The First International Bank of Israel Ltd.

Monitoring Report | June 2019

This credit rating report is a translation of a report that was written in Hebrew for a debt issued in Israel. The binding version is the one in the origin language.

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The First International Bank of Israel Ltd.

Baseline Credit Assessment (BCA)	**aa2.il**	
Long-term Deposits and Bonds	**Aaa.il**	**Outlook: Stable**
Subordinated Notes (Lower Tier 2 Capital)	**Aa1.il**	**Outlook: Stable**
Subordinated Capital notes (Upper Tier 2 Capital)	**Aa2.il(hyb)**	**Outlook: Stable**
Subordinated Notes with a loss absorption mechanism (CoCo)	**Aa3.il(hyb)**	**Outlook: Stable**
Short-term Deposits	**P-1.il**	

Midroog upgrades the Baseline Credit Assessment (BCA) of the First International Bank of Israel Ltd. (The "Bank") from aa3.il to aa2.il. The BCA's direction of development has been modified from positive to stable.

As derived, the rating of the Bank's long-term deposits and senior debt have been upgraded from Aa1.il to Aaa.il, continuing to incorporate assumption for high government support, a two-notch uplift relative to the baseline credit assessment.

The ratings of subordinated and hybrid debts have been upgraded as follows: Subordinated notes (lower Tier 2 capital) from Aa2.il to Aa1.il, and the subordinated capital notes (upper Tier 2 capital) from Aa3.il (hyb) to Aa2.il (hyb). These ratings reflect the structural subordination of these debts relative to the Bank's senior debt, the seniority scale among the subordinated debts themselves and the impact of loss absorption mechanisms. Additionally, these subordinated debts rating likewise reflect an assumption of government support.

The rating of subordinated notes with a loss absorption mechanism (CoCo) through write-off or partial write-off (classified as Tier 2 capital) has been raised from A1.il (hyb) to Aa3.il (hyb). This rating is one notch lower relative to the baseline credit assessment and three notches lower relative to the senior debt rating, reflecting the terms of this instrument, including contractual subordination and loss absorption mechanisms of this instrument, without the assumption of external support.

Additionally, Midroog affirms the P-1.il rating for short-term deposits.

The rating outlook of all liabilities has been modified from positive to stable.

Key considerations for evaluating the baseline credit assessment (BCA) and the Bank's ratings

The upgrades to the baseline credit assessment (BCA) and the Bank's ratings is due to an improvement in the ongoing profitability, which is supported by implementing efficiency measures alongside the potential for growth of the credit portfolio and it's risk levels, supporting the ability to generate future profits and further building the capital cushion. The latter absorbs losses well, is supported by prominent risk indices for credit portfolio and the cushion for absorbing expected losses stands out favorably with respect to BCA over time. With Tier 1 capital adequacy expected to remain above 10.0% throughout the cycle.

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The Bank’s baseline credit assessment (BCA) is supported by a suitable business profile based on a strong brand, reasonable market share, broad and dispersed customer base, diversification of income sources and activities vis-a-vis niche populations, which contribute to the Bank’s revenues return ability. The Bank is a universal bank that provides its customers with a variety of banking services including extensive operations within the capital market; however, its business positioning is limited due to its medium size. The merger of Bank Otsar HaHayal with and into the Bank in early 2019 is expected, as we assess, to continue to improve and expand the range of the offered products and the penetration rates of the defense systems’ employees and retired employees as well as strengthen the position of the Bank group within the retail sector.

The Bank is characterized by a conservative risk management policy, which supports the risk profile, as reflected also by favorably prominent quality indices relative to the baseline credit assessment (BCA) and to the comparison group[1] over time. Similar to the system, the concentration of the Bank's credit portfolio in relation to the capital absorption cushion remains high relative to BCA and constitutes a weight on the Bank's risk profile, but the Bank is acting to reduce it, while continuing to tilt the portfolio to more dispersed segments.

The profitability rates of the Bank show a trend of improvement in recent years, in view of the growth in the credit portfolio that supports the expansion of the income bases and the implementation of an efficiency plan starting in 2016 and the merger of Otsar Hahayal Bank, which limit the increase in the Bank's expenses. In our opinion, the core yield on risk weighted assets and return on assets is expected to fluctuate between 1.9% -1.8% and 0.7% -0.6% during the forecast years. The main assumptions regarding the profitability of the Bank on which the base scenario of Midroog is based for the years 2019-2020 are as follows: (1) an increase in the credit portfolio of 4%-5% per year, mainly vis-a-vis the existing customer base and the utilization of merger advantages in merged banks; (2) an increase in net financing income of 7% per annum in view of the low interest and inflation environment alongside continued growth in retail credit and credit to small and medium-sized businesses (SME), characterized by a surplus financial margin; (3) Expenses for credit losses rate of 0.25% -0.20%; (4) the continued drift of salary expenses in accordance with the wage agreements at the Bank, alongside offsetting effect of the continued reduction in the number of positions; (5) moderate savings in operating expenses due to reduction of the branches’ areas and efficiency due to the merger of Bank Otsar HaHayal.

We believe that the Bank's growth potential is also due to the Bank's ability to grow on the basis of existing customers, increased use of direct banking channels and lifting restrictions on extending credit at the merged banks, good business flexibility (a gap from the regulatory capital buffer), absence of sectoral concentration restrictions and favorably prominent business position in niche populations. These characteristics support the Bank's ability to generate future revenues and further growth in the credit portfolio alongside maintaining its risk profile.

The Bank maintains appropriate capital adequacy ratios for the BCA, and a suitable gap in relation to regulatory capital requirements, which constitutes a positive factor for the Bank's growth potential and the Bank's business

[1] The five largest banks in the system

flexibility. It should be noted that in relation to the stress scenarios of Midroog, the Bank's capital cushion absorbs unexpected losses in a good and supportive manner and supports its stability throughout the economic cycle. Midroog expects that the capital cushion will continue to be built and capital adequacy ratios will continue to improve on the margins in the base scenario as a result of the following factors: (1) accumulated profits; (2) distribution of dividends within the range of 50% of the net profit; (3) an increase in the scope of the risk weighted assets similar to the rate of increase of the credit portfolio.

The Bank's liquidity profile stands out favorably and is supported, on the one hand, by a convenient, wide and diversified source structure, based on a significant rate of stable deposits (retail), significant liquid assets inventory and low risk as well as q liquid coverage ratio (LCR) significantly higher that the regulatory bar (100%), which supports the business flexibility, and on the other hand, is adversely affected by a relatively high wholesale deposits component, which we believe is less stable over the cycle.

The ratings of the Bank's long-term deposits and senior debt have been set two rating notches above the BCA, which embodies our assessment of high probability of external support when necessary. The rating of the Bank's subordinated debt which is not recognized under Basel III also assumes a high probability of government support. It is our assessment that the subordinated debts rating for the purposes of Basel III (CoCo) will not benefit from government support and will bear losses when necessary, as specified below.

The BCA development direction and rating outlook

The stable direction of development for assessing the BCA and the stable outlook for the Bank's ratings reflects Midroog's assessment that the Bank will keep an appropriate financial profile throughout the cycle, maintaining risk indices in the credit portfolio and loss absorption buffers within a range that is appropriate for the rating, in parallel with moderate growth of the credit portfolio.

Factors that could lead to raising the BCA and the Bank’s ratings:

- A significant improvement in the business profile that will be expressed by an increase in the bank's market share, while maintaining the quality of assets and capital adequacy
- Significant improvement in profitability and cost structure

Factors that may lead to lowering the BCA and the Bank’s ratings:

- Significant deterioration of the credit portfolio quality
- Erosion of the capital buffers and their stability
- Adverse impact on the liquidity profile

The First International Bank of Israel Ltd. - key financial data and ratios, in NIS Millions and in percentages:

NIS millions	31.03.2019	2018	2017	2016	2015	2014
Credit to the public	87,246	85,160	81,216	78,175	73,379	69,807
Deposits from the Public	115,349	111,697	113,511	105,817	103,262	95,155
Total equity	8,538	8,413	8,046	7,604	7,337	7,043
Total assets	136,983	134,120	135,717	127,907	125,476	117,807
Profit before taxes + provision for credit losses	329	1,304	1,145	966	784	856
Net profit	192	767	720	560	478	474
(%)						
Problematic debts / credit to the public	1.9%	1.9%	1.8%	2.3%	2.4%	3.5%
Problematic debts / (Total equity and provision for credit losses)	17.9%	18.0%	16.9%	22.0%	22.3%	31.6%
Provision for credit losses / Average credit to the public [1]	0.2%	0.2%	0.2%	0.1%	0.0%	0.1%
Net profit / Average assets [1]	0.5%	0.6%	0.5%	0.4%	0.4%	0.4%
provision for credit losses / Average risk weighted assets [1]	1.7%	1.7%	1.5%	1.3%	1.1%	1.2%
Efficiency ratio	67.2%	68.4%	69.5%	73.5%	77.6%	77.3%
Tier 1 capital adequacy ratio	10.5%	10.5%	10.4%	10.1%	9.8%	9.7%
Total capital adequacy ratio	13.8%	13.9%	13.9%	13.8%	13.3%	14.2%
Total equity / Total assets	6.2%	6.3%	5.9%	5.9%	5.8%	6.0%
Less stable [2] financing sources / Total assets	20.4%	18.0%	20.5%	15.8%	19.1%	NA
Liquid balances [3] / Deposits from the Public	37%	37%	41%	39%	40%	40%

[1] Calculated on an annual basis

[2] Institutional entities (wholesale) deposits, bonds and deferred promissory notes for repayment within one year and deposits from banks

[3] Cash and bank deposits, Israel and United States government bonds and assets backed up by the United States government.

Details of the primary considerations for evaluating the baseline credit assessment (BCA)

Appropriate business profile supporting the Bank's revenue generating capability over the cycle

The Bank is the fifth largest banking group over time, as reflected by approximately 8% of the market share of the total system assets as of March 31, 2019 (and in a similar rate of the total public credit and deposits), however with a significant gap from the other major banks. Notwithstanding, the Bank has a surplus market share in consumer credit excluding housing (approximately 14% as of March 31, 2019) relative to its share in the system, which contributes, in our estimation, to the stability of the dispersion of revenues, in light of heterogeneous characteristics as well as in light of the customers' characteristics. The Bank's business profile is supported due to its being a universal bank that provides a range of banking and financial services, relies on a broad and diversified customer base, maintains strong brands among niche sectors (defense establishment employees, teaching staff, the ultra-Orthodox sector and affluent clients and capital market activists) and grants a higher value offer within the capital market services domain. As part of the strategic plan for the group's streamlining measures, Bank Otsar HaHayal had been merged with and into the Bank in early 2019, a move that is expected, as we assess, to improve, deepen and expand of the service provided to the defense system employees and retired employees as well as strengthen the group's status among the households and small businesses sectors. On the other hand, we believe that the Bank's position within the local banking system is not expected to significantly change in the foreseeable future, as its medium size weigh on the profit return capability limits the business profile.

The stability of the Bank's revenues, as assessed by Midroog, is favorably prominent relative to the BCA and is positively affected by its retail focus, which contributes to the revenue generating capability and moderates the volatility of activities. This is supported mainly by a significant retail revenue mix (75%-78% over the past three years), which is characterized by a broad diversification structure. Indeed, the Bank has a reasonable rate of revenues due to commissions (approximately 32% in 2018), which is declining (2016: approximately 36%), however one highly exposed to securities and foreign currency operations (approximately 51% for that period), which are characterized, as we assess, by higher volatility and dependence on exogenous and cycling factors, and thus weigh on the stability of the operational revenues. We expect that in the coming years a significant share of the commissions will continue stemming from activities within the capital market, as along with the increase in the credit portfolio, the weight of income due to commissions will continue to erode similar to the trend in recent years.

The Bank has an adequate distribution of revenue sources, which rely over time on 4 primary legs, as approximately 35% of the Bank's revenues (excluding financial management sector) have been obtained from the household sector and private banking, approximately 25% from the small sized businesses, approximately 22% from medium and large businesses and institutional entities, and approximately 18% from the mortgage sector in 2018. On the other hand, we should note that the main activities of the Bank are concentrated in the local market, similar to the comparison group, a fact that is not expected to change in the forecast term and strengthens its dependency on the local market. It is our assessment that the changes in the business environment and particularly the Credit Data Law, constitute a potential for increased activity of the Bank, appropriate pricing of risks and expanding the customer base, however such are also expected to increase the level of competition (banking and non-banking) over the customer base during the next two years. In the medium-long term we expect, that the main generator of competition in the industry will be innovation, as banks that do not fit the business model over time may experience significant erosion in the business profile.

The Bank's risk management policy supports its risk profile; however, the credit concentration relative to the capital buffer remains relatively high

The Bank's risk management system is comprehensive and includes several anchors and control circuits that support the risk management policy, setting the Bank's risk appetite (which corresponds to its strategy) as well as monitoring and controlling the risks. The credit risks are managed using statistical rating models (consumer credit) and expert assessment (business credit). The Bank maintains a conservative credit policy, in our assessment, including relatively severe restrictions on the business credit portfolio, underwriting processes, tight monitoring and management of guarantees, as this policy constitutes a positive factor in evaluating the baseline credit assessment and is also expressed by good risk indices relative to the credit portfolio. On the other hand, we should note that the credit concentration (borrowers and sectoral) relative to the capital absorption buffer is still high relative to the BCA and weigh on the Bank's risk profile. Thus, the concentration of the largest sector from the bank's core capital is the real estate and construction sector, like the system, which constitutes approximately 119% (approximately 146% on average in the comparison group) as of March 31 2019, and the exposure to large borrowers, which constitute above 5% of the bank's core capital (above NIS 400 millions) constituted approximately 52% on December 31 2018 (approximately 25% on average within the comparison group). Midroog estimates that in the short and medium term no significant improvement in these indices is expected, despite our expectation of a certain improvement resulting from the continued increase in the Bank's capital. The market risks at the Bank are estimated by the VaR model under conservative assumptions, similar to the entire banking system and as a complementary activity for assessing the risk a number of stress scenarios are examined (including holistic scenarios) at varying degrees of severity. Midroog estimates that the market risk appetite of the Bank is relatively low and matches the BCA, as expressed by a relatively conservative VaR limit of approximately 5% of the core capital.

the BCA upgrade is supported by the quality of the credit portfolio, which stands out favorably relative to the BCA and relative to the comparison group over time, and supports the portfolio performance throughout the cycle

The Bank is characterized by high quality credit portfolio which supports its future ability to return profits, as reflected by good risk indicators relative to the BCA, and it also maintains a relatively high buffer for the absorption of expected losses, which supports the portfolio's performance throughout the cycle. The Bank is operating to reduce the exposure to large borrowers and to the concentration in the business portfolio, while continuing in tilt the portfolio towards more dispersed segments, as the household sectors, private banking and small businesses constitute approximately 70% of the total credit portfolio over time. Similar to the system, in recent years the Bank has been significantly improved the quality indices of the credit portfolio. Thus, the ratio of problematic debts to credit to the public stood at approximately 1.9% as of March 31 2019 (2014: 3.5%) and the rate of impaired debts and arrears over 90 days stood at approximately 0.9% as of that date (2014: 1.5%). Additionally, the Bank is characterized by relatively high coverage, favorably prominent relative to the system, which had stood at approximately 111% (approximately 96% in the comparison group) as of March 31 2019 (2014: 83%). This continued improvement of the credit portfolio's quality, which is due to significant write-offs over the past few years, conservative underwriting and focusing on more dispersed segments, enable the Bank great flexibility in managing the credit portfolio and generating revenues throughout the economic cycle. We should note, that the quality of the portfolio is adversely affected, as the rest of the system, by the lack of geographical diversification, structural characteristics of the local market and centralization of the business credit portfolio as well as the high correlation between it and the economic environment.

The Bank has relatively reasonable exposure to the mortgage and real estate industries, which stood in aggregate at approximately 38% of the total sum of the Bank's debts on March 31 2019, and contrary to that characterizing the comparison group with a higher level of exposure (approximately 47%, in the comparison as of that date). The exposure to the real estate industry (approximately 11% of the Bank's debts), although significantly lower relative to the comparison group is characterized by a relatively high level of risk, in light of homogeneous characteristics and due to the high exposure relative to the capital loss-absorption buffer, as aforementioned. In our estimation, a meaningful risk to the quality of the Bank's mortgage portfolio (approximately 26% of the credit portfolio in average during 2014-2018), in spite of significant price inflation in recent years, and erosion of the apartment purchasing ability, will occur only if unemployment rates advance in the double digit direction, combined with a rise in interest rates, as prior indicator for this being an erosion of the performance of the business sector. This risk is moderated due to the conservative underwriting processes at the Bank, as reflected by maintaining a high repayment capacity, which supports low probability of failure, as the high leverage rates (LTV over 60%) in the housing loan portfolio are relatively low and stand at approximately 28% of the portfolio. In addition, we note that the retail sector is the focus of credit risk developing in recent years due to rapid growth in bank credit balances and the system. This has been accompanied in recent years by an increase in the overall level of leverage of households and alongside the new insolvency law are expected to continue to have a negative impact on the quality of the portfolio. We note that, in our opinion, the characteristics of the Bank moderate this risk, due to relatively conservative underwriting processes, a based customer profile, which is less exposed to the economic cycles and the ability to deduct loans from the wages of part of the Bank’s populations.

In this scenario, the Bank’s credit portfolio is expected to grow in an annual rate of 4% -5%, higher than our estimate in respect of the GDP growth, as the growth rate differs among the segments. We believe that the Bank will continue to focus on household credit (including housing loans) and small businesses in accordance with its strategy in recent years, as the growth potential of the business portfolio is limited, due to the high level of competition and the low risk margins. We should note that the growth potential and the growth mix, which support expanding the revenue base, and thus also support raising the BCA, stem also, as we assess, due to the Bank’s ability to grow based on existing customers while maintaining the risk appetite, increased use of direct banking channels as removal of restrictions on extending credit by the merged banks, good business flexibility stemming from a sufficient margin over the regulatory capital target set forth by the Bank of Israel, lack of sectoral concentration restrictions and favorably prominent business positioning in niche populations.

Midroog scenario regarding the quality of the Bank’s credit portfolio is based on a number of exogenous macroeconomic impacts, including: (1) Average growth of approximately 3.2%-3.5% in the upcoming two years; (2) continued low and stable unemployment rates continued real wage growth; (3) continued slow rise in the interest rates during 2019-2020; (4) moderate inflationary environment in the lower range of Bank of Israel’s target; (5) continued competition by the non-bank debt market of the business portfolio and an increase in the credit supply in the retail sector. We should note that the impacts of the credit bureaus are not part of Midroog’s base scenario.

In the scenario for the next 12-18 months, we expect a certain increase in the rate of expenses for credit losses in the total portfolio, which will be within the range 0.20%-0.25%, while a certain moderation of the collection potential and an increase in the risk level, as acknowledged in the retail sector and SME. However, the Bank’s retail customers, as aforementioned, we believe support continued performance of the retail portfolio also in light of these adverse changes.

Additionally, Midroog examines the development of the quality of the Bank's credit portfolio in the short and medium term also on the basis of several leading macroeconomic indicators, which point to relative stability (varying between the different segments of the credit portfolio) in the quality of the portfolio in the short term, while over the course of the cycle the Bank is expected to continue presenting favorably prominent risk indices relative to the BCA. So we assess, that the rate of problematic debts from the credit portfolio is expected to remain relatively stable relative to the BCA, and to be within the range of 1.9%-2.0%, as an outcome of which their rate from the absorption buffers (equity and provision for credit losses) is expected to be within the range of 17.5%-18.5% in the forecast range.

The BCA is supported by continued improvement in the Bank's profitability; expected improvement during the forecast range in light of continued implementation of the efficiency measures and expanding the revenue base.

The Bank's profitability is on an improvement track in recent years, inter alia, due to an average growth in the portfolio of approximately 5% (2016-2018), which supported expansion of the net interest income, alongside stability in the financial margin and implementation of the efficiency plan commencing 2016, which as a rule supported a decrease in the scope of expenses in recent years. Thus, the core return on risk wieghted assets and the return on the Bank's assets (ROA) stood in 2018 at approximately 1.7% (2015: 0.4%) and 0.6% (2015: 1.1%) similar to the average in the comparison group (approximately 1.7% and approximately 0.6% respectively). We should note that the profit in 2018 had been affected by a number of one-time events (approximately NIS 45 million net) including profit from the sale of Bank Otsar HaHayal's headquarters and the sale of the stock exchange shares, which had been offset against a provision for expenses due to the merger of Bank Otsar HaHayal. Excluding these events, the profitability rates (ROA and the core return on risk weighted assets) stood at 0.5% and 1.6%, respectively. We should note that the Bank benefits from the relatively high component of deposits that do no bear interest (approximately 44% in 2018 compared with approximately 33% in the comparison group), which we believe is expected to contribute to the Bank's profitability in a more significant manner relative to the other major banks, should the base interest rate increase in a moderate manner. The Bank is characterized over time by low operational efficiency relative to the other major banks also due to the retail activity profile, that needs more operational inputs compared to other sectors. At the same time, we should note that the operational efficiency ratio has been improving in recent years and during the first three months of 2019 had stood at approximately 67% compared to 74% in 2016, due to the completion of the efficiency plan, which had been implemented in 2016 and included reduction of positions, consolidation of branches and reduction of areas, and in particular Bank Otsar HaHayal branches and together with signing a number of collective wage agreements, which are expected to continue to contribute to the administrative and operational flexibility. We assess that the improvement of the profitability potential continues to be the Bank's primary challenge, inter alia, due to the challenging business environment, as like the system, many factors alongside the revenues are exogenous to the Bank and therefor better control of the expenses structure is required. The key assumptions underlying Midroog's base scenario regarding the Bank's profitability for the years 2019-2020 are as follows: (1) Continued increase of the credit portfolio by approximately 4%-5% annually, mainly vis-a-vis the existing customer base and utilization of the advantages of the merger of the two banks that had been merged; (2) increase in the net financing revenues of approximately 7% annually also in light of low interest rates and inflation anviorment alongside continued focus on the retail credit and the credit extended to small and medium sized businesses (SME), characterized by excess financial margin; (3) Expense for credit losses at rate of 0.20%-0.25% as aforementioned; (4) continued wage expenses drift in accordance with the wage agreements at the Bank alongside the offsetting effect of continued reduction of the number of positions; (5) moderate savings in operating expenses due to reduction of the branches' areas and efficiency due to the merger of Bank Otsar HaHayal.

In this scenario, Midroog expects that the Bank's profitability ratios will continue to improve and support continued establishment of the capital buffer. Thus, the core yield on risk weighted assets and ROA are expected to range during the forecast years between 1.8%-1.9% and 0.6%-0.7% respectively. Ratios that are reasonable relative to the BCA.

The capital buffer continues to be characterized by a good and appropriate loss absorption capacity for the BCA; expectation of continued establishment of the capital buffer within the forecast range

The Bank maintains appropriate capital adequacy ratios and a good margin above the regulatory bar due to accumulation of profits deducting dividends (policy 50% of the net profit), optimization and management of the risk assets and asset mix. The Tier 1 capital adequacy ratio of the Bank (the core capital), the primary unexpected loss absorption buffer, had stood at approximately 10.5% on March 31 2019 (10.4% prior to the effect of the efficiency plan) and in a good gap relative to the Bank of Israel's requirement of 9.3%. This gap constitutes a positive factor for the BCA, supports and positively affects the Bank's business flexibility as well as its growth potential. On the other hand, the Bank's simple balance leverage level (total equity to total assets) which stood at approximately 6.2% on March 31, 2019, is still high relative to the system (an average of approximately 7.4%) and relative to the BCA. In this context we should note the asset mix, which is comprised of a significant rate of liquid and marketable assets that moderate the relatively high balance leverage.

Midroog has examined a number of stress scenarios for the term of one year (some of them holistic) of varying degrees of severity with respect to the Bank's loss-absorption buffers relative to its risk profile, assuming varying PD and LGD rates in the different industries and various scenarios, exposure to market risks, the construction of equity through profits adjusted for the scenario, and the non-distribution of dividends. The Tier 1 capital adequacy of the Bank ranged between 9.4% for the mild-stress scenario and 8.4% for the severe stress scenario, allowing for the Bank good unforeseen loss-absorption, and supporting its stability throughout the economic cycle.

Midroog expects that the capital buffer will continue to be built and the capital adequacy ratios will continue to improve margins in the base scenario as a result of the following factors: (1) Accrued profits; (2) distribution of dividends within the range of 50% of the net profit; (3) an increase in the scope of the risk weighted assets similar to the rate of increase of the credit portfolio.

A favorably prominent high liquidity profile that is supported by a convenient funding structure and a significant inventory of liquid assets

The Bank's funding structure relies, similarly to the entire local banking system, primarily on a broad deposits base that has demonstrated stability throughout the economic cycle and is favorably affected by the savings culture in the local economy. The Bank is characterized by a convenient, stable and favorably prominent ratio between credit to the public, which stood at approximately 75.5% on March 31, 2019, compared to an average of 83% in the local system. Additionally, the Bank's overall funding structure includes a significant component of stable deposits (retail) in wide dispersion (approximately 50% of households and private banking and approximately 15% of small and micro businesses on March 31, 2019), which match Midroog's assessment, of the Bank's risk profile. Additionally, the Bank has an NSFR ratio, as calculated by us[2], which is high and favorably prominent at approximately 139%, which supports its financing profile. Nevertheless, the Bank has a relatively high component of less stable[3] financing sources out of the total assets, which stood at approximately 20% compared to an average of 13% in the comparison group and this due to a relatively high rate of wholesale deposits (22% compared to approximately 15% in average within the system), a rate that we believe is not expected to significant change in the forecast range, also due to a significant component of capital market activists.

This component is compensated in light of a significant inventory of liquid assets[4], which constitutes a high rate relative to the total deposits and as of March 31, 2019 stood at approximately 37%. The Bank's securities portfolio constitutes approximately 8% of the total assets as of March 31, 2019 and is characterized by a low (credit) risk level due to a significant component of Israeli Government bonds (approximately 61%) and United States bonds (approximately 18%). The portfolio constitutes a tool for absorbing excess sources and for managing the Bank's various market exposures, however, exposes it to various types of interest risks, a risk that is enhanced in the current interest rate environment. Additionally, Liquidity management is supported also by the regulatory liquid coverage (LCR) of approximately 132% as of March 31 2019, significantly higher than the regulatory benchmark (100%) and favorably prominent relative to the system, which too supports the liquidity profile and business flexibility.

Midroog predicts that the Bank's good funding structure and good liquidity will be maintained over the short and medium term, inter alia, in view of our assessment regarding the absence of a change in the savings culture and preservation of the financial profile of the Bank's retail customer base. Thus, we expect that the liquidity profile will remain high in the next two years and continue to be a positive factor of the Bank's BCA.

[2] Calculated by us based on the settings of the Basel Committee

[3] Bank deposits, institutional entities deposits and bonds and notes due within the next 12 months.

[4] Cash and deposits at banks, Israeli and United State Government bonds as well as assets secured by the United States government

Structural considerations and external support

Characteristics of the subordinated instruments

According to Midroog's methodology, the rating of the Bank's subordinated debts (subordinated notes) is based on the Bank's BCA, the anchor for rating the Bank's liabilities, which reflects the risk of failure and the Bank's ability to service its obligations independently, without assuming external support. Subsequently, we adjust the rating to the credit risk of the subordinated debt instrument, according to its specific characteristics – taking into consideration the extent of the instrument's structural subordination, the loss absorbency mechanisms per the instrument's terms and the uncertainty regarding their point of activation (at the contractual trigger or at the discretion of the Supervisor of Banks). We reduce one rating notch from the BCA for rating subordinated notes (lower Tier 2 capital). The downward notching embodies the legal/contractual subordination of these debts relative to the Bank's senior debt. We are reducing one rating notch from the Bank's BCA for rating subordinated notes with a loss absorption mechanism (CoCo). The one notch downgrade embodies the legal-contractual subordination to the Bank's other liabilities (excluding upper Tier 2 capital, Tier 1 instruments and equity) and the contractual loss-absorbency mechanism. Given the Bank's BCA rating, the current and anticipated capital adequacy levels, and the favorable prominent liquidity profile, the uncertainty regarding the likelihood of reaching the "non-viability point" is low and therefore, it was not embodied in a further notch downgrade. We are reducing two notches from the Bank's BCA rating for subordinated capital notes (upper Tier 2 capital). The notch downgrade embodies the legal-contractual subordination to the Bank's other obligations (excluding Tier 1 instruments and equity) as well as the contractual loss-absorbency mechanism. Given the Bank's BCA rating, the current and anticipated capital adequacy levels, and the favorable prominent liquidity profile, the uncertainty regarding the likelihood of reaching the regulatory intervention is low and therefore, it was not embodied in a further notch downgrade.

External support

The ratings for the deposits, senior debt and subordinated debts, excluding subordinated notes with a loss-absorbency mechanism (CoCo), have benefited from a two-notch uplift, due to the high probability of external support from the government, according to Midroog's JDA model. The assumption of the probability of external support throughout the entire liability structure (excluding CoCo) is based on the following reasons: The high importance of the banking system for the local economy and the payment system, and the need to maintain its stability; the high concentration of the banking and financial system; the relatively high connectivity between the banking system and institutional bodies; the local financial system serving as a central credit provider to the government; some degree of uncertainty concerning the behavior and confidence of the different debt holders in relation to bail-ins close to the point of failure, in the absence of previous experience. Furthermore, the Israeli government has proven in the past, its willingness to support failed banks, and we do not assume any change in this policy.

The assumption of a high probability of support for subordinated debts (excluding CoCo) stems from the fact that no significant change has been observed in Israel's system support paradigm in recent years. To date, Israeli regulators have not had to deal with significant stress scenarios in the banking system, and unlike other regions in the world, no legislation was enacted and no directives were given that might imply that a change has occurred in subordinated debt risk from a legal standpoint. It is our understanding that the recommendations of the Committee for Dealing with Failed Banks are unlikely to include a proposal for bail-in of old subordinated debts (not recognized for Basel III purposes) also out of a desire to retain the trust of the public, who had invested in these instruments in the past assuming support, as well as due to subordinated notes inclusion of a contractual loss-absorbency mechanism (CoCo), the only tool for raising subordinated debt, while making timely repayment of old debts.

We should note that even after the weighting of external support in the rating of subordinated debts, Midroog generally maintains a minimum possible gap of at least one notch between the rating of the Bank's senior debt and the rating of its subordinated debts, reflecting the higher relative expected loss in these debts compared to the senior debt.

About the Bank

The First International Bank of Israel Ltd. Is a commercial bank, providing various banking services in Israel and abroad to retail, commercial and business customers, and constitutes the fifth largest banking group in Israel. The International Group includes, in addition to the First International Bank of Israel Ltd., Bank Massad Ltd. (held at the rate of approximately 51%). The Group also operates within the credit cards' domain through holding (28.2%) of Israel Credit Cards Ltd.

Outstanding subordinated notes and bonds rated by Midroog*:

Series	ISN	Rating	Outlook	Maturity
Y	1126598	Aa1.il	Stable	10.07.2019
H	1134212	Aaa.il	Stable	13.01.2021
X	1121953	Aa1.il	Stable	28.01.2021
D	1103126	Aa1.il	Stable	20.03.2021
I	1135177	Aaa.il	Stable	30.03.2021
Z	1138585	Aa3.il(hyb)	Stable	26.06.2026
ZA	1142058	Aa3.il(hyb)	Stable	01.10.2027
ZB	1151000	Aa3.il(hyb)	Stable	12.07.2029

** Had been issued by First International Issues Ltd. - a subsidiary fully owned by the Bank*

The Baseline Credit Assessment (BCA) Score Card

			As of 31.03.2019		Midroog forecast [1]		
Category	**Parameter**	**Sub-parameter**	**Measurement [1]**	**Score**	**Measurement**	**Score**	**Additional considerations**
Business profile	**Business positioning**		-	aa.il	-	aa.il	*Positioning in niche populations*
	Revenue stability	% retail revenues	76%	aa.il	76%	aa.il	*Rate of income from commissions*
	Revenue diversification	Number of business lines over 15%	4	aa.il	4	aa.il	*Retail sectors*
Risk profile	**Corporate governance**		-	aa.il	-	aa.il	
	Risk management policy		-	aa.il	-	aa.il	
	Credit portfolio concentration	The largest sector to core capital	119%	a.il	119%~	a.il	*The real estate sector*
	Credit portfolio concentration	Largest borrowers to core capital	52%	baa.il	52%~	baa.il	
	Market risk appetite	VAR limit on core capital	5%	aa.il	5%~	aa.il	
Financial profile	**Asset quality**	Problematic debts for credit extended to the public	1.9%	aaa.il	1.9%-2.0%	aaa.il	*Business portfolio concentration*
		Problematic debt to the capital equity and provision for credit losses	17.9%	aa.il	17.8%-18.0%	aa.il	*The coverage ratio*
	Profitability	Net profit to average assets	0.6%	aa.il	0.6%-0.7%	aa.il	
		Profit before tax + loan loss provisions to average risk weighted assets	1.7%	aa.il	1.8%-1.9%	aa.il	*Profit volatility*
		Efficiency ratio	67%	a.il	60%-65%	a.il	
	Capital adequacy ratios	Tier 1 equity to risk weighted assets	10.5%	aa.il	10.6%-10.8%	aa.il	*Distance from regulatory requirements; endurance under stress scenarios*
		Total equity to total assets	6.2%	a.il	6.1%-6.3%	a.il	
	Financing and liquidity	Less stable financing to total assets	20%	aa.il	20%~	aa.il	*Quality of sources; NSFR ratio*
		Liquid assets to public deposits	37%	aaa.il	37%~	aaa.il	*LCR ratio*
Derivative baseline credit assessment						**aa2.il**	
Actual baseline credit assessment						**aa2.il**	

[1] The indices presented in the table are after Midroog adjustments and are not necessarily identical to those displayed by the company. Midroog's forecast includes Midroog's assessment in respect of the issuer in accordance with Midroog's base scenario, rather than the issuer's assessments.

Bank Debt Ratings

	Baseline credit assessment (BCA)	Owners' and/or related parties' support	Adjusted BCA	Subordination and loss absorption mechanism	Government support	Rating
Deposits and Bonds	aa2.il	0	aa2.il	0	+2	Aaa.il
Subordinated notes (lower Tier 2 capital)	aa2.il	0	aa2.il	-1	+2	Aa1.il
Subordinated capital notes (upper Tier 2 capital)	aa2.il	0	aa2.il	-2	+2	Aa2.il(hyb)
Subordinated capital notes with a contractual mechanism for absorbing losses (Tier 2 capital)	aa2.il	0	aa2.il	-1	0	Aa3.il(hyb)

Related Reports

The First International Bank of Israel Ltd. - Related Reports

Bank Ratings - Methodology Report March 2019

Affiliations and Holdings Chart

Midroog's Rating Scale and Definitions

The reports are published on Midroog's website www.midroog.co.il

General Information

Date of rating report:	26.06.2019
Date of last revision of the rating:	27.06.2018
Date of first publication of the rating	28.09.2006
Rating commissioned by:	The First International Bank of Israel Ltd.
Rating paid for by:	The First International Bank of Israel Ltd.

Information from the Issuer

Midroog relies in its ratings, inter alia, on information received from competent personnel at the issuer.

Rating Scale for Baseline Credit Assessment (BCA)

aaa.il	**Issuers or issues rated aaa.il present, according to Midroog's judgment, internal or independent financial strength that is the highest compared to other domestic issuers, in absence of any possibility of external support from an affiliated company or from the government.**
aa.il	**Issuers or issues rated aa.il present, according to Midroog's judgment, internal or independent financial strength that much higher compared to other domestic issuers, in absence of any possibility of external support from an affiliated company or from the government.**
a.il	**Issuers or issues rated a.il present, according to Midroog's judgment, internal or independent financial strength that is higher compared to other domestic issuers, in absence of any possibility of external support from an affiliated company or from the government.**
baa.il	**Issuers or issues rated baa.il present, according to Midroog's judgment, internal or independent financial strength that is the intermediate compared to other domestic issuers, in absence of any possibility of external support from an affiliated company or from the government and may have certain speculative characteristics.**
ba.il	**Issuers or issues rated ba.il present, according to Midroog's judgment, internal or independent financial strength that is weak compared to other domestic issuers, in absence of any possibility of external support from an affiliated company or from the government and have speculative characteristics.**
b.il	**Issuers or issues rated b.il present, according to Midroog's judgment, internal or independent financial strength that is very weak compared to other domestic issuers, in absence of any possibility of external support from an affiliated company or from the government and have significant speculative characteristics.**
caa.il	**Issuers or issues rated caa.il present, according to Midroog's judgment, internal or independent financial strength that is the weakest compared to other domestic issuers, in absence of any possibility of external support from an affiliated company or from the government and have most significant speculative characteristics.**
ca.il	**Issuers or issues rated ca.il present, according to Midroog's judgment, internal or independent financial strength that is extremely weak, in absence of any possibility of external support from an affiliated company or from the government and are very close to default with some likelihood of principal and interest recovery.**
c.il	**Issuers or issues rated c.il present, according to Midroog's judgment, internal or independent financial strength that is the weakest, in absence of any possibility of external support from an affiliated company or from the government and are typically in default with faint likelihood of principal and interest recovery.**

Note: Midroog uses numeric variables 1,2, 2 and 3 for each of the rating categories from aa.il to caa.il. Variable '1' indicates that the debenture is at the high end of its rating category, as denoted by the letters. The variable ‘2’ indicates that it is at the middle of its rating category; while the variable ‘3’ indicates that the debenture is at the bottom part of its rating category, as indicated by letters.

Midroog does not publish outlook for the baseline credit assessment (BCA) as opposed to the previous publications so as to differentiate the BCA from credit rating

Long-Term Rating Scale

Aaa.il	**Issuers or issues rated Aaa.il are those that, in Midroog judgment, have highest creditworthiness relative to other local issuers.**
Aa.il	**Issuers or issues rated Aa.il are those that, in Midroog judgment, have very strong creditworthiness relative to other local issuers.**
A.il	**Issuers or issues rated A.il are those that, in Midroog judgment, have relatively high creditworthiness relative to other local issuers.**
Baa.il	**Issuers or issues rated Baa.il are those that, in Midroog judgment, have relatively moderate credit risk relative to other local issuers, and could involve certain speculative characteristics.**
Ba.il	**Issuers or issues rated Ba.il are those that, in Midroog judgment, have relatively weak creditworthiness relative to other local issuers, and involve speculative characteristics.**
B.il	**Issuers or issues rated B.il are those that, in Midroog judgment, have relatively very weak creditworthiness relative to other local issuers, and involve significant speculative characteristics.**
Caa.il	**Issuers or issues rated Caa.il are those that, in Midroog judgment, have extremely weak creditworthiness relative to other local issuers, and involve very significant speculative characteristics.**
Ca.il	**Issuers or issues rated Ca.il are those that, in Midroog judgment, have extremely weak creditworthiness and very near default, with some prospect of recovery of principal and interest.**
C.il	**Issuers or issues rated C are those that, in Midroog judgment, have the weakest creditworthiness and are usually in a situation of default, with little prospect of recovery of principal and interest.**

Note: Midroog appends numeric modifiers 1, 2, and 3 to each rating category from Aa.il to Caa.il. The modifier '1' indicates that the obligation ranks in the higher end of its rating category, which is denoted by letters. The modifier '2' indicates that it ranks in the middle of its rating category and the modifier '3' indicates that the obligation ranks in the lower end of that category, denoted by letters.

Short-Term Rating Scale

P-1.il	**Issuers or issues rated Prime-1.il are those that, in Midroog judgment, have a very good ability to meet their short-term liabilities relative to other local issuers.**
P-2.il	**Issuers or issues rated Prime-2.il are those that, in Midroog judgment, have a good ability to meet their short-term liabilities relative to other local issuers.**
P-3.il	**Issuers or issues rated Prime-3.il are those that, in Midroog judgment, have a moderate ability to meet their short-term liabilities relative to other local issuers.**
NP.il	**Issuers rated Not Prime.il do not belong to any of the prime categories**

The relationship between the long-term rating scale and the short-term rating scale

The table below lists the long-term ratings that correspond to the short-term ratings as long-term ratings exist[5]

Long-term Rating	Short-term Rating
Aaa.il	
Aa1.il	
Aa2.il	
Aa3.il	Prime-1.il
A1.il	
A2.il	
A3.il	
Baa1.il	Prime-2.il
Baa2.il	
Baa3.il	Prime-3.il
Ba1.il,Ba2.il,Ba3.il	
B1.il,B2.il,B3.il	
Caa1.il,Caa2.il,Caa3.il	NotPrime
Ca.il	
C.il	

[5] Short-term structured financing ratings are usually based on the short-term rating of the liquidity to the transaction or on the estimated free cash flow to repay the rated liability.

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