respect to the maintenance of "industrial peace".

Subsequent to the sanctions, which the employee committee introduced on October 19, 2005, The Bank appealed to the Labor Court again requesting a temporary injunction. As part of the hearing held on the subject on that date, the employee representative committee advised that the sanctions were suspended, and the parties undertook to resume their negotiations at an intensive pace.

On November 10, 2005, the employee representative committee resumed the sanctions, due, as claimed, to the sale by the Bank of the provident funds and mutual funds (see the item "Capital Market Segment" above). The Bank again appealed to the Labor Court requesting a temporary injunction, which was given on November 13, 2005 until November 15, 2005, on which date the main hearing on the petition which had been submitted by the Bank was held. At this hearing the parties accepted the suggestion of the Court that the "industrial peace" clause would remain in effect until December 31, 2005, and will also apply to the issue of the sale of the provident funds and mutual funds. The parties' consent was given the effect of a Court order.

On January 1 2006, the Workers' Committee began implementing sanctions as a result of the failure to reach a wage agreement. The sanctions were carried out intermittently at various units of the Bank. On January 11, the Committee held a meeting during Banking hours, thus bringing the Bank's operations to a halt on that day.

On January 24, the parties signed a wage agreement for the years 2004 –2006 in which the following was decided: the rate of the selective wage increments for the years 2004-2006, an additional monthly payment for staff working split hours, and the amounts of staff bonuses. It was also agreed that labor disputes with regard to bonuses, wages and provident funds would be called off.

On February 23, 2006, an agreement regarding the manner of allocating the bonus in respect of the sale of the Bank to the staff was signed.

BANK BRANCHES

At the end of 2005, the Bank operated 124 branches across the country.

MERGER OF BRANCHES

As part of reorganizing the Bank's branch layout, carried out during the years 2004 and 2005, the operations of 31 branches were merged into other branches absorbing their activities (no merger of branches took place in 2005). In some of the cases, the operations of the branch closed down were absorbed by more than one integrating branch. In addition, during the said years several partial mergers of branches were made, where some operations of a branch were transferred to another branch without closing down the transferring branch. 70 branches – over a half of the branches of the Bank – were involved in such a process in the years 2001 to 2004.

During the process of the merger, the absorbing branches were organized to receive customers and staff of the closed down branches through reinforcement, training and adjustment of means and manpower. In most cases the premises of the absorbing branches have also been renovated.

OPENING OF NEW BRANCHES

During 2005, three additional branches of the "Discount your way" series were opened. For further details of the adjustment of the branch layout, see the retail segment.

CONTROL OF THE BANK

In consequence of the crisis on the shares market in October 1983, with respect to the "regulation" of this market, and as part of the measures taken to confront the situation that had occurred, The Government of Israel, on behalf of the State of Israel, entered into a series of agreements that created an arrangement to finance the acquisition from the public of the shares in each of the banking groups that were involved in the crisis.

In accordance with the Bank Shares in Arrangement (Temporary Provision) Law, 1983, (hereinafter – "the Bank Shares in Arrangement Law"), the shares of the Bank were transferred to the ownership of the State of Israel on October 31, 1983, which as from that date became the controlling owner of the Bank, due to its holdings of the shares of the Bank.

According to the Bank Shares in Arrangement Law, use of the voting rights attached to the shares held by the State of Israel shall be exercised by the Committee for the shares of the Bank for and on behalf of the State of Israel.

Up to January 31, 2006 the State held 559,870,403 Ordinary "A" Shares of NIS 0.1 each par value of the Bank, comprising 57.09% of the outstanding capital of the Bank and of the voting rights therein. This, after two offers for sale by the State of the Bank shares made in 1996 and 1997 to the public and to the employees of the Bank, in accordance with Prospectuses published by the State and the Bank, and after a private placement of the Bank's shares made to institutional investors in 2001.

On January 31, 2006, upon the closing of the transaction for the sale of controlling interest in the Bank, as described hereunder, control of the Bank was transferred to the Bronfman-Schron Group.

ENTITIES IN POSSESSION OF BANK SHARES

According to information provided to the Bank, upon the closing of the transaction the Bronfman-Schron Group holds 254,966,194 ordinary A Shares of NIS 0.1 each par value of the Bank, comprising approx. 26% of the outstanding capital of the Bank and of the voting rights therein, the State holds 304,904,204 ordinary A Shares of NIS 0.1 each par value of the Bank, comprising approx. 31.09% of the outstanding capital of the Bank and of the voting rights therein. The Bronfman-Schron Group has an option to purchase a further 25% of the outstanding capital of the Bank and of the voting rights therein.

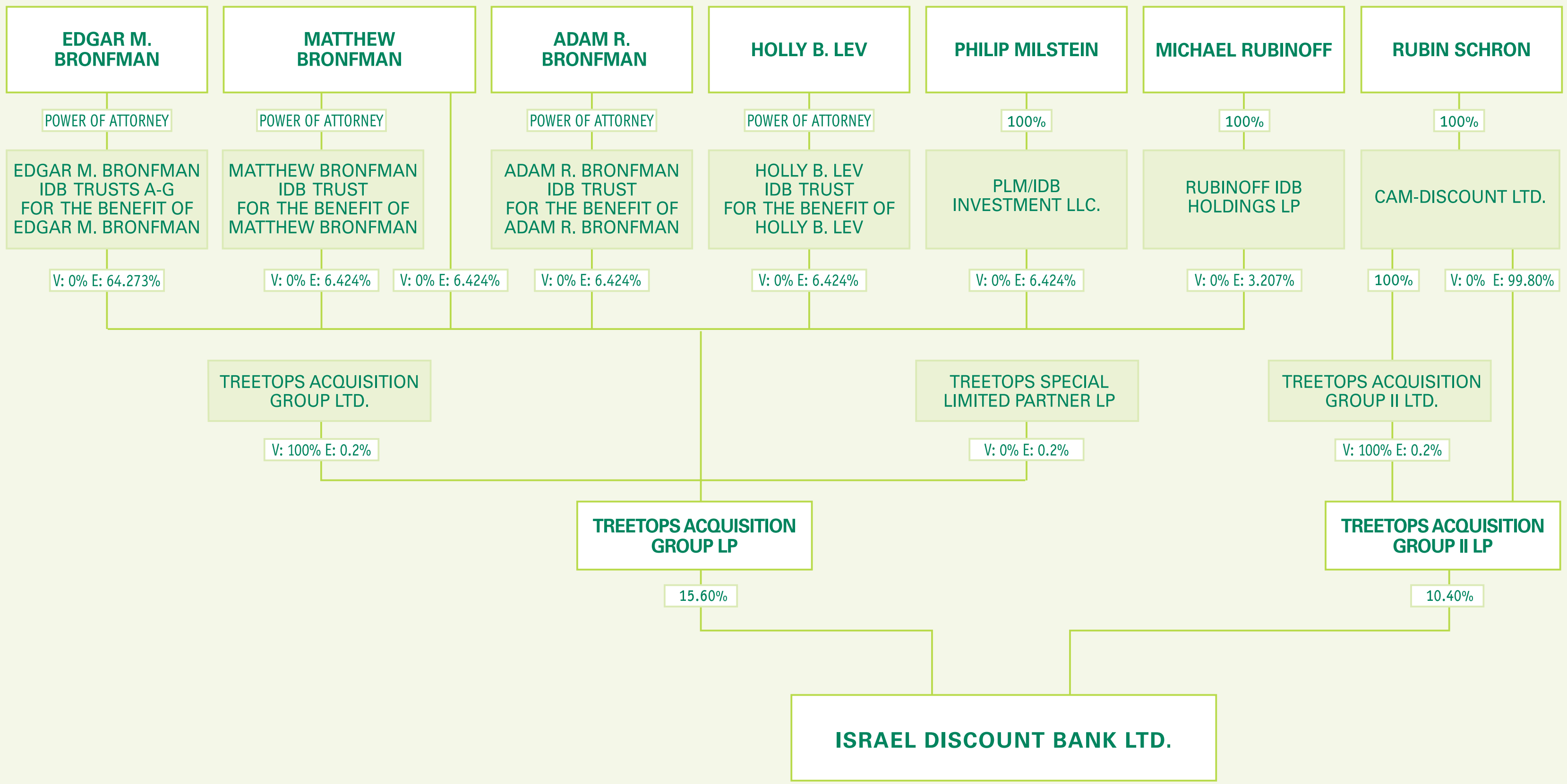
152,979,716 shares, representing approx. 15.6% of the Bank's issued capital and of the voting rights therein, are held by the limited partnership Treetops Acquisition Group LP (hereinafter: "Treetops");

101,986,478 shares, representing approx. 10.4% of the Bank's issued capital and of the voting rights therein, are held by the limited partnership Treetops Acquisition Group II LP (hereinafter: "Treetops II").

Treetops is a limited partnership that was incorporated in the Cayman Islands. The limited partners in Treetops are members of the Bronfman Group, as set forth below:

- Edgar Miles Bronfman IDB Trusts A through G (seven trusts), the beneficiary whereof is Edgar M. Bronfman, hold approx. 64.273% of Treetops;

CONTROLLING SHAREHOLDERS OF ISRAEL DISCOUNT BANK AS OF JANUARY 31, 2006



V = VOTING
E = EQUITY

- Matthew Bronfman personally holds approx. 6.424% of Treetops;
- Matthew Bronfman IDB Trust, the beneficiary whereof is Matthew Bronfman, holds approx. 6.424% of Treetops;
- Holly B. Lev IDB Trust, the beneficiary whereof is Holly B. Lev, holds approx. 6.424% in Treetops;
- Adam R. Bronfman IDB Trust, the beneficiary whereof is Adam R. Bronfman, holds approx. 6.424% of Treetops;

Edgar M. Bronfman is the father of Matthew Bronfman, Holly B. Lev and Adam Bronfman. All the trusts specified above are hereinafter jointly referred to as "the Bronfman Trusts". The trustees of each of the Bronfman Trusts have empowered the beneficiary of the Trust (and with regard to the Trusts the beneficiary whereof is Edgar M. Bronfman, the head of the family - the power of attorney has been given to Edgar M. Bronfman and Matthew Bronfman, provided that in the event of a dispute between them, Mr Edgar M. Bronfman's opinion shall prevail) to make all the decisions with regard to the investment in the Bank, save for matters of replacement of the power attorney (subject to the Bank of Israel's prior approval), making further investments in Treetops and/or the Bank and a sale, entering into and agreement for a merger agreement or any transfer of the interests of the Trusts, in Treetops and/or the Bank.

- PLM/IDB Investment LLC, a company fully owned by Philp Millstein, holds approx. 6.424% in Treetops;
- Rubinoff IDB Holdings LP, a limited partnership fully owned by Michael Rubinoff, holds approx. 3.207% in Treetops.

In addition to the Bronfman Group members the limited partnership Treetops Special Limited Partner LP (hereinafter: "SLP"), incorporated in the Cayman Islands, holds approx. 0.2% of Treetops, as limited partner. The limited partners in SLP are Matthew Bronfman (approx. 65%) and Michael Rubinoff, through Rubinoff IDB Holdings LP (approx. 35%). The SLP's general partner, is Treetops SLP Ltd., (a company fully owned by Matthew Bronfman, incorporated in the Cayman Islands) holds approx. 0.2% of SLP).

Treetops' general partner, that holds approx. 0.2% of Treetops, is Treetops Acquisition Group Ltd (hereinafter: "Treetops Ltd."), a company incorporated in the Cayman Islands. The means of control in Treetops Ltd. are held by the Bronfman Group members, in accordance with the ratio of their holdings in Treetops.

Treetops II is a limited partnership incorporated in the Cayman Islands. The limited partner of Treetops II is Cam Discount Ltd. (hereinafter: "Cam Discount"), that holds approx. 99.8% of Treetops II. Cam Discount is a company incorporated in the Cayman Islands, all the means of control wherein are held by Rubin Schron.

Treetops II's general partner, that holds approx. 0.2% of Treetops II, is Treetops Acquisition Group II Ltd (hereinafter: "Treetops II Ltd."), a company incorporated in the Cayman Islands, all the means of control wherein are held by Cam Discount.

For details regarding the transaction for the sale of a controlling interest in the Bank, and the arrangements between the buyers and the government and arrangements among the buyers, see this chapter hereunder.

COMPLETION OF THE SALE OF A CONTROLLING INTEREST IN THE BANK

On January 31, 2006, the transaction entered into by M.I. Holdings Ltd. and the Government of Israel (hereinafter – "the Government") on the one hand, and a corporation controlled by the Bronfman Family and others and a corporation controlled by Mr. Rubin Schron (hereinafter together – "the Buyers") on the other hand, for the sale of a controlling Treetops is a limited partnership tat was incorporated in the Cayman Islands. The limited partners in Treetops are members of the Bronfman Group, as set forth below:

- Edgar Miles Bronfman IDB Trusts A through G (seven trusts), the beneficiary whereof is Edgar M. Bronfman, hold approx. 64.273% of Treetops;

- Matthew Bronfman personally holds approx. 6.424% of Treetops;
- Matthew Bronfman IDB Trust, the beneficiary whereof is Matthew Bronfman, holds approx. 6.424% of Treetops;
- Holly B. Lev IDB Trust, the beneficiary whereof is Holly B. Lev, holds approx. 6.424% in Treetops;
- Adam R. Bronfman IDB Trust, the beneficiary whereof is Adam R. Bronfman, holds approx. 6.424% of Treetops;

Edgar M. Bronfman is the father of Matthew Bronfman, Holly B. Lev and Adam Bronfman. All the trusts specified above are hereinafter jointly referred to as "the Bronfman Trusts". The trustees of each of the Bronfman Trusts have empowered the beneficiary of the Trust (and with regard to the Trusts the beneficiary whereof is Edgar M. Bronfman, the head of the family - the power of attorney has been given to Edgar M. Bronfman and Matthew Bronfman, provided that in the event of a dispute between them, Mr Edgar M. Bronfman's opinion shall prevail) to make all the decisions with regard to the investment in the Bank, save for matters of replacement of the power attorney (subject to the Bank of Israel's prior approval), making further investments in Treetops and/or the Bank and a sale, entering into and agreement for a merger agreement or any transfer of the interests of the Trusts, in Treetops and/or the Bank.

- PLM/IDB Investment LLC, a company fully owned by Philp Millstein, holds approx. 6.424% in Treetops;
- Rubinoff IDB Holdings LP, a limited partnership fully owned by Michael Rubinoff, holds approx. 3.207% in Treetops.

In addition to the Bronfman Group members the limited partnership Treetops Special Limited Partner LP (hereinafter: "SLP"), incorporated in the Cayman Islands, holds approx. 0.2% of Treetops, as limited partner. The limited partners in SLP are Matthew Bronfman (approx. 65%) and Michael Rubinoff, through Rubinoff IDB Holdings LP (approx. 35%). The SLP's general partner, is Treetops SLP Ltd., (a company fully owned by Matthew Bronfman, incorporated in the Cayman Islands) holds approx. 0.2% of SLP).

Treetops' general partner, that holds approx. 0.2% of Treetops, is Treetops Acquisition Group Ltd (hereinafter: "Treetops Ltd."), a company incorporated in the Cayman Islands. The means of control in Treetops Ltd. are held by the Bronfman Group members, in accordance with the ratio of their holdings in Treetops.

Treetops II is a limited partnership incorporated in the Cayman Islands. The limited partner of Treetops II is Cam Discount Ltd. (hereinafter: "Cam Discount"), that holds approx. 99.8% of Treetops II. Cam Discount is a company incorporated in the Cayman Islands, all the means of control wherein are held by Rubin Schron.

Treetops II's general partner, that holds approx. 0.2% of Treetops II, is Treetops Acquisition Group II Ltd (hereinafter: "Treetops II Ltd."), a company incorporated in the Cayman Islands, all the means of control wherein are held by Cam Discount.

For details regarding the transaction for the sale of a controlling interest in the Bank, and the arrangements between the buyers and the government and arrangements among the buyers, see this chapter hereunder.

SALE OF A CONTROLLING INTEREST IN THE BANK

According to the information provided to the Bank, on January 31, 2006, the transaction for the sale of a controlling interest in the Bank, entered into on February 1, 2005 by M.I. Holdings Ltd. and the Government of Israel (hereinafter – "the Government") on the one hand, and the Bronfman-Schron Group (hereinafter– "the Buyers") on the other hand, (hereinafter – "the Agreement for the sale of a controlling interest in the Bank"), was completed.

In the Agreement the Bronfman-Schron Group had purchased shares in the Bank comprising 26% of its issued share capital (hereinafter "the control nucleus") and was granted an option for a period of three years from date of the closing of the transaction, to purchase further shares comprising up to an additional 25% of the issued share capital of the Bank, all for the consideration of approximately NIS 1.3 billion (that was approximately NIS 5.1 per share), together with interest accrued until the closing date.

On the closing date the Buyers payed the sum of US$241,649,508, together with interest of US$7,925,895, totalling US$249,575,403. the balance of the consideration in the sum of US$55,765,271 (hereinafter - "the balance of the consideration") together with the interest accrued thereon until the closing date, in the sum of US$1,829,053, totalling US$57,594,324, was translated into new shekels in accordance with the representative exchange rate of the dollar on the closing date.

On the closing date the undischarged balance of the consideration shall be linked to the index and bear annual interest of 4%. The balance of the consideration shall be paid by the Buyers by the first business day that shall occur after the end of 36 Gregorian months from 31 December 2005 (hereinafter referred to as "the first period"), save for the interest amounts that shall be paid by the Buyers in annual payments.

For details regarding the credit terms see "Credit agreement" hereinafter.

In light of the above, the price per share, according to which the sale transaction was carried out, calculated as to the closing date, according to the sum of the first instalment, together with the interest accrued thereon until the date of the closing, in addition to the sum of the balance of the consideration, together with the interest accrued thereon until the date of the closing, divided by the number of the sold shares – is approx. US$1.2047 for one share (the fact that against the payment of the consideration the Buyers received the option, was not taken into account, within the above calculation; the above calculation does not include also the additional consideration, which is conditional, as detailed below.)

For details about the calculation of the effective price per share in the the Agreement for the sale of a controlling interest in the Bank, as was done for M.I. Holdings Ltd. shortly after entering the agreement, see "the effective price per share in the the Agreement for the sale of a controlling interest in the Bank" below.

In the event that the option to purchase a further 245,159,802 shares will be exercised, the Buyers will pay an exercise price that might reach an additional sum of approximately NIS 1.25 billion (in the event of the full exercise of the option).

The exercise price for each of the option shares is NIS 5.0824 per share, linked to the increase of the index as of the index published on December 15, 2004 with adjustment provisions that were prescribed in the agreement. The option is exercisable by the Buyers or either of them in accordance with the ratio of their holdings of the control nucleus.

An additional consideration of up to NIS 156 million might be paid by the Buyers to the State according to the return on equity of the Bank during the period from 1st October 2004 to 30 September 2008. If the terms and conditions for the payment of the additional consideration are fulfilled, the Buyers shall pay it out of dividends that shall be received as from 31 December 2008 or out of monies that shall be received as from the said date in respect of a sale of the control nucleus shares or the option shares that shall be charged to the Government (if they shall be charged and for so long as they shall be subject to a charge), and all at the rates and upon the terms and conditions prescribed for such purpose in the agreement.

Concurrently with signing the Agreement for the Sale of a Controlling Interest in the Bank, the Buyers and the Government entered into an agreement providing interim financing for the State Grant to employees in respect of that part of the option, which may not be exercised by the Buyers (see hereunder for details of the "State Grant to Employees" provided in "the Employees Agreement"). According to the said agreement, in the event that the Buyres would not exercise the option in full, they are committed to finance that part of the State's grant due to the employees in respect of the unexercised shares, and the Government shall refund this amount to them out of the consideration to be received by it from future sales of the shares of the Bank or at the end of eight years.

For arrangements that have been made between the Government and the Buyers as to the coordination of their voting and of their exercise of control of the Bank see "Arrangements with Regard to Cooperation Between the Buyers and the Government, in Respect of Holding Shares of the Bank and Exercising the Control in the Bank", below.

THE GOVERNOR OF THE BANK OF ISRAEL'S PERMIT FOR THE CONTROL AND HOLDING OF MEANS OF CONTROL IN THE BANK

The Govermor of the Bank of Israel, after consultation with the liscencing committee, granted on January 29, 2006, a permit the to Edgar M. Bronfman, Mathew Bronfman, Adam R. Bronfman, Holly B. Lev, Michael Rubinoff, Philip Milsteinand Rubin Schron (hereinafter: "the Group"), to jointly control and hold means of control in the Bank in a percentage of 26% of any type of means of control in the Bank. In addition the Governor permitted the Group's members to hold additional means of control in the Bank, in a percentage not exceeding 40% of any type of means of control, all subject to the pecentage determined in such regard in respect of each of the Group's members in the annex to the permit. The annex to the permit details the holding of each member of the Group in the Bank and in Treetops and Treetops II pertnerships, as detailed in "Entities in possession of Bank shares" above. The corporations and trusts details as aforementioned are prohibited from engaging in any business other than holding the means of control in the Bank. Further detailed in the annex to the permit are the additional percentages of means of control that any one of the members of the Group is permitted to hold beyond his or her share in the controlling interest. It is further determined that additional percentages of means of control will be held in the same manner as that of the controlling interest.

The said permit also includes a permit to control and hold means of control, through the Bank, in banking corporations controlled by the Bank, and in which it duely holds the means of control, all as shall be from time to time.

Following are the main conditions of the pemit:

1. "Controlling interest" or "minimum percentage" means at least 26% of any type of means of control in the Bank, divided amongst the Group's members in the manner and ratio detailed in the annex to the permit.
2. If the Bank issues, after the grant of the permit, rights to shares or any other security convertible int shares, the Group shall maintain the minimum percentage holdings, computed on the basis of full dilution.
3. (a) For a period of five years subsequent to the date of the grant this permit, the Group shall not directly or indirectly sell or transfer means of control in the Bank, if as a result thereof it is left with means of control of any type in a percentage lower than the minimum percentage. Any one of the Group's members may sell means of control from the additional percentage exceeding his or her share in the controlling interest, provided that a minimum of six months have elapsed since the last purchase affected by such Group member (in such regard, the excercise of the option from the government shall not be deemed a purchase act).

   (b) Five years from the date of the grant of this permit, the Group may sell or transfer its means of control, provided that it sells or transfers the entire means of control constituting the minimum percentage, to an individual or a Group that has duly received a permit for the control and holding of the aforesaid means of control.

   In the Supervisor of Bank's letter annexed to the permit (hereinafter: "the letter anenxed to the permit") it was stated that in the event that after five years from the date of the grant of the permit a decision is made by the Buyers to sell means of control in the Bank from the controlling interest such that after the sale none of the Group's members or the buyers require a permit for the control or holding of the means of control in the Bank, pursuant to the law, the following provisions shall apply:

   - The two Buyers shall approach the Governor of the Bank of Israel, notify him of their decision and detail the manner of the sale planned by them;

- Before the sale of the means of control, as aforesaid, the Buyers shall make a preliminary with the Governor of the Bank of Israel, regarding the arrangements that shall be mae, including the modification of the permit and the trust instrument, in order to allow them to effect the sale of the shares within a reasonable period of time (hereinafter: "the transitional period"), taking into account, inter alia, the implications on the Bank's management and transfer thereof, business relations with the Bank, the market conditions and the quantity of shares being sold, and the format of holding and voting in respect of the Bank's shares constituting a holding of more than 5% of the means of control in the Bank during the transitional period (without such derogating from the Buyers' fundamental right to effect the sale, as aforesaid).

(c) Notwithstanding the abovesaid, an additional member may be added to the Group and each of the Group's members may, at the end of five years as aforesaid, transfer or sell the means of control held by him and constituting his share of the minimum percentage, or part thereof, provided that the transferee or buyer cooperate on a regular basis with the rest of the Group pursuant to the Summary of Principal Terms entered upon by the Group as aforementioned, or another agreement approved the the Supervisor of Banks, and that a permit was duely granted for the control and holding of the aforesaid means of control. Notwithstanding the above, an additinal member may be added to the Group and a Group member may transfer or sell means of control as aforementioned also during the five year period from the grant of the permit, provided that the conditions set forthe above had been fulfilled, and provided that the Group will continue being the leading factor both in regard to the percentage holdings as well as with regard to the cooperation between them.

4. (a) The Group's members and the entities through which the means of control are held shall act in accordanc with the Summary of Principal Terms approved in advance and in writing by the Supervisor. The beneficiaries of the trusts from the Bronfman Group shall act in accordance with their undertakings to the Bank of Israel, which were approved in advance and in writing by the Supervisor.

(b) The Group's members shall at all times hold the control and means of control in the Bank in the percentages and manner st forth and specified in paragraph 4 and in the addendum in respect of each of them, and shall not sell or otherwise transfer to another, including to corporations or other entities controlled by them, directly or indirectly, means of control in the Bank or in any of the entities detailed in these paragraphs, even if such sale or transfer does not require a permit pursuant to section 34 to the Law, unless otherwise provided in this permit or unless the Supervisor grants his prior written consent thereto.

In this regard, "sale" – includes a charge, save for certain charges within the Group specified in the permit.

(c) Notwithstanding the aforesaid, for a period not exceeding three years from the date of the grant of this permit, the provisions of sub-paragraph (b) regarding a charge shall not apply to 6% of the means of control in the Bank that will be charged to the Government of Israel to secure the debt of Treetops and Treetops II to the Government.

5. (a) The Group's memeber shall not expressly or impliedly agree to the imposition of an attachment on the means of control in the Bank or any of the entities detailed in paragraph 4 and in the addendum; the Group's members shall not act in any manner that is such as to actully alter the ownership rights in these means of control or the rights embodied therein and and detailed in the definition of "means of control" in section 1 of the Law.

(b) Should an attachment be imposed despite the aforesaid, over means of control as

'80

1985. Artists collect 120 million dollars for Africa, with the song We Are the World.
1984. The bank establishes the Israel Discount Bank in Support of Art and Culture fund, as a contribution to the community.

Israel Discount Bank has always believed that activities for the benefit of the community are a part of its social, cultural and business commitment. This principle strikes root with the establishment of the Israel Discount Bank in Support of Art and Culture Fund in 1984. The objective: support for Israeli artists and culture, for the benefit of the Israeli public.

So the bank acquires the best Israeli works of art and presents them to the general public, helps struggling artists, grants scholarships for art-loving youth, initiates international cultural events in Israel and sponsors organizations that promote social objectives.

The bank management and staff also volunteer in cultural community activities as part of Discount's Lemaan project, and contribute to numerous national projects designed to assist needy families. All for the community. This is the motto at Bank Discount.

Art on the Roof. Lament of the Angels, by artist Motti Mizrachi, was purchased by the bank in 1986 and displayed on the roof of the Ramat Aviv branch. The statue is part of the Peace Rider series, which was displayed at the Venice Biennale that year.

aforesaid held by a member of the Group, the said member shall act in a way available to him for the immediate removal of the attachment.

6. The means of control in the Bank which are held directly shall be deposited by the Group, for the Group's members or for the Group's members and the government, as the case may be, with one or more Israeli resident trustees whose identity, trust instruments and the instructions given to them within the trust instruments shall be subject to the Supervisor's prior written approval.
7. The Group's members, their relatives or corporations under the control of any one of them shall not receive management fees or any other consideration neither from the Bank nor from corporations under the Bank's control; however, they may provide services ordinarlity provided by the providers thereof, at market prices, provided that prior written notice has been given to the Supervisor regarding the nature of the service and the consideration, at least 14 business days prior to providing of the service; if the Supervisor has given notice that the service is not of the type ordinarily provided to others or that the consideration for the service is unreasonable, the service shall not be provided.

   The provisions of this paragraph shall not apply to directors' remuneration that is paid in an indentical amount to all the Bank's directors.
8. (a) No dividend shall be distributed from the Bank's profits that accrued prior to September 30, 2004. If losses accrued after this date, no dividend shall be distributed until after these losses have been covered; in addition, no dividend shall be distributed from profits from the sale of material assets of the Bank for five years from the date of the grant of this permit. Thereafter, dividend may be distributed from the sale of assets as aforesaid, subject to the Supervisor's prior written approval.

   (b) Notwithstanding the aforesaid, dividend may be distributed from profits from a sale of material assets of the Bank in the five years follwoing the date of the grand of the permit, on the fulfillment of all the following conditions:

   (1) The sale derives from legal requirements governing the Bank;

   (2) The distribution of dividend from profits from a sale of such assets does not result in a reduction in the minimum capital ration of the Bank existing prior to the sale of the said assets;

   (3) The Bank's board of directors approves the distribution after examining the Bank's needs and its business plans;

   (4) The Supervisor gives his prior written approval to an aforesaid distribution, after examining the Bank's capital adequacy and the board of directors' decision and the basis thereof.
9. (a) Without the Supervisor's prior written approval, the Group's members or any of them, or corporations under their control, shall not engage in any business, in Israel or abroad, of receiving deposits – even from less than 30 people, or granting credit, or any other financial business in Israel that is such as to compete with the Bank's business.

   (b) Without the Supervisor's prior written approval, the Group's members or any of them, or corporations under their control, shall not be interested parties, directors or senior managers in corporations engaging in business of the type mentioned in sub-paragraph (a) above; in such regard, "interested party" means someone holding 5% or more of any type of the means of control.
10. Financing of the purchase of the means of control in the Bank, including the grant of guarantees for financing as aforesaid, shall not be provided, directly or indirectly, by the Bank or by banking corporations under its control.
11. The Bronfman and Schron Group shall reduce their liability to the Bank in order to comply with Proper Banking Management Directive No. 312 concerning a banking corporation's business with related persons, unless otherwise approved by the

Supervisor, in advance and in writing.

12. The Group shall do the utmost to ensure that the memorandum, srticles of association and all the procedures of the Bank will match and conform with, insofar as required and at any time, with the provision of the permit.

ARRANGEMENTS WITH REGARD TO COOPERATION BETWEEN THE BUYERS AND THE GOVERNMENT, IN RESPECT OF HOLDING SHARES OF THE BANK AND EXERCISING THE CONTROL IN THE BANK

In the Agreement for the sale of a controlling interest in the Bank arrangements and various undertakings have been prescribed with regard to cooperation between the Government and the Buyers, in respect of their holdings of shares of the Bank, and with regard to the exercise of control in the Bank by the Buyers, the principal aspects whereof are as follows:

- Provisions were prescribed that will apply for as long as the period for the exercise of the Option shall not have ended (meaning until the end of 2008 or before that due to the Full Exercise of the Option) (hereinafter "the Support Period") with regard to coordinating the manner of voting, by virtue of the Buyers' holding of the Bank's shares and by virtue of the holding of the Government of the option shares, at the Bank's general meetings and also with regard to the appointment of directors to the Bank's board of directors, pursuant whereto four directors who were proposed for election by the Government and nine directors who were proposed for election by the Buyers shall be appointed (and if the Government's holdings in the Bank fall below 10%, two directors proposed by the Government for election and 11 directors proposed by the Buyers for election shall be appointed) and an arrangement was also prescribed with regard to determining the identities of the candidates to serve as external directors of the Bank, and all for the period and on the terms and conditions prescribed for such purpose in the and all for the period and on the terms and conditions prescribed for such purpose in the agreement.
- It was prescribed that during the Support Period, the Parties will employ their best efforts to cause that on all of the key committees of the board of directors of the Bank there will serve at least one Public Director; in addition, for as long as the Bank remains the controlling shareholder of material companies, and directors of the Bank are appointed as directors of the aforesaid companies, one Public Director shall serve as a director on behalf of the Bank in each one of the aforesaid companies, and all on the terms and conditions prescribed for such purpose in the agreement.
- It was prescribed that during the Support Period, and on condition that the Buyers and those participating with the Buyers in the control nucleus shall hold at least 26% of the Shares of the Bank, shall fulfill their undertakings pursuant to the Agreement, and cause the Bank to comply with all of the provisions which the Buyers are required to cause the Bank to comply with -the Government Representatives will refrain at the general meetings of the Bank, from exercising the voting rights pertaining to the Option Shares held by the Government, up to such portion that the Shares being held by the Buyers and by anyone participating with the Buyers in the control nucleus will confer 50.1% of the voting rights of the totality of Shares voting, for or against, at such meeting. The agreement prescribed terms and conditions in which the Government Representatives at a meeting shall be entitled to vote in their discretion or to vote in conjunction with the Buyers, instead of refraining from voting. During the Support Period the Government shall refrain from giving an instruction in accordance with Section 28(a)(3) of the Bank Shares in Arrangement Law.
- In this clause -

  "The restriction period" means the period commencing on the closing date and continuing: (1) for so long as the Government and any party on its behalf jointly hold no less than 10% of the Bank's issued share capital or (2) until the end of four years from 31st December 2005 in an event in which the Buyers have not fully exercised the option, or (3) until the end of three years from 31st December 2005 in an event in which the Buyers fully exercised the option, whichever is the shortest period.

"The additional period" means the period commencing at the end of the restriction period and continuing: (1) for so long as the Government and any party on its behalf jointly hold no less than 5% of the Bank's issued share capital; (2) until the end of three years from the end of the restriction period; or (3) until after the full exercise of the option, whichever is the shortest period.

- During the restriction period the Buyers shall not carry out any of the following actions and they shall use their best endeavours to ensure that the Bank refrains from executing them, unless the action has been given the Government's prior written consent: (a) the voluntary winding up of the Bank; (b) a split of the Bank, merger of the Bank with companies that are not fully owned subsidiaries, a settlement or arrangement, within the meaning thereof in the Companies Law, 5759-1999, to which the Bank is a party, and any similar operation that affects the Bank's issued share capital; (c) an allotment of shares, change of the rights attached to shares, increase of capital (authorised or issued) and the distribution of bonus shares or the issue of rights by the Bank; (d) payment of management fees or the grant of another benefit by the Bank or corporations of the IDB Group (within the definition thereof in the sale agreement) to interested parties in the Bank, save for determining the terms and conditions of the chief executive officer's employment, and every exceptional transaction in which an interested party at the Bank has a personal interest; (e) a change in the Bank's documents of incorporation.

  Pursuant to the provisions of the agreement, the Government shall not refrain from granting its consent to the actions as set forth in sub clause (b) above and to the actions as set forth in sub-clause (c) above, that are required for such purpose, save on reasonable grounds, relating to a material change of the Government's rights pursuant to the sale contract or an impairment to the value of the Bank's shares that the Government holds or an impairment to its ability to sell them.
- The Buyers have undertaken to use their best endeavours, subject to every law, in order to ensure that during the restriction period the Bank shall refrain from issuing shares and securities convertible into shares, save with the prior written consent of Holdings and the Government, and subject to the matters set forth below: (a) the Government and Holdings shall not refrain from agreeing to the issue of shares of the Bank in accordance with a written initiated demand of the Supervisor of Banks of the Bank of Israel, in accordance with his authority at law; (b) any issue as aforesaid to which the Government or Holdings have given their consent and also any issue of shares by the Bank, during the additional period, shall be effected in coordination with the Government, and the Bank shall enable the Government to join the sale with shares of the Bank out of the shares that it holds, at a rate of up to one half of the total number being sold in any offer, and all subject to the terms and conditions prescribed for such purpose in the sale contract.
- It has been prescribed that in the event of a sale of the control of Discount Bank New York, all the consideration in cash received in respect of the sale shall be transferred to the Bank and it shall not be possible to draw a dividend from the monies of such consideration until five years from the date of signing the Agreement for the sale of a controlling interest in the Bank have elapsed, unless otherwise agreed upon with the Bank's workers' committee.
- Restrictions as to a transfer of the holdings of the parties to the agreement in the Bank during the course of the restriction period and/or during the course of the additional period were prescribed. The Buyers are entitled to transfer Shares or to issue shares to whom ever shall be a Participant in the control nucleus, only after

the Buyers shall purchase from the Government at least 35% of the Issued Share Capital of the Bank. Any sale by the Buyers to a transferee which shall not be a Participant in the control nucleus, including sale offer of Shares of the Bank by means of a prospectus, provided that the Government shall be afforded the right to join in the sale and exercise its tag-along right, to sell Shares from the Bank's Shares held by the Government, and all on the terms and conditions prescribed for such purpose in the agreement.

- The Buyers have undertaken to cooperate with the Government and Holdings and to use their best endeavours such that the Bank and its officers and the other corporations in the IDB Group (as defined in the agreement) and the officers thereof shall cooperate with the Government and Holdings, at the Bank's expense (save with regard to the payment of underwriting and distribution commissions that shall apply to the Government), with the intention of assisting the Government and Holdings to sell the balance of the Bank's shares and such being in accordance with their duties pursuant to the Bank Shares in Arrangement Law, and pursuant to the existing cooperation agreement between the Bank and Holdings and subject to every law, and also in accordance with the provisions prescribed for such purpose in the agreement.

- It was prescribed that for as long as the Buyers control the Bank, the Buyers undertake to act so that the directors and officers who served in the Bank prior to the Closing Date will be afforded exemption, indemnification and insurance terms identical, inasmuch as possible, to the terms which shall be adopted by the Bank in relation to directors and officers who shall be appointed in commencing from the Closing Date in such manner as shall secure them insurance coverage, exemption and indemnification as aforesaid also with respect to their actions during the period preceding the Closing Date. The Buyers agreed that the aforesaid will also apply to the officers of the subsidiaries of the Bank.
- It was prescribed in the Agreement for the sale of a controlling interest in the Bank with regard to Section 41 of the Bank Shares in Arrangement Law, that the provisions contained in the Agreement will prevail over any provisions to the contrary in the Law. Without derogating from the generality of the foregoing it is agreed that the provisions of the Agreement will prevail over the provisions contained in Sections 18, 19(e), 23 and 24 of the Bank Shares in Arrangement Law with regard to the manner of appointment of the directors of the Bank and will prevail over the provisions contained in Section 21(b) with regard to the term of office of external directors. The provisions of the Agreement supplement the provisions contained in Section 33 of the Law with regard to cooperation with the Government and delivery of any information to the Government for the purpose of sell of the balance of the Bank's shares that the Government holds. The provisions contained in Section 22 of the Law with regard to the consent of the committee to the appointment of the chairman of the board of directors will not apply. The provisions contained in the Agreement will prevail over the provisions contained in Chapter F of the Bank Shares in Arrangement Law, with regard to the restriction of the exercise of the voting rights of the Government.

ARRANGEMENTS BETWEEN THE MEMBERS OF THE BRONFMAN-SCHRON GROUP

According to information provided to the Bank, Treetops and Treetops II (hereinafter – "the Buyers") as well as the members of the Bronfman Group and Rubin Schron (hereinafter – the members of the Bronfman Group and Rubin Schron are named together: "the Investors") entered into an agreement with respect to their investment in the Bank, which includes a Summary of Principal Terms detailing the manner of the cooperation between the Investors, which was approved by the Bank of Israel (hereinafter – "the Cooperation Agreement"). Furthermore, the investors signed a Clarification Letter, which clarifies and/or adds to the terms of the Cooperation Agreement (hereinafter – "the Clarification Letter"). The Bank of

Israel informed the Investors that the Clarification Letter includes items that it finds unacceptable. Notwithstanding, the Bank of Israel advised that it has no objection to the Clarification Letter being signed for the purpose of determining certain accords between the Investors, provided that the Clarification Letter would be amended or replaced after the Bank of Israel had examined it.
The Cooperation Agreement determines, among other things, that of the number of directors that the Buyers are entitled to appoint to the Bank's board of directors, the Bronfman Group and Rubin Schron (hereinafter named: "the Schron Group" and together with the Bronfman Group – "the Groups") are entitled to appoint directors in proportion to the relative percentage of each group in the total ownership rights of all the Investors being limited partners in the two Buyers together (the overall ownership rights as above, in the two Buyers together are hereinafter: "the Interests"). To date, according to the Agreement for the Sale of the Controlling Interest, the Bronfman Group is entitled to appoint five members to the board of directors and the Schron Group is entitled to appoint four. In addition, the Bronfman Group is entitled to appoint the first outside director that the two groups would be entitled to appoint, when such office becomes vacant, whereas the Schron Group would be entitled to appoint the second outside director (as to the subject of agreements between the Buyers and the Government regarding the appointment of outside directors, see above). The identity of the members of the board of directors recommended by each Group is to be determined by the majority of shareholders in the general partner of each of the Buyers. The Buyers would vote by power of their shares in the Bank for the appointment to the board of directors, as aforesaid.
The Cooperation Agreement further stipulates that the Buyers would vote jointly on all issues brought before a general meeting of shareholders of the Bank. For this purpose, prior to every such general meeting, each Buyer shall hold a meeting of shareholders in its general partner, during which each shareholder would state how, in his opinion, the Buyers are to vote with respect to the issue in question. Excluding decisions regarding specific matters that require a special majority vote of over 67%, as stated below, and with respect to the appointment of members of the board of directors, as stated above, the Buyers shall not vote in favor of any issue brought before a general meeting of shareholders of the Bank, unless such vote is supported by shareholders holding together over 50% of the Interests.
It has been stipulated that with regard to the following resolutions, a special majority of over 67% of the Interests would be required: sale of Bank shares by the Buyers; a significant raising of capital in which the Bank is involved; mergers, splits, significant acquisitions or sales in which the Bank or the Buyers are involved; issuance of capital or debt securities by the Buyers; any amendment to the rights attaching to the Interests; liquidation (including voluntary) of any of the Buyers; appointment of the chairman of the board of directors of the Bank.
The Cooperation Agreement further stipulates that the net consideration, which each of the Buyers would receive for the sale of shares in the Bank or dividends and other payments that would be received from the Bank, would be distributed by each Buyer as follows: (1) firstly, each Buyer would distribute to each of its Investors a proportion of the said amounts according to the relative share of its investor Interests in that Buyer, until the recovery in full of the amounts invested by him in that Buyer; (2) secondly, each Buyer would distribute to each of the investors in it an amount equal to 8% per annum (cumulative) on his investment in that Buyer; (3) after having made the payments as described in (1) and (2) above, Treetops (and not Treetops II) would distribute 15% plus as additional amounts to SLP, and the balance (85% excluding the additional amounts) would be distributed to the investors in Treetops, pro-rata to their share, all as detailed in the Cooperation Agreement. Certain amounts paid to SLP by Treetops would be distributed to Mr. Matthew Bronfman, to a corporation owned by Mr. Michael Rubinoff as well as to Cam Discount, all according to the distribution and terms stipulated for this purpose in the Cooperation Agreement.
The Cooperation Agreement stipulates that, at the request of shareholders of the general

partners in the Buyers who hold not less than 67% of the Interests, the Buyers would exercise the option granted to them according to the Agreement for the Sale of the Controlling Interest. In as much as it would be decided by the shareholders, as above, that the exercise of the option would be effected by means of additional capital investment of the Investors in the Buyers, then each investor would be entitled not to exercise his right, and in such a case other members of his Group would be entitled to exercise his proportionate share in the option. If all the Investors in any Group elect not to exercise their share in the option, then members of the other Group may do so in their stead. If the option is not exercised in full up to 180 days prior to the expiration of the option, then any Investor may cause the exercise of the option by giving notice, and, in such a case, if Investors holding less than 67% of the Interests would agree to finance the exercise of the option, then the Buyers shall divide, pro-rata, the rights to exercise the option to the Investors interested in exercising it or to entities under their control.

The Cooperation Agreement further stipulates that the Investors in each Buyer will have the right to participate in future allotments of shares by the Buyer in which it has an interest. It is also stipulated in the Cooperation Agreement, that during the first five years from date of acquisition of the controlling interest (or any shorter period that the Agreement for the Sale of the Controlling Interest allows), no sale, exchange, pledge or transfer (hereinafter together – "transfer") of any of the interests in any Buyer (excluding transfers to family members or family entities) would be permitted without the consent of the general partner of that Buyer. In the event that permission for the transfer has been granted, or subsequent to the said period, any transfer would be subject to the right of first refusal granted to Treetops or Treetops II, as the case may be, and to any other investor, as well as subject to a Tag Along right. In addition, members of the Bronfman Family will continue to hold, at all times, at least 50.1% of the Interests held by members of the Bronfman Group, and Rubin Schron will continue to hold, at all times, at least 50.1% of the Interests held by the Schron Group. It is further stipulated in the Cooperation Agreement that if those who hold over 55% of the Interests would decide to sell over 55% of the Interests, they would be entitled to force the other Investors to sell, under the same conditions, the balance of the Interests held by them.

The Clarification Letter stipulates that as from the end of five and one half years from date of closing of the transaction, each Buyer would be entitled to decide to surrender the Bank of Israel permit, for the purpose of the sale of the controlling interest shares, according to the letter attached to the permit (as described above). A Buyer choosing to do so is to inform the other Buyer accordingly, and in such a case the other Buyer would have the right of first refusal or the Tag Along right in respect of all the shares held by him, all subject to and in accordance with the terms to be agreed upon (in the future) between the Buyers regarding this matter. The sale of shares in accordance with this paragraph will not require a majority of 67% of the Investors (as required for the sale of shares according to the Cooperation Agreement).

The Clarification Letter further stipulates that the Cooperation Agreement would be valid so long as anyone of the Buyers holds, directly or indirectly, over 5% of the share capital of the Bank. It is further stipulated that the provisions of the Cooperation Agreement which apply to the controlling interest shares, shall apply also to shares acquired, directly or indirectly, by the Buyers or the Investors through the exercise of the option, including together with others. The voting rights attached to the shares so acquired as well as to other shares held by the Buyers or Investors, including together with others, shall be used in accordance with the manner in which the Buyers of the controlling interest shares vote, as detailed above.

THE EFFECTIVE PRICE OF THE TRANSACTION FOR THE SALE OF A CONTROLLING INTEREST OF THE BANK

On May 17, 2005, M.I. Holdings Ltd. provided the Bank with an opinion given the Goren Capital Group Ltd. which was prepared for M.I. Holdings Ltd. and the Finance Ministry in the matter of "The estimated economic value of the package of shares and options which constitute the controlling interest in the Israel Discount Bank".

In the summary of the Opinion, it is stated that:

- The consideration in the amount of NIS 1,300 million, received by the sellers from the Buyers for the package of shares and options, reflects an effective price for the transaction of between 74% and 81% of the equity of the Bank at date of the sale, and an effective price for the transaction of between NIS 4.67 and NIS 5.20 per share.
- The estimated effective consideration took into account the weighted value of the options granted to the Buyers, these being based on an estimate of 50% of their value according to the B & S model, which reflects, according to the Goren Capital Group Ltd. estimate, a fair economic value, considering the many restrictions imposed on the options, their exercise and the receipt of the potential benefit inherent in them following their exercise.

This Opinion was attached, with the consent of the authors thereof, to an immediate report issued by the Bank in the above matter on May 23, 2005, upon the request of the Supervisor of Banks, which may be viewed on the website of the Israel Securities Authority ("Magna") or on the website of the Tel-Aviv Stock Exchange ("Maya").

It should be mentioned that the Bank was not a party to the process of the sale and that it was neither involved in commissioning the valuation nor in the formation of the Opinion

CREDIT AGREEMENT

According to the information provided to the Bank, the Buyers shall be entitled to pay the balance of the consideration on dates and under terms detailed below, subject to the signing at date of closing of an Annex to the Sale Agreement, which will include provisions for assuring the payment of the balance (hereinafter – "the Credit Agreement"):

- Subject to that stated hereunder, the balance of the consideration shall be paid by the end of 36 months from date of closing of the transaction (hereinafter – "the First Period").
  The exercise price of the option or any part thereof shall be paid upon the exercise of the option, unless a part of the payment has been deferred in terms of circumstances determined for this purpose in the credit agreement.
- In addition, the Buyers shall provide the Government and M.I. Holdings on the closing date, personal letters of guarantee in an agreed text and in a total amount of US$10,800,000.
  The right of recourse to the Buyers, over and above the collateral mentioned above, is subject to a permit from the Bank of Israel.
- Under certain conditions, the Buyers shall be entitled to make an early repayment of the outstanding balance of the consideration, in whole or in part. Furthermore, in the event that the Bank would distribute dividends, the Buyers will have to make an early repayment up to certain determined amounts.
- In the event that an early repayment has been made following the distribution of dividends by the Bank as above, then, under certain conditions, the Buyers may request the granting of new credit in the amount of the early repayments made by them.
- The Buyers shall be entitled to defer the last date for the payment of the balance of the consideration until the end of 36 months from the end of the first period, subject to certain conditions, including:
  - The option has been partly or fully exercised by the end of the exercise period. If only a part of the option is exercised then the last date for the payment of the balance of the consideration will be deferred only as regards a proportion of the

outstanding balance of the consideration in accordance with the ratio of the number of shares exercised to the total number of shares covered by the option.
- Until the end of the first period, the shares comprising the controlling interest in the Bank that are not pledged has to reach a rate of 26% of the outstanding capital of the Bank.
- On the date on which the Buyers request a deferment of the last date for the payment of the consideration, the collateral, as stated above, has to meet with the determined ratio of collateral to debt.

- So long as a debt, as detailed above, exists, the Buyers shall be subject to certain limitations, including limitations on transactions in the pledged shares, on the distribution of dividends, on the registration of an additional pledge on the shares acquired through the exercise of the option, and limitations on various actions regarding the Bank, which may affect the value of the collateral, without the prior consent of the Government. In addition, the Buyers will have to abide by a certain ratio of collateral to outstanding debt (a ratio of the amount of the personal guarantees plus the market value of the pledged shares, according to a determined calculation, or the value of other collateral provided by the Buyers, to the balance of the debt).
- In addition, the Credit Agreement includes events of default and other circumstances in which the debt will become immediately payable.

EMPLOYEES AGREEMENT

On February 1, 2005, concurrently with the signing of the Agreement for the Sale of a Controlling Interest in the Bank, an agreement was signed between the New Histadrut Federation of Labor (hereinafter: “the Histadrut”), the Representative Committee of Discount Bank Employees and the Accountant General of the Ministry of Finance (hereinafter – “the Employees Agreement”), which, among other things, is subject to the approval of the Bank (see hereunder). The Employees Agreement is intended to settle several demands raised on behalf of the employees of the Bank in connection with their rights in light of the sale of the controlling interest in the Bank by the State.
Set out below are the provisions of this Agreement:

- The Histadrut, as the organization representing the workers, conceded, on behalf of the employees, their right to purchase the balance of 10% of the shares of the Bank which are held by the State, at a 25% discount, and to a subsidized loan by the Bank to finance this purchase, as is customary in privatization of banks being part of the “Share Arrangement”.
- In exchange for the above-mentioned concession, the employees will receive from the Government a cash amount equivalent to a value of 30% of the value of the 10% of the Bank shares which were not offered at a discount to the employees. In the Employees Agreement it was declared that the value of the benefit for conceding the purchase of the shares as aforesaid is NIS 120 million (hereinafter – “the State Grant to Employees”).
- The employees would be entitled to receive from the Bank a bonus on account of 2004, of one salary to each employee (hereinafter – “the Bonus for 2004”), as well as a special grant with regard to conceding the right to receive a subsidized loan for which they would have been entitled as is customary for the privatization of the banks being a part of the “Share Arrangement” (hereinafter – “the Special Grant”).
- The total value of the Special Grant and the Bonus for 2004 is approximately NIS 130 million (hereinafter together: “the Bank Grant to Employees”).

  It should be clarified that in a conversation held between the President & CEO of the Bank and the Deputy Accountant General at the Ministry of Finance, it was made clear to the Bank that the amount of the Bank Grant to Employees (amounting as stated above to NIS 130 million) reflects the total cost to the Bank as the employer of these employees. The content of this discussion has been put in writing in a letter sent by the Bank to the Deputy Accountant General.

Amounts in excess of the said NIS 130 million, will be paid by the Government.

- The State Grant to Employees and the Bank Grant to Employees (hereinafter – "the Total Grant") amount to NIS 250 million. The Total Grant shall be paid to the employees subject to the closing of the Agreement for the Sale of the Controlling Interest in the Bank, and on dates determined in the agreement.
- The employees entitled to the Total Grant are those who at date of closing are employees of the Bank, of Mercantile Discount Bank and of the wholly owned subsidiaries in Israel, and who are tenured and permanently employed, and also those employed under personal employment agreements, which, at the closing date have been with the Bank for at least one year. The Employees Agreement clarifies that the share in the total bonus relating to the employees of Mercantile Discount Bank shall be paid by the Government and the Bank subject to the signing of a separate agreement with these employees (see "Mercantile Employees Agreement" hereunder).
- The power of the Labor Charter as a collective labor agreement at Discount Bank, shall be extended for a period of five years, namely until December 31, 2009. At the end of this period, the parties shall act with regards to the power of the Labor Charter, in accordance with section 3 thereto.
- The Agreement for the Sale of a Controlling Interest in the Bank is to include a provision that in the event that the control of Israel Discount Bank of New York is sold, then the full cash proceeds of such sale will be transferred to the Bank, and that no dividend shall be distributed out of such proceeds for a period of five years from date of signing the Agreement for the Sale of a Controlling Interest in the Bank, unless otherwise agreed with the Representative Committee of the Employees.
- The labor dispute announced on March 11, 2004, with regard to the privatization of the Bank, shall be terminated immediately upon the approval of the Employees Agreement.
- Immediately following the approval of the Employees Agreement, the employees will cooperate in any matter or action required for the closing of the transaction for the Sale of the Controlling Interest in the Bank, and for the sale of the balance of the shares remaining in the hands of the State, and in any other required process, if at all. (In this respect, it has been clarified that that the term "employees" in relation to the above, excludes the employees of Mercantile Discount Bank).
- Subject to the approval of the Employees Agreement, the parties to the Employees Agreement have mutually committed that for the period until the closing date of the transaction or until September 30, 2005, whichever is later, they will mutually maintain "industrial peace". No one-sided actions will be taken or one-sided organizational changes be made by any of the parties that are not compatible with the Labor Charter. No strike or closing-down measures, in whole or in part, will be taken, nor will anything that might impair labor relations and orderly work procedures be brought into effect.

The Employees Agreement was subjected to the approval of the authorized institutions of the Bank. On February 7, 2005, the Audit Committee of the Bank and the Board of Directors of the Bank approved the Bank joining the Agreement. The resolution emphasized that the total cost to the Bank (employer's cost) will be NIS 130 million (and shall not exceed that amount). On April 5, 2005, the General Meeting of Shareholders of the Bank approved the Bank joining the Employees Agreement. Within the approval, it was stated that the total cost to the Bank (employer's cost) will be NIS 130 million (and shall not exceed that amount).

The Employees Agreement was also subject to the approval of the Finance Committee of the Knesset. The Finance Committee approved the Employee Agreement.

Soon after the closing of the agreement for the sale of a controlling interest in the Bank, which occurred in the first quarter of 2006, the Bank and its relevant subsidiaries paid the overall bonus agreed upon in the Employees Agreement. The total cost of this bonus, including related expenses (payroll VAT and National Insurance contributions) amounted to NIS 305 million. Accordingly, the bonus that is to be paid by the State will amount to NIS

175 million, of which NIS 120 was paid in March 2006, and the balance will be paid upon the exercise of the option by the Bronfman-Schron Group.

Mercantile Employees Agreement. On May 22, 2005, the Histadrut, The Representative Committee of Mercantile Discount Bank Employees and the Accountant General at the Ministry of Finance signed an agreement, which, inter-alia, is subject to Mercantile Discount Bank's approval (see hereinunder). The Mercantile Employees Agreement is intended to settle several demands raised by employees of this bank regarding their rights in light of the sale of the controlling interest in the Bank by the State.

The terms of the Mercantile Employees Agreement are as follows:

- The Histadrut, as the organization representing the workers, conceded, on behalf of the employees, their right to purchase the balance of 10% of the shares of Discount Bank which are held by the State, at a 25% discount, and to a subsidized loan to finance this purchase, as is customary in privatization of banks being part of the "Share Arrangement".
- In exchange for the above-mentioned concession, the employees will receive from the Government a cash amount equivalent to a value of 30% of the value of the 10% of the Bank shares which were not offered at a discount to the employees.
- The employees would be entitled to receive from Mercantile Discount Bank a bonus on account of 2004, of one salary to each employee (hereinafter – "the Bonus for 2004"), as well as a special grant with regard to conceding the right to receive a subsidized loan for which they would have been entitled as is customary for the privatization of the banks being a part of the "Share Arrangement" (hereinafter – "the Special Grant").
- The total amount of the bonus payable to the employees of Mercantile Discount Bank will be the proportional amount applicable to the Mercantile Discount Bank out of the total amount of the bonus (NIS 250 million) as defined in the said Employee Agreement. The said bonus will be paid to the employees subject to the closing of the agreement for the sale of a controlling interest in the Bank, and at dates specified in the Agreement.
- The employees entitled to the Total Grant are those who, at date of closing, are employees of Mercantile Discount Bank and of the wholly owned subsidiaries of Mercantile Discount Bank in Israel, and who are tenured and permanently employed, and also those employed under personal employment agreements, which, at the closing date have been with the Bank for at least one year.
- The validity of the collective agreements at Mercantile Discount Bank (as the term is defined in the collective agreement dated December 21, 2004 and all its Annexes) will be extended for a specified period until December 31, 2009. At the end of this period, the parties shall act as regards to the validity of the collective agreements, in accordance with the terms of Section 5 of the labor agreement dated May 17, 1968.
- The labor dispute announced at Mercantile Discount Bank on March 29, 2004, with regard to the privatization of Discount Bank, shall be terminated immediately upon the approval of the Mercantile Employees Agreement.
- Immediately following the approval of the Mercantile Employees Agreement, the employees of Mercantile Discount Bank will cooperate in any matter or action required for the closing of the transaction for the Sale of the Controlling Interest in Discount Bank, and for the sale of the balance of the shares remaining in the hands of the State, and in any other required process, if at all.
- Subject to the approval of the Mercantile Employees Agreement, the parties to the Mercantile Employees Agreement have mutually committed that in the period until the closing date of the transaction or until September 30, 2005, whichever is later, they will mutually maintain "industrial peace". No one-sided actions will be taken or one-sided organizational changes made by any of the parties that are not compatible with the collective labor agreements. No strike or closing-down measures, in whole or in part, wil be taken, nor will anything that might impair labor relations and orderly work procedures be brought into effect.

The validity of the Mercantile Discount Bank Employees' Agreement was subject to approval of the authorized institutions of this bank, approval of Mercantile Discount Bank Employees' Council and the approval of the Finance Committee of the Knesset. On May 30, 2005, the Representative Committee of Mercantile Discount Bank Employees approved the Mercantile Employee Agreement. The Board of Directors of Mercantile Discount Bank approved the agreement on June 9, 2005, and the general meeting of shareholders of Mercantile Discount Bank approved the agreement on June 20, 2005. The Finance Committee of the Knesset approved the Agreement.

In an Annex to the Mercantile Discount Bank Employees Agreement, which the signatories thereto (the New Histadrut Federation of Labor, Mercantile Discount Bank Employees' Committee and Mercantile Discount Bank) agreed to be an integral part of the said agreement, it has been agreed that despite the time schedule determined in the Mercantile Discount Bank Employees' Agreement, the date of payment of one month salary shall be advanced, and that following the approvals by the Mercantile Discount Bank institutions and by the Employees' Council of Mercantile Discount Bank, it will be payable to whomever at date of payment will comply with the entitlement terms prescribed in the Mercantile Discount Bank Employee Agreement. With this, all the claims of the employees of the Mercantile Discount Bank as regards to the bonus in respect of 2004 have been exhausted. The said payment will be deducted from the payment that will be carried out according to the Mercantile Discount Bank Employees' Agreement.

Israel Discount Bank, Discount Bank's Employees Committee, the employees' committee of Mercantile Discount Bank and the New Histadrut Federation of Labor approved in writing their consent that any differences of opinion regarding the exact amount of the bonus due to Mercantile Discount Bank's employees out of the total bonus of NIS 250 million mentioned in the Employee Agreement, will be resolved by Mr. Shlomo Zohar, CPA, who will submit his ruling within thirty days from the date on which any of the parties will approach him in this matter, will report the dispute and will request a decision.

As stated above, the award to the employees of Mercantile Discount Bank was paid in the first quarter of 2006, soon after the closing date of the agreement for the sale of controlling interest in the Bank.

THE ACCOUNTING TREATMENT OF THE EMPLOYEE AGREEMENT

The financial statements for 2004 included a provision in respect of the bonus for 2004, to the amount of one salary, based on the assessment that in view of the results for the year 2004, the Bank and its other relevant subsidiaries in the Group would have, in any case, paid such a bonus to their employees. The amount of the said bonus is NIS 73 million.

The provision in respect of the balance of the Bank Grant to Employees in the amount of NIS 57 million, comprising the said special bonus, will be reflected in the financial statements for the first quarter of 2006, in which the conditions precedent in the Employees Agreement were fulfilled, and in particular the closing of the transaction for the sale of a Controlling Interest in the Bank.

As to the State Grant to Employees, the Bank was informed by the Supervisor of Banks that the Grant to be paid by the State (an amount of NIS 175 million, including employer related costs) is considered "a transaction with a controlling party". Therefore the grant paid by the State is to be recorded as part of payroll expenses against a capital reserve.

The expense regarding the State Grant to Employees will be recorded in the financial statements of the Bank, in accordance with the said directive of the Supervisor of Banks, in the first quarter of 2006, along with recording the provision for the special bonus.

SPECIAL ARRANGEMENTS IN THE INTERIM PERIOD UNTIL THE CLOSING OF THE TRANSACTION FOR THE SALE OF A CONTROLLING INTEREST IN THE BANK

On February 21, 2005, the Minister of Finance approached the Chairman of the Bank's Board of Directors in view of signing the agreement for the Sale of a Controlling Interest in the Bank, and the expected time-table for the closing of the transaction, which may last for several months, mainly due to the need to obtain regulatory approvals for the transaction, both in Israel and abroad.

In view of the scope and materiality of the transaction on the one hand, and the long interim period that might pass from the date of signing of the agreement to the closing date of the transaction on the other, the Minister of Finance was of the opinion that it would be appropriate that measures be taken so as to minimize, as far as possible (and subject to the provisions of the law), the changes that might take place in the business of the Bank in this period, unless after receiving the opinion of the representatives of the Buyers or after consulting with them, as follows. Accordingly, the Minister of Finance asked that his opinion be brought before the Board of Directors, as follows:

1. Until the closing date of the transaction, any material transaction that is not within the ordinary course of business of the Bank, shall be effected only after the opinion of the representatives of the Buyers has been brought before the Board;
2. Until the closing date of the transaction, the appointment of senior executive officers of the Bank (from the position of executive vice president and above) would be made only after consultation with the representatives of the Buyers, unless it would be possible to remove the said executive officers from office after closing date, without the payment of indemnification in excess of that prescribed by law, or if the terms of the agreement with that executive officers are similar to those existing in agreements with other executive officers, and which do not relate to the payment of any indemnification in respect of removal from office or retirement following the change of control in the Bank;
3. Until the closing date of the transaction, the Board of Directors are to allow an observer, recommended by the Buyers and approved by the Chairman of M.I. Holdings Ltd. and by the Chairman of the Board of the Bank, and with the consent of the Supervisor of Banks, to participate in meetings of the Board of Directors of the Bank;
4. To the extent that the matter is within its control, the Bank shall act that the matters stated above will apply, mutatis mutandis, also to its branch and to its subsidiaries: Discount Bancorp Inc. (including IDB NY); Mercantile Discount Bank Ltd., Discount Mortgage Bank Ltd., Israel Credit Cards Ltd., Israel Discount Bank (Switzerland) SA, Israel Discount Bank Ltd. – London Branch.

In this respect, the Minister of Finance clarified that the representative of the Buyers is Mr. Shlomo Zohar, CPA, (so long as the Buyers have not notified about the appointment of another representative), subject to the consent of the Supervisor of Banks to the identity of this person, and subject to the Bank being notified of the identity of the observer recommended by the buyers (or other observers in the case of the various companies of the Bank's Group) following approval by the Supervisor of Banks.

In its meeting of March 15, 2005, the Board of Directors took notice of the said letter of the Minister of Finance, and resolved that, subject to restrictions setout by law and subject to that discussed below as regards the overseas subsidiaries, the Board shall act taking notice of the Minister's opinion.

The Board instructed the Management of the Bank to seek guidance with the Supervisor of Banks as to whether an approach by the Bank to its overseas subsidiaries in which it requests their Boards of Directors to place on their agendas the letter of the Minister of Finance, would not create a situation where the Bank and/or its overseas subsidiaries will be deemed to have acted in contravention to the provisions of the law and/or regulations applying to such subsidiaries, and that the Supervisor of Banks instruct the Bank how to act in this matter. A letter in this respect was sent on March 17, 2005. On June 9, 2005, the Supervisor advised that, following discussions conducted with the regulatory authorities in the United States, he requests that an observer to the foreign banking subsidiaries of the Bank not be appointed and that these subsidiaries should not be instructed to act in a particular manner following for the acquisition of the Bank's shares.

The letter of the Minister of Finance has been brought to the attention of Mercantile Discount Bank, Discount Mortgage Bank and Israel Credit Cards and these subsidiaries have been asked to include the matter on the agenda of their next Board meeting. The letter was also brought to the attention of the Manager of the London Branch of the Bank.

On March 17, 2005, the Bank received the approval of the Supervisor by Banks to the appointment of Mr. Shlomo Zohar as an observer to the Board of Directors of the Bank and to committees of the Board: Human Resources, Computerization and Financial Statements, as well as to the Board of Directors of the following subsidiaries of the Bank: Mercantile Discount Bank, Discount Mortgage Bank, and Israel Credit Cards. Among other things, the approval by the Supervisor of Banks is subject to Mr. Zohar abiding by all the provisions regarding the conflict of interest included in Proper Banking Management Directives in regard to the "Board of Directors" (Directive No. 301), mutatis mutandis. The consent of the Supervisor of Banks to Mr. Zohar acting also as the representative of the Buyers was also received on that date.

On March 22, 2005, M.I. Holdings and the Chairman of the Board of the Bank approved the appointment of Mr. Zohar as observer to the Board of Directors of the Bank, and to the Human Resources, Computerization and Financial Statements Committees of the Board, as well as his appointment as observer to the Board of Mercantile Discount Bank Ltd. On March 30, 2005, the Board of Directors of Discount Mortgage Bank Ltd. approved the appointment of Mr. Zohar as an observer at the Board of Directors of the Discount Mortgage Bank. On May 15, 2005, the Board of Directors of ICC approved the appointment of Mr. Zohar as an observer at the Board of Directors of ICC.

The said interim arrangements have been in effect up to the closing of the transaction for the sale of a controlling interest in the Bank on January 31, 2006. On that date, Mr. Shlomo Zohar was appointed a director in the Bank, and soon afterwards Mr. Zohar was appointed Chairman of the Boards of Directors of the Bank and of certain of its principal subsidiaries.

LEGISLATION AND SUPERVISION

GENERAL

The Bank operates within the framework of Laws, Regulations and Directives, certain of which are exclusive for the banking industry, and others, though even not exclusive as above, do have an effect on certain sections of its operations.

The Banking Ordinance, various banking laws and the proper banking management directives issued from time to time by the Supervisor of Banks, constitute the central legal basis for the operations of the Bank Group.

These, among other things, define the limits of the operations of the Bank, the permitted operations of subsidiaries and companies related to the bank and the terms for owning and controlling them, the relations between the Bank and its customers, the use made of assets of the Bank, and the mode of reporting to the Supervisor and the public as to the Bank's said operations.

Alongside these, the Bank is subject to a wide legislation that regulates its capital market operations both on behalf of customers an on its own behalf (for example: investment and customer portfolio management consulting, mutual investments funds, the overall activities of provident funds, securities laws and restrictions on insurance business activity).

Additional legislation as regards special subjects imposes on banks, including the Bank, specific duties and rules. Thus for instance, the legislation relating to the prohibition of

money laundering and the prohibition of financing of terror activities, the credit data law, legislating relating to housing loans, guarantees, etc.
In addition legislation exists, which because of its connection to the operations of the Bank, has a considerable implication on the way the Bank is being managed. In this respect it should be mentioned, among other things, the debt execution laws, liquidation and receivership laws, laws relating to specific economic sectors (local authorities, mortgagees, the agricultural sector) and various tax laws.
Following is a summary of legislation changes and relevant legislation initiatives during the reported period, which affect or might have a significant effect on the operations of the Bank.

REFORM IN THE STRUCTURE OF THE ISRAELI CAPITAL MARKET AND IN THE ACTIVITY OF THE BANKS AND OTHER PLAYERS IN THE CAPITAL MARKET FIELD

The most important change in legislation in 2005, was the enactment of the laws passed in the wake of the Bachar Committee recommendations, which regularize banks' holdings in mutual funds and in provident funds as well as the activity of the banks and other players in the capital market field.
Towards the end of 2004, the Government adopted the recommendations of the inter-office committee, headed by the Director General of the Ministry of Finance (the Bachar Committee) and in the course of 2005, the legislation designated to carry out the Government's decisions in these areas, was formed and approved. This concluded in fact the legislation work intended to formulate arrangements in various areas relating to the activity of the banking industry, as to which decisions were taken by the Government as early as 1993.
In August 2005, three comprehensive laws were published relating to the activity of the banks and other players in the capital market. Regulations and various principles designated at complementing the arrangements by way of secondary legislation were published later on that year and in 2006.
The new legislation is designed to bring about a change in structure of the capital market and in the role of the banking industry therein. Banks are required, within a transition period as determined in the legislation, to discontinue their present form activity in the field of provident and mutual funds, and to transfer the management and ownership thereof to other capital market players, thereby turning into consultants in the capital market and pension fields, who do not have a direct interest in the products that are being sold to their customers. Within the framework of the new legislation, the provident fund industry has been regularized for the first time by primary legislation, and a new law was passed regarding the pension industry, dealing with pension consultancy and marketing.
For a condensed review of the principle changes in legislation and their implications, see Note 33 to the financial statements.

CLASS ACTION SUITS LAW, 2006

In March 2006, the Knesset passed the abovementioned law, which determines a general arrangement for the filing and management of class action suits, and replaces, among other things, the provisions regarding class actions against banks included in the Banking Law (Customer service), 1981. The law broadens the causes for filing class action suits against banks, and determines that a class action suit may be filed against a bank "in respect of a matter between the bank and the customer, whether they have entered into a transaction or not". Further causes have been determined, which might serve as a basis for an action against banks, such as a cause deriving from the affinity to securities or to a participation unit in a mutual fund, and so forth.
The law is forthcoming to plaintifs and allows the Court extensive judgment as regards the approval of an action as a class action, and in this regard the conduct of the class action, defining the group and subgroups, replacing the representative plaintiff or representative

attorney, attaching representative plaintiff or a representative attorney, permitting a public service organization to participate in the hearing. The law requires a closer supervision than previously on the withdrawal of an action and on compromise arrangements and determins the possibility of ruling for compensation in favor of the appellant and to the representative plaintiff even when the class action was not approved or was not ruled in favor of the group. The law provides protection to certain entities, including banks, both at the approval stage of the class action and at the stage of ruling for damages in favor of the plaintiffs, in cases where the action has been admitted, and allows the Court to take into consideration the damage that could be caused to the defendant and to the public using the services of the defendant or to the public at large, as opposed to the benefit of conducting the class action or of the compensation granted.

However, the damage to the defendant that the Court may take into consideration is a damage that might be caused "as a result of impairment to the economic stability of the defendant", a condition the realization of which as a result of a single action (albeit a class action) served against a bank, is remote.

The law is also forthcoming rgarding the limitation provisions, in that, among other things, it determines that in cases where the Court has dismissed or removed a motion for approval of a class action, a claim of a person belonging to the group (or an individual in repect of whom it was determined that he should not be a party of the group) shall not be subject to limitation unless one year has passed since the date on which the motion for approval became definitive.

The transitional provisions of the law apply the new law to class actions and motions for approval of class actions that are pending at date of publication of the law, and provisions were set to avoid the extension of the period of limitation in respect of such motions and motions that had been dismissed prior to the publication of the law.

The new law is intended to encourage the submission of class actions, and it is reasonable to assume that a larger number of class actions would now be served generally and against banks in particular. However, at this stage it is yet unknown how the Courts will interpret and implement the provisions of the law in the future. Accordingly, it is not possible to assess the law's impact on the Bank.

LEGISLATION PROPOSALS AND ARRANGEMENTS REGARDING BANKING COMMISSIONS

In the course of the years 2004 and 2005, various matters pertaining to commissions charged by banks appeared on the public agenda, including their rates, types and disclosure given to customers with regards thereof. In this respect, a large number of private bills have been tabled before the Knesset, concerning limiting the ability to increase commission rates, limiting the total income from commissions, prohibiting charging commissions in respect of certain services and more, as well as a bill proposing the establishment of a Fair Trade Authority which will be responsible for various matters, including the regulation of bank/customer relations. The matter was also examined by various professional teams who have submitted their recommendations thereon.

At a certain stage during 2004, the Commissioner of Restrictive Trade Practices informed that he is considering using his authority under the Restrictive Trade Practices Law in order to determine that five banks, among which the Bank is included, form a "concentrated group", and following this even published a proposal for the amendment of the Restrictive Trade Practices Law in the matter of regulating his authority with respect to "concentrated groups".

The Bank of Israel, on its part, had presented to the Knesset Economics Committee a draft bill in the matter of bank commissions, which was not approved by the Government. According to this draft Bill the Supervisor of Banks would be authorized, among other things, to be involved in the fixing of the level of certain commissions, including fixing the

maximum level for some of them, and will also be authorized to prohibit the charge of certain commissions.
During the said period, efforts were made by the Knesset Economics Committee to reach a "package deal" on the subject of commissions and of the removal of obstacles regarding the transfer of private customer/household accounts from bank to bank.
Eventually, the Supervisor of Banks and the banks reached an arrangement in July 2005, with respect to commissions charged from household accounts. The Supervisor informed the Knesset Economics Committee of this arrangement, and on July 14, 2005, issued to the banks a letter detailing the principles for the implementation of the "package deal" in the matter of commissions pertaining to current accounts of private customers.
For further details see "Retails sector – Household segment", in the section "Activities of the Group according to principal segments of operation".

PROHIBITION OF MONEY LAUNDERING LAW AND PROHIBITION OF THE FINANCING OF TERROR ACTIVITIES

Prohibition of money laudering. The Prohibition of Money Laundering Law, 2000 came into force on August 17, 2000. The Law, inter alia, provides that a person knowingly effecting an operation with prohibited property, knowing that it is prohibited property, or with the object that there will be no report or to procure an incorrect report, commits a criminal offence. The Law further provides, inter alia, that a person reporting actions as aforesaid shall be exempt from liability.
Following the legislation, regulations were enacted, orders were issued and proper banking management directives were determined, applying to banking corporations and other entities, including subsidiaries of the Bank. In this respect, principles have, among other things, been determined, regarding the identification, reporting and recording management, determination of policy, monitoring certain accounts and the treatment thereof, and more. A Proper Banking Management Directive has also been determined, which instructs banks, among other things, to prepare for the forming of a group policy regarding these issues and for the supervision of its implementation, and for the installation of a computerized system to assist in the monitoring and discovery of unusual activities in customers' accounts. As regards certain areas, only drafts of the secondary legislation or proposals for amendment thereof exist.
The Bank and certain of its subsidiaries have appointed officers responsible for the compliance with the requirements of the Law, and they prepared and are preparing for the implementation of the said provisions, including the updating of customer data, verification of customer identity, determining procedures and installing appropriate computer programs. Inter-alia, in accordance with the Regulations, customer accounts were blocked on August 18, 2003, because they did not have the details of identity required by the relevant Regulations, so that until such details are available, customer initiated activity in these accounts is not permitted, except for the settlement of debts.
Prohibition of the financing of terror activities. In December 29, 2004, the Knesset passed the Prohibition of the Financing of Terror Activities, 2004, which came into force at the beginning of August 2005. According to this Law, anyone who takes action as regards assets of a person knowingly that such a person is active in terror activities or has been declared as such (according to a procedure determined in the Law) is committing a felony. It is also determined that a bank is obligated to report any attempt to act as above and/or or any such action actually taken, and that the non-reporting also constitutes a felony.
Regulations under the above Law have not as yet been published, and there are many ambiguities as to what is required from the banks under this Law, in particular, as to the ability of a bank to locate and prevent transactions of terrorists, whose names do not appear on lists published by law, and the capability of the Bank to monitor and prevent the transfer of funds to and from residents of the Palestinian Authority, which might be used for the encouragement of terror activities.

The implementation of this Law required the Bank additional EDP preparations, intensive training of staff as to everything connected with this subject (which is not similar to money laundering activities) and for the promulgation of additional operating procedures.

The Bank's preparations. The Bank is preparing for the implementation of that which is required from it in accordance with the Law for the Prohibition of Money Laundering and the Law for the Prevention of Financing of Terror and the existing and anticipated related secondary legislation. The Bank is acting to acquaint all relevant employees with the procedures relating to money laundering prohibition and the prevention of terror financing. In this respect, systems for the identification and location of customers and activities and reporting them to the Authorities are being developed and currently improved, work procedures are being brought up to date, and new procedures determined, where necessary, and study and training means are provided to managers and employees. Considering the many changes that are taking place in the primary and secondary legislation regarding the prohibition of money laundering and the new legislation regarding the prevention of financing of terror, the preparations and assimilation is a continuous activity carried out throughout the year.

Audit report in the matter of the implementation of the "Money Laundering Law". In 2004, the Bank of Israel performed an audit at Discount Trust Ltd. The audit report was received by Discount Trust Ltd. in April 2005. Following the audit report, The Supervisor of Banks motioned for the charging of Discount Trust Ltd. with sanctions in respect of the alleged violation of the provisions of section 7 of the Prohibition of Money Laundering Law. Representatives of the Bank and of Discount Trust appeared before the Monetary Sanctions Committee, established under the Law, in order to present their case. On December 25, 2005, the Supervisor of Banks informed Discount Trust Ltd. of the Committee's decision that Discount Trust Ltd. had violated the provisions of the Prevention of Money Laundering Order (Obligations for identification, reporting and maintenance of records by banking corporations), 2001, but that despite these violations the Committee decided not to charge Discount Trust Ltd. with a monetary sanction, but that a warning in writing would suffice. For the last several months, the audit department of the Bank of Israel has been performing an across the board audit in respect of the Bank's conduct regarding the prohibition of money laundering.

"PRINCIPLES OF CONDUCT" DOCUMENT

In 1985, the Bank voluntarily agreed to an arrangement with the Attorney General of the Government and with the Commissioner of Restrictive Trade Practices ("the Commissioner") regarding principles of conduct. This arrangement determined the areas in which banks are not permitted to act jointly on the one hand, and the areas in which banks have a legitimate interest to act among themselves on the other hand.

The arrangement also included provisions for the recording and reporting of certain meetings between representatives of various banks.

The arrangement was made within the framework of a plea bargain and as part of the proceedings for the cancellation of an indictment against the chairmen of the boards of four banks (including the Bank).

In 2001, the Commissioner informed the banks that the principles of conduct do not constitute a law, they are not enforceable, and the Commissioner is no longer bound by them. The Bank together with the three other banks applied to the Commissioner for an exemption from a binding arrangement as regards agreements to which the Bank is a party, concerning the companies Automatic Bank Services Ltd. and Bank Clearing Center Ltd. In addition, the Bank, similarly to other banks, has applied for exemption from a binding arrangement as regards the authorization for debiting accounts.

Continued holding and joint activity of Automatic Bank Services Ltd. (ABS). On June 19, 2002 the Commissioner informed the banks that he authorizes them to operate within the framework of ABS subject to the provisions determined by him, which include a limitation on the areas of activity of ABS; the non-distribution of profits in any form or manner to the shareholders of ABS (five banks including the Bank); imposing an obligation on ABS to allow any person (and not only a bank) to connect to the access services both as an operator of automatic teller machines and as an issuer; charging identical commissions to all users; the obligation of providing full information to whoever connects to the service; a limitation on the information to be transmitted to or passed between the shareholders of ABS.

The Bank has submitted to the Commissioner a computation providing the basis for the commission collected in respect of the withdrawal of cash using automatic teller machines. On September 17, 2002, the Commissioner informed the Bank that he was convinced of the reasonableness of the commission, and approved its amount for a period of two years from the date of the exemption granted under the ABS agreement. On June 17, 2004, the Commissioner extended the validity of the said exemption, under the same terms, for an additional period of three years.

The continued holding and joint activity of the Bank Clearing Center (BCC). On June 19, 2002, the Commissioner informed the shareholders of BCC (five banks including the Bank) of his approval of their joint holding of BCC, subject to the provisions determined by him, including limitation on the areas of operation of BCC; an obligation to allow access for any bank to the said clearing services; the non-distribution of profit or of any other payments to the shareholders; identical commissions to all users of the clearing services; the possibility of charging "access fee" for a new connection (if no agreement will be reached between the said newly connected bank and BCC, an arbitrator will be appointed, with the approval of the Commissioner, who shall determine the amount of the access fee and the parameters to be considered in determining such fee; the obligation to present full information to the bank being connected; a limitation on the information to be passed between the shareholders of BCC.

On June 17, 2004, the Commissioner extended the validity of the said exemption, under the same terms, for an additional period of three years.

Authorization for debiting accounts. Following discussions and various notices of the Commissioner and of the Supervisor of Banks in this matter, the Supervisor of Banks informed on July 7, 2003, that for a period of one year, all banks will pay inter-bank commissions at a uniform rate determined by him, both for establishing a new authorization as well as for each entry, provided that the banks have not reached an agreement involving lower commission rates. The Supervisor further informed that he would conduct examinations during the year as to the proper commission rate. Since then the Supervisor of Banks did not inform the banks otherwise, and the banks are continuing to act according to the said notice from the Supervisor of Banks dated July 2003.

Consortium agreements. On August 18, 2002, the Commissioner informed Bank Leumi, Bank Hapoalim and the Bank that at this stage he is not able to determine the terms for a "class exemption" regarding consortium agreements. Therefore, he does not intend to enforce the terms of the exemption for six months or until the establishment of a "class exemption", whichever is earlier, subject to the fulfilment of the following provisions: the joining of a consortium is vital in the sense that otherwise it would not be possible to grant credit to the customer at reasonable terms; the customer agrees to the consortium; the customer shall be entitled to negotiate separately with the member banks of the consortium; and where both Bank Leumi and Bank Hapoalim are members of the consortium – the minimum amount of credit to be granted is to be greater then NIS 150 million.

On March 5, 2003, the Commissioner extended the period of effect of his said notice until December 31, 2003, determining that the said limitation on the Consortium in which Bank Hapoalim and Leumi participate, will not apply to an arrangement regarding the repayment of loans granted by them to the same customer prior to August 18, 2002.

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1990. www. The internet becomes an open, global network.
Discount satellite branches are established for self-service banking.
Open banking, all the time, everywhere.

The American programmer Tim Berners-Lee develops a computer program in 1990, generating a revolution in communication. This makes the internet an infinite network, open to all.

At the beginning of the nineties, Israel Discount Bank already understands that the world is connected, open, accessible. Time is private, personal, flexible.

As part of this concept, Discount Satellite systems are spread out over Israel. With these systems, customers are able to perform almost any banking transaction in their free time, irrespective of the bank's opening hours. To receive information on transactions and account status, to draw cash and foreign currency, to receive updated information on foreign currency rates and shares, and a range of other services.

Service is the key word in this concept. Personal service also means meeting the customers' personal needs, at their own convenience.

Receiving Feedback. A Discount satellite branche. Most banking transactions are self service.


סניף אוטומטי בשרות

Since then the Commissioner has extended from time to time the validity of his notice, which recently has been extended until December 31, 2006. The banks were requested to relate to the possibility that the said terms would be established as a class exemption.

Cooperation between underwriters. During December 2003 and February 2004, the Commissioner of Restrictive Trade Practices informed that cooperation between competing underwriters with respect to public issues of securities, is on the face of it, considered a binding arrangement. Concurrently, the Commissioner specified conditions, which when fulfilled, it would seem that cooperation between securities issue managers would not raise material questions of violation of fair competition, meaning that in such circumstances he also will not put into action the enforcement setup in accordance with the Restraint of Trade Law. These guidelines are in effect until December 2004. The Bank believes that the said guidelines do not adversely affect the activities of the underwriting company of the Discount Bank Group.

AMENDMENT NO. 3 TO THE INCOME TAX REGULATIONS (RULES FOR APPROVAL AND MANAGEMENT OF PROVIDENT FUNDS)

The above Regulations were published on April 14, 2005, in which, among other things, the Minister of Finance determined that the deposit of funds with a provident fund should be made only after certain amounts had been deposited in respect of each member with a pension provident fund. Implementation of this provision will begin gradually as from January 1, 2006. Starting with January 1, 2006, provident funds (savings) shall not be permitted to receive deposits from self-employed members who do not comply with the rules. The Regulations have also restricted the right of a self employed member, to withdraw amounts from the fund until reaching the age of 60 on condition that he has been a member of the fund for at least five years (and not at the end of 15 years from the first deposited amounts with the fund). This provision applies to deposits made from January 1, 2006.

It should be noted that neither Discount Management of Provident Funds Ltd. nor the Bank have any information as to the deposits in respect of pensions for each of its members. Therefor many difficulties are expected in implementing the above.

In the last quarter of 2005 Discount Management of Provident Funds informed all members of its provident funds of the principal anticipated changes in the rules. Where appropriate, members were requested to sign tan attached declaration as to their eligibility in accordance with Regulation relating to depositing money for pension.

The said Regulations have an adverse effect on the attractiveness of investments in provident funds.

LOCAL AUTHORITIES

In the course of 2005, on the background of the deepening crisis in local authorities, several legislation processes were launched with the aim of distinguishing certain funds received by local authorities, so that they could not be pledged or forfeited.

The Economic Policy Law for 2005 that was passed in 2005 with retroactive effect to January 1, 2005. The law includes a section concerning local authorities which amends, inter-alia, the Budgetary Principles Law, the Municipalities Ordinance and the Local Authorities Ordinance with regards to the granting of credit to local authorities and corporations under their control.

According to the amendment to the above laws, the entity granting credit has a parallel responsibility to ascertain, according to the provisions of the law, whether the local authority complies with the requirements for proper budgetary management, as well as to ascertain and approve the purpose of the loan.

In the wake of the above legislative amendments, the Bank is preparing to amend its procedures with respect to granting credit and guarantees to local authorities.

The effect of the law is not material.

FINANCIAL ASSETS CONTRACTS LAW, 2006

In February 2006, the Knesset passed the abovementioned law, designed to provide legal and business certainty to parties involved in repurchase of securities transactions (REPO) as well as the validity of framework agreements and netting agreements, regulating several transactions between the same parties. These agreements include provisions allowing the parties to terminate all the transactions between them and to offset the values of all these transactions, so that only one of the parties would be required to pay the other party a certain amount. The agreements in question are agreements where one of the parties is a financial institution or the State which are executed according to clearing house principles. The Law enables to consider all the transactions involved in such agreements as one piece and to offset mutual charges between the parties, even when one of the parties turns insolvent. The transactions are considered as sale transactions and not credit transactions, and the provisions of the Pledge Law would not apply to them – which would absolve the parties from the registration duty required in a pledge transaction. Thus the Law has removed the uncertainty that has prevailed in the Israeli law regarding such matters, and it will enable the integration of Israeli entities in the regular activity of the international financial markets.

EXTENDING DAILY BANKING HOURS

Amendments to the Banking Instructions (Customer service) (Date of debiting and crediting checks) and the Banking Instructions (Customer service) (Manner of calculating interest) came into effect at the beginning of 2006, changing the definition of daily banking hours and the end of the banking day, so that the banking day terminates at 18:30 during ordinary week days and at 14:00 on Fridays and on the eve of holidays (as defined in the instructions). Following the above amendments, Proper Banking Management Directive No. 402 has also been amended, requiring banks to publish the latest time for submission of customer orders to be executed on the same business day. The Bank is preparing to implement the changes according to the new instructions. At this stage no change has taken place in the operating hours of most of the branches.

ABUNDANCE OF LEGISLATION INITIATIVES

The year 2005, as its preceding year, was typified by an abundance of legislation initiatives. Many private law proposals have been tabled recently (part of which supported by the Government) regarding the imposition of restrictions on banks (by law or by regulations under it) applying to various fields of activity, including: restrictions on the granting of credit, restrictions on the charging of commissions, restrictions on the payment and/or collection of interest, etc. These law proposals and other similar ones, if passed, might have a material adverse effect on the activities of the Bank and its subsidiaries and on their results of operations in the future. The Bank is not able to evaluate which of these law proposals will in fact be passed and what would be the scope of their effect.

The year 2005 was also characterized by an abundance of regulatory directives, mostly Proper Banking Management Directives and various instructions regarding reporting to the public issued by the Supervisor of Banks. To these were added instructions by the Commissioner of the Capital Market, Insurance and Savings of the Ministry of Finance and by the Securities Authority, as to issues under their control. The implementation of the various instructions requires, on more than one occasion, preparations involving the investment of resources, and sometimes it has a possible adverse impact on the income of banking corporations from various sources.

CRITICAL ACCOUNTING POLICIES

INSTRUCTIONS OF THE SUPERVISOR OF BANKS

On January 7, 2004, the Supervisor of Banks issued a Temporary Instruction in the matter of disclosure of accounting policies on critical issues, which will apply to financial statements of banking corporations for 2003 and thereafter. This Instruction follows an Instruction by the SEC dated December 12, 2001, regarding the same issues. The Instruction relates to two layers: the one – adoption of an accounting policy on critical matters and its application; and the other – the disclosure of such policies.

Accounting policy on critical matters is defined as a policy relating to issues, which are both most important to the description of the financial position of a corporation and are difficult, subjective and require complex assessments, due to the necessity to perform assessments as to matters that by their nature are uncertain.

GENERAL

The financial statements of the Bank are prepared according to generally accepted accounting principles (summarized in Note 1 to the financial statements) and according to instructions and guidelines of the Supervisor of Banks.

The level of regulation regarding the financial reporting of banking corporations is among the highest in the financial reporting field in Israel. The instructions and guidelines of the Supervisor of Banks are comprehensive, detailed and sometimes even dictate the wording to be used by banking corporations. Nonetheless, there are areas where application of the accounting policy involves a high level of evaluation and assessment performed by Management of the banking corporation in the course of preparation of the financial statements.

Application by Management of the accounting principles and the instructions and guidelines of the Supervisor of Banks, requires sometime various assumptions, evaluations and assessments that affect the reported amounts of assets and liabilities, including contingent liabilities, as well as the financial results reported by the Bank. It is possible that when the evaluations and assessments materialize in the future, their results may be different than those anticipated at the time the financial statements were prepared

Certain of the evaluations and assessments applied involve uncertainty or sensitivity to various variables to a large extent. Such evaluations and assessments, changes in which might have a considerable effect on the reported financial results, are considered evaluations and assessments of “critical” matters.

Management believes that the evaluations and assessments used in the preparation of the financial statements are fair and were made in accordance with the best of its information and professional judgment.

Following is a summary review of evaluations and assessments made as regards “critical” matters:

A. PROVISIONS FOR DOUBTFUL DEBTS

The provisions for doubtful debts include specific provisions for doubtful debts, a general provision and a supplementary provision.

The specific provision for doubtful debts reflects the evaluation of Management as to the loss inherent in the credit portfolio, based on rules set by the Supervisor of Banks and on evaluations and assessments. The specific provision in respect of housing loans is made according to a scale (rates of provision and periods in arrears) specified by the Supervisor of Banks. The general provision for doubtful debts comprises 1% of the outstanding debts at December 31, 1990, in inflation adjusted terms. The supplementary provision for doubtful debts is based on various risk characteristics, including those in relation to the classification and volume of the problematic debts as determined in the instructions of the Supervisor and according to rates set by him.

Once in every quarter, Management of the Bank examines the credit portfolio with the aim of evaluating the possible loss inherent therein. The process of the loss evaluation includes two stages:

- Identifying customers, the ability of whom to honor their obligation to the Bank has changed, and their resulting classification as "problematic debtors", in accordance with the classes of debts specified in the instructions of Bank of Israel and the criteria determined therein: "doubtful debts", "non-performing debts", "debts that have been restructured", "debts temporarily in arrears", "debts under special supervision".
- Creating provisions that reflect the anticipated loss in respect of "doubtful debts". In determining the provisions Management relies on information at hand regarding the debtor: his credit rating, history of honoring obligations to the Bank, quality of the collateral given by him and the risk level of the economic sector in which he operates. In addition Management takes into account when making the provision, additional factors, such as: The quality of the debtor's management, his repayment ability and financial flexibility.

The process of assessing the loss inherent in the credit portfolio, as described above, is based on significant assessments that involve extensive uncertainties (such as: the repayment ability of the debtor, etc.), and on subjective evaluations, both as regards the category to which the problematic debt was classified (such as: the differentiation between "debt in arrears" and "debt temporarily in arrears") and as regards the factors used in computing the provision (such as the quality of management of the debtor and the risk level of the sector in which he operates).

A change in the assessments or evaluations as stated above, might have a significant effect on the provision for doubtful debts included in the financial statements of the Bank.

In addition to the above, part of the assessments mentioned above relies on economic or market variables and part thereof is updated in as much as the cumulative experience gathered in dealing with the debtor increases. Accordingly, the Bank's Management examines once every quarter the assessments used in determining the provisions in respect of problematic debts and updates them where necessary.

See the above section "Development of Assets and Liabilities" for details of the overall credit risk of the Group with respect to problematic debts. See the above section "Exposure to Risks and Risk Management" for details regarding the credit risk management at the Bank. See the above section "Development of Assets and Liabilities" for details regarding the draft Instruction relating to "the measurement and disclosure of problematic debts and the provision for doubtful debts in the financial statements of banking corporations".

B. CONTINGENT LIABILITIES

Against the Bank and against other banks and companies in the Group are pending legal actions on various issues, including class action suits and requests for approval of actions as class action suits.

The accounting treatment of contingencies is implemented in accordance with the US Standard FAS 5 – "Accounting for Contingencies" and its related guidelines, and in accordance with the guidelines and clarifications of the Supervisor of Banks, including public reporting directives in the matter of "Accounting for Contingencies" (2004: draft publice reporting directive).

In assessing the required provision, it is necessary to examine the probability of a loss and to assess its amount. These evaluations affect both the duty itself of creating a provision in respect of the claim and the mode and scope of the disclosure in the financial statements.

According to FAS 5 there are three levels for evaluating the loss : (1) Remote; (2) Reasonably possible; (3) Probable. The US Standard also rules that if the loss cannot be assessed, no provision should be created in respect thereof, but the matter should be disclosed if it might be significant.

For the purpose of assessing possible losses as a result of actions filed against the Bank, Management of the Bank and the managements of other banks and companies in the Group rely on opinions of Counsels representing them in these matters.

In the nature of things, such opinions are subjective and face objective evaluation difficulties. Such difficulties grow immensely in cases of class action suits, due to the following reasons.

According to Israeli law, a plea for the approval of a class action constitutes in fact a preliminary procedure in which the Court examines several prerequisites in order to decide the plea. Inter-alia the Court examines whether the claimant is appropriate and fitting, whether he is in good faith, whether a class action is the fair and appropriate way of dealing with the matter, whether the action reveals joint questions of fact and law, and the Court assesses also the prospects of the action. The Court further determines in the same decision the nature of the group that the claimant would be entitled to represent and on grounds of what cause the action will be filed.

It is understood from the above that most of the parameters are exogenous to the prospects of the action itself, and they are generally clarified in the course of the proceedings (which may continue over several years).

Furthermore, both the manner in which the Court interprets the said prerequisites and the weight that is given to each of them as well as the level of proof required (in view of the little experience and legal precedents), at this early stage, lack uniformity in the legal system, and accordingly it is most difficult to evaluate the prospects of such pleas.

When the Court's decision in the matter is given, a request for permission to appeal is usually submitted, which is also dealt with over a long period. Only afterwards, if the request for appeal is dismissed, the class action begins to be heard subject to limitations determined in the preliminary procedure.

It should be also mentioned that class actions relate to specific laws, to specific causes and to various effective dates (the date on which the relevant law adopted the option of a class action suit). Also as to the interpretation of these issues contradicting judgments exist today.

Indeed, as stated, the accepted practice in Israel adopted the US Standard, however it is vital to bring into account in this respect the difference in the characteristics of the US reality in comparison to Israeli reality, and the difficulties that arise as a result.

The US has experience of many years (several decades) regarding the issue of class action suits and there is recognized and tested data, including the rate of compromise agreements and the amounts paid in compromise settlements. Such an experience is completely lacking as regards the law and practice in Israel.

Also the legal procedures in the US are different than those in Israel, allowing each party to interrogate the witnesses of the other party before the case is heard in Court, thus making it possible to evaluate the prospects of the action at an earlier stage.

The issues discussed above create special difficulties in everything related to class action suits.

The new law recently passed by the Knesset in the matter of class actions has in fact consolidated all the arrangements in the matter of class actions under one law, however it sets different criteria to those that have been included up to now in legislation.

The law also applies to class actions and motions for approval of class actions pending at the Courts at date of its publication. The new provisions determined by the law and the fact that these have not been tested in Court rulings, add a new dimension of uncertainty to everything concerning the assessment of the prospects and results of class actions and motions for approval of class actions (for details as to the Class Actions Law, 2006, see the section "Legislation and supervision").

As stated, the Management of the Bank and the managements of other banks and companies in the Group rely on opinions of Counsels. Such opinions are subjective and face objective evaluation difficulties.
Accordingly, it is possible that the actual results of certain of the actions would be different from those estimated based on the opinions of Counsels. In view of the volume of actions pending against the Bank, other banks and companies in the Group, it may transpire that the non-materialization of such estimates would have a material effect on the financial results of the Discount Group.
The Management of the Bank and its Counsels, as well as the managements and counsels of other banks and companies in the Group, examine once every quarter the pending actions and update, where necessary, the provisions created therewith in the light of developments.
On January 10, 2006, the Supervisor of Banks distributed a public reporting directive in the matter of "The accounting treatment of contingent claims".
It has been determined in the directive that in evaluating the outstanding legal actions, the management of a banking corporation is to rely upon legal opinions of Counsel, which should determine the probability of the exposure to the risk involved in such actions materializing.
Claims have been classified according to the probability range for a risk exposure materializing, as follows:
1) Probable – probability of over 70%;
2) Reasonably possible – probability of over 20% and up to and including 70%;
3) Remote – probability of 20% or below.
According to the Directive only in rare cases a banking corporation is entitled to state in its financial statements that in its Management's opinion, based on Counsel's opinion, it is not possible to assess the prospects that a risk exposure would materialize in respect of an ordinary legal action and an action approved as a class action. As to a motion for approval of a class action, the banking corporation is entitled to determine that it is not possible to assess the prospects of realization of the exposure to risk and in four financial statements (including one annual report) to be published subsequently to the filing of an action together with a plea to have it approved as a class action suit. Such period is not to include the period in which the Court has stayed the proceedings in the matter. Note 19 to the financial statements states separately the outstanding claims, in respect of which a reasonable assessment of the exposure is not possible.
The banking corporations have been asked to determine for themselves a graded disclosure level relating to the classification of the proceedings according to the assessment of the risk involved therein. Accordingly, the financial statements include disclosure of material legal proceedings conducted against the Bank and Group companies, based on the following criteria: as a general rule, a material legal proceeding is one where the amount claimed is in excess of 0.5% of the equity capital of the Bank, and if it is not possible to assess the prospects of the risk materializing; of 1% of the equity capital if the prospects of the risk materializing are reasonably possible; and of 2% of the equity capital if the prospects of the claim are remote.
The banking corporations have also been asked to provide disclosure regarding the total exposure in respect of claims that have been assessed, in whole or in part (in respect of the relevant part), as "reasonably possible". Disclosure as above is given in Note 19 to the financial statements.
It should be further mentioned that where the Bank is one of the defendants in an action, and the claimants have not attributed an amount to each of the defendants, the evaluation of the claim amount relevant to the Bank has been made to the best of ability, taking into account that consideration of the total amount might mislead and is incorrect in the circumstances, and that the evaluation does not necessarily represent the allocation as finally determined by the Court.

See Note 19 C to the financial statements for details of legal actions pending against the Bank and against other companies in the Group. For details as to additional proceedings and claims settled during the year, see Section "Legal proceedings" hereunder.

C. ASSESSMENT OF THE FAIR VALUE OF DERIVATIVE FINANCIAL INSTRUMENTS

The Bank is active to a considerable extent in the derivative financial instruments field, which are presented in the financial statements on a fair value basis as different from the accrual basis. The calculation of the fair value of derivative financial instruments in respect of their foreign currency component is based on interest rates and prices prevailing in the international money markets, and with respect to their Israel currency component on non-linked interest rates and linked interest rates, determined by the asset and liability management department of the Bank, taking into consideration market prices, liquidity and the existing trading level in the local market. The margin between the sales interest rate and the purchase interest rate comprises a subjective factor, which affects the computation of the fair value of derivative financial instruments.

The fair value of options is based mainly upon the Black and Scholes Model, and is influenced by the inherent fluctuations and interest rates of the base assets. The data regarding the fluctuations in exchange rates of the Israel currency against foreign currencies are determined by the dealing room of the Bank and are controlled by the Middle Office, while comparing them with several sources of information and fluctuation data of one foreign currency against another determined according to the international money markets.

The interest rates in foreign currency and in Israeli currency for the various time periods, constitute also the basis according to which the fair value of the balance sheet items is computed, as well as the cash flows deriving from assets and liabilities of the Bank, as detailed in Notes 18 and 21 to the financial statements.

These interest rates serve also for the computation of the fair value of assets and liabilities hedged against derivative financial instruments, to the extent that they comply with the hedging criteria, as required in the guidelines of the Supervisor of Banks.

D. EMPLOYEE RIGHTS

Employees of the Bank and of its consolidated Banking subsidiaries in Israel are entitled to long-service bonuses ("Jubilee Bonuses") comprising several monthly salaries and additional paid vacation days, at the end of 20, 30 and 40 years of employment with the Bank. Bank employees are also entitled to certain benefits subsequent to their retirement from the Bank. These liabilities depend on several conditions that have to materialize in the future.

The Supervisor of Bank requires the Bank to base the provision for Jubilee bonus on an actuarial computation and to present it at discounted value. The Bank engages the services of an independent actuary in preparing the said provision.

The actuarial computation is based on several parameters, including the probability that all conditions for the payment of the bonus will materialize: life expectancy, retirement age, the rate of employee retirement prior to the prescribed retirement date, the rate of increase in salary anticipated until date of payment of the bonus and the discount rate. These parameters were determined, inter-alia, in a temporary instruction of Bank of Israel, based on forecasts prepared by the actuary and the experience accumulated in the Bank.

The calculation of the provision for Jubilee bonus is sensitive to each of the values and parameters mentioned above.

E. DEFERRED TAXES

Deferred taxes are recorded in respect of temporary differences between the value of assets and liabilities in the balance sheet and their value for tax purposes.
Deferred tax assets in respect of timing differences are recorded only if it is probable that a tax savings will accrue upon reversal of the difference and deferred tax assets in respect of carry forward losses for tax purposes are recorded only if the realization of the tax asset in the foreseeable future is not in doubt.
Accordingly, when deferred tax assets are being recorded, the Bank is required to perform assessments and estimates as to the probability of realization of these assets in the future. For further details see Note 29 to the financial statements.

LEGAL PROCEEDINGS

OUTSTANDING CLAIMS AGAINST THE BANK

Various actions are pending against the Bank and its consolidated subsidiaries, including class action suits and pleas to approve actions as class action, brought against them by customers of the Bank and of its consolidated subsidiaries, past customers as well as various third parties, who consider themselves harmed or damaged by the actions of the Bank and its consolidated subsidiaries in the ordinary course of their business. Among other things, these actions raise allegations with regard to the unlawful debiting of interest and/or not in accordance with agreements, subjecting one service to another, the failure to execute instructions, applications for the confirmation of attachment orders in respect of attachments served by third parties as regards assets of debtors held, as alleged by them, with the bank, the unlawful debiting of accounts, mistakes in value dates, the invalidity of collateral security and the realization thereof, requests for injunction orders instructing the Bank to refrain from paying out of bank guarantees or documentary credit, as well as to provident funds, securities, construction loans, and applications for the removal of restrictions on an account pursuant to the Dishonored Checks Law, 1981. Management of the Bank believes, based inter-alia on Counsel's opinion and on the opinions of the managements of the consolidated subsidiaries of the Bank, which are also based on counsel's opinion, as the case may be, respectively, that adequate provisions have been included in the financial statements, if required.
Material actions outstanding against the Bank and its consolidated subsidiaries are described in Note 19 to the financial statements.

DEBT COLLECTION PROCEDURES

As part of the debt collection policy of the Bank and its consolidated subsidiaries, legal procedures are instituted in the ordinary course of business for the collection of debts from the borrowers or from guarantors for such debts, including the realization of collateral provided by the borrowers or by any third parties. Included in such procedures are procedures for receiverships, liquidations, the foreclosure of pledged assets, etc.

ADDITIONAL LEGAL PROCEEDINGS TO WHICH THE BANK IS A PARTY

On January 30, 2006, the Bank was served with a demand based on Section 194 of the Companies Law, 1999, by an individual representing herself as the owner of 1,000 shares in the Bank (hereinafter: "the server"). The demand relates to "a derivative claim in the matter of the payment of a fine of US$25 million to the New York Authorities", and as part thereof the Bank is requested to claim the damage suffered by it from various officers, as follows: the directors and officers, the internal auditor and the independent auditors of IDB New York, in respect of breach of duties of care by act or omission to act; the directors, the internal auditor of the Bank and members of the Bank's management in charge of the operations of IDB New York, in respect of breach of their duties to supervise the subsidiary

and establish proper control procedures at the subsidiary and/or at Discount Bank, with a view of assuring adequate control of Discount Bank over the subsidiary.
The board of directors of the Bank discussed the said demand and decided, in the existing circumstances, to reject it.

SIGNIFICANT LEGAL PROCEEDINGS SETTLED IN 2005

1. On August 25, 1998, it transpired that despite the fact that a number of letters of guarantee issued by the Bank in a total amount in NIS equaling US$ 8 million, were returned to the Bank due to the cancellation of the transaction giving rise to these letters of guarantee, another bank as well as the beneficiary under such letters of guarantee, who allegedly endorsed his rights to that other bank, claim that the other bank is in possession of the original letters of guarantee. Both the other bank and the beneficiary claimed that such letters of guarantee are in force, as no notice of cancellation was given by them, and that the Bank is liable under these letters of guarantee, whether they are in possession of the original letters or in possession of identical copies. In view of these circumstances, which gave rise to suspicion of criminal acts, the matter was referred to a police investigation; following which a third party was charged with fraud and falsification. The said third party has since been found guilty and was sentenced to a long term imprisonment.
   On October 19, 1998, the other bank filed a lawsuit against the Bank in the amount of NIS 6 million, in respect of two of the letters of guarantee the date of which fell due.
   On November 10, 1998, the Bank filed a lawsuit against the other bank and the beneficiary, which, inter alia, requests a declaration that the said letters of guarantee are invalid or are to be cancelled, requests the reimbursement of an amount of NIS 3 million, which had already been paid (under protest) under these letters of guarantee up to the date of submitting the lawsuit, and for a declaration of the right of the Bank for reimbursement of any amount which may be paid in the future in respect thereof. Alternatively, the Bank requests that the damage be allocated among the parties involved, so that the full burden of the damage will not fall on the Bank.
   On January 14, 2004, a verdict was given by the Jerusalem District Court, in which the Court admitted the claim of the other bank and dismissed the claim of the Bank.
   The Bank paid the plaintiffs the amount determined in the judgment, and then submitted an appeal on March 19, 2004.
   On February 1, 2005, the Supreme Court approved a compromise agreement made by the parties and granted the authority of a judgment thereto. Under the terms of the agreement, the Bank's insurer undertook to pay the sum of US$ 50,000 to the guarantee beneficiary. The agreement clearly specified that the Bank had no obligation or responsibility with respect to this payment. Subject to the foregoing, all the parties agreed to a final and absolute waiver of any claim or demand, as from one against the other, with respect to any matter connected to or touching upon the guarantees that were the subject of the proceedings, the amounts paid in respect thereof both before and after the granting of the judgment by the District Court, and all other matters brought before the Court during the course of the legal proceedings in this matter.
   The legal proceedings in this matter have thus been terminated.
2. On August 17, 1998, a petition was filed with the Tel-Aviv District Court, to approve the filing of a class action suit against CAL, Diners Club Israel Ltd., Isracard Ltd., Poalim American Express Ltd., Bank Leumi, Israel Discount Bank Ltd. and Bank Hapoalim (the "petition"). Concurrently a lawsuit was filed against the same respondents (the "lawsuit" and the "petition" together will be referred to hereunder as the "claim").
   The claim purports to represent all business entities in Israel, which during the relevant period (as from October 22, 1994 to date of filing the claim) paid to the defendants or any one of them, for clearing services of credit card transaction vouchers, business

commissions in excess of 2%, which according to the claimants, is the maximum rate that can be considered fair.
As claimed, the amount of the class action suit, were it to be approved in its entirety, would be NIS 1.725 billion, payable by all the defendants jointly and severally. The Court decided, with the consent of the plaintiff's attorney that the cause of action under the Consumer Protection Law shall not be dealt with as part of the petition for approval of a class action. This decision meant that the amount of the claim, in respect of which approval of a class action was requested, stood at NIS 1.025 billion only (as of date of submission of the claim).
On January 29, 2003, the Court admitted the submission of the class action suit against CAL, Diners Club, Isracard and American Express, as detailed in the amended indictment submitted by the appellant, inter-alia, in relation to the claim of the appellant that in the relevant period concerning the action, the above defendants were party to a monopoly in the clearing market of VISA, Diners, Isracard, MasterCard and American Express credit cards, respectively, and that, prima facie, they have misused their alleged monopolistic position, and allegedly fixed improper prices for their services (hereinafter – "the approval decision").
The Court also decided to admit the filing of a class action suit against the Bank and Bank Leumi, only in the matter of the cause of action in respect of the existence of a binding arrangement. Amongst other matters, the Court decided that, prima facie, the conduct of the two banks with respect to VISA and Diners credit cards issued by CAL and Diners Club would indicate a binding arrangement. On the face of it, a binding arrangement avoids competition and the lack of competition damages those who require a service with no competition, and that the appellant and the members of the group that are, prima facie, the victims of the lack of competition.
On February 10, 2003, the Court ordered that the procedures in the class action, including the issue of the notice to the approved group, should be delayed until a decision is given in the petition for permission to appeal. On March 17, 2003, the bank petitioned to the Supreme Court for permission to appeal against the approval decision, as aforementioned. On the same day CAL together with Diners have also requested permission to appeal against the said decision of the Court.
On March 14, 2005, the Supreme Court decided to accept the Bank's appeal, and thus dismissed the plaintiff's request that the action be treated as a class action suit.

3. In view of the fact that due to sanctions of the employees, the Bank was unable to submit in time the interim financial statements as of June 30, 2004, the Bank made several applications to the Israeli Securities Authority for extension of the period of submission of the financial statements in accordance with the power vested in it under Section 36(h) of the Israeli Securities Law. The Authority responded to the requests of the Bank and extended the period for submission of the report to September 21, 2004. However on that date the Authority informed the Bank of its refusal to grant any further deferment for submission of the report. It also rejected the bank's request for a review of its decision.
On September 27, 2004, the Bank appealed to the Tel-Aviv District Court against the decision of the Authority under Section 14(a) of the Securities Law. The Court was asked to admit the appeal and instruct the Authority to extend the period for submission of the financial statements. The Court was also asked to hear the appeal at the earliest possible date, and alternatively, if this was not possible, to issue a provisional order for the extension of the said period until another decision is given after hearing of the case.
On September 28, 2004 the Court decided to summon the parties for an urgent hearing of the case on October 1, 2004, before a judge on duty.
At the hearing of the appeal of the Bank against the decision of the Authority, held on October 1, 2004, at the Tel-Aviv District Court, the Court issued a provisional order

extending the period for the submission of the financial report of the Bank up to October 3, 2004 at 17:00, without pronouncing its opinion as to the matter itself. The financial statements were submitted in the late hours of October 2, 2004.
The case was heard in December 2004.
On May 17, 2005, the Court decided to accept the appeal of the Bank against the decision of the Authority.

4. In May 2004 a law suit was filed against the Bank and a request that was filed to approve it as a class action suit. In the action the claimants stated an amount of NIS 779 million for the class action. The class action requests a declarative relief according to which the Bank was not entitled to collect an excess line entry commission during the period of seven years prior to the filing of the action and that it was not entitled to collect a line commission at all.
   On July 13, 2005, the plaintiffs requested that the action, together with the plea for approving it as a class action suit be struck. On August 5, 2005, the Court agreed to this request.
5. In August 1998 a plea was filed by the Institute of Insurance Agents in Israel and the Israeli Consumers Council, with the Supreme Court in Jerusalem, presiding as the High Court of Justice, requesting an Order Nisi and an Interim Order against the Minister of Finance, the Attorney General, the Supervisor of Banks, the Commissioner of the Capital Markets, Insurance and Savings (the "Commissioner of Insurance"), the Commissioner of Restrictive Trade Practices and four mortgage banks including Discount Mortgage Bank Ltd.
   It is alleged in the plea that the respondent banks engage in insurance brokerage, a matter prohibited by law, and, therefore, the Court was requested to instruct the governing bodies appearing as respondents to the plea, to exercise their authority in the matter of supervision, inquiry and indictment, respectively. As to the supervisory authority, the Court was requested to instruct the relevant governing bodies to cause the mortgage banks to refrain from dealing in insurance brokerage, and to cause insurance companies to refrain from accepting insurance business referred to them by the banks and from paying the banks' commissions in this respect.
   Over the years, since 2001, the hearing in the High Court of Justice had been continually postponed at the request of the State authorities, which had been trying, in different ways, to arrive at an arrangement on the subject of insurance policies being sold along with mortgage loans.
   On February 20, 2005, the Supervisor of Banks published a circular relating to the marketing of life and property insurance policies in connection with loans taken out for housing purposes. The circular was accompanied by a joint policy declaration of the Supervisor of Banks and the Supervisor of Insurance, dated February 17, 2005, which prescribes the principles for marketing life and property insurance policies by a banking corporation as security for the repayment of a housing loan.
   An arrangement permitting banks to control a corporate body being an insurance broker, whose sole business is the sale of life or property insurance to housing loan borrowers associated with granting housing loans to customers of the particular bank, has been established in legislation in August 2005, within the framework of the legislation enacted in the wake of the Bachar Committee recommendations.
   In August 2005, the appellants requested the withdrawal of the action. On August 17, 2005, the Supreme Court decided to dismiss the action with the consent of the parties, without ordering expenses.
6. A customer of the Bank appealed to the Tel-Aviv District court in August 2003, to enforce the Bank to fulfill an agreement according to which the Bank committed, still in March 1999, to provide that customer a credit facility of NIS 700 million (in values of that time) for the construction of the Carmel tunnels project. The Carmel Tunnels

Authority (the State), the grantor of the concession to the project, was attached as a formal defendant to the action.

The appeal was made to the Court after the Bank informed the customer in June 2003, that it does not intend to finance the project and that it does not see itself tied any longer by the agreement as a result of the conduct of the customer towards it, and in view of the developments that have taken place since the commitment for finance had been given.

In March 2004, the Court issued an order enforcing the said agreement. In its decision, the Court dismissed he bank's arguments, according to which, inter-alia, certain conditions precedents have not been fulfilled so that the agreement was in fact not validated; the customer did not act in good faith in that it refrained from submitting vital information to the Bank; serious apprehension arose regarding the viability of the project, which justified the cancellation of the agreement.

The Court admitted the arguments of the customer and the State according to which the Bank had no contractual right to require an update of the business plan, which was at the base of the financing agreement; the project is viable despite the changes that have occurred; even if the customer did not inform the Bank as to the full changes that had taken place or are expected to take place in the project, this does not constitute a breach of the agreement.

Accordingly, the Court also dismissed the alternative argument of the Bank that in the circumstances an enforcement order should not be issued, as its execution would require an unreasonable amount of supervision on the part of the Court.

In May 2004, the Bank filed an appeal against this verdict.

Concurrently, negotiations were held with the customer for the amendment of the terms of the financing agreement, based on the changes that had been made to the terms of the concession, agreed to in July 2005 by the customer and the State, and the Bank has given its consent to the changes in ownership of the customer group.

On November 24, 2005, the Bank and the customer agreed upon the terms of an amended financing agreement, and this agreement was signed by the Bank and the customer on January 10, 2006, after being approved by the respective authorized organs of the Bank and the customer as well as by the State. The amended agreement includes, among other things, a mutual withdrawal by the parties of all claims against each other, and an agreement for the submission of a motion for the cancellation of the ruling of the District Court and the withdrawal of the appeal against it. On February 20, 2006, the Supreme Court ruled that the compromise agreement achieved between the parties would take effect as a Court ruling.The legal proceedings in this matter have thus been terminated.

7. For details regarding significant legal proceedings that were settled at the beginning of 2006, see Note 19 C, sections 14.1.4 and 14.3.

PROCEEDINGS REGARDING AUTHORITIES

1. For details regarding various proceedings conducted by the Commissioner of Restrictive Trade Practices concerning the Groups activities in the credit card field, see Note 34 to the financial statements.
2. For details regarding various proceedings conducted by the Commissioner of Restrictive Trade Practices concerning the "Principles of Conduct Document", see the chapter "Legislation and supervision" above.
3. On December 1 and 2, 2004, investigators of the Restrictive Trade Practices Authority arrived at units at the Bank and seized a large number of documents and computer material. The search order presented by the investigators was a very wide one and indicated an investigation concerning "binding arrangements".

   On several occasions in July 2005, investigators of the Restrictive Business Practices

Authority revisited several of the Bank's units and seized documents and computer material. In addition, Bank employees, including a member of Management, were summoned for interrogation at the Restrictive Business Practices Authority on several dates in July and August 2005.

Management of the Bank has no knowledge of the suspicions being investigated or as to the progress of the investigation, and accordingly it is unable to evaluate the results of the investigation.

4. The Commissioner of Restrictive Trade Practices decided on November 2, 2005, that the exclusivity arrangement existing between Harel Mall Ltd. and Discount Bank constitutes a binding arrangement and that the absence of an approval by the Commissioner to such a condition constitutes a violation of the provisions of the Restrictive Trade Law. This decision may have an implication on exclusivity stipulations, which are customary in rental agreements for commercial areas. The Bank has appealed this decision at the Restrictive Trade Practices Court.
5. On February 13, 2005, the US Internal Revenue Service (IRS) informed that following an audit performed at the Bank in 2003 by the independent auditors, with regard to the manner of operation of the Bank as a Qualified Intermediary in 2002, it requests additional clarifications and examinations.

   In January 2006, the IRS informed that it approves the report on the audit performed at the Bank in 2003 by the independent auditors and have no further comments. The notice stated that the IRS hopes that towards the next audit, planned to be performed in the current year, the Bank will complete the improvement of its customer data.

   The Bank is currently implementing the required data improvement and is preparing for the renewal of the agreement with the US Tax Authorities in respect of recognizing the Bank as an qualified intermediary.
6. For details of the investigation regarding matters relating to the prohibition of money laundering, conducted at IDB New York, see "Discount Bancorp, Inc." under "Main investee companies" above and Note 6 D to the financial statements.
7. For details of an investigation regarding suspected violations of the Prohibition of Money Laundering Law, see "Mercantile Discount Bank Ltd." above under "Main investee companies".

MATERIAL AGREEMENTS

Hereunder is presented a summary description of agreements, entered into outside the ordinary course of business, that might be considered material, to which the Bank is a party, or which according to its best knowledge, the Bank is a beneficiary in terms thereof, including agreements that were valid in the period covered by this annual report, or which affected the Bank's operations during such period.

A. AGREEMENT FOR THE ACQUISITION OF MEANS OF CONTROL IN THE FIRST INTERNATIONAL BANK ("FIBI")

According to an agreement dated July 31, 1983, between the Bank and FIBI Holdings Ltd. and one of its subsidiaries, in terms thereof the Bank acquired ordinary shares of a par value of NIS 5 each in FIBI, which granted the Bank approximately 26% share in the equity and 11% share in the voting rights of FIBI, it was agreed, among other things, that the Bank shall not be involved in the management of FIBI.

The agreement provided that so long as the Bank is in possession of at least 80% of the shares in FIBI acquired by it under this agreement (including bonus shares and rights in respect of these shares), FIBI Holdings will see to it that one quarter of the members of the board of directors and of board of directors' committees of FIBI will be members recommended by the Bank, on condition that the Bank will not recommend persons the appointment of whom might, in the opinion of the Governor of the Bank of Israel, create a conflict of interests. In addition, the said agreement provided that each of the parties thereto shall have the right of first refusal in respect of the acquisition of shares in FIBI held by the other party, whether such sale shall be made on or off the market. The right of first refusal does not apply to sales of up to 20% of the total holdings of each party effected on the Tel-Aviv Stock Exchange in the ordinary course of business. Furthermore, the right of first refusal does not apply in the case of a sale of FIBI shares by any of the parties to its parent company or to a company controlled by such party.

The acquisition of the said shares was made in terms of a permit for the acquisition of means of control, under Section 34 of the Banking Law (Licensing), 1981, granted by the Governor of the Bank of Israel on July 20, 1983, in the framework of which the Bank was permitted to acquire up to 30% of the issued and paid share capital of FIBI. As part of the process of obtaining the permit to acquire means of control, the Bank has made a commitment to the Bank of Israel that FIBI will be managed in an independent manner, and that all members of the Board of Directors of FIBI shall be appointed by FIBI Holdings Ltd., 25% thereof to be appointed in accordance with the recommendation of the Bank as approved by the Governor of the Bank of Israel. It was further agreed that the Governor would not withhold his approval of the recommendation of the Bank as above, unless based on reasonable grounds and considering the possibility that such appointments might create a conflict of interests.

B. OBLIGATIONS OF THE BANK WITH RESPECT TO CAPITAL MARKET OPERATIONS

In October 1983, within the framework of the "bank shares arrangement", the Bank informed the Minister of Finance and the Governor of the Bank of Israel that, among other things, it would not initiate, either directly or indirectly, orders for the purchase or sale of securities within the orders submitted to the Stock Exchange prior to the beginning of trading ("Leaders"), or as part of the setoff of purchase or sale orders prior to the beginning of trading.

The Bank further confirmed that it would prevent, either directly or indirectly, any transaction in securities issued or which would be issued by banks or bank holding corporations, unless such transactions are on behalf of its customers, including provident and mutual funds. However, the Bank noted that nothing in the above would avoid transactions effected in the ordinary course of business.

C. LETTERS OF INDEMNIFICATION TO WHOEVER ACTS OR HAS ACTED AS DIRECTOR IN INVESTEE COMPANIES OF THE BANK

The previous version of the Articles of Association of the Bank, which was amended in March 2002, included provisions regarding the indemnification of whoever acts or has acted, at the request of the Bank, as director in another company, in which the Bank has an interest, as detailed in Note 19 C 10 a to the financial statements. Accordingly the Bank had issued at that time letters of indemnification, unlimited in amount, to the acting directors or who have acted at the request of the Bank in other companies owned by it.

D. COMMITMENT FOR COOPERATION DURING THE PROCESS OF SALE OF THE BANK'S SHARES

In an Annex to the agreement dated August 29, 1991, between the Government of Israel, in the name of the State of Israel, M.I. Holdings Ltd.(hereinafter – "M.I. Holdings"), Israel Financial Holdings and IDB Holding Company Ltd., the parties thereof are M.I. Holdings and the Bank, the Bank committed to cooperate with M.I. Holdings and assist in the process of sale of the Bank's shares, this, subject to adherence to any law and the guidelines of the Supervisor of Banks, and subject to the matters detailed in the Annex.

2000

2000. The Human Genome Project has been completed. Heredity has been demystified.
March 2006. Over the past three years, 240,000 new customers have joined Israel Discount Bank. They each receive personal attention. It's genetic.

What makes us what we are? What do we bequeath the next generations? All this knowledge is encoded in our genes. It is now known that we each have close to 35,000 genes, and our DNA is 99.9 percent identical. Only 0.1 percent, that's all the difference between us.
This minute difference is what probably led 240,000 new customers to join Israel Discount Bank in the past three years.
The tiny difference is expressed in compassion, tolerance and openness. In the recognition that the individual, the customer, is at the center. It is expressed in integrity, professionalism, sensitivity. It is expressed in how our customers know that Discount relates to each and every one of them personally, with all their similarities and differences.
It's in their genes.

Taking You Personally. The main branch of Bank Discount on 27, Yehuda Halevi Street in Tel Aviv, with the bank's current campaign slogan. The headlines change, the content has remained the same for seventy years.


דיסקונט
לוקחים אותך אישית

Among other things, the Annex determined that the Bank will provide information to assessors acting on behalf of M.I. Holdings and on behalf of potential buyers, everything subject to the limitations and confidentiality arrangements detailed in the Annex.

As determined in the Annex, M.I. Holdings has agreed to indemnify and/or compensate the Bank and/or any member of the Board of Directors of the Bank and/or any employee of the employees of the Bank in respect of any damage suffered by the Bank and/or any of the above, as applies, and /or any of the customers of the Bank (on condition that the Bank or any of the above would be charged in respect of any damage determined by a Court's verdict) as a result of the performance of the Annex and everything related to it; however, the commitment to indemnify and/or compensate as above, shall not apply to responsibility for or in respect of a violation of the Securities Law, 1968. It shall also not apply to damage resulting from error, misrepresentation or omission in the information, documents or presentations made by the Bank in accordance with the Annex, if it is proved that the error, misrepresentation or the omission were caused intentionally or not in good faith.

The form of the cooperation in accordance with the said agreement was later formalized in the The Bank Shares in Arrangement (Temporary Provision) Law, 1993. The said agreement has been amended several time with the consent of the parties.

Special arrangements in the interim period up to completion of the transaction for the sale of a controlling interest in the Bank. Arrangements determined according to the approach of the Minister of Finance on February 21, 2005, to the Board of Directors of the Bank, on the background of the agreement for the sale of a controlling interest in the Bank and the anticipated schedule for its completion (for details see "Control of the Bank" above).

E. AGREEMENT FOR THE ACQUISITION OF MEANS OF CONTROL IN ICC

An agreement dated January 3, 2000, according to which the Bank acquired from Leumi Financial Holdings Ltd. (hereinafter – "BLL") means of control in ICC and in Diners, including a commitment of BLL to indemnify the Bank in respect of claims detailed in the agreement, as discussed in Note 34 A to the financial statements.

According to this agreement BLL is committed to indemnify the Bank also in respect of amounts that ICC or Diners shall be liable to pay to the Tax Authorities in respect of certain tax years mentioned in the agreement and/or in respect of events the cause of which occurred up to the date of the agreement, as well as in respect of amounts that ICC shall be liable to refund AlphaCard Ltd. regarding issuer commissions following an agreement dated July 7, 1998.

F. AGREEMENTS FOR THE SALE OF MEANS OF CONTROL IN ICC TO STRATEGIC PARTNERS

In the course of the years 2000 and 2001, the Bank sold to strategic partners shares in ICC comprising 49% of the equity and 37% of the voting rights, and shares in Diners comprising 21.4% of the equity and voting rights, at a price based on the value of ICC and Diners as determined in the agreement for the purchase of means of control in ICC (see E above).

The agreements with Fishman Chain Stores Ltd. are dated June 25, 2000 and December 13, 2001; the agreement with Harel Insurance Investments Ltd. is dated June 22, 2002; and the agreement with FIBI is dated September 29, 2000.

According to the said agreements, the strategic partners are committed to releasing the Bank from and indemnifying it in respect of a proportional share of the guarantees and/or liabilities provided by the Bank for ICC or Diners in favor of VISA International Service Association (as described in Note 19 C 12 to the financial statements) and in favor of businesses in accordance with engagement agreements between them and ICC.

The partners have also committed to indemnify the Bank in respect of: (a) the amounts that the Bank will have to refund to BLL out of the amount of damages that BLL will pay, if at all required to pay to ICC, as part of the disputes relating to the "Buy and Bonus" Club; (b) amounts of indemnity to officers of ICC and Diners, to the extent that such indemnity would be required in accordance with the agreement for the purchase of means of control in ICC; (c) any amount that would be paid under a guarantee or commitment for indemnity that the Bank would be required to provide as a shareholder (and due to being a banking institution) for the purpose of operations in the credit card field of ICC or Diners, all in proportion to the rate of their holdings in ICC or Diners, as the case may be.

On the other hand, the Bank is committed to transfer to the strategic partners a proportional share (according to their rate of holdings) of any amount that would be received by it from BLL in respect of the indemnity granted to the Bank as part of the agreement for the purchase of means of control in ICC, provided that the amount transferred to each of the partners should not exceed on a cumulative basis, the amount of the consideration paid by that partner in accordance with his agreement with the Bank.The said agreements also include provisions with respect to the use of the voting rights in ICC and Diners, in a manner that established the exclusive control of the Bank in ICC and Diners. On the other hand, provisions were also set in them regarding special majority demands of 68% for the purpose of passing certain material decisions. Furthermore, the said agreements granted the strategic partners certain minority rights, the principal of which are: the right to appoint the minority of the directors and preferential rights as to the acquisition of shares in the case of a private placement. In addition, the said agreements determined provisions regarding restrictions on the transfer of shares in ICC and in Diners, the right of first refusal, the right of participation and the right of a compelled sale.

G. AGREEMENT FOR THE ACQUISITION OF MEANS OF CONTROL IN ILANOT DISCOUNT

An agreement was signed on September 21, 1999, between the Bank, Ilanot Batucha Investment House Ltd. (hereinafter – "Ilanot Batucha") and Ilanot Discount Ltd. (hereinafter – "Ilanot Discount"), according to which, it was agreed, among other things, on the acquisition of control by the Bank in Ilanot Discount.

The agreement included consents and additional provisions, including changes in the distribution agreements and brokerage services that existed between the Bank and Ilanot Discount. The Bank continues to receive from Ilanot distribution fees in accordance with the format, the principles of which have been agreed by the parties, until March 31, 2006.

The agreement granted each of the parties the right of first refusal and the right of participation, which would apply in the case of the sale of holdings in the company by the other party.

For details as to the exercise of the right of first refusal, see above, under "Capital market activity" under "Further details as to activity in certain products", and Note 6 E to the financial statements.

H. AN AGREEMENT IN PRINCIPLE FOR THE SALE OF ILANOT DISCOUNT LTD. AND THE PROVIDENT FUND ACTIVITY

For details as to the agreement in principle for the sale of the shares in Ilanot Discount Ltd. and the provident fund activity, see above "Capital market activity" under "Further details as to activity in certain products" and Note 6 F to the financial statements.

I. AGREEMENT FOR THE ACQUISITION OF MEANS OF CONTROL IN HAREL

On December 28, 2000, the Bank signed an agreement with the Hamburger Group for the purchase of means of control in Harel and for the regularization of the relations between themselves as shareholders in Harel. The agreement determines, among other things, that the Board of Directors of Harel will number ten directors, and so long as the Bank is a shareholder in Harel having between 15% and 20% of the voting rights therein, the Hamburger Group would vote for the appointment of two directors recommended by the Bank. So long as the Bank holds between 10% and 15% of the voting rights in Harel, the Hamburger Group would vote for the appointment of one director recommended by the Bank.

The agreement determins that the Hamburger Group would vote in the general meetings of shareholders of Harel and of its principal companies against a resolution regarding certain material actions, unless the prior consent of the Bank has been obtained (liquidation, merger or reorganization; sale, disposal or suspension of the insurance activities; changes in the capital structure of Harel that would result in a dilution of the Bank's holdings, and so forth). In addition, the Hamburger Group has committed that to the best of its ability it would cause material resolutions of Harel and other resolutions of Harel as determined from time to time, as well as resolutions of the Boards of Directors of any one of the significant companies regarding matters that require immediate reporting (even if the relevant company is not a public company) and also material transactions with interested parties from the Hamburger Group and transactions in which interested parties from the Hamburger Group have a personal interest, even though they are not exceptional, to be brought for a prior discussion by the Executive Committee that would be established for this purpose among directors of Harel, in which at least one member would be appointed at the Bank's recommendation.

The agreement also includes provisions regarding the right of participation of the Bank in a sale of means of control in Harel by the Hamburger Group, in whole or in part, under conditions determined in the agreement, as well as the right of first refusal of the Hamburger Group in the sale of the shares of the bank in Harel, that would arise to the Harel group under certain circumstances determined in the agreement.

J. AGREEMENT WITH THE EMPLOYEES

An agreement dated February 1, 2005, signed concurrently with the agreement for the sale of a controlling interest in the Bank, between the New Histadrut Federation of Labor, the Representative Committee of Discount Bank Employees and the Accountant General of the Ministry of Finance, which was later joined by the Bank, following approval by the Bank's authorized organs, and which is intended to regularize certain demands raised on behalf of the Bank employees in the matter of their rights on the background of the sale of a controling interest in the Bank by the State, everything as described in the Section "Sale of the Bank" above.

THE INTERNAL AUDIT IN THE GROUP

GENERAL

The Israel Securities Authority published in October 2004 a guideline under Section 36A(b) of the Securities Law –1968, in the matter of "Disclosure regarding the internal auditor of a reporting corporation" (hereinafter – "the Authority's Guideline"). In December 2005, the Supervisor of Banks issued an instruction in the matter of the disclosure in the Directors' report of a banking corporation regarding the internal auditor, in which the Supervisor applied, mutatis mutandis, the Authority's Guideline to the banking corporations, and specified several subjects pertaining particularly to the banking industry, which should be addressed when implementing the Guideline.

DETAILS REGARDING THE INTERNAL AUDIT IN THE GROUP IN 2005

The internal auditor of the Bank is Mr. Shlomo Pitchon, who heads the internal audit operation at the Bank. Mr. Pitchon, who entered office on September 1, 1994, is an economist and a certified public accountant, and has internal audit experience in a banking corporation for over thirty years.

The internal auditor is an officer of the Bank ranking as Senior Executive Vice President, he is fully employed, heads the internal audit operation of the Bank and of the Group, and attends also to complaints submitted by the public.

From the organizational aspect, the Chairman of the Board of Directors is in charge of the internal auditor of the Bank.

In addition, as from February 1, 1994, Mr. Pitchon serves also as the internal auditor of certain subsidiaries of the Bank, including:

Discount Mortgage Bank Ltd. and its subsidiaries, Discount Provident Fund Management Ltd., Israel Discount Capital Market and Investments Ltd. and its subsidiaries, Tachlit Discount – Investment, Counselling & Management Co. Ltd., Discount Trust Ltd., Discount Leasing Ltd., BDL Computer and Administration Services Ltd.

He serves as internal auditor of Ilanot Discount since November 1, 2001, of Manpikim Issuance Company of Discount Bank Ltd. since April 1, 1999, and of Manpikim Financial Operations Ltd. since December 8, 2004.

During the reported period, the average number of positions subject to the internal auditor was 92.5, of which 15 positions at the Bank's public complaints unit, and 5 positions at the consolidated subsidiaries, in which the internal auditor of the Bank serves as their internal auditor. At consolidated subsidiaries, which employ internal auditors of their own – Mercantile Discount Bank Ltd., Israel Credit Cards Ltd., Bancorp Inc. IDB New York, Discount Bank Latin America, Discount Bank (Switzerland) SA – the number of positions during the reported period was 40.1.

The annual and multi-annual work plans are structured on the basis of risk focused methodology that maps all units of the Bank in accordance with the probability of the risk materializing and its implications. The multi-annual work program is reviewed annually and is updated as required.

The work plan for 2006 was structured according to international methodology and standards accepted in Israel and overseas, according to guidelines of the Bank of Israel with reference to Basel II guidelines for internal audit and the risk management approach presented by COSO.

The planned work programs for the material subsidiaries, at which the Bank's internal auditor serves also as their internal auditor, are combined with the annual work program for the internal audit of the Bank, while addressing each subsidiary separately. The scope of the work program for each subsidiary as above, is discussed by the audit committee of each subsidiary, and/or by the Board of Directors.

Each audit report is submitted by the internal auditor to the chairman of the board, to the

President and CEO of the Bank and to the Bank's auditors. Each report with respect to head office units and a management summary of audit report regarding the Bank's branch offices is submitted to the chairman of the audit committee of the Board.
Within about 45 days from the end of each quarter, the internal auditor submits a quarterly report, which covers all the activities of the internal audit during the respective quarter. The quarterly report details extensively all the audit reports that had been submitted during that quarter, includes details of the response of the audited units to the audit findings, as well as monitors prior quarterly reports and matters raised in them, the treatment of which has not yet been concluded.
The quarterly report is submitted to the Chairman of the Board, to the President and CEO and to all Board members, so that at each quarter they have a very detailed picture as to the findings of all audits performed by the internal auditor, the response to these findings and the manner in which audit findings had been treated. The audit committee of the board discusses the quarterly report.
In addition, the audit committee of the board discusses specific audit reports regarding the Bank's units, in cases where the chairmand of the board, the chairman of the audit committee and/or the internal auditor consider that the findings in these reports or the significant issues which they raise require special attention.
Once a year, the internal auditor submits to the Chairman of the Board, to the President and CEO and to all Board members an annual report (in addition to the four quarterly reports). This report details the principal matters that were audited during the year, the manner in which the findings and recommendations were treated. The annual report is being submitted within 75 days from the end of the year to which it relates, and is being discussed by the board and by the audit committee of the board.
The quarterly reports in respect of 2005 were submitted and discussed by the audit committee of the board, as follows: First quarter report – submitted on May 16, 2005 and discussed by the audit committee of the board on June 27, 2005; Second quarter report – submitted on August 10, 2005 and discussed by the audit committee of the board on September 12, 2005; Third quarter report – submitted on November 2, 2005 and discussed by the audit committee of the board on December 20, 2005; Fourth quarter report – submitted on February 8, 2006 and has not yet been brought up for discussion.
The annual report for 2005 was submitted on March 12, 2006 and has not yet been brought up for discussion. The audit committee of the board also discussed in 2005 the annual audit report for 2004 (submitted on March 6, 2005 and discussed on April 17, 2005 by the audit committee of the board and on May 26, 2005 by the board) and the report for the fourth quarter of 2004 that was submitted on February 6, 2005 and discussed on March 13, 2005.
Audit reports relating to subsidiaries at which Mr. Pitchon serves as internal auditor, are submitted to the Chairman of the Board of the respective subsidiary, to the chairman of the audit committee (where one exists) and to the CEO of that subsidiary, and to its auditors.
In respect of subsidiaries that have their own internal auditor, the internal auditor of the Bank reviews once every year the performance of the internal auditor in each such subsidiary.
The internal auditor of the Bank is allowed free access to every information or document required by him or by the internal audit staff for the purpose of the audit, including continuous and direct access to the information system of the Bank and its subsidiaries in which he acts as internal auditor, including financial data.
The Board of Directors is of the opinion that the work program of the internal auditor and the manner and continuity of his operations are most reasonable, and that they accomplish the targets of the internal audits at the Bank and at the Group.

INVOLVEMENT WITH AND CONTRIBUTION TO THE COMMUNITY

Since its formation, Israel Discount Bank has been active in community affairs, having an overall management conception, according to which, activities beneficial to the community form part of a business, social and cultural obligation.

In addition to the activities of "Lema'an – Discount Employees for the Community" project, described hereunder, the following activities were also conducted in 2005 in the culture and arts field, providing sponsorship, "Tzalash" activities in the branches and donations.

The total volume of activities of Discount group in 2005, including the Lema'an Project, amounted to NIS 5,184 thousand, compared with NIS 3,460 thousand in 2004.

The social work and involvement in the community was carried out by the Bank in the following areas:

Donations – these were directed mainly to associations, clubs, education establishments, health organizations and others, that focus on children and personal welfare.

In 2005, the Bank continued the trend of supporting children and youth in various states of distress, and Art seeking youth.

THE "LEMA'AN" PROJECT – DISCOUNT EMPLOYEES FOR THE COMMUNITY

This project was launched at the end of March 2002. The project constitutes the joint effort of management and the employees' committee, whereby Bank employees volunteered for activities for the community. In 2005, the effort was focused on voluntary activities of the following associations: "Yad Sarah" Association, "Elem" – Youth in Distress Association, children clubs and various associations that support the needy.

Presented below is a selection of examples of the activity within the framework of the "Lema'an" Project:

"Oranit" Center – A convalescence home for juvenile cancer patients. Within the framework of the "Lema'an" Project, employees of the Bank elected to contribute a specified sum to be debited monthly to their accounts, in favor of the "Oranit" Center. This initiative was formed following the presentation of the activities of the Center to the Bank employees and the Center's need for financial assistance in order to secure its continued activity.

The "Oranit" Center belonging to the "Ezer Me'Zion" Association, provides a caring home to children suffering from cancer and their families residing in distant areas who have to come to the medical centers in central Israel and stay for long periods in order to receive treatment. The Center is located adjacent to the "Rabin" and "Schneider" Medical Centers in Petach-Tikva.

The contribution by Discount Bank employees is intended to enable the continued operation of the Center, which significantly relieves the suffering of the sick children and their families. Among other things, the Center provides enrichment activities such as a special petting zoo.

The Center is managed by a volunteer staff and is financed solely by donations.

Tsunami victims. Along side the Banks' activity in favor of the local community, the Bank decided to take part in the help for the victims of the Tsunami disaster in South-East Asia. The Bank's employees joined the effort by making cash contributions and by redeeming vacation days, donating a total of NIS 56 thousand to the victims. The donations were transferred to the Sri Lanka victims through the "Latet" Organization.

"Elem" Organization. Since the launching of the project, most of the voluntary activity is focused on youth information and consultation centers, the night consulting mobile units, and additional activities as requested specifically by the "Elem" branches.

Bank employees are deeply involved in the activities of the "Hafooch al Hafooch" center in Kiryat Yam. Youth who visit the Association's facility in Kiryat Yam are engaged by the Branch Manager of the Bank in Nahariya for volunteer work at the Kind Deeds branch in Kiryat Yam – packing food baskets and distributing them to needy families.

During the first quarter of 2005 an effort was made to recruit volunteers from among the Bank's employees in the Ramla, Holon and Rehovot area. In addition, on the Association's annual fundraising day, Bank branches enabled the deposit of contributions collected past the regular operating hours, and employees of the Nazareth Branch even took part in collecting contributions.

"I shall also go to university" Association. A donation of NIS 70,000 was given in aid of the Association's program in Tel-Mond. The program is designed to advance children with scholastic potential and to provide them with equal opportunities, so that when the time comes they will be able to obtain higher education.

The Netanya Academic College Program for Excellence. The college conducts a project established to provide an appropriate response to the existing need to combine the academic world with the practical one. Within the framework of the "Lema'an" Project, the Bank donated scholarships in the total amount of NIS 24,000 to two students.

The Association for the promotion of education. The Bank donated religious articles to Ethiopian boys celebrating their "Bar Mitzvah" at the Beith Shemesh Boarding School. Representatives of the Bank presented the boys with the said articles at the ceremonies.

Haifa City Star for contribution to the community. "The International Day for the Elimination of Violence Against Women" recently took place in Haifa, in the framework of which a ceremony took place with the participation of senior City officials, headed by the Mayor, representatives of the New Histadrut Federation of Labor, representatives of various associations and volunteers. At the ceremony, the Mayor of Haifa granted the City Star to Maggie Atias of the Haifa Region Employee Committee, who represented Discount Bank, for contributing to the community in Haifa.

Cooperation with soldiers in activities for the community. The Haifa Main Branch initiated an extraordinary cooperation with the Tira Military Equipment Base for the adoption of the "Eyal" School for Special Education children, where mentally retarded children study. Soldiers serving on the base will collaborate with employees of the Branch for the welfare of these school children.

Activities in aid of children. The Haifa Business Center has adopted clubs for orphaned children of Etheopian descent. Alongside this activity the Business Center has adopted the "Hod" Hostel – a mentally retarded children's institution. Employees of the Business Center also encourage customers of the Center to join them in helping the children.

"Latet Be'Pesach" drive. Towards the Passover holiday, several dozens Bank employees participated in the drive "Latet Be'Pesach" in cooperation with the "Latet" Organization. The Bank employees dressed in "Lema'an" shirts, manned collection locations at the various branches of the food chain stores participating in the drive and encouraging their customers to donate products or cash to needy families.

"Donate lovingly for the New Year" Drive. Continuing the tradition created at the Bank, this year too a drive was instituted to collect food for the upcoming High Holidays. As part of the Drive, 1,500 containers were placed at the Bank's branches and departments, and the Bank's employees, customers and the public at large were invited to donate food to be distributed to the needy. The full containers were shipped to 28 aid associations across the country.

In addition, the Bank purchased 700 family-size food packages containing basic foodstuff. These packages were distributed by Bank employees directly to needy families, according to lists received from the welfare departments of several local authorities, as well as at the distribution centers for needy families of the welfare departments of those local authorities.

"Better together" Project. A joint action plan has been formed together with "Ashalim" organization for the operation of an existing youth club in the Hatikva Quarter in Tel-Aviv which will be attended by youth 12-14 years of age who do not have any after school activities to attend. The youth will receive a hot meal, assistance in preparing their homework and studying for exams, enrichment courses and additional activities to be provided by instructors of the "Ashalim" Organization. Employees of the Bank who will join the Project would participate in the range of activities.

"Yad Sarah" Organization. Volunteers from the Bank take part in various activities of this organization, such as the installation of distress call appliances, distribution of equipment, home industry services for the old and the handicapped, etc. Particular activity is also performed at the request of "Yad Sarah" all over the country, such as administrative assistance, work at the equipment distribution depots, etc. It should be noted that the Chairman of the Board of the Bank serves also as the Chairman of the Public Committee of "Yad Sarah".

| "TZALASH" LOCAL ACTIVITY

This activity is been carried on in all branches, the object of which is to tighten the bonds between the branch and the neighbouring community.

Various events took place during the year in the branches and in voluntary institutions in cooperation with the local community. Inter-alia, holidays of Israel were celebrated, works of amateur artists were exhibited, lectures were held on various subjects, etc.

Following are several examples of the event that took place in 2005:

| ARTS AND CULTURE

These activities were conducted within the framework of the "Discount Culture and Art Activities", which encourage and cultivate the original Israeli artistic creativity.

"Artist Wall" – A project for encouraging Israeli art and creativity. "Artist Wall" is an additional layer in the wide range of activities carried out by the Bank for the benefit of the community, which combines support of the art with community activity.

Within the framework of this Project, the Bank will offer its branch facilities all over the country to serve as a platform where artists would be able to exhibit their works to the public. The Bank is committed to purchasing one work from each exhibition, and, concurrently, the exhibiting artist will also donate one item. At the conclusion of the Project, which would last for about one year, an exhibition would be held in which all the works purchased by the Bank and donated by the artists would be offered for sale. All the proceeds from the sale would be used for financing projects in aid of children and youth.

In the course of 2005 five exhibits were presented: At the **Yavneh Branch**, **"Nostalgia"** by **Ran Kasmy**; At the **Gedera Branch, "Sculpture in Iron and Stone"** by the artist and sculptor **Yoma Segev**; At the **Ness Tziona Branch**, **Nurit Isic**'s **"The flag in three basic colors"**; At the **Sharon Region Administration**, a group exhibition of ten artists residents of the area **"After hours"**; At the **Holon Industrial Branch**, **Sarit Gura's "At eye level"**.

Dis-Cover. As part of the activities of the Mifalot Discount Fund for Culture and Art, a new enterprise has been launched for the enhancement of youth studying within the framework of youth boarding schools in the field of art product design. The enterprise, a joint venture with the Ministry of Education and the Holon Technological Institute, took place as part of an academic course "Design tutorship", in which students studying industrial design at the Holon Technological Institute tutored pupils of the Johanna Jabotinski Youth Boarding School, acquainting them with basic concepts of design teaching them how to design applied art products, which would be sold to business corporations. Income from these sales is designated for higher education scholarships for pupils of youth boarding schools.

Art class at the "Hadarim" school in Rehovot. The Bank has rallied for the cultivation of an art class at the "Hadarim' school in Rehovot. Most of the pupils at this school are children of new immigrants from the former Soviet Union and Ethiopia, who have not been exposed to Israeli art. The Bank jointly with the Ministry of Education and the Rehovot Municipality established an art class at the school with a view of exposing the pupils to a wide range of works of art. For this purpose, the bank has donated prints from the Discount Bank collection, which focused on: portraits, still lifes, Jerusalem and landscapes of Israel. The art works donated by the Bank are used as a basis for creative work, in which the pupils are to be integrated during the year.

SPONSORSHIPS

Sponsorship is provided to entities that promote significant social targets.

"Zavit" – Photographic work of children hospitalized at the Schneider Children's Hospital. In 2005 the Bank provided sponsorship to a unique exhibition that concluded a year of joint activity between the Ministry of Education and the Schneider Children's Hospital. The children in this hospital, guided by a team of teachers from the education system, elected to engage themselves during this year in the art of photography as a tool that provides the opportunity to discover new angles in the world of the hospitalized children.

The exhibition was opened on September 19, 2005, at the performing arts center, in the presence of the Director General of the Ministry of Education, Ms. Ronit Tirosh; the Director General of General health services, Mr. Zeev Warmbrand; the Director of the Schneider Hospital Prof. Mark Maimoni; and the President and CEO of Discount Bank Mr. Giora Offer.

The exhibition was open to the public for one week and was visited by students, youth, school principles, senior representatives of the General Health Services and customers of Discount Bank.

This event took place for the second consecutive year under the sponsorship of Discount Bank and in the spirit of the vision of "Humane Banking", a combination of professionalism with humaneness, according to the values by which the Bank operates.

"Media coverage" to the "Tachlit" and the "Center for Medical Information" associations. In the first quarter of 2005, the Bank provided media coverage for "Tachlit" and the "Center for Medical Information" associations, whereby radio broadcasts were produced for these two associations under the patronage of the Bank.

"Tachlit" Association. This association connects donors from the general public with needy families, allowing the general public to provide festive meals to needy families and also host families on festive occasions. Bank employees in the Jerusalem area volunteered by manning the telephone call-center of the Association.

"Center for Medical Information". This Association provides information for medical inqueries, tailored to the patient and to his medical profile as well as general information regarding a particular illness, its characteristics, nature of development and organizations, that assist patient and family. Bank employees volunteered to accompany patients and their families.

Enrolment of Bank customers for community activities – The marketing department for business customers together with the Bank's business centers have initiated a move incorporating Bank customers in joint activities in aid of the community.

Customers of the Bank so enrolled contributed their products and the Bank delivered these contributions to the needy on behalf of the contributing company. Among the contributors were "Kravitz" which donated stationery, notebooks and additional products distributed to needy school children in anticipation of the upcoming academic year, "Mabat", which donated men's shirts which were delivered to the "Breshit" Association in Holon, "Shooki Meat House" which donates meat each week that is delivered by the Bank's economic department to a senior citizens club in Jaffa.

DISCOUNT START-UP

Israel Discount Bank is a member of the "Sprint for the Future" Association, and has adopted the program focused on school age children from peripheral regions with difficulties in their studies. The aim of the program is to provide assistance to school children so that they will be able to graduate high school, attaining a full matriculation certificate, enabling them to continue with higher education. The name of the program is "Discount Start Up".

The Bank is a party to both the financial support of the Association as well as to promoting and advancing its activities. Representatives of the Bank's management are members of the

executive board of the Association and employees of the Bank have started voluntary activity in the framework of the Association's programs, among other things, in the form of the adoption by nearby Bank branches of schools participating in the project.
The first branch that has begun activities in this form was the **Holon Branch**, which adopted the **"Mikve Israel"** school in Holon. 250 youth study in the religious section of this school, of which some 100 youth participate in the project. The youth in question are of Ethiopian descent coming from families in distress, and which were defined as youth at risk. The first activity organized by the Branch was a Hanukkah party in which the standup artist Danny Reches, a Bank employee, and employees of the Branch participated. Customers of the Branch were also brought into the project: a dentist who volunteered to treat two youngsters per week free of charge; an optometrist who volunteered to carryout eye tests fitting eye glasses and referrals to specialists at no cost; "good Samaritans" who donated 100 pairs of brand name shoes, belts etc.
Three additional branches of the Bank are preparing to adopt additional schools.

THE "DRIVE" CLUB FOR YOUTH AND THEIR PARENTS

Following strenuous preparatory work of over a year, the Bank initiated, in May 2005, an innovative marketing/social initiative launching the "Drive" Club intended to promote safe driving habits with young persons.
The Bank, together with the "Green Light" Association, Ayalon Insurance Company, "Champion Motors" (which imports Volkswagen cars to Israel)
and other leading businesses, established the "Drive" Club aimed at young persons and their parents, and offering an "economic revolution" moving the youth persons towards safe and calm driving.
Motor accidents form a painful national problem, which claims a heavy price in human lives and casualties as well as causing huge economic losses. Research has shown that the share of young drivers involved in road accidents is 2.5 times higher than their relative share in the population.
Changing the driving culture. The many and important activities intended to bring about a change of the driving culture among young persons, are well known to all. Alongside its other activities for the benefit of the community, the Bank decided to implement a singular move and establish a club adopting a positive approach towards young persons and their parents. By providing both an economic and inspiring value, the Bank urges them to drive in a different and calmer manner.
As part of the activities of the Club, the Bank implements an extensive move to recruit young persons and their parents as customers of the Bank, as well as a unique and a continuous activity (not a one-time occurence) which motivates young persons to adopt another mode of driving – safe and calm.
Members of the "Drive" Club – youth and their parents. The "Drive" Club is intended for youth aged 16 to 21 having received their driving license and for their parents. At this stage in their lives the young people are aware of the economic and physical dependence on their parents in everything connected with obtaining a driver's licence, having parental guidance while driving and the actual use of the car, which normally belongs to the parents. Moreover, the economic burden on the parents at this stage is high and includes the additional insurance premium payable in respect of a novice driver.
In addition, during this period the parents seek assistance from various entities that are able to provide know-how and guidance to them and to the young driver, both during the initial driving period (requiring an adult escort) and thereafter.
Bank employees volunteer for the "Green light for life" Association. This Association was established in 1997 with the object of reducing, to the extent possible, the number of road accident victims and to initiate a change of the driving culture in Israel. At the beginning of 2004, the association launched its "Green light for life" program.

This Project is designed to assist and ensure that the "escort period" determined by law for new drivers shall be effectively used, thus giving the new driver the experience and know-how needed to cope with the circumstances expected on the road.
As the first stage, the Project was operated as a pilot project in several towns. The Bank, through its branch network, serves as a national distribution network for the Project.
Stands of the "Drive" Club will be positioned at some 120 branches of the Bank and will be manned by Bank employees, volunteers for "Green light for life". At these locations, personal guidance manuals developed by the Association will be distributed to the young drivers and their parents. The manual is intended for the "escort period" of three months from date of issue of the license. In addition, a booklet containing safe driving tips will also be distributed people joining the Club.
The distribution of the manuals to young drivers and their parents will be made to all young persons nearing the "escort" period who have had over 20 driving lessons, or have recently obtained a driving license. This distribution is not conditional upon joining the Club. At the time of receiving the manual, the youth and their escort undergo a short training period provided by the Bank employee manning the stand.
Drive carefully and save – Refund of the "young driver" premium, win a car, etc.
Young persons joining the "Drive" Club will participate in prize lotteries, provided that they drive safely and have not accumulated driving penalty point carrying offences. First prizes are Volkswagen "Polo" cars donated by Champion Motors Ltd.
Ayalon Insurance Company also joined the campaign against road accidents and teamed up with the Bank in providing thousands of shekel in benefits, providing an incentive to the young driver to drive safely. Parents of young drivers who are members of the Club, who elect to insure their car under a comprehensive "DriveSafe" policy put out by Ayalon Insurance Company, will be entitled to a refund in respect of the "young driver" insurance supplement for two years, if at the end of that period that the young driver has a clean sheet regarding traffic offences.
In addition, all those joining the Club will receive invitations to various functions and activities and will enjoy a variety of changing benefits offered to club members from time to time. All this is achieved through cooperation with leading businesses active in the area of youth.

"MAALEH" – BUSINESS SECTOR OBLIGATION TOWARDS SOCIETY IN ISRAEL

The Bank joined the "Maaleh" Organization in the first quarter of the year as part of the leadership group of "Maaleh" for 2004. It is important to note that the business companies that belong to the leadership group of "Maaleh" see in their organizations companies of merit, which are among the leaders of social change in Israel
"Maaleh" Index for Social Responsibility. On February 13, 2004, the Tel-Aviv Stock Exchange Ltd. launched the "Maaleh Index for Social Responsibility, which is to include the first twenty companies in the "Maaleh" rating for social responsibility, that comply with the threshold conditions of the TA 100 Index. The Bank is included among the 20 companies covered by the Index at the date it was launched.
The criteria for the rating reflect the concept of "Maaleh" that social responsibility does not constitute mere financial contributions, but also business conduct of the company as part of overall social responsibility. Accordingly, the criteria include the total amount (in NIS) of donations, The ratio of donations to earnings or to turnover (according to earnings) and the conduct of the company in the course of transacting its business based on criteria of working environment, investment in the community and environment quality.

CSR (CORPORATE SOCIAL RESPONSIBILITY) REPORT

In September 2005, the Bank issued a CSR Report for 2004. In publishing this report, the Bank joins a long list of leading large corporations in the world. In Israel, the Bank is one of the leaders of the general move towards issuing CSR reports, and in the banking and finance sector in particular.

CSR reporting stems from the concept maintaining that corporations are accountable to the society and environment in which it operates. The main objective of this report is to create the ground work for a dialogue between the reporting corporation and the entities that influence it or which may be affected by it, and which are defined as having a stake in the corporation. The Bank views the publication of this report as an additional expression of the vision of "Humane Banking" – banking that is based upon humane values: love of mankind, professionalism, integrity, enterprise and commitment.

The CSR report deals with three dimensions influencing the stakeholders: the social dimension, the environmental dimension and the economic dimension. The report also describes the vision and strategic vision of the Bank and the "Discount Code" – the Bank's ethical code.

"THE MARCH OF THE LIVING"

In April 2005, a delegation of Discount Bank employees participated for the third time in the "March of the Living" from Auschwitz to Birkenau that takes place every year on the memorial day for the Holocaust and Heroism. The delegation, headed by the Chairman of the Board, numbered 120 bank and Mercantile Discount Bank staff. This continued a tradition started on 2003, of participation of a Discount Group delegation in the "March of the Living", the Bank and the Employee Union participating in the cost thereof. In addition, 35 young persons from development towns join the delegation, the Bank and the Employees Union bearing the cost of their travel to Poland. A delegation numbering 120 of the Bank's and the Mercantile Discount Bank staff is expected to participate in 2006 in the "March of the Living".

AUDITORS' REMUNERATION (1)(2)

The Bank's auditors are Ziv Haft and Somekh Chaikin - joint auditors. Below are particulars of the remuneration that was paid to the auditors (in NIS thousands):

	Consolidated		The Bank	
	For the year ended December 31,			
	2005	2004	2005	2004
For Auditing[3]:				
To the joint auditors[5]	10,695	8,531	4,146	3,988
To other auditors	-	3,228	-	-
Total	10,695	11,759	4,146	3,988
For Other Services:				
Audit related services[4]:				
To the joint auditors	1,494	591	1,337	537
To other auditors	-	446		-
Taxation Services[5]:				
To the joint auditors	1,907	2,932	721	2,170
To other auditors	-	1,065	-	-
Other Services:				
To the joint auditors	363	766	340	201
To other auditors	-	-	-	-
Total	3,764	5,800	2,398	2,908
Total Auditors' Remuneration	14,459	17,559	6,544	6,896

* Reclassified

Footnotes:

(1) The auditors' remuneration includes payments to partnerships and corporations under their control and also includes payments pursuant to the VAT law.

(2) Includes remuneration that has been paid and remuneration that has been accrued.

(3) Auditing annual financial statements and reviewing interim financial statements.

(4) Includes mainly audit work at the overseas branches of the Bank, dealing with tax assessments and special examinations.

(5) Including mainly annual tax reconciliation statements paid for as part of the audit fees and attributed to tax services based on estimate, tax assessments and tax consultations.

REMUNERATION OF THE CHAIRMAN OF THE BOARD OF DIRECTORS AND SENIOR EXECUTIVE OFFICERS

IN NIS THOUSANDS

2005

	Salary and bonuses*	Employer's provisions(1)	Supplemental reserves(2)	Total salary and related expenses**	Loans given on beneficial conditions(3) Balance	Average repayment period (in years)	Benefit given during the year	Loans given on usual conditions
Arie Mientkavich(4)	(8)(7)(6)(5)2,857	645	26	3,528	-	-	-	-
Giora Offer	4,925	685	32	5,642	6	0.21	-	-
Dr. Amnon Goldschmidt(10)	1,605	293	17	1,915	-	-	-	-
Reuven Spigel(11)	(12)2,210	306	6	2,522	-	-	-	36
Shlomo Pitchon	1,551	229	28	1,808	-	-	-	209
Eli Hoter	1,757	309	5	2,071	-	-	-	79
Michael Fokschaner(13)	(15)2,207	199	26	2,432	-	-	-	-
2004								
Arie Mientkavich	(7)(5)2,547	(9)3,082	229	5,858	-	-	-	-
Giora Offer	*3,149	(14)598	323	4,070	18	0.71	1	96
Dr. Amnon Goldschmidt	*1,360	317	155	1,832	3	0.08	-	-
Reuven Spigel	*1,352	319	57	1,728	-	-	-	50
Shlomo Pitchon	*1,246	288	177	1,711	-	-	-	233
Nissim Alagem	1,287	273	185	1,745	2	0.08	-	-
Michael Fokschaner	(15)2,072	149	132	2,353	-	-	-	-

* Not including the allocation of a provision in respect of the "Employee agreement" (see the section "Sale of the Bank" above).

** Excluding VAT on salary.

(1) Including severance, emoluments, vocational studies fund, leave and National Insurance.

(2) Supplemental reserves for related expenses in consequence of salary changes.

(3) Loans upon terms and conditions given to all Bank employees.

(4) Acted as chairman of the board of the Bank. Retired from office on January 31, 2006.

(5) The remuneration and employment conditions were approved at Shareholders' Meetings held on January 15, 1998 on October 5, 1999, and on June 14, 2004.

(6) At a meeting of the board of directors, held in May 2005, it was resolved (following the approval of the audit committee) to approve an award to the Chairman of the board in the amount of NIS 1,255 thousand. This matter has not yet been brought for approval of the general meeting of shareholder, but nonetheless, this item is included in the payroll expense data above.

(7) The Board of Directors in its meetings of August 2004 and October 2004 (after receiving the approval of the cudit committee) decided to approve a remuneration increment of 6.5% and a grant equal to seven monthly salaries to the chairman. These subjects have not as yet been brought before the General Meeting of Shareholders of the Bank, though they are however included in the above remuneration data.

(8) For details as to the approach made by the controlling shareholders to the Accountant General at the Ministry of Finance and to the President of M.I. Holdings Ltd. as to the payments to the former Chairman of the board, including a special award of NIS 10 million, see Note 22 to the financial statements.

(9) Including a provision for a payment to the chairman of the board in the event of his retirement from office due to change in ownership of the Bank as a result of change of ownership. According to the decision of the board of directors of May 2004 (following the approval of the audit committee) the chairman would be entitled to a payment of an amount equal to 15 full monthly salaries, in addition to the amounts due to him in accordance with the personal employment agreement with him, subject to the conditions specified in the resolution. This subject was on the agenda of the general meeting of shareholders held in June 2004, however it was not debated at that date.

(10) Retired from office on December 31, 2005.

(11) Retired from office on February 23, 2006, upon being appointed President and CEO of IDB New York.

(12) Including an appreciation award for his exceptional contribution to the development of the retail banking division and for accepting the challenge in New York.

(13) Retired from office on December 31, 2005.

(14) Including adjustment grant.

(15) Including overseas employment conditions.

The terms of engagement of executive officers are determined in personal employment contracts. In determining payments included in the report, the Board of Directors took into account the contribution of the executive to the activities of the Bank and its profitability, and the position he holds at the Bank.

For details as to an option plan and an award plan to senior officers of the Bank, including the Chairman of the board of directors and the President and CEO, see Notes 13 and 22 to the financial statements.

MISCELLANEOUS

PROVISIONAL INSTRUCTIONS REGARDING THE DESCRIPTION OF THE BUSINESS OF A BANKING CORPORATION AND FORWARD LOOKING INFORMATION IN THE REPORT OF THE BOARD OF DIRECTORS

In June 2004, Amendment No. 23 to the Securities Law, 1968, was published, in the spirit of the principles recommended by the Barnea Committee. In September 2004, amendments were published to the Securities Regulations (Details of a Prospectus, its Structure and Form), 1969, and to the Securities Regulations (Periodic and Immediate Reports), 1970.

Following the amendments to the law and regulations, discussions were held with the Supervisor of Banks on the matter of adapting the reporting requirements set out in the regulations of the Israeli Securities Authority to the reporting requirements to be applied to banking corporations. On February 19, 2006, the Supervisor of Banks issued a provisional instruction regarding the description of the business of a banking corporation and with respect to forward-looking information in the directors' report, which applies to the annual report for 2005 and thereafter.

The principal adjustments included in the provisional directives compared with the Addendum to the Securities Regulations, are:

- The provisional directive omitted certain articles in respect of which the Supervisor of Banks was convinced were not relevant to the activity of banking corporations;
- Specific transitional directives for 2004 have been set out with respect to certain matters.

DECLARATIONS AS TO DISCLOSURE IN FINANCIAL STATEMENTS

Following the accounting scandals exposed in recent years in the United States, the Sarbanes-Oxley Act of 2002 was passed with the intension of improving the accuracy, reliability and transparency of reporting by corporations, in order to restore public trust in them.

In the spirit of Section 302 of the said Act and the instructions published in accordance therewith by the SEC in the United States, the Supervisor of Banks issued a directive regarding a declaration as to disclosure in quarterly and annual reports of banking corporations. This directive was applied for the first time in the financial statements for the second quarter of 2005.

The Bank and its banking subsidiaries in Israel have engaged an independent firm of Certified Public Accountants, to provide consultation, support and guidance to assist them in their preparations towards the signing of the required declaration.

In order to establish these declarations, the Bank, engaging outside assistance as stated, has examined the principal processes of production and delivery of information related to the financial statements by the various units of the Bank, as well as the controls applying to these processes. As part of this review, the processes of data communication have been mapped and documented in detail, including the controls implemented in these processes. Additional new controls have been formed, the absorption of which in the work processes is being implemented.

Based on the findings of the said detailed examination, the Bank's Management in conjunction with its President and CEO and its Chief Accounting Officer have evaluated, on the basis of the said evaluation, the efficiency of the controls and procedures relating to disclosure at the Bank. Based on this evaluation, the President and CEO and Chief Accounting Officer have reached the conclusion that as of the end of the reporting period, the controls and procedures relating to disclosure at the Bank operate efficiently in order to record, process, summarize and report the information that the Bank is required to disclose in its quarterly report, in accordance with the directives of the Supervisor of Banks in the matter of reporting to the public.

During the quarter ended December 31, 2005, no change occurred in the internal control

over the financial reporting at the Bank, which had a material effect or which is reasonably expected to have a material effect on financial reporting. For details as to material weaknesses in the internal control at IDB New York, as to controls applying to compliance with ABS and AML provisions that are not considered disclosure controls, see "Material weaknesses in internal control" udner "Discount Bancorp, Inc.".
These statements include a declaration by the President and CEO and by the Chief Accounting Officer of the Bank, as required by the directives of the Supervisor of Banks (see below).
It should be stressed that, at this stage, the declaration regarding disclosure in the financial statements (see above) is not supposed to cover the extensive aspects of evaluating the effectiveness of the internal control over the financial reporting determined in section 404 (see hereunder). Included in this, the Bank has not as yet used the internal control model for examining its effectiveness, as required by the said Section 404.

CIRCULAR REGARDING "MANAGEMENT'S RESPONSIBILITY AS TO THE INTERNAL CONTROL OVER FINANCIAL REPORTING – SOX ACT 404"

The Supervisor of Banks issued in December 2005 a draft circular in the above matter, according to which banking corporations are to prepare for the inclusion in their financial statements, starting with the financial statements as of December 31, 2008, a certification with regards the management's responsibility for the establishment and maintenance of a proper system and procedures for the internal control over financial reporting as well as an assessment as of the end of the fiscal year of the efficiency of the internal control system and procedures regarding financial reporting. At the same time, the independent auditors of banking corporations would be required to render an opinion on the assessment made by the management of the banking corporation, in the preparation of which they will be required to implement the relevant standards to be adopted or published by the Public Company According Oversight Board (PCAOB). Everything in accordance with the provisions of Section 404 of the US Sarbanes Oxley Act and the directives issued by the SEC under it.
The circular requires the banking corporations to complete, until the date of issue of the report for the first quarter of 2006, the preliminary preparations for the implementation of the project – planning of the project (at the Bank and at the subsidiaries) – the appointment of a steering committee, the appointment of a project team, definition of the internal control and the scope of the work, its targets, interim products, the determination of a methodology, the identification of hardware and software to be used, establishment of work plans, budgets, employee training schemes, means of communication between the various factors, etc. The banking corporations must complete the overall project in the first half of 2008, so that the audit work of the independent auditors would begin in June 2008 at the latest and should be completed until the reporting date (December 31, 2008).
The circular states that the internal control model "COSO", to which the regulatory authorities in the United States refer, may be used by the banking corporations in Israel, within the framework of implementing the provisions of section 404, for the purpose of assessing the internal control. The COSO model defines the internal control, and provides methodologies and criteria according to which the effectiveness of the internal control system is to be examined.
The implementation of the Supervisor of Banks' requirements would require the upgrading and/or establishment of infrastructure systems of internal controls at the Bank, a matter that in the opinion of the Bank would require the allocation of large both financial and executive resources in the coming years.
The Bank and its banking subsidiaries in Israel have chosen an independent firm of Certified Public Accountants to assist, advise, guide and accompany them in their preparations for the implementation of the project, and have begun their preliminary preparations towards achieving this goal.

BOARD OF DIRECTORS AND MANAGEMENT

GENERAL

A list of the members of the Board of Directors and their occupation and a list of the Bank's executive officers and their areas of responsibility appear on page 4 of this report. These lists are correct as at the date hereof.

REPORT ON DIRECTORS HAVING ACCOUNTING AND FINANCIAL EXPERTISE

According to Section 92 (12) of the Companies Law, the board of directors must determine the required minimum number of directors having accounting and financial expertise, as this term is defined in Section 240 of the Companies Law. (The said requirement has been added in Amendment No.3 to the law and is effective as from January 20, 2006).

In accordance with Regulations enacted under the said Section 240, the evaluation of the accounting and financial expertise of a director shall be made by the board of directors, and, among other things, the following should be taken into account as part of the overall considerations: the director's education, experience and knowledge of the matters detailed in the Companies Regulations (terms and tests for a director having accounting and financial expertise and a director having professional qualifications), 2005.

In March 2004, the board of directors determined the minimum number of directors that should have accounting and financial expertise, in accordance with guidelines issued by the Securities Authority in October 2003, which was adopted by the Supervisor of Banks in December 2003.

In February 2006, the newly comprised board of directors, adopted, once again, the said resolution. Accordingly, the minimum number of such directors to serve on the board is three.

According to the directives of the Supervisor of Banks, a banking corporation must determine the minimum number of directors having accounting and financial expertise, who could properly serve as members of the audit committee of the board or of any other committee of the board which is empowered to discuss the financial statements of banking corporations.

In February 2006, the board determined that the minimum number of directors as abovementioned, who would serve on the audit committee of the board and on the financial statements committee of the board, is one.

The Directors having "accounting and financial expertise", and the factual background providing the basis for attributing these qualifications to them, are as follows. It should be mentioned that according to the reporting requirements of the Bank of Israel, against each name of a director it is stated whether he is a member of the financial statements committee of the board dealing with the Bank's financial statements and/or a member of the audit committee of the board.

Shlomo Zohar – Certified Public Accountant, Bachelor in Economics and Accounting and Master in Business Administration (specializing in accounting and finance).

From 1980 to the end of December 2005 was a partner in the accounting firm of Zohar, Zohar & Co., CPA (Isr). Also served as director in various companies.

As from February 2006, Mr. Zohar serves as active chairman of the Bank's board of directors, as chairman of the boards of directors of Mercantile Discount Bank Ltd., Israel Credit Cards Ltd. and several other corporations within the Group and also as deputy chairman of the board of directors of IDB New York.

Mr. Zohar serves as a member of the financial statements committee.

Gad Arbel – Bachelor in Economics and Master of Business Administration. Engages in economic and financial consulting.

Serves as outside director of Nitsba Holdings 1995 Ltd., director of Discount Bancorp, Inc.

and Israel Discount Bank of New York (where he had previously served as director). Member of the board of trustees and chairman of the audit committee of the College of Management and Academic Studies, member of the administrative committee of the Veteran Pension Funds.

Between the years 1971-1992, served in various capacities at the Ministry of Finance, including Deputy Accountant General, as representative of the Ministry of Finance in the United States (1983-1987) and as Commissioner of Capital Market, Insurance and Savings, Supervisor of Insurance as well as Deputy Chairman of the Israel Securities Authority (1988-1992). From 1992 to 1997 served as economic and financial consultant and as member of boards of directors of various companies, including Israel Discount Bank (also as chairman of the financial statements committee), Israel Discount Bank of New York, The Central Securities Company (Mutual Fund Management) (Chairman), Avner – Motor Vehicle Accident Victims Ltd., Yozma – New Pension Fund for Employees, and others. Until August 2005, served as a member of the audit committee of the Israeli Center for Management. In the period from 1997 to 2001, served as Executive Vice President of United Mizrahi Bank heading the capital market and investment operations, and from April 1999 acted as member of management in charge of the capital market and investments division. As part of his duties he also served as Chairman and director of various companies in the Mizrahi Bank Group as well as director of the Tel-Aviv Stock Exchange and of Ma'alot – the Israel Securities Rating Company.

Mr. Arbel serves as chairman of the audit committee.

Ben-Zion Granit – BSc. in Agriculture from Hebrew University with a minor in agricultural economics. Studied senior business management at the Business School of the Hebrew University and took courses in a wide range of financial subjects.

Served as chief internal auditor of Union Bank of Israel Ltd. and its subsidiaries (1993-2000), as executive vice president, member of management and head of the operations division at Union Bank (2000-2004), as risk manager (market and credit risks) of Union Bank (2004). He also served as CEO of Union Systems Company (2000-2004) and as director of Carmel Mortgages and Investments Society, Ltd. and of Igudim Ltd. (2000-2004).

Mr. Granit serves as member of the audit committee and the financial statements committee.

Zeev Vurembrand – BSc. in industrial engineering and management specializing in financial management, Technion, Israel Institute of Technology.

Since October 2002, serves as CEO of Clalit Health Services. Prior thereto, from January 1995 to October 2002, served as vice president, finance. Clalit Health Services has a financial turnover of NIS 17 billion. As part of his duties he was occupied with auditing and reporting procedures similar to those accepted in public companies.

From January 2001 to January 2006, he served as an outside director of Blue Square Israel Ltd., also acting as chairman of its audit committee and its financial statements committee. Blue Square Israel Ltd. is a public company traded on the NYSE (in the form of ADRs). One of the first moves made by that company in 2001 was the dual listing of its shares for trading also on the Tel-Aviv Stock Exchange. As part of his duties as chairman of the audit committee at Blue Square, he closely followed the process, audit and implementation of risk management required for compliance with the Sarbanes-Oxley Act. Blue Square reported that he was a director having accounting and financial expertise.

From 1995 to October 2002 he served as Chairman of the Board of Dikla Insurance Company Ltd.

From October 2003 to December 2004, he was an outside member of the rating committee of Midroog Ltd.

Since October 2002, in addition to his duties as CEO of Clalit Health Services, he has also been chairman of the boards of Clalit Health Services subsidiaries: Mor – Institute for Medical Data Ltd., Shila Ltd. (Clalit Smile, Clalit Esthetics and Clalit Complementary Medicine) as well as Clalit Medical Engineering Ltd.

From January 2005 to January 2006, he served on the board of directors and member of the audit committee of UBank where he was reported as a director having accounting and financial expertise.
From 1993 to 1994, he served as Vice President of Finance and Business Development of Shekem Ltd.
From 1989 to 1992, he served as Deputy CEO in charge of finances at Automotive Industries Ltd. of the Automotive Equipment Group.
Mr. Vurmbrand serves as chairman of the financial statements committee.
Prof. Ben-Zion Zilberfarb – Bachelor in Economics and Business Administration, Master in Economics, Ph.D. in Economics from the University of Pennsylvania. Serves as Professor of Economics at Bar-Ilan University and is the Baron Edmond de Rothschild Professor of Assets Management at the School of Banking and Capital Markets at the Netanya Academic College. Serves as external director and member of the audit committees of Brimag Digital Age, Fundtech Ltd., and in Clal Provident Fund and Education Fund Financing Ltd.
Served as director in Partner Communications (including a tenure as chairman of the audit committee). Served as Chairman of the Board of Directors of Karnit (1998-2000) and of Eurotrade Bank Ltd. (2000-2001). In the years 1982-1985, he served as director of the Economic Planning Authority, and 1988-1989 as Director General of the Ministry of Finance. Partner Communications reported him as having financial expertise under the US Securities Regulations. As a member of the audit committees of Fundtech and of Partner accompanied the process implementing requirements under the Sarbanes-Oxley Act. Is proficient in accounting matters pertaining to GAAP and to the recognition of earnings and other subjects relating to the communications industry.
Prof. Zilberfarb serves as member of the financial statements committee.
Joseph Singer – Bachelor in Economics and Business Administration, Master in Business Administration.
Serves as director and partner of Giza Singer Even Ltd., an economics and business consulting company specializing in two central areas: one, analysis and valuation of companies and the other, company and project financing. In addition, is a member of the boards of directors of various companies, including Singer and Even Ltd., Midroog Ltd., a rating company, Midroog Holdings Ltd., Giza Singer & Even Finance Ltd. and Singer, Even & Kreizberg Holdings Ltd. Serves as outside director of Edmond de Rothschild Mutual Funds Management Ltd. and as Chairman of its investments committee. Served as outside director of Otzarit Mutual Funds Management Co. Ltd.
For over a decade served as President and CEO of Singer and Even Ltd. – Economics and Business Consulting Company.
Mr. Singer is a member of the financial statements and audit committees.
Ms. Tsippi Samet – Bachelor in Economics and Mathematics, Masters in Economics (Hebrew University, Jerusalem).
Serves as President of Adif College for Insurance, Pension and Finance Studies, and as outside director in Sinai Insurance Holdings (1993) Ltd., Mivtachim Pension Funds Ltd., Menora Mivtachim Gemel Ltd. and Hazera Genetics Ltd., as well as Chairperson of the Investment Committee of Avner –Motor Vehicle Accident Victims Insurance Ltd.
In the period 1998-2002, served as Commissioner of Capital Markets, Insurance and Savings and at the same time served as director of M.I. Holdings Ltd. In the period 1996-1998, served as a member of the Israel Securities Authority. In the period 1983-1995, held the office of senior economist in the research unit of the Supervisor of Banks.
Ms. Samet serves as member of the audit committee.
Dr. Arieh Ovadia – Bachelor in Accountancy and Economics, Master in Business Administration and Ph.D. in Economics. Lecturer at universities and academic institutions in Israel and abroad. Consultant to companies on economic issues.
Serves as a member of the Israel Phoenix Assurance Co. Ltd., and of Giron Development and

Building Ltd. and as director in various companies (Strauss-Elite Ltd., Israel Petrochemical Industries Ltd., Carmel Ulpinim Ltd., Hadar Ltd. Mehadrin Ltd).
Served as a member of the Israel Securities Authority (1981-1996), as a member of the Israeli Accounting Standards Board (1998-2001). In the years 1996-1999, served as CEO of Dubek Ltd. Concurrently served for various periods as director of several companies (including Dubek Ltd., Koor Industries Ltd., Participation in Real Estate in Israel Ltd, Orda Print Industries Ltd. and Tadiran Communications Ltd).
Dr. Ovadia serves as a member of the financial statements committee.

CHANGES IN THE BOARD OF DIRECTORS AND MANAGEMENT

Changes in the Board of Directors. On October 4, 2005, the tenure of Prof. Zvi Adar and Mr. Yehuda Milo as members of the board of directors came to an end and the tenure of Mr. David Schlacht as director came to an end on December 27, 2005, this after completing tenure of office as outside directors, as defined in Proper Banking Management Directives of the Bank of Israel.
As discussed in the section “Control of the Bank” above, the control of the Bank was transferred to the Bronfman-Schron Group on January 31, 2006.
As part of the transfer of control, a special general meeting of shareholders was held on January 31, 2006, in which it was resolved to appoint Messrs. Shlomo Zohar, Bezalel Eager, Ben Zion Granot, Zeev Vurembrand, Prof. Ben Zion Zilberfarb, Jorge Zafran, Gene Kleinhendler, Zvi Striegold and Prof. Eitan Shishinsky, as members of the Board of Directors of the Bank, upon the recommendation of the Bronfman-Schron Group.
In addition, the said general meeting resolved to appoint Ms. Tsippi Samet for an additional tenure of office as outside director, as defined in the Companies Law, 1999, effective as of February 24, 2006.
Concurrently, the said general meeting resolved to terminate the tenure of office of Messrs. Arie Mientkavich, Chaiman of the Board, Nissim Baruch, Eli Goldschmidt, Willie Itzchaki, Yaacov Lifshitz and Ms. Noga Yatziv as members of the Board.
The Board of Directors and the President and CEO wish to thank the retiring members of the board for their activity and contribution to the Bank during their period of office.
The board of directors and the President and CEO wish to thank Mr. Mientkavich for his exceptional contribution to the Bank during his tenure of office.
Mr. Mientkavich acted as Chairman of the Board since November 1997, and from the time he assumed office he headed the long and complex process of recovery, rehabilitation and promotion of the Bank. Mr. Mientkavich also contributed vastly to the successful conclusion of the privatization process of the Bank, which was considered a target of principal strategic importance for the Bank and the shareholders at large.
Election of a Chairman. At a meeting held on February 6, 2006, the board of directors elected Mr. Shlomo Zohar as Chairman of the Board.
Changes in Management. On February 23, 2006, Mr. Reuven Spiegl, senior executive vice president was appointed as President and CEO of IDB New York, thus terminating his office as head of the Retail Division.
The Board of Directors, the President and Management wish Mr. Spiegl every success in his new office.
The following changes in management took place on March,1,2006:
Mr. Israel David replaced Mr. Spiegl as head of the Retail Division.
Mr. Eli Hoter replaced Mr. David as head of the Marketing and Strategic Planning Division.
Mr. Amnon Gideon began his tenure as a member of management as executive vice president heading the Human Resources Group, replacing Mr. Hoter in this office.
The said changes were made pursuant to the resolution of the board of directors of February 6, 2006.
On December 26, 2005, the board of directors resolved to appoint Ms. Dorit Ben Simon as

member of management as executive vice president in charge of the Financial Division.
Ms. Ben Simon is replacing in this office Dr. Amnon Goldshmidt, senior executive vice president, who acted as head of the Financial Division from September 1994 to December 31, 2005. Ms. Ben Simon is expected to assume office on April 2, 2006.
Mrs. Ronit Abranson-Rokach, Executive Vice President, legal advisor informed of her intention to retire from the Bank. The date of termination of her office has not yet been agreed.
The board of directors, the President and CEO and management wish to thank the members of management who retired from office for their activity and contribution to the Bank during their tenure of office, and wish every success to the members of management assuming new duties.

MEETINGS OF THE BOARD AND ITS COMMITTEES

In 2005, the Board of Directors held 29 meetings. In addition, 56 meetings of committees of the Board of Directors were held.
The Board of Directors wishes to thank the President & Chief Executive Officer, the members of Management, the Bank's employees and employees of the Group's companies and their management for their work towards the advancement of the Bank and the Group.

Shlomo Zohar Chairman of the Board of Directors	Giora Offer President and Chief Executive Officer

March 28, 2006

'05

MANAGEMENT REVIEW

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SCHEDULE A - CONSOLIDATED BALANCE SHEET - MULTI-PERIOD DATA

	As at December 31				
	2005	2004	2003	2002	2001
	Reported amounts(1)		Adjusted amounts(1)		
	In NIS millions				
Assets					
Cash and deposits with banks	20,586	17,751	16,888	18,878	24,510
Securities	42,188	40,068	38,774	36,581	30,457
Credit granted to the public	83,890	*77,518	76,464	74,334	74,110
Credit granted to the Government	92	271	367	552	546
Investments in affiliated companies	1,527	1,320	1,238	1,282	1,316
Buildings and equipment	2,268	1,978	2,102	1,955	1,881
Other assets	4,247	*3,604	*3,442	3,692	2,960
Total assets	154,798	142,510	139,275	137,274	135,780
Liabilities and Shareholders` Equity					
Deposits from the public	130,300	*121,974	*120,102	119,734	118,981
Deposits from banks	6,518	*4,806	*4,948	4,051	3,622
Deposits from the Government	252	144	171	166	189
Debentures and subordinated capital notes	5,342	4,809	4,223	3,787	3,766
Other liabilities	5,201	*3,942	*3,392	4,023	3,212
Total liabilities	147,613	135,675	132,836	131,761	129,770
Minority interest	467	449	484	449	445
Shareholders` equity	6,718	6,386	5,955	5,064	5,565
Total liabilities and shareholders` equity	154,798	142,510	139,275	137,274	135,780

* Reclassifed.
Footnote:
(1) See Note 1 B.

SCHEDULE B - CONSOLIDATED STATEMENT OF INCOME - MULTI-PERIOD DATA

	For the year ended December 31				
	2005	2004	2003	2002	2001
	Reported amounts[1]			Adjusted amounts[1]	
	In NIS millions				
Financing Income					
Income from financing activities before provision for doubtful debts	3,697	[2]3,473	[2]2,970	[2]2,857	2,866
Provision for doubtful debts	691	880	845	896	990
Income from financing activities after provision for doubtful debts	3,006	2,593	2,125	1,961	1,876
Non-Financing Income					
Operating commissions	1,858	[2]1,771	[2]1,661	[2]1,530	1,516
Net income (loss) on investment in shares	3	103	9	(11)	20
Other income	540	352	434	243	352
Total non-financing income	2,401	2,226	2,104	1,762	1,888
Non-Financing Expenses					
Salaries and related expenses	2,891	[2]2,510	[2]2,263	[2]2,182	[2]2,403
Maintenance and depreciation of buildings and equipment	666	632	636	596	573
Other expenses	1,167	[2]881	[2]706	[2]786	[2]837
Total non-financing expenses	4,724	4,023	3,605	3,564	3,813
Operating income (loss) before taxes in reported amounts	683	796	624	159	(49)
Erosions and adjustments[1]	-	-	30	-	-
Operating income (loss) before taxes	683	796	654	159	(49)
Provision for taxes on operating income	324	342	371	207	246
Operating income (loss) after taxes	359	454	283	(48)	(295)
Bank's share in operating income (loss) of affiliated companies, net of tax effect	174	135	117	(1)	56
Net operating income (loss) before minority interest	533	589	400	(49)	(239)
Minority interest, after taxes, in the operating income of consolidated subsidiaries	(75)	(56)	(60)	(25)	(34)
Net operating income (loss)	458	533	340	(74)	(273)
Net cumulative effect as of the beginning of the year of change in accounting	(4)	(1)	10	-	-
Net income (loss), before extraordinary income (loss) after taxes	454	532	350	(74)	(273)
Provision for impairment in value of investment in affiliated companies	-	-	(173)	(8)	-
Net gain (loss) from extraordinary items, net of taxes	4	24	(23)	44	6
Net income (loss)	458	556	154	(38)	(267)

SCHEDULE B - CONSOLIDATED STATEMENT OF INCOME - MULTI-PERIOD DATA (CONTINUED)

	For the year ended December 31				
	2005	2004	2003	2002	2001
	Reported amounts[(1)]			Adjusted amounts[(1)]	
	In NIS millions				
Earnings (losses) per NIS 1 Nominal Value of Share Capital (in NIS)[(1)]					
Net operating income (loss)	4.67	5.44	3.47	(0.75)	(2.90)
Net gain (loss) from extraordinary items, net of taxes[(3)]	-	0.23	(1.90)	0.36	0.06
Net income (loss)	4.67	5.67	1.57	(0.39)	(2.84)
Weighted nominal value of share capital used in the above calculation (in NIS thousands)	98,064	98,064	98,064	98,064	94,173

Footnotes:
(1) See Note 1 B.
(2) Reclassified.
(3) December 31, 2005 and December 31, 2004: Including net cumulative effect as of the beginning of the year of change in accounting.
December 31, 2003: Including a provision for impairment in value of investment in an affiliated company and the net cumulative effect as of the beginning of the year of change in accounting.
December 31, 2002: Including a provision for impairment in value of investment in an affiliated company.

SCHEDULE C – INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1]

REPORTED AMOUNTS

	2005				2004			
			Rate of income (expense)				Rate of income (expense)	
	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]
	In NIS millions		%		In NIS millions		%	
Non-Linked Israeli Currency:								
Assets[4][5]	45,005	2,800	6.22		43,083	2,822	6.55	
Effect of derivatives:[3]								
Embedded derivaties and ALM	7,800	224			6,690	226		
Total assets	52,805	3,024		5.73	49,773	3,048		6.12
Liabilities[5]	(46,171)	(1,359)	(2.94)		(43,975)	(1,519)	(3.45)	
Effect of derivatives:[3]								
Embedded derivaties and ALM	(5,082)	(157)			(4,333)	(145)		
Total liabilities	(51,253)	(1,516)		(2.96)	(48,308)	(1,664)		(3.45)
Interest margin			3.28	2.77			3.10	2.67
Israeli Currency Linked to the CPI :								
Assets[4][5]	21,207	1,715	8.09		22,795	1,530	6.71	
Effect of derivatives:[3]								
Embedded derivaties and ALM	431	21			562	26		
Total assets	21,638	1,736		8.02	23,357	1,556		6.66
Liabilities[5]	(19,219)	(1,280)	(6.66)		(21,257)	(1,096)	(5.16)	
Effect of derivatives:[3]								
Embedded derivaties and ALM	(395)	4			(464)	(26)		
Total liabilities	(19,614)	(1,276)		(6.51)	(21,721)	(1,122)		(5.17)
Interest margin			1.43	1.51			1.55	1.49

For footnotes see page 209.

SCHEDULE C – INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1] (CONTINUED)

REPORTED AMOUNTS

	2005				2004			
			Rate of income (expense)				Rate of income (expense)	
	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]
	In NIS millions		%		In NIS millions		%	
Foreign Currency:								
Domestic Operations:[6]								
Assets[4][5]	32,361	1,898	5.87		30,171	1,128	3.74	
Effect of derivatives:[3]								
Hedging derivatives	1,036	34			1,067	124		
Embedded derivaties and ALM	23,836	1,120			24,697	*459		
Total assets	57,233	3,052		5.33	55,935	1,711		3.06
Liabilities[5]	(33,442)	(1,631)	(4.88)		(31,635)	(620)	(1.96)	
Effect of derivatives:[3]								
Hedging derivatives	(1,088)	(30)			(1,146)	(145)		
Embedded derivaties and ALM	(26,499)	(1,104)			(27,143)	(397)		
Total liabilities	(61,029)	(2,765)		(4.53)	(59,924)	(1,162)		(1.94)
Interest margin			0.99	0.80			1.78	1.12
Overseas Operations of Foreign Extensions of the Bank:								
Assets[4][5]	41,057	4,344	10.58		38,051	886	2.33	
Effect of derivatives:[3]								
Hedging derivatives	3,822	325			3,388	6		
Embedded derivaties and ALM	458	78			1,548	(3)		
Total assets	45,337	4,747		10.47	42,987	889		2.07
Liabilities[5]	(36,902)	(3,362)	(9.11)		(34,429)	(193)	(0.56)	
Effect of derivatives:[3]								
Hedging derivatives	(3,759)	(288)			(3,230)	41		
Embedded derivaties and ALM	(456)	(6)			(1,561)	(78)		
Total liabilities	(41,117)	(3,656)		(8.89)	(39,220)	(230)		(0.59)
Interest margin			1.47	1.58			1.77	1.48

* Reclassified.

For footnotes see page 209.

SCHEDULE C – INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1] (CONTINUED)

REPORTED AMOUNTS

	2005				2004			
			Rate of income (expense)				Rate of income (expense)	
	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]
	In NIS millions		%		In NIS millions		%	
Total:								
Monetary assets which generated finacning income[4][5]	139,630	10,757	7.70		134,100	6,366	4.75	
Effect of derivatives:[3]								
Hedging derivatives	4,858	359			4,455	130		
Embedded derivaties and ALM	32,525	1,443			33,497	*708		
Total assets	177,013	12,559		7.09	172,052	7,204		4.19
Monetary liabilities which generated financing expenses[5]	(135,734)	(7,632)	(5.62)		(131,296)	(3,428)	(2.61)	
Effect of derivatives:[3]								
Hedging derivatives	(4,847)	(318)			(4,376)	(104)		
Embedded derivaties and ALM	(32,432)	(1,263)			(33,501)	(646)		
Total liabilities	(173,013)	(9,213)		(5.33)	(169,173)	(4,178)		(2.47)
Interest margin			2.08	1.76			2.14	1.72
In respect of options		(16)				*48		
In respect of other derivatives (excluding options, hedging derivatives, ALM and detached embedded derivatives)[3]		-				*-		
Commissions on financing operations and other financing income[7]		437				*410		
Other financing expenses		(70)				(11)		
Income from financing activities before provision for doubtful debts		3,697				3,473		
Provision for doubtful debts (including general and supplemental provisions)		(691)				(880)		
Income from financing activities after provision for doubtful debts		3,006				2,593		

* Reclassified.

For footnotes see next page.

SCHEDULE C – INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1] (CONTINUED)

REPORTED AMOUNTS

	2005	2004
	Average balance[2]	Average balance[2]
	in NIS millions	
Total:		
Monetary assets which generated finacning income[4][5]	139,630	134,100
Assets related to derivative instruments[8]	-	*20
Other monetary assets[5]	5,631	*4,481
General and supplemental provisions for doubtful debts	(701)	(662)
Total monetary assets	144,560	137,939
Total:		
Monetary liabilities which generated finacning expenses[5]	(135,734)	(131,296)
Liabilities related to derivative instruments[8]	(103)	-
Other monetary liabilities[5]	(5,607)	(3,912)
Total monetary liabilities	(141,444)	(135,208)
Surplus of monetary assets over monetary liabilities	3,116	2,731
Non-monetary assets	4,092	3,903
Non-monetary liabilities	(55)	(56)
Total capital resources	7,153	6,578

* Reclassified.

Footnotes:

(1) The data in this table is presented before and after the effect of derivative instruments (including off-balance sheet effect of derivative instruments).

(2) Based on monthly opening balances, except for the non-linked Israeli currency segment in respect of which the average balances are based on daily data, and after deduction of the average balance of the specific provisions for doubtful debts.

(3) Hedging derivative instruments (excluding options), detached embedded derivatives and derivatives (ALM) constituting a part of the asset and liability management system of the Bank.

(4) The average balance of assets is net of/includes the average balance of non-realized gains/losses on adjustments to fair value of trading bonds and gains/losses in respect of available-for-sale securities, included in shareholders equity under other cumulative comprehensive income, in the item "Adjustments for the presentation of available-for-sale securities at fair value" (including in respect of bonds transferred from the available-for-sale portfolio to the bonds held to maturity portfolio), 2005 – NIS (145) million in the non-linked segment, NIS (1) million in the CPI linked segment and NIS 29 million in the foreign currency segment; 2004 – NIS (66) million in the non-linked segment, NIS (38) million in the CPI linked segment and NIS (12) million in the foreign currency segment.

(5) Excluding derivative instruments.

(6) Including Israeli currency linked to foreign currency.

(7) Including gains/losses on sale of investments in bonds and adjustment to fair value of trading bonds.

(8) Average balances of derivative instruments (excluding average off-balance sheet balances of derivative instruments).

SCHEDULE C – INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1] (CONTINUED)

	2005				2004			
			Rate of income (expense)				Rate of income (expense)	
	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]
	In US$ millions		%		In US$ millions		%	
Foreign Currency – Nominal in US$*								
Domestic Operations[6]								
Assets[4][5]	7,164	285	3.98		6,720	206	3.07	
Effect of derivatives:[3]								
Hedging derivatives	231	6			239	23		
Embedded derivates and ALM	5,314	137			5,496	85		
Total Assets	12,709	428		3.37	12,455	314		2.52
Liabilities[5]	(7,467)	(176)	(2.36)		(7,051)	(86)	(1.22)	
Effect of derivatives:[3]								
Hedging derivatives	(243)	(11)			(257)	(27)		
Embedded derivates and ALM	(5,908)	(125)			(6,041)	(71)		
Total liabilities	(13,618)	(312)		(2.29)	(13,349)	(184)		(1.38)
Interest margin			1.62	1.08			1.85	1.14
Overseas Operations of Foreign Extensions of the Bank								
Assets[4][5]	9,163	434	4.74		8,458	326	3.85	
Effect of derivatives:[3]								
Hedging derivatives	854	19			755	21		
Embedded derivates and ALM	443	7			345	4		
Total Assets	10,460	460		4.40	9,558	351		3.67
Liabilities[5]	(8,236)	(242)	(2.94)		(7,859)	(180)	(2.29)	
Effect of derivatives:[3]								
Hedging derivatives	(840)	(11)			(720)	(11)		
Embedded derivates and ALM	(444)	(11)			(347)	(8)		
Total liabilities	(9,520)	(264)		(2.77)	(8,926)	(199)		(2.23)
Interest margin			1.80	1.63			1.56	1.44

* Nominal Israeli Shekel amounts translated to US$ Dollars at the representative rate of exchange.
For footnotes see next page.

SCHEDULE C – INCOME AND EXPENSE RATIOS OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES[1] (CONTINUED)

	2005				2004			
			Rate of income (expense)				Rate of income (expense)	
	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]	Average balance[2]	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives[3]
	In US$ millions		%		In US$ millions		%	
Total:								
Monetary assets generating financing income[4][5]	16,327	719	4.40		15,178	532	3.51	
Effect of derivatives:[3]								
Hedging derivatives	1,085	25			994	44		
Embedded derivates and ALM	5,757	144			5,841	89		
Total assets	23,169	888		3.83	22,013	665		3.02
Monetary liabilities generating financing expenses[5]	(15,703)	(418)	(2.66)		(14,910)	(266)	(1.78)	
Effect of derivatives:[3]								
Hedging derivatives	(1,083)	(22)			(977)	(38)		
Embedded derivates and ALM	(6,352)	(136)			(6,388)	(79)		
Total liabilities	(23,138)	(576)		(2.49)	(22,275)	(383)		(1.72)
Interest margin		312	1.74	1.34		282	1.73	1.30

Footnotes:
(1) The data in this table is presented before and after the effect of derivative instruments (including off-balance sheet effect of derivative instruments).
(2) Based on monthly opening balances (except for the non-linked Israeli currency segment in respect of which the average balances are computed based on daily data, and after deduction of the average balance of the specific provisions for doubtful debts).
(3) Hedging derivative instruments (excluding options), detached embedded derivatives and derivative (ALM) constituting a part of the asset and liability management system of the Bank.
(4) The average balance of assets is net of/includes the average balance of non-realized gains/losses on adjustments to fair value of trading bonds and gains/losses in respect of available-for-sale securities (including bonds transferred from the available-for-sale to the held-to-maturity portfolios) 2005 - in amount of US$ 6 million 2004 - in the amount of US$ (4) millions.
(5) Excluding derivative instruments.
(6) Including Israeli currency linked to foreign currency.

SCHEDULE D – BANK'S EXPOSURE TO FLUCTUATIONS IN INTEREST RATES AS OF DECEMBER 31, 2005

Reported Amounts (in NIS millions)

	On demand to 1 month	Over 1 month to 3 months	Over 3 months to 1 year	Over 1 to 3 years	Over 3 to 5 years
Non-linked Israeli Currency					
Total assets	30,015	7,719	4,412	2,911	1,983
Total liabilities	40,330	3,011	4,561	1,834	346
Difference	(10,315)	4,708	(149)	1,077	1,637
Effect of forward transactions and special commitments	79	(61)	1,750	433	14
Options	(12)	30	(225)	15	(36)
Exposure to changes in interest rates in the segment	(10,248)	4,677	1,376	1,525	1,615
Cumulative exposure in the segment	(10,248)	(5,571)	(4,195)	(2,670)	(1,055)
Israeli Currency Linked to the CPI					
Total assets	576	770	3,384	6,419	3,751
Total liabilities	676	1,393	3,939	4,175	2,802
Difference	(100)	(623)	(555)	2,244	949
Effect of forward transactions and special commitments	45	112	(700)	(190)	-
Options	51	5	31	1	-
Exposure to changes in interest rates in the segment	(4)	(506)	(1,224)	2,055	949
Cumulative exposure in the segment	(4)	(510)	(1,734)	321	1,270
Foreign Currency **					
Total assets	31,762	17,189	10,140	7,269	5,362
Total liabilities	33,356	19,668	11,410	6,466	4,391
Difference	(1,594)	(2,479)	(1,270)	803	971
Effect of forward transactions and special commitments	(89)	(163)	(974)	(242)	(2)
Options	(39)	(35)	192	(16)	36
Exposure to changes in interest rates in the segment	(1,722)	(2,677)	(2,052)	545	1,005
Cumulative exposure in the segment	(1,722)	(4,399)	(6,451)	(5,906)	(4,901)
Overall Exposure to Changes in Interest Rates					
Total assets***	62,353	25,678	17,936	16,599	11,096
Total liabilities***	74,362	24,072	19,910	12,475	7,539
Difference	(12,009)	1,606	(1,974)	4,124	3,557
Effect of forward transactions and special commitments	35	(112)	74	1	12
Exposure to changes in interest rates in the segment	(11,974)	1,494	(1,900)	4,125	3,569
Cumulative exposure in the segment	(11,974)	(10,480)	(12,380)	(8,255)	(4,686)

General notes:

(1) Full data as the exposure to changes in interest rates in each segment according to the various balance sheet items, is available on request.

(2) In this table, the data according to periods present the present value of future cash flows discounted at the internal yield rate of the particular balance sheet item. Future cash flows discounted as above include interest which will accrue at maturity date or at the date of change in the interest rate, the earlier of the two.

(3) The effect of hedge transactions is included in total assets or total liabilities, as the case may be.

* The column "No fixed maturity" shows the amount stated in the balance sheet.

** Including Israeli currency linked to foreign currency.

***Including non-monetary assets and liabilities which are presented in the "No fixed maturity" column.

Over 5 to 10 years	Over 10 to 20 years	Over 20 years	No fixed maturity *	Total	Rate of return %	Average duration in years	31.12.2004 Rate of return %	Average duration in years
1,564	62	39	726	49,431	5.41	0.61	4.97	0.50
205	193	116	73	50,669	2.06	0.32	2.31	0.32
1,359	(131)	(77)	653	(1,238)	3.35	0.29	2.66	0.18
11	5	-	-	2,231				
(52)	326	38	-	84				
1,318	200	(39)	653	1,077				
263	463	424	1,077	-				
4,570	1,714	59	102	21,345	5.44	4.08	5.77	3.79
5,039	913	2	82	19,021	4.31	3.64	4.50	3.45
(469)	801	57	20	2,324	1.13	0.44	1.27	0.34
-	-	-	-	(733)	-	-	-	-
3	-	-	-	91	-	-	-	-
(466)	801	57	20	1,682	-	-	-	-
804	1,605	1,662	1,682	-	-	-	-	-
4,931	1,866	459	85	79,063	4.20	1.49	3.71	1.38
2,459	17	2	27	77,796	2.90	0.79	2.78	1.02
2,472	1,849	457	58	1,267	1.30	0.70	0.93	0.36
(23)	(5)	-	-	(1,498)	-	-	-	-
49	(326)	(38)	-	(177)	-	-	-	-
2,498	1,518	419	58	(408)	-	-	-	-
(2,403)	(885)	(466)	(408)	-	-	-	-	-
11,065	3,642	557	5,872	154,798		1.57		1.49
7,703	1,123	120	309	147,613		0.99		1.13
3,362	2,519	437	5,563	7,185		0.58		0.36
(12)	-	-	2	-				
3,350	2,519	437	5,565	7,185				
(1,336)	1,183	1,620	7,185					

SCHEDULE E – CREDIT RISK CLASSIFIED BY ECONOMIC SECTORS ON A CONSOLIDATED BASIS ADJUSTED AMOUNTS* (IN NIS MILLIONS)

	December 31, 2004				
	Balance sheet Credit risk(1)	Off-balance Sheet credit risk(2)	Total credit risk	Annual expense on specific provision for doubtful debts	Balance of problematic debt(3)
1. Lending Activity in Israel					
Agriculture	681	337	1,018	10	105
Industry	12,203	8,199	20,403	89	1,072
Construction and real estate	10,784	7,790	18,574	226	2,992
Electricity and water	1,409	246	1,655	1	4
Commerce	7,808	3,985	11,793	105	595
Hotels, hotel services and food	2,274	403	2,677	15	1,053
Transportation and storage	2,832	1,021	3,853	8	111
Communications and computer services	2,840	1,606	4,445	36	887
Financial services	5,399	5,019	10,418	17	118
Other business services	4,788	2,848	7,635	23	219
Public and community services	1,593	914	2,507	-	163
Individuals - housing loans	8,921	147	9,068	31	444
Individuals - other loans	8,346	10,632	18,979	68	667
Total	69,878	43,147	113,025	629	8,430
Less a deposit abroad linked to the credit risk of the borrower	(69)	-	(69)	-	-
Total	69,809	43,147	112,956	629	8,430
Credit Risk Included in the Various Economic Sectors:					
Agricultural Settlement Movements(4)	257	3	260	14	38
Local authorities(5)	293	153	446	-	27
2. Lending Activity Outside of Israel					
Agriculture	23	-	26	-	-
Industry	3,196	3,553	6,748	-	86
Construction and real estate	4,369	1,316	5,686	-	26
Electricity and water	110	176	286	-	-
Commerce	4,116	3,613	7,730	17	78
Hotels, hotel services and food	337	34	371	-	-
Transportation and storage	168	1	169	-	-
Communications and computer services	153	7	160	-	-
Financial services	3,730	738	4,467	-	7
Other business services	1,274	1,287	2,560	-	43
Public and community services	55	1	56	(2)	1
Individuals - housing loans	18	-	18	-	-
Individuals - other loans	1,327	184	1,511	(2)	4
Total	18,876	10,910	29,788	13	245

* See Note 1 B.

Footnotes:

(1) Credit to the public of NIS 84,570 million and investments in public bonds of NIS 3,345 million and assets relating to derivative instruments entered into by the public in the amount of NIS 770 million.

(2) Credit risk in off-balance sheet financial instruments as calculated for purposes of borrower liability limitation. Due to lack of data, only partial information regarding unutilized credit lines is included in respect of a consolidated subsidiary.

(3) The balance of problematic debts net of credit covered by collateral allowed for setoff for the purpose of a borrower or a group of borrowers liability limitation. Includes the components of off-balance sheet risk.

(4) Kibbutzim and moshavim, regional and national organizations and corporations controlled by the agricultural settlement movements.

(5) Including corporations under their control.

Credit risk and the balance of problematic debts are presented after deducting specific provisions for doubtful debts.

SCHEDULE E – CREDIT RISK CLASSIFIED BY ECONOMIC SECTORS ON A CONSOLIDATED BASIS (CONTINUED)

ADJUSTED AMOUNTS* (IN NIS MILLIONS)

	December 31, 2004				
	Balance sheet Credit risk(1)	Off-balance Sheet credit risk(2)	Total credit risk	Annual expense on specific provision for doubtful debts	Balance of problematic debt(3)
1. Lending Activity in Israel					
Agriculture	605	298	903	2	139
Industry	11,176	7,027	18,203	83	1,140
Construction and real estate	10,956	6,274	17,230	383	2,919
Electricity and water	1,495	183	1,678	6	37
Commerce	6,904	3,366	10,270	71	607
Hotels, hotel services and food	2,356	390	2,746	6	1,122
Transportation and storage	2,799	591	3,390	19	108
Communications and computer services	2,913	1,479	4,392	104	918
Financial services	4,668	3,810	8,478	(1)	158
Other business services	4,233	2,053	6,286	15	198
Public and community services	1,461	687	2,148	26	282
Individuals - housing loans	8,417	27	8,444	37	456
Individuals - other loans	7,789	9,530	17,319	72	605
Total	65,772	35,715	101,487	823	8,689
Credit Risk Included in the Various Economic Sectors:					
Agricultural Settlement Movements(4)	262	1	263	-	113
Local authorities(5)	308	57	365	-	42
2. Lending Activity Outside of Israel					
Agriculture	8	65	73	-	-
Industry	3,044	2,178	5,222	1	29
Construction and real estate	3,680	1,309	4,989	1	39
Electricity and water	104	9	113	-	-
Commerce	3,432	2,200	5,632	1	120
Hotels, hotel services and food	308	1	309	-	-
Transportation and storage	165	15	180	(9)	-
Communications and computer services	182	35	217	15	-
Financial services	3,058	712	3,770	8	12
Other business services	989	889	1,878	1	-
Public and community services	36	3	39	-	*2
Individuals - other loans	973	131	1,104	4	5
Total	15,979	7,547	23,526	22	207

* See Note 1 B.
** Reclassified.
Footnotes:
(1) Credit to the public of NIS 78,144 million, investments in bonds of NIS 3,235 million. Excluding assets relating to derivative instruments created with the public of NIS 372 million.
(2) Credit risk in off-balance sheet financial instruments as calculated for purposes of borrower liability limitation. Due to lack of data, only partial information regarding unutilized credit lines is included in respect of a consolidated subsidiary.
(3) The balance of problematic debts net of credit covered by collateral allowed for set-off for the purposes of a borrower or a group of borrowers liability limitation. Includes the components of off-balance sheet risk.
(4) Kibbutzim and moshavim, regional and national organizations and corporations controlled by the agricultural settlement movements.
(5) Including corporations under their control.
Credit risk and the balance of problematic debts are presented after deducting specific provisions for doubtful debts.

SCHEDULE F - CREDIT RISK ON A CONSOLIDATED BASIS BY GEOGRAPHIC REGION - ULTIMATE RISK IN DEVELOPING COUNTRIES (LDC)

ADJUSTED FOR THE EFFECT OF INFLATION - BASED ON CPI FOR DECEMBER 2004 (IN NIS MILLIONS)

	December 31	
	2005	2004
Credit [(1)(2)]	661	678
Off - balance sheet credit risk[(3)]	72	70
Total	733	748

Footnotes:
(1) After deducting specific provisions for doubtful debts.
(2) The amount of expense in respect of the specific provision for doubtful debts totals NIS 0.1 million (2004: NIS 0.5 million).
(3) Credit risk in off-balance sheet financial instruments as calculated for purposes of borrower liability limitation.

SCHEDULE G - CONDENSED CONSOLIDATED BALANCE SHEET FOR END OF EACH QUARTER - MULTI - QUARTER DATA

	2005				2004			
Quarter	4	3	2	1	4	3	2	1
	In NIS millions							
Assets								
Cash and deposits with banks	20,586	18,057	19,643	16,607	17,751	16,813	17,010	17,431
Securities	42,188	42,890	41,896	41,223	40,068	40,241	40,934	39,527
Credit granted to the public	83,890	83,199	81,164	*78,679	*77,518	77,775	76,785	77,136
Credit granted to the Government	92	179	227	276	271	324	354	372
Investments in affiliated companies	1,527	1,495	1,425	1,371	1,320	1,275	1,213	1,258
Buildings and equipment	2,268	2,221	2,043	1,998	1,978	1,950	1,913	2,122
Other assets	4,247	*3,919	*3,856	*3,518	*3,604	*3,018	*3,301	*2,866
Total assets	154,798	151,960	150,254	143,672	142,510	141,396	141,510	140,712
Liabilities and Shareholders' Equity								
Deposits from the public	130,300	127,432	126,935	*121,102	*121,974	*121,583	*122,262	*121,098
Deposits from banks	6,518	6,888	6,840	*6,431	*4,806	*5,075	*4,592	*5,041
Deposits from the Government	252	154	136	139	144	163	136	154
Debentures and subordinated capital notes	5,342	5,226	4,859	4,828	4,809	4,783	4,586	4,489
Other liabilities	5,201	*4,814	*4,308	*4,257	*3,942	*3,148	*3,428	*3,348
Total liabilities	147,613	144,514	143,078	136,757	135,675	134,752	135,004	134,130
Minority' interest	467	449	440	434	449	448	497	501
Shareholders' equity	6,718	6,997	6,736	6,481	6,386	6,196	6,009	6,081
Total liabilities and shareholders' equity	154,798	151,960	150,254	143,672	142,510	141,396	141,510	140,712

*Reclassified

SCHEDULE H - CONDENSED CONSOLIDATED STATEMENT OF INCOME FOR EACH QUARTER - MULTI-QUARTER DATA

REPORTED AMOUNTS

	2005			
Quarter	4	3	2	1
	In NIS millions			
Financing Income				
Income from financing activities before provision for doubtful debts	955	955	910	877
Provision for doubtful debts	188	201	173	129
Profit from financing activities after provision for doubtful debts	767	754	737	748
Non-Financing Income				
Operating commissions	484	478	453	443
Net income (loss) from investment in shares	2	-	2	(1)
Other income	131	188	116	(1)105
Total non-financing income	617	666	571	547
Non-Financing Expenses				
Salaries and related expenses	950	(1)679	633	(1)629
Maintenance and depreciation of buildings and equipment	170	169	158	169
Other expenses	382	(1)281	258	(1)246
Total non-financing expenses	1,502	1,129	1,049	1,044
Operating income (loss) before taxes	(118)	291	259	251
Provision for taxes on operating income	11	100	106	107
Operating income (loss) after taxes	(129)	191	153	144
Bank's share in operating income of affiliated companies, net of tax effect	45	46	43	40
Net operating income (loss) before minority interest	(84)	237	196	184
Minority interest in the operating income after taxes of consolidated companies	(19)	(21)	(18)	(17)
Net operating income (loss)	(103)	216	178	167
Net cumulative effect as of the beginning of the year of change in accounting	-	-	-	(4)
Net income (loss) from extraordinary items, net of taxes	(8)	1	11	-
Net income (loss)	(111)	217	189	163
Earnings (losses) per NIS 1 Par Value of Share Capital (in NIS)				
Net operating income (loss)	(1.05)	2.20	1.82	1.70
Net gain (loss) from extraordinary items, net of taxes(2)	(0.08)	0.01	0.11	(0.04)
Net income (loss)	(1.13)	2.21	1.93	1.66
Weighted par value of share capital used for the above calculation (in NIS thousands)	98,064	98,064	98,064	98,064

Footnotes:
(1) Reclassified.
(2) Including the net cumulative effect as of the beginning of the year of change in accounting.

SCHEDULE H - CONDENSED CONSOLIDATED STATEMENT OF INCOME FOR EACH QUARTER - MULTI-QUARTER DATA (CONTINUED)

REPORTED AMOUNTS

	2004			
Quarter	4	3	2	1
	In NIS millions			
Financing Income				
Income from financing activities before provision for doubtful debts	887	871	865	(1)850
Provision for doubtful debts	256	257	204	163
Income from financing activities after provision for doubtful debts	631	614	661	687
Non-Financing Income				
Operating commissions	452	433	437	(1)449
Net income on investment in shares	19	15	13	56
Other income	113	79	83	77
Total non-financing income	584	527	533	582
Non-Financing Expenses				
Salaries and related expenses	657	(1)577	585	691
Maintenance and depreciation of buildings and equipment	170	154	153	155
Other expenses	267	(1)199	208	207
Total non-financing expenses	1,094	930	946	1,053
Operating income before taxes	121	211	248	216
Provision for taxes on operating income	12	(1)110	115	105
Operating income after taxes	109	101	133	111
Bank's share in operating income of affiliated companies, net of tax effect	41	18	43	33
Net operating income before minority interest	150	119	176	144
Minority interest, after taxes, in the operating income of consolidated subsidiaries	(5)	(18)	(16)	(17)
Net operating income	145	101	160	127
Cumulative effect of change in accounting	(1)	-	-	-
Net income (loss) from extraordinary items, net of taxes	(10)	-	44	(10)
Net income	134	101	204	117
Earnings per NIS 1 Par Value of Share Capital (in NIS)				
Net operating income	1.48	1.03	1.63	1.30
Net income (loss) from extraordinary items, net of taxes(2)	(0.11)	-	0.45	(0.11)
Net income	1.37	1.03	2.08	1.19
Weighted par value of share capital used in the above calculation (in NIS thousands)	98,064	98,064	98,064	98,064

Footnotes:
(1) Reclassified.
(2) Including the cumulative effect of change in accounting.

CERTIFICATION

I, Giora Offer, certify that:

1. I have reviewed the quarterly report of Israel Discount Bank Ltd. (hereinafter: "the Bank") as of December 31, 2005 (hereinafter: "the Report");
2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made therein, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the Report;
3. Based on my knowledge, the financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and changes in shareholders' equity of the Bank as of, and for, the periods presented in this report;
4. Other officers of the Bank providing this certification and I are responsible for establishing and maintaining controls and procedures for the disclosure required in the Report of the Bank and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank, including its consolidated subsidiaries, is made known to us by others within the Bank and those entities, particularly during the period of preparing this report;
   (b) Evaluated the effectiveness of the Bank's disclosure controls and procedures and presented in the Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report based on such evaluation; and
   (c) Disclosed in the Report any change in the Bank's internal control over financial reporting that occurred during this quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and
5. The other officers of the Bank providing this certification and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's Auditors, to the Board of Directors to the audit committee of the Board of Directors, and to the finance committee of the Board of Directors:
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Bank's internal control over financial reporting.

Nothing in that stated above derogates my responsibility or the responsibility of any other person under any law.

Giora Offer,
President & Chief Executive Officer

March 28, 2006

CERTIFICATION

I, Joseph Beressi, certify that:

1. I have reviewed the quarterly report of Israel Discount Bank Ltd. (hereinafter: "the Bank") as of December 31, 2005 (hereinafter: "the Report");
2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made therein, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the Report;
3. Based on my knowledge, the financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and changes in shareholders' equity of the Bank as of, and for, the periods presented in this report;
4. Other officers of the Bank providing this certification and I are responsible for establishing and maintaining controls and procedures for the disclosure required in the Report of the Bank and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank, including its consolidated subsidiaries, is made known to us by others within the Bank and those entities, particularly during the period of preparing this report;
   (b) Evaluated the effectiveness of the Bank's disclosure controls and procedures and presented in the Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report based on such evaluation; and
   (c) Disclosed in the Report any change in the Bank's internal control over financial reporting that occurred during this quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and
5. The other officers of the Bank providing this certification and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's Auditors, to the Board of Directors to the audit committee of the Board of Directors, and to the finance committee of the Board of Directors:
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Bank's internal control over financial reporting.

Nothing in that stated above derogates my responsibility or the responsibility of any other person under any law.

Joseph Beressi, Executive Vice-President
Chief Accountant

March 28, 2006

STATEMENT OF THE BOARD OF DIRECTORS AND MANAGEMENT'S RESPONSIBILITY FOR THE ANNUAL REPORT

The annual report was prepared by the Management of the Bank, which is responsible for its propriety. This report includes financial statements prepared in accordance with generally accepted accounting principles and the reporting requirements and directives of the Supervisor of Banks, related supplementary data similarly prepared, as well as other information.

The preparation of periodic financial statements also requires the preparation of estimates determining certain amounts and items in the financial statements. Such estimates were prepared by the Bank's Management using its best judgment.

In order to ensure that the Bank's financial statements are presented fairly, the Bank's Management maintains a comprehensive system of internal control for the purpose of ensuring that the transactions effected by the Bank are properly authorized, that the Bank's assets are properly protected and that the accounting records are a reliable basis for the preparation of the financial statements. The system of internal control is, by nature, limited in that the certainty of its ability to uncover and prevent errors and irregularities is reasonable rather than absolute. The principle of reasonable certainty is based on the recognition that the decision as to the amount of resources to be invested in operating the control procedures must take into account the benefit to be derived from such procedures.

The Bank's Board of Directors, which is responsible for drawing up the financial statements and their approval pursuant to section 92 of the Companies Law, determines the accounting policy, controls its application and the structure of the internal control system, and supervises its implementation. The President and Chief Executive Officer is responsible for the routine management of the Bank's affairs within the context of the policy determined by the Board of Directors, and he is subject to its directions. The Bank's Management operates in accordance with the policy established by the Board of Directors. The Board of Directors, through its committees, holds meetings on a regular basis with Management, the internal auditor, and the Bank's auditors for the purpose of reviewing the scope of their work and the results thereof.

The Bank's auditors, Messrs. Ziv Haft., Certified Public Accountants (Isr.), and Messrs. Somekh Chaikin, Certified Public Accountants (Isr.), audited the Bank's annual financial statements in accordance with generally accepted auditing standards including standards prescribed by the Auditors Regulations (Manner of Auditor's Performance) - 1973 and certain auditing standards published by the American Institution of Certified Public Accountants and whose application was enforced by the Supervisor of Banks. The purpose of the audits is to enable the auditors to express an opinion as to the extent to which the financial statements reflect, in accordance with generally accepted accounting principles and the reporting requirements and directives of the Supervisor of Banks, the Bank's financial position, the result of its operations, the changes in shareholders' equity and its cash flows. Pursuant to section 170 of the Companies Law, the auditors are responsible to the Bank and its shareholders for the matters stated in their report on the financial statements. The auditors' report is appended to the annual financial statements.

In addition, the data included in the Report of the Board of Directors to Shareholders and Management Review (hereinafter "the annexed data") was submitted to the auditors so that they could advise whether there were any material differences between the data contained in the financial statements and the annexed data, or whether the annexed data included details which were in substantial disagreement with evidence or information which came to their attention during the course of their audit. No such advice was received from the auditors. The auditors did not undertake any auditing procedures for this purpose in addition to those they were required to employ in their examination of the financial statements.

	Shlomo Zohar	Giora Offer	Joseph Beressi
	Chairman of the	President and	Executive Vice President,
March 28, 2006	Board of Directors	Chief Executive Officer	Chief Accountant

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FINANCIAL STATEMENT

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Somekh Chaikin

ZIV HAFT

AUDITORS' REPORT TO THE SHAREHOLDERS OF ISRAEL DISCOUNT BANK LTD.

We have audited the attached balance sheets of Israel Discount Bank Limited (hereinafter - "the Bank") as at December 31, 2005 and December 31, 2004, and the consolidated balance sheets as at these dates and the statements of income, statement of changes in shareholders' equity and statements of cash flows - of the Bank and consolidated – for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Bank's Board of Directors and Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We did not audit the financial statements of consolidated subsidiaries, the assets of which included in the consolidation constitute approximately 1% of the total consolidated assets as at December 31, 2004, and whose income from financing activities before provision for doubtful debts included in the consolidation constitute approximately 1% and 12% of the total consolidated income from financing activities before provision for doubtful debts for the years ended December 31 2004 and 2003, respectively. We also did not audit the financial statements of certain affiliated companies, the investment in which amounted to NIS 74 million and NIS 47 million at December 31, 2005 and 2004, respectively, and the share of the Group in their net operating income is NIS 1 million, NIS 7 million and NIS 19 million, for the three years, the last of which ended December 31, 2005. The financial statements of those companies were audited by other auditors, whose reports were furnished to us, and our opinion, insofar as it relates to amounts included in respect of those companies, is based on the reports of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards, including those prescribed under the Israeli Auditors' Regulations (Auditor's Mode of Performance), 1973 and auditing standards applied in the audit of banking corporations as determined by guidelines of the Supervisor of Banks. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examination, on a test basis, of evidence supporting the amounts and disclosures 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 statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and on the reports of the other auditors, the financial statements referred to above present fairly, in conformity with generally accepted accounting principles, in all material respects, the financial position - of the Bank and consolidated - as at December 31, 2005 and 2004, and the results of operations, the changes in shareholders' equity and cash flows - of the Bank and consolidated – for each of the three years in the period ended December 31, 2005. Furthermore, in our opinion, the abovementioned financial statements were prepared in accordance with the directives and guidelines of the Supervisor of Banks.

As explained in Note 1 B, the financial statements for dates and reporting periods subsequent to December 31, 2003, are presented in reported amounts, in accordance with accounting standards of the Israeli Accounting Standard Board. The financial statements for dates and reporting periods ended up to that date, are presented in amounts that had been adjusted up to that date based on the changes in the general purchasing power of the Israeli currency, in accordance with Opinions of the Institute of Certified Public Accountants in Israel and directives and guidelines of the Supervisor of Banks.

Without qualifying our opinion, we draw attention to the following Notes to the financial statements:

(a) Concerning Note 33 as to the changes in the capital market structure. The said Note stated, among other things, that the Bank believes that even after entering into an agreement in principal for the sale of all the shares in Ilanot Discount Ltd. and for the sale of the operations of provident funds, the implementation of the amendments to the legislation may have a material adverse effect on the business position of the Bank and its results of operations. Nonetheless, in view of all which is stated in the Note, the future implications that the implementation of the capital market reform may have in the future on the Bank's position and results of its operations cannot be estimated or quantified at this stage.

(b) Concerning Note 19 C, 15.1 and 15.3 as to a claim and a motion for the approval of a certain action as a class action against the Bank and against a consolidated subsidiary.

(c) Concerning Note 6 D as regards the investigation that was conducted in the United States with respect to matters related to the Prohibition of Money Laundering Regulations and its impact upon IDB New York (a consolidated subsidiary).

Somekh Chaikin	Ziv Haft
Certified Public Accountants (Isr.)	Certified Public Accountants (Isr.)

March 28, 2006

BALANCE SHEET AS AT DECEMBER 31
REPORTED AMOUNTS

		Consolidated		The Bank	
		December 31		December 31	
	Notes	2005	2004	2005	2004
		in NIS millions			
Assets					
Cash and deposits with banks	2	20,586	17,751	21,728	20,622
Securities	3	42,188	40,068	17,233	16,433
Credit granted to the public	4	83,890	*77,518	47,362	*44,182
Credit granted to Governments	5	92	271	89	268
Investment in investee companies (consolidated – affiliated companies)	6	1,527	1,320	6,433	5,871
Buildings and equipment	7	2,268	1,978	1,699	1,432
Other assets	8	4,247	*3,604	2,380	*2,265
Total assets		154,798	142,510	96,924	91,073
Liabilities and Shareholders` Equity					
Deposits from the public	9	130,300	*121,974	80,297	*76,738
Deposits from banks	10	6,518	*4,806	2,970	*1,980
Deposits from the Government		252	144	126	38
Debentures and subordinated capital notes	11	5,342	4,809	3,519	3,575
Other liabilities	12	5,201	*3,942	3,294	*2,356
Total liabilities		147,613	135,675	90,206	84,687
Minority interest		467	449	-	-
Shareholders` equity	13	6,718	6,386	6,718	6,386
Total liabilities and shareholders` equity		154,798	142,510	96,924	91,073

* Reclassified
The notes to the financial statements are an integral part thereof

Shlomo Zohar	Giora Offer	Joseph Beressi
Chairman of the Board	President &	Executive Vice President
of Directors	Chief Executive Officer	Chief Accountant

March 28, 2006

STATEMENT OF INCOME FOR THE YEAR ENDED DECEMBER 31
REPORTED AMOUNTS

	Notes	2005	2004	2003
			Consolidated	
			In NIS millions	
Financing Income				
Income from financing activities before provision for doubtful debts	23	3,697	(2)3,473	(2)2,970
Provision for doubtful debts	1i,4c	691	880	845
Income from financing activities after provision for doubtful debts		3,006	2,593	2,125
Non-Financing Income				
Operating commissions	24	1,858	(2)1,771	(2)1,661
Net income on investment in shares	25	3	103	9
Other income	26	540	352	434
Total non-financing income		2,401	2,226	2,104
Non-Financing Expenses				
Salaries and related expenses	27	2,891	(2)2,510	(2)2,263
Maintenance and depreciation of buildings and equipment		666	632	636
Other expenses	28	1,167	(2)881	(2)706
Total non-financing expenses		4,724	4,023	3,605
Operating income before taxes in reported amounts		683	796	624
Erosions and adjustments(1)		-	-	30
Operating income before taxes		683	796	654
Provision for taxes on operating income	29	324	342	371
Operating income after taxes		359	454	283
Bank's share in operating income of affiliated companies, net of tax effect	6b1	174	135	117
Net operating income before minority interest		533	589	400
Minority interest, after taxes, in the operating income of consolidated subsidiaries		(75)	(56)	(60)
Net operating income		458	533	340
Net cumulative effect as of the beginning of the year of change in accounting	1w	(4)	(1)	10
Net income, before extraordinary income after tax		454	532	350
Provision for impairment in value of investment in affiliated companies	6g	-	-	(173)
Net gain (loss) from extraordinary items, net of taxes	30	4	24	(23)
Net income		458	556	154
Earnings per NIS 1 par value of share capital (in NIS):	1s			
Net operating income		4.67	5.44	3.47
Net gain (loss) from extraordinary items, net of taxes(3)		-	0.23	(1.90)
Net income		4.67	5.67	1.57
Weighted par value of share capital used in the above calculation (in NIS thousands)		98,064	98,064	98,064

Footnotes:
(1) See Note 1 B.
(2) Reclassified.
(3) December 31, 2005 and December 31,2004: Including net cumulative effect as of the beginning of the year of change in accounting.
December 31, 2003: Including a provision for impairment in value of investment in an affiliated company and the net cumulative effect as of the beginning of the year of change in accounting.

The notes to the financial statements are an integral part thereof.

STATEMENT OF INCOME FOR THE YEAR ENDED DECEMBER 31
REPORTED AMOUNTS

		The Bank		
	Notes	2005	2004	(1)2003
		In NIS millions		
Financing Income				
Income from financing activities before provision for doubtful debts	23	1,848	(2)2,005	(2)1,939
Provision for doubtful debts	1i,4c	441	582	656
Income from financing activities after provision for doubtful debts		1,407	1,423	1,283
Non-Financing Income				
Operating commissions	24	922	(2)890	(2)840
Net income on investment in shares	25	-	75	12
Other income	26	378	241	353
Total non-financing income		1,300	1,206	1,205
Non-Financing Expenses				
Salaries and related expenses	27	1,958	1,671	1,445
Maintenance and depreciation of buildings and equipment		429	398	404
Other expenses	28	522	(2)432	339
Total non-financing expenses		2,909	2,501	2,188
Operating income (loss) before taxes in reported amounts		(202)	128	300
Erosions and adjustments(1)		-	-	(36)
Operating income (loss) before taxes		(202)	128	264
Provision for taxes on operating income	29	26	24	116
Operating income (loss) after taxes		(228)	104	148
Bank's share in operating income of investee companies, net of tax effect	6b1	686	429	192
Net operating income		458	533	340
Net cumulative effect as of the beginning of the year of change in accounting	1w	(4)	(1)	10
Net income, before extraordinary income after tax	6g	454	532	350
Provision for impairment in value of investment in affiliated companies		-	-	(173)
Net gain (loss) from extraordinary items, net of taxes	30	4	24	(23)
Net income		458	556	154

Footnotes:
(1) See Note 1 B.
(2) Reclassified.

The notes to the financial statements are an integral part thereof.

STATEMENT OF CHANGES IN SHAREHOLDERS' EQITY

		Capital reserves		
	Share capital	Share premium reserve	Other capital reserves	Total share capital and reserves
	In NIS millions			
Balance at December 31, 2002*	658	2,939	37	3,634
Changes in 2003:				
Classification of other comprehensive income*	-	-	-	-
Income for the year*	-	-	-	-
Net adjustments for the presentation of available-for- sale securities at fair value*	-	-	-	-
Related tax effect*	-	-	-	-
Financial statements translation adjustments*	-	-	-	-
Net loss on the hedging of cash flows*	-	-	-	-
Net loss on the hedging of cash flows reclassified to the income statement*	-	-	-	-
Balance at December 31, 2003*	658	2,939	37	3,634
Changes in 2004:				
Income for the year	-	-	-	-
Net adjustments for the presentation of available-for- sale securities at fair value	-	-	-	-
Related tax effect	-	-	-	-
Net income on the hedging of cash flows	-	-	-	-
Net income on the hedging of cash flows reclassified to the income statement	-	-	-	-
Balance at December 31, 2004	658	2,939	37	3,634
Changes in 2005:				
Income for the year	-	-	-	-
Net adjustments for the presentation of available-for- sale securities at fair value	-	-	-	-
Related tax effect	-	-	-	-
Financial statements translation adjustments	-	-	-	-
Net loss on the hedging of cash flows	-	-	-	-
Net loss on the hedging of cash flows reclassified to the income statement	-	-	-	-
Balance at December 31, 2005	658	2,939	37	3,634

* Adjusted amounts - see Note 1 B.

Footnotes:

(1) Translation adjustments of foreign autonomous units. The consolidated subsidiary Israel Discount Bank of New York was treated until December 31, 1994, in the financial statements of the Bank as an autonomous unit. Accordingly this item included the financing sources of this investment and the related tax effect until that date (see also Note 1 G).

(2) Including an amount of NIS 2,704 million that is not available for distribution (for details see Note 32).

The notes to the financial statemtns are an integral part thereof.

Other cumulative comprehensive income (loss)				
Adjustments for presentation of available for sale securities at fair value	Translation adjustments[1]	Net gains (losses) on cash flow hedging	Retained earnings	Total shareholders' equity
In NIS millions				
(467)	(231)	-	2,128	5,064
9	-	(9)	-	-
-	-	-	154	154
779	-	-	-	779
(43)	-	-	-	(43)
-	(1)	-	-	(1)
-	-	(7)	-	(7)
-	-	9	-	9
278	(232)	(7)	2,282	5,955
-	-	-	556	556
(169)	-	-	-	(169)
43	-	-	-	43
-	-	2	-	2
-	-	(1)	-	(1)
152	(232)	(6)	2,838	6,386
-	-	-	458	458
(270)	-	-	-	(270)
136	-	-	-	136
-	3	-	-	3
-	-	(3)	-	(3)
-	-	8	-	8
18	(229)	(1)	3,296	6,718

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31

	Consolidated			The Bank		
	2005	2004	2003	2005	2004	2003
	Reported (1)amounts	Reported (1)amounts	Adjusted (1)amounts	Reported (1)amounts	Reported (1)amounts	Adjusted (1)amounts
Cash Flows from Operating Activities						
Net income (loss) for the year	458	556	154	458	556	154
Adjustments necessary to present cash flows from operations:						
Bank's share in undistributed income (loss) of investee companies (consolidated - affiliated companies)	(167)	(109)	(101)	(719)	(332)	(116)
Minority interest in income of consolidated subsidiaries	75	56	61	-	-	-
Depreciation of buildings and equipment	286	259	260	193	171	169
Amortization	-	-	7	-	-	-
Provision for decline in value of securities held for investment	8	*11	6	-	-	3
Provision for doubtful debts	763	*961	909	510	*663	722
Loss (gain) on sale of available-for-sale and held-to-maturity securities	(29)	*(121)	(17)	(22)	(99)	(38)
Realized and non realized loss (gain) from adjustment to fair value of trading securities	(4)	(70)	(71)	(3)	- (39)	(37)
Loss (gain) on change in controlling interest and provision for impairment in value in investee companies	-	(40)	205	-	(40)	173
Provision for impairment in value of buildings	10	-	22	10	-	21
Gain (loss) on sale of buildings and equipment	(7)	41	6	(6)	39	6
Net deferred taxes	121	(67)	(60)	10	(37)	(5)
Severance pay – decrease (increase) in excess of deposits over the provision	(123)	(46)	(244)	(86)	(48)	(215)
Inflation adjustment component of investing and financing activities	(850)	1,624	*310	330	(31)	36
Changes in Balance Sheet Items:						
Other assets, net	(612)	*(39)	*95	(21)	*49	*282
Other liabilities, net	1,342	*565	*(635)	901	*288	*(363)
Net Cash Flows from Operating Activities	1,271	3,581	907	1,555	1,140	792

* Reclasiffied.
Footnote:
(1) See Note 1 B.

The notes to the financial statements are an integral part thereof.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31 (CONTINUED)

	Consolidated			The Bank		
	2005	2004	2003	2005	2004	2003
	Reported (1)amounts	Reported (1)amounts	Adjusted (1)amounts	Reported (1)amounts	Reported (1)amounts	Adjusted (1)amounts
Cash Flows from Asset Transactions:						
Acquisition of held-to-maturity bonds	(2,289)	(2,171)	(3)	-	-	-
Proceeds from redemption of held-to-maturity bonds	2,370	2,205	-	-	-	-
Acquisition of available-for-sale securities	(18,009)	(21,272)	(42,532)	(7,067)	(9,121)	(8,113)
Proceeds from sale of available-for-sale securities	12,021	13,230	3,287	2,031	3,999	2,821
Proceeds from redemption of available-for-sale securities	4,786	5,874	38,017	4,504	5,789	4,834
Net deposits with banks	270	*248	406	(584)	*(26)	(600)
Trading securities, net	(297)	(627)	(1,312)	(370)	(539)	(879)
Net credit granted to the public	(6,952)	*(1,921)	(2,814)	(3,648)	*(261)	(698)
Net credit granted to the Government	180	95	182	179	54	161
Additional investment in investee companies	(34)	109	10	16	180	226
consolidated companies (annex A)	(2)	-	(3)	-	-	-
in previously consolidated subsidiaries (annex B)	-	1	*2	-	-	-
Acquisition of buildings and equipment	(585)	*(375)	*(528)	(474)	*(297)	*(421)
Proceeds from sale of buildings and equipment	31	220	66	28	219	63
Acquisition of other assets in a consolidated subsidiary	-	-	33	-	-	-
Net Cash Flows from Asset Transactions	(8,510)	(4,384)	(5,189)	(5,385)	(3)	(2,606)
Cash Flows From Liability and Capital Transactions:						
Net deposits from the public	8,387	*1,816	*1,918	3,620	*(143)	(609)
Net deposits from banks	1,711	*(141)	*556	990	*387	385
Net deposits from the Government	108	(27)	70	89	(16)	19
Issuance of subordinated capital notes	644	742	609	100	65	528
Redemption of bonds and subordinated capital notes	(449)	(426)	(350)	(447)	(373)	(277)
Dividend paid to shareholders	(56)	(49)	(31)	-	-	-
Net cash flows from liability and capital transactions	10,345	1,915	2,772	4,352	(80)	46
Increase (decrease) in cash	3,106	1,112	(1,510)	522	1,057	(1,768)
Cash balance at beginning of year (see Note 2)	14,993	13,881	15,391	12,631	11,574	13,342
Cash balance at end of year (see Note 2)	18,099	14,993	13,881	13,153	12,631	11,574

* Reclasiffied.
Footnote:
(1) See Note 1 B.

The notes to the financial statements are an integral part thereof.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31 (CONTINUED)

Annex A – Decrease in cash due to initially consolidated subsidiaries

	2005	2004	2003
	Reported amounts(1)	Reported amounts(1)	Adjusted amounts(1)
		In NIS millions	
Assets and liabilities at acquisition date of consolidated subsidiaries:			
Working capital (excludung cash and cash equivalents)	-	-	21
Long-term assets	(2)	-	(25)
Goodwill	-	-	(1)
Non-cash proceeds	-	-	2
Total decrease in cash due to initially consolidated companies	(2)	-	(3)

Annex B - Proceeds from sale of investments in previously consolidated subsidiaries

	2005	2004	2003
	Reported amounts(1)	Reported amounts(1)	Adjusted amounts(1)
		In NIS millions	
Assets and liabilities of previously consolidated subsidiaries, at date of sale:			
Assets	-	2	-
Liabilities	-	(1)	-
Debtors in respect of capital gains	-	(1)	-
Capital gain	-	1	2
Net cash flows on sale of investments in previously consolidated subsidiaries	-	1	2

Annex C - Non-cash asset and liability activity during the reported year

	2005	2004	2003
	Reported amounts(1)	Reported amounts(1)	Adjusted amounts(1)
		In NIS millions	
The Bank:			
Purchase of fixed assets	41	21	3
Lending of securities	41	*58	(224)
Dividend	-	50	-
Consolidated:			
Purchase of fixed assets	50	24	7
Lending of securities	184	*92	*(151)
Investment in shares	-	-	91
The reclassification of securities from the available-for-sale portfolio to the bonds held to maturity portfolio	-	5,587	-

* Reclasiffied.
Footnote:
(1) See Note 1 B.

The notes to the financial statements are an integral part thereof.

NOTES TO THE FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

A. GENERAL

(1) The financial statements are prepared in accordance with the directives and guidelines of the Supervisor of Banks in Israel.

(2) The Notes to the financial statements relate to the Bank's financial statements and to the consolidated financial statements of the Bank and its subsidiaries, except where it is stated that the note relates only to the Bank, or only to the consolidated statements.

(3) In these financial statements -

Consolidated subsidiaries - companies in which the Bank holds voting rights, either directly or indirectly, exceeding fifty percent, and/or is entitled to appoint over one half of the members of their boards of directors, and whose financial statements are consolidated with those of the Bank.

Affiliated companies - companies, other than consolidated subsidiaries, the investment in which is included on the equity basis.

Investee companies – consolidated subsidiaries or affiliated companies.

Extensions abroad - consolidated subsidiaries and branches abroad.

B. DISCONTINUATION OF THE ADJUSTMENT OF FINANCIAL STATEMENTS TO THE EFFECT OF INFLATION – FINANCIAL STATEMENTS IN REPORTED AMOUNTS

Standard No. 12 of the Israeli Accounting Standard Institute, dealing with the discontinuation of the adjustment of financial statements ("Standard 12") came into effect in October 2001. According to Standard 12 and according to Standard No. 17 of December 2002, as from January 1, 2003, the adjustment of financial statements was discontinued and they are presented in reported amounts (namely, amounts adjusted on the basis of the CPI for the month of the transition, together with nominal amount which were added subsequent to date of transition, and less amounts which were deducted after that date). Until December 31, 2003, the Bank prepared financial statement on an inflation adjusted basis in accordance with instructions of the Supervisor of Banks, based on the principles determined in Opinion 36 of the Institute of Certified Public Accountants in Israel. The adjusted amounts included in the financial statements for December 31, 2003, served as a starting point for the nominal financial reporting in accordance with the Standard as from January 1, 2004.

The Supervisor of Bank has issued a provisional instruction regarding the transition of banking corporations from financial reporting on an inflation-adjusted basis to reporting in reported amounts. In view of the materiality that the Supervisor of Banks attaches to income and expenses from financial instruments included in the business results of banking corporations, and in order to enable users of their financial statements to examine the data included in the statements for 2004 in comparison to the data of 2003, special instructions were determined in respect of the comparative figures included in the financial statements for 2004, as detailed hereunder.

In these financial statements, "cost" – cost in reported amounts.

The data included in these financial statements are presented in accordance with the Standard and with the instructions of the Supervisor of Banks in "reported amounts" as follows:

(1) Balance sheet

- Monetary items are stated in nominal amounts.
- Non-monetary items are stated in reported amounts. The amounts of non-monetary assets do not necessarily represent their realizable value or updated economic value, but rather the reported amounts of such assets.
- The comparative figures are stated in inflation adjusted amounts, based on the CPI for December 2003.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(2) Statement of income

- Income and expenses relating to non-monetary items or to provisions included in the balance sheet are derived from the movement between the reported amount of the opening balance and the reported amount of the closing balance.
- The remaining components of the income statement are stated in nominal historical values.
- The comparative figures for 2003 are stated in these interim financial statements as follows:

Income statement line items up to and including the item operating income before taxes in reported amounts, are stated when the discontinuation of the adjustment for the effect of inflation in their respect was made according to the CPI for December 2002.

Erosions and adjustments for the effect of inflation according to the CPI for December 2003, of income and expenses included in operating income before taxes, were reclassified and are stated in a single amount in a separate line item before operating income before taxes.

Income statement items appearing after the line item operating income before taxes, are stated in amounts adjusted for the effect of inflation based on the CPI for December 2003.

(3) Statement of shareholders' equity

The comparative figures for the statement of shareholders' equity data are stated as adjusted for the effect of inflation based on the CPI for December 2003.

C. COMPARATIVE FIGURES

Several items have been reclassified, as stated in the financial statements.

D. PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the financial statements of the Bank and those of its consolidated subsidiaries. Inter-company balances and transactions between the consolidated companies are eliminated in the consolidated financial statements. Financial statements of provident funds managed by the Bank or by a consolidated subsidiary have not been consolidated.

The Bank's financial statements include the financial statements of the property company "Nidbach Real Estate and Investments Ltd." and "Badal Computer and Management Services Ltd.", which are wholly owned by the Bank.

E. INVESTMENTS IN INVESTEE COMPANIES

Investments in the shares of investee companies (in the consolidated statements - investments in shares of affiliated companies) are presented on the equity basis, based on the financial statements of these investees as at the balance sheet date.

The Bank's share in the financial results of such investees is stated net, after amortization of the excess of cost arising on the acquisition of the investment. Excess of cost attributed to assets and liabilities is being amortized over the life of the related asset or the acquired company. Excess of cost not attributed as above (goodwill) is amortized at an annual rate of 10%.

F. FOREIGN CURRENCY AND LINKAGE

(1) Assets (except for investments in investee companies, buildings and equipment) and liabilities are stated in the balance sheet as follows:

- Those in foreign currency or linked thereto, are presented at representative exchange rates published by the Bank of Israel at the balance sheet date, or at a different date, in accordance with the terms of the relevant transactions.
- Those linked to the CPI or to other indices are presented in the balance sheet according to the latest known index on the balance sheet date.
- Those optionally linked, are stated in accordance with their related terms ruling on the balance sheet date.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(2) Revenues and expenses in foreign currency or linked thereto, are presented in the statement of income at representative rates prevailing at the time of the transactions, with the addition of exchange rate differences on assets and liabilities from which these revenues or expenses resulted.

(3) The following are the representative rates of exchange and the CPI and their annual rates of change:

				Annual rate of change		
	2005	2004	2003	2005	2004	2003
	CPI (in points):			%	%	%
Balance sheet month (December index)	110.0	107.4	106.2	2.4	1.2	(1.9)
Known at balance sheet month (November index)	110.2	107.3	106.4	2.7	0.9	(2.0)
Representative exchange rate At the balance sheet date of the:						
U.S. Dollar (in NIS)	4.603	4.308	4.379	6.8	(1.6)	(7.6)
Basket of currencies (in NIS)	5.089	5.006	4.965	1.7	0.8	(1.6)
Euro	5.446	5.877	5.533	7.3	6.2	11.3

G. TRANSLATION OF FINANCIAL STATEMENTS OF EXTENSIONS ABROAD

Up to the year 1994, foreign subsidiaries were considered autonomous units, and the translation differences with respect to the investment therein was included as a separate item in Shareholders' Equity. Following guidelines of the Supervisor of Banks, foreign subsidiaries are considered, as from 1995, "extensions" of the Bank. Concurrently with the publication of Standard 12, the Israeli Accounting Standard Institute issued Standard No.13 dealing with the effect of changes in foreign currency exchange rates ("Standard 13"). The Bank implements that Standart as from January 1, 2004. Standard 13 deals with the translation of transactions in foreign currency and overseas operations into the reporting currency of the company, for the purpose of including the same in its financial statements. According to the Standard, overseas operations include a subsidiary, a company under joint control, an equity based company, a joint venture or a branch of the reporting entity, the operations of which are located or are being conducted in a country other than the country in which the reporting company is located.

In a provisional Directive issued by the Supervisor of Banks on October 16, 2001 it was clarified that overseas banking subsidiaries of local banking institution will continue to be classified as extensions ("long arm"), and that the classification of a new overseas subsidiary as an "autonomous unit" requires the approval of the Supervisor of Banks. In view of the above, the implementation of Standard 13 did not have any material effect on the financial statements of the Bank.

H. SECURITIES

(1) In accordance with directives of the Supervisor of Banks, the securities portfolio is categorized into three groups:

(a) "Held-to-maturity bonds" - bonds which the Bank intends and has the ability to hold until maturity. The bonds are presented at their adjusted cost at the reporting date.

(b) "Trading securities" - Securities which are held, in principle, with the intention of selling them in the short term. The securities are presented at their fair value at the balance sheet date. Gains or losses due to adjustments to fair value are recorded in the statement of income.

(c) "Available-for-sale securities" - securities not classified under the two previous categories Securities available for sale are stated at their fair value on the balance sheet date, except for shares the fair value of which is not readily available, which are stated at cost. Unrealized gains or losses resulting from the adjustment to fair value, net of the related tax effect, are recorded as a separate line item in Shareholders' Equity, and are taken to income upon sale or redemption

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

of the securities. A provision for impairment in value not of a temporary nature is recorded in the statement of income.

(2) Swap transactions, in which the Bank acquired short-term bills issued by the Bank of Israel in exchange for other Government bonds, in a tender from the Bank of Israel, were recorded as two separate transactions as follows:

- The sale of Government bonds - according to prices set in advance by the Bank of Israel.
  Purchase of short-term bills - at prices the Bank obtained in the tender.

(3) The lending of securities by the Bank as cover for the short selling of securities by the borrower, is presented as part of credit to the public as long as these securities are outstanding.

(4) A foreign subsidiary enters into transactions of sale and purchase of securities, which include "buy back" terms. These transactions are classified as secured loans or secured deposits, respectively.

I. PROVISION FOR DOUBTFUL DEBTS

(1) The provision for doubtful debts includes a specific provision, a general provision, a supplemental provision and a special provision. The supplemental provision for doubtful debts of the Bank and the consolidated subsidiaries in Israel was made according to the directives of the Supervisor of Banks. The provisions for doubtful debts in the consolidated banking subsidiaries abroad, are determined according to generally accepted principles in those countries.

(2) The specific provision for doubtful debts has been recorded on the basis of the Bank's estimate of expected losses in credit portfolios, including off-balance sheet debt items, by examining and monitoring the financial condition of the debtors and their business activities, an assessment of collateral held, and an evaluation of the risks related to their financial condition, performed on a quarterly basis.

The specific provisions regarding housing loans granted by banking subsidiaries in Israel, have been calculated according to the directives of the Supervisor of Banks, on an increasing scale in accordance with the extent of the arrears.

(3) The supplemental provision for doubtful debts is calculated based on the quality of the portfolio of debts according to the characteristics of risk as stated in the directives of the Supervisor of Banks. Annual provision rates as well as final targeted provision rates were set in the original directive for each of the risk characteristics.

In February 2002, the said Directive was amended, the annual provision rates were abolished, and it was determined, with immediate effect, that banks have to reach the final target of the supplemental provision with respect to problem debts already in the same quarter in which a debt has been classified as problematic.

The Bank has implemented this amendment with respect to debts classified as problematic in the last quarter of 2001, and thereafter. As to the required final target of the balance of the provision relating to debts so classified until September 30, 2001 - which amounted to NIS 16 million as of December 31, 2004 - the Bank obtained the approval of the Supervisor of Banks to accrue it in the years 2002 to 2005. Mercantile Discount Bank and Discount Mortgage Bank obtained the approval of the Supervisor to record the said provision over five consecutive quarters ended on December 31, 2002.

(4) The ratios of the general provision and the supplemental provision (not including the provision for off-balance sheet items), to credit granted to the public for the Bank and its consolidated subsidiaries in Israel are:

	Consolidated		The Bank	
	December 31		December 31	
	2005	2004	2005	2004
General provision	0.22%	0.25%	0.23%	0.25%
Supplemental provision	0.20%	0.20%	0.17%	0.17%

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The directives of the Supervisor of Banks stipulate that the balance of the general provision for doubtful debts, at adjusted values, accumulated under the previous directives, at a rate of 1% of total indebtedness as at December 31, 1991, should be maintained. The adjustment of the general provision was discontinued on January 1, 2005, according to directives of the Supervisor of Banks.

(5) The supplemental provision, the general provision and the special provision are not deductible for tax purposes, and in accordance with the directives of the Supervisor of Banks, no deferred tax asset has been created in connection therewith.

(6) A foreign subsidiary creates a general provision for doubtful debts based on past experience and management's estimate of business and economic conditions, the concentration of the credit portfolio, quality of the borrowers and trend of arrears in repayments.

(7) Bad debts are written off when the Bank reaches the conclusion that the debt is uncollectible, either after taking legal proceedings, or as a result of agreements and arrangements made, most of which were in cases where legal proceedings were not taken, and the debts are not collectable, or for other reasons rendering them unrecoverable.

J. BUILDINGS AND EQUIPMENT

Buildings and equipment are presented at cost after deducting accumulated depreciation. Adjusted depreciation is calculated by the straight-line method based on the estimated useful life of the assets. The cost of buildings includes interest capitalized during the construction period. Buildings and designated for sale have been presented at their market price in those cases where it is lower than their adjusted cost.

Certain costs relating to in-house development of computer software are capitalized to investment in equipment. These costs are presented in accordance with the accounting treatment prescribed in the US Accounting Publication (Statement of Position 98-1). Software development costs for own use, which were incurred as from the end of the preliminary development stage, were capitalized. Costs of preliminary research and development as well as costs relating to the post application development stage (end of acceptance tests) were recorded in the income statement as incurred. These expenses are amortized as from the date of completion of the development, over the useful economic lives of these assets.

K. AMORTIZATION OF DEFERRED EXPENSES

Bond issue costs are amortized proportionally to the outstanding principal amount of the bonds.

The inventory of credit cards purchased by a consolidated subsidiary, is stated at cost and is being amortized over the expected period of benefit therefrom of six years, having regards to the number of clients.

L. THE BASIS OF RECOGNITION OF INCOME AND EXPENSES

Income and expenses are recognized on an accrual basis, except for interest in arrears on housing loans of a mortgage bank which is recognized when collected, and except for financing income on non-performing loans.

With respect to securities – see (H) above; with respect to the provision for doubtful debts – see (I) above; with respect to financial instruments – see (M) below.

Sale and leaseback transactions are presented in the financial statements in accordance with International Accounting Standard (IAS) 17.

M. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE TRANSACTIONS

The Bank recognizes all derivatives as assets or liabilities on the balance sheet and measures them at fair value.

The fair value of derivatives as abovementioned is stated, net, in the items "Other assets" or "Other liabilities". Up to December 31, 2004, only IRS transactions were presented in gross amounts. IRS transactions were reclassified in the financial statements as of December 31, 2005, and are shown in net amount, as stated.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Changes in the fair value of a derivative instrument shall be reflected in the statement of income, or shall be included in shareholders equity as an "other comprehensive income" component, in accordance with the designation of the derivative instrument.

The change in the fair value of derivatives hedging exposure to the change in the fair value of an asset, a liability or a firm commitment, shall be recognized in the income statement on a current basis, as well as the change in value of the hedged item, which may be related to the hedged risk.

The accounting treatment of changes in the fair value of derivatives that hedge exposure to changes in the cash flow generated by an asset, a liability or an anticipated transaction, depends on the effectiveness of the hedging relationships.

- The effective part of the change in the fair value of a derivative designated to hedge a cash flow risk, is initially reported in shareholders equity (outside the income statement) as a component of "other comprehensive income", following which, when the anticipated transaction affects the income statement, it is reclassified to the income statement.
- The non-effective part of the change in the fair value of a derivative designated as above is recognized immediately in the income statement.

  For further details see Note 20 hereunder.

N. SET-OFF OF FINANCIAL INSTRUMENTS

Assets and liabilities are set-off against one another where an enforceable legal right of set-off and the intention to set-off the transactions at maturity date exist. Accordingly, designated deposits, the repayment of which to the depositor is conditional upon the extent of collection of the loans granted out of such deposits, and where the Bank has no risk of loss from such loans, are stated in the balance sheet net of the loans granted therefrom. The margin earned on this activity is included in the item "Operating commissions".

O. EMPLOYEE BENEFITS

Liabilities in respect of employee rights are covered by appropriate provisions. For further details see note 16 hereunder.

P. TAXES ON INCOME

(1) The Bank and its consolidated subsidiaries use the tax allocation method with respect to timing differences in the recognition for tax purposes of certain income and expenses.

Deferred taxes have been calculated according to the "liability" method, at tax rates expected to apply during the period in which the deferred taxes are realized, based on laws in force at the balance sheet date. The realization of deferred taxes receivable is contingent upon the future existence of taxable income. Management believes that such deferred tax assets will be realizable in the future.

(2) A provision for deferred taxes is included in the financial statements for that part of the adjustment of depreciable non-monetary assets (excluding buildings - see Note 29 G) which will not be deductible for tax purposes.

(3) Retained earnings of certain investee companies may be subject to additional taxes if and when distributed as cash dividends. With respect to consolidated subsidiaries - when a dividend distribution is not expected in the foreseeable future - no provision for taxes has been recorded. With respect to affiliated companies - a provision for taxes on income was recorded if an additional tax liability is likely to arise in respect of the distribution of dividend.

(4) Profits from the future sale of investments in shares of investee companies may attract additional taxes. The provision for deferred taxes does not include taxes relating to the sale of investments in investee companies as long as the supposition of the ongoing holding of the investment exists. (See also Note 29 H).

(5) The provision for taxes on income of the Bank and its consolidated subsidiaries which are financial institutions, for the purposes of Value Added Tax, includes profit tax levied on income as stipulated in the Value Added Tax Law. Value Added

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Tax levied on payroll of financial institutions is included in the statement of income under the item "Salaries and related expenses".

(6) In July 2004, the Israeli Accounting Standards Board issued Standard No. 19 – "Taxes on Income". The Standard determines that deferred tax liabilities are to be recognized in respect of all temporary differences subject to tax, excluding a small number of exceptions. Furthermore, deferred tax assets are to be recognized in respect of all temporary differences that are tax deductible, tax losses and unutilized tax benefits, to the extent that taxable income is expected in the future against which these could be utilized, excluding a small number of exceptions.

On certain matters relating to the accounting treatment of taxes on income, including the terms for recognizing a deferred tax asset in respect of carry forward losses and timing differences, the instructions of the Supervisor of Banks include additional limitations to those included in Standard No.19. The said additional limitations as determined in the instruction of the Supervisor of Banks, apply also to the Bank with regards to the said matters.

The new Standard applies to financial statements for periods beginning January 1, 2005. The Standard determines that it is to be adopted by way of cumulative effect of change in accounting.

Q. CONTINGENT LIABILITIES

The accounting treatment of outstanding legal actions is in accordance with the provisions of the US Accounting Standard FAS-5 "Accounting for Contingencies" and its related guidelines, and in accordance with the guidelines and clarifications of the Supervisor of Banks, including public reporting directives in the matter of the "Accounting for Contingencies" (2004: draft public reporting directive).

In assessing the outstanding legal actions, Managements of the Bank and of its subsidiaries base themselves on opinions of their legal Counsels, which determine the probability of the exposure to the risk involved in these claims materializing.

Claims have been classified according to the probability range for a risk exposure materializing, as follows:

1) Probable – prospects of over 70%.

2) Reasonably possible – prospects of over 20% and up to and including 70%.

3) Remote – prospects of 20% or below.

According to the guidelines, only in rare cases may a banking corporation state in its financial statements that it is not possible to assess the prospects of a risk exposure materializing in respect of an ordinary legal action and an action approved as a class action, this in four financial statements (including one annual financial statements) to be published subsequently to the filing of an action together with a plea to have it approved as a class action suit, such period is not to include a period in which the Court has decided to stay the proceedings. Note 19 states separately the outstanding claims, in respect of which a reasonable assessment of the exposure to risk is not possible.

The Bank has described material legal proceedings being conducted against the Bank and Group companies. In this respect, the Bank has determined that as a general rule, a legal proceeding shall be disclosed where the amount claimed exceeds 0.5% of the equity capital of the Bank and it is not possible to assess the prospects of the risk exposure materializing, exceeds 1% of the equity capital where there are reasonably possible prospects of the risk exposure materializing, and exceeds 2% of the equity capital where the prospects of the risk exposure materializing are remote. It should be noted that as a result of this decision, certain of the claims described in the past are no longer considered material claims.

It should further be noted, that in cases where the Bank is one of the defendants in the action, and the claimants have not allocated the amount claimed to each of the defendants, the amount estimated as relevant to the Bank is computed to the best of ability, considering the fact that taking the full amount into account might be misleading and is not correct in the circumstances, and that the estimate made does not necessarily represent the allocation which at the end of the

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

day would be decided by the Court.

The financial statements include appropriate provisions in accordance with accepted accounting principles and the estimates of the Managements of the Bank and of its subsidiaries, based on opinions of their legal Counsels.

R. STATEMENT OF CASH FLOWS

Cash flows from transactions in assets and liabilities are presented net, apart from cash flows resulting from non-monetary items, from held-to-maturity bonds, and from available-for-sale securities. Cash for this purpose includes balances of cash on-hand and deposits with banks where the initial period of deposit was up to three months.

S. EARNINGS PER SHARE

Presented in accordance with the guidelines of the Institute of Certified Public Accountants in Israel, and calculated on the basis of the annual weighted average of issued and paid-up nominal share capital.

T. USE OF ESTIMATES

The preparation of financial statements in accordance with generally accepted accounting principles requires the Management to make use of estimates and assessments which affect the reported amounts of assets and liabilities, the disclosure relating to assets and contingent liabilities as well as amounts of income and expenses for the reported period. It should be clarified that actual results may differ from such estimates.

U. IMPAIRMENT IN THE VALUE OF ASSETS

The Israeli Accounting Standard Board published in February 2003, Accounting Standard 15, which deals with the impairment in the value of assets. The Standard sets out procedures which a corporation has to adopt in order to secure that assets are not stated in amounts which exceed their recoverable value, being the higher of the net selling price or the present value of the estimated amount of anticipated future cash flows to be generated by the use of the asset and its realization. The Standard applies to all assets included in the consolidated balance sheet, excluding tax assets and monetary assets (except for monetary assets comprising investments in investee companies that are not subsidiaries). The Standard also determines the principles of presentation and disclosure in respect of assets, the value of which has been impaired.

V. DISCLOSURE OF THE EFFECT OF NEW ACCOUNTING STANDARDS ON THE PERIOD PRIOR TO THEIR APPLICATION.

In June 2000, the Israeli Accounting Standard Board issued Accounting Standard No. 6, which requires "disclosure of the effect of new Accounting Standards on the period prior to the application".

Accounting Standard No. 22 – In August 2005, the Israeli Accounting Standard Board published Accounting Standard No. 22 – "Financial instruments: disclosure and presentation". This Standard determines rules for the presentation of financial instruments in financial statements and specifies the disclosure required in respect thereof. Furthermore, the Standard determines the mode by which financial instruments are to be classified as financial liabilities and as equity, the classification of interest, dividends, losses and profits related thereto and the circumstances in which financial assets and financial liabilities may be offset. The Standard will be applied to financial statements for periods beginning on or after January 1, 2006.

The Standard determines that it be applied by the "from this day forward" mode. Comparative data presented in financial statements for periods beginning on the date on which the Standard becomes effective, are not to be restated. There are some directives of the Supervisor of Banks with respect to certain issues to which the above Standard relates. In such cases, the directives of the Supervisor will apply to banking corporations. The effect of implementing the Standard is not expected to be material on the Bank's financial statements.

Accounting Standard No. 24 – The Israeli Accounting Standards Board issued in September 2005 Accounting Standard No.24 – "Equity based compensation". This Standard requires that transactions involving compensation paid by way of

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

shares should be recognized in the financial statements, including transactions with employees or other parties involving payment in capital instruments, cash or other assets. According to the Standard, transactions involving goods or services received in consideration for payment in shares are to be stated at their fair value.

The Standard requires, among other things, that as regards share based payment transactions that are settled by capital instruments, the goods or services received thereby and the parallel increase in the share capital, should be measured according to the fair value of the goods or services that had been received, unless it is not possible to assess the fair value in a reliable manner.

As to transactions with employees, it is required to measure the fair value of the capital instruments granted, as generally, it is not possible to reliably assess the fair value of the services that had been received from the employees. The fair value of the capital instruments granted is to be measured on the grant date.

The payroll expenses in the case of options granted to employees, is to be recorded over the vesting period against a credit to a capital reserve.

Moreover, the Standard states the various disclosure requirements regarding the substance and scope of share-based payment arrangements that existed during the reported period and the manner in which the fair value of these arrangements has been determined.

The Standard applies to financial statements for periods beginning January 1, 2006.

The implications of applying the said Standard by the Bank depend on the future granting of share-based compensation by the Bank. (See Note 13 hereunder).

Accounting standard No. 21 – In February 2006, the Israeli Accounting Standard Board published Accounting Standard No.21 – "Income per share". The Standard determines the principles for computing and presenting the basic and the diluted income per share. This Standard replaces the provisions of Opinion 55 of the Institute of Certified Public Accountants in Israel regarding income per share.

The standard applies to financial statements for periods beginning on January 1, 2006 onwards. The Standard determines that it should be adopted by way of a restatement of the income per share data for prior reporting periods. The effect on the financial statements of the Bank of the implementation of the said Standard is not expected to be material.

Founding resolution regarding the preparation of financial statements in accordance with international accounting principles - In November 2005, the Professional Committee of the Israeli Accounting Standard Board published a resolution according to which, public companies in Israel would be required to prepare their financial statements for periods beginning January 1, 2008, in accordance with international accounting principles.

The resolution determines, among other things, that financial statements of banking corporations would be prepared in accordance with the public reporting directives of the Supervisor of Banks. It is unclear at this stage, whether the Supervisor of Banks will decide to adopt some of the international accounting standards, and if so – which of them. Accordingly, it is not possible at this stage to assess the effect of the said implementation, if at all.

W. CUMULATIVE EFFECT

1) **Cumulative effect of a change in accounting – initial implementation of Accounting Standard No. 19 (2005)**

As from January 1, 2005, the Bank is implementing the provisions of Standard No.19 (see above in Section 6 G 6). The effect of the Standard in the amount of NIS 4 million is stated by way of a cumulative effect of a change in accounting.

2) The cumulative effect of changes in accounting – the implementation of the instructions of the Supervisor of Banks with respect to financial instruments and hedging transactions (2003)

As from January 1, 2003, the bank implements the rules of the Supervisor of Banks concerning derivative instruments and hedging activities. Following the application of these rules, transition adjustments have been recorded, by way of

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

cumulative effect of change in accounting, which have the following effect on the financial position of the Bank at January 1, 2003:

Increase in net earnings of the Bank for 2003:	NIS 27 million
Increase in assets deriving from derivatives:	NIS 12 million
Increase in liabilities deriving from derivatives:	NIS 15 million

The said change increased the per share income for the year ended December 31, 2003, by NIS 0.27. See Note 20 hereunder.

3) The cumulative effect of a change in accounting method in a consolidated subsidiary (2003)

Part of the investments of DCMI in venture capital funds, where such investments do not grant a significant influence in the funds, are stated at cost. Accordingly, DCMI determined the provisions for impairment in value of these investments on the basis of a valuation of the investment in the fund as a whole, and not on the basis of the value of the specific assets of such funds.

Following an audit of DCMI performed by the Supervisor of Banks, the latter directed that the provision for impairment in value of an investment in a venture capital fund stated at cost, should be based on the financial statements of such fund and not on a valuation of the fund as a whole. This means that if the fund itself has included a provision in respect to one of its investments, then DCMI must accordingly record its share in this provision, regardless of whether there was or was not a decline in the valuation of the investment in the fund as a whole.

DCMI believes that the accounting treatment it had applied in the matter is the appropriate treatment in accordance with generally accepted accounting principles. DCMI has related its position to the Supervisor of Banks and has also submitted an opinion rendered by its Independent Auditors supporting its professional position. However, the Supervisor of Banks rejected the position of DCMI and instructed it to change the accounting treatment of this matter, by way of presenting the cumulative effect of this change.

Based on this directive, DCMI, and following it the Bank, applied this change in accounting by way of stating its cumulative effect as of January 1, 2003.

The implementation of the above directive reduced income by NIS 17 million, and the per share income by NIS 0.17.

2. CASH AND DEPOSITS WITH BANKS[(1)]

	Consolidated		The Bank	
	December 31		December 31	
	2005	2004	2005	2004
	in NIS millions			
Cash and deposits with central banks	1,934	3,423	1,099	2,444
Deposits with commercial banks	17,235	12,777	12,777	10,704
Acceptances	1	8	1	8
Deposits with other banks	1,416	1,543	7,851	7,466
Total	20,586	17,751	21,728	20,622
Includes cash, deposits with banks and deposits with central banks for an initial period of up to three months	18,099	*14,993	13,153	*12,631

*Reclassified
Footnote:
(1) See Note 15 for pledges.

3. SECURITIES[1]

A. CONSOLIDATED

	December 31, 2005				
	Book value	Net adjusted cost (for shares - cost)	Non-realized gains from adjustment to fair value	Non-realized losses from adjustment to fair value	Fair value[2]
	In NIS millions				
(1) Held-to-maturity bonds:					
Bonds and bills:					
Government	5,810	5,810	60	109	5,761
Others	23	23	-	-	23
Total held-to-maturity bonds	5,833	5,833	60	109	5,784
(2) Available for sale securities:					
Bonds and bills:					
Government	27,856	27,873	184	201	27,856
Others[7]	4,761	4,784	69	92	4,761
Total	32,617	[3]32,657	253	293	32,617
Shares:					
Others	1,060	994	66	-	1,060
Total available-for-sale securities	33,677	33,651	[4]319	[4]293	[5]33,677
(3) Trading Securities:					
Bonds and bills:					
Government	2,166	2,159	11	4	2,166
Others	509	500	16	7	509
Total	2,675	2,659	27	11	2,675
Shares:					
Others	3	4	-	1	3
Total trading securities	2,678	2,663	[6]27	[6]12	2,678
Total securities	42,188	42,147	406	414	42,139

General footnotes: See Note 23 E for details of results from bond investment activity. For results of investment activity in shares, see Note 25.

Footnotes:

(1) See Note 15 for pledges.
(2) Fair value data are generally based on market quotations, which do not necessarily reflect the price which may be received when securities are sold in large quantities.
(3) Including securities sold under repurchase terms by a foreign consolidated subsidiary amounting to NIS 4,852 million (US$ 1,054 million).
(4) Included in shareholders' equity in the item "Adjustments for presentation of available-for-sale securities at fair value".
(5) Including shares and bonds, the fair value of which is not readily available, stated at cost of NIS 815 millions.
(6) Recorded in the statement of income.
(7) For details as to shares of a subsidiary company acquired with the intention of sale, see Note 6 E.

3. SECURITIES[1] (CONTINUED)

A. CONSOLIDATED (CONTINUED)

	December 31, 2004				
	Book value	Net adjusted cost (for shares - cost)	Non-realized gains from adjustment to fair value	Non-realized losses from adjustment to fair value	Fair value[2]
	In NIS million				
(1) Held-to-maturity bonds:					
Bonds and bills:					
Government	5,531	5,531	20	27	5,524
Others	35	35	-	-	35
Total held-to-maturity bonds	5,566	5,566	20	27	5,559
(2) Available for sale securities:					
Bonds and bills:					
Government	*26,354	*26,155	346	147	*26,354
Others	4,537	4,494	103	60	4,537
Total	30,891	(3)30,649	449	207	30,891
Shares:					
Others	894	883	12	1	894
Total available-for-sale securities	31,785	31,532	(4)461	(4)208	(5)31,785
(3) Trading Securities:					
Bonds and bills:					
Government	*1,934	*1,904	32	2	*1,934
Others	772	773	42	43	772
Total	2,706	2,677	74	45	2,706
Shares:					
Others	11	10	1	-	11
Total trading securities	2,717	2,687	(6)75	(6)45	2,717
Total securities	40,068	39,785	556	280	40,061

* Reclassified

General footnotes: See Note 23 E for details of results from bond investment activity. For results of investment activity in shares, see Note 25.

Footnotes:

(1) See Note 15 for pledges.

(2) Fair value data are generally based on market quotations, which do not necessarily reflect the price which may be received when securities are sold in large quantities.

(3) Including securities sold under repurchase terms by a foreign consolidated subsidiary amounting to NIS 8,787 million (US$ 2,039 million).

(4) Included in shareholders' equity in the item "Adjustments for presentation of available-for-sale securities at fair value".

(5) Including shares and bonds, the fair value of which is not readily available, stated at cost of NIS 604 millions.

(6) Recorded in the statement of income.

3. SECURITIES(1) (CONTINUED)

B. THE BANK

	December 31, 2005				
	Book value	Net adjusted cost (for shares - cost)	Non-realized gains from adjustment to fair value	Non-realized losses from adjustment to fair value	Fair value[(2)]
	In NIS millions				
(1) Available for sale securities:					
Bonds and bills:					
Government	13,163	13,061	124	22	13,163
Others	1,557	1,555	4	2	1,557
Total	14,720	14,616	128	24	14,720
Shares:					
Others[(6)]	532	484	48	-	532
Total available-for-sale securities	15,252	15,100	[(3)]176	[(3)]24	[(4)]15,252
(2) Trading Securities:					
Bonds and bills:					
Government	1,900	1,899	5	4	1,900
Others	80	80	-	-	80
Total	1,980	1,979	5	4	1,980
Shares:					
Others	1	2	-	1	1
Total trading securities	1,981	1,981	[(5)]5	[(5)]5	1,981
Total securities	17,233	17,081	181	29	17,233

General footnote: See note 23E for details of results of bond investment activity. For results of investments in shares, see note 25.

Footnotes::

(1) See Note 15 for pledges.

(2) Fair value data are generally based on market quotations, which do not necessarily reflect the price which may be received when securities are sold in large quantities.

(3) Included in shareholders' equity in the item "Adjustments for presentation of available-for-sale securities at fair value".

(4) Including shares and bonds, the fair value of which is not readily available, stated at cost of NIS 399 million.

(5) Recorded in the statement of income.

(6) For details as to shares of a subsidiary company acquired with the intention of sale, see Note 6 E.

3. SECURITIES[1] (CONTINUED)

B. THE BANK (CONTINUED)

	December 31, 2004				
	Book value	Net adjusted cost (for shares - cost)	Non-realized gains from adjustment to fair value	Non-realized losses from adjustment to fair value	Fair value[2]
	In NIS millions				
(1) Available for sale securities:					
Bonds and bills:					
Government	13,005	12,849	207	51	13,005
Others	1,567	1,583	5	21	1,567
Total	14,572	14,432	212	72	14,572
Shares:					
Others	253	246	7	-	253
Total available-for-sale securities	14,825	14,678	(3)219	(3)72	(4)14,825
(2) Trading Securities:					
Bonds and bills:					
Government	1,602	1,590	14	2	1,602
Others	5	5	-	-	5
Total	1,607	1,595	14	2	1,607
Shares:					
Others	1	2	-	1	1
Total trading securities	1,608	1,597	(5)14	(5)3	1,608
Total securities	16,433	16,275	233	75	16,433

General footnote: See note 23 E for details of results of bond investment activity. For results of investments in shares, see note 25.

Footnotes::

(1) See Note 15 for pledges.

(2) Fair value data are generally based on market quotations, which do not necessarily reflect the price which may be received when securities are sold in large quantities.

(3) Including an amount of NIS 89 million, comprising investment in shares of a subsidiary company.

(4) Including shares and bonds, the fair value of which is not readily available, stated at cost of NIS 78 million.

(5) Recorded in the statement of income.

3. SECURITIES (CONTINUED)

C. The item includes a balance of: consolidated – NIS 379 million; the Bank – NIS 271 million, representing the proportionate share of the Bank and of Mercantile Discount Bank in the collateral received from a certain borrower, as detailed hereunder.

The Bank and Mercantile Discount Bank have granted a loan as part of a Consortium of banks. As the borrower did not abide by the terms of the loan and did not settle the periodic interest payments, the Court, at the request of the Consortium, appointed a Receiver to realize shares of "Bezeq" pledged as collateral for the loan.

On July 15, 2003 the Supervisor of Banks issued a guideline stating that the balance of the said loan as of June 30, 2003, should be treated as an "investment in shares" classified as "available-for-sale securities", based on the market value of the proportionate share of the Bank and Mercantile Discount Bank in the said collateral.

The Bank and Mercantile Bank have made the classification according to the guideline, based on the market value of their share in the collateral as of June 30, 2003, which amounted to NIS 326 million. As from that date, changes in market value are taken to the capital reserve in respect of the presentation of available-for-sale securities at fair value.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS)

A. CREDIT GRANTED TO THE PUBLIC

	Consolidated		The Bank	
	December 31		December 31	
	2005	2004	2005	2004
	in NIS millions			
Credit	84,258	*77,740	47,477	*44,187
Customers' liabilities for acceptances	312	404	193	293
Total credit	84,570	78,144	47,670	44,480
General provision and supplemental provision for doubtful debts	(680)	(626)	(308)	(298)
Total	83,890	77,518	47,362	44,182

*Reclassified

Footnote:

The specific provision for doubtful debts has been deducted from the relevant items (see Note 4 C).

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

B. CREDIT GRANTED TO THE PUBLIC INCLUDES:

1. Credit to problem borrowers excluding the agricultural sector and local authorities:

	Consolidated		The Bank	
	December 31		December 31	
	2005	*2004	2005	2004
	in NIS millions			
a) Non-Income Bearing Loans to Problem Borrowers				
Balance at balance sheet date:				
In Israeli currency, non-linked	1,950	2,259	1,348	1,724
In Israeli currency, linked to CPI	374	223	159	51
In foreign currency (including linked to foreign currency)	396	363	265	260
b) Restructured Credit to Borrowers				
1) Credit restructured during the current year, with waiver of income				
In Israeli currency, non-linked:				
Balance at balance sheet date	3	1	3	-
Average repayment period, in years	1	1	-	-
Effective rate of income:				
Included in the anticipated repayment flow	-	5.6%	-	-
Included in the repayment flow according to original contracts	-	7.9%	-	-
In Israeli currency, linked to CPI:				
Balance at balance sheet date	7	-	-	-
Average repayment period, in years	9	-	-	-
Effective rate of income:				
Included in the anticipated repayment flow	4.4%	-	-	-
Included in the repayment flow according to original contracts	6.5%	-	-	-

* Reclassified.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

B. CREDIT GRANTED TO THE PUBLIC INCLUDES (CONTINUED):

1. Credit to problem borrowers excluding the agricultural sector and local authorities (continued):

	Consolidated		The Bank	
	December 31		December 31	
	2005	*2004	2005	2004
	in NIS millions			
2) Credit restructured in prior years, with waiver of income:				
Balance at balance sheet date:				
In Israeli currency, non-linked	3	5	-	-
In Israeli currency linked to CPI	-	20	-	2
In foreign currency (including linked to foreign currency)	11	33	-	8
3) Credit restructured during the current year -				
without waiver of income:				
Balance at balance sheet date:				
In Israeli currency, non-linked	94	64	39	45
In Israeli currency, linked to CPI	55	95	7	15
In foreign currency (including linked to foreign currency)	277	141	228	115
c) Restructured Credit Not Yet Executed				
Balance at balance sheet date	92	84	33	13
d) Credit in Temporary Arrears				
Balance at balance sheet date	410	470	291	302
Interest in respect of such credit included in the statement of income	25	19	22	17
e) Credit Under Special Supervision				
Balance at balance sheet date	3,768	4,103	2,818	3,342

* Reclassified.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

B. CREDIT GRANTED TO THE PUBLIC INCLUDES (CONTINUED):

2. Credit to the Agricultural Sector:

a) Kibbutz loans – Since 1989, several arrangements have been made as regards the loans of the Kibbutz settlements, their organizations and enterprises. The parties to the arrangements were the Government, banks (among which was the Bank Group), the United Kibbutz Movement and the Kibbutz Artzi – Hashomer Hatzair (hereinafter - "the Kibbutz Arrangements")

The Kibbutz Arrangements determined, among other things, guidelines regarding the type of rearranged loans, the sources for the repayment of loans, the manner of the arrangement and the write-off required in their respect.

Already in 1997, the Bank Group implemented its share in the Kibbutz arrangements and regulated the debts of all the regional and movement corporations as well as the loans of the peripheral Kibbutz settlements (as they are defined in the Kibbutz arrangements).

Due to the fact that the payment of the amount payable to the banks out of the consideration for the land that was returned to the Israel Lands Administration (as part of the Kibbutz arrangements) has been postponed to such time that the land would be sold, uncertainty exists as to the implementation of the above arrangements.

b) Agricultural Moshavim – In 1992, the Arrangement in the Agricultural Household Sector Law (known as the "Gal Law") was published. This Law is intended to arrange the debts of the agricultural Moshavim. Accordingly, it provides, among other things, for the determination by "Rehabilitators" appointed under this Law, of the amounts of the debts, the write-off of a part thereof, setting limitations on the amounts of guarantees, reduction in interest rates and the rescheduling of the debts.

At this stage no Regulations have been published in respect of the manner of distribution of the proceeds between the various creditors (including the banks), accordingly, this issue is still uncertain.

c) Rezoning of agricultural land – The High Court of Justice cancelled in 2002 three decisions of the Israel Lands Administration regarding the rezoning of the State's agricultural land. The Israel Lands Administration determined transitory provisions for those entitled to continue to rely on earlier decisions and for those to whom the new changes would apply.

All the above affects customers of the Bank belonging to the agricultural sector who had received credit and who had provided agricultural land as collateral for their loans.

The financial statements include, on the basis of estimates, all the provisions required in view of the issues discussed in paragraphs a) to c) above.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

B. CREDIT GRANTED TO THE PUBLIC INCLUDES (CONTINUED):

2. Credit to the agricultural sector (continued):

	Consolidated		The Bank	
	December 31		December 31	
	2005	2004	2005	2004
	in NIS millions			
d. Credit granted to the agricultural sector includes:[(1)]				
Kibbutzim (including regional organizations and concerns)	252	249	195	192
Moshavim (including regional organizations and concerns)	5	13	5	13
Total Kibbutzim and Moshavim	257	262	200	205
Production and Marketing Councils	30	31	13	21
Private agriculture	359	339	198	199
Total credit to the agricultural sector	646	632	411	425

Footnote:
(1) Net of specific provision for doubtful debts.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

B. CREDIT GRANTED TO THE PUBLIC INCLUDES (CONTINUED):

2. Credit to the agricultural sector (continued):

	Consolidated		The Bank	
	December 31		December 31	
	2005	2004	2005	2004
	in NIS millions			
e. Credit Granted to the Agricultural Sector includes:				
(1) Non-income bearing loans to problematic borrowers:				
Balance at balance sheet date:				
In Israeli currency, non-linked	18	11	15	8
In Israeli currency linked to the CPI	2	3	2	3
(2) Restructured credit:				
(a) Restructured credit in prior years with waiver of income:				
Balance at balance sheet date:				
In Israeli currency, non-linked	3	-	3	-
In Israeli currency linked to the CPI	1	-	-	-
(b) Restructured credit during the current year without waiver of income:				
Balance at balance sheet date:				
In Israeli currency linked to the CPI	3	1	3	-
(3) Credit in temporary arrears:				
Balance at balance sheet date	2	-	-	-
(4) Credit under special supervision:				
Balance at balance sheet date	37	60	29	59
(5) Credit to the agricultural sector, that is not included in credit granted to problematic borrowers:				
Balance at balance sheet date	580	557	359	355
Interest in respect of such credit included in the statement of income	45	30	27	16

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

B. CREDIT GRANTED TO THE PUBLIC INCLUDES (CONTINUED):

3. Credit to the local authorities sector

a) In September 1989 an arrangement was signed between the five largest banks, including the Bank, on its own behalf and on behalf of Mercantile Discount Bank Ltd., and the Minister of Interior on behalf of the State of Israel, for rescheduling the debts of certain local authorities to the banks.

The arrangements included, among other things, provisions as to the rescheduling of loans and the granting of additional loans for a period of 15 years, and for the assignment in favor of the banks of certain Government grants.

Pursuant to the aforesaid arrangement, separate agreements were signed at various dates between the Bank and every local authority which became a party to the arrangement, regarding its debts to be covered by the arrangement. The balance of credit in the arrangement at risk of the Bank and its consolidated subsidiary as at December 31, 2005 was: on a consolidated basis - NIS 27 million; for the Bank - NIS 25 million. (December 31, 2004: consolidated - NIS 45 million; the Bank – NIS 41 million).

b) In addition, in the ordinary course of business, some of the local authorities in the arrangement received additional credit, from time to time, the balance of which as at December 31, 2004 was: consolidated – NIS 44 million; the Bank - NIS 33 million (December 31, 2004: consolidated – NIS 46 million; the Bank - NIS 24 million).

c) On June 9, 2004, the Knesset passed the Budget Bases Law (Amendment No. 31 and Provisional Instructions) 2004, which determined instructions regarding local authorities and religious councils in financial difficulties. According to the Law, the said authorities and councils, in respect of which a rehabilitation scheme has been approved, would be entitled to open special bank accounts for a period of six months and deposit therein current receipts to be used for specific purposes. Funds deposited in such accounts shall not be used for the repayment of loans taken prior to the opening of such accounts and they would not be available for pledge, forfeiture or assignment. The Law further determines that entities as above, in respect of which a rehabilitation scheme would be approved until July 1, 2007, would be entitled to deposit certain funds, including State grants, in rehabilitation accounts, and such funds would also not be available for pledge, forfeiture or assignment.

Following a plea to the High Court of Justice filed by the Union of Banks, the State has declared that the policy of the Ministry of the Interior is that local authorities would be entitled to enter the framework of the Law only until December 31, 2004, and that it has no intention of extending the effect of the special accounts for a period exceeding six months. Following this, the plea was withdrawn on November 4, 2004.

The said Law impairs the right of the banks to realize existing pledges, impairs their ability to reimburse themselves out of certain funds due to local authorities and religious councils and impairs current repayments of bank loans.

The outstanding balance of the loans to local authorities as of December 31, 2004, to which the Law applies, amounts to NIS 1 million for the Bank, and to NIS 18 million on a consolidated basis.

Managements of the Bank and of its relevant subsidiary believe, following an examination of the economic condition of these local authority, that no credit loss is expected in their case, therefore no provision has been included in respect of this debt.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

B. CREDIT GRANTED TO THE PUBLIC INCLUDES (CONTINUED):

3. Credit to the local autorities sector (continued):

	Consolidated		The Bank	
	December 31		December 31	
	2005	2004	2005	2004
	in NIS millions			
d. Credit to local authorities				
Balance at the balance sheet date	293	308	259	263
e. The credit to local authorities included:				
(1) Credit under special supervision:				
Balance at balance sheet date	27	42	25	41
(2) Credit that is not included in credit granted to problematic borrowers:				
Balance at balance sheet date	266	266	234	222
Interest in respect of such credit included in the statement of income	26	23	22	18

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

C. PROVISION FOR DOUBTFUL DEBTS

	2005			
	Specific provision(1)(4)			
	According to extend of delinquency	Other	Supplemental provision(2)(3)	Total
	In NIS millions			
Consolidated				
Balance of provision at beginning of year	113	4,854	696	5,663
Provision for current year	63	742	72	877
Reduction of provision	(41)	(105)	(23)	(169)
Collection of debts written-off in previous years	-	(17)	-	(17)
Provision charged to statement of Income	22	620	49	691
Write-offs	(2)	(457)	4	(455)
Inflationary erosion and adjustment of balances	-	4	-	4
Balance of provisionat end of year	133	5,021	749	5,903
Includes - Balance of provision that was not deducted from "credit granted to the public"	-	65	69	134
The Bank				
Balance of provision at beginning of year	-	4,093	340	4,433
Provision for current year	-	506	30	536
Reduction of provision	-	(76)	(18)	(94)
written-off in previous years	-	(1)	-	(1)
Provision charged to statement of Income	-	429	12	441
Write-offs	-	(359)	-	(359)
Inflationary erosion and adjustment of balances	-	4	-	4
Balance of provision at end of year	-	4,167	352	4,519
Includes - Balance of provision that was not deducted from "credit granted to the public"	-	63	44	107

* Reclassified

Footnotes:

(1) For loans for which a provision was made according to the extent of the delinquency - does not include a provision for interest on such debt in arrears. For other loans - does not include provision for interest on doubtful debts after such debts were deemed doubtful.

(2) Includes balance of a general provision for doubtful debts: Consolidated: - NIS 509 million; 2004 - NIS 478 million; 2003 - NIS 460 million. The Bank: - NIS 197 million ; 2004 - NIS 197 million; 2003 - NIS 203 million (see Note 1I).

(3) Including a special provision for doubtful debts of NIS 5 million.

(4) See Note 3C. as regards the classification as from June 30, 2003, of a debt of a certain customer as "Investment in securities" under the item "Available-for-sale securities", as instructed by the Supervisor of Banks.

(5) The amount taken to the income statement: consolidated 2003 – NIS 845 million; the Bank 2003 – NIS 656 million.

In August 2003, the Supervisor of Banks instructed that the full credit risk with respect to the debt of a certain borrower is to be provided for, on the basis of a valuation made by the Supervisor. The Supervisor consented to the said provision being recorded in equal parts over a period of up to three quarters terminating at the end of 2003. In the third quarter of 2004, the Supervisor instructed the Bank to complete the provision according to computations and valuations made by him. The Bank had provided an amount of NIS 97 million according to the instruction of the Supervisor and completed the provision in the fourth quarter of 2004 by providing an additional amount of NIS 14 million. The provision recorded in respect of this borrower in 2005, due to the updating of the amount based on the criteria determined by the Supervisor, amounted to NIS 25 million.

	2004				2003			
	Specific provision [1]				Specific provision [1]			
	According to extend of delinquency	Other	Supplemental provision [2][3]	Total	According to extend of delinquency	Other	Supplemental provision [2][3]	Total
	In NIS millions				In NIS millions			
	95	4,421	661	5,177	74	3,805	657	4,536
	62	993	59	1,114	63	953	46	1,062
	(41)	(160)	(24)	(225)	(38)	(131)	(42)	(211)
	-	(9)	-	(9)	-	(3)	-	(3)
	21	824	35	880	25	819	4	848
	(3)	(396)	-	(399)	(5)	(283)	-	(288)
	-	5	-	5	1	80	-	81
	113	4,854	696	5,663	95	4,421	661	5,177
	-	53	70	123	-	59	78	137
	-	3,794	344	4,138	-	3,266	307	3,573
	-	711	20	731	-	727	39	766
		(124)	(24)	(148)	-	(109)	(2)	(111)
		(1)	-	(1)	-	(1)	-	(1)
	-	586	(4)	582	-	617	37	[5]654
	-	(290)	-	(290)	-	(158)	-	(158)
	-	3	-	3	-	69	-	69
	-	4,093	340	4,433	-	3,794	344	4,138
	-	51	42	93	-	55	51	106

4. CREDIT GRANTED TO THE PUBLIC (CONTINUED):

D. HOUSING LOANS AND THE PROVISION FOR DOUTFUL DEBTS IN RESPECT THEREOF BASED ON THE DURATION OF DELINQUENCY

Consolidated

	December 31, 2005					December 31, 2004				
	Duration of arrears									
	Over 3 and up to 6 months	Over 6 and up to 15 months	Over 15 and up to 33 months	Over 33 months	Total	Over 3 and up to 6 months	Over 6 and up to 15 months	Over 15 and up to 33 months	Over 33 months	Total
	In NIS millions									
Amount in arrears	6	14	18	44	82	6	14	16	34	70
Of which: Interest on the amount in arrears	-	-	1	10	11	-	-	1	8	9
Balance of provision for doubtful debts based on delinquincy period[1]	-	22	41	70	133	-	23	39	51	113
Balance of loans net of provision for doubtful debts	143	137	47	18	345	145	140	45	13	343

Footnote:
(1) Not including a provision for interest in respect of the amount in arrears

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

E. COMPOSITION OF CREDIT TO THE PUBLIC[1] AND OFF-BALANCE-SHEET CREDIT RISK[2], BY SIZE OF CREDIT TO INDIVIDUAL BORROWERS

Consolidated

			December 31					
			2005			2004		
			Number of borrowers[2]	Credit	Credit risk[3]	Number of borrowers[2]	Credit	Credit risk[3]
			in NIS millions					
Credit limit (in NIS thousand):								
	Up to	10	374,949	1,249	1,686	*384,526	1,464	1,206
Over	10 Up to	20	88,553	747	740	*84,848	667	862
Over	20 Up to	40	112,066	1,345	2,351	*105,057	1,256	1,988
Over	40 Up to	80	110,487	2,019	4,438	*107,296	1,825	4,522
Over	80 Up to	150	51,336	2,625	2,503	*49,176	2,546	2,367
Over	150 Up to	300	29,049	4,444	1,306	*28,435	4,395	1,221
Over	300 Up to	600	17,750	5,807	1,136	*16,382	5,313	973
Over	600 Up to	1,200	7,808	4,356	1,532	*6,960	3,818	1,137
Over	1,200 Up to	2,000	2,654	2,729	1,073	2,439	2,567	738
Over	2,000 Up to	4,000	2,170	4,090	1,580	1,928	3,611	*1,087
Over	4,000 Up to	8,000	1,347	5,062	2,035	1,236	4,217	*1,654
Over	8,000 Up to	20,000[4]	1,030	7,627	4,621	957	7,226	*3,351
Over	20,000 Up to	40,000[4]	481	7,689	4,546	421	6,369	*3,472
Over	40,000 Up to	200,000[4]	564	24,711	17,090	524	*24,181	*12,898
Over	200,000 Up to	400,000[4]	35	5,005	4,498	21	4,165	1,790
Over	400,000 Up to	800,000[4]	14	5,835	2,008	12	3,435	2,968
Over	800,000 Up to	1,200,000[4][5]	1	-	914	3	1,461	1,028
Total			800,294	85,340	54,057	790,221	78,516	43,262

* Reclassified

Footnotes:

(1) Including assets related to derivative financial instruments created with the public, net of a specific provision for doubtful debts.

(2) Number of borrowers based on total credit and credit risk.

(3) Credit risk of off-balance sheet financial instruments, as computed for the purpose of limitations on a borrower.

(4) Consolidated - by combining specific balances.

(5) Consolidated: highest credit ceiling 2004: NIS 880 million.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

E. COMPOSITION OF CREDIT TO THE PUBLIC(1) AND OFF-BALANCE-SHEET CREDIT RISK(2), BY SIZE OF CREDIT TO INDIVIDUAL BORROWERS

The Bank

			December 31					
			2005			2004		
			Number of borrowers(2)	Credit	Credit risk(3)	Number of borrowers(2)	Credit	Credit risk(3)
			in NIS millions					
Credit limit (in NIS thousand):								
	Up to	10	209,975	174	1,623	232,043	229	1,142
Over	10 Up to	20	56,011	350	693	55,934	303	805
Over	20 Up to	40	84,688	686	2,260	79,804	612	1,926
Over	40 Up to	80	91,594	1,063	4,383	88,876	874	4,467
Over	80 Up to	150	38,182	1,286	2,444	35,079	1,111	2,291
Over	150 Up to	300	13,467	1,269	1,200	12,693	1,138	1,154
Over	300 Up to	600	5,808	1,169	905	5,455	1,058	867
Over	600 Up to	1,200	3,722	1,468	1,033	3,576	1,328	1,027
Over	1,200 Up to	2,000	1,503	1,290	664	1,425	1,215	630
Over	2,000 Up to	4,000	1,272	2,047	982	1,216	1,968	*913
Over	4,000 Up to	8,000	921	2,976	1,436	814	2,460	*1,376
Over	8,000 Up to	20,000	579	3,451	2,626	539	3,772	*2,327
Over	20,000 Up to	40,000	277	3,610	2,723	233	3,199	*2,399
Over	40,000 Up to	200,000	342	17,303	9,507	301	*16,708	*7,877
Over	200,000 Up to	400,000	34	4,677	4,781	21	4,493	1,605
Over	400,000 Up to	800,000	13	5,187	1,857	12	3,453	2,829
Over	800,000 Up to	1,200,000	1	-	914	2	785	903
Over	1,200,000 Up to	1,600,000	1	44	1,213	1	143	1,088
Total			508,390	48,050	41,244	518,024	44,849	35,626

* Reclassified

Footnotes:

(1) Net of specific provision for doubtful debts.

(2) Number of borrowers based on total credit and credit risk.

(3) Credit risk of off-balance sheet financial instruments, as computed for the purpose of limitations on a borrower.

4. CREDIT GRANTED TO THE PUBLIC (NET OF PROVISION FOR DOUBTFUL DEBTS) (CONTINUED)

F. DETAILS AS TO THE MANNER OF COMPUTING THE SPECIFIC PROVISION FOR HOUSING LOANS – (CONSOLIDATED)

	December 31, 2005				
			Specific provision		
	Balance of debt	Balance in arrears	According to extent of delinquency	Other	Total
	in NIS millions				
Housing loans[1]	328	79	127	-	127
"Large loans"[2]	104	32	6	26	32
Other loans	90	25	17	17	34
Total	522	136	150	43	193
	December 31, 2004*				
	in NIS millions				
Housing loans[1]	320	64	104	-	104
"Large loans"[2]	100	22	9	19	28
Other loans	122	20	22	12	34
Total	542	106	135	31	166

* Reclassified

Footnotes:

(1) Loans, which according to the Directive of The Bank of Israel, the provision in respect thereof is to be computed based on the period in arrears.

(2) Housing loans, the outstanding balance of each exceeds NIS 785 thousand (2004: NIS 767 thousand).

5. CREDIT GRANTED TO GOVERNMENTS

	Consolidated		The Bank	
	December 31		December 31	
	2005	2004	2005	2004
	in NIS millions			
Credit from proceeds of debenture issues	-	5	-	1
Credit for supplementing the interest for qualified housing loans	50	53	-	-
Less - advance interest supplement from the Government	(50)	(53)	-	-
Other credit(1)	92	266	89	267
Total credit granted to Governments	92	271	89	268

Footnote:
(1) Including credit to foreign governments: Consolidated - NIS 26 million (2004: NIS 51 million), the Bank - NIS 23 million (2004: NIS 48 million).

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES

A. CONSOLIDATED

	December 31, 2005			December 31, 2004		
	Affiliated companies	Consolidated subsidiaries	Total	Affiliated companies	Consolidated subsidiaries	Total
	In NIS millions					
Investments						
Shares stated on equity basis[1]	1,471	49	1,520	1,257	62	1,319
Other investments:						
Capital notes	2	-	2	-	-	-
Shareholders' loans	5	-	5	1	-	1
Total other investments	7	-	7	1	-	1
Total investments	1,478	49	1,527	1,258	62	1,320
Includes:						
Earnings accumulated since January 1, 1992	538	(36)	502	359	(23)	336
Items accumulated in shareholders' equity since January 1, 1992:						
Adjustments in respect of presentation of securities available for sale at fair value, net	15	-	15	11	-	11
Adjustment for translation of foreign currency financial statements	(1)	-	(1)	(2)	-	(2)
Details Regarding Goodwill:						
Period of amortization		10 years			10 years	
Original amount	6	82	88	2	85	87
Unamortized balance	5	49	54	1	62	63
Details Regarding the Allocated Excess of Cost:						
Period of amortization		20 years			20 years	
Original amount	114	-	114	114	-	114
Unamortized balance	91	-	91	97	-	97
Book and Market Values of Marketable Investments:						
Book value	1,360	-	1,360	1,179	-	1,179
Market value	1,928	-	1,928	1,398	-	1,398

Footnote:
(1) Includes earnings and translation adjustments in autonomous units accumulated from the acquisition date up to December 31, 1991.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

B. THE BANK

	December 31, 2005			December 31, 2004		
	Affiliated companies	Consolidated subsidiaries	Total	Affiliated companies	Consolidated subsidiaries	Total
	In NIS millions					
Investments:						
Shares stated on equity basis[(1)]	1,434	4,779	6,213	1,232	4,424	5,656
Other investments:						
Subordinated debt notes and Capital notes	2	146	148	-	140	140
Shareholders' loans	-	72	72	1	74	75
Total other investments	2	218	220	1	214	215
Total investments	1,436	4,997	6,433	1,233	4,638	5,871
Includes:						
Retained earnings since January 1, 1992	554	2,328	2,882	376	1,826	2,202
Items accumulated in shareholders' equity since January 1, 1992:						
Adjustments in respect of presentation of securities available for sale at fair value, net	15	(133)	(118)	11	17	28
Adjustment for translation of foreign currency financial statements	(1)	37	36	(2)	35	33
Details Regarding Goodwill::						
Period of amortization		10 years			10 years	
Original amount	4	80	84	-	80	80
Unamortized balance	4	49	53	-	61	61
Details Regarding the Allocated Excess of Cost:						
Period of amortization		20 years			20 years	
Original amount	114	-	114	114	-	114
Unamortized balance	91	-	91	97	-	97
Book and Market Values of Marketable Investments:						
Book value	1,360	527	1,887	1,179	510	1,689
Market value	1,928	488	2,416	1,398	369	1,767

Footnote:
(1) Includes earnings and translation adjustments in autonomous units accumulated from the acquisition date up to December 31, 1991.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

B1. THE BANK'S SHARE OF INCOME OR LOSS OF INVESTEE COMPANIES

	Consolidated			The Bank		
	2005	2004	2003	2005	2004	2003
	Reported amounts(1)	Reported amounts(1)	Adjusted amounts(1)	Reported amounts(1)	Reported amounts(1)	Adjusted amounts(1)
	In NIS millions					
The Bank's share of operating income of investee companies (consolidated - affiliated companies)	196	135	117	770	475	275
Provision for taxes:						
Current taxes	-	-	-	58	44	81
Deferred taxes	22	-	-	26	2	2
Total provision for taxes	22	-	-	84	46	83
The Bank's share of operating income of investee companies (consolidated - affiliated companies), after tax	174	135	117	686	429	192

Footnote:
(1) See Note 1 B.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

C. INFORMATION ON PRINCIPAL INVESTEE COMPANIES

Name of company	Details of company	Share in capital conferring rights to profits		Share in voting rights		Value of investment in shares on equity: Equity basis		Market value	
		2005	2004	2005	2004	2005	2004	2005	2004
		As a percentage				In NIS millions			
1. Consolidated Subsidiaries:									
Discount Bancorp, Inc.[(1)]	Holding company, U.S.A.	100.00	100.00	100.00	100.00	29	27	-	-
Israel Discount Bank of New York[(2)]	Commercial bank, U.S.A	100.00	100.00	100.00	100.00	2,512	2,287	-	-
Mercantile Discount Bank Ltd.	Commercial bank	100.00	100.00	100.00	100.00	1,055	951	-	-
Discount Mortgage Bank Ltd.	Mortgage bank	65.07	65.07	65.07	65.07	527	510	488	369
Israel Credit Cards Ltd.	Credit card service	51.00	51.00	63.00	63.00	200	179	-	-
Discount Leasing Ltd.	Equipment leasing	100.00	100.00	100.00	100.00	96	92	-	-
Discount Israel Capital Markets and Investments Ltd.	Underwriting and investments	100.00	100.00	100.00	100.00	123	123	-	-
Manpikim - Discount Bank Issues Corporation Ltd.	Securities issue	100.00	100.00	100.00	100.00	54	53	-	-
Ilanot-Discount Ltd.[(3)]	Mutual fund management	55.00	55.00	55.00	55.00	37	65	-	-
Israel Discount Bank (Switzerland) SA	Commercial bank, Switzerland	100.00	100.00	100.00	100.00	69	76	-	-
Companies held by Israel Discount Bank of New York:									
(Latin America)[(4)]	Commercial bank, Uruguay	100.00	100.00	100.00	100.00	124	109	-	-
IDBNY Realty (Delaware), Inc.[(4)]	Holding company, USA	100.00	100.00	100.00	100.00	1,678	1,266	-	-
IDBNY Realty Inc.[(5)]	REIT, USA	100.00	100.00	100.00	100.00	7,158	6,756	-	-
2.Affiliated Companies:									
First International Bank of Israel Ltd.[(6)]	Commercial bank	26.45	26.45	11.09	11.09	930	804	1,230	796
Harel Insurance Investments Ltd[(7)]	Holding company	15.89	15.89	15.89	15.89	430	375	698	602

Footnotes:
(1) A holding company, wholly-owned by the Bank, which as of February 9, 2000 fully owns and controls Israel Discount Bank of New York.
(2) The company is owned by Discount Bancorp, Inc.
(3) For details regarding the acquisition of a controlling interest in Ilanot Discount, see section E hereunder. For details as to an agreement in principle for the sale of all the holdings in Ilanot Discount, see section F hereunder.
(4) Included in the financial statements of Israel Discount Bank of New York.
(5) Included in the financial statements of IDBNY Realty (Delaware), Inc.
(6) For further details regarding that investment see g hereunder.
(7) For details as to the requirement that the Bank reduces its holdings in Harel, see Note 33.
(8) Including adjustments for the translation of financial statements of autonomous foreign units and adjustments for the presentation of certain types of securities of investee companies at their fair value.
(9) Goodwill.
(10) Allocated excess of cost.

	of which excess of cost balance		Other investment		Contribution to net operating income		Dividend		Other items recorded In shareholders' equity(9)		Guarantees issued for consolidated subsidiaries in favor of entities outside the Group	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
	In NIS millions											
	-	-	-	-	3	(2)	-	-	2	2	-	-
	-	-	-		308	140	-	153	(377)	(236)	-	
	-	-	69	65	114	104	-	50	11	19	-	-
	-	-	-	-	17	(23)	-	-	-	-	7	7
	(9)36	(9)45	47	46	42	32	26	23	-	-	-	-
	-	-	-	-	3	2	-	-	-	-	4	4
	-	-	96	98	(1)	19	-	-	-	(1)	-	-
	-	-	-	-	1	-	-	-	-	-	-	-
	(9)12	(9)16	-	-	11	6	39	5	-	-	-	-
	-	-	-	-	(7)	1	-	-	-	-	-	-
											Discount Bank	
	-	-	-	-	18	(1)	-	-	(3)	-	-	-
	-	-	-	-	87	4	-	-	-	9	-	-
	-	-	-	-	507	102	296	250	(42)	(2)	-	-
	-	-	-	-	122	65	-	-	15	11	-	-
	(10)91	(10)97	-	-	50	63	16	13	-	-	-	-

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

D. AN INVESTIGATION REGARDING MATTERS RELATING TO THE PROHIBITION OF MONEY LAUNDERING LAWS

The New York County District Attorney's Office conducted an investigation with respect to several banks and financial institutions, including IDB New York, regarding matters pertaining to the transfer of funds from a third country and to the conduct of the bank in matters relating to duties imposed by anti money laundering laws and regulations.

Concurrently, the Banking Department of the State of New York conducted an examination with respect to those and other matters.

An examination performed by the Superindendent of Banks of the State of New York discovered many deficiencies in the efficiency of the systems of the control and reporting relating to matters regarding the prohibition of money laundering and the prevention of financing of terror at IDB New York. Following these findings, the Superindendent of Banks of the State of New York and the FDIC issued Letters of Directives in which IDB New York was instructed, among other things, to refrain from operating according to the existing procedures, due to them being deficient, to correct deficiencies, to reinforce control and supervision processes, to establish an enforcement plan and to correct the procedures related to these matters, all in the manner and dates determined by the said Authorities.

On December 15, 2005, IDB New York confirmed that it would act in accordance with the requirement of the Letters of Directives. The Letters of Directives determined, among other things, that the board of directors of IDB New York would appoint an independent entity that would examine the actions adopted by the senior management for the correction of the deficiencies found by prior inspections; that an overall plan is to be formed, adopted and implemented to assure compliance with the provisions law and the principles governing matters of prohibition of money laundering and the financing of terror, which would relate, inter-alia, to control systems, training programs, audit program and the appointment of an executive in charge of compliance with the said laws and principles; that a compliance committee be appointed of members of the Board of IDB New York, which would monitor the implementation of the requirements stated in the Letters of Directives. In addition, IDB New York is to be charged with the payment of an amount not exceeding US$16.5 million, which is to be paid to the Superindendent of Banks of the State of New York, to the FDIC and to the FINCEN. The final amount to be paid by IDB New York has not yet been determined.

Discount Bank, as the parent company of IDB New York, has declared that it is aware of the said arrangements and that it has taken upon itself to act to the best of its ability to assure the fulfillment of the above commitments.

Concurrently and in addition, IDB New York reached an arrangement on December 15, 2005, with the District Attorney of the County of New York for the termination of the inquiry by way of a civil arrangement. In the agreement IDB New York has undertaken to cooperate with the District Attorney of the County of New York. Furthermore, IDB New York has recognized the facts relating to certain accounts, and to the fact that the internal controls and the procedures of the bank as well as its treatment of the matters relating to the prohibition of money laundering contributed to the findings of the District Attorney of the County of New York and the Civil Authorities. According to the terms of the agreement, IDB New York has undertaken to pay an amount of US$8.5 million, as well as to report to the District Attorney of the County of New York within one year, as to all the actions taken to improve the procedures of the bank and to correct the deficiencies found both by the District Attorney of the County of New York and by the Civil Authorities, as detailed in the abovementioned Letters of Directives. The District Attorney of the County of New York has agreed not to sue IDB New York and its related companies with respect to the investigation.

The Management of IDB New York has begun implementing the requirements included in the Letters of Directives and in the Cooperation Agreement with the District Attorney of the County of New York, and these are being implemented in accordance with the schedule, as required. For this purpose IDB New York engaged the services of KPMG for the preparation of a comprehensive enforcement plan and for performing examinations in accordance with the letters of Directives. In addition, the services of PROMONTORY were also engaged in order to examine the activities of senior

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

D. AN INVESTIGATION REGARDING MATTERS RELATING TO THE PROHIBITION OF MONEY LAUNDERING LAWS (CONTINUED)

management with regard to the implementation of prior inspection findings.

IDB New York estimates that the remediation costs in 2006 might be material for it.

In December 2005, within the framework of the abovementioned declaration, Discount Bank decided to appoint Mr. Reuven Spigel, a Senior Vice President of the Bank, and Mr. Gad Arbel, a director of the Bank, as directors of IDB New York. Mr. Arbel was appointed member of the Audit Committee of the Board and as member of the compliance committee, which has to monitor the implementation of the requirements of the Letters of Directives.

In accordance with a resolution of the Board of Directors of IDB New York of January 2006, adopted after consultation with IDB New York's external legal counsels, the President and CEO Mr. Arie Sheer, was asked to take a paid leave of absence until a different decision is taken. During this period, Mr. Chaim Bar-Ziv, Vice President of IDB New York assumed the duties of acting President & CEO. As part of the said decision Mr. Sheer was asked to cooperate with IDB New York or whoever acts on its behalf and with the various regulatory authorities. Restrictions were also been set with respect to his entry into the premises of the bank and regarding communication with customers and employees. Mr. Sheer informed that he accepts the above decisions under protest.

On February 6, 2006, The Board of Directors of the Bank decided to recommend to the Board of Directors of IDB New York to appoint Mr. Reuven Spigel as President and CEO of IDB New York in place of Mr. Arie Sheer. On February 23, 2006, the Board of Directors of IDB New York decided to terminate the office of Mr. Arie Sher and to appoint Mr. Reuven Spigel as President and CEO of IDB New York.

The financial statements as of December 31, 2005, include a provision of NIS 120 million in respect of fines and consultation expenses

E. ACQUISITION OF MEANS OF CONTROL IN ILANOT DISCOUNT LTD.

On August 16, 2005, IDB Development Corporation Ltd.(hereinafter: "IDB") and Discount Investment Corporation Ltd. (hereinafter: "DIC") reported an agreement they signed on August 15, 2005, with Solomon Mutual Funds Ltd., for the sale of all their holdings (22.5% each) in Ilanot Discount, in consideration of NIS 228 million. The consideration amount is subject to certain adjustments.

According to a shareholders' agreement in Ilanot Discount the Bank had the right of first refusal for the purchase of the shares, under the terms specified in the Solomon Agreement, or it may join the sellers according to proportional shareholding, all within 30 business days from date of the notice.

On September 8 2005, the Bank informed IDB and DIC that it is exercising its right of first refusal. On September 29, 2005, the Bank acquired 45% of the equity capital of Ilanot-Discount Ltd. held by IDB and DIC. The shares were acquired under the terms of the provisions of the "Solomon Agreement", in consideration of NIS 229.7 million (comprising the amount of the consideration determined in the "Solomon Agreement", together with interest up to the date of payment). The "Solomon Agreement" determined, among other things, price adjustments in certain cases, including the possibility of a sale to a third party at a price exceeding that determined in this agreement, within a period of 18 months.

Following the said acquisition, the Bank holds all of the equity of Ilanot Discount.

The said shares were acquired and held from the start with the intention of selling them. Accordingly, the said shares are presented in the financial statements as available-for-sale securities, and the rights of the outside shareholders have been computed at 45%.

On October 6, 2005, the Supervisor of Banks sent a letter to the Bank, which included the Bank of Israel's legal advisor's opinion, according to which the acquisition of the shares of the minority shareholders in Ilanot Discount by the Bank does not comply with the directives of the law (the transitional instructions of the legislation passed in the wake of the Bachar Committee recommendations), its wording and its intent. This is contrary to the legal opinion obtained and

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

E. ACQUISITION OF MEANS OF CONTROL IN ILANOT DISCOUNT LTD. (CONTINUED)

submitted to the Supervisor of Banks prior to the acquisition, according to which no legal hindrance exists as regards the acquisition of the shares. The Supervisor's letter does not include any operative demand, apart from a request for the Bank to respond to the said legal opinion. The Bank disputes the contents of the said legal opinion of the Bank of Israel and has informed the Supervisor of Banks accordingly.

For details with respect to an Agreement in Principle for the sale of Ilanot Discount, see section F hereunder.

F. AGREEMENT IN PRINCIPLE FOR THE SALE OF SHARES OF ILANOT DISCOUNT LTD. AND THE OPERATIONS OF THE PROVIDENT FUND

On November 9, 2005, an agreement in principle was signed between the Bank and Clal Insurance Enterprises Holdings Ltd., whether itself or by way of a company under its control (hereinafter – "the Purchaser") for the sale of all shares of Ilanot Discount Ltd. and for the sale of the operations of Discount Management of Provident Fund Ltd. (hereinafter – "the Provident Funds"), as one package, in consideration for NIS 1,310 million, subject to adjustments.

The consideration for the sale of the shares of Ilanot Discount Ltd. amounts to NIS 600 million, subject to adjustments, and the consideration for the sale of the operations of the Provident Funds amounts to NIS 710 million, subject to adjustments.

The Agreement in Principle determined, among other things, that following the consummation of the transaction, the Bank shall provide Ilanot Discount and the Provident Funds with distribution services in consideration for a distribution fee equal to the rate of fees stated in the draft regulations regarding distribution commissions payable by mutual funds and provident funds, respectively, as well as operating services and additional services. It was also determined that the closing of the transaction is subject to the publication, by June 30, 2006, of regulations regarding the collection of distribution commissions and their rate, as regards mutual funds and provident funds.

The said Agreement in Principle is subject to the signing of detailed agreements between the Bank, the Purchaser as well as Ilanot Discount and the Provident Funds, as the case may be, the approval of their pertinent institutions as well as subject to the required approvals under any law.

The Purchaser and the Bank are negotiating the terms of the detailed agreements and of the related agreements, which are to regularize the various services to be provided to the Purchaser and to Ilanot Discount following the sale. At this stage, the parties have reached an understanding as to the change in the cut-off date for the sale of Ilanot Discount to January 1, 2006 (instead October 1, 2005) so that the results of Ilanot Discount in the last quarter of 2005 would relate in full to the Bank, the reduction in the purchase price of Ilanot Discount to NIS 580 million, and the severing of the connection between the sale of Ilanot Discount and the sale of the provident funds.

The Bank anticipates that the pre-tax profit resulting from this transaction might reach NIS 1 billion subject to adjustments, if and to the extent required. The Bank is studying the tax implications of this transaction. The profit from the transaction will be recognized in the quarter in which the transaction will be concluded, which the Bank estimates to be during 2006.

G. HOLDINGS OF THE BANK IN THE FIRST INTERNATIONAL BANK OF ISRAEL LTD. ("FIBI")

1. **Data regarding the investment in FIBI** (the data in this section is presented in terms of NIS of the reporting month to which it relates, respectively). The net asset value of the Bank's investment in FIBI as of December 31, 2005, is NIS 1,103 million (December 31, 2002 – NIS 866 million; March 31, 2003 – NIS 890 million; December 31, 2003 – NIS 919 million; December 31, 2004: NIS 977 million). The stated value of the investment in FIBI on the books of the Bank (net of the provision required by the Supervisor of Banks, see 2. hereunder) amounted on December 31, 2005 to NIS 930 million (December 31, 2002 – NIS 860 million; March 31, 2003 – NIS 712 million; December 31, 2003 – NIS 746 million; December 31, 2004: NIS 804 million). The market value of the Bank's holdings in FIBI totaled on December 31, 2005 NIS

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

G. HOLDINGS OF THE BANK IN THE FIRST INTERNATIONAL BANK OF ISRAEL LTD. ("FIBI") (CONTINUED)

1,230 (December 31, 2002 – NIS 328 million, March 31, 2003 – NIS 310 million; December 31, 2003 – NIS 694 million; December 31, 2004: NIS 796 million). The market value of this investment at March 21, 2006 was NIS 1,482 million.

2. **Provision for impairment in value.** Towards the publication of the financial statements of the Bank as of March 31, 2003, the Supervisor of Banks instructed the Bank to include a provision for impairment in value of FIBI of 20% of the equity value of the investment as of the above date. Accordingly, the Bank included in the financial statements for March 31, 2003, a provision of NIS 173 million.

3. **An opinion in the matter of the provision for impairment in value.** Prior to the publication of the financial statements of the Bank as of December 31, 2002, the Bank received an opinion rendered by Prof, Yoram Eden, CPA(Isr.), who gave his consent to the inclusion thereof in the financial statements, in which he examined the question whether the Bank should be required, in accordance with accepted accounting principles, to include a provision for the impairment in value of its investment in FIBI (hereinafter – "the original opinion").

A valuation based on public information. FIBI rejected an approach by the Bank and refused to provide to an appraiser appointed by the Bank any assistance or information, except for information which is already published by it. The Supervisor of Banks, who was aware of the said refusal by FIBI, informed the Bank of his standing that Discount Bank has to be in a position to have a valuation, which at least would be based upon information published to the public. In view of this, Prof. Eden has been requested to assess the value of FIBI based on public information.

In his opinion, Prof. Eden noted that financial statements issued to the public as well as the accompanying Directors' reports, include information, which in the main is "backward looking". For the preparation of a professional and reliable assessment, additional information is required that may be obtained only from the entity being assessed and from its management.

The preparation of a valuation based on published information only is therefore problematic and by nature more exposed to error. This is even more so in the case of a valuation of a bank, where it is important to have more detailed information regarding the credit portfolio of the bank and the evaluations by its management as regards future developments, the anticipated margins, business plans, etc.

Method of assessment. The assessment was made by the discounted cash flow method (DCF method) and included the following stages:

- Determination of the basic earnings of FIBI, reflecting the income and expense items, which are of a permanent nature and which are derived from the present volume of activity;
- Preparation of a cash flow forecast for the coming five years beginning in 2003, relying on basic assumptions as to developments in the income and expense items of FIBI;
- Computation of the residual value of FIBI at the end of the forecast period, based on the Gordon Model;
- Discounting the resultant cash flow by the appropriate cost of capital.

The valuation was based on the consolidated financial statements of FIBI as of December 31, 2002. The assessment was made as of March 25, 2003.

Principal assumptions applied in the preparation of the assessment:

- The annual rate of growth of income bearing assets: 0% in 2003, 5% in 2004, 3% in the years 2005 and 2006 and 2% in 2007;
- Financial margins: average margin of 2%;
- The saved return on the active capital: 5.5%;
- Provision for doubtful debts – includes two components:

  (1) A "normative" current provision at the rate of 0.5% of outstanding credit to the public for the full forecast period.

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

G. HOLDINGS OF THE BANK IN THE FIRST INTERNATIONAL BANK OF ISRAEL LTD. ("FIBI") (CONTINUED)

(2) An additional amount was included in respect of problematic debts as of valuation date: 1% for 2003, 0.5% for 2004. Also was included an additional provision of NIS 50 million, in respect of large problematic borrowers. This provision, included on a conservative basis in the valuation, is presented in the resulting assessment as a "surplus liability" deducted from the value of the banking activity.

- The annual rate of growth in operating and other income: 3% in the years 2003 to 2006 and 2% in 2007;
- The annual rate of growth in operating expenses: 0.5% in 2003 and 2004, 1% per year in 2005 and 2006 and 2% in 2007;
- Taxes on income: an effective tax rate of 48.8%;
- A fixed in perpetuity rate of growth of 1%;
- Cost of capital: at a rate of between 10% and 11%.

Summary of the assessment results (in terms of December 2002 millions of NIS):

Discount rate	**10%**	**10.5%**	**11%**
Value of Activity	3,975	3,745	3,539
Minority interest	(173)	(173)	(173)
Excess liability	(50)	(50)	(50)
Value of Shareholders Equity	**3,752**	**3,522**	**3,316**

Accordingly, the value of FIBI is in the range of NIS 3,316 million and NIS 3,752 million. This overall economic value reflects a capital multiplier of 1 to 1.136.

The value of the investment, computed according to the proportionate share of Discount Bank in FIBI, is therefore in the range of NIS 875 million and NIS 991 million.

Prof. Eden noted that the value of the investment is not restricted to the value mentioned above, but has an additional value as a shares parcel of 26.4%. Indeed, this value is not readily realizable, but it should not be disregarded, stated Prof. Eden.

Conclusion. In view of the above, Prof. Eden reached the conclusion that the recoverable value of the investment of Discount Bank in FIBI, does not fall below the stated value of the investment in its books. Therefore, no provision for impairment in value is required in respect of this investment.

The Bank deliberated the original opinion and decided to adopt it.

4. **Updates to the original opinion.** Since the original opinion, the Bank has received from Prof. Eden, at the end of every reporting period, updates to the original opinion, in each of which Prof. Eden has concluded that the recoverable value of the investment of Discount Bank in FIBI has not been less than the value at which the investment in FIBI is stated in its financial statements, and therefore he is of the opinion that in accordance to generally accepted accounting principles, no provision for impairment in value was initially required in respect of this investment, neither is it required in any one of the updates.

   The Bank deliberated the updates to the original opinion and decided to adopt them.

5. **An Additional opinion relating to the provision for impairment in value**. Further to the original opinion and the subsequent updates thereto, the Bank has received from Prof. Eden an additional opinion (hereinafter "the additional opinion"). In light of the period of time that has elapsed since the original opinion was prepared, and, in particular, in light of the fact that almost half of the forecast period referred to in the original opinion has elapsed, Prof. Eden has prepared an opinion based on the data as of December 31, 2004 and for the year ended thereon. In the additional opinion, which Prof. Eden consented to its being mentioned in the financial statements, he examines, amongst other matters, the question as to the proper amount in which Discount Bank is required, according to generally accepted accounting

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

G. HOLDINGS OF THE BANK IN THE FIRST INTERNATIONAL BANK OF ISRAEL LTD. ("FIBI") (CONTINUED)

principles, to present its investment in FIBI in its financial statements as of December 31, 2004; and whether, in accordance with generally accepted accounting principles, there is a need to include an impairment in value with respect to the Discount Bank's investment in FIBI.

In his additional valuation, Prof. Eden noted that he had also referred to the forward-looking information included in the Directors' Report of FIBI. Forward-looking information comprises uncertain information regarding future developments, based on data in the possession of FIBI as of the date of the report and to evaluations and statements of intent of FIBI's management as of that date. Should the outcome of the evaluations be at variance with the expectations of management, the actual results of the forecasts may differ substantially from the estimated results or those implied by this information. Prof. Eden further noted that the assessment of the value of the investment in itself contained forward-looking information, reflecting his evaluation of various parameters and based on information (public information) available to him. Prof. Eden noted that should the outcome of his evaluation be at variance with expectations, the actual results could differ substantially from that of the original appraisal.

A valuation of FIBI – Principal assumptions applied in the appraisal:

- The annual rate of growth of income bearing assets – In light of FIBI's plans for 2005, supported as they are by the relatively high capital adequacy ratio, of expanding the credit portfolio, Prof. Eden assumed that the income bearing assets of FIBI will grow the following way: in 2005, at a rate of 3%; in 2006, at a rate of 5%; in 2007, at a rate of 4%; in 2008, at a rate of 3%; and in 2009, at a rate of 2%.
- Rate of financial margins - Prof. Eden assumed that the financial margin in each of the next five years will be approximately 1.18%.
- Rate of return on active capital - Prof. Eden estimated the anticipated rate of return on investment of the active capital of FIBI at 4.5%, the long-term CPI linked interest rate.
- Provision for doubtful debts - Prof. Eden assumed that the rates of provision for doubtful debts in the coming years will be gradually reduced due to the gradual and continuing improvement in the bank's credit portfolio, as follows: 0.8% in 2005, 0.7% in 2006, 0.65% in 2007, 0.6% in 2008 and 0.5% in 2009 and thereafter.
- Operating and other income - Prof. Eden noted that one should be aware of the fact that the banking industry is on the threshold of significant changes as a result of implementing the recommendations of the Bachar Committee and legislation that will restrict banks' income from commission. These changes may effect the future operating income. Subject to the above, Prof. Eden has set the operating income for 2004 excluding the employees' compensation funds as a basis for projecting future income. Prof. Eden assumed that the operating income of FIBI for 2005 will be 2% less than that for 2004, that the operating income for 2006 will be 1% greater than that for 2005, and that, as from 2007, the operating income of FIBI will increase at an annual rate of 2%.
- Operating expenses - Prof. Eden estimated that the future operating expenses of FIBI will be affected by two factors operating in opposite directions: On the one hand, improvements in the bank's computer system, including, inter alia, outsourcing of the computer infrastructure; the improvement in the decision-making infrastructure; the improvement in reporting procedures involving the credit management unit; and the provision of advanced services to private customers and institutional entities. FIBI's Board of Directors of noted that the said improvements will enable the bank a considerable saving in operating costs. On the other hand, the bank's salary costs continue to rise, both as a result of wage agreements (which are linked to salaries paid to Bank Leumi employees), and as a result of a change in the Value-Added Tax Law which extends the scope of the Salary Tax in relation to moneys payable by the bank to its employees, increasing the payroll cost by an amount estimated by management at approximately NIS 12 million per annum.

  In light of the above, Prof. Eden has treated the operating expenses for 2004 (excluding the non-recurring expenses),

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

G. HOLDINGS OF THE BANK IN THE FIRST INTERNATIONAL BANK OF ISRAEL LTD. ("FIBI") (CONTINUED)

totaling approximately NIS 1,302 million, as a suitable basis for projecting future expenses and considers that these expenses will grow at an annual rate of 1.5%. According to this projection, the expenses cover ratio will reach 61.3% in 2009, a ratio consistent with the bank's performance in the past.

- Taxes on income - On June 29, 2004, the Knesset passed the Income Tax Ordinance Amendment (No. 140 and Temporary Order) Law, 2004. The law provides for a gradual reduction in the rate of tax applicable to companies from a rate of 36% to a rate of 30%. Accordingly, the statutory rate of tax applicable to the bank for 2005 will be 43.59%, for 2006 – 41.88%, and for 2007 and thereafter – 40.17%.

  Prof. Eden assumed that the actual tax rate applicable to FIBI will be 3% higher than the statutory tax rate. This difference reflects a cautious estimate of the bank's disallowable expenses on one hand, as well as the effect of the differing bases of income calculation as between the income for accounting purposes (in reported amounts) and the income for tax purposes (which is still affected by the Income Tax (Inflationary Adjustments) Law, 1985) on the other hand.
- Unlimited fixed growth rate - Prof. Eden assumed that, in view of the increase in the gross national product, the growth rate will be 1%, and emphasized that this is the lowest possible growth rate, insofar as it reflects a negative per capita GNP rate of increase.
- Cost of capital - Prof. Eden assumed that the cost of capital will be in the region of between 9.5% and 10.5%. These costs of capital incorporate weightings in the range of 9.5 – 10.5, which, in the view of Prof. Eden, are the weightings that appear today to be appropriate to FIBI's operations.

  In August 2004, FIBI issued a tender for subordinate capital notes totaling NIS 334 million and bearing interest at an annual rate of approximately 5.25%. Ma'alot Ltd., the Israel Securities Rating Company, has rated FIBI, and its bonds and capital notes, with a rate of AA+. Having reviewed the document published by Ma'alot which sets out the principal considerations underlying the rating, Prof. Eden found that the contents of the document support his conclusions with respect to all of the above parameters, and in particular, with respect to the cost of capital.

A valuation of UBank Ltd. (Formerly Investec (Israel) Bank Ltd.) – Principal assumptions applied in the appraisal.

- General - Although the assets of UBank Ltd. (hereinafter: UBnank) were included in FIBI's consolidated balance sheet as of December 31, 2004, its results of operations had not consolidated in 2004. Therefore, in estimating FIBI's projected cash flows, expected contribution from UBank operations were not included. In order to appraise FIBI's value, it is necessary to incorporate UBank operations within FIBI's projected statement of cash flows.
- Rate of increase of income bearing assets – The Board of Directors of UBnank have noted, as forward-looking information, that the bank intends to intensify and expand its operations in all its commercial divisions in 2005. UBank ratio of capital to risk components was about 21% as of the end of 2004. Accordingly, Prof. Eden has set the average balance of assets for 2004 as the basis for the projections – NIS 6,048 million, and assumed that the assets of the bank will grow at the following rates: 4% in 2005, 5% in 2006, 4% in 2007, 3% in 2008 and 2% in 2009.
- Rate of financial margins – UBank has a foothold in the private banking sector, a relatively stable sector marked by lower financial margins. Accordingly, Prof. Eden assumed that the financial margin will be approximately 1.11% in each of the next five years.
- Provision for doubtful debts – Prof. Eden assumed that the rate of provision in future years will be 0.3% of the total credit granted to the public.
- Operating and other income – In light of UBank plans to continue with the expansion of its operations, Prof. Eden assumed that operating income will keep growing, albeit at more moderate rates that also reflect the rates of increase of UBank income bearing assets specified above. Prof. Eden also assumed that the recommendations of the

6. INVESTMENTS IN INVESTEE COMPANIES AND DETAILS OF THESE COMPANIES (CONTINUED)

G. HOLDINGS OF THE BANK IN THE FIRST INTERNATIONAL BANK OF ISRAEL LTD. ("FIBI") (CONTINUED)

Bachar Committee will have little effect, if any, on the level of the bank's operating income, since the operations with which the recommendations are concerned are not material to UBank operations.

- Operating expenses – In Prof. Eden's view, despite the prevailing trend of recent years towards a decline in operating expenses, the fact that UBank now operates within the framework of FIBI Group will, of itself, create a synergistic effect (which may be apparent, for example, in the cequalization of the terms of wage agreements or in relation to the standardization of the computer infrastructure within UBank), the result of which is that UBank expenditures may now be expected to adopt the same behavioral patterns as those of FIBI Group. Accordingly, and for reasons of prudence, Prof. Eden assumed that these expenses will grow at a rate similar to the expected rate of increase of operating expenses at FIBI – an annual increase rate of 1.5%.
- Taxes on income - Prof. Eden assumed that the actual tax rate applicable to UBank will be 2.5% higher than the anticipated statutory tax rate.
- Unlimited fixed growth rate – In tandem with his opinion in relation to FIBI, Prof. Eden again assumed that, in view of the increase in the gross national product, the rate of UBank growth of operations will be 1%, and emphasized that this is the lowest possible growth rate, insofar as it reflects a negative per capita GNP rate of increase.
- Cost of capital – Prof. Eden assumed a cost of capital similar to that applicable to FIBI (9.5% - 10.5%).

Summary of valuation. The valuation is comprised of the following components: the value of the operations of FIBI, the value of operations of UBank, after deducting the amount of NIS 193 million, this sum representing the minority shareholders of FIBI as of December 31, 2004.

Following is a summary of the results of FIBI (in NIS millions):

Discount rate	**9.5%**	**10.0%**	**10.5%**
Valuation of operations of FIBI	3,841	3,615	3,413
Valuation of operations of UBank	287	270	255
Less: Rights of minority shareholders	(193)	(193)	(193)
Total	**3,935**	**3,692**	**3,475**
Ratio of calculated net worth to shareholders' equity as of December 31, 2004	**105.9%**	**99.4%**	**93.6%**

The above economic value reflects a capital multiplier of 0.936 to 1.059.

Labor relations at FIBI. At the end of October 2004, the managers' committee declared a labor dispute on two pretexts: the bonus in respect of the bank's profits for 2003, and the securing of the rights of managers and their employment security following structural changes in the bank Group (the acquisition of Investec). The labor dispute has not yet been settled. Prof Eden noted that, at this stage, he is unable to predict whether or not settlement of the labor dispute will have a material effect on the future profits of the bank.

Summary. The valuation performed by Prof. Eden indicates that the recoverable value of Discount Bank's investment in FIBI is in the range of 93.6% and 105.9% of Discount Bank's share in the equity of FIBI. Prof. Eden noted that this additional valuation is consistent in its assumptions and results with the original valuation and with the quarterly updates thereof. The reported results of operations of FIBI for 2003 and 2004 were better than those assumed in the original valuation.

In light of the above, Prof. Eden reached the conclusion that the recoverable value of Discount Bank's investment in FIBI is not lower than its share in the equity value of FIBI, and therefore he is of the opinion that according to generally accepted accounting principles, no provision for an impairment in value was initially required in respect of the

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investment, neither is it required at the present time.

The Bank has deliberated Prof. Eden's additional opinion and decided to adopt it.

6. Updates to the Additional Opinion. In the course of 2005 the Bank has received from Prof. Eden updates to the additional opinion, based on March 2005 data, June 2005 data and September 2005 data ("the first update", "the second update" and "the third update", respectively). In each of these three updates Prof. Eden has concluded that the recoverable value of the investment of Discount Bank in FIBI has not been less than the value at which the investment is stated in its financial statements, and therefore he is of the opinion that in accordance to generally accepted accounting principles, no provision for the impairment in value was initially required in respect of this investment, neither is it required in any one of the updates.

The reasonableness test included in the first update estimated the value of FIBI in the range of NIS 3,482 million to NIS 3,932 million (in NIS of March 2005), which reflects a capital multiplier of 0.938 to 1.089. Prof Eden noted in this opinion that the possible consequences of setting the labor dispute at FIBI, on the earnings of FIBI in the future (if there are to be significant), have not been reflected.

The reasonableness test included in the second update estimated the value of FIBI in the range of NIS 3,821 million to NIS 4,310 million (in NIS of June 2005), which reflect a capital multiplier of 1.029 to 1.160. In his opinion Prof. Eden stated that uncertainty exists as to the possible effects of legislation amendments passed in the course of the year, intended to implement the recommendations of the Bachar Committee regarding capital market reform, and of the directives regarding the transfer of customer accounts from bank to bank and commissions. Such changes might have a material effect upon the business results and the value of FIBI, effects that Prof. Eden is unable to assess at this stage.

The reasonableness test included in the third update estimated the value of FIBI in the range of NIS 3,846 million to NIS 4,321 million (in NIS of September 2005), which reflects a capital multiplier of 1.036 to 1.164. In his opinion, Prof. Eden stated that uncertainty exists as to the possible effects of legislation amendments passed in the course of the current year, intended to implement the recommendations of the Bachar Committee regarding capital market reform, and the directives regarding the transfer of customer accounts from bank to bank and commissions. Such charges might have a material effect upon the business results and the value of FIBI, effects that Prof. Eden is unable to assess at this stage. Prof. Eden added that the operations of FIBI are being conducted under two labor disputes that have not as yet been resolved. Prof. Eden anticipates that in the coming years the entire banking industry will be subject to labor unrest, a matter that might also have implications on the system of relations in FIBI. In his evaluation, Prof. Eden did not reflect the possible implications of such labor disputes.

The Bank has deliberated Prof. Eden's updates to the additional opinion and decided to adopt them.

7. Update to the Additional Opinion – December 2005 data. The Bank has received from Prof. Eden an update to the additional opinion (hereinafter: "the fourth update"), which he has agreed may be referred to in the financial statements. As part of the fourth update, Prof. Eden examined the following question: whether in view of the publication of FIBI's financial statements as of December 31, 2005, the assumptions and parameters standing at the base of the opinion, should be altered and/or updated, and to what extent, if at all, such changes affect the amount of the valuation of FIBI, as reflected in the additional opinion.

In the fourth update Prof. Eden noted that he had referred also to the forward looking information appearing in the Directors' Report of FIBI. The forward looking information relates to uncertain forecasts regarding future developments based on data in the possession of FIBI as of the date of the report and to evaluations and statements of intent of that bank's management as of that date. Should the outcome of the evaluations be at variance with management's expectations, the actual results may differ substantially from the original extrapolation. Prof. Eden added that his

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valuation in itself includes forward looking information that reflects his assessment regarding various parameters and based on the information in his possession at the time (public information). Should the outcome of the evaluations be at variance with his expectations, the actual results may differ substantially from those, which he predicted.

Examination of the assumptions serving as a basis for the valuation. Prof. Eden noted that the operating results of FIBI for 2005 also include for the first time, the operating results of UBank Ltd. (hereinafter: "UBank", formerly Investec Israel Bank Ltd.).

Prof. Eden believes that the data of 2005 are in the range of the valuation as included in the additional opinion and support its conclusions. The annualized performance for 2005 in itself, is better than his forecast for 2005.

Prof. Eden examined the validity of all the assumptions serving as a basis for the valuation as included in the additional opinion, and found that as a general rule the assumptions were reasonable.

Prof. Eden noted that great care should be taken in trying to draw conclusions based on the results of operations for 2005 with reference to the whole forecasted period, not to mention the fact, as he has learnt in the past, that fluctuations may take place in the rates of the provision for doubtful debts and in the rates of the financial margin between each of the later quarters. Notwithstanding, Prof. Eden is of the opinion that the data for 2005, are within the range of the additional valuation he had prepared, and support its conclusions. All this, subject to the uncertainty arising as a result of the effect of the laws that have been passed on the financial results of FIBI.

Following the publication of the financial statements of FIBI for 2005, Prof. Eden examined the assumptions serving as a basis for the valuation, as follows:

- Rate of increase in income bearing assets – the year 2005 showed an increase of 7% in the consolidated income of bearing assets of FIBI (monetary assets and derivatives) as compared with the income bearing assets of FIBI and UBank as of the end of 2004. Prof. Eden believes that in view of the continued growth of the economy, a growth may also be expected in the volume of income bearing assets of FIBI, even though at more moderate rates.
- Rate of financial margins – the overall financial margin (relating to monetary assets and derivatives) in 2005 was 1.19% compared with 1.11% in 2004, not including UBank. The Directors Report points out that eliminating certain factors not related to the current financial business operations, the rate of the margin in the first nine months of 2005 would have reached 1.34%, as compared with a rate of 1.26% in 2004.

  Prof. Eden further stated that it should be noted that the margin rates already reflect the effect of non-income bearing problematic debts of FIBI (NIS 1,188 million as of December 31, 2005, compared with NIS 1,454 million at December 31, 2004.

  The Directors Report further indicates that the net income from FIBI's bond portfolio in 2005 amounted to NIS 39 million and they stem mostly from the sale of securities included in the available-for-sale securities portfolio. In the corresponding period last year this portfolio produced an income of NIS 71 million. Significant differences might occur in this component of income also in future periods.
- Credit to the public – the consolidated amount of credit to the public at December 31, 2005, reached NIS 43,307 million, in comparison with NIS 43,247 million at December 31 2004 (not including UBank), an increase of 0.1%.

  The Board of Directors of FIBI notes that the board of directors of FIBI notes that the stability in the credit item reflects the implementation of the risk spreading policy and the improvement in the credit portfolio policy of FIBI and that the growth in the volume of capital raising on the capital market on the backdrop of the surge typifying it on the one hand, and the relatively low interest rates on the other hand, reduced the demand for bank credit.
- Provision for doubtful debts - The rate of provision for doubtful debts in the 2005 was approximately 0.6% of the total credit granted to the public, as compared to 1.0% in 2004. The decrease in the provision for doubtful debts compared

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with the previous year is explained mainly by the decrease in the provision for doubtful debts in respect of the hotel and accommodation services and in the provisions in respect of the communications industry.

- Operating income – the consolidated operating income in the first half of 2005 amounted to NIS 1,018 million as compared with NIS 832 million in the corresponding period last year, not including UBank.

  Management of FIBI estimates that the sale of the operations of the mutual funds of FIBI Holdings Ltd., parent company of FIBI, will not have a significant effect on the income of FIBI. Due to the fact that in consideration for the loss of income on the part of FIBI from operation services granted to Dikla, it would be possible for FIBI to charge distribution commissions in respect of all the mutual funds it distributes, including external funds in respect of which no distribution commission has been charged up till now.

  In April 2005, an Amendment to the Income Tax Regulations (Rules for approval and management of provident funds) was published. Management of FIBI believes that the said amendment might have an effect on the level of deposits with provident funds. As a result, income from provident funds may possibly decline.

  Prof. Eden concluded from Note 17 B to the financial statements of FIBI that legal suits are pending against this bank as well as a plea to the Supreme Court in the matter of the legality of charging management and service fees in respect of life assurance policies relating to borrowers and property insurance policies provided as collateral to the mortgage banks of FIBI Group. The income from such activities that these mortgage banks of FIBI recorded in the first nine months of 2005 amounted to NIS 22 million (similar to 2004). If the Courts rule against the bank in these law suits, this may significantly reduce the income of the mortgage banks of FIBI Group.

  In February 2005 the Supervisor of Banks published a circular in which the principles for the marketing of life assurance policies and property insurance policies as collateral for housing loans granted by banking corporations were outlined.

  The Directors of FIBI noted that within the framework of the preparations for the implementation of the said principles, FIBI established in September 2005, an insurance agency in the form of a wholly owned private subsidiary of the bank. The First International Mortgage Bank estimates that the activity within the framework of the said insurance agency may result in erosion of its income, but since this is a new outline of activity, its volume cannot be evaluated.

- Operating and other expenses - the consolidated operating and other expenses in 2005 amounted to NIS 1,575 million (compared with expenses of NIS 1,362 million in 2004, excluding UBank).

  Payroll expenses amounted in 2005 to NIS 906 million, compared with NIS 820 million in 2004. Payroll expenses also include the cost of the annual award in the amount of NIS 42 million granted to the employees. According to the policy that had been approved, the award should have amounted to NIS 30 million. The Directors of FIBI note that the increase in the award for 2005 is a result of the improvement in business results.

  Operating expenses, excluding payroll, amounted in 2005 to NIS 669 million, compared with NIS 542 million in 2004. Most of the increase in operating expenses stemmed from an increase in computer, communication and legal expenses. It transpires from the directors' report of FIBI, that in October 2005 this bank signed an agreement for the outsourcing of its computer infrastructure activities for a period of eight years.

  FIBI's management believes that the engagement would create an average annual savings in expenses of NIS 26 million, before taxes.

- Taxes on income – The effective tax rate on the total consolidated operating earnings before tax amounted in 2005 to 44.5%, compared with the statutory tax rate of 43.6% applying to FIBI as a financial institution. The Directors Report explains this difference as resulting from two factors having a contrasting effect: one – the book earnings

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before tax are based on reported amounts while the provision for taxes is computed on a real-term basis reflecting the effect of the inflation; and the other – the effective tax rate increased as a result of the decline in value of investments in foreign subsidiary due to the appreciation of the Shekel as against the Pound Sterling and the Swiss Franc.

On July 25, 2005, the Knesset passed, the Income Tax Ordinance Amendment Law, which determines a further reduction in corporate tax, the effect of which will be reflected in the reduced tax rates expected to apply in the coming years. The effect of the change on the balance of the deferred taxes of FIBI as of December 31, 2005, results in an increase of NIS 9 million in tax expenses.

Reasonableness examination. For reasons of caution, Prof. Eden also performed reasonableness examinations of the additional valuation by way of changing certain of the assumption in accordance with the results of the first nine months of 2005 (which, as stated, should be viewed with caution):

- Income bearing assets – Prof. Eden entered into the basis of the forecast for 2005 the average balances of monetary assets and the effect of derivatives, as reflected on a consolidated basis in 2005. Prof. Eden did not find it necessary to alter the assumptions as to the growth in income producing assets in future years.
- Financial margins – In his updated opinion Prof. Eden assumed that the average rate of the financial margin would be 1.18%. In view of the actual consolidated rate of financial margin's and the rate of financial margins after elimination of non-recurring items, as reported in 2005, Prof. Eden did found it proper to change the financial margins to 1.23%.
- Rate of return on the active capital - Prof. Eden did not find it proper to change the rate of return as included in the second update.
- Provision for doubtful debts - Despite the sharp decline in the rate of provision for doubtful debts in 2005, Prof. Eden did not find it proper, for reasons of cautiousness to change the rate of the provision as included in the further opinion.

  Operating and other income - On conservative grounds, Prof. Eden deemed it proper to eliminate from operating income for 2005 the amount earned on the severance pay funding in a sum of NIS 41 million, as well as an additional amount of NIS 12 million in respect of the anticipated reduction in income from management and service fees in respect of insurance sold to mortgage loan borrowers, as described above. The result reflects earnings of NIS 965 million, earnings that are higher than the forecast included in the additional opinion.

  For reasons of cautiousness Prof. Eden assumed that in 2006 there will be no increase in FIBI's operating income. Prof. Eden did not find it proper to change the expected rate of increase in operating and other income for the remainder of the forecasted period (from 2007 and onwards).
- Operating expenses – being analogous with the treatment of operating income, Prof. Eden eliminated from the basis of the forecast the provision in respect of voluntary retirement created in 2005 (in the amount of NIS 21 million). Considering that operating expenses for the second quarter of 2005 were lower than those of the first quarter of the year, and considering FIBI's forecast of as to the expected savings in computer expenses as a result of the outsourcing, Prof. Eden did not find it proper to change the assumptions as to the expected growth rate of operating expenses for the remainder of the forecasted period.
- Taxes on income - the effective tax rate in 2005 reached 44.5%, which was 2.1% lower than the tax rate entered as the basis of the forecast (being 3% higher than the statutory tax rate). Prof. Eden found it proper to update the assumption as to the effective tax rates and to estimate the future anticipated effective tax rates at 2% above the statutory tax rate. Prof. Eden entered into the basis of the reasonableness examination, the reduced tax rates in view of the Income Tax Ordinance Amendment.
- Discount rate - In view of the increase in real-term interest rates in the market in the recent period, Prof. Eden found

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it proper to add 0.25% to the discount rates as included in his additional opinion, in a manner that the discount rates of this reasonableness test would be in the range of between 9.75% and 10.75%).

- Contingent liabilities – The discussion included in Note 17 3 K to the financial statements indicates that the exposure of FIBI and its subsidiaries to contingent claims, the probability of their realization, in whole or in part, is not remote, and in respect thereto no provisions had been included, amounts to NIS 10 million. For reasons of cautiousness Prof. Eden decided to deduct from the net discounted operating value an amount of NIS 20 million in respect of these contingent liabilities.

Conclusion of the reasonableness examination. Hereunder is presented the reasonableness test to the updated valuation, following the changes made to the assumptions as detailed above. Prof. Eden states that as this comprises a reasonableness examination to a valuation made as of December 31, 2004, and is not a new valuation, the results have been discounted as of December 31, 2004, and the capital multiplier has been computed in relation to the equity of the Bank as reflected in its financial statements as of December 31, 2004.

Conclusion of the reasonableness test (in millions of NIS discounted as of December 31, 2004):

Discount rate	**9.75%**	**10.25%**	**10.75%**
Actual earnings in 2005	413	411	409
Forecasted value of operations as from 2006 and onwards	4,464	4,195	4,955
Provision for contingent liabilities	(20)	(20)	(20)
Minority shareholders' rights	(193)	(193)	(193)
Value of shareholders' equity	4,664	4,393	4,150

The above economic value reflects a capital multiplier of between 1.117 and 1.256.

Prof. Eden noted that the results received are better than the results that had been received by the valuation contained in the update (which followed the publication of the audited financial statements of FIBI as of December 31, 2004).

Additional test. Prof. Eden made an additional examination in which he tested the value of the operations of FIBI in proportion to its equity capital at December 31, 2005.

The valuation of the anticipated activity (as of December 31, 2005):

Discount rate	**9.75%**	**10.25%**	**10.25%**
Actual earnings in 2005	413	411	409
Forecasted value of operations as from 2006 and onwards	4,464	4,195	4,955
Provision for contingent liabilities	(20)	(20)	(20)
Minority shareholders' rights	(193)	(193)	(193)
Value of shareholders' equity	4,664	4,393	4,150

Additional sensitivity analysis. Prof. Eden has performed an additional sensitivity analysis, in order to study the sensitivity of the reasonableness test to the assumption regarding the financial margin, Prof. Eden examined the results of the test that would have been received had he changed the assumption regarding the financial margin by 0.05%.

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The ratio of economic value to equity value resulting from the changes in the financial margin and in the rate of discount (as of December 31, 2004):

	Rate of financial margin		
Discount rate	**1.18%**	**1.23%**	**1.28%**
9.75%	115.4%	125.6%	135.8%
10.25%	108.7%	118.3%	127.9%
10.75%	102.7%	111.7%	120.8%

Prof. Eden has performed an additional sensitivity analysis, in order to study the sensitivity of the reasonableness test (as od December 31,2005) had he changed the assumption regarding the financial margin by 0.05%.

The ratio of economic value to equity value resulting from the changes in the financial margin and in the rate of discount (as of December 31, 2005):

	Rate of financial margin		
Discount rate	**1.18%**	**1.23%**	**1.28%**
9.75%	104.5%	114.4%	124.3%
10.25%	98.4%	107.8%	117.2%
10.75%	93.0%	101.9%	110.8%

Capital market reform. On August 10, 2005, three laws were passed intended to implement the recommendations of the Bachar Committee regarding capital market reform. The provisions of these laws amend various laws and determine new legal provisions.

A. The Law for Increase Competition and Reducing of Concentration and Conflict of Interests in the Capital Markets in Israel (Legislation Amendments), 2005. The principal provisions of this Law are:

1) A banking corporation and/or whoever controls a banking corporation is not permitted to hold the means of control in provident fund management companies and in mutual fund management companies. A banking corporation and/or whoever controls a banking corporation is not permitted to hold more than 10% of any type of means of control in a corporation that controls or holds over 25% of any type of means of control in a provident fund management company or in a mutual fund management company. The law provides for the gradual reduction in the said holdings that the Bank will have to carry out in order to reach a market share of 0% in the provident funds and mutual funds under its control, within a period of six and eight years respectively, from date of publication of the law.

2) A banking corporation and whoever controls a banking corporation is not permitted to control (only in respect of the banking corporation) or own over 5% of any type of the means of control in a portfolio manager, who manages investment portfolios that include assets of mutual funds, asset of provident funds or assets of an insurer. Neither are they permitted to own over 20% of a corporation that owns over 25% of any type of means of control in a portfolio manager as stated.

3) As part of the business which banking corporations may engage in, a bank is permitted to engage in:
   - Pension advisory services, subject to the Pension Advisory Law;
   - The marketing of investments in respect of structured products, option or future contracts issued by that banking corporation;
   - Managing the accounting system of provident funds on behalf of the management company.

   Within the framework of this Law, the appropriate sections in the laws listed hereunder, have been amended in a way

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that regulates and determines rules for the implementation of the said law. It has been determined, among other things, that a distributor may collect distribution commissions from mutual fund managers, provided that a uniform rate of commission is to be collected from the various mutual fund managers. The Minister of Finance is empowered to determine conditions under which a mutual fund manager would be entitled to pay a distributor a distribution commission, its maximum rate and the mode of its calculation. The Minister of Finance has not yet issued regulations as regards to the collection of commissions as aforesaid.

Following is the list of laws:

- The Banking Law (Licensing), 1981;
- The Banking Ordinance, 1941;
- The Banking Law (Customer service), 1981;
- Regulating Investment Advisory Business and Investment Portfolio Management Law, 1995;
- The Mutual Investment Trusts Law, 1994;
- The Supervision of Insurance Business law, 1981.

B. The Supervision of Financial Services (Pension Advisory and Pension Marketing Business) Law, 2005, which regulates the engagement in pension advisory services and in the marketing of pensions as two different fields and the license required for such occupations. The law specifies the conditions under which a banking corporation is permitted to engage in pension advisory services.

C. The Supervision of Financial Services (Provident Funds) Law, 2005, which regulates the operations of all types of provident funds in the framework of the principal legislation.

The said laws include additional subjects and provisions above and beyond those included in the recommendations of the Bachar Committee.

In Note 17 O to the financial statements as of December 31, 2005, the management of FIBI noted that it believes that the implementation of these laws will not have a material effect on the equity of FIBI.

In calculating the growth rate of operating income in his previous opinion, Prof. Eden considered the possible effects of the implementation of the Bachar Committee recommendations on the financial results of FIBI.

Transfer between banks and commissions. On December 1, 2005, the proper banking management directive No. 423 in the matter of the transfer of activity and the closing of a customer's account came into effect. This procedure is intended to facilitate and simplify the transfer procedure customers who wish to close their account at a bank or transfer their activity from one bank to another. In the opinion of FIBI's management it is not possible to assess the effect of this new directive on the bank's income from commissions. Management of FIBI anticipates that application of the said Directive would enable the increase of the bank's opportunities to expand its customer base on the one hand, while increasing the cost of maintaining the existing customers on the other.

At the same time the "package deal" in the matter of commissions on private customers' Israeli currency current accounts, the reduction in commissions that interfere with competition and facilitating the transfer of accounts from one bank to another came into effect.

In order to cope with the possible decline in income, FIBI has begun the marketing of account management services in consideration of a fixed monthly commission. The directors of FIBI believe that the adverse effect on income as a result of the implementation of this directive, will be minimal.

The directors of FIBI believe the adverse effect on income, if at all, as a result of the implementation of the provisions of Proper Banking Management Directive No. 325, would be small.

Acquisition of Otsar Ha-Hayal Bank. On January 24, 2006, FIBI signed an agreement with Bank Hapoalim Ltd.

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(hereinafter – "Hapoalim") for the acquisition of all the holdings of Hapoalim – 68% in equity and 66% in voting rights – in Otsar Ha-Hayal Bank Ltd. (hereinsfter – "Otsar Ha-Hayal"), in consideration for NIS 703 million, subject to adjustments in accordance with the equity capital of Otsar Ha-Hayal as of December 31, 2005.

The consideration reflects 185% of the equity capital of Otsar Ha-Hayal as of December 31, 2005, after deduction of a dividend of NIS 80 million, which is to be distributed prior to the closing of the transaction.

The acquisition agreement determined arrangements regarding the continued provision of computer services by Hapoalim to Otsar Ha-Hayal, in accordance with the existing agreement between them since 1997, which will expire at the end of 2011, in order to assure that full banking services would be provided by Otsar Ha-Hayal to its customers, as was hitherto customary. According to these arrangements, Hapoalim will continue to provide Otsar Ha-Hayal with computer services for a period of three years, in return for the consideration that had been agreed between them. At the end of this period, or earlier if the parties are so required by a regulatory authority, Otsar Ha-Hayal is entitled to terminate the engagement with Hapoalim, giving prior notice, and for a payment of NIS 20 million per year in respect of the remaining period of the engagement with Hapoalim. The above undertakings are backed by commitments of FIBI.

Moreover, arrangements have been made for the continued engagement between Otsar Ha-Hayal and the IsraCard Group and for cooperation of FIBI with IsraCard Group.

FIBI is committed to hold the acquired shares for a period of at least five years from date of closing of the transaction.

Prof. Eden stated that FIBI has not yet made public its plans for the integration of the operations of Otsar Ha-Hayal with those of FIBI Group, for retirement of employees and for the implementation of efficiency measures, etc. Accordingly, Prof. Eden does not have sufficient information to enable him to evaluate the synergetic advantages for FIBI deriving from the completion of this transaction.

Prof. Eden also added that he does not have sufficient information for testing the price determined for the transaction. Nevertheless, in view of the fact that this is a transaction between non-related parties and at a price determined within the framework of a pricing process conducted by several parties, it is reasonable to assume that the price is fair and proper, and would not adversely affect the value of FIBI.

Labor relations at FIBI. Two employee representative committees exist at FIBI: The non-managerial employee committee and the authorized signatories committee. The representative committee of the non-managerial employees declared in February 2006 a labor dispute, in which two claims were raised:

A. A demand for signing an agreement securing the rights of, the employees and their compensation with respect to the acquisition of Otsar Ha-Hayal Bank by FIBI.

B. A demand for a collective agreement to secure the rights of the employees in case of a future sale of the control over FIBI and/or a structural change at FIBI and/or organizational changes that might have a substantial effect on the rights of the employees and their working conditions.

The parties reached an agreement on March 1, 2006, which was granted the power of a Labor Court ruling, according to which no compensation would be, paid by FIBI in respect of the actual acquisition of Otsar Ha-Hayal Bank, but negotiations would be held for the resolution of the problems that are expected to arise as a result of the said acquisition, such as: increased workload, etc., in as much as such problems will arise, including the resolution of a compensation payment or any other agreed solution.

In addition, the non-managerial employee committee filed an action with the Labor Court with respect to the recruitment of new employees at a salary higher than that customary for the non-managerial employees at FIBI, and on February 27 2006, within the framework of this action, motioned the Court for the dismissal of 33 employees, which, as alleged by the non-managerial employee committee, were admitted for work at FIBI as from January 2005,

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G. HOLDINGS OF THE BANK IN THE FIRST INTERNATIONAL BANK OF ISRAEL LTD. ("FIBI") (CONTINUED)

while violating the provisions of the agreement of FIBI with the non-managerial employee committee. On October 28, 2004, the authorized signatories committee declared a labor dispute with respect to two causes:

A. An award with respect to FIBI's earnings in 2003;

B. Securing the rights of managers and authorized signatories and their employment assurance following organizational changes at FIBI group (the acquisition of UBank).

On January 19 2006, the dispute was submitted, with the consent of the parties, to arbitration, the parties agreeing that the arbitrator ruling would be binding on both parties, also agreeing that the fact that an arbitrator had been appointed, terminates the above dispute.

In addition, the managers committee informed the management of its intention to demand an award also in respect of the bank's earnings in 2004. The directors' report states that management has no intention of paying an award for 2004, due to the low level of profitability typifying that year.

Prof. Eden noted that he is unable at this stage, to assess whether the settlement of the said labor disputes would have a material effect on the earnings of the bank in the future.

Summary. The reasonableness examination undertaken by Prof. Eden, which examined the validity of the valuation contained in the update as of December 31, 2004, indicates that the recoverable value of Discount Bank's investment in FIBI is not less than the Discount Bank's of the equity value of FIBI. Prof. Eden has therefore held to his original view that, in accordance with generally-accepted accounting principles, there was never any need to make a provision for a impairment in value of the investment, and that, in addition, no such need exists today.

Prof. Eden performed an additional examination in which he tested the recoverable value of the investment of Discount Bank in FIBI as of December 31, 2005. This examination also supports the conclusions he had reached.

Notwithstanding the above, Prof. Eden, in his opinion, stated that uncertainty exists as to the possible effects of legislation amendments passed in the course of the current year, intended to implement the recommendations of the Bachar Committee regarding capital market reform, and of the directives regarding the transfer of customer accounts from bank to bank and commissions. The Management of FIBI notes that in its opinion, the legislation changes passed during the reported year, and which were intended to implement the recommendations of the Bachar Committee regarding the capital market reform, the instructions regarding the commissions and the transfer of customers from one bank to another and the instructions regarding the management of credit facilities in current accounts, are expected to have only a minimal effect, if at all, on the future earnings of FIBI.

Prof. Eden added that the operations of FIBI are being conducted under two labor disputes that have not as yet been resolved. In his valuation, Prof. Eden did not reflect on the possible implications of these labor disputes.

The Bank has deliberated Prof. Eden's fourth update and decided to adopt it.

8. Personal interest. Prof. Eden stated in his opinion that he has no personal interest in the shares of Israel Discount Bank or in the shares of FIBI. He further stated that he serves as Director and member of the Investments Committee of the provident funds managed by FIBI. (As to the letter of indemnity granted by the Bank to Prof. Eden in respect of the original opinion, the additional opinion and the updating opinions, see Note 19 C (12) to the financial statements as of December 31, 2002. A similar letter of indemnity has been granted also in respect of the updated opinion).

7. BUILDINGS AND EQUIPMENT

A. COMPOSITION

	Consolidated			The Bank		
	Buildings and land*	Equipment, furniture and vehicles	Total	Buildings and land*	Equipment, furniture and vehicles	Total
	In NIS millions					
Cost						
Balance at beginning of the year	1,739	2,638	4,377	1,210	1,690	2,900
Additions	200	411	611	184	309	493
Disposals	(46)	(59)	(105)	(39)	(52)	(91)
Balance as at December 31,2005	1,893	2,990	4,883	1,355	1,947	3,302
Depreciation						
Balance at beginning of the year	812	1,587	2,399	572	896	1,468
Depreciation for the year	38	248	286	22	171	193
Accumulated depreciation on disposals	(18)	(52)	(70)	(12)	(46)	(58)
Balance as at December 31, 2005	832	1,783	2,615	582	1,021	1,603
Depreciated balance as at December 31,2005	1,061	1,207	2,268	773	926	1,699
Depreciated balance as at December 31,2004	927	1,051	1,978	638	794	1,432
The average depreciation rate in 2005	3.0%	15.1%	9.9%	2.6%	16.2%	10.2%
The average depreciation rate in 2004	2.9%	15.1%	9.4%	2.7%	16.9%	9.8%

* Includes:
- Installations and leasehold improvements, the depreciated balance of which amounted to NIS 93 million - consolidated and to NIS 48 million in the Bank. (2004: NIS 93 million - consolidated; and NIS 45 million - in the Bank).
- Interest capitalized in prior years net of amortization, in the amount of NIS 3 millions (2004: NIS 3 millions).
- Including a provision for decline in value in the amount of NIS 25 million (2004: NIs 15 million).

B. The Bank and a consolidated subsidiary own leasehold rights for various periods ending in the years 2008 to 2044. The Bank and a consolidated subsidiary are the owners of non-capitalized leasehold rights: Consolidated – NIS 33 million (2004: NIS 30 million). The Bank, stand alone: NIS 31 million (2004: NIS 28 million).

The Bank and a consolidated subsidiary are the owners of capitalized leasehold rights: Consolidated – NIS 123 million (2004: NIS 132 million). The Bank, stand alone – NIS 93 million (2004: NIS 101 million).

C. The depreciated cost of buildings not yet registered in the names of the Bank or of its subsidiaries at the Land Registry Office, excluding buildings intended for sale, amounts to NIS 183 million (2004: NIS 221 million) on a consolidated basis, and NIS 131 millio (2004: NIS 168 million) for the Bank.

D. The depreciated cost of buildings not in use by the Bank, and which are mostly let to outside parties, amounts to NIS 33 million (2004: NIS 25 million) on a consolidated basis, and NIS 27 million (2004: NIS 18 million) for the Bank.

7. BUILDINGS AND EQUIPMENT (CONTINUED)

E. THE COST OF IN-HOUSE DEVELOPMENT OF COMPUTER SOFTWARE :

	Consolidated		The Bank	
	2005	2004	2005	2004
	In NIS millions			
The cost of software put into operation	505	470	452	428
Accumulated depreciation	(203)	(134)	(169)	(106)
Undepreciated balance	302	336	283	322
Cost of software not yet in operation	319	176	315	167
Total	621	512	598	489

See Notes 19 C 19 hereunder, for details regarding the renovation of the central computer infrastructure of the Bank.

8. OTHER ASSETS

	Consolidated		The Bank	
	December 31		December 31	
	2005	2004	2005	2004
	In NIS millions			
Net deferred tax assets (see Note 29 J)	491	593	416	409
Excess advance tax payments over current provisions	85	230	-	186
Excess deposits for severance pay and pensions, over provision (see Note 16 F and I)	522	*436	479	394
Issue costs and discount expenses of debentures and subordinated capital notes	7	4	5	5
Income receivable	150	142	76	128
Debit balances of derivative financial instruments	1,507	*1,204	1,129	*929
Credit cards activity debts	96	121	-	-
Surrender value of life assurance policies owned by the Bank and corporate owned life insurance	678	510	-	-
Other debtors and debit balances	711	*364	275	214
Total other assets	4,247	3,604	2,380	2,265

* Reclassified.

9. DEPOSITS FROM THE PUBLIC

	Consolidated		The Bank	
	December 31		December 31	
	2005	2004	2005	2004
	in NIS millions			
Demand deposits	11,691	11,375	8,217	8,395
Time and other deposits	(1)110,992	*(1)101,649	65,356	*60,436
Acceptances	1	8	1	8
Savings schemes deposits	7,616	8,942	6,723	7,899
Total deposits from the public	130,300	121,974	80,297	76,738

*Reclassified

Footnote:

(1) A consolidated subsidiary entered into short-term repurchase agreements for the sale and repurchase of substantially identical securities. These agreements were classified as secured borrowings.
All the securities sold under the repurchase agreements (see Note 3 A), are secured by designated deposits, the balance of which at December 31, 2005 was NIS 4,852 million (December 31, 2004: NIS 8,787 million).

10. DEPOSITS FROM BANKS

	Consolidated		The Bank	
	December 31		December 31	
	2005	2004	2005	2004
	in NIS millions			
Commercial banks:				
Demand deposits	603	148	1,015	204
Time deposits	2,565	*1,602	1,581	*1,218
Acceptances	312	404	193	294
Central banks:				
Time deposits	-	111	-	91
Specialized banking institutions:				
Demand deposits	72	39	96	39
Time deposits	2,966	2,502	85	134
Total deposits from banks	6,518	4,806	2,970	1,980

* Reclassified

11. DEBENTURES AND SUBORDINATED CAPITAL NOTES[1]

	Average maturity years[1]	Internal rate of return [1] %	Consolidated December 31 2005	Consolidated December 31 2004	The Bank December 31 2005	The Bank December 31 2004
			in NIS millions			
Subordinated capital notes in Israeli currency, linked to CPI	4.43	5.59	5,191	*4,658	3,292	3,365
Subordinated capital notes in non-inked Israeli currency	0.08	5.49	151	151	227	210
Total debentures and subordinated capital notes			5,342	4,809	3,519	3,575

*Reclassified
Footnote:
(1) Rate of return which discounts the projected payment flow of amounts presented in the balance sheet. Period to maturity is the average of the repayments periods weighted by the cash flows discounted at the internal rate of return.
Data regarding the internal rate of return and the period to maturity relates to the consolidated statements at December 31, 2005.

12. OTHER LIABILITIES

	Consolidated December 31 2005	Consolidated December 31 2004	The Bank December 31 2005	The Bank December 31 2004
	in NIS millions			
Excess current tax provisions over advance payments	99	83	41	3
Net provision for deferred taxes (see Note 29 J)	45	27	44	27
Income in advance	141	107	59	44
Provision for doubtful debts in respect of guarantees	128	122	101	92
Accrued expenses	1,009	*356	708	189
Provisions for vacation pay, seniority bonus and retirement benefits	917	*823	777	697
Excess of the provision for severance and retirement benefits over amounts deposited (See Note 16 F and I)	12	3	-	-
Credit balances of derivative financial instruments	1,524	*1,244	1,286	*1,065
Credit cards activity creditors	463	389	-	-
Amounts received from realization of Other creditors and credit balances	863	*788	278	239
Total other liabilities	5,201	3,942	3,294	2,356

* Reclassified

13. SHAREHOLDERS' EQUITY

A. THE AUTHORIZED, ISSUED AND PAID-UP NOMINAL SHARE CAPITAL (IN NEW ISRAEL SHEKELS):

	December 31,2005 and 2004	
	Authorized	Issued and Fully Paid-Up
Ordinary "A" Shares of NIS 0.1 par value each	100,000,000	98,063,921
6% Cumulative Preference Shares, of NIS 0.00504 par value each (equivalent to 10 pounds sterling each)	202	202
Total	100,000,202	98,064,123

Ordinary "A" Shares are registered and are listed for trade on the Tel Aviv Stock Exchange.

B. 6% CUMULATIVE PREFERENCE REGISTERED SHARES:

The dividend and the rights of these shareholders are linked to the representative rate of exchange of the New Israel shekel to the pound sterling at the date of each payment. At the balance sheet date, every holder of a preference share, the par value of which is equivalent to 10 pounds sterling, is entitled to an annual dividend in an amount of NIS 4.76 and at the time of liquidation to a distribution in an amount of NIS 79.41, According to an Opinion issued by the Institute of Certified Public Accountants in Israel, non-participating preference shares are not to be included as part of shareholders' equity, and and accordingly they are presented under the item "other liabilities".

C. INCREASE IN THE REGISTERED SHARE CAPITAL

The agenda of a special general meeting of shareholders called for April 26, 2006 , includes a proposal for the increase of the registered share capital of the Bank by an amount of NIS 4,000,000, divided into 40,000,000 ordinary A shares of NIS 0.1 par value each.

D. OPTION PLAN

The meeting of the board of directors of the Bank held on March 26, 2006, resolved to approve a stock option plan for officers of the Bank, including the Chairman of the Board and the President and CEO of the Bank.

The purpose of this plan is to enhance the interests of the Bank and its goals, by way of increasing the material interest of Bank officers in the success and results of operations of the Bank. As part of the program, a new layer of long-term compensation is to be added, in order to give executives an incentive for reaching long-term growth targets and in order to maintain in the long run the high quality senior managerial team of the Bank.

According to the plan, 9,806,392 option warrants will be issued to the Chairman of the board of the Bank and the President and CEO, while 10,787,031 option warrants will be issued to ten other officers of the Bank, including the Internal Auditor (hereinafter – "the other officers"). The granting of option warrants to the Chairman of the board of directors of the Bank, within the framework of the plan, is to be brought for approval of a special meeting of shareholders of the Bank.

Each option warrant is exercisable into one ordinary "A" share of NIS 0.1 par value each of the Bank (hereinafter – 'the share") subject to adjustments, as detailed in the plan.

The exercise price of each option warrant granted to the Chairman of the board of directors of the Bank or to the President and CEO, according to the plan, would be NIS 5.5 (subject to adjustments according to the terms of the plan), together with linkage increments to the CPI, from the last CPI published prior to February 1, 2005 and up to the known Index on the exercise date with the addition of interest at an annual rate of 5%. The said exercise price has been determined in accordance with a formula based mainly on the price of the shares stipulated in the agreement for the acquisition of the controlling interest in the Bank.

The exercise price of each option warrant granted to eight of the other officers according to the plan, will be NIS 6.379 (subject to adjustments according to the terms of the plan), together with linkage increments to the CPI, from the last CPI published prior to February 1, 2005 and up to the known Index on the exercise date. The said exercise price has been determined according to the closing market price of the shares of the Bank on February 1, 2005.

13. SHAREHOLDERS' EQUITY (CONTINUED)

The exercise price of each option warrant granted to one of the other officers, who took office at the Bank on March 1, 2006, as well as to another one of the other officers, who is to take office at the Bank on April 2, 2006, will be the market closing price of the shares of the Bank on the last trading day prior to the day on which such officer shall take office, as the case may be (subject to adjustments according to the terms of the plan), together with linkage increments to the CPI, from the last CPI published prior to the said trading date and up to the known Index on the exercise date.

The said exercise prices are subject to adjustments deriving from the distribution of cash dividends and/or bonus shares as well as rights issues by the Bank.

The exercise period of two thirds (2/3) of the option warrants to be granted under the plan, will begin on January 5, 2009, and end on January 4, 2011, and the exercise period of the remaining third (1/3) will begin on January 1, 2011 and end on December 31, 2012, all subject to the terms stipulated in the plan as regards the termination of the employment of the grantees with the Bank.

The theoretical value of the benefit attached to the 30,399,815 option warrant approved, based on the provisions of Accounting Standard No.24, is estimated at NIS 122 million. The value of this benefit is to be charged in the books of the Bank in installments, as a payroll expense against a credit to a capital reserve, this as from the quarter in which the option warrants are issued and until the beginning of the exercise period of each part (two thirds over a period of 2.8 years and the remaining third over a period of 4.8 years).

The evaluation of the benefit to the officers is based on the Black & Scholes formula, considering known parameters and assessments, or which are assessable at date of the evaluation.

The fair value of each stock option granted as part of the plan to the Chairman of the Bank's board of directors and to the President and CEO is assessed at NIS 3.49. The fair value of each stock option granted as part of the plan to eight long standing officers is assessed at NIS 4.29. The fair value of each stock option granted as part of the plan to the officer who took office on March 1, 2006, is assessed at NIS 2.81. The fair value of each stock option granted as part of the plan to the officer who is to take office on April 2, 2006, is assessed at NIS 2.53.

All data pertaining to the theoretical value of the benefit and its effect upon the financial statements of the Bank as well as data pertaining to the fair value of each option warrant, were computed based on data available on March 23, 2006. It should be emphasized that the determining date for computing the value of the option is the actual date of the granting thereof; accordingly, actual values might be different from the values stated above. A new valuation would therefore be performed on the date of allotment of the option warrants.

The parameters of the model for computing the theoretical value of the options are:

- Price of the share on March 23, 2006 – NIS 9.1, 5% higher than the average price in the month preceding this date;
- Exercise price – as stated above;
- Expiration period of the options – two thirds are to expire at the end of 4.8 years from date of issue, and one third at the end of 6.8 years from date of issue;
- Non-risk interest rate – 3.7%
- Rate of return of dividends – "0", as the exercise price of the option warrants is adjusted to dividend distributions;
- The standard deviation of the return on the share – 19%.

According to the provisions of Section 102 of the Income Tax Ordinance, all option warrants under the plan are to be issued in the name of a trustee for and on behalf of the grantees, in accordance with the terms of the capital gains alternative.

The process of exercising the option warrants – At each exercise date, the amount of the cash benefit for each grantee would be computed, and the Bank would issue to the trustee for the grantee, a number of ordinary shares, the total market value of which, according to the closing market price of the ordinary shares of the Bank on the stock exchange, on the trading day preceding the exercise date, equals the amount of the cash benefit.The Bank shall convert a part of its retained earnings, within the meaning of Section 302(b) of the Companies Law, 1999, of its premium on shares, or of any other source included

13. SHAREHOLDERS' EQUITY (CONTINUED)

in its shareholders' equity, as stated in Section 304(a) of the Companies Law, into share capital in an amount equal to the par value of the exercise shares to be issued as stated.

Any option warrant not exercised according to the terms of the plan until the end of the period stipulated for its exercise according to the terms of the plan, would expire and shall not convey any right.

On March 26, 2006, the State informed of its consent to the stock option plan for officers of the Bank and of its consent for voting with the controlling shareholders of the Bank, by virtue of the option shares that the State holds.

E. DIVIDEND

The distribution of dividends by the Bank is subject to the provisions of the law, including limitation deriving from Directives of the Supervisor of Banks.

For details as to a limitation on the distribution of dividends from funds from a future sale of control over IDB New York, if at all, see "Employee agreement" in Note 32 C hereunder. For details as to a limitation determined by the Governor of the Bank of Israel, included in the permit granted to the Bronfman-Schron Group for the acquisition and holding of means of control in the Bank, see Note 32 B hereunder.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS

General - Proper Banking Procedures Nos. 311 and 341 regarding "minimum capital ratio" and "allocation of capital in respect of exposure to market risk" require banking institutions to maintain a ratio of capital to risk components which shall not fall below a rate of 9% of the weighted total of the risk components in their balance sheet and off-balance sheet assets. The measurement of capital for this purpose is based on its classification into three main components: Tier I capital, Tier II capital and Tier III from which are deducted the banking institution's investments in non-banking affiliates and in subsidiaries which are not consolidated in its consolidated financial statements.

Tier I capital includes the shareholders equity, and the minority interest in the capital of consolidated subsidiaries, net of goodwill.

Tier II capital includes certain subordinated notes, which comply with characteristics defined by the Supervisor of Banks, and which have been approved by him for this purpose, as well as the general provision for doubtful debts. The volume of subordinated notes is limited to 50% of the Tier 1 capital that wasn't allocated against market risks.

The Tier III capital includes subordinated capital notes, which comply with characteristics determined in Directives of the Supervisor and which were approved by him for this purpose. It was required, inter-alia, that these capital notes will include an explicit condition, according to which payment of the indebtedness shall not be made if such payment will result in the minimal capital ratio falling below the minimum requirements of the Supervisor.

The weighted total of risk components in the business of the Bank, includes the balances of all assets included in the balance sheet and of off-balance sheet items (guarantees, derivative financial instruments etc.), which are weighted according to the degree of credit risk, as determined by the Directives.

Included in the weighted total of risk assets is the estimate of market risk relating to the marketable portfolio of the Bank and to its exposure to linkage base and interest risk. Such estimate was made based on principles determined by the Supervisor.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS

1. Capital for Calculating Ratio of Capital (In NIS milion)

	December 31	
	2005	2004
	In NIS millions	
Tier I capital	7,092	6,619
Tier II capital:		
Upper Tier II capital (1)	254	254
Other Tier II capital	3,542	3,305
Tier III capital (2)	37	41
Deductions (3)	(947)	(824)
Total capital	9,978	9,395

2. Weighted Credit Risk Balance

	December 31			
	2003		2002	
	Balances(4)	Weighted credit risk	Balances(4)	Weighted credit risk
	In NIS millions			
Credit risk assets				
Cash and deposits with banks	20,586	3,810	17,751	*3,002
Securities	42,188	8,161	40,068	*7,528
Credit granted to the public (1)(5)	84,108	71,812	*77,730	65,902
Credit granted to the government	92	3	271	2
Investment in affiliated companies (3)(5)	1,520	519	*1,319	432
Buildings and equipment	2,268	2,268	1,978	1,978
Other assets	4,247	3,601	*3,604	2,909
Total assets	155,009	90,174	142,721	81,753
Off-Balance Sheet Instruments				
Transactions whose balance represents credit risk	12,935	10,929	*13,109	*10,191
Derivative financial instruments (6)	6,523	3,428	*5,319	*2,619
Other	375	375	*391	*391
Total off-balance sheet instruments	19,833	14,732	18,819	13,201
Total credit risk assets	174,842	104,906	161,540	94,954
Market risk	-	1,521	-	1,318
Total risk assets	174,842	106,427	161,540	96,272

* Reclassified.

Footnotes:

(1) The balance of the general provision for doubtful debts in the amount of NIS 211 million (2004: NIS 211 milion) constitutes a part of the upper Tier II and is not deducted from credit to the public.

(2) Held against market risk only.

(3) The balance of investment in shares and in subordinated liability notes of financial affiliated companies and non-consolidated subsidiaries. This balance is deducted from the amount of capital and therefore also from the balance of investments in affiliated companies.

(4) Assets - year-end balances Off balance sheet instruments - par value The weighted average balances of off balance sheet instruments, are computed taking into account their conversion factor into credit.

(5) Loans and capital notes presented in the balance sheet under investments in affiliated companies in the amount of NIS 7 million (2004: NIS 1 million) are included in credit to the public.

(6) including a NIS 48 million (2004: NIS 65 million) liability towards the Ma'of Clearing House.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

3. Ratio of Capital to Risk Assets

	December 31	
	2005	2004
	Percent	
A. The bank		
Ratio of tier I capital to credit risk assets	6.7	6.9
Ratio of total capital to credit risk assets	9.4	9.8
Ratio of total minimal capital required by the Supervisor of Banks	9.0	9.0
B. Significant subsidiaries		
1. Mercantile Discount Bank LTD. and its subsidiaries		
Ratio of tier I capital to credit risk assets	7.9	7.3
Ratio of total capital to credit risk assets	12.2	10.6
Ratio of total minimal capital required by the Supervisor of Banks	9.0	9.0
2. Discount Mortgage Bank LTD. and its subsidiaries		
Ratio of tier I capital to credit risk assets	9.1	9.3
Ratio of total capital to credit risk assets	11.3	10.5
Ratio of total minimal capital required by the Supervisor of Banks	9.0	9.0
3. Discount Bakcorp Inc. (1)		
Ratio of tier I capital to credit risk assets	10.8	11.4
Ratio of total capital to credit risk assets	11.8	12.5
Ratio of total minimal capital required by the Supervisor of Banks	(2)8.0	(2)8.0
4. Israel Credit Cards LTD.		
Ratio of tier I capital to credit risk assets	11.3	8.5
Ratio of total capital to credit risk assets	12.7	9.9
Ratio of total minimal capital required by the Supervisor of Banks	9.0	9.0

Footnotes:
(1) The data in this item were computed in accordance with the rules applicable in the U.S.A.
(2) IDB New York, a subsidiary of Discount Bankcorp Inc., was classified by the FDIC as "well capitalized". Maintaining the said classification requires the maintenance of a capital ratio, including the minimum ratio, of 10% and of a primary minimum capital ratio of 6%.

14. CAPITAL ADEQUACY IN ACCORDANCE WITH INSTRUCTIONS OF THE SUPERVISOR OF BANKS (CONTINUED)

4. **Issue of subordinate capital notes – March 2004.** On March 18, 2004, Manpikim – Discount Bank Issues Corporation Ltd. ("Manpikim"), completed an issue of NIS 236 million of subordinate capital notes (series "A"). The proceeds of the issue was deposited in full with the Bank, which is obligated towards the notes holders for the payment in full of the principal, interest, and linkage increments on the capital notes. Additional capital notes in the amount of NIS 264 million, were issued to a subsidiary of Manpikim immediately prior to the publishing of the prospectus. Such capital notes were listed for trade on the Stock Exchange, and were gradually sold by the said subsidiary, in accordance with the needs of the Bank. The Supervisor of Banks approved the inclusion of the said subordinate capital notes as second tier capital of the Bank.

   Issue of deferred capital notes – November 2004. On November 10, 2004, Manpikim successfully concluded an issue of deferred capital notes (series "B") in the amount of NIS 73 million. Additional deferred capital notes (series "B") in the amount of NIS 227 million, were issued prior to the publication of the Prospectus to a subsidiary of Manpikim and were registered for trade on the Stock Exchange.

   Near to that date, deferred capital notes (series "A") in a total amount of NIS 300 million, were registered for trade (these were added to deferred capital notes (series "A") of a par value of NIS 500 million that are traded already) of which NIS 40 million were issued to institutional investors, and the balance was issued to a subsidiary of Manpikim.

   The deferred capital notes series "A" and "B" that were issued to a subsidiary of Manpikim are being gradually sold by it, in accordance with the needs of the Bank. The proceeds of the issue were deposited with the Bank, which has accepted responsibility towards the note holders for the repayment in full of the principal, interest and linkage increments of all the capital notes.

   Most of the said deferred capital notes were issued to replace capital notes that had been issued in the past and which in accordance with Bank of Israel instructions were deducted from the second tier capital of the Bank in the course of the years 2004-2005. The Supervisor of Banks approved the inclusion of the said subordinate capital notes as second tier capital of the Bank.

   The balance of deferred capital notes not yet sold by the subsidiary of Manpikim amounted, at December 31, 2005, to a par value of NIS 266 million.

   Issue of deffered capital notes – Mercantile Hanpakot Ltd. On August 23, 2005, Mercantile Hanpakot Ltd., a subsidiary of Mercantile Discount Bank, completed issuing NIS 200 million of deferred capital notes (series A), out of a series of a total of NIS 300 million. which were listed for trading on the Tel-Aviv Stock Exchange.

   Mercantile Discount Bank received the approval of the Supervisor of Banks to have the said capital notes included as Mercantile discount Bank's second tier capital. (Accordingly, the said captial notes are considered second tier captial for the purpose of calculating the Bank's capital ratio).

   Up to December 31, 2005, Mercantile Discount Bank raised additional secondary capital out of the same series of NIS 57 million.

   Issue of deffered capital notes – Discount Mortgage Issues Ltd. On November 23, 2005, Discount Mortgage Issues Ltd., a subsidiary of Discount Mortgage Bank, published a prospectus for issuing of NIS 125 million deferred capital notes (Series "A"), out of a total series of NIS 300 million. Discount Mortgage Bank requested the approval of the Supervisor of Banks for inclusion of the said capital notes as part of Discount Mortgage Bank's secondary capital (once this approval is obtained, the Bank will also be able to include these capital notes as part of its secondary capital in computing its capital ratio).

15. PLEDGES

A. Israel Discount Bank of New York ("Discount New York") placed a lien on securities in favor of the Federal Reserve Bank in New York, which serves as security for certain liabilities of Discount New York, stemming from its appointment as a recipient of deposits of payments and taxes for the U.S. Treasury and as collateral security for certain liabilities, which include the payments and undertakings for indemnity against members of the Clearing House in New York, in accordance with the rules of the Clearing House, and as part of its obligations as a recipient of deposits of moneys administered within the scope of bankruptcy proceedings. The market value at December 31, 2005, of the pledged securities amounts to US$ 23 million (NIS 106 million) [December 31, 2004 – US$ 23 million (NIS 99 million)].

In addition, Discount New York pledged securities and loans in favor of the Federal Home Loan Bank, in the amount of US$382 million (NIS 1,758 million) as of December 31, 2005 as a collateral for deposits received from it [as at December 31, 2004: US$ 582 million (NIS 2,507 million)].

B. Discount New York has sold securities, under buyback terms, in the amount of US$ 1,428 million (NIS 6,573 million) as of December 31, 2005 [as at December 31, 2004: US$ 2,245 million (NIS 9,671 million)].

C. Deferred notes issued by the Bank in accordance with a Prospectus of April 1997, are not secured by a pledge on the assets of the Bank, except for a token first charge on a deposit of NIS 1.

D. The Bank is a member of the Euroclear Clearing House, which serves as a clearing system for transactions in securities traded on international markets, made through this clearing house. For this purpose, the Bank has pledged cash and securities in the amount of US$ 20 million.

E. Discount Leasing Ltd. registered in favor of the State of Israel, a first floating charge on its assets, unlimited in amount, in respect of investment grants received.

F. Note 19 C 6 discribes the risk fund established by the Maof clearing house. The Bank's share in the fund, deriving from the volume of the clearing activity on behalf of the Bank's customers as of December 31, 2005, amounted to NIS 24 million.

The balance of the security, which the Bank has to provide in favor of the clearing house (an off-balance sheet liability) based on scenarios devised by the Stock Exchange in respect of the activity of the Bank's customers and in respect of the activity of the Bank itself (nostro) as of December 31, 2005, was NIS 24 million (2004: Nis 75 million). According to the resolutions of the board of directors of the Maof clearing house, the Memorandum and Bye Laws of the Maof clearing house were amended as from April 1, 2004, as was the security setup of the Maof clearing house. All member of the clearing house, including the Bank, were asked to sign new pledge agreements to secure their liabilities, which replaced the previous pledge documents signed in favor of the Maof clearing house, and to deposit liquid security only (State of Israel bonds and/or cash as required by the Bye Laws).

The Bank provided the Ma'of Clearing House with a first degree pledge on all monies that had been deposited by the Bank in an account in the name of the Ma'of Clearing House at the Stock Exchange Clearing House and at an account in the name of the Ma'of Clearing House in another bank, all as collateral for amounts that the Bank will be liable for in respect of Ma'of transactions to which it is responsible towards the Ma'of Clearing House. The obligation is subject to conditions, and the Bank is entitled, under certain conditions, to demand the repayment of certain amounts. Within the framework of these accounts the Bank has pledged bonds in favor of the Ma'of Clearing House, the amount of which at December 31, 2005, totaled NIS 307 million.

G. In accordance with an agreement signed by the Mercantile Discount Bank and the Ma'of Clearing, the bank made a collateral in favor of the Ma'of Clearing, in respect of its responsibility towards the Clearing for transactions effected by the bank or by its customers and for the bank's share in the Risk Fund. According to the agreement, the Clearing House is committed to refund to Mercantile Discount Bank the amount of the collateral together with the profits thereon. Nonetheless, the "Maof" Clearing House, at its discretion, retains the right to realize the collateral, in whole or in part,

15. PLEDGES (CONTINUED)

in reducing the debt of Mercantile Discount Bank towards it by a similar amount.

The value of the collateral in favor of the "Maof" Clearing House, as stated, amounted on December 31, 2005, to NIS 35 million.

H. As collateral for the obligations of Yatzil Finance and its subsidiaries towards the banks, the said companies registered an assignment by way of a pledge and a fixed and floating pledges on all their rights according to agreements with business houses for the discount of IsraCard, VISA, American Express and Diners Club Israel vouchers, and all the rights to receive monies and payments from IsraCard, ICC, American Express and Diners, under power of assignment of rights and under the business house agreement. As of balance sheet date, the amount of the rights to receive monies and payments as above, totals NIS 419 million.

I. Israel Discount Bank (Switzerland) has pledged assets in the amount of SFR 7.5 million, as collateral for credit facilities in the amount of US$2 million and for a deposit in respect of the leasing of premises.

J. As detailed in Note 19 C 7 hereunder, since May 2005 the Bank amended its arrangement with the Tel-Aviv Stock Exchange Clearinghouse, in accordance with the requirements of the Articles of the Stock Exchange Articles and the bylaws of the Clearinghouse, and pledged as security for its obligations towards the Clearinghouse all the Bank's rights in the security deposit managed by the Clearinghouse (in which the Bank deposits securities) and all its rights in an account opened with another bank. The value of the collateral amounted on December 31,2005, to NIS 24 milllion.

K. According to an agreement signed between Mercantile Discount Bank and the Tel-Aviv Stock Exchange Clearinghouse Ltd. (hereinafter – "the Clearinghouse"), this bank deposited a security – Government bonds – in favor of the Clearinghouse, in respect of the responsibility of the bank towards the Clearinghouse for transactions made by the bank or by its customers by means of the Clearinghouse. The value of the collateral as of December 31, 2005, amounted to NIS 3 million.

L. In order to secure credit which the Bank receives from time to time from the Bank of Israel, the Bank pledged, in May 2005, in favor of the Bank of Israel, a portfolio of bonds held by it. The said pledge does not preclude the sale by the Bank of the portfolio of bonds or a part thereof, provided that the sale is made in the ordinary course of business of the Bank with regards to the securities of the type pledged by it.

As of December 31, 2005, no assets were pledged within the framework of the said arrangement.

M. As part of a general agreement for a credit facility from the Bank of Israel and for securing all sums that are or will be due to the Bank of Israel in respect of credit received or to be received by Mercantile Discount Bank from the Bank of Israel, Mercantile Discount Bank registered, on May 30, 2005, in favor of Bank of Israel, a first floating charge on two types of Israel Government bonds included in its securities portfolio (excluding bonds loaned to the public).

As security for this agreement Mercantile Discount Bank registered on April 13, 2005, a first degree fixed charge on the said security and the rights therein, in favor of the Clearinghouse.

Following are details relating to this pledge arrangement:

	Balance as of December 31, 2005	Highest balance during the year	Average balance in 2005
		In NIS millions	
Pledged securities(market value)	734	770	729
Deposits with the Bank of Israel	315	1,341	585
Deposits by Bank of Israel	-	20	13

16. EMPLOYEE BENEFITS

A. The liability of the Bank and its subsidiaries for severance pay to their employees, based on the customary one month's salary for each year of employment, is fully covered by deposits with severance pay funds, by insurance policies and pension funds. The redemption value of the insurance policies and amounts accumulated in pension funds are not included in the balance sheet since they are neither controlled nor managed by the Bank or its subsidiaries.

Members of the Bank's Management are entitled to the customary severance payments, while several of whom are entitled also to an "adjustment" bonus of up to 12 months' salary upon retirement pursuant to individual agreements signed with them. This liability is covered by deposits in severance pay funds and insurance policies. The pension liability of foreign subsidiaries is covered by current deposits into a recognized foreign pension fund, based on actuarial computations.

In certain consolidated banking subsidiaries, several officers are entitled to "adjustment" bonus" equal to nine to twelve months' salaries, and in respect of which adequate provisions have been included.

B. The Board of Directors of the Bank resolved in 2003, that if the President and CEO of the Bank or any of the Vice Presidents would be dismissed or would be compelled to retire from the Bank due to change of ownership of the Bank, this within a period of twelve months from the date of the said change, they will be entitled to a payment, over and above the amounts due to them under the personal employment agreement with them, subject to the limitations specified in the resolution. The financial statements include a general provision of NIS 1.3 million, which constitute 25% of the maximum theoretical liability, based on a conservative assessment of the total risk in this respect.

Certain of the General Managers of the subsidiaries are also entitled to a special bonus in case they would be dismissed or would be compelled to retire due to change of ownership of the Bank, this within a period of twelve months from the date of such change. The financial statements include a provision of 25% of the maximum theoretical liability, based on a conservative assessment of the risk as a whole in this respect.

C. The Bank's employees and those of its consolidated subsidiaries in Israel are entitled to long-service bonuses equal to a certain number of monthly salaries, and to a certain number of additional vacation days, upon completing 20, 30 and 40 years of employment in the Bank. In accordance with instructions of the Supervisor of Banks the provision in respect of this liability is computed on an actuarial basis and stated at its present value. The capitalization rate, set by the Supervisor of Banks, on an actuarial computation is 4%, and considering the future payroll increases, the amount of the liabilities for employee rights, in respect of the Bank employees, is capitalized at a payroll increase rate of 2% (December 31, 2004 – 2%). The financial statements include provisions for long-service bonuses totaling: Consolidated – NIS 412 million (2004: NIS 385 million); the Bank - NIS 353 million (2004: NIS 330 million).

Employees of the Bank and its consolidated subsidiaries in Israel are entitled to annual vacation as provided by labor agreements in force, and subject to the guidelines of the Annual Vacation Law - 1951. The financial statements include provisions for vacation pay as follows: Consolidated - NIS 125 million (2004 - NIS 124 million); and for the Bank - NIS 98 million (2004 - NIS 101 million).

D. Employees of the Bank and its subsidiaries are entitled to certain benefits after retirement. The liability was computed on an actuarial basis at a discount rate of 4%. The amount of the provision at balance sheet date: Consolidated – NIS 380 million (2004: NIS 314 million); the Bank - NIS 326 million (2004: NIS 266 million).

16. EMPLOYEE BENEFITS (CONTINUED)

E. On October 10, 2005, the Chief Actuary at the Capital Markets, Insurance and Savings Department of the Ministry of Finance informed the managements of insurance companies that the determination of pension coefficients and evaluation of the reserves in respect of pension life assurance policies shall be made in accordance with the recommendations relating to the mortality base, presented in the paper published by the Supervisor of Insurance in April 2005, to be updated from time to time, this beginning with the financial statements in respect of the first quarter of 2006.

The Supervisor of Banks informed the Bank that it is his intention to apply the said mortality basis also to banking corporations.

The Bank included in the financial statements a provision of NIS 12 million, based on the actuary's evaluation of the effect of the change in the said mortality basis.

F .The provision and deposits for employees' severance pay are as follows:

	Consolidated		The Bank	
	December 31		December 31	
	2005	2004	2005	2004
	In NIS millions			
Deposits	2,181	1,973	1,911	1,721
Provision	1,661	1,543	1,432	1,327
Excess of deposit over provision	520	430	479	394
The excess (shortage) of amounts deposited over the provision is included in the item:				
Other assets (Note 8)	522	433	479	394
Other liabilities (Note 12)	(2)	(3)	-	-
Total, Net	520	430	479	394

The Bank and its subsidiaries are not permitted to withdraw these deposit funds except for the purpose of making severance payments.

16. EMPLOYEE BENEFITS (CONTINUED)

G. In the years 2000-2005, the Bank encouraged early retirement of employees, focusing on an employee population having defined characteristics, in respect of which a focused effort to encourage their early retirement was made. In this framework, the said employees were approached and were offered early retirement at beneficial terms.

(As to expenses relating to early retirement, see note 27).

H. Several of the subsidiaries have adopted employee remuneration plans, according to which the General Managers and/or other employees of these subsidiaries are entitled to a bonus, the amount of which is based upon their business results. The necessary provisions in respect of these bonuses are included in the financial statements.

The previous general manager of one of the subsidiaries might be entitled in the future to a share of the gain on investments made in the period of his employment by the subsidiary, also during a number of years subsequent to his retirement.

I. **An award plan for members of the Bank's management.** In March 2006, the board of directors of the Bank resolved to approve an award plan to members of the Bank's management, including the Internal Auditor. In terms of the plan the Bank is to grant to every member of management an annual award in respect of each year in which he served as member of management in the period from 2006 to 2010.

The annual award would be derived in part from the rate of the annual return on equity and in part by the decision of the President and CEO (within the framework of an additional budget, the volume of which will also be derived from the annual rate of return on equity), in a differential manner according to his judgment, and in accordance with the extent of achievement of the specific targets set by him for each management member. The said distribution requires the approval of the board of directors of the Bank.

The minimum annual rate of return required for a distribution of an award to members of management in a particular year, is 8.5%.

The board of directors of the Bank is entitled to eliminate exceptional profits or losses, that do not stem from current operations, for the purpose of computing the rate of annual return on equity. The board of directors of the Bank is entitled to change or cancel the award plan, in whole or in part, provided that the change or cancellation would take effect in the calendar year following the year in which the decision for cancellation or change was taken.

For details regarding a stock option plan for officers of the Bank, see Note 13 D.

16. EMPLOYEE BENEFITS (CONTINUED)

J. IDB New York has a liability for the payment of pensions to its employees, in respect of which it has established a pension fund, in which contributions by the employer and by the employees are deposited. The annual deposits with the fund are based on calculations made by an independent actuary. Following are the principal details concerning the said liability:

	As at December 31	
	2005	2004
	In US$ millions	
The actuarial liability for pension payments	37	31
Fair value of the pension fund assets	31	29
The actuarial liability for pension payments, net of market valueof the Fund's assets	(6)	(2)
Balance of the deferred actuarial loss	4	3
Balance of the net assets of the pension fund included in the financial statements (Note 8)	-	1
The outstanding net liability of the pension fund, as reflected in the financial statements (Note 13).	2	-
Pension payment expenses recognized in the income statement	3	2

The assumptions used for the measurement of the components of the pension plan:		
	%	%
The annual discount rate	5.75	6.00
The anticipated annual rate of return on the Fund's Assets	8.50	8.50
The annual rate of increase in employee payroll	4.25	4.25

K. For details as to an agreement singed in February 2005, alongside with the agreement signed for the sale of a control core of the Bank, between the New Federation of Labor, the Representative Committee of Discount Bank Employees and the Accountant General at the Ministry of Finance, and which determined, among other things, that the "entitled employees" (as defined in the agreement) will receive, under certain conditions, a bonus from the State and from the Bank, and that the power of the employment charter as a collective employment agreement at the Discount Bank would be extended for a period of five years, see Note 37 hereunder.

17. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS

CONSOLIDATED

	Unaudited						
	December 31, 2005						
	Israeli currency		Foreign currency[1]				
	Non linked	Linked to the CPI	In US$	In Euro	In other currencies	Non monetary items	Total
	in NIS millions						
Assets							
Cash and deposits with banks	1,095	1,417	10,929	5,439	1,706	-	20,586
Securities	15,089	708	24,076	925	327	1,063	42,188
Credit granted to the public	31,786	19,196	27,638	2,169	3,101	-	83,890
Credit granted to the Government	-	5	87	-	-	-	92
Investments in affiliated companies	4	2	1	-	-	1,520	1,527
Buildings and equipment	-	-	-	-	-	2,268	2,268
Other assets	1,457	17	2,595	14	56	108	4,247
Total assets	49,431	21,345	65,326	8,547	5,190	4,959	154,798
Liabilities							
Deposits from the public	46,236	12,947	60,287	8,193	2,637	-	130,300
Deposits from banks	1,396	752	4,122	210	38	-	6,518
Deposits from the Government	170	12	70	-	-	-	252
Debentures and subordinated capital notes	151	5,191	-	-	-	-	5,342
Other liabilities	2,716	119	2,101	94	44	127	5,201
Total liabilities	50,669	19,021	66,580	8,497	2,719	127	147,613
Difference	(1,238)	2,324	(1,254)	50	2,471	4,832	7,185
Effect of hedging derivative instruments:							
Derivative instruments (except for options)	-	-	27	126	(153)	-	-
Effect of non hedging derivative instruments:							
Derivative instruments (except for options)	2,231	(733)	931	(222)	(2,207)	-	-
Options in the money, net (in terms of base asset)	285	56	(456)	110	3	2	-
Options out of the money, net (in terms of base asset)	(201)	35	203	(73)	36	-	-
Total	1,077	1,682	(549)	(9)	150	4,834	7,185
Options in the money, net (discounted nominal value)	598	61	(828)	167	-	2	-
Options out of the money, net (discounted nominal value)	(750)	209	653	(89)	(23)	-	-

Footnote:
(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS (CONTINUED)

CONSOLIDATED (CONTINUED)

	Audited						
	December 31, 2004						
	Israeli currency		Foreign currency(1)				
	Non linked	Linked to the CPI	In US$	In Euro	In other currencies	Non monetary items	Total
	in NIS millions						
Assets							
Cash and deposits with banks	2,612	1,550	7,108	4,609	1,872	-	17,751
Securities	12,784	1,978	22,750	1,212	439	905	40,068
Credit granted to the public	*27,451	18,768	25,798	2,111	3,390	-	77,518
Credit granted to the Government	-	12	259	-	-	-	271
Investments in affiliated companies	-	1	-	-	-	1,319	1,320
Buildings and equipment	-	-	-	-	-	1,978	1,978
Other assets	*1,731	12	*1,624	*47	*63	127	3,604
Total assets	44,578	22,321	57,539	7,979	5,764	4,329	142,510
Liabilities							
Deposits from the public	*45,415	14,872	*50,640	*8,547	*2,500	-	121,974
Deposits from banks	315	339	*3,993	*129	30	-	4,806
Deposits from the Government	63	23	58	-	-	-	144
Debentures and subordinated capital notes	151	4,658	-	-	-	-	4,809
Other liabilities	*2,053	125	*1,505	*53	*110	96	3,942
Total liabilities	47,997	20,017	56,196	8,729	2,640	96	135,675
Difference	(3,419)	2,304	1,343	(750)	3,124	4,233	6,835
Effect of hedging derivative instruments:							
Derivative instruments (except for options)	-	-	244	45	(289)	-	-
Effect of non hedging derivative instruments:							
Derivative instruments (except for options)	3,590	184	(1,863)	916	(2,827)	-	-
Options in the money, net (in terms of base asset)	70	-	160	(231)	-	1	-
Options out of the money, net (in terms of base asset)	274	50	(381)	57	-	-	-
Total	515	2,538	(497)	37	8	4,234	6,835
Options in the money, net (discounted nominal value)	465	-	(220)	(246)	-	1	-
Options out of the money, net (discounted nominal value)	1,090	490	(1,508)	(65)	(8)	1	-

* Reclassified.

Footnote:

(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS (CONTINUED)

BANK (CONTINUED)

Reported Amount

	December 31, 2005						
	Israeli currency		Foreign currency[1]				
	Non linked	Linked to the CPI	In US$	In Euro	In other currencies	Non monetary items	Total
	in NIS millions						
Assets							
Cash and deposits with banks	941	6,328	7,575	5,370	1,514	-	21,728
Securities	14,298	138	1,399	831	33	534	17,233
Credit granted to the public	22,893	7,886	11,999	1,869	2,715	-	47,362
Credit granted to Governments	-	5	84	-	-	-	89
Investments in affiliated companies	2	144	70	-	-	6,217	6,433
Buildings and equipment	-	-	-	-	-	1,699	1,699
Other assets	1,117	7	1,135	12	46	63	2,380
Total assets	39,251	14,508	22,262	8,082	4,308	8,513	96,924
Liabilities							
Deposits from the public[3]	37,444	9,682	23,644	7,404	2,123	-	80,297
Deposits from banks	1,441	183	1,067	236	43	-	2,970
Deposits from the Government	116	10	-	-	-	-	126
Debentures and subordinated capital notes	227	3,292	-	-	-	-	3,519
Other liabilities	1,875	92	1,130	93	31	73	3,294
Total liabilities	41,103	13,259	25,841	7,733	2,197	73	90,206
Difference	(1,852)	1,249	(3,579)	349	2,111	8,440	6,718
Effect of non hedging derivative instruments:							
Derivative instruments (except for options)	2,180	(728)	1,110	(423)	(2,139)	-	-
Options in the money, net, (in terms of base asset)	352	56	(525)	114	3	-	-
Options out of the money, net, (in terms of base asset)	(193)	35	169	(47)	36	-	-
Total	487	612	(2,825)	(7)	11	8,440	6,718
Options in the money, net, (discounted nominal value)	475	61	(705)	169	-	-	-
Options out of the money, net, (discounted nominal value)	(926)	209	830	(90)	(23)	-	-

Footnote:
(1) Includes those linked to foreign currency.

17. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS (CONTINUED)

BANK (CONTINUED)

Reported Amount

	December 31, 2004						
	Israeli currency		Foreign currency[1]				
	Non linked	Linked to the CPI	In US$	In Euro	In other currencies	Non monetary items	Total
	in NIS millions						
Assets							
Cash and deposits with banks	2,499	5,665	6,154	4,560	1,744	-	20,622
Securities	12,170	1,522	1,481	997	10	253	16,433
Credit granted to the public	*18,993	8,230	12,107	1,872	2,980	-	44,182
Credit granted to Governments	-	12	256	-	-	-	268
Investments in affiliated companies	-	144	65	-	-	5,662	5,871
Buildings and equipment	-	-	-	-	-	1,432	1,432
Other assets	*1,420	6	*687	*33	*48	71	2,265
Total assets	35,082	15,579	20,750	7,462	4,782	7,418	91,073
Liabilities							
Deposits from the public[3]	*36,760	10,852	*19,398	*7,681	2,047	-	76,738
Deposits from banks	321	187	*1,167	*255	*50	-	1,980
Deposits from the Government	18	20	-	-	-	-	38
Debentures and subordinated capital notes	210	3,365	-	-	-	-	3,575
Other liabilities	*1,228	96	*823	*52	*90	67	2,356
Total liabilities	38,537	14,520	21,388	7,988	2,187	67	84,687
Difference	(3,455)	1,059	(638)	(526)	2,595	7,351	6,386
Other transactions:							
Futures contracts	3,343	184	(1,565)	712	(2,674)	-	-
Options in the money, net, (in terms of basic asset)	286	-	(55)	(231)	-	-	-
Options out of the money, net, (in terms of basic asset)	243	50	(350)	57	-	-	-
Grand total	417	1,293	(2,608)	12	(79)	7,351	6,386
Options in the money, net, (discounted nominal value)	293	-	(47)	(246)	-	-	-
Options out of the money, net, (discounted nominal value)	1,041	491	(1,467)	(65)	-	-	-

* Reclassified.
Footnote:
(1) Includes those linked to foreign currency.

18. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS AND MATURITY PERIODS[1]

CONSOLIDATED (IN NIS MILLIONS)

A. Anticipated Future Contractual Cash Flows as of December 31, 2005

	On demand or within 1 month	Over 1 month and up to 3 month	Over 3 months and up to 1 year	Over 1 year and up to 2 years
Israeli currency, non-linked:				
Assets	12,208	5,003	14,381	5,141
Liabilities	25,048	5,147	15,742	3,839
Difference	(12,840)	(144)	(1,361)	1,302
Derivative instruments (excluding options)	15	(3)	1,738	398
Options (in terms of base assets)	(13)	30	(226)	(22)
Israeli currency, CPI-linked:				
Assets	451	592	2,922	3,963
Liabilities	566	465	3,055	2,417
Difference	(115)	127	(133)	1,546
Derivative instruments (excluding options)	48	116	(677)	(160)
Options (in terms of base assets)	50	5	32	1
Foreign currency - local activity[3]:				
Assets	15,002	4,876	3,941	2,841
Liabilities	17,794	11,828	4,335	1,102
Difference	(2,792)	(6,952)	(394)	1,739
Derivative instruments (excluding options)	(57)	(86)	(1,084)	(245)
Options (in terms of base assets)	(37)	(35)	192	21
Foreign currency - foreign activity of extensions:				
Assets	8,671	2,997	5,427	2,496
Liabilities	14,864	7,277	6,135	2,382
Difference	(6,193)	(4,280)	(708)	114
Non-monetary items:				
Assets	-	-	-	-
Liabilities	-	-	-	-
Difference	-	-	-	-
Options (in terms of base assets)	-	-	-	-
Total:				
Assets	36,332	13,468	26,671	14,441
Liabilities	58,272	24,717	29,267	9,740
Difference	(21,940)	(11,249)	(2,596)	4,701
Derivative instruments (excluding options)	6	27	(23)	(7)
Options (in terms of base assets)	-	-	-	-

B. Balance Sheet Amount at Decemver 31, 2004

	On demand or within 1 month	Over 1 month and up to 3 month	Over 3 months and up to 1 year	Over 1 year and up to 2 years
Total:				
Assets	33,722	9,557	27,331	11,216
Liabilities	52,544	18,493	26,566	11,781
Difference	(18,822)	(8,936)	765	(565)
Derivative instruments (excluding options)	48	23	(34)	(58)

*Reclassified

Footnotes:

(1) This Note presents the anticipated future contractual cash flows in respect of assetes and liabilities according to linkage base and according to the remaining period to the contractual maturity date of each cash flow. The data is shown net of the provision for doubtful debts.

(2) Includes past-due receivables totaling NIS 1,565 million (2004: NIS 1,802 million).

(3) Includes linked to foreign currency.

(4) As included in Note 17 "Assets and liabilities according to linkage base", including off-balance sheet amounts in respect of derivatives.

							Balance sheet amount[4]	
Over 2 years and up to 3 years	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	No fixed maturity date[2]	Total
2,032	2,652	2,424	6,071	298	71	50,281	3,336	49,431
511	236	170	277	205	115	51,290	72	50,669
1,521	2,416	2,254	5,794	93	(44)	(1,009)	3,264	(1,238)
116	2	15	13	7	-	2,301	-	2,231
37	(20)	(15)	(51)	326	38	84	-	84
2,642	2,428	2,223	6,989	4,964	427	27,601	545	21,345
1,855	1,560	1,920	9,476	1,951	7	23,272	63	19,021
787	868	303	(2,487)	3,013	420	4,329	482	2,324
(48)	(7)	(3)	-	-	-	(731)	-	(733)
-	-	-	3	-	-	91	-	91
1,774	1,398	2,091	2,494	914	18	35,349	656	34,104
151	164	99	370	42	8	35,893	27	37,439
1,623	1,234	1,992	2,124	872	10	(544)	629	(3,335)
(79)	(15)	(21)	(7)	(7)	-	(1,601)	-	(1,498)
(37)	20	15	48	(326)	(38)	(177)	-	(177)
2,561	1,795	1,735	3,730	10,880	24,447	64,739	295	44,959
3,034	2,821	1,682	3,335	-	-	41,530	-	40,357
(473)	(1,026)	53	395	10,880	24,447	23,209	295	4,602
-	-	-	-	-	-	-	4,959	4,959
-	-	-	-	-	-	-	127	127
-	-	-	-	-	-	-	4,832	4,832
-	-	-	-	-	-	2	-	2
9,009	8,273	8,473	19,284	17,056	24,963	177,970	9,791	154,798
5,551	4,781	3,871	13,458	2,198	130	151,985	289	147,613
3,458	3,492	4,602	5,826	14,858	24,833	25,985	9,502	7,185
(11)	(20)	(9)	6	-	-	(31)	-	-
-	-	-	-	-	-	-	-	-
9,596	5,664	6,772	19,818	16,570	19,905	160,151	9,333	142,510
5,066	4,228	5,089	15,327	2,509	93	141,696	278	135,675
4,530	1,436	1,683	4,491	14,061	19,812	18,455	9,055	6,835
(22)	(16)	(2)	-	-	-	(61)	-	-

18. ASSETS AND LIABILITIES - ACCORDING TO LINKAGE TERMS AND MATURITY PERIODS[1] (CONTINUED)

THE BANK (IN NIS MILLIONS)

A. Anticipated Future Contractual Cash Flows as of December 31, 2005

	On demand or within 1 month	Over 1 month and up to 3 month	Over 3 months and up to 1 year	Over 1 year and up to 2 years
Israeli currency, non-linked:				
Assets	9,503	3,708	10,731	4,205
Liabilities	19,279	4,650	12,986	3,553
Difference	(9,776)	(942)	(2,255)	652
Derivative instruments (excluding options)	1	(12)	1,728	397
Options (in terms of base assets)	(22)	48	(203)	128
Israeli currency, CPI-linked:				
Assets	257	466	2,310	2,622
Liabilities	196	296	1,664	1,445
Difference	61	170	646	1,177
Derivative instruments (excluding options)	48	116	(672)	(160)
Options (in terms of base assets)	51	5	32	-
Foreign currency - local activity[3]:				
Assets	14,265	4,436	3,827	2,550
Liabilities	16,399	11,123	4,378	1,033
Difference	(2,134)	(6,687)	(551)	1,517
Derivative instruments (excluding options)	(44)	(81)	(1,079)	(244)
Options (in terms of base assets)	(29)	(53)	171	(128)
Foreign currency - foreign activity of extensions:				
Assets	479	521	438	329
Liabilities	605	470	216	1
Difference	(126)	51	222	328
Non-monetary items:				
Assets	-	-	-	-
Liabilities	-	-	-	-
Difference	-	-	-	-
Total:				
Assets	24,504	9,131	17,306	9,706
Liabilities	36,479	16,539	19,244	6,032
Difference	(11,975)	(7,408)	(1,938)	3,674
Derivative instruments (excluding options)	5	23	(23)	(7)
Options (in terms of base assets)	-	-	-	-

B. Balance Sheet Amount at Decemver 31, 2004

	On demand or within 1 month	Over 1 month and up to 3 month	Over 3 months and up to 1 year	Over 1 year and up to 2 years
Total:				
Assets	*23,862	6,052	20,136	7,763
Liabilities	*31,869	14,835	17,841	7,648
Difference	(8,007)	(8,783)	2,295	115
Derivative instruments (excluding options)	49	28	(34)	(58)

Footnotes:

(1) This Note presents the anticipated future contractual cash flows in respect of assetes and liabilities according to linkage base and according to the remaining period to the contractual maturity date of each cash flow. The data is shown net of the provision for doubtful debts.

(2) Includes past-due receivables totaling NIS 1,172 million (2004: NIS 1,373 million).

(3) Includes linked to foreign currency.

(4) As included in Note 17 "Assets and liabilities according to linkage base", including off-balance sheet amounts in respect of derivatives.

Over 2 years and up to 3 years	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	No fixed maturity date[2]	Balance sheet amount[4] Total
1,704	2,485	2,177	5,863	165	65	40,606	2,254	39,251
324	117	87	238	167	113	41,514	108	41,103
1,380	2,368	2,090	5,625	(2)	(48)	(908)	2,146	(1,852)
114	2	13	-	-	-	2,243	-	2,180
138	31	28	11	-	-	159	-	159
1,941	1,709	1,579	5,068	1,464	119	17,535	545	14,508
1,322	1,077	1,327	7,120	1,822	4	16,273	82	13,259
619	632	252	(2,052)	(358)	115	1,262	463	1,249
(48)	(7)	(3)	-	-	-	(726)	-	(728)
-	-	-	3	-	-	91	-	91
1,997	1,304	2,143	1,748	227	1	32,498	550	32,288
100	112	81	346	-	-	33,572	27	34,492
1,897	1,192	2,062	1,402	227	1	(1,074)	523	(2,204)
(77)	(15)	(19)	6	-	-	(1,553)	-	(1,452)
(138)	(31)	(28)	(14)	-	-	(250)	-	(250)
455	153	96	-	-	-	2,471	5	2,364
-	-	-	-	-	-	1,292	-	1,279
455	153	96	-	-	-	1,179	5	1,085
-	-	-	-	-	-	-	8,513	8,513
-	-	-	-	-	-	-	73	73
-	-	-	-	-	-	-	8,440	8,440
6,097	5,651	5,995	12,679	1,856	185	93,110	11,867	96,924
1,746	1,306	1,495	7,704	1,989	117	92,651	290	90,206
4,351	4,345	4,500	4,975	(133)	68	459	11,577	6,718
(11)	(20)	(9)	6	-	-	(36)	-	-
-	-	-	-	-	-	-	-	-
6,511	4,019	4,601	12,805	2,403	297	88,449	10,858	*91,073
1,913	1,415	1,232	8,934	2,304	79	88,070	261	*84,687
4,598	2,604	3,369	3,871	99	218	379	10,597	6,386
(23)	(17)	(6)	-	-	-	(61)	-	-

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS

	Consolidated		The Bank	
	December 31		December 31	
	2005	2004	2005	2004
	in NIS millions			
A. Off-Balance Sheet Financial Instruments				
Contract balances or their stated amounts at year end				
Transactions involving credit risk:				
Letters of credit	1,944	1,902	564	581
Credit guarantees	1,781	1,601	1,258	991
Guarantees for home purchasers	3,306	3,019	1,303	1,495
Liabilities for open credit card transactions	3,993	5,326	1,813	1,852
Other guarantees and obligations	2,272	1,998	1,878	1,656
Unutilized credit line for credit cards	12,250	11,722	8,212	8,068
Unutilized revolving and other credit lines	4,500	3,221	3,905	2,723
Irrevocable commitments to extend credit approved but not yet granted	12,168	8,589	5,188	3,814
Commitment to issue guarantees	2,105	1,760	1,258	727
B. Off-Balance Sheet Commitment at Year-End Regarding activity based on loan repayments[(1)]				
1.Balance of loans granted out of deposits repayable according to the repayment of the loans[(2)]				
Israeli currency - non linked	272	270	233	227
Israeli currency - linked to the CPI	2,322	2,397	41	47
Foreign currency	778	654	779	654
Total	3,372	3,321	1,053	928

Footnotes:
(1) Loans and deposits granted out of deposits, the repayment of which to the depositors is conditional upon, the collection of these loans (or deposits),with a margin or with a collection commission (instead of a margin).
(2) Standing loans and government deposits made in respect thereof, totaling NIS 255 million (2004: NIS 299 million), have not been included in the table.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

B. OFF-BALANCE SHEET COMMITMENT AT YEAR-END REGARDING ACTIVITY BASED ON LOAN REPAYMENTS (CONTINUED)

2. Cash flows in respect of collection commissions and interest margins of activity based on loan repayments - Consolidated[1]

	December 31,2005							2004
	Up to 1 year	Over 1 and year up to 3 years	Over 3 and years up to 5 years	Over 5 years and and up to 10 years	Over 10 years and up to 20 years	Over 20 years	Total	Total
Future contractual flows	19	33	29	58	60	2	201	220
Expected future flows based on Management's estimates of early repayments	19	31	27	48	42	1	168	189
Discounted expected future flows based on Management's estimates of early repayments[2]	17	28	23	35	25	1	129	146

3. Information as to the granting of loans during the year by the mortgage banks:

	31.12.2005	31.12.2004
Loans out of deposits repayable according to the repayment of loans	107	141
Standing loans	1	2

Footnotes:
(1) The CPI linked segment includes the foreign currency segment. The CPI linked segment includes also the non-linked shekel segment as amounts in this segment do not exceed 10% of totl amounts repayable according to collection of loans granted therefrom.
(2) Discounted at the rate of 4.01% (2004: 4.14%).

C. Contingent liabilities and other special commitments

	Consolidated		The Bank	
	December 31		December 31	
	2005	2004	2005	2004
	in NIS millions			
1. Long-term lease contracts - rent payable in future years[3]:				
First year	79	69	39	32
Second year	75	69	37	33
Third year	48	68	24	34
Fourth year	42	44	20	23
Fifth year	35	41	15	21
Sixth year and thereafter	153	286	30	163
Total	432	577	165	306
2. Guarantees to ensure rights of members in provident funds	7,170	6,945	7,170	6,945
3. Commitment to Maof Clearing House – Banks[1]	2	6	-	5
4. Commitment to acquire buildings and equipment	15	21	7	9
5. Borrowed securities[2]	425	*254	111	10

Footnote:
(1) See Note 6.
(2) Not including transactions of lending securities to cover securities short sales, where the Bank serves as an at-risk broker between customers and institutional bodies, which are presented in the Bank's balance sheet as credit to the public and as deposits of the public, respectively. The balance of these transactions at December 31, 2005 was NIS 85.
(3) For details as to long-term lease agreements, see section 20 hereunder.
(4) See section 21 hereunder

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

6. The Bank and Mercantile Discount Bank, which are members of the Ma'of Clearing House Ltd., are responsible along with other Ma'of Clearing House members towards the Clearing House for any financial obligations resulting from option transactions conducted on the Stock Exchange.

For this purpose, the Ma'of Clearing House established a risk fund. The share of the Bank in the risk fund as of balance sheet date, amounts to NIS 24 million, comprising 2.3% of the total risk fund at that date. The share of the Mercantile Discount Bank in the risk fund as of balance sheet date, amounts to NIS 3 million, comprising 0.31% of the total risk fund at that date. Both banks were required to provide collateral in favor of the Ma'of Clearing House by way of securities (Government bonds) in an amount that would cover their possible liability in respect of their share in the risk fund, as stated, as well as an additional amount derived from the volume of operations in this field of each of the banks (see Note 15 F and G).

Each of the banks is also committed to pay the Ma'of Clearing House any monetary charge that may result from operation of their customers involving the writing of options traded within the framework of the Clearing House.

7. A mutual guarantee of members of the Tel-Aviv Stock Exchange Clearing House was in effect until May 2005, according to which members of the Clearing House were obliged at the request of the Clearing House, to cover any loss sustained by the Clearing House as a result of a shortage of securities or default of one of its members.

The share of each member in such loss is based on the ratio of the monetary turnover of the member to the overall monetary turnover of all members responsible for covering the loss caused to the Clearing House, over a period of twelve months ending on the last day of the month preceding the month in which the event causing the loss occurred.

The validity of this guarantee expired in May 2005, and as from that date the arrangements with the Stock Exchange Clearing House were changed according to the articles of the Stock Exchange and the byelaws of the Clearing House. The members are committed towards the Clearing House to cover any amount resulting from the obligations on behalf of themselves or their customers as well as for other Stock Exchange members who are not members of the Clearing House and their customers, in respect of transactions conducted by way of the Clearing House. In addition, each member is responsible for its share in the risk fund based on the ratio of the monetary turnover as described above.

As collateral for their obligations towards the Clearing House, the Bank and Mercantile Discount Bank pledged their rights to accounts maintained at the Clearing House (in which securities are deposited) and at another bank (in which cash is deposited). (See Note 15 J and K).

8. The Bank is committed to the Tel Aviv Stock Exchange and to the Exchange Clearing House to maintain the integrity of the assets of the customers of Tachlit Discount - Investment Consulting and Management Company Ltd. (a wholly owned consolidated subsidiary of the Bank), and to the effect that it will act in accordance with the guidelines of the Stock Exchange.

9. Consolidated subsidiaries of the Bank are engaged in providing a variety of trusteeship services and serve, inter alia, as trustees for certain debentures issued to the public according to a prospectus and which are traded on the Stock Exchange.

10. a) The previous Articles of Association of the Bank, which were amended in March 2002, prescribed that the Bank shall indemnify any person who serves or served as a representative of the Bank, or at its request, as a Director in another company in which the Bank has an interest, for the expenses incurred by such person in connection with legal proceedings instituted against him in respect of acts of commission or omission in the course of fulfilling his duties as a Director of such other company, and for an amount he is ordered to pay under a judgment handed down in such legal proceedings, including by way of a settlement to which the Bank has agreed, unless the judicial authority in such proceedings has found that the acts as aforesaid on the part of such person were performed not in good faith. The

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

Bank is entitled to issue a letter of indemnity to any such Director of another company, including a Director of the Bank who serves as a Director in the other company, at terms and conditions approved by the Board of Directors. Accordingly, the Bank has issued letters of indemnity, unlimited as to amount, to Directors who serve or served at the Bank's request in other companies held, directly or indirectly, by the Bank.

b) According to the Articles of Association of the Bank, any employee or clerk of the Bank who is not an executive officer, will be indemnified out of the funds of the Bank for any liability incurred by him in his capacity as an employee or clerk of the Bank in defending himself in any legal proceedings, whether civil or criminal, in which a judgment is given in his favor or in which he is acquitted, and the Bank is entitled to indemnify him for any financial liability imposed on him in favor of another person for an act done in his capacity as an employee or clerk of the Bank.

c) The Articles of Incorporation of certain consolidated subsidiaries of the Bank allow for indemnification of officers under certain conditions, subject to the provisions of the Law. Certain companies in certain cases granted such indemnification

d) Manpikim – Issue Company of Discount Bank Ltd., a wholly owned and controlled subsidiary of the Bank, has granted indemnification to its Directors, with respect to a financial liability that might be imposed on any of them and with respect to reasonable legal expenses in connection with a Prospectus for the public issue and the listing for trade of subordinate capital notes, published in March 2004, of subordinated capital notes in a total amount of NIS 500 million, under terms specified in the letter of indemnification. In any event, the maximum amount of the indemnification payable to all Directors as a group will not exceed the gross proceeds of the said issue.

Manpikim – Issue Company of Discount Bank Ltd. has granted its Directors identical indemnification in connection with a Prospectus regarding the offer to the public and the listing for trade of subordinated capital notes issued in November 2004, of subordinated capital notes in a total amount of NIS 600 million.

11. The practice of the Bank is to grant, from time to time, and at terms and circumstances accepted in the banking business, letters of commitment and of indemnification, limited or unlimited in amount, and for limited or unlimited periods, and everything in the ordinary course of business of the Bank. Inter alia, such letters of indemnity are granted within the framework of the regulations of the Clearing House as to lost checks; are granted to Receivers and Liquidators; are granted in respect of negligence claims, to providers of various services including assessors, project manager etc; to customers in respect of lost check books; to credit card companies as part of the accountability with them; or indemnification granted as part of a contractual obligation.

This includes a full indemnification granted by the Bank to an assessor, in respect to any damage, which might be caused to him as a result of rendering valuation opinions, except in the case where gross negligence or malfeasance might be found (see Note 6 D above); and a similar indemnification that the Bank gave to an expert who had provided the bank with an economic opinion.

12. The Bank is obligated to Visa International Service Association, that should Israel Credit Cards Ltd. ("ICC") or one of the banks recommended by it for membership in Visa International, breach, deny or neglect the payment of any sum, or will do or refrain from doing anything required of it according to the bylaws of Visa International and its standards of operations, the Bank shall unconditionally indemnify Visa International and its members against all losses, damages, costs, expenses, etc. which may be caused as a result, and which exclusively relate to international payments outside of Israel.

The Bank's guaranty to Visa International is a continuous guaranty, which will remain fully in force until all the moneys and obligations due are fully settled and fulfilled.

A similar undertaking was given to Visa International by Bank Leumi (BLL). BLL and the Bank agreed between

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

themselves, inter alia, that although each of them signed an unlimited guaranty for the benefit of Visa International on behalf of CAL, the responsibility as per the above guaranty shall take effect in a manner so that BLL will assume the responsibility for 65% of the sums that shall be demanded in accordance with the guaranties, and the Bank shall assume the responsibility for 35% of the sums that shall be demanded in accordance with the guaranties, this being in accordance with the ownership percentages of each of the banks in CAL.

In accordance with an agreement dated January 3, 2000, signed by the Bank and Leumi Financial Holdings Ltd., whereby the Bank acquired BLL's shares in CAL, the Bank agreed to cause the release of BLL from its said guaranties as from the date the agreement came into force, in respect of any guaranty that had not been exercised prior to January 3, 2000 (date of signature of the agreement). The Bank has further agreed that in the event that it will not succeed in releasing BLL of the said guaranties, the Bank will indemnify BLL, upon the latter's first request, in each case where BLL will in fact pay any amount as a result of these guaranties. Visa International confirmed in a letter dated February 26, 2002, that BLL was released from its guarantees. In agreements with other shareholders of CAL signed by the Bank, such other shareholders have undertaken to cause the release of the Bank and to be responsible for the indemnification of the Bank in respect of their relative share in such guarantee. (See also Note 34).

In November 2004, the Bank endorsed the above guarantees in favor of Visa Europe Services Inc., an autonomous branch of Visa International representing Visa members operating in Europe.

13. Within the framework of permits granted to the Bank for the construction of a building at 156 Herzl Street, Tel Aviv, which was sold during the course of its construction to a third party, the Bank is obligated to the Tel Aviv Municipality and to the third party, to bear the costs involved in evacuating tenants from the plot. To the best of the Bank's knowledge as at the date of the financial statements, the Municipality had not yet begun evacuating the tenants from the plot, and the Bank is unable to assess the cost of its participation in the evacuation of tenants as aforesaid.

14. Various actions against the Bank and its consolidated subsidiaries:

Various actions are pending against the Bank and its consolidated subsidiaries. These include class action suits and requests to approve actions as class action suits. Among others, allegations are raised in these claims with regard to the unlawful debiting of interest and/or the debiting of interest not in accordance with agreements, subjecting one service to another service, failure to execute instructions, applications for the confirmation of attachment orders in respect of attachments served by third parties on the assets of debtors which they allege are held by the Bank, the unlawful debiting of accounts, mistakes in value dates, the invalidity of collateral security and the realization thereof, applications for injunctions ordering the Bank to refrain from paying out bank guarantees or documentary credit, as well as allegations pertaining to provident funds, securities, construction loans, applications for the removal of restrictions on an account pursuant to the Dishonored Checks Law, 1981. In the opinion of the Management of the Bank, which is based, inter alia, on legal opinions and/or on the opinion of managements of its consolidated subsidiaries, which are based upon the opinion of their counsels, respectively, as the case may be, adequate provisions have been included in the financial statements, where required.

The total exposure with respect to claims filed against the Bank and its consolidated subsidiaries, whose prospects of materializing, in whole or in part, has been assessed as reasonably possible, amounts to approximately NIS 139 million.

14.1 Below are details with regard to actions against the Bank, including a class action suit and a request to approve an action as a class action suit:

14.1.1 On November 14, 1999, the Bank received notice of a request for exemption from litigation levy submitted to the Tel-Aviv District Court by a former customer of the Bank, to enable him to file a claim against the Bank in the amount of NIS 467 million. Both the State and the Bank opposed this exemption request. In a hearing, which took place on

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

May 1, 2000, the plaintiff was awarded an exemption from litigation levy of NIS 456 million, which would have applied to the action.

In the action, the plaintiff alleges wrongful doings made in his accounts until 1989, and attributes to the bank acts of misappropriation of funds, which allegedly were deposited in his business and private accounts. The hearing of the evidence commenced in January 2004.

14.1.2 A lawsuit was filed on June 19, 2002, with the District Court in Tel-Aviv together with a plea to approve it as a class action suit against the Banking Clearing Center (hereinafter – "MSB") and against six banks including the Bank and Mercantile Discount Bank Ltd.

The amount of the claim relating specifically to the claimant (the Ramla Municipality), as valued for the purpose of the claim totals NIS 811 thousand. Of the amount of the specific claim, the Bank's share amounts to NIS 91 thousand, and the share of Mercantile Discount Bank amounts to NIS 58 thousand. The amount of the class action against all the defendants, which the Court is asked to approve, is valued by the claimant at NIS 967.5 million. It should be noted that the First International Bank, an affiliated company of the Bank, is also a defendant in this suit.

The cause for the claim is that the defendants have created a cartel and/or a binding arrangement with respect to the clearing of permanent payment orders which the defendant banks execute. According to the claimant, in consequence of the binding arrangement between the defendants, she and similarly other customers who are charged payment order clearing services commissions, pay unreasonable and improper amounts, which are considerably higher than their real price, and which range between US$0.325 and US$0.5 for each payment order credit and NIS 17.80 for each return of a payment order. An expert opinion submitted by the claimant claims that the proper price for each such clearing transaction should be NIS 0.15 at the most, and only NIS 6.5 for each return transaction. Amongst other things, the claim is based also on the decision of the Commissioner of Restrictive Trade Practices of June 10, 2002.

The group, which the claimant proposes to represent in the class action, comprises of whoever made use of the service offered by the defendants or anyone of them, for executing the clearing of payment orders in the period of seven years prior to the date of the lawsuit.

The claimant requests the Court to declare that the defendants are party to a binding arrangement in everything connected with the charging of commissions for the clearing and return of payment orders, and to determine that the commissions collected in respect of the above transactions are higher that the reasonable and proper price which should be charged for such transactions. The Court is also requested to determine the correct and proper price for these transactions, and to instruct the defendants to repay the excess amounts collected.

On September 12, 2002, the Bank requested the Court to summarily dismiss the claim and the request for approval as a class action suit, basing itself on the following: Non payment of Court fees as due; lack of authority of the Municipality to act as a representative claimant in a matter which does not have a special and separate relationship to the population and residents of the City of Ramla; the claim relating specifically to the Municipality in the amount exceeding NIS 800 thousand, is not appropriate for a hearing in the matter of a class action.

On December 1, 2002, the Court decided in the matter of the structure of the proceedings. The Court decided that the petition for a separate hearing of the claims for summary dismissal would be only partly admitted in as far as the matter relates to the claim that the plaintiff, as a Municipality, is not authorized and may not properly proceed with its own claim as a class action. The Court ordered the representative for the Attorney General, through the Tel-Aviv District Attorney's Office (civil claims), to appear at the hearing to be fixed and allowed him also to submit his position in writing. The Court also instructed the parties to submit in writing their claims as to lack of authority.

In the meantime, all the parties had submitted their briefs in writing and it transpired that the Attorney General supports

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

the claim of the Bank that the Municipality has no authority to act as a representative of a class action in a matter which does not have a direct and separate effect upon the population of the City of Ramla.

On November 11, 2003 the Court decided to dismiss the action in limine. On February 18, 2004 the claimant filed an appeal at the Supreme Court against this decision.

On November 28, 2005, the Court conceded to this request. On December 13, 2005, the plaintiff filed a motion for an additional hearing at the Supreme court. A date for the hearing has not yet been fixed.

14.1.3 On November 1, 2004, an action was filed with the Court in Los Angeles against the Bank and others for the payment of damages in the sum of US$350 million as well as a plea for punitive damages against the Bank as the Court will determine.

Until prior to the issue of the financial statements, the Court documents have not been served on the Bank.

The plaintiff alleges that the Bank has breached explicit undertakings towards it for the granting of a credit line in the amount of US$3 million. The plaintiff bases the action upon several causes, amongst which are: the non-disclosure of material facts, making promises with no intension of honoring them, deceit through the non-disclosure of material facts, misrepresentations, negligence, breach of a written agreement, cover up and violation of non-competition laws.

The plaintiff alleges that due to the said breach of undertakings, the Bank brought about its demise and caused it heavy losses estimated at amount in excess of US$350 million.

It should be noted that according to the agreements signed between the plaintiff and the Bank, the applicable jurisdiction is that of the Courts in Israel and the applicable law is the Israeli law.

On December 17, 2004, the Bank submitted to the Court in Los Angeles a petition, requesting that the hearing of the claim be transferred from the Court of the State of California to the Federal Court. On January 25, 2005, ErgoQuest submitted an objection to this request.

On February 18, 2005, the Bank again submitted to the Court in Los Angeles, a petition requesting that the claim be dismissed on the grounds, inter alia, that the Court in Los Angeles has no jurisdiction in this matter, due to the fact that the agreement between the plaintiff and the Bank contains a clause stipulating that exclusive jurisdiction in any legal proceedings is given to a Court in Israel and applying the Israeli law to the agreements, and that the appropriate forum for hearing this matter is a Court in Israel. ErgoQuest also submitted an objection to this petition.

The hearing of the petitions of both parties has been set for April 2005.

Management of the Bank, based on Counsel's opinion, believes that there are good prospects that the Court in the United States will admit the preliminary arguments of the Bank and will dismiss the action in the United States. Accordingly, the prospects of this claim are remote and in any event it would seem that the amount claimed is highly excessive. Nonetheless, the Management of the Bank, based on counsel's opinion, is unable to estimate whether the plaintiff would submit a similar claim in Israel, and if so under what causes of claim and for what amount.

On April 8, 2005, the Federal Court in Los Angeles dismissed the action on the grounds that the appropriate forum for dealing with this action is the Court in Israel. The Court did not refer to the other arguments of the Bank including the argument regarding the jurisdiction.

On May 6, 2005, the plaintiff appealed the said decision.The Court has fixed dates for the submission of briefs, though a date for the hearing of the appeal has not as yet been set.

Management of the Bank, based on Counsel's opinion, believes that there are good prospects that the Court in the United States will admit the preliminary arguments of the Bank and will dismiss the action in the United States. Accordingly, the prospects of this claim are remote and in any event it would seem that the amount claimed is highly excessive. Nonetheless, the Management of the Bank, based on counsel's opinion, is unable to determine whether the

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

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plaintiff would submit a similar claim in Israel, and if so under what causes of claim and for which amount.

14.1.4 On June 23, 2004, an action was filed with the Tel-Aviv District Court together with a request for approval of this action as a class action. The personal claim included in the action is NIS 6. The claimant estimates that the class numbers about 375,000 members and the amount of the class action is estimated by the claimant at NIS 200 million. (According to the Bank's examination, even in the most extreme scenarios, the maximum amount to which the Bank would be exposed would not exceed NIS 100 million).

According to the claimant, the Bank, in its publications and in information provided orally, created a presentation according to which the drawing of cash by way of the automatic teller machines is a commission free transaction, while in fact the Bank collects a line entry commission with respect to such an activity.

On May 25, 2005, a request was submitted to the Court, with the consent of both parties, to delay the hearing of the case until a verdict is given in another action submitted against the Bank in respect of a similar cause of action.

The Bank informed the Court on July 14, 2005, that the plaintiffs in the other action had requested its dismissal (see 4.2 above). Following this, proceedings in this case have been renewed.

On January 1, 2006, the court dismissed the plea and the claim without an order for costs.

14.2 A request to approve an action against Mercantile Discount Bank ("MDB") as class action suit:

An action and a request to have it approved as a class action suit under the Banking Law (Customer Service), 1981, were submitted on December 8, 2002, against MDB and against the Bank by a customer, who in the past had submitted an action on the same ground together with a request to have it approved as a class action suit under the Securities Law, which action was dismissed because of non-payment of Court fees. The ground for the claim is the alleged damage caused to the claimant as a result of impairment in value of securities purchased on his behalf by portfolio managers, who unlawfully hiked up the prices of securities. The claimant argues that the connection of MDB to the damage claimed results from the credit granted by the Bank to the said portfolio managers, which enabled them to conduct transactions in the said securities, and from the impression received by that customer that the granting of credit served to support the prices of the securities.

As estimated by the claimant, the damage caused to him amounts to NIS 735 thousand. The total amount of damage stated in the request for approval of a class action suit against MDB and the Bank together, is NIS 500 million.

14.3 A petition to approve an action against ICC and the Bank as a class action suit, where the appeal against its approval as a class action was accepted, and a petition to approve an action against ICC and the Bank as a class action suit, which the plaintiff moved to strike:

In September 2004, an action was filed with the Tel-Aviv District Court against ICC, the Bank and Bank Leumi together with a request for approval of the action as a class action. The amount of the class action is NIS 320 million, and it purports to represent all businesses, which since 1999 were charged by ICC with "manual statement commission" and with "minimum commission".

The claimant argues that when it joined the agreement of business houses with ICC it was promised that the only commissions that will be charged to it will be a sales commission, therefore the collection of additional commissions is unlawful; that the power determined in the agreement between it and ICC, according to which ICC is entitled to change at any time the terms of payment is a discriminating term in a uniform agreement; that the collection of commissions was made without due disclosure; and that in any event there is no factual justification for the collection of the said commissions.

The plaintiff submitted a request that the action against all the defendants be dismissed without an order for costs. The Court requested the Attorney General's position. The Attorney General has not yet presented his position. The Court

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dismissed the claim on January 16, 2006.

14.4 Request to approve an action against Discount Mortgage Bank ("DMB") as a class action suit:

On November 2, 1997 a petition was filed with the Tel-Aviv District Court to approve the filing of a class-action suit against DMB and against three additional mortgage banks regarding the charging of commissions for life assurance and property insurance of borrowers. The amount set in the class-action suit is NIS 500 million, with no specific allocation to the banks involved.

Whereas, with respect to another request to approve an action as a class action, in a matter practically identical, the Court had already handed down its decision, which was appealed against, the Judge presiding in this case has decided that it will be heard only after the Supreme Court will issue a judgment in principle on the matters in dispute that were raised in the appeal against the ruling already given with respect to the other motion.

At the hearing held on January 6, 2002. the Court decided to defer the hearing of the case to an undefined future date, anticipating the decision in principle of the Supreme Court. It should be noted that on April 3, 2003 the Supreme Court ruled in another case (not related to the banking sector). The Court ruling states that the effectiveness of Regulation 29 (of the Civil Proceedings Regulations) should be interpreted in a narrow manner, an interpretation that supports the Banks' claim in the matter. A verdict has been recently given in an additional hearing in this case at the Supreme Court, according to which it is not possible to file a class action suit under Regulation 29 of the Civil Code Regulations.

In a preliminary hearing held on January 26, 2006, the plaintiff waived the cause of action in as much as they rely on the said Regulation 29. The hearing of this action was again suspended with no date.

14.5 Israel Discount Capital Markets and Investments Ltd. ("DCMI") – a legal procedure:

On December 21, 1999, an indictment was filed with the Magistrate Court in Tel-Aviv against several parties including DC MI and its two former employees. The felonies attributed to DCMI and the said two employees, constitute violations of the Securities Law, which allegedly were committed during the years 1994 and 1995.

DCMI denied the accusations and has submitted to the Court a response brief. The hearing of the evidence began on March 2002. The Management of the Bank based on the opinion of the Management of DCMI, based on Counsel's opinion, is of the opinion that, it is not possible at this stage to estimate the prospects of a conviction in this case.

15. Additional claims against the Bank and its consolidated subsidiaries:

A class action suit and requests to approve certain actions as class action suits are pending against the Bank and its consolidated subsidiaries, which in the opinion of the Management of the Bank, which is based on legal opinions and/or on the opinion of managements of its consolidated subsidiaries, which is based on the opinions of their Counsels, respectively, as the case may be, it is not possible at this stage to evaluate their prospects of success, and therefore no provision have been included in respect therewith.

15.1 A request to approve a certain action against the Bank as class action suits:

On December 8, 2002, a lawsuit was filed against the Bank and against Mercantile Discount Bank together with a plea to have it approved as a class action suit under the Banking Law (Customer Service) – 1981. This lawsuit was filed by a former customer of the Bank and of Mercantile Discount Bank, who in the past filed a suit on the same ground and a plea to have it approved as a class action suit under the Securities Law, which lawsuit was rejected as a result of non payment of Court fees.

The plaintiff raises claims against the Bank, according to which the Bank allowed the opening of fictitious accounts at the time of the securities issue by the Einy Company and granted credit to hundreds of "Straw Customers" without obtaining collateral. It is also alleged that, at a later stage, the Bank enabled the manipulation in the price of the shares. The plaintiff alleges that in doing so, the Bank violated the Securities Laws (Dispersion obligations, reporting obligations,

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

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responsibility for misstatement in a Prospectus and fraudulently manipulating the price of the shares), violating the Banking Laws (Banking Law, Customer Service [Investment consulting]), violated proper banking procedures, caused damaging injustice (negligence, fraud and violation of legal obligations) and also performed illegal acts.

The plaintiff estimates that the damage caused to him amounts to NIS 5.7 million. The total amount of the damage stated in the petition for a class action against the Bank and Mercantile Discount Bank together is NIS 500 million.

The Bank and Mercantile Discount Bank have submitted several preliminary pleas, including a plea for dismissal of the action due to the non-payment of Court fees, pleas for summary dismissal of the action, due to duplicate proceedings and misuse of the judicial process, and a plea for deleting documents and items from the claim brief. A date for the hearing the said pleas has not been fixed as yet.

The Court has deferred the date by which the reaction to the request for approval may be submitted until such time as these requests are decided, so that in effect, at this stage, the proceeding is in practice delayed until the decision on the preliminary requests.

See section 15.2 above for details of the action filed against Mercantile Discount Bank based on other grounds.

15.2 On September 1, 2004, an application for exemption from the Court fee was submitted to the Tel Aviv District Court in connection with a suit in a sum of NIS 500 million brought by the liquidators of a company against forty defendants, one of which was the Bank.

The suit against the Bank turns on three causes only, which relate to alleged injury valued at $4 million in respect of a transaction undertaken between the company in liquidation and a third party involving the sale of an asset mortgaged to the Bank, which, according to the liquidators' assertions, was sold for less than its true value, the release of the shareholders of one of the companies in the group from their guarantees in relation to the debts of the company to the Bank totaling NIS 3 million; and the return of deferred payment orders to the company in liquidation without the items passing through the company's bank account, thus causing injury valued at NIS 9 million.

For reasons of caution, it should be noted that although the liquidators claim that the behavior of the Bank as described above led to the final liquidation of the company, but this assertion was made in general terms only without any specific claims having been made by the liquidators as to the injury attributable to the Bank in relation to this cause of action.

The Bank submitted an objection to the requested exemption. The hearing of the petition was fixed for April 10 2006. As long as the exemption from payment of the Court fee is withheld, the suit is not considered to have been submitted.

15.3 On December 8, 2005, a former customer of the Bank (hereinafter – 'the plaintiff") filed a lawsuit in the amount of US$300 million in the Court of the State of California, USA, being a counterclaim following peoceedings instituted by the Bank in the United States, for the enforcement of Court rulings given in Israel against the Plaintiff, in an amount of US$13 million. The counterclaim is based on the argument that the Bank had violated its obligation to provide credit to the plaintiff and to a company of which he was one of the owners (hereinafter – "the company"), for the purpose of purchasing another company. It is also alleged that false and negligent representation had been provided to the plaintiff.

The direct damages were set at an amount of at least US$100 million in respect of loss of earnings as a result of the failure of the transaction to purchase that other company, and at least US$200 million in respect of loss of earnings as a result of the collapse of the company. Punitive damages are also claimed in an amount not estimated by the plaintiff.

It should be noted that a similar action filed by the plaintiff and others already in 2000 was dismissed in limine with the consent of the company's Liquidator, and that the proceedings instituted in the USA by the plaintiff several years ago with respect to the issue which is the subject of the claim, had been dismissed by the Court in New York, following the admittance of the Bank's argument regarding improper forum.

The bank motioned the Court in the USA for dismissal of the claim in limine on grounds of lack of jurisdiction and

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

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improper forum and at this stage, preliminary procedures and other discussions are taking place concerning the appropriate Court to hear these threshold arguments (the Federal court or the Court of the State of California).

15.4 Motion for approval of a certain action against the Bank and against Mercantile Discount Bank as a class action suit:

On January 25, 2006, an action was filed at the Tel-Aviv District Court against the Bank and against Mercantile Discount Bank (hereinafter – "the banks"), together with a motion to approve the action as a clas action suit.

The plaintiffs, customers of the banks, allege that in 2001 the banks changed the method of interest computation in a manner that they had been charged on deviation from a credit facility with an exceptional addition to the maximum interest charge, instead of an exceptional addition to the interest charge agreed between them and the bank, as was previously customary.

The plaintiffs allege that the banks have violated the principles of fair disclosure determined under the Banking Law (Customer service), 1981 (hereinafter – "the banking Law"), and have thus acted contrary to sections 5 and 15 of the banking law; moreover, they ascribe to the banks a transgression of Sections 3 and 4 of the banking law, prohibition on misleading customers and the exploitation of customers' ignorance and lack of experience.

The plaintiffs motioned the Court for a declaration that the mechanism of interest computation implemented since 2001 is illegal, that the agreements regarding interest rates that they require customers to sign are not in compliance with the requirements of the law in accordance with the principles of fair disclosure, and accordingly instruct the two banks to refund all the customers the excessive interest paid by them (the difference between the agreed risk premium and the maximum addition, in respect of all those customers who had paid the reduced risk premium but were charged with excessive interest in the period from December 31, 2001 to date of filing of the action).

The plaintiffs claim a personal damage of NIS 5,954 as regards discount bank and NIS 13,985 as regards Mercantile Bank. The Plaintiffs estimate that the total refundable amount to be charged to Discount Bank is NIS 44 million and NIS 10 million to be charged to Mercantile Discount Bank.

15.5 A request to approve a certain action against Discount Mortgage Bank ("DMB") as class action suit:

On June 19, 2000, two borrowers of DMB filed with the District Court a petition for approval of an action as a class action suit against DMB and against the Israel Phoenix Insurance Co. Ltd. ("Phoenix"), where the properties of the borrowers are insured. The action is for an amount of NIS 105 million.

The borrowers claim, inter alia, that DMB has insured their properties for amounts which exceed their reinstatement value, and that the sum insured was increased in excess of the increase in the Consumer Price Index.

On September 10, 2000, DMB filed its response to the petition for approval of a class action suit, in which the Court is requested to dismiss the petition in limine and as regards its substance. It should be noted that Phoenix Insurance also responded to the petition requesting the Court dismiss the petition in limine and as regards its substance.

On October 29, 2000, the claimants submitted their reply to the above response, in which they repeat the request for approval of a class action suit.

On December 25, 2000, the Court decided that the arguments raised in this petition were similar to the arguments raised in the pleas for approval of class actions discussed in 14.4 above, and consequently the Court decided to defer the hearing of the said petition until after the verdict is given in those other pleas. The Supreme Court rejected on April 4, 2001, a plea for permission to appeal this decision.

In its decision of December 25, 2000, the District Court did not determine that proceedings against Phoenix Insurance should also be stayed. Phoenix Insurance petitioned the Supreme Court for permission to appeal in this respect. On January 28, 2002, the Supreme Court admitted the plea of Phoenix Insurance and ordered to stay proceedings against it at the District Court.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

By mutual consent of the parties, thehearing of the pre-trial in this action has been postponed to March 27, 2006.

16. Pleas for approval of suits as class action suits – Harel Insurance Investments Ltd. (hereinafter - "Harel"):

The financial statements of Har'el describe, inter alia, various claims and requests for those claims to be approved as class action suits, in relation to which it was noted that, after consulting the company's legal advisors, the management of Har'el is unable to assess the prospects of these claims as follows:

16.1 A plea was submitted in October 2000, to the District Court in Tel-Aviv-Yafo, to approve an action against a consolidated subsidiary of Harel - Harel Insurance - as a class action suit, on behalf of all customers of Cellcom Israel Ltd. ("Cellcom"), who purchased insurance for their cellular telephones as from 1994 (hereinafter - "the Plea"). The other respondents in this case are Cellcom and Clal Insurance Company Ltd.

It is claimed in the Plea that VAT was unlawfully collected on the premium component, and also that unlawful insurance services were provided, in contravention of the Insurance Business Supervisory Law, 1981. A claim affidavit was attached to the Plea, which the claimants request to approve, the total amount of which, against all respondents, is NIS 402 million. On October 31, 2005, the defendants filed a motion for the dismissal in limine of the petition to approve the lawsuit as a class action suit. On February 5, 2006, the Court admitted the petition of the defendants.

16.2 On January 9, 2005, a request was submitted in the Tel Aviv District Court for the approval of a class action against a subsidiary of Har'el, Har'el Insurance. The claim concerns a claim that Har'el Insurance misled its commercial customers on the signing of comprehensive insurance contracts for vehicles weighing up to four tons, by failing to disclose that while the premium payable is calculated by reference to the full value of the vehicle as set out in the Yitzchak Levi tariff (which includes a VAT component), in the event of a claim being made on the policy, Har'el Insurance deducts the VAT component from the value of the vehicle. The plaintiffs estimated the total value of the damage sustained by all the members of the above group at NIS 31 million per year, and over a period of seven years, at NIS 217 million. (The relief sought is recompense by reference to of Har'el Insurance's records, and not by reference to the said estimate).

17. Certain requests for approval of class actions against the First International Bank of Israel Ltd.

The financial statements of the First International Bank of Israel Ltd. in describing details of requests for approval of class actions that are pending against this bank and against its subsidiaries, and with respect to which management of the First International Bank, after consulting with legal advisors, is unable to estimate, at this stage, the prospects of these claims and therefore no provision has been made therein, make mention, inter alia, of the following procedure:

In 1997, claims were brought in the Tel Aviv District Court against two subsidiaries of the First International Bank – the First international Mortgage Bank Ltd. and the Mortgage Ltd. and Atzma'ut Mortgage and Development Bank Ltd. (hereinafter: "the mortgage banks in the First International Group"), and against other mortgage banks, in which it was claimed that the said banks unlawfully charged borrowers with a commission relating to life assurance and property insurance policies, and that the borrowers are entitled to the refund of such amounts. These claims total approximately NIS 1.5 billion (in nominal values). A petition to approve these action as a class action suits was also filed. The said claims and petition did not include the manner of calculation of the said amount; neither did they include details as to what part of the amount is attributed to the mortgage banks in the First International Group.

In November 1997, the Court rulled as to the action filed in July 1997, according to which it dismissed the claim in the form of a class action according to the Banking Law (Customer service), 1981, and the Restrictive Practices Law, 1988. Nevertheless, the Court ruled that it was possible to hear a claim for a declarative relief under Section 29 of the Civil Code Regulations, with respect to causes of action created prior to May 10, 1996 (date of publication of the amendments to these Laws regarding class actions).

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

In December 1997, the said banks applied to the Supreme Court for permission to appeal against the said judgment, as well as petitioned the court to stay execution of the proceedings until judgment is passed in this appeal. The request for permission to appeal and for the stay of execution has been admitted by the Supreme Court.

In a hearing held by the Supreme Court in the above appeal on November 25, 2001, the parties accepted the suggestion of the Court to stay the hearing of the appeals until a judgment is given in another appeal case pending at the Supreme Court, in which a fundamental decision is to be given in the matter of the status, applicability and terms of Section 29 of the Civil code Regulations, a question standing at the heart of the said appeal.

On April 2, 2003, a judgment was given in that other appeal in the matter of the status and applicability of Section 29 for the purpose of submitting a class action. Therefore, on April 10, 2003, the Supreme Court decided that the parties submit their arguments in writing as to the continuation of the appeal proceedings. All the parties have submitted their briefs as stated.

The decision of the Supreme Court in the matter has not yet been given.

On September 1, 2005, a decision was given in the further hearing in the matter of the status and application of Regulation 29, which left the ruling as is. This ended, for the time being, the use of Regulation 29 as an instrument for serving class action suits.

The First International Bank has noted that if the above claims are admitted, it would result in a significant decrease in the income of the mortgage banks of the First International Bank Group.

18. Discount Israel Capital Markets and Investments Ltd., is a partner in several venture capital funds, and in this respect is obligated to invest in these funds. Furthermore, Discount Israel Capital Markets and Investments Ltd. owns 19.6% of the equity capital of Menif – Financial Services Ltd., which is engaged in the complementing of the equity capital of building contractors by providing guarantees.

As of December 31, 2002, Discount Capital Markets is committed to additional investments as follows: US$2.9 million in the Mezzanine Fund; US$0.4 million in the International Fund; US$5.6 million in the second Vertex Fund; US$3.1 million in the Vitalife Fund; US$2.6 million in the Stage One Fund; US$0.8 in the Goldengate Bridge Fund and US$4 million in the Fortisimo Capital Fund. Through "Menif", the company also has an obligation to grant to building contractors guarantees amounting to US$6 million. As of December 31, 2003, outstanding guarantees granted amounted to NIS 11.6 million.

In addition, as of December 31, 2004, the Bank is committed to invest US$17.4 million in FIMI Opportunity Fund. Furthermore, Mercantile Discount Bank has a commitment to invest in five venture capital funds amounts totaling NIS 11 million, as of December 31, 2003 (as of December 31, 2003 – NIS 14 million).

19. The Bank has formed a workplan concerning the execution of a project; the main part thereof is the renovation of the central computer infrastructure of the Bank, while replacing the existing operating system and transition to the IBM operating system. In this respect, the Bank has completed the process of identifying a "software package" that would replace, subject to the necessary modifications, most of the existing banking software.

On October 31, 2001, the Bank signed an agreement with Accenture Ltd. (an Israeli company) and with Alnova Technologies Corporations S.L., both of the international Accenture Group, for the purchase of a "Core Banking" system and services to modify the system to the needs of the Bank and for the absorption thereof by the Bank.

The first stage in the development of the purchased system was the definition of the processes required for the modification of the system (PDP). In this framework and in the detailed testing of the different modules, the required modifications to the software, the order of development, and the solutions to for the transitional period (co-existence) were defined, a workplan was established, including principle milestones, and a budgetary framework for their execution

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

was defined. The Bank's Management and the Board of Directors approved the results of the PDP stage as well as the workplan and the budgetary framework. The original budgetary framework amounted to US$116 million, not including VAT. Release of the software for operation at the Bank, is planned at several stages over a number of years, the first stage being defined as the pioneer stage, at the end of which conclusions would be drawn regarding the manner of execution of the project and the workplan would be updated accordingly. At the end of October 2003, the first stage of the system was installed at all branches of the Bank and is being successfully operated. Following certain difficulties, which arose during the execution of the first stage (which as stated had been defined as a pioneer stage and was successfully completed), and which caused a delay of five months in the completion thereof, a process of drawing conclusions was undergone at the end of 2003. Following this process, changes were made to the setup of the Bank for the execution of the project; modifications were made to the contents of the project while expanding its contents in respect of certain issues and reducing the contents in respect of other issues. The Board of Directors approved the enlargement of the budgetary framework of the project as well as a postponement in the time schedule for completion of the project. The budget of the project following the update amounts to US$155 million, excluding VAT. This budget includes the direct costs of the project but does not include indirect costs and the cost of the effect on the current operations of the Bank caused by the execution of the project.

During the second half of 2004, additional systems were installed within the framework of the second roll out, including a significant system concerning deposits that was launched successfully in December 2004. Following the launching of this system, several failures have been discovered (most of them repaired), including the non-presentation of data relating to deposits in foreign currency at the automatic service machines (though this data was recorded in the central EDP system), and a failure as a result of which notices to customers have not been issued in time regarding deposits entries made and notices as to future maturities of deposits.

The second stage was also not implemented according to the set time schedules (as updated) and also deviated from the updated budget.

As a result of the conclusions drawn from the second roll out, the third roll out has been re-planned (as was the execution of all projects relating to the fourth roll out). Following this, Management of the Bank has prepared an update of the budget required for the second roll out (based on the actual cost) and of the budgets for the third and fourth roll outs. An update for the fifth roll out will be made, if necessary, with the progress of the project and the preparation of a detailed planning of these roll outs.

This budgetary update was discussed in March 2005 by the Computerization Committee of the Board, which decided to recommend to the Board that the budget be increased to US$185 million, excluding VAT (namely: US$216 million including VAT). The Board of Directors approved the said increase in April 2005.

Until December 31, 2005, US$127 million (excluding VAT) have been invested in this project.

20. Sale of properties:

a) On June 30, 2002, the Bank signed an agreement for the sale of the plot of land adjacent to the Bank's Management building, on the corner of Yehuda Halevi and Lillienblum Streets in Tel-Aviv. The consideration for the sale is US$13.4 million. The agreement includes provisions for the payment of additional consideration in respect of additional building rights, if these are approved.

The Bank is committed to lease an area of some 11.6 thousand square meters in the office building to be erected on this site as well as underground and parking space, for a period of 13 years at an annual cost of US$2.6 million.

b) On September 19, 2002, the Bank signed an agreement for the sale of a warehouse area in Ashdod of some 37 dunums, in consideration for US$6.1 million.

19. CONTINGENT LIABILITIES AND SPECIAL COMMITMENTS (CONTINUED)

C. CONTINGENT LIABILITIES AND OTHER SPECIAL COMMITMENTS (CONTINUED)

The Bank is committed to lease an area of some 15.2 thousand square meters, of which a built-up area of 6.5 thousand square meters, for a period of 11 years, at an annual cost of US$309 thousand.

In July 2005, the Bank entered into an agreement with Meshulam Levinstein Buildings (1986) Ltd. (hereinafter – "the Company") for the purchase from the Company of office space of 12.5 thousand square meters, basement and parking areas with regard to the "Discount Tower" which is being constructed on Yehuda Halevi Street.

Upon the signing of the said agreement, the said commitment of the Bank, pursuant to the agreement dated June 2002 for the lease of an office space was cancelled.

The Bank has also entered into an agreement with Meshulam Levinstein Contracting Ltd. and Engineering (the parent company of the Company) to supply construction services in respect of an additional 4 thousand square meters in the "Discount Tower".

The total cost of the area, which the Bank will receive in the Tower, including betterment levy, acquisition tax and value added tax, amounts to US$67 million.

c) On June 4, 2004, the Bank signed an agreement with another party for the sale of the building in Ramat-Gan, which had previously been designed to serve as the offices of the Bank's management, as well as for the sale of additional rights in the property, present and future. The proceeds of the sale amount to NIS 229 million.

The bank has undertaken to lease for a period of ten years an area of 430 sq. mtrs. In the commercial floor and an area of 2,145 sq. mtrs. in the office floors, in consideration for US$578 thousand per annum (two floors out of the 20 floors being built).

21. The Articles of "Tamar, "Geffen" and "General Severance Pay Fund" provident funds state that the Bank has guaranteed each of its members that the provident fund would pay the member no less than the total amount of the deposits made by the member or on his behalf. Therefor, in the event that the total amount to be received by a member from the provident fund, according to his entitlement therein is lower than the total amount deposited by him or on his behalf with the provident fund, the Bank would pay the difference to that member. A similar arrangement also exists with the "Mercantile Central Severance Pay Fund" managed by Mercantile Discount Bank. As a general rule, the amounts accumulated in the said funds significantly exceed the amounts guaranteed by the Bank and Mercantile Discount Bank. In view of the above and based on past experience, the Bank believes that the amounts that the Bank and Mercantile Discount Bank might have to pay in respect of the said guarantees are negligible.

The Articles of the provident funds "Tamar" and "Geffen" and the Articles of "General Severance Pay Fund" have been changed recently, and it has been determined in them that the guarantee of the Bank shall not apply to members who will join the funds subsequent to June 30, 2006 and to accounts opened subsequent to this date (based on an assessment made by the Bank, the fair value of the said guarantee amounts to NIS 0.5 million).

20. DERIVATIVE INSTRUMENT ACTIVITY – VOLUME, CREDIT RISK AND DUE DATES

GENERAL

1. Transactions in derivative financial instruments involve market, credit and liquidity risks.
   A. The activity of the Bank involves exposure to various risks, including market risk. The market risk includes, inter-alia, linkage base, interest and exchange rate fluctuation risks, in the correlation characteristics between the various economic parameters, etc. As part of the overall Bank's strategy for the management of market risk, as stated above, the Bank combines in its financial asset and liability management and as a market maker, a wide range of derivative financial instruments. Among these financial instruments are: Forward transactions, IRS, FRA, SWAP, options purchased or written by the Bank, which hedge against changes in foreign currency exchange rates, inflation rates, interest rates, share indices, embedded options, etc.
   B. The credit risk involved in these transactions derives from the fact that the stated amount of the transaction does not necessarily reflect its credit risk. Such risk is measured according to the maximum amount of the loss that the Bank might sustain if the other party to the transaction will not honor its terms, net of amounts subject to enforceable set-off agreements.
      In computing the fair value, the Bank takes into consideration the credit risk relating to the counter party to the transaction, as regards two categories: customers and banks, considering the quality of the product.
   C. Market liquidity risk derives from the fact that it might not be possible to contain rapidly the exposure involved, mainly in markets of low level trading.
2. Where a derivative instrument is not intended as a qualified hedging, it is stated according to its fair value, changes in fair value being taken currently to income. Certain of these derivatives are intended and qualified as fair value hedging and cash flow hedging, while others are purchased or written as part of the asset and liability management of the Bank (ALM).
3. It is possible for the Bank to enter an agreement that in itself does not constitute a derivative instrument but which contains an embedded derivative. In respect of each contract the Bank evaluates whether the economic characteristics of the embedded derivative are not clearly and closely connected to those of the hosting agreement, and examines whether an independent instrument with the same terms of the embedded instrument would have agreed with the definition of a derivative instrument. Where the above terms are fulfilled, the embedded derivative is separated from the host agreement, treated as a derivative in its own right and stated in the balance sheet together with the host agreement at its fair value, changes in its fair value being taken currently to income. Where the Bank is unable to reliably identify and measure an embedded derivative for the purpose of its separation from the host agreement, the agreement as a whole is stated in the balance sheet at fair value.
4. The Bank maintains a written documentation of all hedging relations between hedging instruments and the items hedged, as well as the object and strategy of risk management by way of creating the various hedging transactions. The documentation includes the specific identification of the asset, liability, the firm commitment or the anticipated transaction, which were determined as the hedged item, and the manner in which the hedging instrument is expected to hedge against risks involved in the hedged item. The Bank assesses the effectiveness of hedging relations both at the beginning of the transaction and on a continuing basis, in accordance with its risk management policy.
5. The Bank discontinues its hedging accounting from the following points onward when:
   a. It has been determined that the derivative is no longer effective, setting off the changes in fair value or the cash flows of the hedged items;
   b. The derivative has expired, cancelled or realized;
   c. The designation of the derivative as a hedging derivative is discontinued, due to the probability of the execution of the transaction being remote.

20. DERIVATIVE INSTRUMENT ACTIVITY – VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

d. A firm hedging commitment no longer complies with the definition of a firm commitment.

e. Management cancels the designation of the derivative as a hedging derivative.

When hedging accounting is discontinued due to the fact that a derivative is no longer qualified as hedging an effective fair value, the derivative will continue to be stated in the balance sheet at its fair value, however the hedged asset or liability will no longer be adjusted for changes in fair value. When hedging accounting is discontinued due to the fact that the hedged item no longer qualifies as a firm commitment, the derivative will continue to be stated in the balance sheet at fair value and every asset or liability which previously were stated based on the recognition as a firm commitment shall be removed from the balance sheet and recognized as income or loss for the reported period.

The net income or loss in respect of derivatives related to discontinued hedging of cash flow, will continue to be stated as part of other cumulative comprehensive profit, unless it is probable that the anticipated transaction will not materialize until the end of the initially determined time period (as documented at the beginning of the hedging relations) or within a period of two months thereafter.

Notwithstanding the above, on rare occasions, the existence of mitigating circumstances related to the nature of the anticipated transaction, which are not subject to the control or influence of the Bank, might indicate the probability that the anticipate transaction would in fact materialize at a date subsequent to the end of the additional two month period. In such a case, the net profit or loss in respect of the derivative, which hedges the discontinued cash flow, will continue to be reported as part of other cumulative comprehensive profit, until they are reclassified when the anticipated transaction will affect the income statement. If it is probable that the additional period of two months and the anticipated hedged transaction do not fall even under the exception mentioned above, the profit or loss reported as part of other cumulative comprehensive profit, are to be immediately reclassified to the income statement.

FAIR VALUE HEDGING

6. Certain derivatives are being designated by the Bank as hedging fair value. The changes in the fair value of derivatives hedging against exposure to changes in fair value of an asset or liability, are currently recognized in the income statement, as well as the changes in the fair value of the hedged item, that could be related to the risk being hedged.

   In 2005, the Bank recorded an expense of les than NIS 0.02 million, in respect of the lack of effectiveness related to fair value hedging in the item "Income from financing operations (before provision for doubtful debts") (In 2004: NIS 0.03 million).

CASH FLOWS HEDGING

7. The Bank designates certain derivatives as hedging against cash flows. The accounting treatment of changes in derivatives hedging against exposure to changes in the cash flow derived from an asset, liability or an anticipated transaction depends on the effectiveness of the hedging relations.

   The effective part of the change in the fair value of the derivative designated to hedge cash flow, is initially recognized in the shareholders equity (and not in the income statement) as a component of other comprehensive profit, and later on, when the anticipated transaction affects the income statement, it is reclassified to the income statement.

   The non-effective part of the change in the fair value of the derivative designated as above is forthwith recognized in the income statement.

20. DERIVATIVE INSTRUMENT ACTIVITY – VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

A. VOLUME OF ACTIVITY ON A CONSOLIDATED BASIS

	December 31, 2005				
	Interest rate contracts		Foreign currency	Contracts on	Commodities
	Shekel/CPI	Other	shares	contracts	and other
	in NIS millions				
1. Par value of derivative instruments					
A. Hedging derivatives [1]					
Forward contracts	-	1,209	172	-	-
Other option contracts:					
Options purchased	-	101	6	820	9
Swaps	-	1,890	276	-	-
Total	-	3,200	454	820	9
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	792			
B. ALM derivatives [1] [2]					
Futures contracts	-	275	-	-	-
Forward contracts	982	3,815	24,624	-	-
Marketable option contracts:					
Options purchased	-	-	-	2	-
Other option contracts:					
Options written	-	-	66	-	-
Options purchased	-	-	409		-
Swaps	-	7,452	2,676	-	-
Total	982	11,542	27,775	2	-
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	3,270			
C. Other derivatives [1]					
Forward contracts	240	2,141	169	985	1,747
Marketable option contracts:					
Options written	-	18	269	2,113	1
Options purchased	-	18	269	2,113	1
Other option contracts:					
Options written	-	478	21,030	1,004	9
Options purchased	-	405	22,858	169	-
Swaps	-	785	2	-	-
Total	240	3,845	44,597	6,384	1,758
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	138			
D. Credit derivatives and SPOT foreign currency swap contracts					
SPOT foreign currency swap contracts	-	-	3,423	-	-

Footnotes:
(1) Excluding credit derivatives and SPOT foreign currency swap contracts
(2) Derivatives comprising a part of the asset and liability management system

20. DERIVATIVE INSTRUMENT ACTIVITY – VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

A. VOLUME OF ACTIVITY ON A CONSOLIDATED BASIS (CONTIUED)

	December 31, 20043				
	Interest rate contracts		Foreign currency shares	Contracts on contracts	Commodities and other
	Shekel/CPI	Other			
	in NIS millions				
A. Hedging derivatives (1)					
Forward contracts	-	1,334	-	-	-
Other option contracts:					
Options purchased	-	153	6	847	9
Swaps	-	1,916	340	-	-
Total	-	3,403	346	847	9
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	746			
B. ALM derivatives (1) (2)					
Futures contracts	-	82	-	-	-
Forward contracts	606	2,077	19,001	-	-
Marketable option contracts:					
Options purchased	-	-	-	2	-
Other option contracts:					
Options written	-	-	63	-	-
Options purchased	-	-	469	1	-
Swaps	-	5,782	4,107	-	-
Total	606	7,941	23,640	3	-
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	3,186			
C. Other derivatives (1)					
Forward contracts	-	1,345	310	134	1,105
Marketable option contracts:					
options written	-	-	594	1,860	14*
Options purchased	-	-	594	1,868	14*
Other option contracts:					
Options written	-	1,195	13,476	977*	9
Options purchased	-	1,043*	13,390	-	-
Swaps	-	638	-	-	-
Total	-	4,221	28,364	4,839	1,142
Of which, interest rate swap contracts, where the Bank agreed to pay a fixed interest rate	-	-			
D. Credit derivatives and SPOT foreign currency swap contracts					
SPOT foreign currency swap contracts	-	-	2,921	-	-

Footnotes:
* Reclassified
(1) Excluding credit derivatives and SPOT foreign currency swap contracts
(2) Derivatives comprising a part of the asset and liability management system

20. DERIVATIVE INSTRUMENT ACTIVITY – VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

A. VOLUME OF ACTIVITY ON A CONSOLIDATED BASIS (CONTIUED)

	December 31, 2005				
	Interest rate contracts		Foreign currency	Contracts on	Commodities
	Shekel/CPI	Other	shares	contracts	and other
	in NIS millions				
2. Gross fair value of derivative instruments					
A. Hedging derivatives					
Positive gross fair value	-	74	62	221	4
Negative gross fair value	-	241	2	2	-
B. ALM derivatives					
Positive gross fair value	2	37	280		-
Negative gross fair value	1	114	281	-	-
C. Other derivatives					
Positive gross fair value	1	36	1,171	147	42
Negative gross fair value	1	49	1,169	187	42

	December 31, 2004				
	Interest rate contracts		Foreign currency	Contracts on	Commodities
	Shekel/CPI	Other	shares	contracts	and other
	in NIS millions				
A. Hedging derivatives					
Positive gross fair value	-	36*	117	62	2
Negative gross fair value	-	166*	-	5	-
B. ALM derivatives					
Positive gross fair value	1	30*	497		-
Negative gross fair value	7	114*	413	-	-
C. Other derivatives					
Positive gross fair value	-	39*	553	49	57
Negative gross fair value	-	17*	597	44	57

Footnote:
* Reclassified

20. DERIVATIVE INSTRUMENT ACTIVITY – VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

B. DERIVATIVE INSTRUMENT CREDIT RISK BASED ON THE COUNTERPART TO THE CONTRACT, ON A CONSOLIDATED BASIS

	December 31, 2005					
	Stock markets	Banks	Dealers/ brokers	Governments and central banks	Others	Total
	In NIS millions					
Gross positive fair value of derivative instruments(1)	17	745	214	-	1,101	2,077
Net of set-off agreements	4	-	-	-	389	393
Balance of assets deriving from derivative instruments(2)	13	745	214	-	712	1,684
Off-balance sheet credit risk in respect of derivative instruments(3)	14	3,659	67	-	2,735	6,475
Total credit risk in respect of derivative instruments	27	4,404	281	-	3,447	8,159

Footnotes:
(1) Of which, NIS 177 million of positive gross fair value of derivative instruments.
(2) Of which, a balance of non-related derivative instruments of NIS 1,507 million reflected in the item "Other assets".
(3) Off-balance sheet credit risk in respect of derivative instruments (including derivative instruments having a negative fair value) as computed for the purpose of limitations on a single borrower indebtedness.

	December 31, 2004					
	Stock markets	Banks	Dealers/ brokers	Governments and central banks	Others	Total
	In NIS millions					
Gross positive fair value of derivative instruments(1)	15	355*	140	56*	877	1,443
Net of set-off agreements	6	-	-	-	125	131
Balance of assets deriving from derivative instruments(2)	9	355*	140	56*	752	1,312
Off-balance sheet credit risk in respect of derivative instruments(3)	79	2,605*	143	182	2,245*	5,254
Total credit risk in respect of derivative instruments	88	2,960	283	238	2,997	6,566

Footnotes:
* Reclassified
(1) Of which, NIS 108 million of positive gross fair value of derivative instruments
(2) Of which, a balance of non-related derivative instruments of NIS 1,204 million reflected in the item "Other assets".
(3) Off-balance sheet credit risk in respect of derivative instruments (including derivative instruments having a negative fair value) as computed for the purpose of limitations on a single borrower indebtedness.

20. DERIVATIVE INSTRUMENT ACTIVITY – VOLUME, CREDIT RISK AND DUE DATES (CONTINUED)

C. DUE DATES – PAR VALUE: CONSOLIDATED YEAR END BALANCES

	December 31, 2005				
	Up to 3 months	From 3 months to 1 year	From 1 Year to 5 years	Over 5 years	Total
	in NIS millions				
Interest rate contracts:					
Shekel/CPI	202	940	80	-	1,222
Other	4,196	5,074	7,606	1,711	18,587
Foreign currency contracts	43,724	25,559	5,029	1,937	76,249
Contracts on shares	5,510	306	1,390	-	7,206
Commodities and other contracts	1,385	360	22	-	1,767
Total	55,017	32,239	14,127	3,648	105,031

	December 31, 2004				
	Up to 3 months	From 3 months to 1 year	From 1 Year to 5 years	Over 5 years	Total
	in NIS millions				
Interest rate contracts					
Shekel/CPI	-	412	194	-	606
Other	3,372*	4,485	5,423	2,285	15,565
Foreign currency contracts	32,141	18,538	2,486	2,106	55,271
Contracts on shares	3,880*	331	1,306	172	5,689
Commodities and other contracts	1,040*	94	17	-	1,151
Total	40,433	23,860	9,426	4,563	78,282

Footnote:
* Reclassified

21.BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS

A. GENERAL

The instruction of Bank of Israel regarding the determination of the fair value of financial instruments (the "instruction"), was applied based on the methods and principal assumptions described hereunder. Nothing in the data presented hereunder should be taken as an indication of the economic value of the Bank, nor does the data purport to assess such value.

B. FAIR VALUE OF FINANCIAL INSTRUMENTS

Most of the financial instruments of the Bank do not have a ready "market price" because there is no active market in which they are traded. Therefore, in accordance with the instruction, fair value is based on accepted pricing models, such as the present value of future cash flows discounted at a rate which reflects the estimated risk level related to the financial instrument.

Assessing the fair value by discounting future cash flows and determining the discount rate, is subjective. Therefore, the data for most of the financial instruments given hereunder, does not serve as an indication for the realization value of the financial instrument on the reporting date. Discounting the future cash flows was made, where possible, by discount rates in effect at the reporting date, without taking into consideration fluctuations in interest rates. Using different discount rates assumptions, may result in significantly different fair value amounts. This relates particularly to financial instruments bearing a fixed interest rate or non-interest bearing.

Additionally, in arriving at the fair value amounts, no consideration was given to commissions receivable or payable as part of the business activity, neither do they include the tax effect.

It should be further noted, that the differential between the book value of the financial instrument and its fair value, may never be realized, as the Bank usually holds the financial instrument to maturity.

In consequence of the above, it should be stressed that the data included in this Note, is no indication of the value of the Bank as a going concern.

Furthermore, due to the wide range of valuation techniques and possible assessments used in determining the fair value, and in view of the methods and assumptions used in applying the instruction, care should be taken when examining the fair value data itself as well as when comparing it with the fair value data presented by other banks.

C. METHODS AND MAIN ASSUMPTIONS USED IN ESTIMATING THE FAIR VALUE OF FINANCIAL INSTRUMENTS

Bank deposits, non-marketable bonds and loan notes and credit to the Government:

Discounting future cash flows at rates at which the Bank transacted business at the reporting date.

Marketable securities - At their market value.

Credit to the public - Fair value of the balance of credit to the public was determined at the present value of future cash flows using an appropriate discount rate. The credit balance was segmented into homogeneous groups, the cash flows of which were discounted at rates, which reflects the estimated risk related to the credit in each group.

The classification into homogenous categories in the business sector, has been made, to the extent possible, on the basis of a grading model used at present by the Bank, which reviews the level of risk inherent in the debt in accordance with financial and other indices. It should be noted that as of December 31, 2005, the Bank has classified some 95% of the indebtedness which has to be classified according to the directives of the Supervisor of Banks (31.12.2004: 95%). In certain cases, where grading data is not available, the segmentation is made on the basis of an overall evaluation of the risk level relating to the business sectors in which the borrowers operate. In this respect, it should be noted that the general risk level, as evaluated for a particular business sector, is not necessarily identical to the risk level of a particular borrower operating in that sector, none the less, to the risk level relating to the credit which the Bank grants to that borrower.

The discount rates used were generally determined according to interest rates applying to similar transactions effected

21.BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

at the reporting date. With respect to short-term credit balances (initial period of up to three months), or balances bearing variable market interest (prime, LIBOR, etc.), it was assumed that the amount stated in the balance sheet reflects their fair value.

The fair value of problem debts, net of the provision for loan losses, was calculated using discount rates reflecting the high credit risk involved. In any event, these discount rates are not less than the higher interest rate applying to transactions made by the Bank at the reporting date.

Problem debts having no maturity date, are stated according to their value in the books of the Bank, as in the circumstances, it was not practicable to evaluate the timing of their repayment rate, and therefore no expected future cash flow was calculated in their respect.

The general, supplemental and special provisions for doubtful debts were not deducted from the balance of outstanding credit for the purpose of calculating the cash flows when determining the fair value.

Deposits, bonds and loan notes - Capitalizing future cash flows at a rate at which the Bank pays interest on similar deposits, or on the issue of similar bond and loan notes at the reporting date.

Financial instruments (except for derivatives and marketable financial instruments) for an initial period of up to three months and at a variable market interest rate - It is assumed that the amounts stated in the balance sheet reflect their fair value.

Derivative financial instruments - Such financial instruments, which have an active market, were evaluated at their market value, and where several such markets exist, the evaluation was made in accordance with the most active market.

Derivative financial instruments which are not traded on an active market were evaluated according to models in use by the Bank in its current operations and which take into account the risks involved in the financial instrument: market, credit and other risks. The consideration as regards the credit risk relating to the counter party to the transaction, relates to two categories: customers and banks, considering the quality of the product.

Off balance sheet financial instruments which involve credit risk - The fair value is presented according to the outstanding balance of commissions on the said transactions, which approximate fair value. The fair value of irrevocable commitments to grant credit, which were approved but not yet executed, does not differ materially from the value of these commitments, as they are presented in Note 19 A.

The bank and its banking subsidiaries in Israel present the balances and fair value estimates of Financial Instruments according to the directive of the Supervisor of Banks. A banking subsidiary abroad presents the balances and fair value estimates of Financial Instruments according to generally accepted accounting principles in the US, which do not materially differ from those of the Supervisor.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

D. COMPOSITION AS OF DECEMBER 31,2005 - CONSOLIDATED (IN NIS MILLION)

	Balance as of December 31,2005			
	(1)	(2)	Total	Fair value
	in Nis millions			
Financial assets:				
Cash and deposits with banks	17,983	2,603	20,586	20,762
Securities	35,540	5,833	41,373	41,324
Credit to the public	43,634	40,256	83,890	84,474
Credit to the Government	64	28	92	92
Other financial assets	1,956	-	1,956	1,956
Total financial assets	99,177	48,720	147,897	148,608
Financial liabilities:				
Deposits from the public	95,544	34,756	130,300	130,565
Deposits from banks	5,516	1,002	6,518	6,535
Deposits from the Government	159	93	252	253
Debentures and subordinated capital notes	151	5,191	5,342	5,528
Other financial liabilities	3,241	-	3,241	3,241
Total financial liabilities	104,611	41,042	145,653	146,122

	Balance as of December 31,2004			
	(1)	(2)	Total	Fair value
	in Nis millions			
Financial assets:				
Cash and deposits with banks	15,146	2,605	17,751	18,073
Securities	*33,898	5,566	*39,464	*39,457
Credit to the public	*38,453	39,065	*77,518	*78,171
Credit to the Government	107	164	271	270
Other financial assets	*1,774	-	*1,774	*1,774
Total financial assets	89,378	47,400	136,778	137,745
Financial liabilities:				
Deposits from the public	*90,206	31,768	*121,974	*122,401
Deposits from banks	*3,637	1,169	*4,806	*4,918
Deposits from the Government	77	67	144	155
Debentures and subordinated capital notes	131	4,678	4,809	5,043
Other financial liabilities	*2,098	-	*2,098	*2,098
Total financial liabilities	96,149	37,682	133,831	134,615

* Reclassfied

Footnotes:

(1) Financial instruments the stated amounts of which approximate their fair value – instruments stated in the balance sheet at market value or which are for an initial period not exceeding three months, or based on market interest varying at frequencies of up to three months.

(2) Other financial instruments.

21. BALANCES AND FAIR VALUE ESTIMATES OF FINANCIAL INSTRUMENTS (CONTINUED)

E. COMPOSITION AS OF DECEMBER 31,2005 - THE BANK (IN NIS MILLION)

	Balance as of December 31,2005			
	(1)	(2)	Total	Fair value
	in Nis millions			
Financial assets:				
Cash and deposits with banks	13,119	8,609	21,728	21,986
Securities	16,834	-	16,834	16,834
Credit to the public	20,224	27,138	47,362	47,382
Credit to the Government	61	28	89	89
Other financial assets	1,323	-	1,323	1,323
Total financial assets	51,561	35,775	87,336	87,614
Financial liabilities:				
Deposits from the public	50,295	30,002	80,297	80,473
Deposits from banks	2,406	564	2,970	2,978
Deposits from the Government	116	10	126	126
Debentures and subordinated capital notes	227	3,292	3,519	3,665
Other financial liabilities	2,117	-	2,117	2,117
Total financial liabilities	55,161	33,868	89,029	89,359

	Balance as of December 31,2004			
	(1)	(2)	Total	Fair value
	in Nis millions			
Financial assets:				
Cash and deposits with banks	12,647	7,975	20,622	20,958
Securities	*16,355	-	16,355	*16,355
Credit to the public	*17,970	26,212	44,182	*44,306
Credit to the Government	104	164	268	267
Other financial assets	*1,320	-	1,320	*1,320
Total financial assets	48,396	34,351	82,747	83,206
Financial liabilities:				
Deposits from the public	*50,439	26,299	76,738	*77,059
Deposits from banks	*1,598	382	1,980	*1,992
Deposits from the Government	18	20	38	37
Debentures and subordinated capital notes	210	3,365	3,575	3,749
Other financial liabilities	*1,354	-	1,354	*1,354
Total financial liabilities	53,619	30,066	83,685	84,191

* Reclassfied

Footnotes:

(1) Financial instruments the stated amounts of which approximate their fair value – instruments stated in the balance sheet at market value or which are for an initial period not exceeding three months, or based on market interest varying at frequencies of up to three months.

(2) Other financial instruments.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES

A. BALANCES

	December 31, 2005					
	Interested parties[1]		Related parties held by the Bank			
	Directors and President[2]		Affiliated companies		Others[3]	
	(4)	(5)	(4)	(5)	(4)	(5)
	In NIS millions					
Assets						
Securities[6]	-	-	9	9	4	4
Credit granted to the public	1	1	89	182	476	476
Deposits with banks	-	-	2	4	-	-
Investments in affiliated companies[6]*	-	-	1,471	1,471	-	-
Liabilities						
Deposits from the public	2	4	234	311	1,400	2,596
Deposits from banks	-	-	215	317	-	-
Debentures and subordinated capital notes	-	-	28	32	221	245
Other liabilities	-	-	2	2	-	-
Credit risk in off-balance-sheet financial instruments[7]	1	1	321	346	457	457

* Includes non-consolidated subsidiaries in the amount of NIS 42 million (highest balance during the year – NIS 42 million).
See notes to this table after section D.

	December 31, 2004					
	Interested parties[1]		Related parties held by the Bank			
	Directors and President[2]		Affiliated companies		Others[3]	
	(4)	(5)	(4)	(5)	(4)	(5)
	In NIS millions					
Assets						
Securities[6]	-	-	3	4	4	4
Credit granted to the public	1	1	35	35	435	435
Investments in affiliated companies[6]*	-	-	1,258	1,258	-	-
Liabilities						
Deposits from the public	4	6	212	263	2,851	2,910
Deposits from banks	-	-	64	117	-	-
Debentures an subordinated capital notes	-	-	18	22	185	312
Other liabilities	-	-	-	2	-	-
Credit risk in off-balance-sheet financial instruments[7]	3	3	44	85	391	391

* Includes unconsolidated subsidiaries in the amount of NIS 25 million (highest balance during the year - NIS 25 million).
For notes to the tables see after Note D.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

B. SUMMARIZED RESULTS OF TRANSACTIONS WITH RELATED AND INTERESTED PARTIES

	For the year ended December 31, 2005		
	Interested parties[1]	Related parties held by the Bank	
	Directors and President[2]	Affiliated companies	Others[3]
	In NIS millions		
Income from financing activities before provision for doubtful debts*	-	(3)	(39)
Non-financing income	-	2	[8]114
Non-financing expenses**	(10)	(40)	-
Total	(10)	(41)	75

	For the year ended December 31, 2004		
	Interested parties[1]	Related parties held by the Bank	
	Directors and President[2]	Affiliated companies	Others[3]
	In NIS millions		
Income from financing activities before provision for doubtful debts*	-	(18)	(82)
Non-financing income	-	2	[8]109
Non-financing expenses**	(12)	(12)	-
Total	(12)	(28)	27

* See Note D.
** See Note C.

C. BENEFITS FROM THE BANK AND CONSOLIDATED SUBSIDIARIES TO INTERESTED PARTIES

	For the year ended December 31, 2005		For the year ended December 31, 2004	
	Directors and President and CEO[2]		Directors and President and CEO[2]	
	Number of benefit		Number of benefit	
	Total benefit	Recipients	Total benefit	Recipients
	In NIS millions			
Interested parties employed by the Bank or on its behalf	9	2	10	2
Directors who are not employed by the Bank or on its behalf	2	12	2	14
Total	11	14	12	16

For notes to the tables see after Note D.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

D. RESULTS OF FINANCING TRANSACTIONS (BEFORE PROVISION FOR DOUBTFUL DEBTS) OF THE BANK AND ITS CONSOLIDATED COMPANIES WITH RELATED AND INTERESTED PARTIES*

	Consolidated			Of which from Affiliated Companies		
	2005	2004	**2003	2005	2004	**2003
	in NIS millions					
A. On assets						
Credit granted to the public	34	24	-	4	-	-
Total	34	24	-	4	-	-
B. On liabilities						
Deposits from the public	(54)	(82)	(114)	(2)	(11)	(7)
Deposits from the banks	(6)	(7)	(1)	(6)	(6)	(1)
Debentures and sobordinated capital notes	(17)	(36)	(16)	(1)	(2)	-
Total	(77)	(125)	(131)	(9)	(19)	(8)
C. On Derivative Financial Instrument						
Financing income from other transactions	1	1	20	1	1	16
Total	1	1	20	1	1	16
Total income (expenses) from financing activities before provision for doubtful debts	(42)	(100)	(111)	(4)	(18)	8

* In respect of transactions made on the same terms that would have been made with a person that is not a related or interested party.

** Adjusted amounts - see note 1B.

Footnotes: (relating to Note 22 A,B & C):

(1) Interested party - as defined by Securities Regulations.
Related party - as defined in Opinion 29 of the Institute of Certified Public Accountants in Israel, but is not an interested party.

(2) Including spouses and their infant children.

(3) A corporation in which a banking corporation holds 10% or more of its issued share capital or of the voting rights therein, or is entitled to appoint 10% or more of the members of its board of directors or is entitled to appoint its president and CEO, and another corporation that a related party holds 25% or more of its issued share capital or of the voting power therein or of the right to appoint its directors.

(4) The balance at balance sheet date.

(5) The highest balance during the year on the basis of month-end balances.

(6) Details of these items are included also in the following notes:
Securities - Note 3.
Investments in Investee Companies - Note 6.
Guarantees - Note 19A.

(7) Credit risks of off-balance sheet derivative financial instruments as calculated for the purpose of setting borrower's limits.

(8) Income from securities operations received from provident funds managed by the Bank and by a consolidated subsidiary.

22. RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

E. DATA IN REGARD TO PROVIDENT FUNDS ACCORDING TO THEIR BALANCE SHEETS WHICH HAVE NOT BEEN CONSOLIDATED:

	December 31	
	2005	2004
	in NIS millions	
(1) Managed by Discount Provident Fund Management Ltd. and the Bank[(1)]:		
Members' balance	30,153	27,900
Investments in securities of related and interested parties	166	413
Deposits with the Bank and with its consolidated subsidiaries and affiliated companies	1,070	*2,483
Capital notes	209	*221
Management fees	109	104
(2) Managed by Mercantile Discount Bank:		
Members' balance	3,567	3,059
Investments in securities of related and interested parties	21	23
Deposits with the Bank and with its consolidated Subsidiaries	320	308
Management fees	23	19

* Reclassified.

Footnote:

(1) Including "Kahal" – Employees Supplemental Training Fund Ltd. and "Kahal" - Management of Further Education Funds (1996) Ltd., managed jointly with Bank Leumi Le Israel B.M. See also Note 19 C2.

F. As of October 31, 1993, the State of Israel holds a majority of the shares of the Bank (on December 31, 2004 and 2005, it held 57.09% of the shares). The Supervisor of Banks has exempted the Bank from defining the State as "a related party" in the Bank, and accordingly balances and transactions with the State and companies under its control are not given. (see Note 32 regarding details of the agreement for the sale of the controlling interest of the Bank, signed in February 2005, and the closing of the transaction on January 31, 2006).

G. Until 2003 IDB held approximately 12.54% of the shares of the Bank and was regarded as an interested party of the Bank. In the second half of 2003 IDB reported the sale of the shares in the Bank and since October 30, 2003, IDB is no longer an interested party in the Bank. In May 2003 the change in control of IDB was completed and a large number of companies was added to those which may have been considered interested parties in the Bank, for the said short period. Under these circumstances the Supervisor of Banks exempted the Bank from providing information as to "assets relating to transactions made with whoever was an interested party at the time of the transaction", in respect of transactions made in the ordinary course of business with IDB.

H. The Supervisor of Banks has exempted the Bank from providing information regarding transactions made in the ordinary course of business with provident and mutual funds of the Bank Leumi Group and with provident and mutual funds of the Bank Hapoalim Group, which are considered interested parties in the Bank.

I. **Personal contract with the Chairman of the Board.** On March 26, 2006, the board of directors of the Bank resolved to approve the engagement of the Bank in a personal contract with the Chairman of the Board. The period of the personal contract is for five years, starting on February 6, 2006, to be renewed subsequently for an indeterminate period until its cancellation. In the event that the Bank should terminate the contract before the end of the period of five years, the Chairman would be entitled to compensation in an amount equal to his full salary, including the benefits and provisions (as stated in the agreement), for the remaining period of the five years, as well as to a proportionate part of the yearly award for the year in which the contract was terminated.

22 RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

The contract stipulates also, among other things, that the Bank would grant the Chairman of the Board, in respect of each year in which he holds office, starting with 2006 and as long as the agreement with him is in force, a special award (hereinafter – "the annual bonus"), derived from the annual rate of return on equity, at rates of between 0.45% of the net annual earnings if the annual return on equity will equal 8.5%, to a maximum rate of 0.70% on the net annual earnings if the annual return on equity will reach 13% or more. In computing the annual rate of return on equity, the board of directors is entitled to eliminate exceptional profits or losses that do not derive from current operations.

As regards details of the proposal for the granting of option warrants to the Chairman of the Board as part of an option plan for officers of the Bank, see Note 13.

The remuneration and terms of employment of the Chairman of the Board (including an adaptation grant equal to a full twelve months salary) are to be included on the agenda of a special general meeting of shareholders called for April 26, 2006. On March 26, 2006, the State informed of its consent to the terms of service of the Chairman of the board of directors and of its consent with regards to voting together with the controlling shareholders, by power of the option shares held by the State.

J. Amendment of the personal contract with the President and CEO. The board of directors of the Bank resolved to approve an amendment to the personal contract with the President and CEO of the Bank, in a manner that would include provisions identical to the provisions described in section I above.

K. 1. The preceding Chairman of the Board of Directors ended his tenure of office on January 31, 2006, following the closing of the transaction for the sale of a controlling interest in the Bank (see Note 32 hereunder). His remuneration and terms of employment were approved by the general meetings of shareholders held on January 15, 1998, October 5, 1999 and June 14, 2004, including his entitlement to regular severance pay and an adaptation award equal to full twelve months salary.

2. In 2004, the board of directors of the Bank decided that in the event that the preceding Chairman would have to terminate his tenure of office following a change in ownership of the Bank due to privatization, then he would be entitled to a payment equal to a full fifteen months salary in addition to the amounts due to him in accordance with the personal contract with him. This issue was on the agenda of the general meeting of shareholders held in June 2004, but was not discussed at that meeting.
3. In 2004, the board of directors of the Bank resolved to approve the preceding Chairman an additional remuneration of 6.5% as from July 2004, together with an award equal to seven months salary (comprising 89% of the award approved to the President and CEO of the Bank). These matters have not yet been brought for approval by the general meetings of shareholders.
4. In May 2005, the board of directors of the Bank resolved to approve the preceding Chairman an award in the amount of NIS 1,255 thousand. This matter has not yet been brought for approval by the general meetings of shareholders.
5. Without derogating from the resolutions detailed in items 2 to 4 above, the Bank intends to bring for approval of the board of directors of the Bank a proposal for a one-time payment of NIS 10 million to the preceding Chairman, as compensation for the termination of his tenure as Chairman of the board of directors and to express appreciation for his outstanding contribution to the Bank
6. The financial statements include full provisions in respect of items 2-4 stated above.
7. In a letter dated March 26, 2006, the controlling shareholders of the Bank informed the Accountant General at the Ministry of Finance and the CEO of M.I. Holdings Ltd. of their intention to bring for approval of the authorized organs of the Bank, as the case may be, the proposals for various payments to the preceding Chairman of the board of directors of the Bank, as detailed in items 2 to 5 above.

   The controlling shareholders clarified that, for the sake of propriety they deemed it proper to bring to the attention of

22 RELATED AND INTERESTED PARTIES OF THE BANK AND ITS CONSOLIDATED SUBSIDIARIES (CONTINUED)

the Government the proposed payments by the Bank to the preceding Chairman, as detailed above, though, in their opinion, such payments are not considered payments to an interested party within its meaning in the agreement for the sale of the controlling interest in the Bank, and therefore do not require the consent of the Government.

8. In a letter dated March 26, 2006, the Accountant General at the Ministry of Finance informed that the State opposes the intended payments as detailed in the letter of the controlling shareholders (see 7 above). In view of the above said, the Bank did not record a provision in respect of the amounts stated in 5 above.

L. The Bank has a commitment to pay directly to debenture holders and subordinate capital motes holders of the consolidated subsidiaries: Manpikim Discount Bank Issues Corporation Ltd. and Discount Mortgage Bank Ltd., upon the debentures' maturity, the amounts of the principal plus accrued interest and linkage differentials. The undertaking is in respect of the repayment of debentures, the proceeds of which were deposited with the Bank. The total of the liability in respect of the debentures of the consolidated subsidiaries, as at December 31, 2005, amounted to NIS 897 million (as at December 31, 2004 - NIS 659 million).

M. The Bank has commitments to the Tel-Aviv Stock Exchange as mentioned in Note 19C.6 and Note 19 C 7.

N. The Bank is committed towards the "Ma'of" clearing house in respect of all clearing of "Ma'of" transactions and monetary liabilities derived from them relating to Ilanot.

O. Investee companies of the Bank are included in the framework of the undertaking granted by the Bank to VISA International (as stated in Note 19 C 12).

P. In respect of indemnification of related and interested parties - see Note 19C.10 .

Q. The amount of available-for-sale securities in the consolidated balance sheet includes NIS 231 million comprising an investment in the shares of a consolidated subsidiary (see Note 6 E).

23. INCOME FROM FINANCING ACTIVITIES BEFORE PROVISION FOR DOUBFUL DEBTS

	Consolidated			The Bank		
	2005	2004	2003	2005	2004	2003
	In NIS millions					
A. On Assets**						
Credit granted to the Public	6,762	4,271	2,798	3,365	2,469	1,884
Credit granted to the Government	25	5	(24)	24	4	(21)
Deposits with the Bank of Israel and cash	48	128	325	9	96	323
Deposits with Banks	467	538	(56)	798	798	219
Bonds	3,460	1,450	(252)	872	937	751
Total	10,762	6,392	2,791	5,068	4,304	3,156
B. On Liabilities**						
Deposits from the public	(6,717)	(2,934)	(976)	(3,111)	(2,297)	(2,080)
Deposits from the Government	(10)	(6)	(2)	(1)	(1)	(1)
Deposits from the Bank of Israel and cash	(3)	(4)	(9)	(3)	(3)	(7)
Deposits from banks	(453)	(185)	33	(129)	(55)	(38)
Debentures and subordinated capital notes	(413)	(299)	(158)	(291)	(235)	(130)
Total	(7,596)	(3,428)	(1,112)	(3,535)	(2,591)	(2,256)
C. In Respect of Derivative Financial Instruments and Hedging Activities						
Income net in respect of ALM derivative instruments***	182	*47	*919	190	*8	*818
Income (expenses) net in respect of other derivative instruments	(18)	*63	*64	(38)	*61	*55
Total	164	110	983	152	69	873
D. Other						
Commissions on financing activities	138	120	109	70	58	48
Other financing income	215	*191	*76	53	*89	*86
Interest income on problem debts	84	99	57	71	83	39
Other financing expenses	(70)	(11)	66	(31)	(7)	(7)
Total	367	399	308	163	223	166
Total income from financing activities before provision for doubtful debts	3,697	3,473	2,970	1,848	2,005	1,939
Of which: Net exchange differences	172	(57)	(224)	(5)	(2)	(23)

* Reclassified.
** Including the effective component of hedging relations.
*** Derivative instruments comprising a part of the assets and liabilities management system of the Bank, which were not designed for hedging relations.

23. INCOME FROM FINANCING ACTIVITIES BEFORE PROVISION FOR DOUBTFUL DEBTS (CONTINUED)

	Consolidated			The Bank		
	2005	2004	2003	2005	2004	2003
	In NIS millions					
E. Results of Activity in Investments in Bonds						
Accrual basis, financing Income (expenses) from bonds:						
Held-to-maturity	611	(114)	3	14	6	(1)
Available for-sale	2,686	1,498	(263)	789	866	723
Trading	163	66	8	69	65	29
Total included in income on assets from financing activities	3,460	1,450	(252)	872	937	751
Gains on sale of available-for-sale bonds	32	112	86	19	86	59
Losses on sale of available-for-sale bonds*	(2)	(2)	(47)	2	(1)	(5)
Provision for decline in value of available-for-sale bonds	-	(12)	(24)	-	(9)	(16)
Net realized and unrealized gains (losses) from adjustment of trading bonds to fair value**	2	29	64	3	(3)	37
Total included in other financing income	32	127	79	24	73	75
Total from investments in bonds	3,492	1,577	(173)	896	1,010	826

* Of which: NIS 9 million in respect of the transfer of bonds to the trading portfolio in 2004 (2003: NIS 14 million).
** Of which: a part of the gains and losses relating to trading bonds that are still on hand at balance sheet date. Consolidated – NIS 16 million, the Bank – NIS 1 million (2004: consolidated – NIS 32 million, the Bank – NIS 12 million, 2003: consolidated – NIS 57 million, the Bank – NIS 18 million).

	2005	2004	2003	2005	2004	2003
F. Details of the Net Effect of Derivative Instruments Hedging Earnings From Financing Operations						
Financing income (expenses) in respect of assets (item A)	44	26	1	6	(21)	-
Financing expenses in respect of liabilities (item B)	(3)	-	-	(3)	-	-

24. OPERATING COMMISSIONS

	Consolidated			The Bank		
	2005	2004	2003	2005	2004	2003
	In NIS millions					
Ledger fees (in Israeli and in foreign currency)	268	273	274	182	184	186
Payment order system service (in Israeli and in foreign currency)	440	*421	*417	318	*307	*306
Income from credit cards	565	519	470	54	54	53
Credit and contracts service	150	143	133	93	92	85
Computerized services, information and confirmations	42	43	44	36	36	37
Foreign trade transactions and special foregin exchange services	80	75	62	58	56	50
Income from customers' securities transactions	214	206	167	160	143	103
Margins and collection fees on credit and deposits, from deposits according to collection:						
Collection commissions on credit granted out of Treasury funds	16	17	18	-	-	-
Commissions and other margins	4	3	3	4	3	3
Management fees and commissions from life insurance	16	14	15	-	-	-
Management fees and commissions from property insurance	11	13	14	-	-	-
Commission on transfer of rent	3	3	4	-	-	-
Other income	49	41	40	17	15	17
Total operating fees	1,858	1,771	1,661	922	890	840

*Reclassified.

25. NET GAIN FROM INVESTMENTS IN SHARES

	Consolidated			The Bank		
	2005	2004	2003	2005	2004	2003
	In NIS millions					
Gains on sale of shares available-for-sale	-	23	6	-	23	6
Provision for decline in value of available-for-sale shares	(9)	(12)	(19)	-	-	(3)
Net realized and unrealized gains from adjustment of trading securities to fair value[1]	2	41	6	-	41	2
Dividends from available-for-sale or trading shares	10	51	16	-	11	7
Total from investments in shares	3	103	9	-	75	12

Footnote:

(1) Of which part of the income (loss) related to trading shares that are still on hand at balance sheet date: consolidated: NIS (1) million, Bank: NIS (1) million, (2004 - consolidated: NIS 1 million, Bank: NIS (1) million; 2003 - consolidated: NIS 3 million, Bank: NIS 1 million).

26. OTHER INCOME

	Consolidated			The Bank		
	2005	2004	2003	2005	2004	2003
	In NIS millions					
Management fees and expense refunds from provident funds	177	150	137	109	104	98
Management fees from mutual funds	182	138	76	20	14	5
Management fees from consolidated subsidiaries	-	-	-	3	3	3
Profit from severance pay funds	160	29	183	145	24	173
Other income	21	35	38	101	96	74
Total other income	540	352	434	378	241	353

27. SALARIES AND RELATED EXPENSES

	Consolidated			The Bank		
	2005	2004	2003	2005	2004	2003
	In NIS millions					
Salaries	1,845	1,638	1,530	1,162	1,017	924
Severance pay, pension, further education fund, seniority bonuses, vacation and medical insurance	363	302	253	249	207	146
National Insurance and payroll taxes	382	321	292	288	244	230
Other related expenses	91	*88	*86	53	49	44
Adjustment of reserves for salary-related expenses due to changes in salaries during the year	14	40	21	10	37	20
Voluntary retirement program expenses	196	121	81	196	117	81
Total salaries and related expenses	2,891	2,510	2,263	1,958	1,671	1,445
Includes: Overseas salaries and related expenses	394	336	337	17	17	14

*Reclassified.
Footnote:
(1) 2005: Including payroll tax.

For details regarding a change in the definition of wages in the Value Added Tax Law, see Note 29 H hereunder.

28. OTHER EXPENSES

	Consolidated			The Bank		
	2005	2004	2003	2005	2004	2003
	In NIS millions					
Advertising	153	138	107	51	41	38
Communications	109	92	99	53	42	49
Computer services	297	(1)211	136	247	172	103
Office expenses	29	24	25	13	11	10
Insurance	38	42	44	17	22	22
Professional services	122	(1)103	(1)89	39	35	33
Directors' fees	8	9	8	2	2	2
Instruction and training	10	10	10	8	7	7
Fees	45	(1)32	(1)12	19	(1)20	11
Amortization of goodwill	12	7	3	-	-	-
Other	(2)(3) 344	(2)(1)213	(2)(1)173	73	80	64
Total other expenses	1,167	881	706	522	432	339

Footnotes:
(1) Reclassified.
(2) Including expenses of NIS 14 million (2004: NIS 6 million, 2003: NIS 14 million) in respect of damage due to the use of credit cards.
(3) Including a provision in the amount of NIS 120 million in respect of a settlement signed by IDB New York with the regulatory authorities in the USA (See Note 6 D).

29. PROVISION FOR TAXES ON OPERATING INCOME

A. COMPOSITION:

	Consolidated			The Bank		
	2005	2004	2003	2005	2004	2003
	Reported amounts(1)	Reported amounts(1)	Adjusted amounts(1)	Reported amounts(1)	Reported amounts(1)	Adjusted amounts(1)
	In NIS millions					
Taxes for current year	346	393	423	47	67	120
Taxes for previous years	(1)	(39)	3	-	(38)	1
Total current taxes	345	354	426	47	29	121
Addition (deduction):						
Deferred taxes for current year	(23)	(12)	(55)	(21)	(5)	(5)
Deferred taxes for previous years	2	-	-	-	-	-
Total deferred taxes	(21)	(12)	(55)	(21)	(5)	(5)
Total provision for taxes on operating profit	324	342	371	26	24	116
Includes taxes of foreign subsidiaries	105	154	78	-	-	-

Footnote:
(1) See Note 1 B.

29. PROVISION FOR TAXES ON OPERATING INCOME (CONTINUED)

B. RECONCILIATION BETWEEN THE THEORETICAL TAX WHICH WOULD APPLY HAD THE OPERATING INCOME BEEN TAXED AT THE STATUTORY TAX RATE APPLYING TO A BANK IN ISRAEL, TO THE PROVISION FOR TAXES ON OPERATING INCOME, AS CHARGED IN THE STATEMENT OF INCOME:

	Consolidated			The Bank		
	2005	2004	2003	2005	2004	2003
	In percentage					
Statutory tax rate on banks in Israel	43.6	44.5	45.8	43.6	44.5	45.8
	Reported amounts[(1)]	Reported amounts[(1)]	Adjusted amounts[(1)]	Reported amounts[(1)]	Reported amounts[(1)]	Adjusted amounts[(1)]
	In NIS millions					
Income tax at the statutory tax rate	298	354	299	(88)	57	120
Income tax (tax savings) on:						
Increment (deduction) for inflation	(17)	(6)	-	4	1	-
Net adjustment differences on monetary assets	-	-	(6)	-	-	(7)
Income of foreign subsidiaries[(2)]	(75)	22	71	-	-	-
General and supplemental provision for doubtful debts	8	4	16	6	(2)	16
Income exempt from tax or taxed at preferred rates	3	(2)	(7)	5	1	(3)
Adjustment differences on depreciation and capital gains	(10)	(5)	3	(11)	(5)	2
Other non-deductible expenses	23	18	14	19	12	9
Deferred taxes in respect of non-financial assets	(5)	1	-	(4)	(1)	-
Losses and timing differences (utilization), net, in respect of which no deferred tax assets were recorded	46	(44)	(30)	42	(37)	(36)
Profit tax on payroll tax	25	21	20	21	17	17
Change in the balance of deferred taxes resulting from the change in tax rates	37	30	-	32	19	-
Taxes for prior years	1	(39)	3	-	(38)	1
Erosion of advance-tax payments	-	-	(4)	-	-	(3)
Income of Israeli subsidiaries	(10)	(12)	(8)	-	-	-
Provision for taxes on income	324	342	371	26	24	116

Footnotes:
(1) See Note 1 B.
(2) Not including the effect of the addition to equity as of the beginning of the year on the provision for taxes for the reported year.

29. PROVISION FOR TAXES ON OPERATING INCOME (CONTINUED)

C. (1) Final tax assessments have been issued to the Bank for the tax years up to and including 2002. Following the settlement of the tax assessments for the years 2001 - 2002, the Bank cancelled excess provisions for income tax recorded in prior years on a conservative basis, in the amount of NIS 41 million.

(2) The major consolidated subsidiaries have received final tax assessments, or assessments deemed final, for tax years between 2001 to 2003.

D. The balance of carry forward losses and deductions for tax purposes, (Including losses in respect of available-for-sale securities, included in a capital reserve) in respect of which deferred tax assets have not been recorded by the Bank, as of December 31, 2005, amount to NIS 878 million, and to NIS 959 million on a consolidated basis. As of December 31, 2004: NIS 1,029 million and NIS 1,069 million on a consolidated basis.

E. On February 9, 2000, the Bank's shares in IDB New York were transferred to Discount Bankcorp. Inc. (hereinafter – "Bankcorp"), a wholly-owned holding subsidiary of the Bank, registered in the State of Delaware in the US. The transfer of the shares to Bankcorp was made at their value in the books of the Bank, in consideration for shares issued by Bankcorp.

The transfer of the shares was made in accordance with the provisions of Section 104A of the Income Tax Ordinance. The Bank is obligated to pay taxes in Israel with respect to the said transfer of shares, if and when such shares will be sold. The Bank provided the Income Tax Authorities with a guarantee as to the payment of the said taxes.

F. On June 29, 2004, the Knesset passed the Income Tax Ordinance Amendment Law (No.140 and provisional instruction) 2004 (hereinafter – "the Amendment").The amendment provides for a gradual reduction in the rate of company tax, from a rate of 36% to a rate of 30%. The net effect on the balance of deferred taxes as of January 1, 2004, was a decrease of NIS 48 million (concurrenty, the Bank recorded a deferred tas asset of NIS 44 million in respect of the net change in timing differences in 2004).

G. On July 25, 2005, the Knesset passed the Income Tax Ordinance Amendment Law (No.147 and Temporary Provision) – 2005 (hereinafter – "the Amendment"). The Amendment provides for a gradual reduction in the rate of company tax, as follows: a rate of 31% for 2006, a rate of 29% for 2007, a rate of 27% for 2008, a rate of 26% in 2009 and a rate of 25% for 2010 and thereafter.

The provision for taxes on the Bank's earnings and of subsidiaries that are considered "financial institutions", includes profit tax under the Value Added Tax Law. Accordingly, the statutory tax rate applying to the Bank and to the said consolidated subsidiaries in 2006 is 41.03%, in 2007 - 39.32%, in 2008 - 37.61%, in 2009 - 36.75% and as from 2010 onwards a tax rate of 35.90% will apply.

In view of the said amendment of the Ordinance, the provisions for net deferred tax expenses (deferred tax assets) have been recalculated on the basis of the tax rates that will apply in the periods in which the deferred taxes are expected to materialize.The net effect on the balance of deferred taxes as of January 1, 2005, coused an expense of NIS 37 million (concurrently, the Bank recorded a deferred tax asset of NIS 60 million in respect of the net change in timing differences in 2005).

29. PROVISION FOR TAXES ON OPERATING INCOME (CONTINUED)

H. A change in the definition of wages in the Value Added Tax Law. The Economic Policy Law for the fiscal year 2005 (Legislation Amendments) – 2005, passed the second and third readings by the Knesset on March 29, 2005, in which the definition of wages, in respect of the payment of payroll tax by financial institutions, was expanded to also include all the benefits that a financial institution pays its employees, such as: a grant payable upon retirement or death, excluding an award paid by a provident fund, or paid out of funds that had been deposited with a provident fund and later withdrawn by the employer for the purpose of payment of the award and any amount paid by an employer to a supplemental education fund or to a provident fund on the employee's behalf even if they are exempt from tax upon transfer to the fund (and where no employee benefit value has been charged in their respect in accordance with Section 3 of the Ordinance). The Amendment is effective commencing January 1, 2005.

The said amendment has an effect on the payment of payroll tax in respect of amounts payable by the Bank to its employees, and on the increase in the payroll expense of the Group. The Bank and its subsidiaries recorded, in 2005, an expense of NIS 49 million in respect of the above.

I. PRESENTED BELOW IS THE ADJUSTED AMOUNT OF NON-MONETARY ASSETS, THE DEPRECIATION OF WHICH WILL NOT BE RECOGNIZED AS A DEDUCTIBLE EXPENSE OR AS PART OF THE COST WHEN SOLD, AND WHICH IS DEEMED A PERMANENT DIFFERENCE IN RESPECT OF WHICH NO DEFERRED TAXES ARE RECORDED:

	Consolidated		The Bank	
	December 31			
	2005	2004	2005	2004
	In NIS millions			
Balance at beginning of year	105	116	91	100
Non-deductible amount for the current year	(14)	(11)	(12)	(9)
Balance at end of year	91	105	79	91

29. PROVISION FOR TAXES ON OPERATING INCOME (CONTINUED)

J. YEAR-END BALANCES OF DEFERRED TAXES RECEIVABLE AND PROVISION FOR DEFERRED TAXES:

	Consolidated				The Bank			
	Deferred tax receivable		Provision for deferred taxes		Deferred tax receivable		Provision for deferred taxes	
	2005	2004	2005	2004	2005	2004	2005	2004
	In NIS millions							
On specific provision for doubtful debts	50	52	-	-	38	38	-	-
On provision for vacation pay, seniority bonuses provision in respect of retirees and provision in respect of encouragement of voluntary early retirement plan	328	305	-	-	292	266	-	-
On excess of deposits of severance pay	-	-	88	73	-	-	70	56
On income tax carry-forward deductions	180	189	-	-	166	170	-	-
On foreign operations	41	132	-	-	-	-	-	-
On securities	-	-	14	2	-	-	6	1
On adjustment of depreciable non-monetary assets	-	-	35	42	-	-	26	33
On adjustment of other non-monetary assets	14	9	-	-	8	2	-	-
Reserve for tax on income of Investee companies	-	-	30	4	-	-	30	4
Total, net	613	687	167	121	504	476	132	94

	Consolidated		The Bank	
	December 31			
	2005	2004	2005	2004
	In NIS millions			
Deferred taxes are included:				
In "Other assets" (Note 8)	491	593	416	409
In "Other liabilities" (Note 12)	(45)	(27)	(44)	(27)
Total, net	446	566	372	382

30. NET GAIN (LOSS) ON EXTRAORDINARY ITEMS, AFTER TAXES

	Consolidated			The Bank		
	2005	2004	2003	2005	2004	2003
	Reported amounts(1)	Reported amounts(1)	Adjusted amounts(1)	Reported amounts(1)	Reported amounts(1)	Adjusted amounts(1)
	In NIS millions					
Capital gain on sale of buildings and equipment	16	2	2	16	2	2
Capital loss on sale of buildings and equipment	(3)	(42)	(2)	(3)	(40)	(2)
Provision for impairment in value of buildings(2)	(10)	-	(22)	(10)	-	(21)
Gain on sale of shares of previously consolidated subsidiary	-	40	-	-	40	-
Gain (loss) before taxes	3	-	(22)	3	2	(21)
Provision for taxes on profit from extraordinary items:						
Current taxes	-	(8)	-	-	(8)	(1)
Deferred taxes	1	32	-	1	32	-
Total provision for taxes	1	24	-	1	24	(1)
Gain (loss) after taxes	4	24	(22)	4	26	(22)
Bank's share in loss on extraordinary items of investee (in consolidated affiliated) companies, after taxes	-	-	(1)	-	(2)	(1)
Gain (loss) on extraordinary items, after taxes	4	24	(23)	4	24	(23)

Footnotes:
(1) See Note 1 B.
(2) According to the estimated recoverable value amount of the buildings.

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION

A. GENERAL

In December 2001, the Supervisor of Banks in Israel issued directives concerning segment information reporting in a banking corporation, which followed the approval of Accounting Standard No. 11 regarding segment reporting by the Israeli Accounting Standard Board and in view of the application abroad of accounting standards concerning segment information, and in particular the application of the US Accounting Standard FAS 131 (Disclosure about segments of an enterprise and related information), implementing certain modifications concerning the special characteristics of banking corporations, mostly on the basis of the disclosure prevalent in the US banking system.

According to the directives, a segment of operations is a component of a banking corporation having the following three characteristics:

(a) Engaged in business activities that may produce income and bear expenses (including income and expenses deriving from transactions with other components of the same banking corporation);

(b) The results of its operations are reviewed on a current basis by Management and the Board of Directors in order to make decisions as to the allocation of resources to the segment and evaluate its performance;

(c) Separate financial information exists with regard to the segment.

In addition, the directives determine the disclosure requirements and the manner of presenting the financial results of segments in the financial statements.

The Supervisor of Banks clarified in January 2002, that he expects that a banking corporation heading a banking group would include disclosure as to the following segments: corporate banking, retail banking, middle market banking, private banking, real estate and construction, mortgages, credit card operations, capital market operations, non-financial companies.

Towards the publication of financial statements for 2004, the Supervisor clarified that the retail banking segment should be split into two segments, as follows: "household segment" and "small business segment"

In accordance with the above, beginning with the financial statements as of December 31, 2005, the product segments, which were reported in the past as separate segments (credit cards, capital market operations, construction and real-estate activity, and mortgage loans), are reflected now in the relevant customer segments, and in addition disclosure is given in their respect in the Section "Additional details regarding activity in certain products" hereunder. Activity of the "Non financial companies" which had also been presented in the past as a separate segment is presented as a sub-segment of the "Finanical management segement". As a result of this presentation format, every relevant segment also includes a part of the activities of the Group subsidiaries, which are designated to engage in operations in these areas.

The Bank is installing a management information system to manage profit centers according to customers, products and additional profiles (the "Tomar" system). It should be noted that due to the short time that has elapsed since the system was put into operation, and since the system as a whole has not yet been completed and implemented, the use of it as a management tool has not yet begun. Furthermore, as the organizational structure of the Bank does not fully coincide with the reported segments of operations, the model used for providing the data is based on various assumptions and estimates. On the other hand, in view of the frequent changes in the definition of segments, as discussed above, together with the fact that the system is not able to provide retroactive data, a periodic series of data segmentized according to operating segments has not yet been created. In the future, once the information produced by the system is studied and analyzed over a period of time, and concurrently with the process of implementation of the system, certain changes in the said assumptions and estimates may be required.

It should be noted that in the said questions and answers file, the Supervisor of Banks requires banking corporations to consolidate the data of their subsidiaries according to quantitative characteristics determined by the parent company. Providing such data requires the maintenance of a double database for earnings and segments of subsidiaries. This involves tremendous difficulties and at this stage the Bank is not prepared for its implementation.

The Bank is preparing for implementing the said requirement, and at this stage, with the consent of the Supervisor of banks the consolidation of the segments of operations of the banking subsidiaries has been made based on the

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

segments of operation reported by them, without adjustment for the differences, if any, that exist between the characteristics of operation of customers of the Bank and those of customers of the subsidiaries in the same segment (except for the segmentation of the data relating to the retail and middle market banking segments of Mercantile Discount Bank, which was made on the basis of an estimate, up to December 31, 2004).

The operations of the Group are divided into seven principal segments, as detailed hereunder.

It should be noted that these segments of operation do not accord with the organizational structure, mainly due to the fact that certain operations are reflected in the various segments, such as credit card activities and the capital market activity, and not within the organizational framework in which they are being operated.

- **Retail banking - General:** This segment includes customers of the Retail Division of the Bank, except for the customers of the private banking centers. In accordance with a directive of the Supervisor of Banks issued towards the preparation of the financial statements for 2004, this segment was divided into "households" and "small business" segments. The segment also included customers of the middle market and retail banking of Mercantile Discount Bank. The Supervisor of Banks has agreed that Mercantile Discount Bank will present in its financial statements for 2004, the said data, until it is ready to divide them into at least two segments (households and middle market segments). Until December 31, 2004, the data for this segment have been divided between the household segment and the small business segment, for the purpose of the segment data of the Discount Group, on the basis of an estimate. Starting with the financial statements for 2005, the segment also includes the part relating to customer activities in certain products (credit cards, capital market operations, mortgage, construction and real estate).
- **Retail Banking– Household Segment:** This segment includes customers of the Bank's Retail Division who are private customers, who are defined as customers who are either salaried employees, possess the potential for growth, or may be viewed as VIP customers (the definition excludes customers of the private banking centers). The segment also includes the customers of Mercantile Discount Bank in that bank's household segment. (Until December 31, 2004, the segment included the customers of Mercantile Discount Bank in that bank's household segment and commercial segment, on the basis of an estimate as aforesaid).
- **Retail Banking -** Small Business Segment - This segment includes customers of the Bank's Retail Division which are defined as small companies and small businesses with borrowings of up to NIS 4 million. The segment also includes the customers of Mercantile Discount Bank in that bank's small business segment as defined by that bank.
  Starting with the financial statements for 2005, the segment also includes the part relating to customer activities in certain products (credit cards, capital market operations, construction and real estate).
- **Corporate banking:** This segment includes customers of the Bank's Corporate Division (As of December 31, 2004 – except for construction and real estate customers). The segment in the Bank includes mainly companies with annual turnovers of over NIS 150 million and/or total indebtedness exceeding NIS 40 million. The segment also includes customers of the business segment of the Mercantile Discount Bank.
- **Middle Market banking:** This segment includes customers of the Bank's Commercial Banking Division. This segment in the Bank includes mainly companies with annual turnovers of NIS 15 – 150 million and/or total indebtedness of NIS 4 – 40 million. The segment also includes customers of the Middle Market banking of Mercantile Discount Bank.
  Starting with the financial statements for 2005, the segment also includes the part relating to customer activities in certain products (credit cards, capital market operations, mortgage, construction and real estate).
- **Private banking:** This segment includes customers of the Bank's Retail Division (individuals and corporations) who maintain their accounts at the private banking centers (Until December 31, 2004 – excluding customers from the construction and real estate segment) and customers of the center for private banking.
  Starting with the financial statements for 2005, the segment also includes the part relating to customer activities in certain products (credit cards, capital market operations, mortgage).
- International activity: This segment includes the overseas operations of the Discount Group. These operations are mainly

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

carried out by the Bank's subsidiaries in the United States, South America and Switzerland, and by the Bank's branch in the U.K. The international operations are characterized by commercial business activity and by private banking.

In a "Qustions and Answers" file published by the Supervisor of Banks, it was clarified that the data relating to the international operations segment needs to be divided between the segments relating to the Group's domestic operations. In view of the fact that, at this stage, the Bank's subsidiary in New York is not in a position to provide the required information, the Supervisor has agreed that, for the time being, the Bank may continue to present details of international operations in one column

- **Financial Management Segment -** This segment includes activities that are characterized as banking operations, but do not involve customers of the Group. These activities are mainly comprised of for their own account operations of the Bank and Mercantile Discount Bank involving securities and other banks, as well as exposure management (the Consumer Price Index and foreign exchange) and trading desk operations, including those involving financial sectors. This segment also includes the Bank's share in the income of the First International Bank and its share in the income of its affiliated companies which operate in a supporting capacity.

  In addition, starting with the financial statements for 2005, this segment includes the sub-segment of non-financial companie, which had been presented in the past as a separate segment, which includes the Group's operations with respect to non-financial investments. The greater part of the sub-segment's operations relate to investments of the Bank in Harel Ltd., and investments undertaken by a subsidiary, Israel Discount Capital Markets and Investments Ltd., as well as direct investments by the Bank itself.

C. THE PRINCIPAL ASSUMPTIONS, ESTIMATES AND PRINCIPLES USED IN THE PREPARATION OF SEGMENT INFORMATION - 2004

The classification of the business results of the Group into the various segments of activity, as stated above, was prepared based on the principles, assumptions and estimates detailed hereunder:

1) Income

Income from financing operations before provision for doubtful debts. The segment is credited with the margin resulting from the difference between interest on loans granted to customers of the segment and the interest paid on deposits of customers of the segment and the transfer prices.

The transfer prices reflect the marginal alternative cost of financing sources or the application thereof.

The margins are set at the date the transaction is entered into and stay in effect for the duration of the transaction free of market risks.

According to this methodology, earning or losses from financing operations resulting from changes in market conditions, are taken to the "Financial Management" segment.

Income earned on the nostro securities of the Bank is also reflected in the "Financial Management" segment.

Provision for doubtful debts. This is included in the segment in which the activity of the customer is reflected, in respect of which the provision has been created. In the same manner, collection in respect of a debt provided for or the decrease in the provision is also reflected in the segment in which the activity of the customer is reflected.

Operational income. All the operational and other income, which the bank collects from customers, are reflected directly in the segment in which the activity of the customer is reflected. Some of the income derived from foreign currency operations with customers is credited to the trading desk (in 2004 income from capital market and credit card activities were reflected separately as separate segments).

2) Expenses

Identifiable direct expenses are specifically and directly reflected in the related segments.

Overhead expenses (mainly head office expenses), which cannot be related to a specific segment, are charged to the segments using an estimate based on various charging formulas, most of them based on volume of operation indices and some of them based on estimates and assessments of the various units of the Bank. (For details see paragraph 4 hereunder).

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS INFORMATION (CONTINUED)

Depreciation and amortization expenses are charged as part of the overhead expenses.

The model for the charging of expenses used in calculating the data includes the allocation of inter segment expenses, mainly in relation to operational services provided by the branch setup to customers related to other segments by charging all the branches' expenses to customers of these branches, even if these customers are not amongst the customers of the Retail Division. As stated above, this charge is made by way of an estimate based mainly upon indices for the volume of operations of customers of the Bank's branches.

Taxes on income. In order to exclude the effect of brought forwards tax losses in respect of which deferred tax assets had not been recorded, on the measurement of the profitability according to segments of operation, the following tax computation was made:

The provision for taxes of the various segments of operation was computed on the basis of the statutory tax rate of 43.59% (2004: 44.44%). Segments showing a loss recorded a tax income computed also on the basis of the statutory tax rate.

The difference between the net taxes attributed to the segments of operation and the provision for taxes recorded in the income statement, is charged to the "Financial Management" segment.

3) Allocation of capital and computation of the return

Shareholders' equity and subordinated capital notes, being part of the financing sources of credit, are being allocated to each segment in respect of its risk assets. The allocated capital notes bear the actual interest expense attributed to them. Until December 31, 2004, no cost was charged to a segment in respect of the shareholders' equity allocated to them.

According to directives of the Supervisor of Banks, starting with the financial statements as of June 30, 2005, the operational segments are credited with imputed interest on the capital allocated to them, on the basis the risk assets attributed to the segment.

The computation of the return in each segment is based on the amount of shareholders' equity allocated to the segment The allocation of capital and of the subordinated capital notes is based on a guideline of the Supervisor of Banks, which was received towards the preparation of the financial statements for 2004.

4) Presentation of inter-segment income and expenses

The accountability between the profit centers in the Bank is made by a mechanism that allocates the total amount of expenses to customers of the Bank, using various activity indices, and not by allocating the expenses to the profit centers (and the "sale" of inter-segment services). The method for the allocation expenses used by the Bank is a multi-stage one. In the first stage the direct expenses of the branch are allocated to all the customers keeping their accounts at the branch, (customers attached to various segments). In the second stage, the expenses of designated units are allocated based on an estimate of the distribution of the service to the various headquarters, and the total expenses of the headquarters and administrations to the customers whom they serve. Finally, the costs of the general headquarter units (management, human resources, comptroller, operations and computer services, etc.) to all the customers of the Bank.

According to the system described above, each customer "bears" its own relevant expenses, which are accumulated in the various segments according to the affiliation of customers to these segments.

The format described above does not allow the determination as to what expenses of one segment were charged to another segment (referred to in the reporting format as "inter-segment activity"). The Supervisor of Banks permitted the Bank to report in 2004 on the basis of the mechanism it developed for the purpose of allocating income and expenses, and inconsequence thereof not to report inter-segment transfers.

5) Comparative figures

The comparative figures for the year ended on December 31, 2004, have been restated to implement the guidelines in respect of crediting imputed interest on equity (see paragraph 3 above).

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS (CONTINUED)

D. ACTIVITY SECTORS IN DISCOUNT BANK BUSINESS SEGMENTS

	For the year ended December 31, 2005		
	Households	Small Businesses	Corporate Banking
		in NIS millions	
Income from financing activities before provision for doubtful debts			
- From externals	(827)	575	1,547
- Intersegmental	1,831	(18)	(784)
Total Income from financing activities	1,004	557	763
Non-financing and other income	1,431	383	103
Total Income	2,435	940	866
Provision for doubtful debts	85	182	303
Operating and other expenses	1,826	697	458
Operating Income (loss) before taxes	524	61	105
Provision for taxes on Operating Income	249	40	57
Operating Income (loss) after taxes	275	21	48
Bank's share in operating income of affiliated	-	-	-
Minority interest in the income of subsidiaries	(80)	(3)	8
Net income (loss)	195	18	56
Yield on capital (percentage)	19.7%	3.6%	3.0%
Avarage Assets	16,063	11,577	29,023
Of which- Investment in Investee companies	4	-	-
Avarage Liabilities	48,794	8,189	12,370
Avarage Risk-assets	16,510	8,834	31,389
Avarage assets of provident and mutual funds	29,384	5,060	435
Avarage customers' securities	12,624	3,315	20,540
Avarage other assets under management	3,246	244	101
Margin from credits activity	430	387	602
Margin from deposits activity	541	89	102
Other	33	81	59
Income from financing activities before provision for doubtful debts	1,004	557	763

For the year ended December 31, 2005					
Middle Market Banking	Private Banking	International Activity	Non-Financial Companies	Financial Management	Total Consolidated
in NIS millions					
270	(722)	1,098	5	1,751	3,697
129	843	(150)	(20)	(1,831)	0
399	121	948	(15)	(80)	3,697
159	75	124	1	125	2,401
558	196	1,072	(14)	45	6,098
83	-	38	-	-	691
432	129	768	4	410	4,724
43	67	266	(18)	(365)	683
21	32	39	(9)	(105)	324
22	35	227	(9)	(260)	359
-	-	-	54	120	174
-	-	-	-	-	(75)
22	35	227	45	(140)	458
3.3%	125.5%	16.0%	127.9%	(16.7%)	7.2%
9,844	1,094	45,277	616	35,800	149,294
-	-	-	461	891	1,356
6,062	16,575	40,209	26	9,195	141,420
10,929	471	23,578	583	8,761	101,055
2,335	1,069	-	-	1,911	40,194
11,250	7,713	10,537	-	-	65,979
1,507	502	129	-	-	5,729
280	15	-	-	-	-
94	106	-	-	-	-
25	-	-	-	-	-
399	121	948	(15)	(80)	3,697

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS (CONTINUED)

D. ACTIVITY SECTORS IN DISCOUNT BANK BUSINESS SEGMENTS (CONTINUED)

Reported Amounts

	For the year ended December 31, 2004			
	Households	Small Businesses	Corporate Banking	Middle Market Banking
	in NIS millions			
Income from financing activities before provision for doubtful debts	1,182	462	439	190
Non-financing and other income	469	219	112	68
Total Income	1,651	681	551	258
Provision for doubtful debts	56	118	217	42
Operating and other expenses	1,202	488	266	255
Operating Income (loss) before taxes	393	75	68	(39)
Provision for taxes on Operating Income	174	37	30	(16)
Operating Income (loss) after taxes	219	38	38	(23)
Bank's share in operating income of affiliated	-	-	-	-
Minority interest in the income of subsidiaries	-	-	-	-
Net operating income	219	38	38	(23)
Net gain (loss) from extraordinary items, net of taxes	-	-	-	-
Net income (loss)	219	38	38	(23)
Yield on capital (percentage)	80.2%	10.3%	2.9%	(6.4%)
Avarage Assets	5,592	11,595	19,886	6,985
Of which - Investment in Investee companies	-	-	-	-
Avarage Liabilities	55,761	8,852	6,496	4,859
Avarage Risk-assets	4,548	6,297	21,990	5,899
Avarage assets of provident and mutual funds	-	-	-	-
Avarage other assets under management	-	-	-	705
Margin from credits activity	220	332	344	131
Margin from deposits activity	935	80	40	47
Other	27	50	55	12
Income from financing activities before provision for doubtful debts	1,182	462	439	190

For the year ended December 31, 2004

in NIS millions

Private Banking	International Activity	Construction and Real Estate	Mortgages	Credit Card Activity	Capital Market Activity	Non -Financial Companies	Financial Management	Total Consolidated
87	804	259	125	89	17	(21)	(160)	3,473
9	125	26	57	531	485	51	74	2,226
96	929	285	182	620	502	30	(86)	5,699
0	35	326	78	8	-	-	-	880
67	561	74	65	419	330	11	285	4,023
29	333	(115)	39	193	172	19	(371)	796
12	169	(45)	21	83	76	2	(201)	342
17	164	(70)	18	110	96	17	(170)	454
-	-	-	-	-	-	66	69	135
-	-	18	(6)	(60)	(8)	-	-	(56)
17	164	(52)	12	50	88	83	(101)	533
-	-	-	-	-	(1)	32	(8)	23
17	164	(52)	12	50	87	115	(109)	556
94.7%	13.8%	(5.1%)	2.6%	38.0%		355.1%	(13.8%)	9.3%
1,051	41,144	9,708	9,850	1,604	47	573	34,469	142,504
-	-	-	-	-	3	414	804	1,221
10,271	36,663	1,876	2,298	760	8	-	7,420	135,264
277	19,915	16,801	7,389	2,222	44	539	6,806	92,727
-	-	-	-	-	33,839	-	-	33,839
-	119	-	2,362	-	1,773	-	-	4,959
13	-	218	124	89	-			
74	-	16	-	-	-			
-	-	25	1	-	17			
87	804	259	125	89	17	(21)	(160)	3,473

31. BUSINESS SEGMENTS AND GEOGRAPHICAL AREAS (CONTINUED)

E. INFORMATION ON GEOGRAPHICAL AREAS

	Income[1]			Net Income			Assets	
	For the year end December 31						As at December 31	
	2005	2004	2003	2005	2004	2003	2005	2004
	in NIS millions							
Israel	5,026	4,770	4,559	231	392	244	109,835	103,527
Europe	65	58	44	5	5	(50)	2,964	2,738
North America	904	795	438	214	158	(33)	40,264	34,929
Sout America	103	76	33	8	1	(7)	1,735	1,316
Total Overseas	1,072	929	515	227	164	(90)	44,963	38,983
Total Consolidated	6,098	5,699	5,074	458	556	154	154,798	142,510

Footnote:
(1) Income-earnings from financing operations before provision for doubtful debts and other operating income.

32. SALE OF A CONTROLLING INTEREST IN THE BANK

A. COMPLETION OF THE SALE OF A CONTROLLING INTEREST IN THE BANK

On January 31, 2006, the transaction entered into by M.I. Holdings Ltd. and the Government of Israel (hereinafter – "the Government") on the one hand, and a corporation controlled by the Bronfman Family and others and a corporation controlled by Mr. Rubin Schron (hereinafter together – "the Buyers") on the other hand, for the sale of a controlling interest in the Bank (hereinafter – "the Agreement for the sale of a controlling interest in the Bank"), was completed, whereby:

- The Buyers are to acquire shares in the Bank comprising 26% of its issued share capital;
- The Buyers were granted an option for a period of three years from date of the transaction, to acquire further shares comprising up to an additional 25% of the issued share capital of the Bank;
- Arrangements have been made between the Government and the Buyers as to the coordination of their voting and of their exercise of control of the Bank.

Following the closing of the transaction, as above, control of the Bank has passed to the Bronfman-Schron Group

B. PERMIT OF THE GOVERNOR OF BANK OF ISRAEL

The Governor of Bank of Israel issued a permit to a group of investors to acquire and hold jointly the control and means of control in the Bank. This involves matters that have an impact on the Bank, including:

1. (a) No dividends shall be distributed from earnings retained by the Bank up to September 30, 2004. If losses were incurred after that date, no dividends shall be distributed until after such losses have been recovered. Furthermore, no dividends are to be distributed from gains on sale of significant assets of the Bank during the period of five years from date of the permit. After that date, dividends may be distributed from such gains subject to the prior written approval of the Supervisor.

   (b) Notwithstanding the aforementioned, dividends may be distributed from gains on sale of significant assets of the Bank during the period of five years from date of the permit, if all the following conditions exist:

   (1) The sale results from legal requirements applying to the Bank;

   (2) The distribution of dividends from such gains shall not cause a reduction in the minimum capital ratio that existed at the Bank prior to the sale of the said assets;

   (3) The Board of Directors of the Bank shall approve such distribution after having examined the needs of the Bank and its business plans;

   (4) Prior approval of the Supervisor in writing has been given for such distribution after the Supervisor had examined the capital adequacy of the Bank and the basis for the Board's decision.

2. Members of the Group, their relatives or corporations under the control of any of them, are not to receive management fees or any consideration or other benefit from the Bank or from corporations under the control of the Bank; however, they are permitted to provide services normally provided by suppliers of such services and at market price, on condition that written notice has been given beforehand to the Supervisor as to the type of service and the consideration, at least 14 business days prior to providing the service; in the event that the Supervisor informs that the service is not of the type provided normally to others or that the consideration for it is not reasonable, such service shall not be given.

   The provisions of this Section shall not apply to Directors' remuneration payable to all Directors of the Bank in equal amounts.

C. EMPLOYEES AGREEMENT

On February 1, 2005, concurrently with the signing of the Agreement for the Sale of a Controlling Interest in the Bank, an agreement was signed between the New Histadrut Federation of Labor (hereinafter: "the Histadrut"), the Representative Committee of Discount Bank Employees and the Accountant General of the Ministry of Finance

32. SALE OF A CONTROLLING INTEREST IN THE BANK (CONTINUED)

C. EMPLOYEES AGREEMENT (CONTINUED)

(hereinafter – "the Employees Agreement"), which, among other things, is subject to the approval of the Bank (see hereunder). The Employees Agreement is intended to settle several demands raised on behalf of the employees of the Bank in connection with their rights in light of the sale of the controlling interest in the Bank by the State.

Set out below are the provisions of this Agreement:

- The Histadrut, as the organization representing the workers, conceded, on behalf of the employees, their right to purchase the balance of 10% of the shares of the Bank which are held by the State, at a 25% discount, and to a subsidized loan by the Bank to finance this purchase, as is customary in privatization of banks being part of the "Share Arrangement".
- In exchange for the above-mentioned concession, the employees will receive from the Government a cash amount equivalent to a value of 30% of the value of the 10% of the Bank shares which were not offered at a discount to the employees. In the Employees Agreement it was declared that the value of the benefit for conceding the purchase of the shares as aforesaid is NIS 120 million (hereinafter – "the State Grant to Employees").
- The employees would be entitled to receive from the Bank a bonus on account of 2004, of one salary to each employee (hereinafter – "the Bonus for 2004"), as well as a special grant with regard to conceding the right to receive a subsidized loan for which they would have been entitled as is customary for the privatization of the banks being a part of the "Share Arrangement" (hereinafter – "the Special Grant").
- The total value of the Special Grant and the Bonus for 2004 is approximately NIS 130 million (hereinafter together: "the Bank Grant to Employees").

  It should be clarified that in a conversation held between the President & CEO of the Bank and the Deputy Accountant General at the Ministry of Finance, it was made clear to the Bank that the amount of the Bank Grant to Employees (amounting as stated above to NIS 130 million) reflects the total cost to the Bank as the employer of these employees. The content of this discussion has been put in writing in a letter sent by the Bank to the Deputy Accountant General.

  Amounts in excess of the said NIS 130 million, will be paid by the Government.
- The State Grant to Employees and the Bank Grant to Employees (hereinafter – "the Total Grant") amount to NIS 250 million. The Total Grant shall be paid to the employees subject to the closing of the Agreement for the Sale of the Controlling Interest in the Bank, and on dates determined in the agreement.
- The power of the Labor Charter as a collective labor agreement at Discount Bank, shall be extended for a period of five years, namely until December 31, 2009.
- The Agreement for the Sale of a Controlling Interest in the Bank is to include a provision that in the event that the control of Israel Discount Bank of New York is sold, then the full cash proceeds of such sale will be transferred to the Bank, and that no dividend shall be distributed out of such proceeds for a period of five years from date of signing the Agreement for the Sale of a Controlling Interest in the Bank, unless otherwise agreed with the Representative Committee of the Employees.
- The labor dispute announced on March 11, 2004, with regard to the privatization of the Bank, shall be terminated immediately upon the approval of the Employees Agreement.
- Immediately following the approval of the Employees Agreement, the employees will cooperate in any matter or action required for the closing of the transaction for the Sale of the Controlling Interest in the Bank, and for the sale of the balance of the shares remaining in the hands of the State, and in any other required process, if at all.
- Subject to the approval of the Employees Agreement, the parties to the Employees Agreement have mutually

32. SALE OF A CONTROLLING INTEREST IN THE BANK (CONTINUED)

C. EMPLOYEES AGREEMENT (CONTINUED)

committed that for the period until the closing date of the transaction or until September 30, 2005, whichever is later, they will mutually maintain "industrial peace". No one-sided actions will be taken or one-sided organizational changes be made by any of the parties that are not compatible with the Labor Charter. No strike or closing-down measures, in whole or in part, will be taken, nor will anything that might impair labor relations and orderly work procedures be brought into effect.

The employees entitled to the Total Grant are those who at date of closing are employees of the Bank, of Mercantile Discount Bank and of the wholly owned subsidiaries in Israel, and who are tenured and permanently employed, and also those employed under personal employment agreements, which at closing date have been with the Bank for at least one year.

The Employees Agreement was subjected to the approval of the authorized institutions of the Bank. On February 7, 2005, the Audit Committee of the Bank and the Board of Directors of the Bank approved the Bank joining the Agreement. The resolution emphasized that the total cost to the Bank (employer's cost) will be NIS 130 million (and shall not exceed that amount). On April 5, 2005 the General Meeting of Shareholders of the Bank approved the Bank joining the Employees Agreement. The Employees Agreement was also subject to the approval of the Finance Committee of the Knesset. The Finance Committee approved the Employee Agreement.

In the first quarter of 2006, soon after the closing of the agreement for the sale of a controlling interest in the Bank, the Bank and its relevant subsidiaries paid the overall bonus agreed upon in the Employees Agreement. The total cost of this bonus, including related expenses (payroll VAT and National Insurance contributions) amounted to NIS 305 million. Accordingly, the bonus that is to be paid by the State will amount to NIS 175 million, of which NIS 120 was paid in March 2006, and the balance will be paid upon the exercise of the option by the Bronfman-Schron Group.

Mercantile Employees Agreement. On May 22, 2005, the Histadrut, The Representative Committee of Mercantile Discount Bank Employees and the Accountant General at the Ministry of Finance signed an agreement, which, inter-alia, is subject to Mercantile Discount Bank's approval (see hereunder). The Mercantile Employees Agreement is intended to settle several demands raised by employees of this bank regarding their rights in light of the sale of the controlling interest in the Bank by the State.

The terms of the Mercantile Employees Agreement are as follows:

- The Histadrut, as the organization representing the workers, conceded, on behalf of the employees, their right to purchase the balance of 10% of the shares of Discount Bank which are held by the State, at a 25% discount, and to a subsidized loan to finance this purchase, as is customary in privatization of banks being part of the "Share Arrangement".
- In exchange for the above-mentioned concession, the employees will receive from the Government cash amount equivalent to a value of 30% of the value of the 10% of the Bank shares which were not offered at a discount to the employees.
- The employees would be entitled to receive from Mercantile Discount Bank a bonus on account of 2004, of one salary to each employee (hereinafter – "the Bonus for 2004"), as well as a special grant with regard to conceding the right to receive a subsidized loan for which they would have been entitled as is customary for the privatization of the banks being a part of the "Share Arrangement" (hereinafter – "the Special Grant").
- The total amount of the bonus payable to the employees of Mercantile Discount Bank will be the proportional amount applicable to the Mercantile Discount Bank out of the total amount of the bonus (NIS 250 million) as defined in the said Employee Agreement. The said bonus will be paid to the employees subject to the closing of the agreement for

32. SALE OF A CONTROLLING INTEREST IN THE BANK (CONTINUED)

C. EMPLOYEES AGREEMENT (CONTINUED)

the sale of a controlling interest in the Bank, and at dates specified in the Agreement.

- The validity of the collective labor agreements at Mercantile Discount Bank (as the term is defined in the collective agreement dated December 21, 2004 and all its Annexes) will be extended for a specified period until December 31, 2009. At the end of this period, the parties shall act as regards to the validity of the collective agreements, in accordance with the terms of Section 5 of the labor agreement dated May 17, 1968.
- The labor dispute announced at Mercantile Discount Bank on March 29, 2004, with regard to the privatization of Discount Bank, shall be terminated immediately upon the approval of the Mercantile Employees Agreement.
- Immediately following the approval of the Mercantile Employees Agreement, the employees of Mercantile Discount Bank will cooperate in any matter or action required for the closing of the transaction for the Sale of the Controlling Interest in Discount Bank, and for the sale of the balance of the shares remaining in the hands of the State, and in any other required process, if at all.
- Subject to the approval of the Mercantile Employees Agreement, the parties to the Mercantile Employees Agreement have mutually committed that in the period until the closing date of the transaction or until September 30, 2005, whichever is later, they will mutually maintain "industrial peace". No one-sided actions will be taken or one-sided organizational changes made by any of the parties that are not compatible with the collective labor agreements. No strike or closing-down measures, in whole or in part, will be taken, nor will anything that might impair labor relations and orderly work procedures be brought into effect.

The validity of the Mercantile Discount Bank Employees' Agreement was subject to approval of the authorized institutions of this bank, approval of Mercantile Discount Bank Employees' Council and the approval of the Finance Committee of the Knesset.

On May 30, 2005, the Representative Committee of Mercantile Discount Bank Employees approved the Mercantile Employee Agreement. The Board of Directors of Mercantile Discount Bank approved the agreement on June 9, 2005, and the general meeting of shareholders of Mercantile Discount Bank approved the agreement on June 20, 2005. The Finance Committee of the Knesset approved the Agreement.

D. THE ACCOUNTING TREATMENT OF THE EMPLOYEE AGREEMENT

The financial statements for 2004 include a provision in respect of the bonus for 2004, to the tune of one salary, based on the assessment that in view of the results for the year 2004, the Bank and its other relevant subsidiaries in the Group would have, in any case, paid such a bonus to their employees. The amount of the said bonus is NIS 73 million.

The provision in respect of the balance of the Bank Grant to Employees in the amount of NIS 57 million, comprising the said special bonus, will be reflected in the financial statements for the first quarter of 2006, in which the conditions precedent in the Employees Agreement were fulfilled, and in particular the closing of the transaction for the sale of a Controlling Interest in the Bank.

As to the State Grant to Employees, the Bank was informed by the Supervisor of Banks that the Grant to be paid by the State (an amount of NIS 175 million, including further amounts in respect of the addition of employer related costs) is considered "a transaction with a controlling party". Therefore the grant paid by the State is to be recorded as part of payroll expenses against a capital reserve.

The expense regarding the State Grant to Employees will be recorded in the financial statements of the Bank, in accordance with the said directive of the Supervisor of Banks in the first quarter of 2006, along with recording the provision for the special bonus.

33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE

GOVERNMENT RESOLUTION REGARDING THE BANKING SYSTEM

In the years since 1993, the Government has adopted various decisions with respect to the banking sector, certain of which were turned into legislation, others were proposed for legislation while the others remained as Government decisions. The principal decisions relate to the following matters:

(a) the holding of shares of the banks in the arrangement after October 1993; (b) the splitting-off of banking subsidiaries; (c) the holding of means of control in non-banking corporations by banking corporations; (d) provident funds; and (e) the holding of bank shares by institutional investors controlled by banking institutions.

Most of the amendments relating to the legislation restricted, reduced and regulated the banks' activities in the said areas.

The Bank Shares in Arrangement (Temporary Provision) Law was, inter-alia, published. The law was designed to regulate the holding of such shares and the exercise of the voting rights attached thereto, and other ancillary matters.

Separation of Mercantile Discount Bank Ltd.: The Government resolutions specify, inter alia, that the Government and Bank of Israel would take action to separate Mercantile Discount Bank Ltd. from the Israel Discount Bank Ltd.

In the financial statements issued by the Bank up to the date of the Government's decision as aforesaid, the Bank considered its investment in Mercantile Discount Bank as a fixed investment. Accordingly, prior to the Government's decision, no provision was recorded in the past for tax on the Bank's share in the retained earnings of Mercantile Discount Bank. As a result of the aforesaid Government resolution, the Bank no longer treated the investment in Mercantile Discount Bank as a fixed investment. Thus, the Bank recorded adequate provisions for tax in respect of its share in earnings of Mercantile Discount Bank.

On May 20 2004, the decision of the socio-economic cabinet received the authority of a Government decision to erase the first paragraph of section b(1) of the decision of May 2, 1993, regarding the separation of Barclays-Discount Bank Ltd. (in its present name of Mercantile Discount Bank Ltd.) from Israel Discount Bank Ltd. In view of the said decision, the provision for tax in respect of the Bank's share in the profits of Mercantile Discount Bank' created in the past and amounted to NIS 33 million, became superfluous, and its reversal is reflected in the financial statements as of December 31, 2004.

As regards the sale of the Mercantile Discount Bank shares that Discount Bank had purchased from Barclays Bank PLC, and which the Governor of Bank of Israel instructed their sale until December 31, 1995, the Governor of Bank of Israel extended from time to time the date fixed for the sale of these shares. On July 1, 2004, the Governor of Bank of Israel granted the Bank a permit under Section 34 of the Banking Law (Licensing)-1981, to control and hold all the means of control of any sort whatsoever, in the Mercantile Discount Bank.

CHANGES IN THE STRUCTURE OF THE CAPITAL MARKET

On November 14, 2004, the Government accepted the recommendations of the Bachar Committee relating to many issues previously discussed in the past along with additional issues, with a view of establishing a competitive structure in the capital market, to reduce concentration in the market and minimize conflicts of interest.

Three comprehensive laws were passed on August 10, 2005, relating to the capital market and to the activities of the banks therein. Following is a summary review of the main amendments to the legislation.

The Law for Increasing Competition and Reducing Concentration and Conflicts of Interest in the Capital Markets in Israel (Legislation amendments), 2005. (The Increased Competition Law)

This Law amends several relevant laws, and per the letter of this Law, is intended to establish a competitive structure in the capital markets, improve efficiency and modes of operation and increase public welfare, mostly by reducing

33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE (CONTINUED)

concentration and minimizing conflicts of interest among entities operating in the market, and expanding supervision and control over such entities and over those who own and control them.

Amendments to the Banking Law (Licensing)

- Banking corporations are forbidden to manage provident funds and mutual investment trust funds ("mutual funds") or to hold, directly or indirectly, any means of control over a company that manages provident funds or mutual funds.
- A bank is forbidden to own over 10% of corporations that control or own over 25% of a company that manages provident funds or of a company that manages mutual funds.
- Concurrently, transitional periods were determined in which banks must divest of the said holdings in a manner that banking corporations, the equity of which does not exceed NIS 10 billion (among which is the Bank), are required to reduce their holdings in provident fund management companies over a period of six years from the date the Law becomes effective, and to reduce their holdings of mutual fund management companies over a period of eight years from the date the Law becomes effective. During these periods the Bank must gradually reduce the relevant market share of the provident fund and mutual fund management companies it owns.
- A bank is forbidden to directly control or own over 5% of any type of the means of control in a portfolio manager who manages investments of a mutual fund, a provident fund or an insurer. The indirect ownership of a bank in a corporation that controls a portfolio manager as stated above was also limited to 20%.

  A transitional provision was also passed in this respect, whereby the bank will be entitled to continue exceeding the said maximum ownership until the end of six years from the date on which the Law comes into effect.
- A bank is permitted to provide pension consultation services, subject to the provisions of the Pension Advisory and Marketing Law (see hereunder).
- A duty has been imposed on banks to receive the Supervisor of Banks' approval for the ownership of auxiliary corporations.
- A bank is permitted to have the sole ownership and control of a corporation that is an insurance broker, provided that the insurance business is limited to life insurance and property insurance purchased in connection with granting housing loans to customers of the Group's banking corporations.
- Restrictions as to the ownership of corporations of various kinds have also been imposed on entities controlling banking corporations.
- The Supervisor of Banks has been authorized to impose civil penalties on a bank in respect of violations of a part of the provisions of the Banking Law (Licensing).
- The said provisions are effective as from August 10, 2005.

Amendments to the Banking Ordinance

- The authority of the Supervisor of Banks to issue directives as to bank management has been legislated and the status of the existing directives has been reaffirmed.
- The Supervisor of Banks has been authorized to relate to the regulatory authorities in Israel information attained as part of the performance of his duties.
- The Supervisor of Banks has been authorized to impose a monetary sanction upon a bank if he has reasonable grounds to asume that the bank had violated Proper Banking Management Directives, or other directives issued by the Governor of the Bank of Israel and/or the Supervisor. Concurrently, provisions have been enacted as to the bank's right to appeal the Supervisor's decision.
- The said provisions are effective as from August 10, 2005.

33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE (CONTINUED)

Amendments to the Banking Law (Customer Service)

- The Supervisor of Banks has been authorized to impose a monetary sanction on a bank if he has reasonable grounds to assume that this banking corporation had not corrected certain deficiencies in accordance with this Law or if it had violated certain provisions of this Law and the Regulations passed thereunder.
- The said provisions are effective as from August 10, 2005.

Amendments to the Law Regularizing Engagement in Investment Advisory and Investment Portfolio Management, 1995

- A distinction has been made between investment consultation services and investment marketing (investment advise regarding products towards which the consultant has an affinity), and the duties of those engaged in these areas have been determined. Banks will be permitted to engage in investment advisory services (by means of investment consultants) and in addition will be permitted to market structured products, options and forward contracts issued by them.
- The holder of a consultant license (including a bank) is not permitted to provide consulting services with regards to financial assets of an institutional entity that controls the bank, is controlled by it or is an interested party in the bank (or affiliated with the bank).
- Similar restrictions which were imposed on a bank have also been imposed on portfolio managers connected to that bank.
- A bank shall not be permitted to issue basket notes.

  The engagement of a bank with a provident fund management company, a mutual fund management company or an insurer for the purpose of providing banking services that are not in the ordinary course of business of a bank, or which is not under accepted market terms, or which might have a significant effect upon the bank's profitability, assets or liabilities, requires the prior approval of the Chairman of the Securities Authority and of the Supervisor of Banks, and in the coming years (until 2010) also of the Commissioner of Restrictive Business Practices.
- Certain restrictions in respect of investment advisory services and the marketing of investments have been imposed also on whoever controls a bank, and also on a bank which the controlling entity holds or controls entities as above.
- Prohibitions and restrictions have been imposed upon the receipt of incentives (except for fees and the reimbursement of expenses) in connection with investment advisory services, the marketing of investments, the execution of a transaction or refraining from executing a transaction in financial assets.

  Notwithstanding the aforesaid, an investment consultant is permitted to receive a distribution commission from a mutual fund management company only if such commission is paid in accordance with the provisions of the Mutual Investment Trusts Law and the Regulations to be enacted thereunder.
- A bank is not permitted to grant benefits to its employees or its units in connection with investment advisory services, investment marketing, and the execution of a transaction or abstention from executing a transaction, if such benefit is determined considering the identity of the entity that has an affiliation to the financial assets being the subject of the advisory services, the marketing or the transaction.
- The Securities Authority is empowered to impose a civil penalty on whoever violates certain provisions of the Law.
- The said provisions are to become effective six months following the enactment of the Law. However, with respect to a bank, the provisions in effect prior to the said effective date, will continue to apply so long as the bank or those who control it or corporations owned by it, are holding means of control in companies managing provident funds or mutual funds.

33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE (CONTINUED)

Amendments to the Mutual Investment Trust Law

- The provisions regarding the approval of a mutual fund management company and the cancellation of such an approval have been extended.
- It has been determined that the holding of 30% of a particular type of means of control in a mutual fund management company requires the approval of the Securities Authority.
- The market share of an owner of a mutual fund management company has been restricted to 20%.
- The Minister of Finance has been empowered to determine the maximum rate of commission that a distributor is entitled to collect from a mutual fund management company.
- A distributor is not permitted to collect from different mutual fund mangers a different rate of distribution commission.
- The Minister of Finance has been empowered to determine the maximum rate of commission that a distributor is entitled to collect from a purchaser of a unit in a mutual fund.
- The Securities Authority has been empowered to issue guidelines and instructions as to the proper management of mutual funds.
- The said provisions are effective as from August 10, 2005.

Amendments relating to insurance business

- The authority of the Commissioner of Insurance has been extended, including his power to license the ownership of an insurer and an insurance broker.
- It has been determined that the requirement to receive a permit for holding means of control in an insurer shall also apply to the holding of means of control in an insurer as security for enforcement, unless these are held in a security deposit account of a customer with a bank, and their rate does not exceed 0.001% of the same type of the means of control.
- A pension consultant is also permitted to engage as an insurance broker, provided that the brokerage activity shall be part of the pension advisory services.
- It has been determined that a banking corporation shall not be permitted to receive an insurance brokers license in the pension insurance field.
- The Commissioner of Insurance has been authorized to impose a civil penalty and a monetary sanction on whoever acts in violation of certain provisions of the Law.
- The said provisions are effective as from August 10, 2005.

The Supervision of Financial Services Law (Consulting and Marketing of Pension Schemes), 2005.

- This Law specifies two new occupations requiring a license – pension advisory services and the marketing of pension schemes, and determines the duties applying to those engaged in these fields.
- Banks shall not be permitted to engage in the marketing of pension schemes but will be allowed to engage in pension advisory services (through licensed pension consultants) on the following terms:
  - A. The banking corporation does not own over 5% in the Insurer and does not own over 10% of the means of control in another corporation which controls the insurer or owns over 25%;
  - B. The banking corporation does not own any means of control in a provident fund management company and does not own over 10% of the means of control in another corporation, which controls a provident fund management company or owns over 25% of that company;
  - C. The banking corporation does not own any means of control in a mutual fund management company and does not own over 10% of the means of control in another corporation, which controls the mutual fund management

33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE (CONTINUED)

company;

D. The Commissioner of the Capital Market, Insurance and Savings is convinced that the granting of a license will in no way harm competition and the prevention of concentration in the relevant fields, including banking.

Concurrently, transitional provisions have been enacted according to which the Commissioner is empowered to grant a pension advisory license to a banking corporation, the equity of which and of the banking corporations controlling it or which are controlled by it, does not exceed NIS 10 billion (this includes the Bank) even if this banking corporation controls or owns more than 10% of the means of control in a mutual fund manager or in a provident fund management company, and all within the period in which a banking corporation is permitted to have such holdings.

The transitional provisions further determine that a license granted to a banking corporation with respect to pension advisory services shall, within a specified period (at least until 2009), be restricted in a way that the bank would not be permitted to provide pension advisory services as regards pension funds, provident funds and individual severance pay funds if these funds are insurance funds, and also the bank would not be permitted to provide advisory services as to life assurance schemes or disability insurance schemes that are included in a provident fund or in a further education fund.

- A banking corporation is not permitted to provide pension advisory services with respect to a pension product of an institutional entity that is an interested party in the bank or to which the bank is affiliated.
- Pension advisory services shall be provided only at the branches of the bank.
- A banking corporation is not permitted to control or to have an interest in a corporation engaged in pension advisory services unless that company is a banking corporation.
- A banking corporation is not permitted to enter into a transaction with a representative body of employees for the purpose of providing pension advisory services to such employees, nor is a bank permitted to enter into a transaction with an employer or with an employee organization for the purpose of providing pension advisory services to them or to their employees.
- The engagement of a bank, acting as a pension consultant, with an institutional entity in an agreement that is not within the ordinary course of business of the bank and which might have a significant effect upon its profitability, its assets or its liabilities, requires the prior approval of the Commissioner of the Capital Markets and of the Supervisor of Banks, and, in the coming years (until 2010), also of the Commissioner of Restrictive Trade Practices.
- Prohibition and restrictions have been imposed upon the receipt of incentives (except for fees and the reimbursement of expenses) in connection with pension advisory services or in connection with the carrying out of a transaction on behalf of a customer.

  However, under certain conditions and at a maximum rate to be determined by the Minister of Finance, a pension consultant may receive a distribution commission from a provident fund management company. The said distribution commission is not to be computed as a rate of the management fees, which the management company collects from the customer.
- A bank, acting as a pension consultant, is not permitted to grant benefits to its employees or to its organizational units, if such benefit is determined considering the identity of the institutional entity that has an affiliated to the particular pension product or considering the type of the pension product.
- The Commissioner has been empowered to issue instructions as to proper management directives of pension advisory services.

33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE (CONTINUED)

- Certain violations of the provisions of the Law are considered a criminal offense.
- The Commissioner of Capital Markets is empowered to impose a civil penalty and monetary sanctions on whoever violates certain provisions of the Law.
- The Law is to come into effect six months following its enactment. However, a bank that, prior to the effective date of the Law, engaged in investment advisory services will be entitled to continue providing such services to provident funds and to individual severance pay funds (which are not insurance funds) for a period of three and a half years from the effective date.

The Supervision of Financial Services Law (Provident Funds), 2005.

- This law formalized most of the instructions that had formally been included in the Income Tax Regulations (Rules for Approval and Management of Provident Funds), 1964, as well as other issues, including vesting in the Commissioner of the Capital Markets the authority to impose a civil penalty and monetary sanctions with respect to violations of certain provisions.
- It has been determined that control of a provident fund management company or the ownership of over 5% of a certain type of means of control in a management company requires the approval of the Commissioner of the Capital Markets.

  In this respect, the ownership of the means of control at the said rate as a security for enforcement constitutes ownership that requires a license, unless these are held in a security deposit account with a bank and their rate does not exceed 0.001% of the same type of means of control.
- It has been determined that the rights of a member of a provident fund are not transferable and may not be pledged or foreclosed, unless pursuant to conditions specified in the Law or under regulations to be determined by the Minister of Finance.
- Provident funds are required to continue and keep their cash balances with banks of institutions authorized for this purpose, to keep their securities deposits with a Stock Exchange member or with whoever has been authorized for this purpose by the Commissioner of the Capital Markets.
- A management company will be entitled to collect from the assets of the fund, from members' accounts or from other payments management fees, reimbursement of direct expenses and insurance fees only. The Minister of Finance is empowered to determine the maximum rate of the said expenses and management fees.
- A provident fund management company, or whoever controls it is, prohibited from receiving any benefit over and above the said management fees and expenses.
- A provident fund management company is prohibited from paying a commission or other consideration in respect of a member joining the fund, except for a distribution commission, in respect of which the Minister of Finance is also empowered to determine in regulations an amount or a maximum rate and the mode of computing the commission.
- The Law will come into effect 90 days after the publication thereof.
- It has also been determined that a management company which had been granted a license in the past under the Income Tax Regulations (Provident funds) is entitled to a license also under this Law, provided it filed a request for a license within six months from the effective date.

Concurrently with the legislation process in the wake of the Bachar Committee recommendations, and even more intensely, following the completion of this process, the Bank commenced the examination of the reform in the capital market, the risks faced by the Bank, and the opportunities that it presents the Bank. The Bank began to apply several moves intended to enhance its preparations for capital market activities in the post Bachar Committee era. In this context

33. GOVERNMENT RESOLUTIONS REGARDING THE BANKING SYSTEM AND SUGGESTED CHANGES IN THE CAPITAL MARKET STRUCTURE (CONTINUED)

the Bank has signed an agreement in principal for the sale of all the shares in Ilanot Discount Ltd. and for the sale of the operations of Discount Management of Provident Fund, as detailed in Note __ hereunder. Hence the anticipated damage to the Bank as a result of the detachment of the provident funds and mutual funds stems mostly from the loss of income.

In addition, damage to the Bank is expected as a result of the requirement to reduce its holdings in corporations engaged in the insurance industry, following the Bank's decision to engage in pension consulting services, and this as a result of loss of income as well as a difficulty in obtaining a fair price for the Bank's holdings in Harel Investments due to the constraints deriving from a forced sale.

The Regulations regarding the distribution commissions that a bank would be entitled to collect from provident fund and mutual fund management companies, their rates, the basis of their calculation and circumstances of collection might also have an adverse effect. The Regulations pertaining to these matters have recently been approved by the Knesset Finance Committee and are supposed to come into effect on April 1, 2006. The arrangement determined in the Regulations, in particular with regards to provident funds, might adversely effect the income of the Bank. Accordingly, it is not yet possible, to assess what implications these Regulations and other arrangements to be determined by the market and by the authorities, might have on the Bank's income and on the volume of its activity in distributing the said products on the one hand, nor the effect on the final price which the Bank would receive for its holdings in Discount Provident Fund Management Ltd. and in Ilanot Discount Ltd. on the other hand.

The Bank believes that even after entering an agreement in principal as aforemetioned, the implementation of the new legislation may have a material adverse effect on the Bank's business and on its results of operations. However, in view of everything stated above, the future implications of the implementation of the capital market reform on the position and the Bank's results of operations cannot be evaluated or quantified at this stage.

As stated above, providing pension advisory services would require the Bank to reduce its holdings in Harel Insurance Investments Ltd. (hereinafter – "Harel") by 5.9%. The Bank has recorded a deferred tax liability in the amount of NIS 20 million, in respect of its share in the accumulated earnings of Harel, net of dividends distributed (based on earnings accumulated up to December 31, 2005).

As to the income of the Group from fees for the management of provident and mutual funds, see Note 26.

For details regarding the signing of an Agreement in Principle for the sale of the shares of Ilanot Discount and for the sale of the activity of the provident funds, see Note 6 F above.

34. CREDIT CARD ACTIVITY

A. ACQUISITION OF MEANS OF CONTROL IN ISRAEL CREDIT CARD LTD. (HEREINAFTER – "ICC")

1) On January 3, 2000, the Bank entered into an agreement with Leumi Financial Holdings Ltd. (hereinafter: "LFH") for the purchase of shares in ICC and in Diners Club Israel Ltd. (hereinafter: "Diners") held by LFH, namely shares constituting 65% of the equity capital and 50% of the voting rights in ICC, and shares constituting 28.4% of the equity capital and 50% of the voting rights in Diners.

2) LFH has undertaken to indemnify the Bank for certain claims detailed in the agreement. The amount of the indemnity shall equal the amount resulting from multiplying the amount for which ICC or Diners may become liable, as the case may be, by the rate of holding of LFH. The maximum amount of the indemnity is based on the price paid to LFH for its shares.

   The Bank assigned to its strategic partners in ICC (named in section 3 below), a proportionate part of its right to indemnification by Leumi Holdings, in relation to the ratio of the shares held by them to the total number of shares acquired from Leumi Holdings, provided that the cumulative amount of the indemnification should not exceed the amount of the consideration for the shares.

3) During 2000, several agreements were signed with a number of strategic partners – Fishman Chain Stores Ltd., the First international Bank Ltd. And Harel Insurance Investments Ltd. - for the sale of equity shares and voting rights in ICC and in Diners, based on their value as determined in the agreement of January 3, 2000, whereby the Bank purchased those shares from LFH. Additional shares in ICC and Diners were sold to Fishman Chains in 2001.

   In total, agreements have been signed for the sale of ICC shares granting a 49% equity interest and 37% of the voting rights as well as a right to appoint directors as well as shares in diners constituting 21.38% of the equity and 37% of voting rights, and additional shares granting the right to appoint Directors.

4) During the years 2002-2003, the Bank held 51% of the equity and 63% of the voting rights in ICC and Diners. In view of the Bank's intention to sell part of the shares purchased, while maintaining the control over ICC and Diners, the Bank did not taken into account, in computing equity in the earnings of ICC and Diners during the years 2000-2003, the balance of the shares acquired but designated to be sold.

   The balance of the shares not yet sold and which had been designated for sale, as above, was reflected in the past under "Available-for-sale securities", and the minority interests in ICC and Diners have been computed accordingly.

5) The said shares, which are intended for sale, were classified as such since their acquisition from Leumi Holdings in view of the fact that from the beginning they were purchased and held for the purpose of sale.

   In his letter dated June 17, 2004, the Supervisor of Banks informed the bank that in view of the long time that had passed since their acquisition, he feels uneasy with the said continued classification, therefore, if until the date of publication of the financial statements as of September 30, 2004, a draft agreement for their sale is not reached, or alternatively, an offer for sale of the said shares is not published, then, as from the financial statements of September 30, 2004, onwards, the bank will have to state all its holdings in ICC and Diners by the equity value method. The bank implemented the said instruction in its financial statements as of September 30, 2004, this having no material effect upon the financial statements.

   Accordingly, the outside shareholders' interest in ICC and Diners as of December 31, 2004, was calculated at 49% and 21.4%, respectively.

6) An agreement was signed in January 2005 between ICC and its shareholders, according to which ICC would acquire the balance of the shares in Diners, so that following completion of the sale, ICC would own 100% of the equity and voting rights in Diners. Diners International has approved the transfer of the shares. The approval for this transaction from Bank

34. CREDIT CARD ACTIVITY CONTINUED)

of Israel has not yet been received.

B) THE ESTABLISHMENT OF A NEW CUSTOMER CLUB AND THE SALE OF THE MEANS OF CONTROL IN DINERS

On November 29, 2005, ICC entered into an agreement with Dor-Alon Energy in Israel (1988) Ltd. and Blue Square Israel Ltd. (hereinafter together – "the Purchasers") according to which ICC has committed to sell to the Purchasers shares comprising 49% of the issued and paid share capital of Diners Club Israel Ltd. (hereinafter – "Diners") in consideration of NIS 21.3 million. Concurrently, Diners entered into an agreement with the Purchasers for the establishment of a customer club. The closing of the transaction is subject to conditions precedent, among which are regulatory and other approvals.

The consideration for the shares is to be financed by a loan to be granted to the Purchasers by ICC. The shares sold are to serve as collateral for the loan, which is to be repaid at different dates over a number of years, during which the Purchasers are entitled to decide on returning the shares to ICC instead of repayment of the loan, and ICC on its part is entitled to demand the return of the shares, all in accordance with the terms stated in the agreement for the sale of the shares.

It should be noted that to the Bank's best knowledge, some of the controlling parties amongst the Purchasers according to the above agreement, are also among the Buyers in accordance with the agreement for the sale of a controlling interest in the Bank, or are related to them (see Note 37).

C. CHANGES IN THE ARRANGEMENTS CONCERNING THE CREDIT CARD MARKET

1) a. In July, 1998, an agreement was signed between ICC, Bank Leumi and the Bank, on the one part, and Alpha Card, the First International Bank an Oreq, on the other part, regarding the principles applying to the issue and clearing of credit cards in Israel, within the framework of a local agreement.

The Commissioner of Restrictive Trade Practices granted an exemption from having the agreement approved by the Restrictive Trade Practices Court, in terms of the provisions of Section 14 of the Restrictive Practices Law – 1988. This exemption is valid for a period of four years beginning July 7, 1998.

The exemption includes certain restrictive conditions determined by the Commissioner, which regulate the mode of operation in the VISA credit card market.

Among the terms determined in the agreement between the parties and in the exemption granted by the Commissioner, a mechanism has been determined for determining the structure of issuer commissions (hereinafter: "cross commissions") to be paid by those clearing the vouchers to the issuers, their allocation and rates for the transitional period and thereafter.

b. In May 2000, an agreement was signed between ICC, BLL, Leumi Card Ltd., FIBI and Oreq, whereby the parties agree that the local agreement dated July 1998 will apply also to the relations between Leumi Card Ltd. And ICC, except for certain changes. The Commissioner of Restrictive Trade Practices has also granted an exemption also to this agreement, which is valid until July 7, 2002.

c. In July 2000, the Commissioner advised that the first period with regards to the structure of issuer commission to be paid by those who clear voucher to the issuers, is to terminate on August 31, 2000.

On November 12, 2000, the Commissioner advised that the period of the exemption regarding the rate of the cross commission, is to terminate on March 1, 2001, and until that date another relevant rate of commission is to be determined.

On March 8, 2001, the Commissioner decided to grant ICC and Leumi Card (hereinafter: "the VISA companies"), to BLL, the Bank and FIBI (hereinafter: "the banks") an exemption from the requirement to receive an approval from the Restrictive Practices Court to their being parties to a restrictive agreement regarding the cross commission and its rate as applies according to the agreement dated May 18, 2000.

34. CREDIT CARD ACTIVITY CONTINUED)

C. CHANGES IN THE ARRANGEMENTS CONCERNING THE CREDIT CARD MARKET (CONTINUED)

The exemption was granted in terms of the provisions of Section 14 of the Restrictive Trade Practices Law, and is in effect until September 1, 2001. Among the terms determined are: immediate reduction of the cross commission in one of the categories, from a rate of 2.25% to 2%; a reduction of the cross commission so that the average cross commission for all the categories would not exceed 1.25%, and such being by no later than September 1, 2001; cancellation of existing categories of business enterprises relating to the issue of the cross commission and the conversion of businesses to another structure of categories to be agreed upon, with the approval of the Commissioner, all this not later than July 1, 2001. In the absence of consent as aforesaid, the structure of categories will be as determined in an annex to the exemption letter.

In addition, it has been stipulated in the exemption letter that not later than August 1, 2001, the VISA companies and the banks shall commence issuing credit cards of the MasterCard type, in a quantity required for the clearing of such cards, and not later than October 1, 2001, the VISA companies shall clear MasterCard credit cards.

It was further provided that the VISA companies will do everything that is required to diligently base, on a reasoned methodology and full and detailed data, which will be submitted for examination by the Commissioner not later than May 1, 2001, the rate of the cross commission, which in their opinion should apply in Israel. In case that during the period of the exemption, the Commissioner will not be convinced that the rate of the cross commission proposed by the VISA companies is justified, the VISA companies shall, by no later than 30 days of the exemption date, apply to the Restrictive Trade Practices Court for an approval of a restrictive arrangement for the cross commission, at the rate and upon the terms and conditions which were submitted to the Commissioner.

It was further provided in the exemption letter, that a delay in compliance with the terms of the exemption, which does not exceed 30 days, will not be considered violation of those terms.

At the request of the VISA companies, the Commissioner granted an extension until September 16, 2001, for submission of their opinion as to the rate of the cross commission. The said opinion has been submitted.

The Commissioner has declared that in his opinion, a reasoned methodology for determining the rate and structure of the cross commission requested by the VISA companies, has not been presented to the Authorities, as required by the terms of the exemption of March 2001. However, considering the timetable, the Commissioner did not find it proper to decide at this stage, the question as to whether the terms of the exemption of March 2001, have been violated. Furthermore, the Commissioner recommended that the parties to the exemption will apply to the Restrictive Trade Practices Court for approval of a binding arrangement and request a temporary permit to act in accordance with the binding arrangement. The Commissioner emphasized that all this does not derogate from the obligation of the parties to comply with all the other terms of the exemption of March 2001.

d. At the beginning of September 2001 the Bank, ICC, the First International Bank, BLL and Leumi Card (hereinafter – "the Parties") submitted to the Restrictive Trade Practices Court requests for approval of a binding arrangement between themselves and for temporary permits to act in accordance with such an arrangement. In these requests, the Court was asked to approve the rates of issuer commission agreed between the parties on September 9, 2001.

The Commissioner's recommendation for the issue of a temporary permit, was, inter-alia, conditional upon compliance with provisions for protecting competition between clearing and issuing bodies. In this respect, obligations were imposed on the banks, including: avoidance of discrimination between customers based on the identity of the clearing body to which the customer is related, prohibition on relating banking service to a customer

34. CREDIT CARD ACTIVITY CONTINUED)

C. CHANGES IN THE ARRANGEMENTS CONCERNING THE CREDIT CARD MARKET (CONTINUED)

to the identity of the clearing body to which the customer is related and prohibition on the granting of benefits in respect of clearing operations.

On September 9, 2001 the Restrictive Trade Practices Court issued a temporary permit to the parties allowing them to act in accordance with the agreement between them of September 9, 2001. ICC and the Bank are acting at present in accordance with the agreement and subject to the provisions determined by the Commissioner.

Since then four objections were filed with the Court opposing the approval of a binding arrangement. In addition, pleas were filed for the cancellation of the temporary permit granted by the Court. ICC and the Bank responded to the said objections and pleas.

On December 22, 2002, the Court, in a reasoned decision, dismissed the pleas of the opponents to cancel the temporary permit, and granted the appellants a temporary permit to operate according to the agreement, until a decision is given in the plea for approval of a binding arrangement in the principal process.

On February 12, 2003, within the framework of hearing proofs, the Court requested to receive the response of the Commissioner regarding the arguments raised in the hearing, according to which the Commissioner discriminates between the parties acting in the VISA market and Bank Hapoalim Ltd. and Isracard Ltd. ("Hapoalim Group"). The discrimination argument relates mainly to the rates of commission of the issuer approved for the VISA companies as against the traders commissions that the Hapoalim Group was permitted to collect as part of the agreed Order. The Commissioner rejected the discrimination claims.

The Bank, ICC and the First International Bank in their response to the Court reiterated the said discrimination claim. The hearing of the proofs stages is finished and the hearing is at the stage of summing-up the first stage.

e. On August 11, 2002, the Commissioner extended the validity of the exemption mentioned in sections a and c above by eighteen months, or until the termination of the proceedings at the Restrictive Practices Court (section d above), whichever is earlier, and everything subject to changes made within the framework of the exemption granted in September 2000, and to the extent that the temporary permit given by the Court remains in force.

   On February 10, 2004, the Commissioner once again extended the period of the said exemption for one year or until the conclusion of the proceedings at the Restraint of Trade Court.

f. Within the framework of the proceedings at the Restraint of Trade Court, as described in section d above, the Commissioner of Restrictive Trade Practices applied to the Court for an order instructing the appellants to reduce the issuer commissions during the coming months, and also requested the Court to instruct the appellants to inform business houses of the anticipated reduction, so that they are aware of it. These requests of the Commissioner rely on the argument that the appellants deviated from the issuer commissions specified in the provisions of the temporary permit granted by the Court.

   In November 2003, ICC and the Bank responded to the plea of the Commissioner, arguing, inter-alia, that the Commissioner is prevented from acting against the appellants, as the alleged deviation had been known to the Commissioner and to anyone on his behalf, and that the computation and presentation of the average issuer commission, as presented by him, are incorrect.

   On November 25, 2003, ICC and the Bank received a further request of the Commissioner amending his previous request so that it would apply to longer periods.

   ICC has filed a response, following which the Court requested the parties to try and reach a compromise agreement.

34. CREDIT CARD ACTIVITY CONTINUED)

C. CHANGES IN THE ARRANGEMENTS CONCERNING THE CREDIT CARD MARKET (CONTINUED)

On February 25, 2004, the Restraint of Trade Court approved the compromise agreement reached between the Commissioner and the other parties, according to which the average cross commission would be reduced in the course of the year, so that it would not exceed a rate of 1.21% (instead of 1.25%). The parties also agreed to the mode of computation of the average commission and to the manner in which the present agreement could be amended under certain circumstances and the Supreme Court admitted the appeal against the decision of approval.

g. On August 4, 2003, the Commissioner of Restrictive Trade Practices informed the three credit card companies in Israel, ICC, LeumiCard and IsraCard, that before taking legal action against them under the Restraint of Trade Law, he offers the companies to reach, within 30 days, a local clearing agreement for the cross-clearing of MasterCard credit cards, on the basis of cross commissions approved as part of the temporary permit granted to the appellants by the Court.

On March 25, 2004, the Commissioner approached the company suggesting a draft arrangement for cross-clearing of MasterCard and VISA credit cards, between the three clearing companies operating in Israel. ICC responded to the Controller that prior to the entering into an arrangement regarding cross clearing the Restrictive Business Practices Authority should enforce the undertaking of IsraCard Ltd. to open for competition the brand name "IsraCard", or to amend the terms of the proposed arrangement, so as to resolve failures that might arise in case the brand name "IsraCard" will not be open for competition. On July 12, 2004, the Controller presented to the parties an updated draft of the arrangement and held a joint meeting in the matter with the parties. According to a letter of the Controller of July 18, 2004, and based on the clarifications presented at the above meeting, the three credit card companies were requested to submit their final response to the proposed arrangement by August 8, 2004. ICC has responded to the Controller, however the negotiations regarding the draft arrangement continued. Following discussions held with the Commissioner in this matter, the Commissioner issued on November 18, 2004, a further letter according to which, in the absence of a positive reaction of all the parties to the proposed arrangement, the Commissioner is of the opinion that there is no further sense in trying to proceed with the arrangement, and must be awaited the decision of the Restrictive Practices Court (as stated in sub-section D above).

ICC continues discussions with the Commissioner regarding the arrangement as stated above, while requesting certain changes in the proposed arrangement, among other things, that the rates of the issuer commission determined in the arrangement would be approved by the Restrictive Trade Practices Court in the framework of the process described above.

Further to the many discussions held on the issue of cross-clearing of VISA, IsraCard and MasterCard credit cards, the Commissioner of Restrictive Trade Practices informed on August 9, 2005, that he intends to instruct the IsraCard Company and obligate it to allow, among other things, the local clearing of MasterCard and IsraCard credit cards by additional clearing agents, through the means of a joint interface, and all within 90 days from date of the instruction coming into effect.

The Commissioner wishes to compel IsraCard to sign a cross-clearing agreement with ICC and LeumiCard. This agreement should allow IsraCard to also clear VISA credit cards.

The rate of the cross-clearing commission to be determined would be the one agreed upon by the VISA companies (within the framework of the provisional permit issued by the Commissioner) or a rate to be determined by the Court in connection with the permit for a binding arrangement.

In addition, the parties will be entitled to reach additional accords provided these are submitted for approval by the Commissioner.

34. CREDIT CARD ACTIVITY CONTINUED)

C. CHANGES IN THE ARRANGEMENTS CONCERNING THE CREDIT CARD MARKET (CONTINUED)

The response of the credit card companies has not yet been submitted.

2) According to the requirements of the Commissioner, within the framework of the exemption discussed in B.1.c. above, that the MasterCard market shall be opened also to issuance and clearing by companies not related to Bank Hapoalim group, ICC acted to prepare itself for entry into issuance and clearing operations of MasterCard credit cards. ICC approached Eauropay, which owns the franchise for issuing MasterCard credit cards for a license to issue such cards. This request had been approved and accordingly an agreement was signed by the parties.

   As from October 2001, ICC and the Bank commenced the issuance of MasterCard cards, while their clearing by ICC began in February 2002.

3) ICC and Yatzil Finance (a consolidated subsidiary of ICC) were approached on April 14, 2004, by the Restrictive Business Practices Authority regarding a complaint that had been received from various companies engaged in discount services, alleging that ICC refused to enter into agreements for the provision of discount services for credit cards issued by ICC., this being contrary to the merger terms between ICC and Yatzil Finance. In its response ICC provided the reasons for not engaging in the said agreements. On June 3, 2004, the Restrictive Business Practices Authority instructed ICC to publish until June 23, 2004, guiding criteria for entering into agreements with companies discounting and financing credit card vouchers, in order to avoid further complaints. Accordingly, ICC informed the Restrictive Business Practices Authority that in view of the nature of discounting credit card vouchers, any entity wishing to enter into such an agreement with it must abide by the following criteria: financial stability, reliability and suitable technological means and manpower.

   Following discussions held with the Commissioner in this respect, the Commissioner issued a letter on November 18, 2004, according to which, in view of the lack of a positive response on the part of all the parties to the proposed arrangement, he is of the opinion that there is no sense any more in trying to advance the arrangement, and the parties are to await the decision of the Restrictive Trade Practices Court (as stated in subsection (d) above). ICC continues to discuss the said arrangement with the Commissioner, while asking that certain amendments should be made to the proposed arrangement, inter-alia, that the rates of issuer commission determined in the arrangement should be approved by the Restrictive Trade Practices Court, within the framework of the process described above.

   It is not possible to assess at this stage the effect of the new arrangements being formulated as a result of the initiative of the Commissioner of Restrictive Trade Practices on the results of operations of ICC.

D. ARRANGEMENTS BETWEEN THE FIRST INTERNATIONAL BANK AND THE ISRACARD GROUP

Among other distribution agreements signed with several banks, ICC signed an agreement with the First International Bank ("FIBI") for the joint issue of VISA credit cards to customers of FIBI for a period of six years as from August 1, 2000, at the end of which the agreement would be renewed for an additional period of three years. However, as from February 2006, each of the parties is entitled to terminate the engagement at any time giving prior notice of six months.

In the reports of FIBI regarding the agreement signed recently with Bank Hapoalim for the purchase of means of control in Otsar Ha-Hayal Bank Ltd., it is stated, among other things that the parties to the agreement determined "arrangements as to the continued engagement between Otsar Ha-Hayal and the IsraCard Group and for cooperation between the bank and the IsraCard Group".

The contents of the reports of FIBI raise real concern regarding a violation of the commitments of FIBI towards ICC and towards the Bank, as well as various obligations imposed on it according to any law. A real concern exists also that the actions that are probably planned for the transfer of customers from ICC to IsraCard comprise not only the use of customers as "pawns" and as part of the payment for the acquisition of Otsar Ha-Hayal, but also damage to the customers themselves and to ICC.

Whereas the reports of FIBI are drafted in general and vague terms and do not disclose in full the details of the transaction, the Bank approached FIBI demanding to receive all the documents and details pertaining to the said arrangements. Until now, the demand of the Bank has been turned down.

In the absence of details as above, the Bank is not able to assess what actions would be taken by FIBI in this matter, and therefore the implications, if any, on ICC.

35. LEGISLATION INITIATIVES

Several legislation issues exist (laws, regulations and administrative instructions) which are at different stages of the enactment proceedings. Certain of these issues are liable to have an adverse effect on the operations of the Bank and of its consolidated subsidiaries and their business results in the future. The Bank is not able to evaluate the scope of such effect.

36. INFORMATION BASED ON NOMINAL DATA - THE BANK (IN NIS MILLIONS)

	December 31	
	2005	2004
Balance Sheet		
Total assets	96,536	*90,651
Total liabilities	90,198	*84,675
Shareholders' equity	6,338	5,976

*Reclassified.

	For the Year Ended on December 31	
	2005	2004
Statement of Income		
Net income (loss)	489	586

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