Bank Leumi (UK) plc

Your Specialist Bank

ANNUAL REPORT 2016

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Bank Leumi (UK) plc

Bank Leumi (UK) plc Board of Directors

As at 31 December 2016

Yoel Mintz [4]
Chairman

Eliyahu Katzav [4]
Chief Executive Officer

Michael J. Green [3* & 4*]

Robert C. Hain [1 & 2*]

William M. Lindsay [2 & 4]

Simon P. Rothberg
Chief Risk Officer

Jean M. Stevenson [1* & 2 & 3]

Adrian J. Stirrup [1 & 2 & 3]

Nicholas J. Treble [3 & 4]

1 Member of the Audit & Remuneration Committee
2 Member of the Strategy Committee
3 Member of the Risk Committee
4 Member of the Credit Committee
** Committee Chairman*

Bank Leumi (UK) plc and subsidiaries

Executive Management

Eliyahu Katzav
Chief Executive Officer

Dhavarajh Frank
Chief Operating Officer

Simon P. Rothberg
Chief Risk Officer

Michael J. Duval
Chief Business Officer

Senior Management

Robert T.S. England
Head of Legal and Company Secretary

William Foster
Head of Private Banking

Daniel J. Gabb
Head of Treasury and Global Markets

Dennis J. Hegarty
Head of Credit Risk Management

Paul Hird
Chief Executive Leumi ABL Limited

Paul J. Minkoff
Financial Controller

Oren Riterband
Head of Internal Audit

Lin K. Walling
Head of Human Resources

www.bankleumi.com

Auditor: KPMG LLP,
15 Canada Square, London E14 5GL

Authorised by the Prudential Regulation Authority & Regulated by the Financial Conduct Authority & the Prudential Regulation Authority

Bank Leumi (UK) plc registered in England. Registration No.640370.
Registered Office: 20 Stratford Place London W1C 1BG
Telephone 020 3772 1500
Facsimile 020 3772 1501

Chairman's Statement

I am pleased to present the Annual Report for 2016 of the Bank Leumi (UK) Group.

The Bank's various business desks recorded positive results and returns during 2016, and I am pleased to report a net profit for the year of £17.4 million, up from £13.1 million in 2015, an increase of 34%. As in 2015, the results were also positively impacted by a relatively low rate of new provisions leading to a small net write back to profit relating to impaired debts.

The credit quality of the loan book remains strong, with the level of debts on the Bank's 'watch list' reducing in the past three years, and we continue to remain focused on maintaining effective credit management procedures.

The loan book continued to grow, increasing £116 million or 11% and across many of the Bank's sectors, demonstrating its diverse product offering. The appreciation of the US Dollar and Euro against Sterling contributed to this growth as it increased the value of loans denominated in those currencies. The Bank continues to draw on its areas of expertise and to broaden its client base. Customer deposits increased £345 million or 40%, driven by higher deposits in the Israeli business and Private Banking sectors, with the appreciation of the US Dollar also contributing to the increase.

In line with the group policy, Bank Leumi (UK) plc engaged in selling its holdings in both Jersey subsidiaries. The share sale of Leumi Overseas Trust Corporation Limited was completed on 8 April 2016 and the sale of the banking and investment business of Bank Leumi (Jersey) Limited was completed on 3 October 2016. The operating results of both Jersey companies up to the dates of sale, and income and costs associated with the sale transactions, are reported under discontinuing operations. The loss of customer deposits from the sale of Bank Leumi (Jersey) Limited was mostly compensated by the growth in customer deposits in Bank Leumi (UK) plc and additional funding received from the parent company. It remains a strategic priority to continue to increase the local depositor base.

Operating income for the continuing operations increased £4.7 million or 10%. This increase was attributable to higher net interest income, driven by higher average levels of customer lending. Fee and commission income decreased marginally due to lower invoice discounting fees earned by our asset based lending subsidiary, Leumi ABL Limited. Administrative expenses grew a modest £0.3 million or 1% overall for continuing operations, due to higher legal and professional costs and computer related costs, partly offset by lower staff related costs following headcount reductions during the year. Depreciation costs increased £1.0 million or 60% due to higher technology spend and accelerated depreciation on certain systems following a review of their remaining useful lives.

Leumi ABL Limited continued to grow, with client commitments up by 12%. However net profit was £0.9 million or 19% lower than last year due to an increase in impairment losses. Profit before impairment losses were relatively flat, with lower fee income compensated by lower costs.

The Bank's capital and liquidity ratios remained above regulatory limits throughout the year. In December 2016 the Bank converted £20 million of subordinated debt to equity share capital, thereby increasing the level of Common Equity Tier 1 capital. This positions the Bank well for continued lending growth and for meeting further step increases in minimum capital requirements set by the regulators. As with all banks, we face a number of regulatory and governance challenges and, increasingly, a greater proportion of management time is focused on ensuring that we comply with the latest regulatory rules which impact both our commercial lending and private banking activities.

In line with Financial Reporting requirements, the detailed results for the year and a full business, operating and financial review can be found in the Strategic Report.

Corporate Governance

Both the Board of Directors and Management continue to promote and maintain a sound system of corporate governance in compliance with applicable regulatory requirement. This is achieved through the building of strong internal controls, training programmes to ensure employees understand their responsibilities and annual reviews in all relevant areas.

Highlights of the Year Include:

- **Net profit of £17.4 million, compared with £13.1 million in 2015.**
- **Tier 1 capital ratio of 12.7%, compared with 10.2% in 2015.**
- **Write back to profit of £0.7 million in respect of impaired debts, compared with write back of £0.8 million in 2015.**
- **Operating income before provisions for continuing operations of £52.7 million, compared with £48.0 million in 2015, an increase of 10%.**
- **Administrative expenses for continuing operations of £30.7 million, compared with £30.4 million in 2015, an increase of 1%.**
- **Efficiency ratio for continuing operations of 63% compared with 67% in 2015.**
- **Customer lending of £1,175 million, compared with £1,059 million in 2015, an increase of £116 million or 11%.***
- **Customer deposits of £1,201 million, compared with £856 million in 2015, an increase of £345 million or 40%.***

  *excludes Bank Leumi (Jersey) Limited's loan and deposit books which were sold in 2016.

Directors, Management and Staff

I would like to welcome William Lindsay, who was appointed to the Board as a non-executive Director in January 2016, Adrian Stirrup and Nick Treble, who were appointed to the Board as non-executive Directors in March 2016, and Simon Rothberg who was appointed as an executive Director in March 2016.

Lesley Secretan retired from the Board of Directors, and as an employee of the Bank, in June 2016, ending a period of 44 years' service during which the Bank has seen substantial growth. I would like to express sincere gratitude to Lesley for her invaluable support over a number of years in the running of the Bank as a member of Executive Management and Chief Operating Officer. We also saw the retirement of two non-executive Directors, Robert Glatter and Siegfried Ramseyer, in March 2016 and the resignation of non-executive director Itai Ben-Zeev in December 2016. I would like to extend my appreciation to them all for their efforts over a number of years.

I would like to thank my fellow Directors for their contribution over the past year. My special thanks are extended to Eli Katzav our CEO, for his leadership and enterprise, as well as to all the management and staff for their efforts and achievements despite the continuing challenging business environment which prevailed during 2016.

Yoel Mintz

Chairman of the Board of Directors

22 February 2017

Strategic Report

Activities

The Leumi Group has been active in the UK since 1902. Bank Leumi (UK) plc is one of the largest subsidiaries of the group.

Founded in 1959 and headquartered in London, Bank Leumi (UK) plc and its subsidiaries provide lending and related banking services to a wide range of commercial and corporate clients. We also offer comprehensive Private Banking and Wealth Management services to private clients.

On 26 October 2015, the Bank announced that it was engaged in preliminary talks regarding the possibility of selling its holdings in its Jersey incorporated subsidiaries. On 8 April 2016 Bank Leumi (Jersey) Limited (BLJ) sold its subsidiary Leumi Overseas Trust Corporation Limited to Valla Limited. On 3 October 2016 the banking and investment business of BLJ was sold to EFG Private Bank (Channel Islands) Jersey Limited (EFG) who took over responsibility for the customer lending and nearly all of the deposit liabilities. At the same time the investment business and custody of securities was transferred to EFG. On 4 November 2016 the remaining customer accounts were closed and the balances repaid.

A further subsidiary, Leumi ABL Limited, provides asset based finance and is based in Brighton.

Strategy statement
We are a specialist bank with a UK focus benefitting from close ties to Europe and Israel. We are uniquely positioned to provide corporate banking services across a range of sectors including property, commercial, media, hotels, commodities and hi-tech as well as meeting the needs of high net worth individuals. We truly value our client relationships, providing added value in the form of expertise and tailored solutions.

Our service commitment
Our priority is to provide a first class service supported by fast decision making and excellent execution capabilities. We focus on understanding our customers' needs, building lasting relationships and taking a proactive approach as their requirements change. We offer a wide range of facilities and financial services to UK and international corporate and private clients.

Review of Business

Corporate Finance

Our corporate finance activities include financing property and hotel transactions and film, television and music production. We also provide finance and related services to corporate clients engaged in international trade, including commodities.

Across certain areas of our corporate finance activities we see greater competition, be it from large high street banks and other banks building their presence in the market place or new entrants into the arena, including private equity funds, challenger banks and the new fin tech sector. Given our strong service commitment we believe that we are well placed to deal with the demands of such competition.

Property Finance

The Bank focuses on financing the construction of residential, mixed use and commercial developments, mainly in London and the South East of England as well as projects in other parts of the UK, on a more selective basis.

The Bank also finances the construction of care homes, retirement villages and student accommodation projects in prime locations across the UK.

During 2016 the Bank continued to diversify its activity to increase its lending on investment and income generating property, offering to re-finance development projects it had financed on a longer investment basis, as well as new proposals and this along with the Bank's ability to provide fast and reliable responses to initial enquiries enabled it to increase its lending in 2016.

The Bank's experienced Property Finance Team will aim to build on this performance in 2017, while monitoring the sectors in which it operates to ensure credit quality is maintained, particularly in respect of the potential impact of Brexit on the real estate market generally.

Hotel Finance

The Bank has been providing hotel finance for more than ten years to clients mainly in the UK and Western Europe, focussing on development finance for new build projects, conversions and renovations as well as investment finance for established trading hotels. We work with a growing customer base across the hotel sector, from development companies and investment funds to owner-operators.

Our specialist Hotel Finance Team benefits from in-depth knowledge of the sector and stays abreast of market trends, which allows us to provide bespoke funding solutions to meet our clients' requirements.

Commercial Finance and Trade Finance

We continue to seek new relationships where we can build upon our strong expertise in financing customers engaged in international trade, particularly UK importers and Israeli businesses active in the world economy.

In both our Commercial Finance and Trade Finance businesses, we have seen excellent opportunities to enhance a number of existing financing structures. We achieve this by providing primarily secured trade finance and working capital facilities.

We support these services by offering treasury and other products as part of an overall comprehensive banking package. The maintenance of our demanding lending criteria and the provision of a high quality service gives us a solid platform for development of these businesses going forward.

Media Finance

Our specialist Media Finance Team allows us to provide secured, senior, short and medium-term finance in the fields of:

- Film production and distribution
- Television production and distribution
- Video games production
- Music publishing

We are involved in syndicated facilities and structure bespoke bilateral credit facilities for clients. We are primarily active across the UK, the US, France and Germany. Some transactions involve companies with a worldwide presence.

Our Media Finance Team operates in an environment marked by the ongoing growth and transformation of the industry, principally due to the acceleration in digitalisation of content.

We expect the competition for finance in Europe will intensify during 2017, as it did during 2016. We also anticipate increased competition from North American lenders as their home markets become more mature and liquidity available in the market remains high.

It is also expected, particularly in the UK that private equity will continue to compete, not only on cost but also on structure. Our team will select opportunities carefully, enabling us to maintain pricing and structure satisfactory to both clients and the Bank. It will also continue to cooperate with Bank Leumi USA's Media and Entertainment Team, leveraging the Leumi group's presence across the two continents.

Commodity Finance

Our Commodity Finance Team specialises mainly in the provision of short-term transactional finance to physical traders of metals, energy and soft commodities.

Whilst 2016 was generally a difficult year for commodity prices, and in particular for the metals, steel and energy producers, the volatility in the markets gave ample trading opportunities to commodity trading houses. We maintained our policy of building close relationships with premium quality trading companies with strong balance sheets and established operations. This allowed us to maintain an acceptable risk profile, despite price volatility and the exigencies of geopolitical events.

Israel Business

We have a strong Israeli heritage as a member of the Leumi Group. This, together with our well-established UK presence, allows us to provide a range of banking services for customers engaged in business opportunities connected with Israel.

Those services include working capital finance, acquisition finance, syndicated facilities, guarantees and deposit taking.

Hi-tech sector

Working closely with our colleagues in Tel Aviv, particularly Leumi Group's specialist subsidiary, LeumiTech, we continue to build our base of tech clients in the Bank. Our strategy in this space is principally to provide banking facilities and financial assistance to existing customers of the Leumi Group in Israel to establish offshoots of their Israeli centred businesses in the UK and Europe. We see this as a potentially major growth area for the Bank in the medium to long term and will shape our offering and risk appetite accordingly.

Asset Based Lending, Factoring and Invoice Discounting

Our Brighton-based subsidiary, Leumi ABL Limited, undertakes asset based lending to a wide range of businesses, enabling them to raise working capital against the value of their assets. Leumi ABL provide receivables finance, stock, plant and machinery finance and term loans.

Facilities secured against business assets, combined with the tight monitoring and control offered by Leumi ABL Limited, can provide higher levels of funding than traditional lending, while maintaining an attractive risk profile. Leumi ABL has retained its strategy of working closely with the Private Equity and Corporate Finance communities and has now completed a significant number of transactions with Private Equity firms.

Manchester office

In line with its mission to provide first class service whilst maintaining robust risk monitoring, Leumi ABL Limited has taken a longer term lease on premises in Manchester and has recruited experienced additional staff thereby affirming its commitment to providing Northern operational capability.

UK award wins

Thanks to its high quality sales team and proactive directors, Leumi ABL Limited has once again re-affirmed its now well established reputation as a leading player within the UK asset based finance market. Strong relationships with regional deal-making, professional advisory and private equity communities have resulted in yet another year of UK award wins, including the ACQ Global UK Asset Based Lender of the Year 2016, M&A Awards 2016 for UK Asset Based Lender of the Year and Finance Monthly Global Awards for UK Asset Based Lending Firm of the Year 2016; regionally Leumi ABL won the Business Insider Dealmakers ABL of the Year award for the regions of Yorkshire, Midlands and also the Business Magazine ABL of the Year in the Thames Valley.

Overall Leumi ABL Limited, with a strong portfolio of performing clients, continues to grow and expand, providing robust income flows.

Leumi ABL Limited remains a significant proportion of our business.

Private Banking and Wealth Management

We offer Investment Management and Banking Services to individual, corporate and trust clients. Our services encompass advisory, non-advisory, execution-only and safe custody solutions.

Our experienced team of investment managers provides high net worth clients with a comprehensive range of investment solutions. We offer traditional private banking services, investment accounts, foreign exchange, securities trading facilities and derivative instruments for hedging purposes.

Together with our Treasury and Global Markets Department, we develop one-off deposit solutions for our clients. These deposits can be capital guaranteed or capital at risk and can be linked to indices and currencies.

In the present low interest rate environment, we provide competitive rates to both existing and new clients. In addition, through our dedicated credit team, we are able to offer secured lending facilities, specifically collateralised against investment portfolios.

During 2016, we broadened both the products we offer and the services we provide. We are continually reviewing our solutions in light of market conditions and in conjunction with clients' needs. 2017 will again prove to be a challenging year, as we start the navigations through the Brexit.

Executive Mortgages

Our innovative Executive Mortgage product is designed to meet the specific needs of high earning, high net worth individuals seeking to purchase or re-mortgage a home in the UK. Worldwide income and assets can be taken into account and the mortgage may be drawn in most major currencies. Mortgages are interest only and typically for a five year term. We also offer the ability to switch borrowings between various currencies.

Treasury, Foreign Exchange and Money Markets

Our Treasury Team can provide a range of tailored foreign exchange solutions to assist our corporate customers with international business in managing the potential risks inherent in global markets.

We offer our clients direct access to a personal contact within Treasury who can provide updates on financial market events and price movements.

We have a wide range of deposit products with attractive rates and with flexible solutions for access to funds.

For further details of any of our products and services, please visit: **www.bankleumi.co.uk**

Risks and Uncertainties

There are a number of potential risks and uncertainties which could have a material impact on the group's long-term performance and could cause actual results to differ materially from expected and historical results.

The Bank has established an integrated risk management structure that clearly assigns ownership and management of specific risks to Executive and Senior Management. The Board approves the Bank's risk appetites which are set out in detailed policy documentation. Independent Risk Control and Credit Risk Management Departments monitor that risk exposures are maintained within approved parameters and appetites.

The Risk Management Committee takes a strategic overview of risk and has prime responsibility for the Bank's risk management structure and strategy. This includes the annual assessment of the Bank's overall risk appetites; the identification, management and apportionment of risk to relevant risk owners; the review and agreement of the operational risk mapping and operational risk survey processes and the review and agreement of the regular group assessments of compliance, and legal risks. The Bank has three other risk management committees which formulate the relevant strategies and policies for risks emanating from their areas of responsibility.

The three committees are:

Credit Risk Management Committee – responsible for all credit risk matters.

Market Risk Management Committee – responsible for all trading and market related risks and for the interest rate and liquidity risks of the Bank.

Operational Risk Management Committee – responsible for all operational related risks.

The Bank has a Board Risk Committee which is responsible for the risk management structure of the Bank and the risk implications of all significant new activities. It makes recommendations to the Board regarding approval of new activity. It also reviews the processes and outcomes of the Bank's Internal Capital Adequacy Assessment process, Individual Liquidity Adequacy Assessment and Recovery and Resolution Plan, and provides challenge prior to submission of those documents to the Board.

Credit risk is managed through the credit risk appetite and by policies and detailed procedures which call for individual assessment of the credit quality of all counterparties, and a separate assessment of the quality of collateral held to mitigate the exposure. A credit grading system has been implemented and each individual rating is independently assessed before being agreed. Concentration risk is carefully monitored by borrower concentration, industry sector and country. Limits sanctioned by the Board are applied to each of these areas.

Market risk is carefully monitored on a daily and weekly basis. Policies and detailed procedures are established and agreed by the Board which set out the parameters of the Bank's proprietary positions and trades and these positions are reported twice a month to the Market Risk Management Committee. Interest rate risk is controlled by way of a set of mismatch limits and loss limits for the impact of interest rate changes. Liquidity is monitored and reported daily using a number of metrics and ratios, each measured against limits set by the Market Risk Management Committee and the Prudential Regulation Authority. Regular stress testing of liquidity using bespoke scenarios is undertaken. Trading Room activity is monitored independently by the Risk Control Department.

Operational exposures are monitored by way of a loss event reporting process which considers actual and potential losses arising from any operational event. These are regularly reported to the Operational Risk Management Committee. This committee also considers, approves and carefully monitors key operational system developments. A quarterly report is submitted to the Board Risk Committee.

Additional disclosures on credit risk, market risk and operational risk are contained in note 27.

Risks associated with the Bank's defined benefit pension plan are detailed in note 11(d).

The level of capital required to be held against these risks is monitored on a regular basis against regulatory and internal limits.

Management information in relation to risk is submitted via the risk management committees with summaries being provided by way of a quarterly Chief Risk Officer's Report to the Board or its specific delegated sub-committees.

Results

The Statement of Financial Position and the Income Statement have been presented in accordance with standards issued by the International Accounting Standards Board.

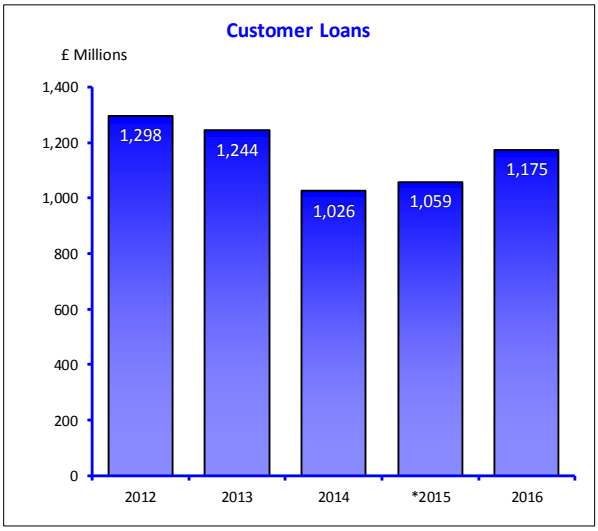
Statement of Financial Position

Total consolidated assets of Bank Leumi (UK) plc amounted to £1,740 million at the end of 2016, compared with £1,586 million at the end of 2015, a 10% increase.

Statement of Financial Position – customer business

Overall customer lending increased £116 million or 11%. Growth was seen across a number of sectors including Commodity Finance, Asset Based Lending, Property Finance and Hotels Finance. The appreciation of the US Dollar and Euro against Sterling increased the value of US Dollar and Euro denominated loans and contributed to the increase.

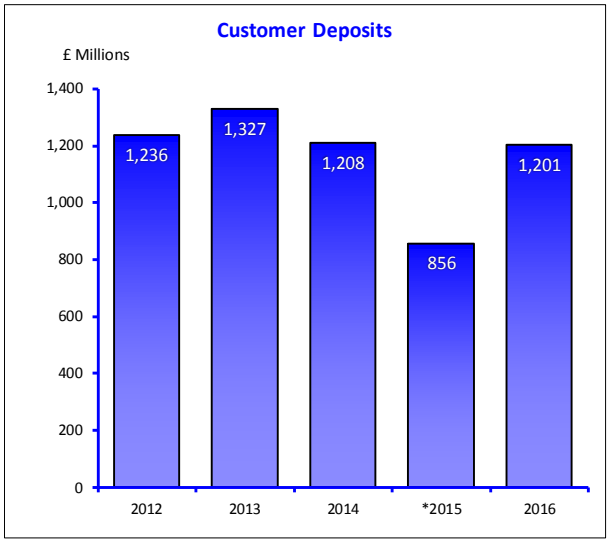
The trend in customer lending over the last five years is reflected in the graph below.



* 2015 excludes £120 million of loans which were classified as 'held for sale'.

Overall customer deposits increased £345 million or 40%. This increase was driven by higher deposits from customers affiliated to our Private Banking and Israel Business sectors, with the appreciation of the US Dollar against Sterling increasing the value of US Dollar denominated deposits and contributing to the increase.

The trend in customer deposits over the last five years is reflected in the graph below.



* 2015 excludes £408 million of deposits which were classified as 'held for sale'.

Debt securities

The Bank holds debt securities as part of its liquidity portfolio. The overall portfolio decreased £76 million during 2016 to £25 million. The decrease was due to a change in composition of the Bank's liquidity buffer where holdings of buffer eligible securities were replaced with higher cash placements in the Bank of England Reserve Account.

Liquidity

During 2016 the liquidity position of the Bank remained strong. The level of the Bank's liquidity buffer was £472 million, an increase of £144 million in the year due to higher cash placements in the Bank of England Reserve Account. During the year the Bank received additional funding of £194 million from its parent in order to maintain liquidity levels following the sale of Bank Leumi (Jersey) Limited's deposit balances to EFG.

Capital

The Bank continues to monitor its capital adequacy ratios on a regular basis to ensure that capital held is always adequate to support the business transacted. The level of capital held remained in excess of regulatory limits throughout the year. On 14 December 2016 the Bank repaid £20 million of subordinated debt held by its parent and simultaneously issued £20 million equity share capital to its parent. The effect of the transaction was to improve the Bank's capital position by converting £20 million of capital from Tier 2 capital to Common Equity Tier 1 capital.

As at 31 December 2016 the Bank's consolidated Common Equity Tier 1 Capital and Total Tier 1 Capital ratio was 12.7%.

Income Statement

The Group posted a net profit for the financial year 2016 of £17.4 million compared to a profit of £13.1 million in 2015.

Net profit includes £1.5 million relating to the Jersey subsidiaries which is classified separately in the Income Statement as discontinuing activities following the decision taken in 2015 to sell Leumi Overseas Trust Corporation Limited (LOTC) and the business of Bank Leumi (Jersey) Limited (BLJ).

Continuing Operations

Net profit on continuing operations of £16.0 million compares to £13.4 million in 2015, an increase of £2.6 million or 20%.

Overall the Bank saw a net write back to income of £0.7 million relating to impaired debts, similar to 2015 when there was a net write back of £0.8 million. The write back was due to a favourable outcome on specific problematic debts, partly offset by a small increase to the collective impairment provision which reflected the higher level of customer lending.

Operating income before impairment charges of £52.7 million compares with £48.0 million in 2015, an increase of £4.7 million or 10%. The increase is due to higher net interest income, partly offset by a modest reduction in fees and commissions income.

Net interest income of £38.7 million compared with £33.9 million in 2015, an increase of 14%. The increase was mainly due to higher interest income on customer lending as average loan balances increased compared to 2015. The strong growth in customer deposits during 2016 would have part mitigated this increase due to higher levels of interest expense.

Fees and commissions income of £12.0 million compared with £12.2 million in 2015, a decrease of 2%. There were no significant decreases to income streams, with lower invoice discounting fees compensated by higher levels of lending fees.

Net Trading Income of £2.0 million compared with £1.9 million in 2015, an increase of 5%. The vast majority of the Bank's income is derived from foreign exchange transactions undertaken to support our customers' needs.

Administrative expenses of £30.7 million compared with £30.4 million in 2015, a marginal increase of 1%. The increase was largely due to consultancy costs and computer related expenses, partly offset by lower staff related costs.

Depreciation of property and equipment of £2.7 million compared with £1.7 million in 2015, an increase of £1.0 million or 60%. The increase is due to higher spend on computer systems and accelerated depreciation on older systems following a re-assessment of useful lives.

The asset based lending subsidiary, **Leumi ABL Limited**, reported net profits of £3.8 million, compared with £4.7 million in 2015, a decrease of 19%. The reduction was due to a higher level of impairment charges, increasing from £0.2 million in 2015 to £1.3 million in 2016. Income fell 3%, mostly due to exceptional income earned in 2015, although this was compensated by lower expenses which reduced 6%. In February 2016 a dividend of £4.7 million was paid to Bank Leumi (UK) plc, being distribution of 2015 profits.

Discontinuing Operations

Overall profit of £1.5 million includes £1.0 million related to the activities of LOTC up to the date of sale of the company on 8 April 2016 and to the activities of BLJ up to the sale of its banking and investment business on 3 October 2016. The remaining £0.5 million relates to the sales of LOTC and BLJ, comprising up-front fees and accrued deferred contingent consideration less costs associated with the sales.

Return on Capital Employed

A key metric monitored by the Bank is Return on Capital Employed (ROCE). ROCE demonstrates the effectiveness of utilising the capital of the business to deliver profits to provide a return to our shareholders. ROCE is calculated as net profit divided by average capital employed in the business and expressed as a percentage.

The ROCE for the group was 11.2%, compared with 9.2% in 2015.

Efficiency Ratio

Another important measure of efficiency is the level of total expenditure compared to the level of total income. This efficiency ratio is calculated as total expenses divided by total income and expressed as a percentage.

For continuing operations, the efficiency ratio was 63%, compared with 67% in 2015.

Looking Ahead

2017 looks set to be a year of change; whether it be the new Trump administration in the United States or Brexit implications. As the Bank's European business activity is originated in the UK and with remaining high levels of uncertainty surrounding the impact of Brexit, we do not see any need to make any policy changes at this time. However, along with the rest of the industry, we continue to monitor the developing UK Brexit strategy.

2016 has closed with both US and UK unemployment figures showing the lowest jobless rates since pre-crisis levels and inflation starting to creep higher. This is likely to have implications for interest rates over the coming year; US Federal Reserve policy makers have indicated that they expect to raise the short term rate "a few times a year" until the end of 2019 aiming for a rate of 3% from the current 0.75%. The probability of the Bank of England raising the base rate in the UK is less likely in the short term despite their forecasting inflation to reach 2.7% by the end of 2017. Bank of England Governor Mark Carney has already commented that there are limits to the Bank's tolerance of higher inflation before it will look to raise interest rates. Europe seems set to keep interest rates lower for longer.

We have seen a strong start to 2017 for equity markets with the FTSE 100 at all-time highs along with the Dow Jones and Standard & Poors 500. How sustainable this is remains to be seen and will inevitably be influenced by our political backdrop. As with the UK, China also looks to improve trade globally. Oil prices have started to move higher causing further pressure on inflation but remain depressed when compared to 2010-2014 levels, much like gold which has opened 2017 with a rally but remains below the average price of the last 5 years.

We will continue to build on our strengths as a flexible player in the banking markets in which we operate, promoting the Leumi brand and identifying new areas for development of our various business sectors. Diversification of our portfolio remains an important part of our philosophy, as is our approach to prudent risk management in assessing new lending opportunities. Whilst recognising the challenges that lie ahead, we remain confident that we can continue to satisfy the financing requirements of our existing clients as well as taking advantage of selective new opportunities that are generated by our marketing efforts.

By Order of the Board
Robert England, Company Secretary
20, Stratford Place
London W1C 1BG
22 February 2017

Report of the Directors

The Directors present their Report and the Accounts of Bank Leumi (UK) plc and subsidiaries for the year ended 31 December 2016.

Board of Directors

The Directors as at 31 December 2016 are listed on page 1.
The Board of Directors appointed the following Directors:

- Mr W Lindsay (non-executive) with effect from 12 January 2016
- Mr S Rothberg with effect from 1 March 2016
- Mr A Stirrup (non-executive) with effect from 24 March 2016
- Mr N Treble (non-executive) with effect from 24 March 2016

The following Directors retired from the Board of Directors:

- Mr R Glatter with effect from 31 March 2016
- Mr S Ramseyer with effect from 31 March 2016
- Ms L Secretan with effect from 1 June 2016

Mr I Ben-Zeev resigned from the Board of Directors with effect from 14 December 2016.

The Directors retiring by rotation in accordance with the Bank's articles of association at the next annual general meeting are Mr S Rothberg, Mr A Stirrup, Mr N Treble, Mr M Green, Mr Y Mintz and Mr E Katzav, each of whom being eligible, will offer themselves for re-appointment.

During the year the Bank provided cover for its Directors and Officers under Directors' and Officers' liability insurance policies.

Statement of Directors' responsibilities in respect of the Strategic Report, the Directors' Report and the Financial Statements

The Directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare group and parent company financial statements for each financial year. Under that law they have elected to prepare both the group and the parent company financial statements in accordance with International Financial Reporting Standards as adopted by the EU and applicable law.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and parent company and of their profit or loss for that period.

In preparing each of the group and parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with International Financial Reporting Standards as adopted by the EU; and

  prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Disclosure of Information to the Auditor

The Directors who held office at the date of the approval of the Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Bank's auditor is unaware, and each of the Directors has taken all steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Bank's auditor is aware of the information.

Share Ownership

As at 31 December 2016, Bank Leumi le-Israel B.M. held, directly or indirectly, 100% of the issued share capital of the Bank. On 14 December 2016 the Bank repaid £20 million of subordinated debt held by its parent and simultaneously issued £20 million equity share capital.

Employees

The average number of persons employed by the group (including contract staff) in each week during the year was 204 (2015: 225), with approximately half of the decrease attributable to the sale of our Jersey businesses. The equivalent number of persons employed at end of 2016 was 194 (2015: 220). The aggregate remuneration paid to all such persons amounted to £19,191,000 (2015: £18,137,000).

Social Responsibility

Bank Leumi (UK) PLC is fully committed to being an active and useful member of all communities it operates in. In this regard, the Bank has always viewed its charitable giving as an aspect of its social responsibility.

We support charities through donations and by organising and hosting fundraising events, thus helping the charities to raise money themselves. We also sponsor charity events, such as dinners, receptions, concerts and festivals. During 2016 we supported the community with more than £40,000 towards various charities. We also organised a number of charity events, leading to many thousands more being raised.

As well as making donations, we believe we should get more involved in the day-to-day work of the causes that we support. As a result, in 2016 we started a new initiative to encourage members of staff to spend time out of the office doing voluntary work for charities supported by the Bank. The initiative has been a great success with almost 200 hours of volunteer time donated to good causes.

Auditor

KPMG LLP has indicated their willingness to continue in office and a resolution to reappoint them, and to authorise the Directors to determine their remuneration will be submitted to the forthcoming Annual General Meeting.

By Order of the Board
Robert England, Company Secretary
20, Stratford Place
London W1C 1BG

22 February 2017

Independent auditor's report to the member of Bank Leumi (UK) plc

We have audited the financial statements of Bank Leumi (UK) plc for the year ended 31 December 2016 as set out on pages 10 to 48. The financial reporting framework that has been applied in their preparation is applicable by law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the company's member, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's member those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's member, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 8, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's web-site at www.frc.org.uk/auditscopeukprivate

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2016 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006: and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Nicholas Edmonds (Senior Statutory Auditor)
For and on behalf KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL

22 February 2017

Consolidated Income Statement

for the year ended 31 December 2016

	Notes	2016 £000's	2015 £000's
Continuing operations			
Interest income		51,237	44,002
Interest expense		(12,515)	(10,099)
Net interest income	6	**38,722**	**33,903**
Net fees and commission income	7	11,979	12,211
Net trading income	8	2,029	1,924
Net gain/(loss) from other financial instruments designated at fair value	9	(3)	11
Total operating income before loan impairment charges		**52,727**	**48,049**
Allowance for impairment	16	669	839
Net operating income		**53,396**	**48,888**
Admininstrative expenses	11	(30,721)	(30,354)
Depreciation of property and equipment	19	(2,686)	(1,681)
Profit before tax	5	**19,989**	**16,853**
Tax expense	12	(4,020)	(3,494)
Profit for the year from continuing operations		**15,969**	**13,359**
Profit/(loss) on discontinued operations (net of tax)	4	**1,476**	**(294)**
Profit for the year attributable to the shareholders of the parent company		**17,445**	**13,065**

The notes on pages 18 to 48 form an integral part of the financial statements.

Bank Leumi (UK) plc registered in England. Registration No. 640370

Consolidated Statement of Comprehensive Income

for the year ended 31 December 2016

	Notes	2016 £000's	2015 £000's
Profit for the year		17,445	13,065
Other comprehensive income			
Items that will be reclassified subsequently to profit or loss when specific conditions are met			
Available for sale financial investments			
- Fair value gains/(losses)		44	(74)
- Fair value gains transferred to the income statement on disposal		-	(51)
- Income taxes	12b	(9)	23
		35	(102)
Items that will not be reclassified subsequently to profit or loss			
Actuarial gains/(losses) on the defined benefit plan			
- Before income taxes	11d	(1,822)	999
- Income taxes	12b	344	(209)
		(1,478)	790
Other comprehensive income for the year (net of tax)		(1,443)	688
Total comprehensive income for the year attributable to the shareholders of the parent company		16,002	13,753

The notes on pages 18 to 48 form an integral part of the financial statements.

Consolidated Statement of Financial Position

For the year ended 31 December 2016

	Notes	31 December 2016 £000's	31 December 2015 £000's
Assets			
Cash and balances at central banks		446,174	230,969
Loans and advances to banks	14	70,310	51,622
Loans and advances to customers	15	1,175,304	1,059,241
Assets classified as held for sale	4	-	120,163
Financial investments	17	25,431	100,985
Property and equipment	19	7,935	6,644
Derivatives	27	8,105	8,916
Other assets	20	4,720	4,639
Prepayments and accrued income		2,513	3,062
Total assets		**1,740,492**	**1,586,241**
Liabilities and equity			
Liabilities			
Deposits by banks	21	263,949	65,925
Customer deposits	22	1,200,849	856,294
Liabilities classified as held for sale	4	-	408,339
Derivatives	27	9,346	7,046
Subordinated liabilities	23	63,546	83,678
Other liabilities	24	7,505	6,673
Provisions	4	944	1,684
Accruals and deferred income		7,452	7,810
Post-employment benefit liabilities	11d	2,941	834
Total liabilities		**1,556,532**	**1,438,283**
Equity			
Called up share capital	25	13,585	11,967
Share premium account		54,475	36,093
Available for sale reserve		(17)	(52)
Retained earnings		115,917	99,950
Total equity attributable to the shareholders of the parent company		183,960	147,958
Total liabilities and equity		**1,740,492**	**1,586,241**

The notes on pages 18 to 48 form an integral part of the financial statements

The financial statements have been approved, authorised for issue and signed on behalf of the Board by:

Yoel Mintz, Chairman

Jean M. Stevenson, Director and Chairman of the Audit and Remuneration Committee

Eliyahu Katzav, Chief Executive Officer

22 February 2017

Consolidated Statement of Changes in Equity

for the year ended 31 December 2016

	Share capital £000's	Share premium £000's	Available for sale reserve £000's	Retained earnings £000's	Total equity £000's
At 1 January 2016	11,967	36,093	(52)	99,950	147,958
Profit for the year	-	-	-	17,445	17,445
Available for sale investments	-	-	35	-	35
Actuarial losses on the defined benefit plan	-	-	-	(1,478)	(1,478)
Total comprehensive income for the year (net of tax)	-	-	35	15,967	16,002
Issued share capital and premium	1,618	18,382	-	-	20,000
At 31 December 2016	**13,585**	**54,475**	**(17)**	**115,917**	**183,960**
At 1 January 2015	11,967	36,093	50	86,095	134,205
Profit for the year	-	-	-	13,065	13,065
Available for sale investments	-	-	(102)	-	(102)
Actuarial gains on the defined benefit plan	-	-	-	790	790
Total comprehensive income for the year (net of tax)	-	-	(102)	13,855	13,753
At 31 December 2015	11,967	36,093	(52)	99,950	147,958

The notes on pages 18 to 48 form an integral part of the financial statements.

Consolidated Cash Flow Statement

for the year ended 31 December 2016

	Notes	2016 £000's	2015 £000'5
Cash flows from operating activities			
Profit before tax on continuing operations		19,989	16,853
Profit/(loss) before tax on discontinued operations		1,436	(200)
Adjustments for:			
- Non cash items included in profit before tax	31	2,724	2,324
- Change in operating assets	31	(14,000)	(154,479)
- Change in operating liabilities	31	55,341	114,920
- Net gain from investing activities		-	51
- Contributions paid to the defined benefit plan		(190)	(237)
- Tax (paid)/received		(3,638)	407
Net cash generated from/(used in) operating activities		61,662	(20,361)
Cash flows from investing activities			
Purchase of financial investments		(15,800)	(277,908)
Proceeds from the sale and maturity of financial investments		92,251	249,799
Payments on the sale of financial liabilities in subsidiary		(210,945)	-
Receipts on the sale of financial assets in subsidiary		114,741	-
Purchase of property and equipment		(4,040)	(2,946)
Net cash used in investing activities		(23,793)	(31,055)
Cash flows from financing activities			
Issue of ordinary share capital		20,000	-
Subordinated loan capital repaid		(20,000)	-
Financing received from parent company		193,620	-
Net cash from financing activities		193,620	-
Net increase/(decrease) in cash and cash equivalents		**231,489**	**(51,416)**
Cash and cash equivalents at 1 January		282,478	336,211
Effect of exchange rate changes on cash and cash equivalents		2,517	(2,317)
Cash and cash equivalents at 31 December	31	**516,484**	**282,478**

The notes on pages 18 to 48 form an integral part of the financial statements.

Statement of Financial Position (Bank only)

for the year ended 31 December 2016

	Notes	31 December 2016 £000's	31 December 2015 £000's
Assets			
Cash and balances at central banks		446,174	230,969
Loans and advances to banks	14	67,447	48,152
Loans and advances to customers	15	1,176,340	1,049,060
Financial investments	17	25,431	100,985
Shares in group undertakings	18	18,858	18,973
Property and equipment	19	7,608	6,471
Derivatives	27	8,105	8,954
Other assets	20	4,082	3,729
Prepayments and accrued income		2,300	2,198
Total assets		**1,756,345**	**1,469,491**
Liabilities and equity			
Liabilities			
Deposits by banks	21	263,949	65,917
Customer deposits	22	1,227,696	1,169,545
Derivatives	27	9,346	7,046
Subordinated liabilities	23	63,546	83,678
Other liabilities	24	6,124	5,498
Accruals and deferred income		4,968	4,502
Post-employment benefit liabilities	11d	2,941	834
Total liabilities		**1,578,570**	**1,337,020**
Equity			
Called up share capital	25	13,585	11,967
Share premium account		54,475	36,093
Available for sale reserve		(17)	(52)
Retained earnings		109,732	84,463
Total equity attributable to the shareholders of the parent company		177,775	132,471
Total liabilities and equity		**1,756,345**	**1,469,491**

The notes on pages 18 to 48 form an integral part of the financial statements

The financial statements have been approved, authorised for issue and signed on behalf of the Board by:

Yoel Mintz, Chairman

Jean M. Stevenson, Director and Chairman of the Audit and Remuneration Committee

Eliyahu Katzav, Chief Executive Officer

22 February 2017

Statement of Changes in Equity (Bank only)

for the year ended 31 December 2016

	Share capital £000's	Share premium £000's	Available for sale reserve £000's	Retained earnings £000's	Total equity £000's
At 1 January 2016	11,967	36,093	(52)	84,463	132,471
Profit for the year excluding dividends	-	-	-	12,136	12,136
Dividends received				14,611	14,611
Available for sale investments	-	-	35	-	35
Actuarial losses on the defined benefit plan	-	-	-	(1,478)	(1,478)
Total comprehensive income for the year (net of tax)	-	-	35	25,269	25,304
Issued share capital and premium	1,618	18,382	-	-	20,000
At 31 December 2016	**13,585**	**54,475**	**(17)**	**109,732**	**177,775**
At 1 January 2015	11,967	36,093	31	72,072	120,163
Profit for the year excluding dividends	-	-	-	8,633	8,633
Dividends received				2,968	2,968
Available for sale investments	-	-	(83)	-	(83)
Actuarial gains/(losses) on the defined benefit plan	-	-	-	790	790
Total comprehensive income for the year (net of tax)	-	-	(83)	12,391	12,308

The notes on pages 18 to 48 form an integral part of the financial statements.

Cash Flow Statement (Bank only)

for the year ended 31 December 2016

	Notes	2016 £000's	2015 £000's
Cash flows from operating activities			
Profit before tax		29,781	10,900
Adjustments for:			
- Non cash items included in profit before tax	31	1,252	1,295
- Change in operating assets	31	(30,664)	(151,583)
- Change in operating liabilities	31	(32,591)	114,222
- Net gain from investing activities		-	22
- Dividends received from subsidiaries		(14,611)	(2,968)
- Contributions paid to the defined benefit plan		(190)	(237)
- Tax (paid)/received		(2,459)	194
Net cash used in operating activities		(49,482)	(28,156)
Cash flows from investing activities			
Dividends received from subsidiaries		14,611	2,968
Purchase of financial investments		(15,800)	(277,908)
Proceeds from the sale and maturity of financial investments		92,251	247,815
Purchase of property and equipment		(3,757)	(2,429)
Net cash generated from/(used in) investing activities		87,305	(29,554)
Cash flows from financing activities			
Issue of ordinary share capital		20,000	-
Subordinated loan capital repaid		(20,000)	-
Financing received from parent company		193,620	-
Net cash from financing activities		193,620	-
Net increase/(decrease) in cash and cash equivalents		**231,443**	**(57,710)**
Cash and cash equivalents at 1 January		279,008	334,168
Effect of exchange rate changes on cash and cash equivalents		3,170	2,550
Cash and cash equivalents at 31 December	31	**513,621**	**279,008**

The notes on pages 18 to 48 form an integral part of the financial statements.

Notes to the Financial Statements

1. Basis of preparation

(a) Statement of compliance

These financial statements are prepared in accordance with International Financial Reporting Standards as adopted by the EU (IFRSs). IFRSs comprise accounting standards issued by the International Accounting Standards Board (IASB) as well as interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC). The significant accounting policies are set out in Note 2 and have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

Judgements made by the Directors, in the application of these accounting policies that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in Note 3.

(b) Presentation of information

These financial statements are presented in accordance with IAS 1 "Presentation of Financial Statements" (IAS 1).

The Bank has taken advantage of the exemption in s408(3) of the Companies Act 2006 not to present its individual income statement, individual statement of comprehensive income and related notes that form a part of these financial statements.

Capital disclosures under IAS 1 have been included in Note 25.

The functional currency of the Bank is Sterling, which is also the presentation currency of these financial statements. All amounts have been rounded to the nearest thousand, unless otherwise indicated.

(c) Consolidation

The consolidated financial statements of the group comprise the financial statements of Bank Leumi (UK) plc and its subsidiaries made up to 31 December.

Subsidiaries are consolidated from the date that the group gains control until the date when control ceases.

The acquisition method of accounting is applied to the acquisition of subsidiaries by the group. The cost of an acquisition is measured at the fair value of the consideration, including contingent consideration, given at the date of exchange. Acquisition-related costs are recognised as an expense in the income statement in the period in which they are incurred. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Any goodwill that arises is recognised as of the date of acquisition and is tested annually for impairment. Any gain on a bargain purchase is recognised immediately in the income statement.

All intra-group transactions are eliminated on consolidation.

(d) Going concern

The financial statements are prepared on a going concern basis, reflecting capital and liquidity ratios above internal triggers and regulatory requirements. This also reflects the strong capital base of the Bank's parent company, Bank Leumi le-Israel B.M. As a consequence of this and the comprehensive risk management framework that the Bank has in place, the Directors believe that the Bank is well placed to manage its business risks successfully and expect it to continue in operational existence for the foreseeable future.

(e) Future accounting developments

A number of new standards and amendments to standards have been issued by the International Accounting Standards Board, which are not effective for these financial statements. Only three of these Standards, IFRS 9, IFRS 15 and IFRS 16, would be applicable to the Bank going forward, and their key requirements are described below. Only IFRS 9 is considered likely to represent a significant change to the Bank's accounting requirements in the future.

IFRS 9, *Financial Instruments*, which is effective for annual reporting periods beginning on or after January 1 2018, replaces the existing guidance in IAS 39, *Financial Instruments: Recognition and Measurement*. IFRS 9 includes revised guidance on the classification and measurement of financial assets and liabilities, including a new expected credit loss model for calculating impairment of financial assets and new general hedge accounting requirements. Although the permissible measurement bases for financial assets – amortised cost, fair value through other comprehensive income and fair value though profit or loss - are similar to IAS 39, the criteria for classification into the appropriate measurement category are significantly different. IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model, which means that a loss event will no longer need to occur before an impairment allowance is recognised.

The Bank has established a working group to implement the requirements of IFRS 9, comprising members of Risk and Finance departments with support from external consultants. During 2016 a key area of focus was to agree the basis for a staging test to identify those exposures which have seen a Significant Increase in Credit Risk (SICR), a key concept in IFRS 9 for distinguishing between the use of one year expected losses (Stage 1) and lifetime expected losses (Stage 2). We also considered approaches for generating forward looking Probability of Default (PD) data and for updating assumptions on Loss Given Default (LGD) and Exposure on Default (EAD), through analysis of internal historic loss default data and benchmarking against information provided by external credit agencies.

A detailed IFRS 9 project plan has been developed, with key deliverables for 2017 including:

- Finalising the staging test for SICR.
- Developing a framework for periodic review of macro-economic conditions and their impact on specific business segments.
- Finalising a framework for generating forward looking PD curves, for both Stage 1 and Stage 2 exposures, and methods for adjusting to take account of latest forecast macro-economic conditions.

- Finalising assumptions for EAD and LGD using historic default data, benchmarked where possible against external data.
- Developing an expected loss model, incorporating risk parameters as above and assessing the impact on the expected loss of changes to those parameters.
- Confirming data sources for disclosures required in the financial statements.

The Bank will transition to IFRS 9 on 1 January 2018, with no early adoption of any parts of the standard. The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods.

Based on our current assessment, the classification and measurement of financial assets and liabilities will remain unchanged under IFRS 9.

We intend to quantify the potential impact of IFRS 9 once it is practical to provide reliable estimates, which will be no later than in the 2017 Annual Report.

IFRS 15 *'Revenue from Contracts with Customers'* was issued in May 2014. The original effective date of IFRS 15 has been delayed by one year and the standard is now effective for annual periods beginning on or after 1 January 2018. The standard provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for obligations as they are satisfied. It should be applied retrospectively, with certain practical expedients available.

IFRS 16 *'Leases'* was issued in January 2016, with an effective date of annual periods beginning on or after 1 January 2019. The standard results in lessees accounting for most leases in a manner similar to the way in which finance leases are currently accounted for under IAS 17 'Leases'. Lessees will recognise a 'right of use' asset and a corresponding financial liability on the balance sheet. The asset will be amortised over the length of the lease and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as in IAS 17.

2. Summary of significant accounting policies

(a) Measurement basis

The financial statements are prepared on an historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments; financial instruments classified as fair value through the profit or loss or as available for sale and the net defined retirement benefit assets and liabilities.

(b) Foreign currency

Transactions in foreign currencies are translated using the rate of exchange ruling at the date of the transaction. Trading profits from dealings in foreign currency securities are translated using the rate of exchange ruling at the end of the month in which they arise. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the reporting date. Any resulting exchange differences are recognised in the income statement.

Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated using the rate of exchange ruling at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated using the rate of exchange ruling at the date the fair value was determined. Any resulting exchange differences are generally recognised in the income statement. However, exchange differences arising from the translation of available for sale financial investments are recognised in other comprehensive income.

(c) Interest income and expense

Interest on financial assets and financial liabilities measured at amortised cost and interest on available-for-sale financial investments is recognised in the income statement using the effective interest method. The effective interest method is a way of calculating the amortised cost of a financial asset or a financial liability (or groups of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the group estimates cash flows considering all contractual terms of the financial instrument but excluding future credit losses. The calculation includes all amounts paid or received by the group that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

Interest on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

(d) Non-interest income

(1) Fee income

Fee income is accounted for as follows:

i. Fee income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (Note 2c). However, when the financial instrument is measured at fair value with the change in fair value recognised in the income statement, the fees are recognised as revenue when the instrument is initially recognised.

ii. Fees earned from the provision of services are recognised as revenue as the services are provided.

iii. Fees earned on the execution of a significant act are recognised as revenue when the significant act is completed.

(2) Net trading income

Net trading income comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes, interest, dividends and foreign exchange differences.

(3) Net income from other financial instruments designated at fair value

Net income from financial instruments designated at fair value through the income statement relates to non-trading derivatives held for risk management purposes. It includes all realised and unrealised fair value changes, interest, dividends and foreign exchange differences.

(4) Dividend income

Dividend income is recognised in the income statement when the right to receive payment is established.

(e) Financial instruments

Financial assets and financial liabilities are recognised in the statements of financial position when the group and the Bank become a party to the contractual provisions of the instrument.

Loans and advances

Loans and advances are recognised when cash is advanced to borrowers. They are derecognised when either the borrower repays its obligations, or the loans are sold or written off, or substantially all the risks and rewards of ownership are transferred. They are initially recognised at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest rate method, less impairment losses. This is considered to be a reasonable approximation of fair value.

Impairment allowances

At each reporting date the Bank assesses whether there is any objective evidence that a financial asset or group of financial assets measured at amortised cost is impaired. Impairment losses are calculated at both a specific and collective level and are measured as the difference between the financial assets carrying amount and the present value of estimated future cash flows discounted at the effective interest rate computed at initial recognition. Impairment losses are recorded as charges to the income statement.

A financial asset or group of financial assets is impaired when objective evidence demonstrates that a loss event has occurred after initial recognition of the asset(s) and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably. Losses expected as a result of future events, no matter how likely, are not recognised.

Objective evidence that financial assets are impaired can include significant financial difficulty of the debtor or other observable data such as adverse changes in the payment status of debtors, or economic conditions that correlate with defaults of the debtor.

All financial assets found not to require a specific provision are collectively assessed for any impairment. In assessing collective impairment the Bank uses historical trends of the losses incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling.

If the amount of an impairment loss decreases in a subsequent period and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed either directly or by adjusting the impairment allowance account. The reversal is recognised in the income statement.

Impaired financial assets are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where the assets are secured, this is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write off may be earlier.

Loans that are subject to forbearance arrangements are included in the Bank's "watch-list" and are regularly assessed for impairment in the same way as all loans that are subject to increased credit monitoring.

Financial investments

Debt securities and equity shares intended to be held on a continuing basis are classified as available for sale or held-to-maturity. Financial investments are recognised on a trade date when the Bank enters into contractual arrangements with counterparties to purchase securities and are normally derecognised when either the securities are sold or the borrowers repay their obligations.

i. Available-for-sale financial assets are initially measured at fair value plus direct and incremental transaction costs. At subsequent reporting dates they are measured at fair value by reference to published price quotations. Gains and losses arising from changes in fair value are recognised in other comprehensive income until the financial assets are either sold or are determined to be impaired. When available for sale financial assets are sold, cumulative gains or losses previously recognised in other comprehensive income are recognised in the income statement.

   Interest income is recognised on available-for-sale financial assets in the income statement using the effective interest method, calculated over the asset's expected life. Premiums and/or discounts arising on the purchase of dated investment securities are included in the calculation of their effective interest rates. Dividends are recognised in the income statement when the right to receive payment has been established.

   At each reporting date an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset. Impairment losses are recognised if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If the available for sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the income statement, is removed from other comprehensive income and recognised in the income statement. Once an impairment loss has been recognised the subsequent accounting treatment for changes in the fair value of that asset differs depending on the nature of the available-for-sale financial asset concerned:

- for an available for sale debt security, a subsequent decline in the fair value of the instrument is recognised in the income statement when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of the debt security increases in a subsequent period and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement the impairment loss is reversed through the income statement to the extent of the increase in fair value.

- for an available for sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised directly in other comprehensive income. Impairment losses recognised on the equity security are not reversed through the income statement. Subsequent decreases in the fair value of the available for sale equity security are recognised in the income statement, to the extent that further cumulative impairment losses have been incurred in relation to the acquisition cost of the equity security.

ii. Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank positively intends, and is able, to hold until maturity. Held-to-maturity investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method, less any impairment losses.

Derivative financial instruments

The Bank's activities expose it primarily to the financial risks of changes in foreign currency exchange rates, interest rates and equity prices. The Bank uses foreign exchange forward contracts and interest rate swap contracts to hedge these exposures.

In order to reduce the risk of derivative instruments sold to customers, the Bank's policy is to cover all open positions by purchasing matching derivatives in the market. The positive fair values of the purchased derivatives represent a counterparty risk which is monitored regularly and added to the counterparty total exposure.

Derivative financial instruments are initially recognised at fair value and are measured to fair value at subsequent reporting dates by reference to the latest market prices. Changes in the fair value of derivative financial instruments are recognised in the income statement as they arise as the Bank does not apply hedge accounting.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of host contract; the terms of the embedded derivative would meet the definition of a stand-alone derivative if they were contained in a separate contract, and the combined contract is not held for trading nor designated at fair value. These embedded derivatives are measured at fair value with gains or losses reported in the income statement.

Derivatives are classified as assets when their fair value is positive and as liabilities when their fair value is negative.

Financial liabilities and equity

Financial liabilities are initially recognised at fair value, and are subsequently measured at amortised cost using the effective interest rate method. This is considered to be a reasonable approximation of fair value.

Equity instruments issued by the Bank are recorded as the proceeds received, net of direct issue costs.

De-recognition of financial assets and financial liabilities

Financial assets are derecognised when the contractual right to receive cash flows from the assets has expired; or when the group has transferred its contractual right to receive the cash flows of the financial assets, and either:

i. substantially all the risks and rewards of ownership have been transferred; or

ii. the Bank has neither retained nor transferred substantially all the risks and rewards, but has not retained control.

Financial liabilities are de-recognised when they are extinguished, that is when the obligation is discharged, cancelled or expires.

(f) Investment in subsidiary undertakings

The Bank's investments in its subsidiary undertakings are stated at cost less any impairment losses (carrying value). Where a decision has been taken to sell a subsidiary undertaking, it is stated at the lower of carrying value, and fair value less costs related to the sale.

(g) Goodwill

Goodwill arises on the acquisition of subsidiaries, when the aggregate of the fair value of the consideration transferred, the amount of any non-controlling interest and the fair value of any previously held equity interests in the acquired subsidiary exceed the amounts of the identifiable assets and liabilities acquired. If they do not exceed the amounts of the identifiable assets and liabilities of an acquired business, the difference is recognised immediately in the income statement.

Goodwill is tested for impairment at least annually and whenever there is an indication of impairment, by comparing the recoverable amount of an acquisition with the carrying amount of its net assets, including attributable goodwill. The recoverable amount of an asset is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of the expected future cash flows from an acquisition. If the recoverable amount is less than the carrying value, an impairment loss is charged to the income statement. Goodwill is stated at cost less accumulated impairment losses.

At the date of disposal of a business, attributable goodwill is included in the Bank's share of net assets in the calculation of the gain or loss on disposal.

(h) Property and equipment

Property, plant and equipment are stated at cost less any impairment losses and depreciation calculated on a straight-line basis to write off the assets over their estimated useful lives as follows:

Short leasehold buildings	unexpired period
Computers	3 to 10 years
Fixtures, fittings and furnishings	5 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate. Items of property, plant and equipment are subject to an annual impairment review to identify circumstances or events which may indicate that the carrying amount may not be recoverable.

(i) Operating leases

Rentals payable and receivable under operating leases are recognised in the income statement on a straight-lines basis over the periods of the leases.

(j) Post-employment benefits

The Bank has 2 sections to its pension provision for employees; (1) a defined benefit plan, which was closed to new entrants from 1 June 2000, and (2) a Self-Invested Personal Pension (SIPP), which was launched during 2014 to replace the defined contribution plan.

The SIPP is available to employees of Bank Leumi (UK) plc and Leumi ABL Limited. The assets of the plan are held separately from the Bank in an independently administered fund.

Defined benefit plan

The assets of the defined benefit plan are held separately from the Bank in an independently administered fund. The Bank's net obligation is calculated by estimating the amount of future benefit that employees have earned in the current and prior periods, discounting that amount and deducting the fair value of any plan assets.

The defined benefit pension costs and the present value of defined benefit obligations are calculated at the reporting date by the plan's actuaries using the Projected Unit Credit Method.

The net charge to the income statement mainly comprises the service cost and the net interest on the net defined benefit asset or liability. Net interest is calculated by applying the AA corporate bond yield discount rate to the net asset or liability. Past service costs relate to the change in the present value of the defined benefit obligation for service in prior periods, resulting from a plan amendment or curtailment and are charged immediately to the income statement.

Actuarial gains and losses comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred), as well as the effects of changes in actuarial assumptions. Actuarial gains and losses are recognised in other comprehensive income in the period in which they arise.

Defined benefit liabilities recognised in the statement of financial position represent the present value of defined benefit obligations adjusted for unrecognised past service costs and reduced by the fair value of the plan assets.

Self-invested pension plan

Payments to the SIPP are charged to the income statement as the related service is provided. Any differences between contributions payable in the period and contributions actually paid are disclosed in the Statement of Financial Position as "other liabilities" or "other assets".

(k) Income tax

Income tax comprises current and deferred tax. It is recognised in the income statement except to the extent that it relates to items recognised directly in equity or other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, amended for permanent differences between the treatment of certain items for tax and accounting purposes and any adjustment in respect of previous years. It is calculated using tax rates enacted or substantively enacted at the reporting date.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised. It is calculated using the tax rates and laws expected to apply in the periods in which the assets will be realised or the liabilities settled based on tax rates enacted, or substantively enacted, by the reporting date.

Deferred tax relating to actuarial gains and losses on post-employment benefits is recognised in other comprehensive income. Deferred tax relating to fair value re-measurements of available for sale investments which are charged or credited directly to other comprehensive income, is also credited or charged directly to other comprehensive income and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

(l) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid financial assets that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in their fair value. Such financial assets are normally those with less than three months' maturity from the date of acquisition, and include cash and balances at central banks, loans and advances to banks and available for sale investments.

(m) Discontinued operations and classification as 'held for sale'

A non-current asset is classified as held for sale if the Bank expects to recover its carrying amount principally through a sale transaction rather than through continuing use. A non-current asset classified as 'held for sale' is measured at the lower of its carrying amount and fair value less costs to sell. Assets and liabilities classified as 'held for sale' are shown separately on the face of the Statement of Financial Position.

The results of discontinued operations, comprising the post-tax profit or loss of discontinued operations, are shown as a single amount on the face of the Income Statement with a more detailed analysis presented in Note 4 of the accounts.

3. Use of assumptions, estimates and judgement

When preparing the financial statements, it is the Directors' responsibility to select suitable accounting policies and to make judgements and estimates that are reasonable and prudent. The accounting policies used in the preparation of these financial statements are described in detail in Note 2.

The accounting policies that are deemed significant to the Bank's results and financial position, in terms of the materiality of the items to which the policy is applied, or which involve a high degree of judgement including the use of assumptions and estimates, are disclosed below:

(a) Impairment of loans and advances

The Bank's accounting policy for losses arising from the impairment of customer loans and advances is described in Note 2(e). Loan impairment allowances represent management's best estimate of losses incurred in the loan portfolio at the reporting date.

Management is required to exercise judgement in making assumptions and estimations when calculating loan impairment allowances on both individually and collectively assessed loans and advances. The most significant judgemental area is the calculation of collective impairment allowances. The methods involve the use of historical information which is supplemented with management judgement to assess whether current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience. In normal circumstances, historical experience provides the most objective and relevant information from which to assess inherent loss within each portfolio.

(b) Defined benefit plan

The Company's defined benefit plan is measured on an actuarial basis with the key assumptions used, and the sensitivity to changes in these assumptions, disclosed in Note 11d.

The most significant judgments in measuring the present value of defined benefit obligations relate to the determination of actuarial and financial assumptions. These assumptions include the nominal discount rate, rate of inflation over the period of projected cash flows and member longevity.

Mortality assumptions are based upon the relevant standard industry and national mortality tables. Discount rates are based on specific corporate bond indices which reflect the underlying yield curve of the plan.

(c) Cessation costs

Management have made certain assumptions and estimates when calculating the future residual costs that are expected to be incurred due to the cessation of businesses. The amounts provided for these residual costs represent the Directors' best estimate of the actual costs that will be incurred. However, due to the inherent uncertainty over the actual outcome, whether due to specific decisions which have not yet been taken, or due to other factors outside the Directors' control, the actual costs to be incurred may differ from the provisions (Note 4).

4. Discontinued operations

On 26 October 2015, Bank Leumi le-Israel B.M. announced that Bank Leumi (UK) plc (BLUK) was engaged in preliminary talks regarding the possibility of selling its holdings in its Jersey incorporated subsidiaries. The decision to sell the Jersey subsidiaries was part of a wider Leumi group policy to cease international private banking activities in all subsidiaries except those situated in Israel, the USA and the United Kingdom.

On 8 April 2016 Bank Leumi (Jersey) Limited (BLJ) sold its subsidiary Leumi Overseas Trust Corporation Limited (LOTC) to Valla Limited. On 3 October 2016 the banking and investment business of BLJ was sold to EFG Private Bank (Channel Islands) Jersey Limited (EFG) who took over responsibility for the customer lending and nearly all of the deposit liabilities. At the same time the investment business and custody of securities was transferred to EFG. On 4 November 2016 the remaining customer accounts were closed and the balances repaid. As part of the divestment of these activities, BLUK and BLJ gave certain limited warranties and indemnities to the purchasers.

The results of the Jersey subsidiaries are classified as discontinuing operations in the Consolidated Income Statement, and are summarised in the following table:

	2016 £000's	2015 £000's
Net interest income	2,278	3,018
Other income	1,622	2,033
Total operating income	**3,900**	5,051
Administrative expenses	(2,464)	(5,251)
Profit/(loss) before tax	**1,436**	(200)
Taxation	40	(94)
Net profit/(loss) for the year on discontinued operations	**1,476**	(294)

Other income includes £968,000 upfront fees and accrued deferred contingent consideration earned for the period to 31 December in respect of the sales of LOTC and the business of BLJ.

The consolidated financial statements include a provision of £944,000 (2015: £1,684,000) as an estimate for cessation costs that will be incurred following the sale of the businesses of BLJ, of which an additional amount of £172,000 has been provided during the year. A further £296,000 has been paid during the year relating to legal and professional fees incurred in relation to BLJ and LOTC, resulting in a total charge to the Income Statement of £468,000 (2015: £2,333,000) which is included in Administration expenses.

The overall impact of the income and expenses as detailed above is a net gain of £500,000 in the 2016 consolidated financial statements.

Cessation costs include:

- Estimated reinstatement costs for the premises based on advice from a professional contractor.
- Estimated costs for the provision of future electronic storage and archiving requirements based on amounts contracted for.
- Onerous lease provisions for the remainder of each lease which, in the case of the premises, expires in 2023 with the residual costs being offset by sub-letting the premises to a tenant who is expected to be in situ on 30 June 2018.
- Staff termination costs estimated based on the terms of the staff contracts and the expected closure date of BLJ after wind down of the company.

The amounts provided for future residual costs at 31 December 2016 represent the Directors' best estimate of the actual costs that will be incurred. However, due to the inherent uncertainty over the actual outcome, whether due to specific decisions which have not yet been taken, or due to other factors outside the Directors' control, the actual costs to be incurred may differ from the provisions.

	2016 £000's	2015 £000's
Cash flows from discontinued operations		
Net cash (used in)/generated from operating activities	(51,964)	28,986
Net cash (used in)/generated from investing activities	(96,204)	1,983
Net cash (used in)/generated from financing activities	(10,000)	-
Net (decrease)/increase in cash and cash equivalents in the year	(158,168)	30,969

In accordance with IFRS 5 ('Non-current Assets Held for Sale and Discounted Operations'), the assets and liabilities of the Jersey incorporated subsidiaries were classified as 'Held for Sale' at 31 December 2015. Following the sale of the banking and investment businesses of BLJ during 2016, there were no assets or liabilities classified as 'Held for Sale' at 31 December 2016.

	2016 £000's	2015 £000's
Assets classified as held for sale		
Loans to customers	-	120,163
Liabilities classified as held for sale		
Deposits from customers	-	408,339

5. Profit before tax

	2016 £000's	2015 £000's
Profit before tax is stated after:		
(i) Crediting:		
Net gain on disposal of available for sale financial assets reclassified from equity	-	51
(ii) Charging :		
Rentals paid on premises under operating leases net of rental income received of £64,000 (2015: £nil)	1,499	1,515
Hire of computers and equipment	73	67
Auditor's remuneration:		
Audit of these financial statements	181	186
Fees payable to the bank's auditor and its associates for other services:		
Audit of the financial statements of the Bank's subsidiaries, pursuant to legislation	14	54
Audit related assurance services	147	87
Tax compliance	25	57
Tax advisory services	29	21
Other assurance services	9	12
Audit fees in respect of retirement benefit plans	3	5
Fees payable to un-associated auditors:		
Audit of the financial statements of the Bank's subsidiaries, pursuant to legislation	34	33
Other services	26	26

6. Net interest income

	Group		Bank	
Interest receivable:	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Loans and advances to banks	1,163	1,470	1,163	1,470
Loans and advances to customers	47,272	41,575	40,340	34,524
Financial investments	347	447	347	447
Other interest earning financial assets	2,455	510	2,455	510
Total interest income	51,237	44,002	44,305	36,951
Interest expense:				
Deposits by banks	722	348	722	348
Customer deposits	8,784	6,646	8,816	6,661
Subordinated liabilities	2,012	2,088	2,012	2,088
Other interest bearing financial liabilities	997	1,017	997	1,017
Total interest expense	12,515	10,099	12,547	10,114
Net interest income	38,722	33,903	31,758	26,837

7. Net fee and commission income

	Group		Bank	
Fees and commission income:	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Banking fees	11,690	11,899	4,597	4,339
Fund management fees	736	926	711	833
Total fee and commission income	12,426	12,825	5,308	5,172
Fees and commission expense:				
Introduction fees	(447)	(614)	(11)	(20)
Total fee and commission expense	(447)	(614)	(11)	(20)
Net fee and commission income	11,979	12,211	5,297	5,152

8. Net trading income

	Group		Bank	
	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Foreign exchange	2,029	1,924	2,029	1,924
Total net trading income	2,029	1,924	2,029	1,924

9. Net gain/(loss) from other financial instruments carried at fair value

	Group		Bank	
	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Derivatives held for risk management purposes:				
Interest rate	(3)	11	(3)	11
Net (loss)/gain	(3)	11	(3)	11

10. Other revenue

	Group		Bank	
	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Dividend income	-	-	14,611	2,968
Total other revenue	-	-	14,611	2,968

11. Administration expenses

		Group		Bank	
		2016 £000's	2015 £000's	2016 £000's	2015 £000's
Wages and salaries		16,428	16,687	11,846	11,757
Compulsory social security contributions		1,985	1,962	1,413	1,414
Contributions to SIPP and other defined contribution plans*		701	718	514	543
Expenses related to post employment defined benefit plans	11d	438	498	438	498
Total personnel expenses		19,552	19,865	14,211	14,212
Other administrative expenses		11,169	10,489	9,092	8,268
		30,721	30,354	23,303	22,480

** There were no prepaid contributions as at 31 December 2016 (2015: £Nil).*

(a) Employees

The average number of persons employed by the group and the Bank was made up as follows:

	Group		Bank	
	2016	2015	2016	2015
Managers	61	72	48	54
Clerical staff	143	152	103	103
Others	-	1	-	1
	204	225	151	158

(b) Directors' emoluments

	2016	2015
	£	£
Aggregate emoluments of the directors of the Bank	1,084,784	824,442
Of which:		
Directors' fees paid to Bank Leumi le-Israel B.M.	-	72,517
Salary and benefits paid to the highest paid director	314,258	279,925

(c) Transactions, arrangements and agreements involving directors and others

There were no transactions between the Bank and the Bank's key management personnel and their connected persons.

(d) Post-employment defined benefit plan

Pension benefits based on final pensionable salaries are available to the members of Bank Leumi (UK) Retirement Benefits Plan, which is a defined benefit plan with assets controlled by a Trustee and held separately from those of the Bank.

With effect from 1 June 2000 the defined benefit plan was closed to new entrants and a defined contribution section of the plan was established for all new employees. The defined contribution plan was replaced with a Self-Invested Pension Plan (SIPP) during 2014, available to staff of Bank Leumi (UK) plc from 1 June 2014 and to staff of Leumi ABL Limited from 1 January 2015. The pension cost charged to profits and paid was £501,144 (2015: £515,091). There were no prepaid contributions as at 31 December 2016.

In accordance with new legislation regarding employee auto-enrolment, all employees of Bank Leumi (UK) plc not in the SIPP at 1 July 2014 were automatically enrolled. All employees who joined the Bank after 1 July 2014 are auto-enrolled within four months of their start date.

The defined benefit plan is subject to the Statutory Funding Objective under the Pensions Act 2004. A valuation of the plan is carried out by a professionally qualified actuary independent of the Bank at least once every three years to determine whether the Statutory Funding Objective is met. The last valuation was carried out as at 1 January 2014. As part of the process the Company must agree with the Trustees of the plan the contributions to be paid to address any shortfall against the Statutory Funding Objective. The Statutory Funding Objective does not currently impact on the recognition of the plan in these accounts.

The plan is managed by a board of Trustees appointed in part by the Company and part from elections by members of the plan. The Trustees have responsibility for obtaining valuations of the fund, administering benefit payments and investing the plan's assets. The Trustees delegate some of these functions to their professional advisors where appropriate.

The plan exposes the Company to a number of risks:

- Investment risk: The plan holds investments in asset classes, such as equities, which have volatile market values and while these assets are expected to provide the real returns over the long-term the short-term volatility can cause additional funding to be required if deficit emerges.
- Interest rate risk: The plan's liabilities are assessed using market yields on high quality corporate bonds to discount the liabilities. As the plan holds assets such as equities the value of the assets and liabilities may not move in the same way.
- Inflation risk: A significant proportion of the benefits under the plan are linked to inflation. Although the plan's assets are expected to provide a good hedge against inflation over the long term, movements over the short-term could lead to deficits emerging.
- Mortality risk: In the event that members live longer than assumed a deficit will emerge in the plan.
- Member options and early retirements: certain benefit options may be exercised by members without requiring the consent of the Trustees or the Employer, for example exchanging pension for cash at retirement. In the example, if fewer members than expected exchange pension for cash at retirement then a funding strain will emerge.

Effect of the plan on the Company's future cash flows

The company is required to agree a Schedule of Contributions with the Trustees of the plan following a valuation. The next valuation of the plan as at 1 January 2017 is currently in progress and will be available later in the year. In the event that the valuation reveals a larger deficit than expected the Company may be required to increase contributions above those set out in the existing Schedule of Contributions. Conversely, if the position is better than expected contributions may be reduced.

The Company expects to pay contributions of £195,000 in the year to 31 December 2017.

The weighted average duration of the defined benefit obligation is approximately 18 years.

Amounts recognised in the statement of financial position

	2016 £000's	2015 £000's
Plan assets:		
Equities*	18,603	16,715
Bonds*	4,998	6,227
Index-linked gilts*	1,355	1,967
Diversified growth funds*	8,478	7,866
Leveraged liability-driven investments	2,313	-
Other (cash)	21	-
Total market value of plan assets	35,768	32,775
Present value of plan liabilities	(38,709)	(33,609)
Deficit in the plan	(2,941)	(834)

* Assets held are predominantly quoted.

Reconciliation of defined benefit (liability)/asset

	2016 £000's	2015 £000's
Net defined benefit liability at beginning of period	(834)	(1,521)
Service cost	(438)	(498)
Net interest expense	(37)	(51)
Remeasurements	(1,822)	999
Employer contributions	190	237
Net defined benefit liability at end of period	(2,941)	(834)

Movement in the fair value of the plan's assets

	2016 £000's	2015 £000's
Plan assets:		
At 1 January	32,775	33,142
Interest on the plan assets	1,237	1,207
Employer contributions	190	237
Member contributions	53	68
Benefits paid by the plan	(2,205)	(1,218)
Expenses paid by the plan	(175)	(145)
Return on plan assets less interest	3,893	(516)
At 31 December	35,768	32,775

Movement in the fair value of the plan's liabilities

	2016 £000's	2015 £000's
Plan liabilities:		
At 1 January	33,609	34,663
Current service cost	438	498
Member contributions	53	68
Interest costs	1,274	1,258
Benefits paid by the plan	(2,205)	(1,218)
Expenses paid by the plan	(175)	(145)
Changes to financial assumptions	8,336	(1,515)
Changes to demographic assumptions	(1,932)	-
Experience gain on defined benefit obligation	(689)	-
At 31 December	38,709	33,609

Accounts recognised in the profit and loss account over the year

	2016 £000's	2015 £000's
Current service cost	438	498
Interest on liabilities	1,274	1,258
Interest on assets	(1,237)	(1,207)
Total	475	549

Re-measurements over the year

	2016 £000's	2015 £000's
Gains/(losses) on plan assets in excess of interest	3,893	(516)
Experience gains on liabilities	689	-
Gains from changes to demographic assumptions	1,932	-
(Losses)/gains from changes to financial assumptions	(8,336)	1,515
Total (loss)/gain re-measurements	(1,822)	999

Experience gains arise due to a lower rate of inflation than assumed since the latest actuarial valuation at 1 January 2014. Gains from changes to demographic assumptions are due to lower life expectancies, an increase in the assumed level of cash commutation allowance and a decrease in the proportions married assumption.

Actuarial assumptions

The value of the plan's liabilities has been determined by a qualified actuary based on the results of an actuarial valuation as at the reporting date, using the following assumptions:

	2016 %	2015 %
Discount rate	2.80%	3.90%
Inflation (RPI)	3.40%	3.10%
Inflation (CPI)	2.40%	2.30%
Rate of increase in salaries	2.50%	2.50%
Rate of revaluation of pensions in deferment	2.40%	2.30%
Increases on retirement benefits in payment in respect of service:		
Before April 1997	n/a	n/a
From April 1997 – June 2005	3.25%	3.00%
From July 2005	2.30%	2.20%

	2016 years	2015 years
Assumed life expectancy on retirement age 65:		
Retiring today		
Males	22.8	23.0
Females	25.5	25.7
Retiring in 20 years		
Males	24.2	24.5
Females	27.1	27.3

Sensitivity analysis

The sensitivities regarding the principal assumptions used to measure the plan liabilities are set out below:

- Increasing the discount rate by 1% decreases the plan liabilities by £6.4 million.
- Decreasing the discount rate by 1% increases the plan liabilities by £8.4 million.
- Increasing the inflation rate by 1% increases the plan liabilities by £3.1 million.
- Decreasing the inflation rate by 1% decreases the plan liabilities by £3.2 million.
- Decreasing the salary increase rate by 1% (increases are capped at the current assumption of 2.5%) decreases the plan liabilities by £1.4 million.
- Increasing life expectancy by 1 year increases the plan liabilities by £1.5 million.

12. Taxation

(a) Income tax recognised in the income statement

	2016 £000's	2015 £000's
Current tax:		
UK corporation tax on profits of the year	4,229	2,938
Foreign tax	(21)	105
Total current tax	4,208	3,043
Deferred tax:		
Origination and reversal of temporary differences	(171)	608
Related to pension deficit	(57)	(63)
Total deferred tax	(228)	545
Total income tax expense	3,980	3,588
Of which:		
Continuing activities	4,020	3,494
Discontinuing activities	(40)	94
	3,980	3,588

(b) Income tax recognised in other comprehensive income

	2016 £000's	2015 £000's
Current tax:		
Change in fair value of assets classified as available for sale	9	(23)
Deferred tax:		
Actuarial (losses)/gains on the defined benefit plan	(344)	209
Total income tax (credit)/expense	(335)	186

(c) Reconciliation of effective tax rate

The tax assessed for the period is lower (2015: lower) than the average rate of UK corporation tax for the year of 20% (2015: 20.25%). The differences are explained below:

	2016 £000's	2015 £000's
Profit before tax	21,425	16,653
Tax using the UK corporation tax average rate of 20% (2015: 20.25%)	4,285	3,372
Effects of current tax:		
Foreign tax	(143)	20
Expenses not deductible for tax	91	169
Effects of deferred tax:		
Depreciation in excess of capital allowances	155	76
Relief for implementation of FRS 26	-	(83)
Carry forward of tax losses	(44)	(522)
Adjustments in respect of prior periods	(39)	-
Profit on sale of business activities	(97)	11
Total income tax expense	4,208	3,043

Factors that may affect future tax charges

The reduction in the UK corporation tax rate from 21% to 20% (effective 1 April 2015) was substantially enacted on 2 July 2013 and further reductions to 19% (effective 1 April 2017) and to 18% (effective 1 April 2020) were substantially enacted on 18 November 2015. This will reduce the group's future current tax charge accordingly. The deferred tax asset and liability at 31 December 2016 has been calculated based on the rate of 19% substantively enacted at the balance sheet date.

(d) Movement in deferred tax balances

Group 2016	Net asset/ (liability) at 1 January £000's	(Charge)/credit recognised in income statement (Note 12a) £000's	Recognised in other comprehensive income (Note 12b) £000's	Net asset/ (liability) at 31 December £000's	Of which deferred tax assets £000's	Of which deferred tax liabilities £000's
Capital allowances	(125)	159	-	34	34	-
Available for sale investments	-	12	(9)	3	3	-
Pension deficit	158	57	344	559	559	-
Total deferred tax assets/(liabilities)	33	228	335	596	596	-

Bank 2016	Net asset/ (liability) at 1 January £000's	(Charge)/credit recognised in income statement £000's	Recognised in other comprehensive income £000's	Net asset/ (liability) at 31 December £000's	Of which deferred tax assets £000's	Of which deferred tax liabilities £000's
Capital allowances	(124)	144	-	20	20	-
Available for sale investments	-	12	(9)	3	3	-
Pension deficit	158	57	344	559	559	-
Total deferred tax assets/(liabilities)	34	213	335	582	582	-

Group 2015	Net asset/ (liability) at 1 January £000's	(Charge)/credit recognised in income statement (Note 12a) £000's	Recognised in other comprehensive income (Note 12b) £000's	Net asset/ (liability) at 31 December £000's	Of which deferred tax assets £000's	Of which deferred tax liabilities £000's
Capital allowances	(111)	(14)	-	(125)	-	125
Loan impairment allowance	61	(61)	-	-	-	-
Effective interest rate	25	(25)	-	-	-	-
Unused tax losses	522	(522)	-	-	-	-
Arising on consolidation	(15)	15	-	-	-	-
Available for sale investments	1	(1)	-	-	-	-
Pension deficit	304	63	(209)	158	158	-
Total deferred tax assets/(liabilities)	787	(545)	(209)	33	158	125

Bank 2015	Net asset/ (liability) at 1 January £000's	(Charge)/credit recognised in income statement £000's	Recognised in other comprehensive income £000's	Net asset/ (liability) at 31 December £000's	Of which deferred tax assets £000's	Of which deferred tax liabilities £000's
Capital allowances	(109)	(15)	-	(124)	-	124
Loan impairment allowance	61	(61)	-	-	-	-
Effective interest rate	25	(25)	-	-	-	-
Unused tax losses	522	(522)	-	-	-	-
Available for sale investments	(2)	2	-	-	-	-
Pension deficit	304	63	(209)	158	158	-
Total deferred tax assets/(liabilities)	801	(558)	(209)	34	158	124

13. Segmental analysis

In the opinion of the Directors there is only one class of business and this is conducted entirely from the United Kingdom. In accordance with Country-by-Country Reporting requirements under CRD IV, the Bank has included additional disclosure on its website at: www.bankleumi.co.uk/FullArticles/34169/

14. Loans and advances to banks

	Group		Bank	
Analysed by remaining maturity:	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Repayable on demand	66,770	47,801	63,907	44,331
3 months or less excluding repayable on demand	3,540	3,708	3,540	3,708
1 year or less but over 3 months	-	113	-	113
Total loans and advances to banks	70,310	51,622	67,447	48,152

15. Loans and advances to customers

	Group		Bank	
Analysed by remaining maturity:	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Repayable on demand	386,247	370,942	194,347	188,164
3 months or less excluding repayable on demand	495,213	389,913	715,322	561,307
1 year or less but over 3 months	107,401	110,123	78,151	110,123
5 years or less but over 1 year	207,206	196,189	207,206	196,189
Over 5 years	10,707	24,657	10,707	24,657
Impairment allowances (note 16)	(31,470)	(32,583)	(29,393)	(31,380)
Total loans and advances to customers	1,175,304	1,059,241	1,176,340	1,049,060

	Group		Bank	
Analysed by industrial sector	2016 £000's	2015 £000's	2016 £000's	2015 £000's
(net of specific impairment)				
Property	318,868	290,421	317,616	289,912
Commerce	327,896	276,470	284,501	231,530
Industry	125,280	113,842	48,793	48,400
Other services	225,362	201,829	347,532	302,539
Hotels	174,362	171,002	174,362	171,002
Other	9,686	11,568	9,686	11,568
	1,181,454	1,065,132	1,182,490	1,054,951
Less collective impairment (note 16)	(6,150)	(5,891)	(6,150)	(5,891)
Total loans and advances to customers	1,175,304	1,059,241	1,176,340	1,049,060

16. Allowance for impairment

	2016			2015		
	Individual £000's	Collective £000's	Total £000's	Individual £000's	Collective £000's	Total £000's
Group						
At 1 January	26,692	5,891	32,583	49,858	5,657	55,515
(Credit)/Charge against profits*	(928)	259	(669)	(1,073)	234	(839)
Recoveries	169	-	169	202	-	202
Amount written off	(1,480)	-	(1,480)	(22,656)	-	(22,656)
Exchange differences	867	-	867	361	-	361
At 31 December	25,320	6,150	31,470	26,692	5,891	32,583

	2016			2015		
	Individual £000's	Collective £000's	Total £000's	Individual £000's	Collective £000's	Total £000's
Bank						
At 1 January	25,489	5,891	31,380	48,828	5,657	54,485
(Credit)/Charge against profits*	(2,271)	259	(2,012)	(1,316)	234	(1,082)
Recoveries	169	-	169	202	-	202
Amount written off	(1,000)	-	(1,000)	(22,585)	-	(22,585)
Exchange differences	856	-	856	361	-	361
At 31 December	23,243	6,150	29,393	25,489	5,891	31,380

*Figures are stated net of recoveries.

17. Financial investments

The financial investments are not subject to re-pledge or resale by counterparties.

	Group		Bank	
	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Debt securities				
Issued by:				
Government	16,123	87,263	16,123	87,263
Banks and Building Societies	9,308	13,722	9,308	13,722
Total financial investments	25,431	100,985	25,431	100,985
Analysed by remaining maturity				
Due within one year	-	92,274	-	92,274
Due one year and over	25,431	8,711	25,431	8,711
Total financial investments	25,431	100,985	25,431	100,985

The following table presents an analysis by rating agency designation of debt securities based on Moody's ratings or their equivalent.

	Group		Bank	
	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Aaa to Aa3	25,431	100,985	25,431	100,985
Total financial investments	25,431	100,985	25,431	100,985

18. Shares in group undertakings

Name	Activity		Principal Place of Business	Interest in Equity Capital %
AIB Nominees Limited	Nominee		England	100%
AIB Trustees Limited	Trustee for the Retirement Benefit Plan		England	100%
Leumi ABL Limited	Factoring and Invoice Discounting	++	England	100%
Bank Leumi (Jersey) Limited	Banking Services/Administrative Company	+++	Jersey	100%

++ *The book value of the investment in Leumi ABL Limited is £2,763,519.*

+++ *On 3 October 2016 the Bank completed an asset sale of Bank Leumi (Jersey) Limited to EFG Private Bank (Channel Islands) Limited. Accordingly, Bank Leumi (Jersey) Limited ceased to provide banking services and currently operates as an administrative entity. As at 31 December 2016 the book value of the investment in Bank Leumi (Jersey) Limited was £16,094,578. During January 2017, Bank Leumi (Jersey) Limited surrendered its banking licence, was renamed BLJ Limited and distributed £13,461,456 of capital to Bank Leumi (UK) plc.*

On 8 April 2016 the Bank completed the share sale of Leumi Overseas Trust Corporation and its subsidiaries, Stanhope Gate Nominees Limited and 27 Hill Street Nominees Limited, to Valla Limited.

The group undertakings in the table above all make their financial statements up to 31 December.

In respect of the above group undertakings, the Bank does not have significant restrictions on its ability to access or use their assets and settle their liabilities other than those resulting from the supervisory frameworks within which the banking undertakings operate. The supervisory frameworks require the banking undertakings to keep certain levels of regulatory capital and liquid assets, limit their exposure to other parts of the group and comply with other ratios.

19. Property and equipment

	Leases of less than 50 years unexpired £000's	Computer and other equipment £000's	Total £000's
Group:			
Cost			
At 1 January 2016	4,586	20,205	24,791
Additions	41	3,999	4,040
Disposals	-	(42)	(42)
At 31 December 2016	**4,627**	**24,162**	**28,789**
Accumulated depreciation			
At 1 January 2016	3,128	15,019	18,147
Charge for year:			
- For continuing operations	346	2,340	2,686
- For discontinuing operations	6	57	63
Disposals	-	(42)	(42)
At 31 December 2016	**3,480**	**17,374**	**20,854**
Net carrying amount at 31 December 2016	**1,147**	**6,788**	**7,935**
Net carrying amount at 31 December 2015	1,458	5,186	6,644

The above leasehold properties are occupied by Bank Leumi (UK) plc and its subsidiary undertakings for their operations.
The group had no capitalised borrowing costs related to the acquisition of computer and other equipment during the year (2015: £Nil).

	Leases of less than 50 years unexpired £000's	Computer and other equipment £000's	Total £000's
Bank:			
Cost			
At 1 January 2016	4,357	18,627	22,984
Additions	3	3,754	3,757
At 31 December 2016	**4,360**	**22,381**	**26,741**
Accumulated depreciation			
At 1 January 2016	2,977	13,536	16,513
Charge for the year	334	2,286	2,620
At 31 December 2016	**3,311**	**15,822**	**19,133**
Net book value at 31 December 2016	**1,049**	**6,559**	**7,608**
Net book value at 31 December 2015	**1,380**	**5,091**	**6,471**

20. Other assets

	Group		Bank	
	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Assets awaiting settlement	1,453	1,803	829	893
Acceptances and endorsements	2,671	2,678	2,671	2,678
Deferred taxation (Note 12d)	596	158	582	158
Total other assets	4,720	4,639	4,082	3,729

21. Deposits by banks

	Group		Bank	
Analysed by remaining maturity	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Repayable on demand	10,329	5,925	10,329	5,917
3 months or less excluding repayable on demand	232,373	-	232,373	-
1 year or less but over 3 months	-	40,516	-	40,516
5 years or less but over 1 year	21,247	19,483	21,247	19,483
Total deposits by banks	263,949	65,925	263,949	65,917

22. Customer deposits

	Group		Bank	
Analysed by remaining maturity	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Repayable on demand	524,910	432,435	551,757	443,947
3 months or less excluding repayable on demand	323,743	128,033	323,743	321,553
1 year or less but over 3 months	323,798	236,429	323,798	334,340
5 years or less but over 1 year	28,398	59,398	28,398	69,705
Total customer deposits	1,200,849	856,294	1,227,696	1,169,545

23. Subordinated liabilities

Group and Bank	Interest Fixing	2016 £000's	Rate of Interest	2015 £000's	Rate of Interest
Loan note 1 notice	3 monthly	3,580	1.123%	3,580	1.332%
Loan note 2 notice	3 monthly	1,250	0.998%	1,250	1.207%
Loan note 3 notice	3 monthly	30,650	0.873%	30,655	1.082%
Loan note 4 notice	3 monthly	7,510	0.904%	7,512	1.076%
Loan note 5 notice	3 monthly	2,518	3.401%	2,518	3.579%
Loan note 6 dated	3 monthly	-		11,071	4.078%
Loan note 7 perpetual	3 monthly	13,028	4.376%	17,034	4.582%
Loan note 8 perpetual	3 monthly	-		5,046	4.579%
Loan note 9 perpetual	3 monthly	5,010	1.304%	5,012	1.476%
		63,546		83,678	

On 14 December 2016 the Bank repaid a total of £20 million of subordinated loan notes and simultaneously issued shares in the Bank to the parent company. The effect of the transaction was to convert subordinated debt (a Tier 2 capital resource) to equity (a Common Equity Tier 1 capital resource) to improve the Bank's capital position. The repayments comprised all of loan notes 6 (£11 million) and 8 (£5 million), and £4 million of loan note 7 to reduce it from £17 million to £13 million.

The notice subordinated loan notes are callable with a notice period of five years and one day given by either the Bank or the parent company. They can be called at the next interest payment date and, after notice is given, the redemption will take place following the expiration of five years and one day.

The perpetual subordinated loan notes have an indefinite maturity period and, any repayment of capital at the option of the Bank can be made at the earliest on the fifth anniversary of the date of drawdown of the loan. Advance notification of one month is required to be given to the Prudential Regulation Authority before commencing repayments.

All subordinated loan notes are issued to the parent company. The rights of the subordinated loan holders are subordinated to the claims of all other creditors of the Bank.

The group has not had any defaults of principal, interest or other breaches with respect to its subordinated loan notes during the years ended 31 December 2016 and 2015.

24. Other liabilities

	Group		Bank	
	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Taxation	1,964	1,964	1,946	1,223
Social security payments	537	437	537	437
Liabilities awaiting settlement	2,333	1,469	970	1,036
Acceptances and endorsements	2,671	2,678	2,671	2,678
Deferred taxation (Note 12d)	-	125	-	124
Total other liabilities	7,505	6,673	6,124	5,498

25. Called up share capital

	Group		Bank	
	2016	2015	2016	2015
	£000's	£000's	£000's	£000's
Equity share capital				
Authorised share capital: Ord. shares £1 fully paid	20,000	20,000	20,000	20,000
Issued share capital: Ord. shares £1 fully paid	13,585	11,967	13,585	11,967

All ordinary shares confer identical rights in respect of capital, dividends, voting and otherwise to the shareholders. The Directors may, if they think fit, from time to time pay to the shareholder such interim dividends as appear to the Directors to be justified by the profits of the Bank.

Capital management

The Bank calculates its capital and risk weighted assets (RWA's) in accordance with CRD IV which gives effect to the Basel lll framework in the European Union. The Bank has continued with the standardised approach for credit and market risk, and the basic indicator approach for operational risk. Rules prescribed in the Capital Requirements Regulation determine the RWA's attributable to the Bank's exposures, and these are multiplied by 8% to determine the Pillar 1 minimum capital requirements.

Pillar 2 assesses those risks which are either not adequately covered or not covered at all under Pillar 1 (Pillar 2A), as well as seeking to ensure that firms can continue to meet their minimum capital requirements throughout a stress (Pillar 2B). The PRA requires firms to meet Pillar 2A with at least 56% Common Equity Tier 1 Capital (CET1) and at most 25% in Tier 2 capital. CRD IV introduced new combined capital buffers which all firms are expected to meet as part of Pillar 2B. These buffers must be met with CET1 capital and for Bank Leumi (UK) plc, include the capital conservation buffer and the countercyclical buffer. In addition the PRA sets an additional 'PRA buffer' where the CRD IV buffers are deemed inadequate for a particular firm, and they also set out transitional arrangements for holding this buffer as CET1. All capital buffers took effect from 1 January 2016.

Currently under Pillar 2, the Bank is subject to an overall regulatory capital requirement based on individual capital guidance (ICG) received from the PRA, which incorporate the results of the Bank's latest Internal Capital Adequacy Assessment Process and the new buffers referred to above. Using the ICG, the Finance Department calculates on a weekly basis the Bank's capital requirement and compares this against its capital resources. An internal limit is also incorporated, designed to ensure that a comfortable margin is maintained at all times to meet growth and sudden variations. The Bank must on an ongoing basis monitor compliance with the relevant regulatory capital requirement and has not reported any breaches during the year.

The following table is an analysis of those items which comprise the regulatory capital base for the purposes of reporting to the PRA. Disclosure is given for the solo level and group, in line with how the Bank reports to the PRA, where the solo level is the aggregation of the Bank and its subsidiary Leumi ABL Limited.

	Group		Solo Level	
Statement of financial position	2016	2015	2016	2015
	£000's	£000's	£000's	£000's
Balance sheet:				
Share capital	13,585	11,967	13,585	11,967
Share premium	54,475	36,093	54,475	36,093
Profit and loss reserve	115,917	99,950	116,026	91,649
Less: regulatory deductions	(17)	(64)	(217)	(2,508)
Common Equity Tier 1 capital	183,960	147,946	183,869	137,201
Collective provision	6,150	5,891	6,150	5,891
Undated subordinated debt	18,000	27,000	18,000	27,000
Dated subordinated debt	45,466	52,249	45,466	52,249
Total Tier 2 capital	69,616	85,140	69,616	85,140
Total regulatory capital	253,576	233,086	253,485	222,341

On 14 December 2016 the Bank repaid £20 million of subordinated debt held by its parent and simultaneously issued 1,618,123 £1 shares with a combined value of £20 million to its parent. The effect of the transaction was to improve the Bank's capital position by converting £20 million of capital from Tier 2 capital to Common Equity Tier 1 capital.

26. Financial assets and financial liabilities

Classification of financial assets and financial liabilities

Financial assets and financial liabilities are measured on an on-going basis either at fair value or at amortised cost. The accounting policies in Note 2 describe how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The table below analyses the financial assets and liabilities in the statement of financial position by category of financial instrument to which they are assigned, and by the measurement basis.

Group 2016	Financial investments £000's	Derivatives £000's	Loans & receivables £000's	Available for sale £000's	Financial liabilities at amortised cost £000's	Total £000's
Assets						
Cash and balances at central banks	-	-	446,174	-	-	446,174
Financial derivatives	-	8,105	-	-	-	8,105
Loans and advances to banks	-	-	70,310	-	-	70,310
Loans and advances to customers	-	-	1,175,304	-	-	1,175,304
Financial investments	-	-	-	25,431	-	25,431
Acceptances	-	-	2,671	-	-	2,671
Total financial assets	-	8,105	1,694,459	25,431	-	**1,727,995**
Total non-financial assets						12,497
Total assets						**1,740,492**
Liabilities						
Deposits by banks	-	-	-	-	263,949	263,949
Customer deposits	-	-	-	-	1,200,849	1,200,849
Financial derivatives	-	9,346	-	-	-	9,346
Subordinated liabilities	-	-	-	-	63,546	63,546
Acceptances	-	-	2,671	-	-	2,671
Total financial liabilities	-	9,346	2,671	-	1,528,344	**1,540,361**
Total non-financial liabilities						16,171
Total liabilities						**1,556,532**
Equity shareholders' funds						183,960
Total liabilities and equity						**1,740,492**

Bank 2016	Financial investments £000's	Derivatives £000's	Loans & receivables £000's	Available for sale £000's	Financial liabilities at amortised cost £000's	Total £000's
Assets						
Cash and balances at central banks	-	-	446,174	-	-	446,174
Financial derivatives	-	8,105	-	-	-	8,105
Loans and advances to banks	-	-	67,447	-	-	67,447
Loans and advances to customers	-	-	1,176,340	-	-	1,176,340
Financial investments	-	-	-	25,431	-	25,431
Shares in group undertaking	18,858	-	-	-	-	18,858
Acceptances	-	-	2,671	-	-	2,671
Total financial assets	18,858	8,105	1,692,632	25,431	-	**1,745,026**
Total non-financial assets						11,319
Total assets						**1,756,345**
Liabilities						
Deposits by banks	-	-	-	-	263,949	263,949
Customer deposits	-	-	-	-	1,227,696	1,227,696
Financial derivatives	-	9,346	-	-	-	9,346
Subordinated liabilities	-	-	-	-	63,546	63,546
Acceptances	-	-	2,671	-	-	2,671
Total financial liabilities	-	9,346	2,671	-	1,555,191	**1,567,208**
Total non-financial liabilities						11,362
Total liabilities						**1,578,570**
Equity shareholders' funds						177,775
Total liabilities and equity						**1,756,345**

Group 2015	Financial investments	Derivatives	Loans & receivables	Available for sale	Financial liabilities at amortised cost	Total
Assets	£000's	£000's	£000's	£000's	£000's	£000's
Cash and balances at central banks	-	-	230,969	-	-	230,969
Financial derivatives	-	8,916	-	-	-	8,916
Loans and advances to banks	-	-	51,622	-	-	51,622
Loans and advances to customers	-	-	1,059,241	-	-	1,059,241
Assets held for sale	-	-	120,163	-	-	120,163
Financial investments	-	-	-	100,985	-	100,985
Acceptances	-	-	2,678	-	-	2,678
Total financial assets	-	8,916	1,464,673	100,985	-	**1,574,574**
Total non-financial assets						11,667
Total assets						**1,586,241**
Liabilities	£000's	£000's	£000's	£000's	£000's	£000's
Deposits by banks	-	-	-	-	65,925	65,925
Customer deposits	-	-	-	-	856,294	856,294
Liabilities held for sale	-	-	408,339	-	-	408,339
Financial derivatives	-	7,046	-	-	-	7,046
Subordinated liabilities	-	-	-	-	83,678	83,678
Acceptances	-	-	2,678	-	-	2,678
Total financial liabilities	-	7,046	411,017	-	1,005,897	**1,423,960**
Total non-financial liabilities						14,323
Total liabilities						**1,438,283**
Equity shareholders' funds						147,958
Total liabilities and equity						**1,586,241**

Bank 2015	Financial investments	Derivatives	Loans & receivables	Available for sale	Financial liabilities at amortised cost	Total
Assets	£000's	£000's	£000's	£000's	£000's	£000's
Cash and balances at central banks	-	-	230,969	-	-	230,969
Financial derivatives	-	8,954	-	-	-	8,954
Loans and advances to banks	-	-	48,152	-	-	48,152
Loans and advances to customers	-	-	1,049,060	-	-	1,049,060
Financial investments	-	-	-	100,985	-	100,985
Shares in group undertaking	18,973	-	-	-	-	18,973
Acceptances	-	-	2,678	-	-	2,678
Total financial assets	18,973	8,954	1,330,859	100,985	-	**1,459,771**
Total non-financial assets						9,720
Total assets						**1,469,491**
Liabilities	£000's	£000's	£000's	£000's	£000's	£000's
Deposits by banks	-	-	-	-	65,917	65,917
Customers deposits	-	-	-	-	1,169,545	1,169,545
Financial derivatives	-	7,046	-	-	-	7,046
Subordinated liabilities	-	-	-	-	83,678	83,678
Acceptances	-	-	2,678	-	-	2,678
Total financial liabilities	-	7,046	2,678	-	1,319,140	**1,328,864**
Total non-financial liabilities						8,156
Total liabilities						**1,337,020**
Equity shareholders' funds						132,471
Total liabilities and equity						**1,469,491**

Fair values of financial assets and financial liabilities

Floating rate loans and deposits fair value approximates to amortised cost carrying value. Fixed rate loans and deposits fair value is calculated based on discounting expected cash flows using current market interest rates and approximates to amortised cost carrying value.

27. Risk management

Primary activities

Banking	Lending, deposit taking, issuing of guarantees to third parties and activities in trade finance.
Investments	Purchasing of debt securities.
Trading	In derivatives

Financial instruments, which comprise loans and deposits, debt securities, spot foreign exchange contracts and derivatives are used to reduce risks arising from the Bank's main activities.

Derivatives with customers are traded on a matching basis with banking counterparties to cover all open positions and eliminate market risk. In addition, the Bank sells forward foreign exchange contracts covered by expected future foreign currency income flow.

Debt securities are used to enhance the Bank's liquidity position, and include the Bank's Liquid Asset Buffer of high quality sovereign debt held to meet liquidity risk management requirements set by the Prudential Regulation Authority. In addition, debt securities are held as collateral against lending.

Risk management structure

The Bank has an integrated risk management structure with risk independently monitored by the Risk Control and Credit Risk Management Departments. Outside of regulatory risk, the Bank faces three main risk areas: Credit Risk, Operational Risk and Market Risk.

Under the risk management structure, committees have been established for each risk area which have the responsibility for recommending risk appetite and policy for approval by the Board and for ensuring that the Bank's aggregate risk remains within the risk appetite set by the Board. Risk arising out of the Bank's business is monitored daily, and the risk appetites are reviewed at regular intervals in light of prevailing market conditions.

Through this Risk Management structure, compliance with regulatory rules and requirements and ensuring that we treat our customers fairly, the Bank seeks to minimise its reputational risk.

(i) Credit risk

This is one of the primary risks inherent in bank lending and can be defined as the risk that a borrower will not meet its obligations in relation to interest payments and loan repayments. Impairment allowances are provided for any losses incurred at the reporting date.

Significant changes in the economy, or in the health of a particular industry segment that represents a concentration in the Bank's portfolio, could result in losses that are different from those provided for at the reporting date. The Bank therefore carefully manages its exposure to credit risk through an independent Credit Risk Management Department.

The Bank's general policy is to mitigate credit risk by evaluating in every case the credit quality of the borrower and separately to evaluate the quality of the collateral. The Credit Risk Management Committee is responsible for credit risk. The responsibility for the day-to-day management of credit risk lies with the management and relationship managers within the Private Banking and Corporate Finance sectors.

The Bank uses internal credit ratings and credit grades to evaluate credit risk. It maintains a grading against all of its loans and advances according to the underlying credit quality. None of the loans and advances to banks are past due or impaired.

A summary of the grading for loans to customers is as follows:

	Group		Bank	
	2016	2015	2016	2015
	£000's	£000's	£000's	£000's
Neither past due nor impaired	1,150,290	1,030,669	1,153,645	1,021,337
Past due but not impaired	98	2,925	98	2,925
Impaired (net of specific provisions)	24,916	25,647	22,597	24,798
Total loans and advances	1,175,304	1,059,241	1,176,340	1,049,060

The internal grading for loans and advances that were neither past due nor impaired is as follows:

	Group		Bank	
	2016	2015	2016	2015
	£000's	£000's	£000's	£000's
Satisfactory credit quality	1,135,326	1,013,919	1,149,955	1,017,042
Weak credit quality	14,964	16,750	3,690	4,295
Total loans that were neither past due nor impaired	1,150,290	1,030,669	1,153,645	1,021,337

Loans are generally considered past due when a customer is in an on-going breach of covenants for 90 days or longer, or is unable to pay interest or capital or otherwise in regular breach of the terms of the facility. The past due category can also include loans where there is no concern over the creditworthiness of the counterparty but where there is a technical reason for inclusion such as a delay in documentation. Problem loans where the Bank holds sufficient collateral against its exposures will generally be classified as past due rather than impaired.

An analysis of loans classified as past due but not impaired is as follows:

	Group		Bank	
	2016	2015	2016	2015
	£000's	£000's	£000's	£000's
Past due less than 90 days	-	2,925	-	2,925
Past due over 180 days but less than one year	98	-	98	-
Total loans that were past due but not impaired	98	2,925	98	2,925

Loans are classified as impaired when the customer has ceased payment of interest and capital and it appears unlikely that the situation will improve or where an event of insolvency has occurred. It is reasonable to assume that some loss will be made.

Non-performing loans are an aggregation of past due and impaired loans, and these are analysed as follows:

	Group		Bank	
	2016	2015	2016	2015
	%	%	%	%
Non performing loans as a percentage of total loans and advances to customers	2.13	2.70	1.93	2.64
Specific provisions as a percentage of total non performing loans and advances to customers	50.30	48.30	50.60	47.90

The Bank may employ a range of forbearance strategies in order to improve the management of customer relationships, maximise collection opportunities and, where relevant, avoid loan default. Such loans are included in the Bank's "watch-list" and are therefore already subject to increased scrutiny for possible impairment.

The value of loans subject to forbearance, including associated specific and collective provisions, is as follows:

	Group		Bank	
	2016	2015	2016	2015
	£000's	£000's	£000's	£000's
Gross value of loans	2,951	27,132	2,951	27,132
of which: past due or impaired	2,951	27,132	2,951	27,132
Specific provision	(2,922)	(19,912)	(2,922)	(19,912)
Net value of loans	29	7,220	29	7,220

(a) Derivatives

The Bank maintains strict limits on net open derivative positions. At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Bank, which in relation to derivatives is only a small fraction of the notional values of the contract. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements.

(b) Credit-related commitments

The primary purpose of these instruments is to ensure that funds are available to a customer in order that it can meet its commitments. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipment of goods to which they relate and therefore carry less risk than a direct borrowing.

With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss for an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards.

The maximum exposure to credit risk on the financial assets at the reporting date was £2,056 million (2015: £1,912 million). This amount excludes any collateral which the Bank holds to mitigate its exposure. Collateral is held in the form of cash, debt and equity securities, security over property and bank guarantees. The table below shows on a group basis the value of the various types of eligible collateral held (according to PRA criteria) in order to mitigate the Bank's credit risk and consequently reduce the Bank's capital requirement on its credit risk exposures:

	Group	
	2016	2015
	£000's	£000's
Cash	7,950	32,052
Bank guarantees	5,904	5,135
Securities	178	414
Total value of eligible collateral held	14,032	37,601

Further details of the Bank's risk exposures are available in the Pillar 3 Disclosures which are available from the following website: http://www.bankleumi.co.uk/Lobby/CRD_IV_DISCLOSURE/39851/

(ii) Operational risk

Operational risk can be defined as the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events.

The Operational Risk Management Committee (ORMC) is responsible for operational risk and assesses the implications of all operational issues and operational volumes. Responsibility for the day-to-day management of operational risk lies with the management of the Bank's operational departments.

The Risk Control Department and the Finance Department monitor certain transactions on a daily basis and Internal Audit conduct regular reviews of the Bank's systems of control. The Bank has implemented an operational loss event reporting procedure to identify actual and potential operational loss events. Such events are reported to the ORMC and a summary given to the Risk Committee of the Board.

(iii) Market risk

Market risk relates to those risks inherent in the treasury operations of the Bank and those arising from the use of financial instruments.

The Market Risk Management Committee (MRMC) is responsible for market risk. The Head of Treasury and Global Markets is responsible for the day-to-day management of market risk which includes liquidity risk, interest rate risk and foreign exchange rate risk.

Liquidity risk

Liquidity risk can be defined as the risk that a bank could have difficulty in realising assets or raising funds in order to meet cash demands which will force the Bank to sell assets at a loss.

The Bank's general policies related to liquidity risk are to hold sufficient cash and marketable assets to match future cash flows from maturing assets and to have a diversified deposit base in terms of maturities and counterparties. The Bank maintains a liquid asset buffer comprising high quality government securities and reserves in the form of sight deposits with a central bank.

On 1 October 2015, the European Commission's Delegated Act with regard to the Liquidity Coverage Ratio (LCR) for credit institutions became effective on a transitional basis. This stipulated that the LCR would become fully effective on 1 January 2018 when the minimum ratio will be 100%, with the initial step being a minimum ratio of 80% from 1 October 2015. At the same time the PRA advised the Bank of its revised Individual Liquidity Guidance which is expressed as an amount of liquidity the Bank needs to hold above the minimum LCR requirement (referred to as Pillar2). The Bank already provides data for calculating the LCR to the European Banking Authority through liquidity returns included as part of Common Reporting (COREP).

As at 31 December the Bank's Liquid Asset Buffer exceeded the Bank's LCR requirement (including the Pillar 2 add-on). The level of Liquid Asset Buffer required is also verified with reference to the results of the Bank's liquidity stress testing. Stress testing is performed weekly using a model which estimates the effect of different types of stresses on the Bank's cash inflows and outflows. This model is used to inform management of the impact of stresses in the market as well as stresses specific to the Bank. The model is regularly updated and is documented as part of the Bank's Individual Liquidity Adequacy Assessment.

The Bank also focuses on several internal metrics where targets and limits are set by the MRMC in order to ensure that the Treasury Department manage the Bank's liquidity in an effective way. These metrics include the ratio of short-term cash resources to total deposits and the proportion of funding from within the Bank Leumi Group.

The Bank maintains sufficient liquidity capacity by maintaining an adequately diversified deposit base in terms of maturity, range of counterparties and concentration. The sources of funding available to the Bank comprise customer deposits and money market placements from our parent company. We manage the customer deposit base by categorising the type of customers from whom we take deposits by nature of their profile and perceived behaviour in stressed circumstances. Longer term placements are encouraged through pricing mechanisms. The Bank also ensures an appropriately matched future profile of cash flows from maturing assets.

Interest rate risk

Interest rate risk can be defined as the risk that arises from re-pricing mismatches in the Bank's books in an unstable interest rate period.

The Bank's general policy in relation to interest rate risk is to impose strict limits on re-pricing mismatches which will reduce possible losses.

The Finance Department monitors the interest rate sensitivity gap on a regular basis, calculating the net exposure by major currency and by re-pricing band, categorised by the earlier of contractual re-pricing or maturity dates. The net exposure is determined as the Bank's position in money market placements, loans and deposits, foreign exchange positions and securities, and after off-setting the impact of interest rate swaps which hedge against specific positions. The net exposures are compared to limits imposed by MRMC. These limits are reviewed periodically by MRMC and, in conjunction with the Treasury Department, revised limits may be adopted which are more representative of the current interest rate risk strategy in the current economic environment.

The Finance Department use the present value of the above assets and liabilities to calculate the possible loss of the Bank's economic value in the event of a 1% movement in interest rates. The possible loss is monitored compared to a limit of 1.5% of the Bank's capital. At 31 December 2016 the possible loss was £0.9 million (2015: £0.4 million) compared with a limit of £2.3 million (2015: £1.8 million).

In addition, the Finance Department calculate the impact on the group's earnings, including its subsidiaries, in the event of a 1% movement in interest rates, and this is compared with an internal limit of 3.5% of the group's capital. As at 31 December 2016 the impact on earnings was 1.85% of the group's capital (2015: 1.72%).

Maturities of financial liabilities

The table below shows the undiscounted cash flows on the group's financial liabilities on the basis of their earliest possible contractual maturity.

For financial derivatives, the amounts included reflect the fair values at the reporting date as this is considered a good approximation of the liquidity risk exposure arising from these positions. In practice foreign exchange option positions can close out earlier than contractual maturity but as these are matched positions there would be no net impact on the Bank's cash flows.

At 31 December 2016	Demand £000's	Up to 3 months £000's	3-12 months £000's	1-5years £000's	Over 5 years £000's	Total £000's
Liabilities						
Deposits by banks	10,329	232,373	-	21,247	-	263,949
Customer deposits - held for sale	-	-	-	-	-	-
Customer deposits - other	524,910	323,743	323,798	28,398	-	1,200,849
Derivatives	662	5,855	2,065	764	-	9,346
Subordinated liabilities	-	-	-	-	63,546	63,546
Acceptances	-	2,671	-	-	-	2,671
Total financial liabilities	535,900	564,642	325,863	50,409	63,546	1,540,361

At 31 December 2015	Demand £000's	Up to 3 months £000's	3-12 months £000's	1-5years £000's	Over 5 years £000's	Total £000's
Liabilities						
Deposits by banks	5,925	-	40,516	19,483	-	65,925
Customer deposits - held for sale	117,787	159,212	120,539	10,801	-	408,339
Customer deposits - other	432,435	128,033	236,429	59,398	-	856,294
Derivatives	31	4,825	2,010	180	-	7,046
Subordinated liabilities	-	-	-	11,071	72,606	83,678
Acceptances	-	2,678	-	-	-	2,678
Total financial liabilities	556,177	294,748	399,495	100,933	72,606	1,423,960

Foreign exchange risk

Foreign exchange risk can be defined as the risk affecting open currency positions by fluctuations in exchange rates. The Bank's general policy in relation to foreign exchange risk is to match all positions and limit the total net overnight open position to £6 million (2015: £6 million). Overall responsibility to manage foreign exchange risk lies with the Head of Treasury and Global Markets. The Risk Control Department monitors foreign exchange positions on a daily basis and the end of day positions are reported by the Finance Department to the Executive Management of the Bank.

Overall foreign exchange open positions are very low and represent minimal risk.

	2016 £000's	2015 £000's
Total open positions	2	58
Of which:		
- long position	92	238
- short position	(90)	(180)
Net long open position	2	58

Valuation of financial assets and financial liabilities

The Group measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

Level 1: Quoted market price (unadjusted) in an active market for an identical instrument.

Level 2: Valuation techniques based on observable inputs, either directly (as prices) or indirectly (derived from prices). This category includes instruments valued using quoted market prices in active markets for similar instruments, quoted prices for identical or similar instruments in markets that are considered less than active or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

Level 3: Fair value measurements using inputs that are not based on observable market data

The table below analyses financial assets and financial liabilities measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which the fair value measurement is categorised:

There are no financial assets and financial liabilities measured according to Level 3 (2015: nil).

	2016			2015		
	Level 1	Level 2	Total	Level 1	Level 2	Total
	£000's	£000's	£000's	£000's	£000's	£000's
Assets						
Financial investments	25,431	-	25,431	100,985	-	100,985
Derivatives	-	8,105	8,105	-	8,916	8,916
	25,431	8,105	33,536	100,985	8,916	109,901
Liabilities						
Derivatives	-	9,346	9,346	-	7,046	7,046
	-	9,346	9,346	-	7,046	7,046

Derivatives

The Bank holds derivatives for both hedging and non-hedging purposes. The derivatives held for hedging purposes are economic hedges including Interest Rate Swaps and Forward Rate Agreements, and ensure that the Bank keeps within its internal interest rate risk limits. These hedges do not meet the requirements for hedge accounting.

Foreign currency forwards represent commitments to buy or sell foreign and domestic currency at agreed rates of exchange on a specified future date.

Forward rate agreements are individually negotiated interest rate futures that call for a cash settlement at a future date for the difference between a contracted rate of interest and the current market rate, based on a notional principal amount.

Currency and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies, or interest rates or a combination of both of these. No exchange of principal takes place, except for certain currency swaps. The Bank's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligation. The risk is monitored on an on-going basis with reference to the current fair value, a proportion of the notional amount of the contracts and the liquidity of the market.

Foreign currency and other options are contractual agreements under which the seller grants the purchaser the right, but not the obligation, either to buy or sell at or by a set date or during a set period, a specific amount of a foreign currency or a financial instrument at a predetermined price. Options may be either exchange-traded or negotiated between the Bank and a customer. The Bank is exposed to credit risk on purchased options only, and only to the extent of their carrying amount, which is their fair value.

The fair value of a derivative contract represents the amount at which that contract could be exchanged in an arm's length transaction, calculated at market rates at the balance sheet date. This equates to a replacement cost.

Structured deposits are contractual agreements offered to customers providing the opportunity to gain enhanced returns compared to market rates via exposure to selected financial markets. The Bank matches the risk on these deposits through the purchase or sale of options in those financial markets.

At 31 December the notional principal amounts and fair values of derivative instruments entered into with third parties were as follows:

	2016			2015		
Group	Notional principal £000's	Year end positive fair values £000's	Year end negative fair values £000's	Notional principal £000's	Year end positive fair values £000's	Year end negative fair values £000's
Foreign exchange	838,727	8,079	9,293	686,882	8,897	6,988
Interest rate	4,060	-	27	4,060	-	39
Equity	755	26	26	249	19	19
Total derivative contracts	843,542	8,105	9,346	691,191	8,916	7,046

	2016			2015		
Bank	Notional principal £000's	Year end positive fair values £000's	Year end negative fair values £000's	Notional principal £000's	Year end positive fair values £000's	Year end negative fair values £000's
Foreign exchange	838,727	8,079	9,293	689,771	8,935	6,988
Interest rate	4,060	-	27	4,060	-	39
Equity	755	26	26	249	19	19
Total derivative contracts	843,542	8,105	9,346	694,080	8,954	7,046

28. Contingent liabilities and contractual commitments

The tables below disclose, for the group and the Bank, the notional principal amounts, credit equivalent amounts and the risk weight of off-balance sheet transactions. The notional principal amounts indicate the volume of business outstanding at the reporting date and do not represent amounts at risk or future liquidity requirements. All amounts can contractually be drawn on demand, although in the case of contingent liabilities the Bank expects the majority of facilities to expire unused, and for lending commitments most loans are provided under facilities which are contractually repayable on demand. The credit equivalent amounts have been calculated in accordance with the Prudential Regulation Authority's guidelines implementing the EC Solvency Directive.

Group	**2016**				2015			
	Notional principal £000's	Credit equivalent amount £000's	Credit conversion factor %	Risk weighted amount £000's	Notional principal £000's	Credit equivalent amount £000's	Credit conversion factor %	Risk weighted amount £000's
Contingent liabilities								
Credit guarantees	26,526	15,060	100%	15,060	21,965	11,547	100%	11,547
Other guarantees	24,235	20,714	20%	4,143	39,487	34,503	20%	6,901
Documentary credits & short term trade related transactions	26,753	23,288	20%	4,657	35,657	18,096	20%	3,619
	77,514	59,062		23,860	97,109	64,146		22,067
Commitments								
Credit lines & other commitments to lend	252,737	-		-	345,923	-		-

Bank	**2016**				2015			
	Notional principal £000's	Credit equivalent amount £000's	Credit conversion factor %	Risk weighted amount £000's	Notional principal £000's	Credit equivalent amount £000's	Credit conversion factor %	Risk weighted amount £000's
Contingent liabilities								
Credit guarantees	26,526	15,060	100%	15,060	21,941	11,547	100%	11,547
Other guarantees	24,235	20,714	20%	4,143	38,650	34,503	20%	6,901
Documentary credits & short term trade related transactions	26,753	23,288	20%	4,657	35,657	18,096	20%	3,619
	77,514	59,062		23,860	96,248	64,146		22,067
Commitments								
Credit lines & other commitments to lend	281,498	-		-	393,247	-		-

29. Other commitments

Capital expenditure

	2016 £000's	2015 £000's
Capital expenditure contracted for:		
By the group and Bank	147	1,030

Lease commitments

At the reporting date, total commitments under non-cancellable operating leases were:

	Group		Bank	
	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Operating leases which expire				
- 1 to 5 years	3,889	5,254	3,889	5,254
- over 5 years	1,834	2,062	-	-
	5,723	7,316	3,889	5,254

30. Related party transactions

The Bank is 100% owned by the parent company Bank Leumi le-Israel B.M. which is listed on the Israeli stock exchange and whose consolidated financial statements are therefore publicly available (Note 32).

Transactions between the Bank and the Bank's Key Management Personnel and their connected persons are disclosed in Note 11c.

The related party transactions for the group and the Bank arose from the ordinary course of business and on substantially the same terms and conditions as for comparable transactions with third party counterparties.

The disclosures in the tables below of the income and expense recognised in the year and the balances at the year-end are considered to be the most meaningful way to represent transactions during the year.

Transactions of the group with Bank Leumi le-Israel B.M. and fellow subsidiaries of Bank Leumi le-Israel B.M. are detailed below:

Group	2016 £000's	2015 £000's
Income statement		
Interest income	7	16
Interest expense	2,980	2,595
Fee and commission income	159	133
Administrative expenses	-	73
Assets		
Derivatives	583	2,421
Loans and advances to banks	2,015	2,238
Other assets	-	250
Liabilities		
Deposits by banks	263,394	65,895
Deposits by customers	21,546	27,644
Derivatives	1,757	1
Other liabilities	256	
Contingent liabilities		
Credit guarantees	7,450	7,851
Other guarantees	607	509
Documentary credits and short term related transactions	3,005	4,658

Transactions of the Bank with its subsidiaries, with Bank Leumi le-Israel B.M. and with fellow subsidiaries of Bank Leumi le-Israel B.M. are detailed below:

Bank	2016 £000's	2015 £000's
Income statement		
Interest income	1,948	1,736
Interest expense	4,683	4,889
Fee and commission income	219	222
Administrative expenses	(200)	(152)
Assets		
Derivatives	583	2,464
Loans and advances to banks	2,015	2,238
Loan and advances to customers	240,490	203,712
Other assets	-	931
Liabilities		
Deposits by banks	263,394	65,895
Deposits by customers	48,393	340,895
Derivatives	1,757	2
Other liabilities	256	
Contingent liabilities		
Credit guarantees	7,450	7,851
Other guarantees	607	509
Documentary credits and short term related transactions	3,005	4,658

31. Cash and cash equivalents

	Group		Bank	
Non cash items included in profit before tax	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Depreciation and amortisation	2,749	2,412	2,620	1,626
Provisions for loan impairment losses	(500)	(637)	(1,843)	(880)
Charge for defined benefit plan	475	549	475	549
	2,724	2,324	1,252	1,295

	Group		Bank	
Change in operating assets	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Change in prepayments and accrued income	549	(1,289)	(102)	(848)
Change in financial derivatives	811	(997)	849	(1,035)
Change in loans and advances to banks	113	(113)	113	(113)
Change in loans and advances to customers	(15,830)	(152,832)	(31,595)	(150,380)
Change in other assets	357	752	71	793
	(14,000)	(154,479)	(30,664)	(151,583)

	Group		Bank	
Change in operating liabilities	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Change in accruals and deferred income	(358)	3,218	466	1,620
Change in financial derivatives	30,631	2,274	30,631	2,267
Change in deposits by banks	(6,834)	50,489	(6,826)	50,535
Change in customer accounts	32,121	56,727	(56,889)	59,335
Change in other liabilities	(219)	2,212	27	465
	55,341	114,920	(32,591)	114,222

	Group		Bank	
Cash and cash equivalents comprise:	2016 £000's	2015 £000's	2016 £000's	2015 £000's
Cash and balances at central banks	446,174	230,969	446,174	230,969
Loans and advances to banks of 3 months or less	70,310	51,509	67,447	48,039
	516,484	282,478	513,621	279,008

Total interest paid by the group during the year was £11,343,000 (2015: £9,971,000). Total interest received by the group during the year was £53,409,000 (2015: £45,868,000).

32. Ultimate parent company

The Bank is a subsidiary of Bank Leumi le-Israel B.M, which is incorporated in Israel.

The largest and smallest group in which the Bank is consolidated is that headed by Bank Leumi le-Israel B.M. The consolidated financial statements of this group are available to the public and may be obtained from the Head Office in Israel at P.O.Box 2, 24-32 Yehuda Halevi Street, Tel Aviv 65546, Israel or from the group web site: www.bankleumi.com

33. Post balance sheet events

There have been no material post-balance sheet events which would require adjustment to the 31 December 2016 financial statements.

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