

# Union Bank of Israel Ltd.<sup>1</sup>

## Monitoring Report | January 2020

*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.*

### Contacts:

#### **Sophie Tobiakov**

Analyst – Primary Rating Assesor

[sophiet@midroog.co.il](mailto:sophiet@midroog.co.il)

#### **Omer Foremberg**

Team Leader – Secondary Rating Assesor

[omer@midroog.co.il](mailto:omer@midroog.co.il)

#### **Avi Benoon, VP**

Manager of the Rating Operations and Head of Financial Institutions

[avib@midroog.co.il](mailto:avib@midroog.co.il)

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<sup>1</sup> Union Bank of Israel Ltd. holds (indirectly) 4.9% of the share capital of Midroog Ltd. through Union Investments and Enterprise (A.S.Y.) Ltd. The Company's shares lack any means of control.

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## Union Bank of Israel Ltd.

|   |            |                                   |
|---|------------|-----------------------------------|
| Baseline Credit Assessment (BCA)  | a2.il      |                                   |
| Long-term deposits and bonds  | Aa3.il     | Under review for possible upgrade |
| Subordinated notes (Lower Tier 2 Capital)                                     | A1.il      | Under review for possible upgrade |
| Subordinated capital notes (Upper Tier 2 Capital)                             | A2.il(hyb) | Under review for possible upgrade |
| Subordinated notes with contractual loss absorbing mechanism (Tier 2 Capital) | A3.il(hyb) | Under review for possible upgrade |
| Short-term deposits   | P-1.il     |                                   |

Midroog places under review (CREDIT REVIEW) for possible upgrade the baseline credit assessment (BCA) of A2.il for Union Bank of Israel Ltd. (the "Bank"). In addition, Midroog places under review (CREDIT REVIEW) for possible upgrade the rating of Aa3.il for the long-term deposits and senior debt of the Bank, which continue to incorporate a high external assumption of government support of two notches with regard to the baseline credit assessment. In addition, Midroog places under review (CREDIT REVIEW) for possible upgrade the rating of the subordinated debt (that is not recognized under Basel III) as follows: a rating of A1.il for the subordinated notes (lower Tier 2 capital) and a rating of A2.il(hyb) for the subordinated capital notes (upper Tier 2 capital). These ratings reflect the contractual terms of the instruments, including the contractual subordination of these debts to the Bank's senior debt, the seniority scale among the subordinated debts themselves and the impact of loss absorption mechanisms. Those subordinated debts ratings also reflect an assumption of government support. In addition, Midroog places under review (CREDIT REVIEW) for possible upgrade the rating of A3.il(hyb) for the subordinated liability notes with a loss absorption mechanism (CoCo) by way of a write-off or partial write-off (classified as Tier 2 capital). This rating is one notch below the baseline credit assessment and three notches below the senior debt rating and reflects the terms of this class of instruments, including contractual subordination and loss absorption mechanisms, without an assumption of external support.

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

The placing of the ratings of the Bank under review for possible upgrade is due to Midroog's assessment of a high probability of the completion of the merger between the Bank and Mizrahi Tefahot Bank Ltd. (hereinafter: "Mizrahi Tefahot") (baseline credit assessment (BCA) of of aa2.il and rating of Aaa.il with a stable outlook for the long-term deposits and debentures) in the short term. This is due to the fulfillment of the primary suspending conditions, to our understanding, in connection with the merger agreement (hereinafter: the 'Acquisition Proposal') from November 28, 2017, whereby the Bank is expected to merge with and into Mizrahi Tefahot, subject to obtaining the required response rate of the tender offer by all of the Bank's shareholders or by way of a statutory merger, the execution of which will require the approval of the competent organs of the Bank and

Mizrahi Tefahot. On November 28, 2019, the Bank received the judgement of the Competition Tribunal whereby the Competition Tribunal accepted the appeals submitted by the controlling shareholders of the Bank, the Bank and Mizrahi Tefahot, with regard to the decision of the Acting Commissioner of Competition to oppose the merger between the Bank and Mizrahi Tefahot. In addition, on January 8, 2019, the Competition Authority announced that the merger of the Bank was conditional on the sale of the credit activity in the field of diamonds of the Bank or of Mizrahi Tefahot in a final and irrevocable manner, following the receipt of the approval of the Commissioner of the the buyer of the activity being sold and the content of the activity being sold. In addition, the Competition Authority has conditional on the merger in updating Proper Banking Management Directive 201, so that the requirement for an increase in capital applies only to a banking corporation whose total balance sheet assets exceeds 24% of the total balance sheet assets in the system.

We may exercise the possible upgrade of the various liability ratings of the Bank and compare them with those of Mizrahi Tefahot, subject to the final merger of the Bank with and into Mizrahi Tefahot, once all required approvals have been obtained, or when there is a high probability of the completion of the merger.

Midroog estimates that a significant change in the business profile, risk profile and financial profile of the Bank is not expected in the short term and until the merger is complete (if completed), and these are reflected in the current BCA of the Bank. This estimate also takes into account a dividend payment of NIS 100 million, which was recently announced. Whereas, pro forma the dividend distribution, Tier 1 capital adequacy ratio of the Bank as of September 30, 2019 was approximately 10.35%, a difference of approximately 97 base points relative to the Banking Supervision requirement.

In addition, we note that in the current BCA, we also embodied the Bank's exposure to operational risks, and in particular technological risks if the merger did not take place. However, we believe that the lengthening of the uncertainty period and its impact on updating the Bank's strategic plan could damage the Bank's business profile and risk profile.

#### **Outstanding subordinated liability notes and debentures rated by Midroog \*:**

| Series | Security no. | Rating |                                   | Final Repayment Date |
|--------|--------------|--------|-----------------------------------|----------------------|
| H      | 1133503      | Aa3.il | Under review for possible upgrade | 01.06.2020           |
| G      | 1131762      | Aa3.il | Under review for possible upgrade | 27.03.2021           |
| S      | 1124080      | A1.il  | Under review for possible upgrade | 04.07.2021           |
| J      | 1154764      | Aa3.il | Under review for possible upgrade | 15.09.2022           |
| K      | 1157353      | Aa3.il | Under review for possible upgrade | 02.04.2024           |
| L      | 1160167      | Aa3.il | Under review for possible upgrade | 05.09.2024           |

|                |         |             |                                   |            |
|----------------|---------|-------------|-----------------------------------|------------|
| I              | 1139492 | Aa3.il      | Under review for possible upgrade | 01.03.2025 |
| M              | 1161538 | Aa3.il      | Under review for possible upgrade | 04.12.2026 |
| T              | 1139153 | A3.il(hyb)  | Under review for possible upgrade | 11.09.2026 |
| U              | 1141878 | A3.il(hyb)  | Under review for possible upgrade | 10.09.2027 |
| Capital Note 1 | 1115278 | A2.il (hyb) | Under review for possible upgrade | 10.09.2059 |
| Capital Note 2 | 1115286 | A2.il (hyb) | Under review for possible upgrade | 10.09.2059 |

*\* Issued by Union Issuances Ltd. (a subsidiary of the Bank) the proceeds of which were deposited in the Bank*

For information of the property rating considerations, please refer to the January 2019 Monitoring Report.

## Bank Profile

Union Bank of Israel Ltd. was founded in 1951 by the Palestine Economic Corporation (U.S.A.) of New York and the Economic Company Ltd. of London, which continued the operations of the banking division of the Palestine Corporation which had commenced operations in Mandatory Palestine already in 1922. From 1983 until May 17, 1993, control of the Bank was held by the State of Israel (through B.L.L. Securities) and by Bank Leumi Le-Israel Ltd., which purchased the shares of the Bank in 1954 and 1961. Further to an agreement to sell the controlling interest in the Bank, the controlling interest was transferred in 1993 to Shlomo Eliahu Holdings Ltd., Yeshayahu Landau Holdings (1993) Ltd. and David Lubinski Properties (Holdings) 1993 Ltd. On October 29, 2012, Shlomo Eliahu Holdings Ltd. ceased to be part of the controlling interest of the Bank, following the completion of the acquisition of control of Migdal Insurance and Financial Holdings Ltd. by Mr. Shlomo Eliahu through Eliahu 1959 Ltd. (formerly, Eliahu Insurance Company Ltd.). The Bank's shares are listed on the Tel Aviv Stock Exchange Ltd. The Bank has 35 branches and extensions across Israel (including a private banking center), providing customers with a variety of banking services. Union Bank is Israel's sixth largest bank, with a 3% market share as of September 30, 2019. On July 30, 2017, the Bank was notified by its controlling shareholders that they intended to sell their holdings in the Bank. On November 27, 2018, the shareholders gave notice of their intention to merge the Bank with Mizrahi Tefahot Bank Ltd. On May 30, 2018, the acting Antitrust Commissioner ruled against the merger. On August 6, 2018, the Bank joined the appeal of the controlling shareholders and Mizrahi Tefahot against the ruling of the acting Antitrust Commissioner against the merger of the Bank with Mizrahi Tefahot, which was filed in September 2018. On November 28, 2019, the Bank received the judgement of the Competition Tribunal, whereby the Competition Tribunal accepted the appeals submitted regarding the decision of the Acting Commissioner not to approve the merger. On January 9, 2019 the Competition Commissioner published the decision thereof with regard to the conditions which may alleviate the concerns of competition being impaired due to the aforesaid merger, as specified above.

## Related Reports

[Union Bank of Israel Ltd. – Related Reports](#)

[Rating Banks – Methodology Report, September 2019](#)

[Short Term Commercial Paper Rating – Methodology Report, July 2015](#)

[Table of Relationships and Holdings](#)

[Midroog Rating Scales and Definitions](#)

The reports are published on the Midroog website at [www.midroog.co.il](http://www.midroog.co.il)

## General Information

|   |                           |
|---|---------------------------|
| <b>Date of rating report:</b>                   | January 14, 2020          |
| <b>Date of last revision of the rating:</b>     | February 12, 2019         |
| <b>Date of first publication of the rating:</b> | February 27, 2006         |
| <b>Rating commissioned by:</b>                  | Union Bank of Israel Ltd. |
| <b>Rating paid for by:</b>                      | Union Bank of Israel Ltd. |

## Information from the Issuer

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

**Baseline Credit Assessment (BCA) Table**

|               |   |
|---------------|---|
| <b>aaa.il</b> | Issuers or issuances rated aaa.il, in accordance with the judgement of Midroog, with the highest internal or independent financial strength relative to other local issuers, in the absence of any external support from a related company or the government.       |
| <b>aa.il</b>  | Issuers or issuances rated aaa.il, in accordance with the judgement of Midroog, with a very high internal or independent financial strength relative to other local issuers, in the absence of any external support from a related company or the government.       |
| <b>a.il</b>   | Issuers or issuances rated aaa.il, in accordance with the judgement of Midroog, with a relatively high internal or independent financial strength relative to other local issuers, in the absence of any external support from a related company or the government. |
| <b>baa.il</b> | Issuers or issuances rated aaa.il, in accordance with the judgement of Midroog, with an intermediate internal or independent financial strength relative to other local issuers, in the absence of any external support from a related company or the government.   |
| <b>ba.il</b>  | Issuers or issuances rated aaa.il, in accordance with the judgement of Midroog, with relatively weak internal or independent financial strength relative to other local issuers, in the absence of any external support from a related company or the government.   |
| <b>b.il</b>   | Issuers or issuances rated aaa.il, in accordance with the judgement of Midroog, with a very weak internal or independent financial strength relative to other local issuers, in the absence of any external support from a related company or the government.       |
| <b>caa.il</b> | Issuers or issuances rated aaa.il, in accordance with the judgement of Midroog, with the weakest internal or independent financial strength relative to other local issuers, in the absence of any external support from a related company or the government.       |
| <b>ca.il</b>  | Issuers or issuances rated aaa.il, in accordance with the judgement of Midroog, with an extremely weak internal or independent financial strength relative to other local issuers, in the absence of any external support from a related company or the government. |
| <b>c.il</b>   | Issuers or issuances rated aaa.il, in accordance with the judgement of Midroog, with the weakest internal or independent financial strength relative to other local issuers, in the absence of any external support from a related company or the government.       |

Remark: Midroog uses 1.2.3 numeric variables in each of the rating categories from aa.il to caa.il. The variable '1' indicates that the debenture is at the top of the rating category to which it belongs, which is indicated by letters. The variable '2' indicates that the debenture is in the middle of the rating category and the variable '3' indicates that the debenture is at the bottom of its rating category, which is indicated in letters.

*Midroog does not publish a rating outline for a Baseline Credit Assessment (BCA) unlike the publications to date, in order to differentiate BCA from a credit rating*

**Long-Term Rating Scale**

|               |   |
|---------------|---|
| <b>Aaa.il</b> | Issuers or issues rated Aaa.il are those that, in Midroog judgment, have highest creditworthiness relative to other local issuers.  |
| <b>Aa.il</b>  | Issuers or issues rated Aa.il are those that, in Midroog judgment, have very strong creditworthiness relative to other local issuers.   |
| <b>A.il</b>   | Issuers or issues rated A.il are those that, in Midroog judgment, have relatively high creditworthiness relative to other local issuers.  |
| <b>Baa.il</b> | 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.        |
| <b>Ba.il</b>  | 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>B.il</b>   | 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.      |
| <b>Caa.il</b> | 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.     |
| <b>Ca.il</b>  | 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.                |
| <b>C.il</b>   | 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 Local Rating Table

|               |  |
|---------------|--|
| <b>P-1.il</b> | Issuers rated Prime-1.il are, in accordance with the judgement of Midroog, have a very good capability of fulfilling their short-term liabilities relative to other local issuers.     |
| <b>P-2.il</b> | Issuers rated Prime-2.il are, in accordance with the judgement of Midroog, have a good capability of fulfilling their short-term liabilities relative to other local issuers.          |
| <b>P-3.il</b> | Issuers rated Prime-3.il are, in accordance with the judgement of Midroog, have an intermediate capability of fulfilling their short-term liabilities relative to other local issuers. |
| <b>NP.il</b>  | 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<sup>2</sup>.

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

<sup>2</sup> 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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