

# MOODY'S

## INVESTORS SERVICE

### CREDIT OPINION

30 October 2023

Update



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#### RATINGS

##### Bank Hapoalim B.M.

Domicile	Tel Aviv, Israel
Long Term CRR	A1 , Possible Downgrade
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	A2 , Possible Downgrade
Type	LT Bank Deposits - Fgn Curr
Outlook	Rating(s) Under Review

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Bank Hapoalim B.M.

Update following initiation of rating review

### Summary

[Bank Hapoalim B.M.](#) (Bank Hapoalim)'s A2 long-term deposit ratings reflect (1) the bank's baa2 Baseline Credit Assessment (BCA); and (2) currently three notches of rating uplift from our assessment of a very high likelihood of support from the [Government of Israel](#) (A1 review for downgrade), in case of need.

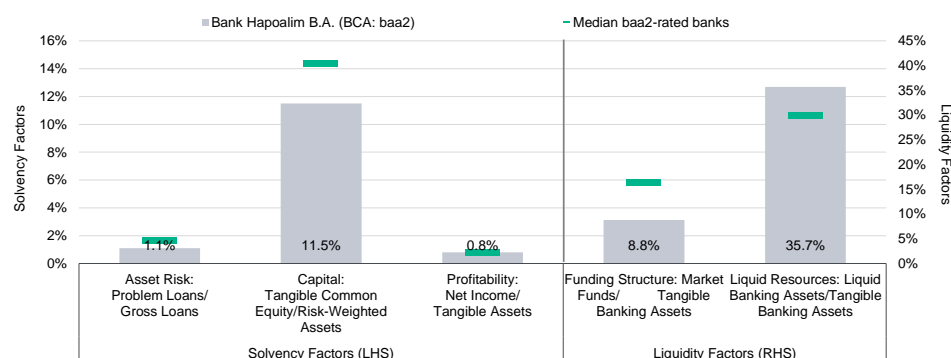
Bank Hapoalim's baa2 standalone BCA reflects the bank's strong deposit-based funding structure, sound liquidity and low levels of problem loans and contained credit losses over an entire economic cycle.

The ongoing military conflict will have an impact on Israel's economy, which will depend on its duration and scale, and therefore on the bank's asset quality and profitability. Profitability, which had been moderate in the past, benefited significantly from higher interest rates and was [well above](#) historical levels prior to the conflict.

The BCA also reflects additional downside risks from a significant exposure concentration to the Israeli property market through lending to the real estate sector and residential mortgages. Capitalisation is moderate. Moody's tangible common equity (TCE)/risk-weighted assets (RWAs) ratio was 11.5% as of June 2023 which, although below similarly-rated international peers, it has been consistently stable and reflects the Bank of Israel's (BoI) conservative risk weights.

Exhibit 1

#### Rating Scorecard - Key financial ratios



These are our [Banks Methodology](#) scorecard ratios. Asset Risk and Profitability reflect the weaker of either the latest figure or the three-year and latest figure average. Capital is the latest reported figure. Funding Structure and Liquid Resources reflect the latest fiscal year-end figures.

Source: Moody's Investors Service

## Credit strengths

- » Strong retail deposit-based funding structure and sound liquidity
- » Loan quality has been solid and single-borrower concentrations contained
- » Very high likelihood of government support, in case of need, underpins the deposit ratings

## Credit challenges

- » Given the crystallisation of geopolitical risks, asset quality will likely deteriorate and profitability will decline
- » Large exposure to Israel's property market is also a tail risk

## Outlook

The bank's ratings are on review for downgrade, reflecting the review for downgrade on the Government of Israel's A1 rating.

## Factors that could lead to an upgrade

- » Potential for an upgrade of Bank Hapoalim's ratings is limited, as indicated by the review for downgrade. However, the ratings could be confirmed at their current level if Israel's A1 issuer rating were confirmed. This would also depend upon the bank's standalone fundamentals, notably solvency and liquidity, being maintained.

## Factors that could lead to a downgrade

- » Bank Hapoalim's ratings could be downgraded if the sovereign rating is downgraded, given the significant government support uplift that is incorporated in the bank's ratings.
- » Bank Hapoalim's ratings could also be downgraded in case of a prolonged and wider conflict that could have a significant impact on the bank's operating environment and standalone fundamentals, or the bank's performance proves more volatile than in previous conflicts and economic crises.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody's.com> for the most updated credit rating action information and rating history.

## Key indicators

Exhibit 2

### Bank Hapoalim B.M. (Consolidated Financials) [1]

	06-23 <sup>2</sup>	12-22 <sup>2</sup>	12-21 <sup>2</sup>	12-20 <sup>2</sup>	12-19 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (ILS Million)	668,784.0	665,353.0	638,781.0	539,602.0	463,688.0	11.0 <sup>4</sup>
Total Assets (USD Million)	180,219.1	188,565.4	205,716.6	168,058.4	134,246.7	8.8 <sup>4</sup>
Tangible Common Equity (ILS Million)	51,011.0	48,359.0	42,632.0	39,363.8	37,860.7	8.9 <sup>4</sup>
Tangible Common Equity (USD Million)	13,746.1	13,705.3	13,729.4	12,259.8	10,961.4	6.7 <sup>4</sup>
Problem Loans / Gross Loans (%)	0.9	0.9	1.2	1.5	1.8	1.3 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	11.5	11.3	10.7	11.0	11.0	11.1 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	6.3	6.5	9.0	10.3	12.6	9.0 <sup>5</sup>
Net Interest Margin (%)	2.5	2.1	1.7	1.8	2.1	2.0 <sup>5</sup>
PPI / Average RWA (%)	3.2	2.5	1.8	1.7	1.6	2.2 <sup>6</sup>
Net Income / Tangible Assets (%)	1.2	1.0	0.8	0.4	0.6	0.8 <sup>5</sup>
Cost / Income Ratio (%)	37.3	43.2	52.6	54.6	58.4	49.2 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	9.3	8.8	6.8	6.5	6.4	7.6 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	33.8	35.7	40.3	38.6	31.5	36.0 <sup>5</sup>
Gross Loans / Due to Customers (%)	76.9	74.0	68.4	71.1	82.7	74.6 <sup>5</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; LOCAL GAAP. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

## Profile

Bank Hapoalim provides banking and other financial services to households, small businesses, middle-market companies and large corporate customers mainly in Israel. Internationally, Bank Hapoalim's New York branch focuses on providing commercial banking services in North America to local middle-market customers and Israeli companies that are active abroad.

In line with its strategy, Bank Hapoalim has reduced its international private banking activities through the sale or transfer of the customer portfolio of its Swiss subsidiary. –In July 2023, the bank's subsidiary received the approval of the relevant authorities for the return of its banking license. The bank also stepped up its efforts to sell its entire stake in Bank Pozitif in Türkiye and in March 2023 it entered into an agreement for the sale of its 100% holding. The transaction was completed in September 2023 and the bank expects no material impact from the completion of the transaction.

As of June 2023, Bank Hapoalim had total assets of NIS669 billion (\$180 billion). Bank Hapoalim was the second-largest bank in Israel with a market share of 28% in terms of total system assets.

Following the divestment by Arison Group of part of its stake in Bank Hapoalim in late 2018, the bank does not have a controlling shareholder. The bank's common stock trades on the Tel Aviv Stock Exchange (ticker: POLI).

## Detailed credit considerations

### Solid loan quality that will likely deteriorate; contained single-borrower concentrations

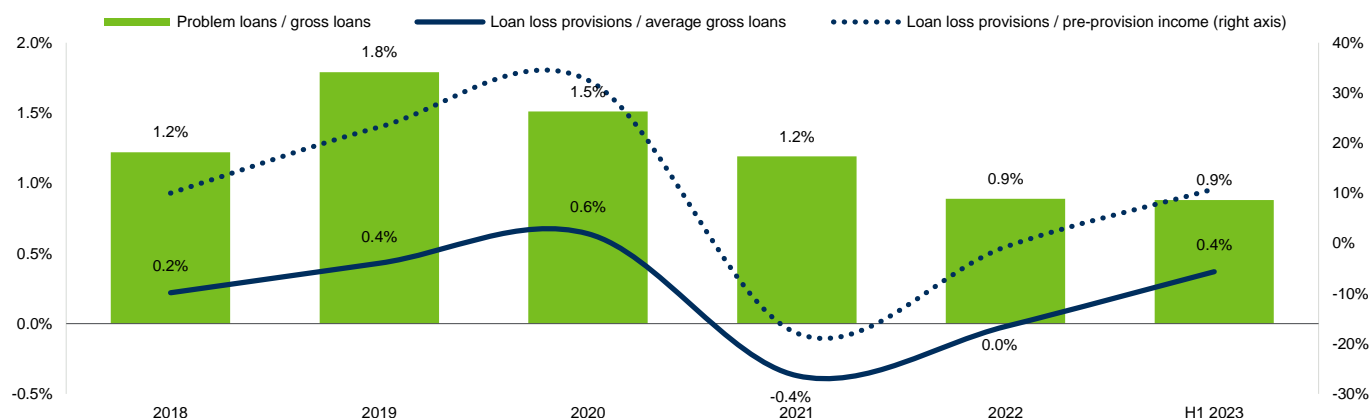
Bank Hapoalim's solid asset quality will likely deteriorate, although the extent of this will depend on the ongoing military conflict's duration and scale, actions by the authorities to mitigate its impact on affected businesses and households and the potential for any lasting economic damage. Israel experienced recessions and sharp growth slowdowns in previous episodes of violent conflict, but the economy has historically managed to recover relatively swiftly.

Additionally to risks from geopolitical tensions and similarly to other Israeli banks, the bank's significant exposure to [Israel's property market](#) through its lending activities along with recent high property prices<sup>1</sup> is also a downside risk for its asset quality. However, our assessment of the bank's asset risk also reflects contained credit losses in the last decade, limited single-borrower concentrations and relatively conservative underwriting.

Bank Hapoalim's problem loans (defined as non-accruing loans and accruing loans that are more than 90 days overdue) to gross loans declined to 0.9% as of June 2023 from 1.2% as of the end of 2021 (see Exhibit 3), reflecting limited new problem loan formation and

strong lending growth. Beyond the impact of the conflict, we also [expect](#) some problem loan formation because of higher interest rates and as the bank's newly originated loans season. Following double digit growth in 2022 that drives some unseasoned risk, loan growth moderated to 3% during the first six months of 2023, mainly in the corporate segment.

Exhibit 3

**Bank Hapoalim's asset quality has been solid****Evolution of problem loans ratio and annualised credit costs**

Source: Moody's Investors Service

We also expect Bank Hapoalim's credit costs (loan loss provision expenses to average gross loans) to also likely rise above the historical average of 0.4%<sup>2</sup>, which includes an entire economic cycle, rising from unsustainably low levels in the last two years. Following provision charge-backs in 2021 equivalent to 0.4% of average gross loans and flat provisions in 2022, credit costs increased to 0.4% in the first six months of 2023, mainly driven by an increase in group provisions because of adjustments in macroeconomic factors, as well as model improvements.

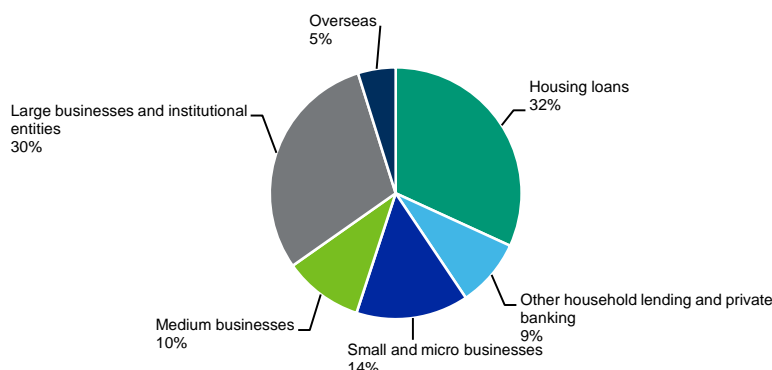
Bank Hapoalim has low borrower concentration levels. The bank had no exposures exceeding 15% of its capital as of June 2023 and its aggregate exposure (on and off-balance sheet) to 30 borrowers whose individual exposure exceeded NIS1.2 billion as of June 2023 accounted for 9.9% of total credit risk to the public or about 114% of TCE.

Residential mortgages accounted for 32% of total loans, while medium and large businesses (including institutional entities) for 40% as of June 2023 (see Exhibit 4). The bank's exposure to small businesses (regulatory definition<sup>3</sup>) and other retail and consumer loans in Israel were 14% and 9% of total gross loans respectively as of June 2023. The bank had been deleveraging from these two higher risk segments in recent quarters.

Exhibit 4

**Bank Hapoalim's loan book is diversified by segment**

Loan book breakdown as of June 2023 (supervisory operating segments)



Source: Bank's financial results

However, sector concentration to real estate is high and Bank Hapoalim's asset quality is susceptible to the risk of a sharp property price correction together with reduced ability of borrowers to service their loans. Also, it is still uncertain what impact the conflict will have on the sector. In addition to the exposure to residential mortgages, lending to the construction and real estate sector made up a further 20% of total lending as of June 2023.

For housing loans, risks are mitigated by (1) banks' full recourse to borrowers and a strong repayment culture; (2) the low level of housing debt at around 34% of GDP<sup>4</sup>; and (3) macroprudential measures<sup>5</sup> that enforce tighter underwriting standards and high capital buffers against mortgages.

There is significantly higher risk in financing of the construction and real estate sector. The bank's construction and real estate exposure grew by a high 15% year-over-year as of June 2023 because of strong demand. Residential projects made up 53% of total credit risk<sup>6</sup> in the corporate division's construction. These are mainly closed construction projects where risk is mitigated by close oversight<sup>7</sup>. Income generating properties were 27% of total credit risk. A significant part, around 21%, of the exposure to the sector was for the acquisition of land for construction where projects will take several years to complete. However, underwriting criteria are relatively conservative, with 90% of this exposure having a loan-to-value of less than 80% and 99% of the bank's real estate exposures under construction having the capacity to absorb a price drop of up to 25% without the bank incurring losses. Problem loans are currently low at 0.8% of total loans to the sector and Bank Hapoalim increased its group provisions for the sector over the past quarters, with total allowance for provisions accounting for 1.9% of gross loans to the sector as of June 2023.

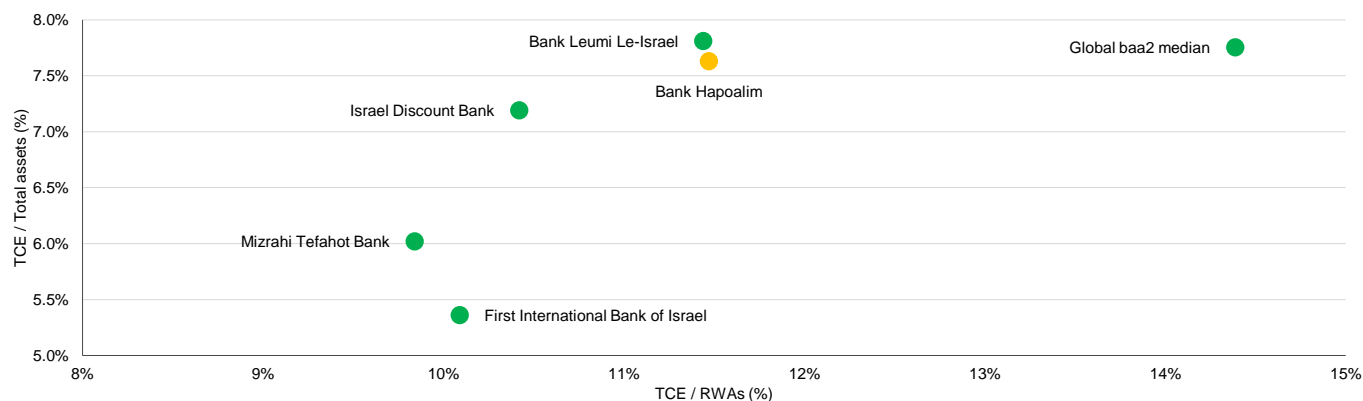
**Moderate risk-weighted capitalisation, although below global peers, but with a stronger leverage ratio**

We consider Bank Hapoalim's capitalisation as moderate. Although risk-weighted capital metrics are below global peers, the bank's loss-absorption buffers are supported by conservative regulatory risk-weights, especially on mortgage lending, that drive stronger leverage. The bank's capital ratios are also significantly more stable compared to banks globally that use a model based approach in calculating credit RWAs.

Bank Hapoalim's TCE/RWAs ratio was 11.5% as of June 2023, below the median level of similarly-rated international peers (see Exhibit 5). However, the BoI maintains a conservative approach to risk-weighting that results in higher loss-absorption buffers than capital ratios show. Israeli banks use the standardised approach to risk-weighting. Mortgages are further risk-weighted according to their loan-to-value, resulting in an average risk weight of over 50% in Israel. This mortgage loan risk weight is significantly higher than the risk weights applied by banks in other developed countries that use the internal ratings-based approach and the 35% risk weight normally used in the standardised approach. The bank's TCE-to-total assets ratio was 7.6% as of June 2023, comparing more favorably with international peers. The reported Basel leverage ratio was 6.7% as of June 2023, above the 5.5% minimum regulatory requirement that applied at that time.<sup>8</sup>

Exhibit 5

**Bank Hapoalim's risk-weighted capitalisation is lower than global peers, but leverage is in line with peers driven by conservative risk weights**  
 Risk-weighted capitalisation and leverage of Israeli banks and the global median as of June 2023



Source: Moody's Investors Service

Bank Hapoalim reported a Common Equity Tier 1 (CET1) ratio of 11.5% as of June 2023, slightly up from 11.2% at the end of 2022 and exceeding the 10.2% minimum regulatory requirement and the bank's own internal target of 10.5%. Capital metrics improved because of strengthened profitability, despite higher profit distribution and still strong loan growth of 3% over the same period. Bank Hapoalim distributed 40% of profits in the first and second quarters of 2023, compared to 30% in the last three quarters of 2022, in line with the bank's dividend policy whereby Bank Hapoalim may distribute up to 40% of net profits in each quarter.

Bank Hapoalim has demonstrated its ability to maintain steady capital ratios over time, including through the use of RWAs management tools and adjustments in earnings distributions. Similarly to other periods of high volatility we also expect the bank to retain more profits while the economic and financial impact of the conflict remains uncertain, which will support its capital metrics and loss absorbing buffers.

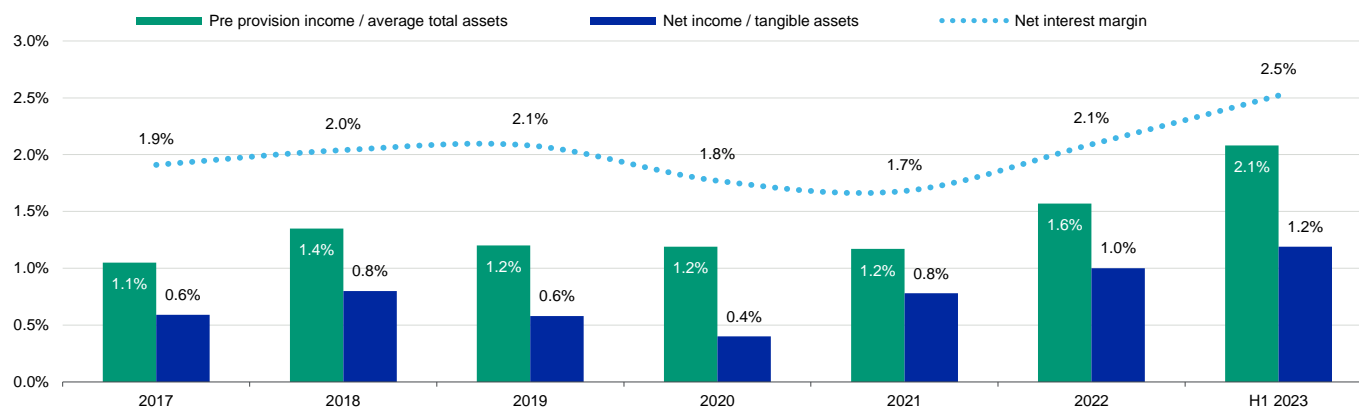
### Profitability is moderate, but is supported by ongoing revenue growth and cost discipline

Profitability will decline from recent exceptionally high levels because of higher cost of risk, lower credit growth and support measures to customers affected by the conflict.<sup>9</sup>

Our assessment also reflects Bank Hapoalim's moderate but stable ongoing profitability, aided by its strong franchise and large customer base in Israel, and the country's robust economic growth potential and population growth that afford new business opportunities. Operating [efficiency gains](#) also support sustainable profitability and the bank's ability to resist [growing competition](#), income headwinds and its ability to withstand and recover from shocks. Because of several streamlining initiatives<sup>10</sup> and strong revenue growth, Bank Hapoalim's cost efficiency improved significantly over time and its cost-to-income ratio of 38.6% in the first six months of 2023 was the lowest ever reported.

Bank Hapoalim reported [higher than usual](#) net profits equivalent to 1.2% of tangible assets in the first six months of 2023 and 1.0% in 2022, up from an average of 0.7% between 2017 and 2019 (see Exhibit 6). Stronger profits were driven by strong revenue growth because of loan growth, an expanding net interest margin and higher CPI benefiting returns from the bank's net long CPI position (deriving mainly from CPI-linked mortgages).

Exhibit 6

**Bank Hapoalim's profitability is moderate****Evolution of profitability metrics**

Source: Moody's Investors Service

The bank's net interest margin had widened to 2.5% in the first three months of 2023 from 2.1% in 2022 and 1.7% in 2021 because of rising policy rates in Israel and the US that have allowed the bank to unlock the value from its low-cost core deposit base. Even before the conflict, we expected limited further upside from higher interest rates because of a gradual shift from current accounts to costlier time deposits, with the bank's non-interest bearing deposits accounting for 29% of total deposits as of June 2023 compared to 36% at the end of 2022.

We expect Bank Hapoalim to maintain its ongoing cost containment efforts in order to mitigate cost inflation as well as ongoing investments in IT and digitalisation. We expect improvements in the bank's cost-to-income ratio to taper off going forward as revenue growth slows down and expense growth rises.

**Strong retail deposit-based funding structure and sound liquidity**

Bank Hapoalim benefits from a strong funding profile driven by a large deposit base in Israel. The bank's growing deposit base comfortably funds its lending activities, supported by the country's strong savings culture. Bank Hapoalim's net-loans-to-deposits ratio was 76% as of June 2023.

Granular household (excluding private banking) and small business deposits accounted for 50% of total deposits as of June 2023. Potentially less stable deposits from institutional investors were 19% of total deposits as of the same date, which we take into account in our assessment, but foreign deposits were contained at 5% of the total. Hapoalim's deposit base has proven to be stable during past systemic shocks, and the risk of shekel-denominated deposit outflows is limited, given that the shekel market is a closed market.

Ample deposits drive a low reliance on potentially more confidence-sensitive market funding. Market funds accounted for 9% of tangible banking assets as of June 2023, part of which reflects senior issuances<sup>11</sup> and derivative balances, which are mainly driven by customer activity. The bank had around NIS25 billion (4% of total assets) of bonds and subordinated notes outstanding as of June 2023. These balances were mainly sourced from the local capital market and allow for better matching of the bank's assets and liabilities maturities.

The bank also maintains sound liquidity, underscored by a conservative investment policy. Liquid banking assets were 34% of tangible banking assets as of June 2023. Bank Hapoalim kept 15% of assets in the form of cash and deposits with banks, and an additional 20% in securities. The bank allocated a higher share of its liquid assets portfolio in securities in order to benefit from higher interest rates. Bank Hapoalim's securities portfolio primarily consists of investments in Israeli government bonds (69% of total) and, to a lesser extent, US government bonds (17% of total), while only 3% of the securities portfolio were investments in shares. The bank's liquidity coverage ratio was 126% and its net stable funding ratio was 125% as of June 2023, both substantially above the 100% minimum regulatory requirement.

### Source of facts and figures cited in this report

Unless noted otherwise, we have sourced data relating to systemwide trends and market shares from the central bank. Bank-specific figures originate from the banks' reports and are based on our own chart of accounts and may be adjusted for analytical purposes. Please refer to [Financial Statement Adjustments in the Analysis of Financial Institutions](#) published on 9 August 2018. We do not use the Bank of Israel's exchange rates in converting figures from Israeli shekel into US dollars, so US dollar figures may differ from bank reported figures.

## ESG considerations

### Bank Hapoalim B.M.'s ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 7

#### ESG Credit Impact Score

# CIS-2

## Neutral-to-Low

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

NEGATIVE IMPACT : : POSITIVE IMPACT

Source: Moody's Investors Service

Bank Hapoalim's **CIS-2** indicates that ESG considerations are not material to the current ratings because a very high level of government support mitigates the impact of ESG factors. In particular, social risks for the bank have increased and are high because of the military conflict in addition to high customer relations risks.

Exhibit 8

#### ESG Issuer Profile Scores

ENVIRONMENTAL

# E-3

## Moderately Negative



SOCIAL

# S-4

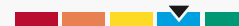
## Highly Negative



GOVERNANCE

# G-2

## Neutral-to-Low



Source: Moody's Investors Service

### Environmental

Bank Hapoalim faces moderate exposure to environmental risks, mainly because of its portfolio exposure to carbon transition risks as a diversified bank and one of Israel's two largest banks with a significant corporate exposure. In line with its peers, Bank Hapoalim faces growing business risks and stakeholder pressure to meet broader carbon transition goals. Bank Hapoalim is engaging in further developing its climate risk and relevant portfolio management capabilities and increasing its green financing.

### Social

Bank Hapoalim faces high social risks, related to societal and demographic trends as well as from customer relations. The current military conflict may cause a severe disruption of the economy and impact the bank's financial performance, depending on its duration and scale. However, a relatively young and growing population in Israel affords business opportunities for the bank. Further, Bank Hapoalim faces high customer relations risk because of the considerable focus on consumer protection in Israel, exposing banks



to potential fines from regulators and litigation from customers. High cyber and personal data risks are mitigated by a sound IT framework.

### Governance

Bank Hapoalim faces low governance risks, and its risk management, policies and procedures are in line with industry practices and commensurate with its universal banking model, while the bank provides timely and detailed external reporting. The bank's financial strategy is conservative, under the oversight of a proactive and hands-on regulator.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

## Support and structural considerations

### Government support considerations

Bank Hapoalim's A2 deposit ratings continue to incorporate three notches of government support uplift from the bank's baa2 Adjusted BCA because of our assessment of a very high likelihood of extraordinary support from the Israeli authorities. This assumption is based on Bank Hapoalim's systemic importance as one of the country's two largest banking groups and the Israeli government's long standing practice of injecting capital into systemically important banks in case of need. A potential weakening of the sovereign's capacity to provide support, indicated by a downgrade of the Government of Israel's rating, may reduce the support uplift incorporated in the bank's ratings.

### Counterparty Risk (CR) Assessment

#### Bank Hapoalim's CR Assessment is A1(cr)/P-1(cr)

Prior to government support, the CR Assessment is positioned one notch above the bank's baa2 Adjusted BCA, reflecting our view that its probability of default is lower than that of deposits. Senior obligations represented by the CR Assessment will be more likely preserved to limit contagion, minimise losses and avoid disruption of critical functions. The CR Assessment also benefits from government support uplift, in line with our support assumptions on deposits.

### Counterparty Risk Ratings (CRRs)

#### Bank Hapoalim's CRR is A1/P-1

For jurisdictions with a non-operational resolution regime, such as Israel, the starting point for the CRR is one notch above the bank's Adjusted BCA. The CRRs also benefit from three notches of government support uplift.

## Methodology and scorecard

### About Moody's Bank Scorecard

Our Bank Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

## Rating methodology and scorecard factors

Exhibit 9

### Bank Hapoalim B.M.

Macro Factors						
<b>Weighted Macro Profile</b>	<b>Strong</b>	<b>100%</b>				
Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.1%	a1	↓↓	baa3	Sector concentration	Expected trend
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	11.5%	baa2	↓	baa3	Expected trend	
Profitability						
Net Income / Tangible Assets	0.8%	baa2	↓	baa3	Expected trend	
Combined Solvency Score		a3		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	8.8%	a2	↔	a3	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	35.7%	a2	↓	a3	Expected trend	
Combined Liquidity Score		a2		a3		
Financial Profile				baa2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				A1		
BCA Scorecard-indicated Outcome - Range				baa1 - baa3		
Assigned BCA				baa2		
Affiliate Support notching				0		
Adjusted BCA				baa2		
Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	1	0	baa1	3	A1	A1
Counterparty Risk Assessment	1	0	baa1 (cr)	3	A1(cr)	
Deposits	0	0	baa2	3	A2	A2

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

## Ratings

Exhibit 10

Category	Moody's Rating
<b>BANK HAPOALIM B.M.</b>	
Outlook	Rating(s) Under Review
Counterparty Risk Rating	A1/P-1 <sup>1</sup>
Bank Deposits	A2/P-1 <sup>1</sup>
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	A1(cr)/P-1(cr) <sup>1</sup>

[1] Rating(s) within this class was/were placed on review on October 24 2023

Source: Moody's Investors Service

## Endnotes

- [1](#) House price growth in Israel peaked at a high 20% year-over-year as of September 2022 with fewer real estate transactions and a marginal decrease in prices in recent months.
- [2](#) Average is for the period in the run-up to the pandemic, 2006-2018. Credit costs had increased to 0.6% in 2020 from 0.4% in 2019, which had included an initial assessment of the impact of the pandemic made by the bank in its full-year 2019 financials. More than 80% of the provisions booked in 2020 were collective provisions.
- [3](#) The regulatory definition of small businesses includes those businesses with an annual turnover of up to NIS50 million.
- [4](#) Based on 2022 figures
- [5](#) The measures [include](#) loan-to-value limits of 75% for sole dwellings and 70% for the rest but for non-investment purposes, a monthly repayment cap at 50% of a borrower's monthly salary and a limit on the variable-rate part of the mortgage at two-thirds of the loan. Higher risk-weights for the calculation of regulatory capital metrics for mortgages with higher loan-to-value and repayment ratios also encourage tighter underwriting.
- [6](#) After haircuts and deductions.
- [7](#) The closed financing structure mitigates risks because credit is managed in a separate account dedicated to the project that is separate from the rest of the borrower's banking activity and from which the developer cannot withdraw funds without the bank's consent. There is external oversight of construction progress by inspectors approved by the bank, who track the pace of progress on-site and monitor expenditure and income in accordance with the planned budget.
- [8](#) In November 2020, the authorities lowered the bank's leverage ratio requirement to 5.5%, from 6% previously. This relief has been extended until the end of 2023, and the leverage ratio requirement will return to 6% within two quarters after that date.
- [9](#) On 15 October 2023, the Bol set out a [comprehensive outline](#) to support bank customers during this period. The measures include a 3-month deferral of loan repayments without accruing interest for a specific set of households and small businesses that are most affected by the conflict. All other bank customers can also defer repayments but with interest accruing. Individual banks are additionally offering more customised solutions.
- [10](#) The bank has operated several voluntary retirement schemes, which more recently reduced its workforce by 8% in 2019-2022, despite hiring to advance IT initiatives. The bank is also looking to further streamline its branch network, which shrunk by 23% in 2019-2022, and to consolidate its headquarters.
- [11](#) Market funds exclude subordinated debt, according to our definition.

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## Rating Action: **Moody's places the ratings of five Israeli banks on review for downgrade**

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24 Oct 2023

Limassol, October 24, 2023 -- Moody's Investors Service ("Moody's") has today placed the deposit ratings of the five Israeli banks it rates on review for downgrade. Specifically, the rating agency has placed on review for downgrade the A2/P-1 long- and short-term deposit ratings of Bank Leumi Le-Israel B.M., Bank Hapoalim B.M., Mizrahi Tefahot Bank Ltd., Israel Discount Bank Ltd. (IDB) and First International Bank of Israel Ltd. Previously, the outlook on the long-term deposit ratings was stable.

Concurrently, Moody's also placed the banks' long-term Counterparty Risk Ratings and Counterparty Risk Assessments on review for downgrade, as well as IDB's long-term foreign currency senior unsecured debt rating. At the same time, Moody's affirmed the five banks' baa2 Baseline Credit Assessments (BCAs) and Adjusted BCAs.

Today's rating action follows the review for downgrade on the Government of Israel's A1 long-term issuer ratings, opened by Moody's on 19 October 2023. For further information on the sovereign rating action, please refer to Moody's press release: <https://ratings.moodys.com/ratings-news/410047>. In line with the sovereign ratings review, the review on the bank ratings may take longer than the usual three months.

Please click on this link [https://www.moodys.com/viewresearchdoc.aspx?docid=PBC\\_ARFTL481686](https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL481686) for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

### RATINGS RATIONALE

#### – RATINGS REVIEW

Today's rating action is driven by the review for downgrade on the Government of Israel's A1 rating.

Moody's assumes a very high probability of government support for Israel's five large banking groups that it rates give their systemic importance and the Israeli government's long standing practice of injecting capital into such systemically important banks, in case of need. This results in three notches of government support uplift from their baa2 Adjusted BCAs to their long-term deposit ratings of A2.

During the review Moody's will assess the impact of a potential weakening of the sovereign's capacity to provide support, indicated by the Government of Israel's rating and whether this may reduce the support uplift incorporated in the banks' ratings.

Additionally, Moody's will also consider whether the military conflict risks weakening the operating environment for banks sustainably. The longer and more severe the military conflict, the greater its impact is likely to be on the economy. Moody's will also assess during the review whether the conflict negatively affects Israel's institutional strength, in particular the effectiveness of policymaking.

#### – BCA AND ADJUSTED BCA AFFIRMATION

The affirmation of the five banks' baa2 BCAs and Adjusted BCAs reflects their strong and resilient financial fundamentals and potential for these to withstand the impact of the current situation.

Asset quality is strong, demonstrated by a problem loan ratio of below 1% for each of the five banks as of June 2023

and contained credit costs over economic cycles, driven by relatively conservative underwriting and close and proactive oversight by the Bank of Israel (BoI).

The banks have a deposit-based funding structure, mostly from households and small businesses, and healthy liquidity.

Capital metrics are moderate (average tangible common equity/risk-weighted assets ratio of 10.6% as of June 2023) but consistently stable and driven by the BoI's conservative risk-weightings, especially on mortgages.

However Moody's expects that the banks' asset quality will deteriorate over time because of the impact the military conflict will have on Israel's economy. The extent of this will depend on its duration and scale, as well as actions by the authorities to cushion the impact on affected businesses and households. Banks also have relatively high, albeit varying, exposure concentrations to the construction and real estate sector that have grown in recent quarters and which could be affected in the event of a sustained disruption in real estate activity and demand.

The Israeli economy recovered relatively swiftly from past episodes of violent conflict and its dynamism benefits from a diversified high-tech sector as the main engine of growth. However, this conflict is more severe than the episodes of violence in the last few decades. As a result, there is a risk of a diversion of resources, drop in investment and loss of confidence, which would undermine Israel's economic outlook. There was already a slowdown in real estate transactions before the conflict and a slight decline in property prices from recent highs. However, although activity in the sector has been curtailed by the current security situation, underlying demand for residential units continues to be driven by a young and growing population.

Profitability will also materially decline from recent exceptionally high levels because of a higher cost of risk, lower credit growth and support measures to customers affected by the conflict, such as interest free loan repayment holidays for the most affected individuals and small businesses. Profitability, which had been moderate in the past, benefited significantly from higher interest rates given banks' low-cost deposit bases, and was well above historical levels prior to the conflict. The five banks reported net income/tangible assets of between 1.1% to 1.3% in the first half of 2023. Positively, banks' had also made significant cost efficiency gains in recent years, which enhances their ability to withstand and recover from shocks.

## FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Potential for upgrades of the banks' ratings is limited, as indicated by the review for downgrade. However, the ratings could be confirmed at their current levels if Israel's A1 issuer rating were confirmed. This would also depend upon banks' standalone fundamentals, notably their solvency and liquidity, being maintained

Israeli banks' ratings could be downgraded if the sovereign rating is downgraded, given the significant government support uplift that is incorporated in their ratings.

The banks' ratings could also be downgraded in case of a prolonged and wider conflict that could have a significant impact on the operating environment for banks and their standalone fundamentals, or if any individual bank's performance proves more volatile than in previous conflicts and economic crises.

## PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at <https://ratings.moodys.com/rmc-documents/71997>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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