

**Bank Leumi le-Israel
(Switzerland)**

Head Office
Zurich, Claridenstrasse 34

Branch:
Geneva, 80, rue du Rhône

Annual Report 2005
to be presented by the
Board of Directors to the
Annual General Meeting
of Shareholders of
Bank Leumi le-Israel (Switzerland)
on April 24, 2006

Board of Directors

Mrs. Galia Maor, Chairperson	Tel Aviv
Dr. Michael Kohn*, Deputy Chairman	Zurich
Dr. Rolf Bloch*	Muri / Bern
Mr. Dov Gilboa**	Tel Aviv
Dr. Michel Haymann*	Zurich
Mr. Zvi Itskovitch**	Tel Aviv
Dr. Rolf Kormann**	Ebmatingen ZH
Dr. Alain B. Lévy**	Geneva
Dr. Richard T. Meier*	Cham
Mr. Ehud Moverman	Tel Aviv
Sir Bernard Schreier	Watford (U.K.)

*) Members of the Executive Committee

**) Members of the Audit Committee

Internal Audit

Youval Dichovsky	Head of Internal Audit (ad interim)
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General Manager

Shouky Oren

**Management and
Members of
Management
Committee**

Roland Wyss	Manager
Dr. Moshe Shimony	Manager (as of January 2006)
Marcos Wolman	Deputy Manager
Ron Baron	Deputy Manager

Geneva Branch

Paul Hazan	Manager
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Auditors

PricewaterhouseCoopers AG	Zurich
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Financial year 2005 World Economy

Global economic growth remained surprisingly robust despite the negative effect of weather and economic factors, such as the Tsunami in Asia, a “record” hurricane season in the US, flooding in many parts of Europe, rising commodity prices and increasing interest rates.

The **United States** remained the driving force of the world economy despite steadily rising interest rates on the short end. However, high energy and commodity prices led to constant uncertainty with respect to inflationary pressures. While headline figures indicated a high level of price strain/pressure on prices, the core rate remained surprisingly low. Importantly, inflationary pressures did not transfer to wages, as had been widely feared. The Federal Reserve successfully abated inflation concerns by aggressively raising its benchmark rates from 2.25 % to 4.25 %. Unfortunately, the most devastating hurricane season for over 30 years interrupted the economic boom phase in the final quarter of 2005 and also led to a sharply increase in fiscal deficit assumptions for the upcoming year. On the positive side, rebuilding efforts may stimulate economic growth in the beginning of 2006.

Growth in **Emerging Countries** such as **China** and **India** remained buoyant, powered by record exports and investments in manufacturing. The Chinese government has taken the first steps to cautiously adjusting its currency policy. It relaxed its fixed exchange rate against the dollar by allowing the Yuan to float within a narrow band against a basket of currencies. More drastic steps are widely expected in the coming year.

Economic growth in the **Euro zone** accelerated during 2005, but remained quite sluggish in comparison to other world regions. Exports were the main driving factor, helped by the decline in the Euro versus the USD. While exports spurred business spending, consumption remained disappointingly low with unemployment arising from legal, social and other conditions in the largest economies, Germany and France, being the main cause. Headline inflation clearly overshot the 2 % target of the European Central Bank and this was the principal reason for the implementation of a rise of the benchmark rate. ECB President Jean-Claude Trichet repeatedly expressed concern that energy rises

would have an effect on other economic areas, such as wages. However, core inflation stayed, surprisingly low.

The economic recovery in the Euro zone also supported growth in **Switzerland**. Early summer exports clearly intensified, due to the growth in foreign demand for chemicals, pharmaceuticals, precision instruments and watches. The export-led recovery also had a positive impact on investments and consumption – the latter supported by a low unemployment rate. The broad-based economic upswing triggered the resumption of benchmark rate increases, which have been unusually low for several years. The Swiss National Bank will strive to normalize interest rates even further in 2006.

In the **UK**, the decisive moves undertaken by the Bank of England in 2004 led to a significant economic slowdown the following year as the end of a decade-long housing boom curbed consumer spending drastically. Corrective measures had to be implemented. Yet, manufacturing continued to shrink under the burden of higher energy prices, which might also explain the disappointingly low level of investments.

At the end of the year, hesitant signs of stabilization in the housing market were observed. The annual rate of consumer price increases decelerated to 2 % in December.

The **Japanese** economic recovery broadened out. While historically exports played a major role, investments and consumer spending were the main contributors to economic growth during 2005. In the last two months of the year, the consumer price index indicated slight inflation, spurring speculation that the Bank of Japan may change its monetary policy in the course of the next year.

Key economic figures 2005 in major economies

Countries	Real GDP growth	CPI growth	Unemployment Rate	Central Bank Rate
US	3.5 %	3.1 %	4.9 %	4.25 %
UK	1.8 %	2.1 %	2.9 %	4.50 %
Euro Zone	1.3 %	2.2 %	8.3 %	2.25 %
Germany	1.0 %	1.9 %	11.2 %	2.25 %
France	1.6 %	1.8 %	9.6 %	2.25 %
Switzerland	1.9 %	1.1 %	3.6 %	1.00 %
Japan	2.7 %	-0.1 %	4.4 %	0.00 %

Financial Markets

The flattening of the **US yield curve** culminated in a slight inversion at the end of the year. Dynamic economic growth combined with continued sharp rises in commodity prices fuelled inflation fears and the FOMC subsequently tightened

its monetary policy. Despite these aggressive steps, yields remained surprisingly low. The 10-year Treasury yield at the end of 2005 was barely higher than at the beginning of the year. Possible explanations for the yield curve inversion may be found in the massive flow of funds streaming to the US, partially due to the currency strategy by Asian central banks, strong demand for investment vehicles – mainly from pension funds, – and higher trust in the inflation – fighting capabilities of the central bank. In the **Euro zone**, the **yield curve** flattened significantly over the year as yields of the 10-year paper slightly declined and yields on the short end markedly rose. Short-term papers reacted to more upbeat economic news – mainly from the export side – in the final quarter of the year and increasing signs that the ECB was about to raise the benchmark rate.

Stock markets performed very well overall in 2005. The exception was the United States, which basically moved sideways most of the year, only showing improvements during the final two months. Investors seemed unwilling to commit capital to US stocks as long as the end of the tightening monetary policy was not in sight. Only the energy and utility sectors could attract interest.

European stock markets showed an impressive performance as the economic picture brightened. Attractive valuation, strong earnings growth, stable or expanding margins, rising productivity and low interest expenses were the contributing factors. Sector-wise, the performances were much more balanced than in the US. The Japanese market recorded outstanding levels, fuelled by a broad-based economic recovery, Prime Minister Koizumi's political victory over the post office privatisation and strong corporate earnings. The Japanese stock market was one of the highest and most expensive at the end of the year. Returns in emerging countries were generally strong, in double-digit figures. However, some indices, such as the Hang Seng, ended the year in low single digits.

The strength in the USD has been the dominant theme in the **currency markets**. The relative high level of interest rates has attracted massive foreign capital to the US. Other factors, such as the repatriation of earnings from US international corporations, inflows of petrodollars and the currency policy of Asian central banks also contributed. Carry-trades were the other key theme: investors indebted themselves in countries with low-interest rates, such as Japan, and invested in high-yielding currencies, such as the Australian and New Zealand dollars. With potentially rising rates in Japan and Switzerland, it will be interesting to monitor to what extent this strategy will succeed in 2006.

Switzerland

The yield curve in Switzerland flattened markedly with yields at the long-end slightly declining from 2.28 to 2 % and

yields at the short-end rising markedly. The broadening out of the economic recovery into investments and even consumption motivated the Swiss National Bank to start raising the benchmark rate. The stock market showed impressive gains, rising by 33 %. Companies benefited from the thriving economic environment and analysts constantly increased their earnings projections as data points continuously improved during the course of the year. A high level of merger and acquisition activity additionally boosted equity prices. The strength in the USD was also evident versus the CHF, which lost 14 % in 2005. Very low level interest rates failed to attract investors. However, the CHF was less volatile versus the EUR as the market anticipated rate hikes in both zones.

Highlights of the Bank's activity

Bank Leumi le-Israel (Switzerland) (the "Bank") was founded in 1953, and operates through a head office in Zurich and a branch in Geneva. It also has representative offices in Israel and Hungary.

The Bank is part of the Leumi Group, which is one of the two largest Israeli banks with worldwide operations and overall assets in excess of 120 billion USD.

The Bank mainly engages in private banking services to High Net-Worth Individuals, including the receipt of discretionary securities investment management mandates. In addition, it has a wholly owned subsidiary that manages two mutual funds.

In 2005, the bank focused on marketing and business development activities in its key markets with the aim of strengthening its presence in these markets and enhancing its reputation as an innovative, performance driven and reliable Private Banking institution.

The successful cooperation between the Leumi Group, the Bank and SEI Investments in introducing the new portfolio of Leumi Global Managers' funds, enabled the Bank to provide its clients with access to leading investment managers from around the world. The funds performed well in comparison with their respective benchmarks. SEI Investments is a US based leading global provider of asset management and investment technology solutions. It administers \$ 254 billion in mutual fund and pooled assets, manages almost \$ 90 billion in assets, and operates 22 offices in 10 countries.

New IT system

In April 2005 the Bank successfully implemented the Globus system by Temenos, a new modular core banking system. Globus replaces Bank Leumi's legacy system, Midas from Mysis – and enables the Bank to offer clients a

better level of service via this significantly upgraded platform.

The new system provides additional functionality in the areas of asset management, accounting, controls and management information, and will support the business development of the Bank. It also aligns the Bank's operations across different sites, and manages customer relationships more successfully.

The integrated approach of the new system positions constitutes a complete new approach whereby the management of major workflows is shifted to the business units. This provides the bank with the capabilities to meet the challenging demands of top tier modern private banking services. The system's asset management module offers a single customer view, performance attribution and modelling, which allows the Bank's relationship managers to more effectively manage and interact with the customer base, and to provide a more complete view of banking and brokerage activity.

Consolidated Financial results

The consolidated financial results include Leumi Fund Holding – Luxembourg, which is engaged in fund management, and Leumi Asset Management – Zurich, which is engaged in advisory investment services: both are fully owned subsidiaries of the Bank.

For the year under review, total income remains unchanged at the same level of CHF 62.5 million (2004: CHF 62.6 million).

As a result of the general increase in interest levels on the CHF, Euro and USD, the consolidated net interest income significantly increased to CHF 13.1 million (2004: CHF 11.0 million).

Total commission income for the year under review was higher at CHF 34.7 million (2004: CHF 33.8 million).

Trading income declined to CHF 14.6 million (2004: CHF 17.5 million). The contribution from the activities in structured products and alternative investments was CHF 8.6 million (2004: CHF 11.4 million), and from Forex income was CHF 6.1 million (2004: CHF 5.5 million).

Operating expenses rose to CHF 49.9 million (2004: 41.2 million) of which personnel expenses were CHF 26.1 million (2004: CHF 23.2 million). This increase is connected to the IT-project for which the Bank hired various employees on a temporary basis. Other operating expenses rose to CHF 23.8 million (2004: CHF 18.0 million). This increase is related to the implementation of the new core banking application "Globus" with which the Bank went live on April 1, 2005.

Depreciation of non-current assets, primarily for IT investments connected to the replacement of the core system, amounted to CHF 6.8 million (2004: CHF 7.9 million).

In 2005 the Bank made provisions of CHF 21.1 million (2004: CHF 10.7 million). In this context, it released reserves for general banking risks in the amount of CHF 0.5 million (2004: CHF 10.7 million), which is reported as extraordinary income. Valuation adjustments, provisions and losses were mainly affected by additional provisions resulting from the final settlement of a major claim in January 2006 as well as additional provisions after reassessing the open cases reported below.

Gross profit decreased to CHF 12.6 million (2004: CHF 21.4 million). For the year under review a net loss of CHF 16.5 million after taxes and extraordinary items was recorded (2004: net profit of CHF 12.0 million).

Private Banking and Business Development

During 2005, the Bank expanded its private banking and trading functions. Following segmentation of the client base, it strengthened its private banking teams in Zurich and Geneva, which now operate on a more streamlined and teamwork approach. The Bank enlarged its Israeli desk to meet the growth in this market and consolidated the activities of the European teams under one desk in order to upgrade the level of service. It also consolidated the management of External Portfolio Managers to upgrade the level of service to this segment. The Bank continued to develop activities with Israeli based institutional investors by providing them with innovative products and portfolio management expertise, mainly in credit derivatives investment instruments and in the alternative investment arena.

During 2005 the clients' assets under the Bank management in Zurich and Geneva increased by 18 % to some 6.4 billion CHF.

Representative Offices in Israel and Hungary

The Israeli representative office moved into new premises in Herzlia, Israel at the beginning of 2006 and is expanding its activities to meet the growing interest from High Net-Worth Individuals and Financial Institutions for international Private Banking services. The Bank, through its representative office in Budapest Hungary, continued with the successful marketing of the Bank's services and products in Hungary and Eastern Europe.

Portfolio Management

During the year, the Bank enhanced the infrastructure of its discretionary portfolio management business and succeeded in increasing the assets overviewed by the portfolio management unit by 13.5 % in comparison with 2004. The Bank now overviews assets of over CHF 700 million in discretionary managed accounts, under five different

investment strategies in various currencies, to best fit each client's investment profile and risk tolerance. In addition, the Bank offers tailor-made discretionary mandates for selected accounts of institutional clients and High Net Worth Individuals. It is also committed to the further development of its assets management capabilities through the stringent implementation of a medium to long-term investment strategy that focuses on asset allocation, in line with the client's investment profile, closely monitored by the Banks' investment and monitoring committee.

Structured Products' Distribution

In 2005, the Bank promoted distribution of a wide range of financial products tailored to its clients' needs. In view of the positive growth in global equity markets, the Bank increased the offering of equity linked products, therefore providing its risk averse clients with exposure to rising equity markets with certain capital protection elements.

Additionally, the Bank focused on investment opportunities in the credit market. The Bank was successful in establishing expertise and a track record in the market for Collateralized Debt Obligations.

The Bank closely monitors the distribution of structured products with the aim of assuring adherence to investment policy, and also to ensure clients' awareness of all risks, as well as the rewards associated with such investments.

Compliance & Legal Function

In July 2005 the Bank successfully implemented the Guidelines for the EU Savings Tax and adopted its IT system and internal work flows to fully comply with the new guidelines.

During 2005 the Bank further enhanced its compliance function and formalized monitoring and control activities in line with the requirements of the New Anti Money-Laundering Ordinance, which came into force in July 2004. Particular emphasis was placed on enhancing the quality of clients' profiles and in the segmentation of Bank accounts according to their risk profile, based on pre-defined risk criteria. Since 2004 the Bank has operated an automated transaction monitoring system to enhance the identification of higher risk transactions.

Board of Directors and its committees

During 2005, the Board of Directors and the Audit Committee of the Board each held five meetings, and the Executive Committee of the Board held six meetings. A Steering Committee of the Board held two meetings accompanying the implementation of the new IT system.

Follow-up on the irregular event discovered in 2001

At the beginning of January 2001, the Bank had discovered that a former management member had carried out unauthorized transactions with regard to certain clients'

accounts. The employee was immediately released from his duties and was dismissed by the Bank. During 2005, the Bank continued with the settlement of claims by clients who sustained monetary damages due to this event and the vast majority of cases are settled. The provisions of CHF 21.1 million that the Bank made in 2005 resulted mainly from the final settlement of a major claim in January 2006 as well as a reassessment of additional provisions.

Shareholder Equity after the off-set of the Bank's net loss
The Board of Directors proposes to off-set the net loss of CHF 16.5 million with the retained earnings.

As a result of this, the published equity of the Bank for the year under review was CHF 202.6 million (2004: CHF 225.0 million).

Reserves for general banking risk, as shown in the consolidated balance sheet, amount to CHF 2.4 million (2004: CHF 2.9 million). Total capital and reserves, including reserves for general banking risk, will amount – after the off-set of the Bank's net loss – to some CHF 206.5 million (2004: CHF 231.8 million).

The Board of Directors expresses its appreciation to the General Manager, Members of the Management and employees for their work and effort.

The Board of Directors

1. Balance sheet – consolidated

(in Swiss Francs)

	Dec. 31, 2005	Preceding year	Changes
Assets			
Cash	10 842 103	2 842 404	7 999 699
Money market instruments	5 261 247	6 219 316	-958 069
Due from banks	150 987 561	154 272 452	-3 284 891
Due from customers	552 380 708	498 992 186	53 388 522
Securities trading portfolios	30 666 462	24 398 465	6 267 997
Financial investments	153 751 279	131 397 750	22 353 529
Fixed assets	2 212 939	3 546 790	-1 333 851
Intangible assets	15 273 648	9 699 700	5 573 948
Accrued income and prepaid expenses	12 767 643	9 746 754	3 020 889
Other assets	23 258 629	48 567 101	-25 308 472
Total assets	957 402 219	889 682 918	67 719 301
Total subordinated claims	3 243 628	3 004 477	239 151
Total due from non consolidated participations and significant shareholders	318 361	120 737	197 624
Liabilities and shareholders' equity			
Due to banks	404 604 878	375 742 487	28 862 391
Due to customers, other	242 953 021	179 243 671	63 709 350
Accrued expenses and deferred income	13 535 254	12 362 996	1 172 258
Other liabilities	24 831 718	48 922 455	-24 090 737
Valuation adjustments and provisions	64 947 728	41 631 603	23 316 125
Reserves for general banking risks	2 371 671	2 885 671	-514 000
Share capital	33 000 000	33 000 000	0
Retained earnings	187 644 038	183 892 774	3 751 264
Net consolidated income / loss	-16 486 088	12 001 261	-28 487 350
Total liabilities and shareholders' equity	957 402 219	889 682 918	67 719 301
Total due to non consolidated participations and significant shareholders	151 598 558	125 517 523	26 081 035
Off-balance sheet transactions			
Contingent liabilities	108 723 509	79 030 137	29 693 372
Derivative instruments – Contract volume	2 103 553 060	2 356 152 443	-252 599 383
– Positive replacement value	19 860 258	44 089 824	-24 229 566
– Negative replacement value	22 185 110	47 483 221	-25 298 111
Fiduciary transactions	1 436 026 244	1 201 607 637	234 418 608

2. Income statement – consolidated

(in Swiss Francs)

	2005	Preceding year	Changes
Revenues and expenses from ordinary banking activities			
Results from interest activities:			
– Interest and discount income	18 020 623	12 372 988	5 647 635
– Interest and dividend income on trading portfolios	1 337 817	491 682	846 135
– Interest and dividend income on financial investments	5 856 893	5 959 299	– 102 406
– Interest expenses	– 12 112 292	– 7 831 213	– 4 281 079
Net interest income (Subtotal)	13 103 041	10 992 756	2 110 285
Results from commission and service fee activities:			
– Commission income on lending activities	607 901	566 890	41 011
– Commission income on securities and investment transactions	33 137 892	32 038 343	1 099 549
– Commission income on other services	2 434 504	2 825 432	– 390 928
– Commission expenses	– 1 482 637	– 1 586 745	104 108
Results from commission and service fee activities (Subtotal)	34 697 660	33 843 920	853 740
Results from trading operations	14 609 043	17 489 146	– 2 880 103
Other ordinary results:			
– Results from the sale of financial investments	97 645	295 471	– 197 826
– Participation income (non-consolidated)	0	0	0
Other ordinary results (Subtotal)	97 645	295 471	– 197 826
Operating expenses:			
– Personnel expenses	– 26 115 379	– 23 191 542	– 2 923 837
– Other operating expenses	– 23 748 495	– 18 000 069	– 5 748 426
Operating expenses (Subtotal)	– 49 863 874	– 41 191 611	– 8 672 263
Gross profit	12 643 515	21 429 682	– 8 786 167
Net consolidated income / loss			
Gross profit	12 643 515	21 429 682	– 8 786 167
Depreciation and write-offs on non-current assets	– 6 800 380	– 7 864 255	1 063 875
Valuation adjustments, provisions and losses	– 21 936 770	– 11 571 014	– 10 365 756
Extraordinary income	646 437	11 945 871	– 11 299 434
Extraordinary expenses	– 133 741	– 2 593	– 131 148
Taxes	– 905 149	– 1 936 430	1 031 281
Net consolidated income / loss	– 16 486 088	12 001 261	– 28 487 349

Statement of cash-flows – consolidated

(in 1000 Swiss Francs)

	2005		Preceding year	
	Source of funds	Application of funds	Source of funds	Application of funds
Cash-flow from operating results (internal sources)				
Net consolidated income	0	- 16 486	12 001	0
Depreciation and write-offs on non-current assets	6 800	0	7 864	0
Valuation adjustments and provisions	24 949	- 136	13 325	- 72
Reserves for general banking risks	0	- 514	41	- 11 480
Accrued income and prepaid expenses	0	- 3 020	0	- 354
Accrued expenses and deferred income	1 172	0	2 566	0
Dividend preceding year	0	- 8 250	0	0
Balance	4 515	0	23 891	0
Cash-flow from investment activities				
Participations	0	0	0	0
Fixed assets	0	- 946	0	- 903
Intangible assets	0	- 10 095	0	- 7 875
Balance	0	- 11 041	0	- 8 778
Cash-flow from banking operations				
Medium and long-term operations (more than 1 year)				
- Due to banks	0	- 111	0	- 224
- Other liabilities	0	- 689	0	- 2 051
- Due from banks	0	0	0	0
- Due from customers	65 032	0	0	- 20 872
- Financial investments	0	- 22 354	6 649	0
Short-term operations				
- Due to banks	28 973	0	36 842	0
- Due to customers	64 398	0	1 327	0
- Due from money market instruments	958	0	0	- 4 362
- Due from banks	3 285	0	0	- 69 786
- Due from customers	0	- 118 420	74 736	0
- Securities and precious metal portfolios	0	- 6 267	0	- 2 669
- Other assets / liabilities	1 218	0	1 623	0
Specific usage of valuation adjustments and provisions		- 1 497		- 40 861
Liquidity				
- Cash	0	- 8 000	4 535	0
Balance	6 526	0	0	- 15 113
Total	11 041	- 11 041	23 891	- 23 891

Notes to the Consolidated Financial Statements

Bank Leumi le-Israel (Switzerland)

1. Comments on Business Activities

Introduction

Bank Leumi le-Israel (Switzerland) is primarily active in providing private banking services to high net worth individuals worldwide and operates via the head office in Zurich and its branch in Geneva. The Bank holds a representative office in Israel and in Hungary. As of year-end, the Group employed a total of 129 members of staff (2004: 132), of which 26 (2004: 28) are located in Geneva.

Strategic business units

The Bank provides a comprehensive range of investment and asset management services. Therefore commission and service fees represent the main source of income, amounting to 56 % (2004: 54 %) of the gross income before operating expenses. Interest-bearing activities amount to 21 % (2004: 18 %) and trading to 23 % (2004: 28 %) of the gross income before operating expenses.

Core business activities are:

Asset management and investment activities

Asset and portfolio management for mainly international customers constitutes the Bank's main activity.

Trading

Foreign exchange and security trading is carried out mainly for clients and for the nostro book. The activity in structured products, which also contributes to trading income, has been introduced primarily to meet the needs of private banking clients. As of year-end, all items that are traded for the Bank's own account are in line with the guidelines approved by the Board of Directors.

Lending Activities

The Bank primarily engages in collateralized lending to private banking clients, by means of Lombard credits.

Risks

The Management of the Bank places strong emphasis on risk management as reflected in its risk policy. In principle, the Bank does not undertake any business with a high-risk profile. The supervision and control of the material risk can be summarized as follows:

Interest rate risks are controlled within the framework of the asset & liability management. The Bank hedges interest rate risks, but they are expressly considered in investing in financial securities for the Bank. The development of the financial markets is monitored daily and reported to the Investment Committee of the Bank.

As of year-end, currency risks were hedged according to the guidelines approved by the Board of Directors.

Price risk from trading activity is limited by a system defining maximum exposure. Risk related to the replacement value of open derivative items is modest. Market liquidity risk in foreign exchange trading is negligible as the Bank refrains from trading in illiquid markets.

81 % of the Bank's assets are held in Europe, Switzerland, North America and Israel (2004: 87 %). No loans were classified as exposed to country risk during 2005.

Credit approvals are subject to quality requirements, margins and limits, set forth in internal regulations, and regularly reported to the credit committee of the Bank. All credit positions, including derivative financial instruments, are subject to exposure limits and are continuously monitored.

Liquidity risk is monitored and controlled in line with the provisions of the Federal Law on Banks and Saving Banks (BankL).

The Legal & Compliance Department ensures that the Bank's business activities comply with the regulatory provisions in force, as well as with internal directives and guidelines. The department was responsible for the adherence to the new money laundering directive, which is in force since June 2004. For this purpose the Group implemented an adequate IT application which supports the working processes in the area of transaction monitoring efficiently.

Operating risk is defined as "risk of direct or indirect losses resulting from the inadequacy or the failure of internal procedures, persons and systems or from external events". It is limited by means of internal regulations and directives. The Internal Audit Department periodically checks the internal controls, and issues its activity reports directly to the Board of Directors or to its Audit Committee.

The Bank ensures that the executive bodies are regularly informed with respect to market, credit, liquidity, legal and operational risk by means of a management information system.

There are adequate provisions for litigation risks.

In accordance with Federal Banking Commission regulations, no business functions were outsourced.

Events after the balance sheet date

No events took place with a negative impact on the assets, financials and income situation of the Bank, which not have been considered.

2. Accounting and Valuation Principles for the Consolidation

Principles of Consolidation

The following accounting and valuation principles correspond with the bank accounting guidelines of the implementing ordinance of the federal law on banks and saving banks (BankO). The consolidated financial statements consist of the balance sheet, income statement, the statement of cash-flows and the notes to the financial statements.

The structure of the consolidated financial statements was established according to Art. 25f – Art. 25i of the BankO. Accordingly, the capital and the profit reserves as well as the income from equity participations are disclosed separately.

The group accounts outline the assets and earnings of Bank Leumi le-Israel (Switzerland) in accordance with the “true and fair view” principle.

The business activities are recorded as at value date; i.e. the recording is generally based on the transfer of power to dispose of an asset. Thus, purchased assets are only recorded at the time when the right of ownership is acquired or the authority to dispose assets is transferred.

Companies subject to full consolidation are bound by group-wide, consistent and binding valuation guidelines. All companies have the same fiscal year.

It is the Group’s policy to establish specific value adjustments for possible losses. Contingent risks are covered by global provisions and reserves and are disclosed in the consolidated balance sheet under “reserves for general banking risk”.

The capital consolidation was performed according to the purchase method.

Foreign currency transactions are converted and recorded at the respective daily exchange rates in Swiss Francs. Assets reported in the balance sheet are converted at the exchange rates valid on the balance sheet date and are posted to the appropriate income account accordingly. Any differences in exchange rates which may result between conclusion and settlement of a transaction are reported in the income statement.

All Group companies keep their accounts in Swiss Francs.

The following exchange rates (against the CHF) were applied for the currency conversions:

	2005 Balance sheet rate	Preceding year Balance sheet rate
USD	1.3187	1.1315
EUR	1.5539	1.5437
GBP	2.2684	2.1835
CAD	1.1304	0.9400
AUD	0.9650	0.8820
JPY	1.1194	1.1030

Any inter-company transactions and provisional profits are eliminated.

In addition to the Bank, the consolidated entity comprises the following fully consolidated companies:

	Equity (in CHF)	Capital Interest	Business activity
Leumi Fund Holding, Luxembourg	120 000	100 %	Investment Fund Management
Leumi Asset Man- agement, Zurich	100 000	100 %	Investment Advisory

Cash Assets, Money Market Instruments and due to Customers

Items are reported in the balance sheet at par value. The as yet unearned discount component on money market instruments is shown under the specific balance sheet position and is accrued until maturity.

Due from Banks and Customers

Items are reported in the balance sheet at par value. Value adjustments are made for discernible risk according to the principle of caution. If a debtor is more than 90 days in arrears with interest payments, the interest arrears are allocated directly to the provisions; in this instance, they are not recovered until the interest has been paid.

If a debt is deemed to be unrecoverable, either in whole or in part, or a debt waiver is granted, the debt is written off against the corresponding bad debt charge. Any previously reported amounts re-entered shall be credited directly to the bad debt charge.

Repo and Reverse Repo Transactions

These transactions are used mostly for short-term financing and they are therefore shown under the item “Due to Banks”. Pledged securities are disclosed as “Loans- and pension-business with securities”.

Securities and Precious Metals Trading Portfolio

Items in the trading portfolio are always valued and recorded in the balance sheet at fair value. The price quoted on a recognized exchange or a representative market is taken as the fair value. For structured products held in the trading portfolio, the price quoted is examined by means of a price model. If this is not possible, valuation is based on the principle of lower of cost or market. Transactions executed on behalf of clients are classified as trading transactions due to the fact that during a certain period the risk of such transactions remains within the Bank's own books.

Price gains and losses resulting from the valuation are recorded under "Results from trading operations". Interest and dividend income on trading portfolios are entered under the item "Interest and dividend income on trading portfolios".

Financial Investments in Securities and Precious Metals

These assets serve the medium and long-term needs of the Bank. The accrual method is applied to value such items.

Fixed Assets

Investments in fixed assets exceeding CHF 2,500 are reported in the balance sheet as assets and in accordance with the acquisition cost principle, provided they are used for longer than one accounting period.

Investments in existing fixed assets are reported in the balance sheet as assets, if, as a result, the economic value is increased on a sustained basis, the service life is considerably extended. Items are recorded at acquisition cost less straight-line depreciation over conservative estimated life of the asset. The declared value is checked yearly. In the case of decreased value or of a lowered service life, the remaining value will either be depreciated over the planned life time or an extra depreciation will be carried out. Planned and eventual additional unplanned depreciation will be recorded in the profit & loss statement under "Depreciation and write-offs on non-current assets".

The estimated utilization of investments in fixed assets is as follows:

Investments in rented property	max. 5 years
Information technology equipment	max. 4 years
Software and communication equipment	max. 3 years
Other fixed assets	max. 4 years

Intangible Assets

Acquired intangible assets are reported in the balance sheet if they provide the company with quantifiable benefits over a period of several years. They are recorded and valued at acquisition cost. As a rule, depreciation is on a straight-line basis and the depreciation period lasts a maximum of 5 years.

The estimated utilization of Intangible assets is as follows:

Software	max. 5 years
Other intangible assets	max. 4 years

The declared value is checked yearly. In the case of decreased value or of a lowered service life, the remaining value will either be depreciated over the planned life time or an extra depreciation will be carried out.

In the period under review management reassessed the estimated useful life period for intangible assets. Based on this reassessment the estimated useful life period for software has been increased from max. 3 to max. 5 years.

Pension Plan Liabilities

All Group employees belong to the Bank's own pension fund "Pension fund of Bank Leumi le-Israel (Switzerland)" which carries out direct investments. Only contribution-based plans are included in the fund.

Pension fund liabilities together with the assets serving as cover are structured in a legally independent foundation. The foundation has reinsured itself by taking out insurance for cases of death and disability. The manner in which the pension plans are organised, managed and funded complies with legal provisions, foundation deeds and the applicable pension regulations.

The Bank contributes to the insurance premium for the above mentioned reinsurance policy.

Employer Contributions are recorded under personnel expenses.

The Bank renounced on an early applying of Swiss GAAP FER 16 as per 01.01.2006

Taxes

Taxes are calculated and entered in the accounts based on the results for the year under review and from an operational point of view, and reported as expenditure for the accounting period in which the corresponding income arises. Direct taxes owed that arise from current income are recorded as a deferred tax liability.

Deferred Taxes

The tax implications arising from time differences between the values disclosed in the consolidated balance sheet from assets and liabilities and their tax values are reported as deferred taxes under the provisions. The deferred taxes are determined separately in each financial period and for each tax item. Tax effects arising from loss offsetting options are disregarded.

Contingent liabilities, irrevocable commitments and similar off-balance sheet items

These items are recorded with the nominal amount in the off-balance sheet.

Valuation adjustments and provisions are established for foreseeable risks under the liabilities in the balance sheet.

Valuation Adjustments and Provisions

Valuation adjustments and provisions are established for all risks according to the principle of caution.

Precious Metals Accounts

The valuation of precious metals accounts is based on the market prices as of the balance sheet date.

Derivative Financial Instruments

Please refer to "Comments on Business Activities" on p. 10 for information regarding the Bank's corporate policy and risk management.

Trading Transactions

Items are valued and reported at fair value (excluding derivatives which are used for hedging purposes). Such derivatives are either reported at positive replacement values or at negative replacement values under "Other Assets / Other Liabilities". The fair value is based on market prices, price confirmation by brokers, discounted cash-flow – and option-pricing-models.

Transactions with derivative financial instruments that are based on trading purposes, realised and unrealised profits, are reported under "income from trading operations".

Hedging Transactions

Besides trading transactions, the Group uses derivative financial instruments for hedging purposes in its asset & liability management with respect to interest rate risk, currency risk and counterparty risk. Income from hedging continues to be reported under the same income item as the corresponding income from the basic transaction to be hedged.

The Group hedges especially against interest rate risk arising from balance sheet transactions, by means of interest rate swaps in particular. The income from so-called "Macro- & Micro-Hedges" is reported under "Interest income and expenses".

Changes to Accounting and Valuation Principles

For the year under review, with the exception of a change in the estimated utilization of Software, no change in accounting and valuation principles has been amended.

3. Information to the balance sheet – consolidated

Listing of collateral

(in 1000 Swiss Francs)

	Mortgage collateral	Type of collateral Other collateral	Without collateral a)	Total
Loans				
Due from customers	600	515 859	35 922	552 381
Total loans	600	515 859	35 922	552 381
Preceding year	5 592	461 752	31 648	498 992
Off-balance sheet transactions				
Contingent liabilities	0	108 007	716	108 723
Total off-balance sheet transactions	0	108 007	716	108 723
Preceding year	0	78 831	199	79 030
	Gross debt amount	Assumed liquidation income of securities	Net debt amount	Individual provisions
Contested balances b)	42 012	10 262	31 750	64 261 b)

a) amounts covered by valuation adjustments and provisions; refer to the note disclosures "other information on the income statement".

b) CHF 41,9 million of the contested balances are in connection with unauthorized and alleged transactions of a former management member identified in the year 2001. Individual provisions cover possible other claims in connection with these unauthorized transactions.

Securities and precious metal trading portfolios, financial investments and participations – consolidated

(in 1000 Swiss Francs)

	2005	Preceding year
Securities and precious metal trading portfolios		
– Debt securities		
– Exchange listed	19 692	16 811
– Unlisted	9 597	7 496
– Participation instruments	1 377	91
– Precious metals	0	0
Total securities and precious metal trading portfolios	30 666	24 398

	Book Value		Fair Value	
	2005	Preceding year	2005	Preceding year
Financial investments				
– Debt securities (“accrual method”)				
– Exchange listed	135'615	124'003	140'867	130'798
– Unlisted	14'646	5'657	14'541	5'657
– Participation instruments	179	237	179	296
– Precious metals	0	1'500	0	0
– Premises 1)	3'311	0	3'311	0
Total financial investments	153 751	131 397	158 898	136 751

1) The premises recorded in financial investments are due to a liquidation of a Bank's client assets.

Main participations – consolidated

(in 1000 Swiss Francs)

Name of company, location	Business	2005		Preceding year	
		Capital	Quota	Capital	Quota
Consolidated participations					
Leumi Asset Management, Zurich	Investment Advisory	100	100 %	100	100 %
Leumi Fund Holding, Luxembourg	Fonds Management	120	100 %	120	100 %

Fixed and intangible assets – consolidated

(in 1000 Swiss Francs)

	Historical cost	Write-offs/ Accumulated depreciation	Book value end of preceding year	2005			
				Additions	Deductions	Write-offs/ Depre- ciation	Book value end of current year
Fixed assets							
– Other fixed assets	29 976	– 26 429	3 547	946	0	– 2 280	2 213
Total fixed assets	29 976	– 26 429	3 547	946	0	– 2 280	2 213
Intangible assets							
– Other intangible assets	28 061	– 18 362	9 699	10 095	0	– 4 520a)	15 274
Total intangible assets	28 061	– 18 362	9 699	10 095	0	– 4 520	15 274
Fire insurance value of other fixed assets							13 500

a) In the period under review the estimated useful life of software has been increased from max. 3 up to max. 5 years. If the depreciation period in the period under review had been unchanged, the depreciation charge for would have been amounted to CHF 8.19 million compared to the actual charge of CHF 4.52 million

Other assets and liabilities – consolidated

(in 1000 Swiss Francs)

	2005		Preceding year	
	Other assets	Other liabilities	Other assets	Other liabilities
Replacement value of derivative instruments				
Own trading contracts				
– replacement value of client transactions	19 590	19 377	44 000	43 775
– replacement value of nostro positions	40	100	2	64
– replacement value of asset/liabilities management	230	2 708	88	3 644
<i>Total derivative instruments</i>	<i>19 860</i>	<i>22 185</i>	<i>44 090</i>	<i>47 483</i>
Equalization account	2 540	0	3 727	0
Indirect taxes	608	1 490	365	173
Transit account	0	0	0	402
Coupons not cashed	0	13	0	8
Other assets and liabilities	251	1 144	385	856
Total	23 259	24 832	48 567	48 922

Assets pledged or ceded to secure own liabilities, and assets subject to ownership reservation – consolidated

Assets pledged

(in 1000 Swiss Francs)

	2005		Preceding year	
	Collateral resp. Book Value	Liability resp. amount used	Collateral resp. Book Value	Liability resp. amount used
Type of not available assets and reason for pledge				
Short and longterm investments for lombard credit business	5 903	0	5 915	0
Longterm investments as collateral for security clearing	36 676	0	39 761	0
Money market instruments for derivative business	5 261	0	6 219	0
Due from banks for derivative business	31 649	0	27 156	0
Total of assets pledged or ceded to secure own liabilities and assets subject to ownership reservation	79 489	0	79 051	0

Loans- and pensions-business with securities

(in 1000 Swiss Francs)

	2005	Preceding year
Bookvalue of liabilities of cashdeposits in correlation with securities borrowing und reverse-repurchase business	18 000	21 000
Bookvalue of in securities lending borrowed or in securities borrowing as collateral delivered as well as for repurchase transactions transferred securities in own possession. thereof unlimited right for sale or pledge allowed	17 126 17 126	19 832 19 832

As per December 31, 2005 no open securities lending and borrowing transactions on accounts

Liabilities to own pension plans – consolidated

(in 1000 Swiss Francs)

	2005	Preceding year
Pension Fund of Bank Leumi le-Israel (Switzerland)	14 389	7 417

All employees of the Group are included in the Group's autonomous pension fund "Pension Fund of Bank Leumi le-Israel (Switzerland), Zurich", which is based on contribution agreements.

Valuation adjustments and provisions / reserves for general banking risks – consolidated

(in 1000 Swiss Francs)

	Balance, end of preceding year	Specific usage	Recoveries, overdue interest, currency differences	2005 New creation charged to income statement	Reversals credited to income statement	Balance end of current year
Reserves for deferred taxes	823	0	0	0	- 136	687
Valuation adjustments and provisions for loan losses (credit and country risks)	40 809	- 1 497	3 830	21 119	0	64 261 a)
Total valuation adjustments and provisions as per balance sheet	41 632	- 1 497	3 830	21 119	- 136	64 948
Reserves for general banking risks	2 886	0	0	0	- 514	2 372

a) The line item valuation adjustments and provisions for loan losses includes provisions for credit risks for doubtful loans and possible other claims in connection with unauthorized and alleged transaction of a former management member identified in the year 2001.

The amount of the valuation adjustments and provisions was determined based upon the requirements that an adequate amount has to be provided for risks which lead to a likely liability for the Bank. The amount of the provisions is based upon information available to the Bank taking into account positive and negative factors known at the time these financial statements have been prepared. It should be noted that the amount of the provisions set aside may not necessarily cover the amounts claimed by the plaintiffs as such claims may be unjustified or inflated.

During the period under review, further claims were settled or reassessed based upon new factors or settlement suggestions from the court. These settlements and reassessments lead to a substantial increase in the level of provisioning in financial year 2005.

Capital structure and share holders with participations above 5 % of voting rights – consolidated

(in 1000 Swiss Francs)

	2005			Preceding year		
	Total nominal value	Number of units	Dividend bearing capital	Total nominal value	Number of units	Dividend bearing capital
Share capital						
Registered shares A (100.–)	13 350	133 500	13 350	13 350	133 500	13 350
Bearer shares B (500.–)	19 650	39 300	19 650	19 650	39 300	19 650
Total capital	33 000	172 800	33 000	33 000	172 800	33 000

	2005		Preceding year	
	Nominal value	Voting rights in %	Nominal value	Voting rights in %
Significant shareholders of Bank Leumi le-Israel (Switzerland)				
Bank Leumi le-Israel B.M., Tel Aviv	24 703	90.40 %	23 197	88.65 %

	2005		Preceding year	
	Nominal value	Voting rights in %	Nominal value	Voting rights in %
Significant shareholders of Bank Leumi le-Israel B.M., Tel Aviv				
State of Israel	59 933	19.78 %	134 202	36.29
Barnea Investments B.V.	40 477	5.00 % b)	0	0.00
Shlomo Eliahu Holdings Ltd. and its subs. and ass. companies	40 450	9.98 %	36 971	10.00
Bank Hapoalim Funds	0	0.00 %	20 878	5.65
Otzar Hityashvut Hayehudin B.M.	20 536	5.07 %	18 745	5.07
Others	a)	a)	a)	a)

a) below 5 %

Rate CHF/ILS 0.2865

0.2615

b) 4.99 % of the shares that had been bought by Barnea, are being held in trust.

The "Shares Committee" of the Bank Leumi le-Israel, Tel Aviv is empowered to execute the respective voting rights.

Statement of changes in shareholders' equity – consolidated

(in 1000 Swiss Francs)

Shareholders' equity, at beginning of current year

Share capital	33 000
Retained earnings	183 893
Reserves for general banking risks	2 886
Net consolidated income	12 001

Total shareholders' equity at beginning of current year

231 780

(before profit distribution)

+ Capital increase / decrease	0
+ Premium over nominal value	0
+/- Other allocations to/from reserves	-514
- Dividends and other distributions of retained earnings brought forward	-8 250
- Net consolidated loss	-16 486
+/- Currency differences	0

Total shareholders' equity, at end of current year

206 530

(before profit distribution)

<i>Thereof</i> Share capital paid-in	33 000
Retained earnings	187 644
Reserves for general banking risks	2 372
Net consolidated loss	-16 486

The amount of not distributable retained earnings is 35,4 Mio CHF.

Maturity structure of current assets, financial investments and borrowed funds – consolidated

(in 1000 Swiss Francs)

	At sight	Redeemable by notice	Within 3 months	Maturities Within 3 to 12 months	Within 1 to 5 years	After 5 years	Total
Current assets							
Cash	10 842	–	–	–	–	–	10 842
Money market instruments	0	0	5 261	0	0	0	5 261
Due from banks	30 657	13 370	106 961	0	0	0	150 988
Due from customers	83 069	0	194 575	169 552	103 866	1 319	552 381
Securities and precious metal trading portfolios	30 666	–	–	–	–	–	30 666
Total current assets	155 234	13 370	306 797	169 552	103 866	1 319	750 138
Preceding year	129 384	4 403	255 376	127 344	151 574	18 642	686 723
Financial investments	179	0	8 001	15 011	78 497	52 063	153 751
Preceding year	1 500	0	5 001	11 020	90 625	23 252	131 398
Borrowed funds							
Due to banks	4 991	0	304 134	95 480	0	0	404 605
Due to customers, other	235 352	0	509	1 543	4 230	1 319	242 953
Total borrowed funds	240 343	0	304 643	97 023	4 230	1 319	647 558
Preceding year	172 961	0	292 399	83 277	6 349	0	554 986

Due from and due to affiliated companies and loans and exposures to the members of the bank's governing bodies – consolidated

(in 1000 Swiss Francs)

	2005	Preceding year
Due from affiliated companies	32 188	27 824
Due to affiliated companies	3 933	9 062
Loans and exposures to the members of the bank's governing bodies	757	442

Transactions with affiliated companies and members of the bank's governing bodies

Within the group the bank represents the center of competence regarding the distribution of structured products. For the sale of such products through group companies, the bank pays the group retrocessions on a case to case basis based on the particular transaction. In the year 2005 an total of TCHF 126 had been paid and had been recorded under results from trading operations as well as commission on income on securities and investment transactions.

Members of the board of directors, members of the management as well as ordinary employees benefit from special conditions, which are stipulated in the guidelines for employees.

The conditions applied for other affiliates companies (such as security transactions, loans and compensations on deposits) are equal to clients conditions.

Assets and liabilities by domestic and foreign origin – consolidated

(in 1000 Swiss Francs)

	2005		Preceding year	
	Domestic	Foreign	Domestic	Foreign
Assets				
Cash	10 842	0	2 842	0
Money market instruments	0	5 261	0	6 219
Due from banks	15 130	135 858	24 113	130 159
Due from customers	44 641	507 740	36 837	462 155
Security trading portfolios	0	30 666	0	24 398
Financial investments	98 589	55 162	86 424	44 975
Participations	2 213	0	3 547	0
Fixed assets	15 274	0	9 700	0
Accrued income and prepaid expenses	5 955	6 813	5 173	4 574
Other assets	22 941	318	18 175	30 392
Total assets	215 585	741 818	186 811	702 872
Liabilities and shareholders' equity				
Due to banks	29 939	374 666	45 768	329 975
Due to customers, other	49 155	193 799	37 646	141 598
Accrued expenses and deferred income	8 509	5 025	10 797	1 566
Other liabilities	21 937	2 895	19 721	29 201
Valuation adjustments and provisions	40 697	24 251	29 067	12 564
Reserves for general banking risks	2 372	0	2 886	0
Share capital	33 000	0	33 000	0
Retained earnings	187 644	0	183 893	0
Net consolidated income / loss	- 16 486	0	12 001	0
Total liabilities and shareholders' equity	356 767	600 636	374 779	514 904

Assets by countries / country groups – consolidated

(in 1000 Swiss Francs)

	2005		Preceding year	
	Total	in %	Total	in %
Europe				
– Switzerland	158 854	18 %	147 605	18 %
– Liechtenstein	9 043	1 %	2 611	0 %
– Belgium	52 078	6 %	24 603	3 %
– Germany	177 859	20 %	162 101	20 %
– United Kingdom	19 052	2 %	46 763	6 %
– France	35 659	4 %	26 820	3 %
– Italy	349	0 %	36 200	4 %
– Netherlands	528	0 %	5 398	1 %
– Monaco	10 402	1 %	3	0 %
– Luxembourg	1 563	0 %	12 022	1 %
– Austria	8 779	1 %	21 590	3 %
– Spain	522	0 %	9 548	1 %
– Other countries	8 649	1 %	7 809	1 %
	483 337	54 %	503 073	61 %
Israel	163 531	18 %	150 773	18 %
North America				
– United States	62 331	7 %	48 964	6 %
– Kanada	20 595	2 %	16 071	2 %
	82 926	9 %	65 035	8 %
Latin America				
– Belize	34 211	4 %	13 110	2 %
– Panama	26 978	3 %	4 313	1 %
– Brasil	14 428	2 %	1 171	0 %
– Other countries	3 415	0 %	4 223	0 %
	79 032	9 %	22 817	3 %
Africa	2 614	0 %	2 717	0 %
Caribic				
– Virgin Islands (BR)	46 527	5 %	42 835	5 %
– Neth. Antilles	20 858	3 %	16 780	2 %
– Cayman Islands	18 742	2 %	9 645	2 %
– Other countries	1 181	0 %	20	0 %
	87 308	10 %	69 280	9 %
Asia / Oceania	1 916	0 %	329	0 %
Australia and New Zealand	3 226	0 %	4 099	1 %
Total receivables/securities	903 890	100 %	818 123	100 %

Balance sheet by currencies – consolidated

(in 1000 Swiss Francs)

	Currencies					Total
	CHF	EUR	USD	JPY	Other	
Assets						
Cash	8 801	1 186	212	0	643	10 842
Money market instruments	0	0	5 261	0	0	5 261
Due from banks	43 833	14 517	45 017	914	46 707	150 988
Due from customers	180 426	80 936	180 153	99 123	11 743	552 381
Securities and precious metal trading portfolios	0	1 145	29 172	0	349	30 666
Financial investments	122 530	20 365	10 856	0	0	153 751
Fixed assets	2 213	0	0	0	0	2 213
Intangible Assets	15 274	0	0	0	0	15 274
Accrued income and prepaid expenses	7 331	1 871	3 122	307	137	12 768
Other assets	23 259	0	0	0	0	23 259
Total on-balance assets	403 667	120 020	273 793	100 344	59 579	957 403
Due from FX- Spot, – Forward and – Option transactions	342 165	241 517	547 031	232 920	214 226	1 577 859
Total assets	745 832	361 537	820 824	333 264	273 805	2 535 262
Liabilities and shareholders' equity						
Due to banks	79 065	58 584	173 660	88 784	4 512	404 605
Due to customers, other	50 624	49 744	82 830	11 027	48 728	242 953
Accrued expenses and deferred income	9 082	1 662	2 593	155	43	13 535
Other liabilities	23 751	152	917	0	12	24 832
Valuation adjustments and provisions	37 571	9 128	12 415	38	5 796	64 948
Reserves for general banking risks	2 372	0	0	0	0	2 372
Share capital	33 000	0	0	0	0	33 000
Retained earnings	187 644	0	0	0	0	187 644
Net consolidated loss	– 16 486	0	0	0	0	– 16 486
Total liabilities and shareholders' equity	406 623	119 270	272 415	100 004	59 091	957 403
Due from FX- Spot, – Forward and – Option transactions	335 221	255 647	557 068	218 440	211 483	1 577 859
Total liabilities	741 844	374 917	829 483	318 444	270 574	2 535 262
Net position per currency	3 988	– 13 380	– 8 659	14 820	3 231	0

4. Information on off-balance sheet transactions

Analysis of contingent liabilities – consolidated

(in 1000 Swiss Francs)

	2005	Preceding year	Changes
Contingent liabilities			
– Credit guarantees and similar	99 493	64 909	34 584
– Irrevocable commitments	9 230	14 121	–4 891
Total contingent liabilities	108 723	79 030	29 693

Outstanding derivative instruments – consolidated

(in 1000 Swiss Francs)

	Own trading contracts			Hedging-Instruments		
	Positive replacement value	Negative replacement value	Contract volume	Positive replacement value	Negative replacement value	Contract volume
Interest rate instruments						
Forward contracts	176	12	61 159	0	0	0
Swaps	88	239	94 397	230	2 708	233 205
Futures	0	0	0	0	0	0
Options (OTC)	0	0	0	0	0	0
Foreign exchange						
Forward contracts	15 180	15 050	1 263 707	0	0	0
Options (OTC)	4 185	4 175	451 011	0	0	0
Precious metals						
Forward contracts	0	0	0	0	0	0
Futures	0	0	0	0	0	0
Shares/Indicies						
Forward contracts	1	1	74	0	0	0
Others						
Futures	0	0	0	0	0	0
Total	19 630	19 477	1 870 348	230	2 708	233 205
Preceding year	44 002	43 949	2 120 278	88	3 534	235 874
2005						
Preceding year						
	Positive replacement value	Negative replacement value	Contract volume	Positive replacement value	Negative replacement value	Contract volume
Analysis by counterparties						
Banks and derivative exchanges	10 876	11 797	1 207 335	20 113	29 580	1 386 285
Customers	8 984	10 388	896 218	23 977	17 903	969 867
Total	19 860	22 185	2 103 553	44 090	47 483	2 356 152
Analysis by remaining life						
Up to 3 months	13 105	12 981	1 516 362	36 396	36 338	1 758 815
Over 3 months to 1 year	6 442	6 822	370 015	7 613	7 820	424 766
Over 1 year to 5 years	179	2 265	130 142	65	3 325	171 439
Over 5 years	134	117	87 034	16	0	1 132
Total	19 860	22 185	2 103 553	44 090	47 483	2 356 152

Analysis of fiduciary transactions – consolidated

(in 1000 Swiss Francs)

	2005	Preceding year	Changes
Fiduciary transactions			
– Fiduciary placements with third party banks	1 247 749	1 041 799	205 950
– Fiduciary placements with banks of the group	150 212	121 333	28 879
– Fiduciary credits	38 065	38 476	–411
Total fiduciary transactions	1 436 026	1 201 608	234 418

Assets under Management – consolidated

(in Mio. Swiss Francs)

	2005	Preceding year
Assets under management:		
Assets in own mutual funds	116	180
Assets in managed accounts	715	630
Other assets under management	5 668	4 783
Total clients assets (incl. double-counted amounts)	6 499	5 593
thereof double-counted amounts	116	180
net balance of assets inflow-outflow	561	–8

Calculation Method

All clients assets managed or held for investment purposes are considered as assets under management. Assets under management include in general all liabilities due to customers, fiduciaries and all valued customer deposits. Custody-only assets (held only for transaction and custodian purposes) are not included.

Re-classifications of custody-only transactions into reported assets under management didn't occur.

Net Balance of Assets In-/Outflow

The net balance of assets in-/outflow is defined by the acquisition of new customers, customer leavings and in- and outflows of existing customers. Performance related in-/outflows such as market price changes, interests or dividend payments as well as interest charges to customers are not included in the net balance of assets in-/outflow.

All components regarding the determination of assets under management are regularly performed and reported on a monthly basis to the respective bodies.

5. Information on the income statement

Analysis of results from trading operations – consolidated

(in 1000 Swiss Francs)

	2005	Preceding year	Changes
Results from trading operations			
– Foreign exchange and other business segments	6 108	5 476	632
– Precious metals	0	5	–5
– Securities	–61	880	–941
– Income structured product activities	8 562	11 388	–2 826
– Interest rate instruments	0	–260	260
Total results from trading operations	14 609	17 489	–2 880

Analysis of personnel expenses – consolidated

(in 1000 Swiss Francs)

	2005	Preceding year	Changes
Personnel expenses			
– Remuneration and fees for board of directors	347	324	23
– Salaries	20 561	18 403	2 158
– Contributions to AHV and unemployment insurance	1 336	1 051	285
– Contributions to social benefits	1 564	1 523	41
– Other personnel expenses	2 307	1 891	416
Total personnel expenses	26 115	23 192	2 923

Analysis of other operating expenses – consolidated

(in 1000 Swiss Francs)

	2005	Preceding year	Changes
Other operating expenses			
– Occupancy expense	2 986	2 796	190
– Expenses for electronic data processing, machinery, furniture, vehicles and leasehold improvements	8 057	3 192	4 865
– Expenses for electronically communication	3 459	3 157	302
– Other operating expenses	9 247	8 855	392
Total other operating expenses	23 749	18 000	5 749

Tax expenses – consolidated

(in 1000 Swiss Francs)

	2005	Preceding year	Changes
– Release / Creation of provision for deferred taxes	– 136	823	–959
– Current tax expenses	1 041	1 113	–72
Total tax expenses	905	1 936	– 1 031

Tax expenses are mainly for capital taxes, due to the possibility for unutilized tax loss carry-forwards practically no income taxes are payable. As per December 31, 2005 the possibility for tax loss carry-forwards amounts to CHF 6.3 million. There were no deferred tax asset for the possibility for unutilized tax loss carry-forwards.

Accruals for current tax expenses as per December 31, 2005 amounts to CHF 0.678 million.
(preceeding year: CHF 0.469 million)

Other information on the income statement – consolidated

Explanation of significant losses, extraordinary income and expense as well as with respect to the significant release of reserves for general banking risks

For the year under review valuation adjustments and provisions had been increased by CHF 21.1 million. This increase was created in connection with the alleged unauthorized transactions of a former management member as identified in 2001.

Under the extraordinary income there is a release included of reserves for general banking risks in the amount of CHF 0.5 million.

6. Sundries

Informations regarding market risks in the trading book – consolidated

(12 months average in 1000 Swiss Francs)

	2005	Preceding year	Changes
Debt instruments including derivatives	29 083	23 602	5 481
Participation certificates including derivatives	3 147	753	2 394
Foreign currency positions including derivatives	12 592	4 476	8 116
Precious metal positions including derivatives	236	69	167

Report of the group auditors
to the general meeting of
Bank Leumi le-Israel (Switzerland)
Zurich

As auditors of the group, we have audited the consolidated financial statements (balance sheet, income statement, statement of cash flows and notes / pages 7 to 29) of Bank Leumi le-Israel (Switzerland) for the year ended 31 December 2005.

These consolidated financial statements are the responsibility of the board of directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with Swiss Auditing Standards, which require that an audit be planned and performed to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the consolidated financial statements. We have also assessed the accounting principles used, significant estimates made and the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the financial position, the results of operations and the cash flows in accordance with the accounting rules for banks and comply with Swiss law.

We recommend that the consolidated financial statements submitted to you be approved.

PricewaterhouseCoopers AG



Thomas Romer



Stefan Wüest

Zurich, 27 March 2006

1. Balance sheet – Bank

(in Swiss Francs)

	Dec. 31, 2005	Preceding year	Changes
Assets			
Cash	10 842 103	2 842 404	7 999 699
Money market instruments	5 261 247	6 219 316	–958 069
Due from banks	150 448 745	151 349 892	–901 147
Due from customers	552 380 708	498 992 186	53 388 522
Securities trading portfolios	30 511 568	24 398 465	6 113 103
Financial investments	153 751 279	131 397 750	22 353 529
Participations	220 000	220 000	0
Fixed assets	17 483 945	13 241 000	4 242 945
Accrued income and prepaid expenses	12 608 234	9 583 208	3 025 026
Other assets	23 249 342	48 563 156	–25 313 814
Total assets	956 757 171	886 807 377	69 949 794
Total subordinated claims	3 243 628	3 004 477	239 151
Total due from group entities and significant shareholders	318 361	120 737	197 624
Liabilities and shareholders' equity			
Due to banks	404 604 878	375 742 487	28 862 391
Due to customers, other	244 102 365	180 494 774	63 607 591
Accrued expenses and deferred income	13 338 167	12 061 999	1 276 168
Other liabilities	24 815 682	48 905 216	–24 089 534
Valuation adjustments and provisions	67 319 399	44 517 273	22 802 126
Share capital	33 000 000	33 000 000	0
General legal reserve	35 395 000	34 735 000	660 000
Other reserves	148 440 000	146 270 000	2 170 000
Retained earnings brought forward	628	2 905	–2 277
Net income / loss	–14 258 948	11 077 723	–25 336 671
Total liabilities and shareholders' equity	956 757 171	886 807 377	69 949 794
Total due to group entities and significant shareholders	152 747 903	126 768 626	25 979 277
Off-balance sheet transactions			
Contingent liabilities	108 723 509	79 030 137	29 693 373
Derivative instruments – Contract volume	2 103 553 060	2 356 152 443	–252 599 383
– Positive replacement value	19 860 258	44 089 824	–24 229 566
– Negative replacement value	22 185 110	47 483 221	–25 298 111
Fiduciary transactions	1 436 026 244	1 201 607 637	234 418 608

2. Income statement – Bank

(in Swiss Francs)

	2005	Preceding year	Changes
Revenues and expenses from ordinary banking activities			
Results from interest activities:			
– Interest and discount income	18 019 579	12 372 988	5 646 591
– Interest and dividend income on trading portfolios	1 337 817	491 682	846 135
– Interest and dividend income on financial investments	5 856 893	5 959 300	– 102 407
– Interest expenses	– 12 119 088	– 7 834 018	– 4 285 070
Net interest income (Subtotal)	13 095 201	10 989 951	2 105 250
Results from commission and service fee activities:			
– Commission income on lending activities	607 901	566 890	41 011
– Commission income on securities and investment transactions	32 513 969	30 548 962	1 965 007
– Commission income on other services	2 444 503	2 835 432	– 390 929
– Commission expenses	– 1 693 625	– 1 813 545	119 920
Results from commission and service fee activities (Subtotal)	33 872 748	32 137 739	1 735 009
Results from trading operations	14 578 362	17 500 496	– 2 922 134
Other ordinary results			
– Results from the sale of financial investments	97 645	295 471	– 197 826
– Participation income (consolidated)	2 500 000	0	2 500 000
Other ordinary results (Subtotal)	2 597 645	295 471	2 302 174
Operating expenses:			
– Personnel expenses	– 25 787 101	– 22 773 794	– 3 013 307
– Other operating expenses	– 23 546 169	– 17 746 116	– 5 800 053
Operating expenses (Subtotal)	– 49 333 270	– 40 519 910	– 8 813 360
Gross profit	14 810 686	20 403 747	– 5 593 061
Net income / loss			
Gross profit	14 810 686	20 403 747	– 5 593 061
Depreciation and write-offs on non-current assets	– 6 797 533	– 7 852 930	1 055 397
Valuation adjustments, provisions and losses	– 21 936 770	– 11 571 014	– 10 365 756
Extraordinary expenses	– 133 741	– 2 593	– 131 148
Extraordinary income	782 437	11 121 454	– 10 339 017
Taxes	– 984 027	– 1 020 941	36 914
Net income / loss	– 14 258 948	11 077 723	– 25 336 671

	2005	Preceding year	Changes
Allocation of retained earnings / losses			
Net income / loss	- 14 258 948	11 077 723	- 25 336 671
Retained earnings brought forward	628	2 905	- 2 277
	<hr/>	<hr/>	<hr/>
Accumulated deficit / profit	- 14 258 320	11 080 628	- 25 338 948
Allocation of retained profit / loss			
Allocation to general legal reserve	0	- 660 000	660 000
Allocation to other reserves	0	- 2 170 000	2 170 000
Ordinary dividends 25 %	0	- 8 250 000	8 250 000
Release of other reserves	14 260 000	0	14 260 000
	<hr/>	<hr/>	<hr/>
Retained earnings brought forward	1 680	628	1 052
	<hr/>	<hr/>	<hr/>

The Bank's Activity

Description of Business Activities

The description of the Bank's business activity is included in the consolidated financial statements of the Bank.

As of December 31, 2005, the Bank employed 127 people (2004: 131), of whom 26 (2004: 28) are located in Geneva.

Accounting and Valuation Principles of the Bank

The financial statements of the Bank have been prepared in accordance with the relevant Swiss Accounting Standards stipulated in the Swiss Code of Obligations, the Federal Law on Banks and Saving Banks, and the accounting rules defined by the Federal Banking Commission.

In general, the Bank's financial statements are based on the same accounting policies and valuation principles used for the consolidated financial statements. The Bank's financial statements may include and be influenced by hidden reserves. Deferred taxes are not considered in the financial statements of the Bank.

In addition, the intangible assets that are recorded separately in the consolidated financial statements are recorded as fixed assets. Participations are reported at acquisition cost principle. In case of a decreased value, depreciation will be carried out.

Change in Accounting and Valuation principles of the Bank

For the year under review, with the exception of a change in the estimated utilization of Software, no change in accounting and valuation principles has been amended.

Other assets and liabilities – Bank

(in 1000 Swiss Francs)

	2005		Preceding year	
	Other assets	Other liabilities	Other assets	Other liabilities
Replacement value of derivative instruments				
Own trading contracts				
– replacement value of customer transactions	19 590	19 377	44 000	43 775
– replacement value of nostro positions	40	100	2	64
– replacement value of asset / liabilities management	230	2 708	88	3 644
<i>Total derivative instruments</i>	19 860	22 185	44 090	47 483
Equalization account	2 540	0	3 727	0
Indirect taxes	599	1 474	361	156
Transit account	0	0	0	402
Coupons not cashed	0	13	0	8
Other assets and liabilities	250	1 144	385	856
Total	23 249	24 816	48 563	48 905

Assets pledged or ceded to secure own liabilities, and assets subject to ownership reservation – Bank

Assets pledged

(in 1000 Swiss Francs)

	2005		Preceding year	
	Collateral resp. Book Value	Liability resp. amount used	Collateral resp. Book Value	Liability resp. amount used
Type of not available assets and reason for pledge				
Short and longterm investments for lombard credit business	5 903	0	5 915	0
Longterm investments as collateral for security clearing	36 676	0	39 761	0
Money market instruments for derivative business	5 261	0	6 219	0
Due from banks for derivative business	31 649	0	27 156	0
Total of assets pledged or ceded to secure own liabilities and assets subject to ownership reservation	79 489	0	79 051	0

Loans- and pensions-business with securities

(in 1000 Swiss Francs)

	2005	Preceding year
Bookvalue of liabilities of cashdeposits in correlation with securities borrowing und reverse-repurchase business	18 000	21 000
Bookvalue of in securities lending borrowed or in securities borrowing as collateral delivered as well as for repurchase transactions transferred securities in own possession.	17 126	19 832
thereof unlimited right for sale or pledge allowed	17 126	19 832

As per December 31, 2005 no open securities lending and borrowing transactions on accounts

Liabilities to own pension plans – Bank

(in 1000 Swiss Francs)

	2005	Preceding year
Pension Fund of Bank Leumi le-Israel (Switzerland)	14 389	7 417

All employees of the Group are included in the Group's autonomous pension fund "Pension Fund of Bank Leumi le-Israel (Switzerland), Zurich", which is based on contribution agreements.

Valuation adjustments and provisions – Bank

(in 1000 Swiss Francs)

	Balance, end of preceding year	2005			Balance end of current year	
		Specific usage	Recoveries, overdue interest, currency differences	New creation charged to income statement		Reversals credited to income statement
Valuation adjustments and provisions for loan losses (credit and country risks)	40 809	- 1 497	3 830	21 119	0	64 261 a)
Other provisions	3 709	0	0	0	- 650	3 059
Total valuation adjustments and provisions as per balance sheet	44 518	- 1 497	3 830	21 119	- 650	67 320

a) The line item valuation adjustments and provisions for loan losses includes provisions for credit risks for doubtful loans and possible other claims in connection with unauthorized and alleged transaction of a former management member identified in the year 2001.

The amount of the valuation adjustments and provisions was determined based upon the requirements that an adequate amount has to be provided for risks which lead to a likely liability for the Bank. The amount of the provisions is based upon information available to the Bank taking into account positive and negative factors known at the time these financial statements have been prepared. It should be noted that the amount of the provisions set aside may not necessarily cover the amounts claimed by the plaintiffs as such claims may be unjustified or inflated.

During the period under review, further claims were settled or reassessed based upon new factors or settlement suggestions from the court. These settlements and reassessments lead to a substantial increase in the level of provisioning in financial year 2005.

Capital structure and share holders with participations above 5 % of voting rights – Bank

(in 1000 Swiss Francs)

	2005			Preceding year		
	Total nominal value	Number of units	Dividend bearing capital	Total nominal value	Number of units	Dividend bearing capital
Share capital						
– Registered shares A (100.–)	13 350	133 500	13 350	13 350	133 500	13 350
– Bearer shares B (500.–)	19 650	39 300	19 650	19 650	39 300	19 650
Total capital	33 000	172 800	33 000	33 000	172 800	33 000

	2005		Preceding year	
	Nominal value	Voting rights in %	Nominal value	Voting rights in %
Significant shareholders of Bank Leumi le-Israel (Switzerland)				
Bank Leumi le-Israel B.M., Tel Aviv	24 703	90.40 %	23 197	88.65 %

	2005		Preceding year	
	Nominal value	Voting rights in %	Nominal value	Voting rights in %
Significant shareholders of Bank Leumi le-Israel B.M., Tel Aviv				
State of Israel	59 933	19.78 %	134 202	36.29 %
Barnea Investments B.V.	40 477	5.00 % b)	0	0.00 %
Shlomo Eliahu Holdings Ltd. and its subs. and ass. companies	40 450	9.98 %	36 971	10.00 %
Bank Hapoalim Funds	0	0.00 %	20 878	5.65 %
Otzar Hityashvut Hayehudin B.M.	20 536	5.07 %	18 745	5.07 %
Others	a)	a)	a)	a)

a) below 5 %

Rate CHF/ILS

0.2865

0.2615

b) 4.99 % of the shares that had been bought by Barnea, are being held in trust.

The "Shares Committee" of the Bank Leumi le-Israel, Tel Aviv is empowered to execute the respective voting rights.

Statement of changes in shareholders' equity – Bank

(in 1000 Swiss Francs)

Shareholders' equity, at beginning of current year

Share capital	33 000
General legal reserve	34 735
Other reserves	146 270
Accumulated profit	11 081

Total shareholders' equity at beginning of current year

(before profit distribution)

225 086

+ Capital increase / decrease	0
+ Premium over nominal value	0
+/- Other allocations to/from reserves	0
- Dividends and other distributions of retained earnings brought forward	- 8 250
- Net loss	- 14 259

Total shareholders' equity, at end of current year

(before profit distribution)

202 577

<i>Thereof</i> Share capital paid-in	33 000
General legal reserve	35 395
Other reserves	148 440
Accumulated loss	- 14 258

Due from and due to affiliated companies and loans and exposures to the members of the bank's governing bodies – Bank

(in 1000 Swiss Francs)

	2005	Preceding year
Due from affiliated companies	32 188	27 824
Due to affiliated companies	3 933	9 062
Loans and exposures to the members of the bank's governing bodies	757	442

Transactions with affiliated companies and members of the bank's governing bodies

Within the group the bank represents the center of competence regarding the distribution of structured products. For the sale of such products through group companies, the bank pays the group retrocessions on a case to case basis based on the particular transaction. In the year 2005 an total of TCHF 126 had been paid and had been recorded under results from trading operations as well as commission on income on securities and investment transactions.

Members of the board of directors, members of the management as well as ordinary employees benefit from special conditions, which are stipulated in the guidelines for employees.

The conditions applied for other affiliates companies (such as security transactions, loans and compensations on deposits) are equal to clients conditions.

Analysis of fiduciary transactions – Bank

(in 1000 Swiss Francs)

	2005	Preceding year	Changes
Fiduciary transactions			
– Fiduciary placements with third party banks	1 247 749	1 041 799	205 950
– Fiduciary placements with banks of the group	150 212	121 333	28 879
– Fiduciary credits	38 065	38 476	– 411
Total fiduciary transactions	1 436 026	1 201 608	234 418

Assets under Management – Bank

(in Mio. Swiss Francs)

	2005	Preceding year
Assets under management:		
Assets in own mutual funds	116	180
Assets in managed accounts	715	630
Other assets under management	5 668	4 783
Total clients assets (incl. double-counted amounts)	6 499	5 593
thereof double-counted amounts	116	180
net balance of assets inflow-outflow	561	– 8

Calculation Method

All clients assets managed or held for investment purposes are considered as assets under management. Assets under Management include in general all liabilities due to customers, fiduciaries and all valued customer deposits. Custody-only assets (held only for transaction and custodian purposes) are not included.

Re-classifications of custody-only transactions into reported assets under management didn't occur.

Net Balance of Assets In- / Outflow

The net balance of assets in- / outflow is defined by the acquisition of new customers, customer leavings and in- and outflows of existing customers. Performance related in- / outflows such as market price changes, interests or dividend payments as well as interest charges to customers are not included in the net balance of assets in- / outflow.

All components regarding the determination of assets under management are regularly performed and reported on a monthly basis to the respective bodies.

5. Information on the income statement

Analysis of results from trading operations – Bank

(in 1000 Swiss Francs)

	2005	Preceding year	Changes
Results from trading operations			
– Foreign exchange and other business segments	6 077	5 487	590
– Precious metals	0	5	– 5
– Securities	– 61	881	– 942
– Income structured product activities	8 562	11 388	– 2 826
– Interest rate instruments	0	– 260	260
Total results from trading operations	14 578	17 501	– 2 923

Other information on the income statement – Bank

Explanation of significant losses, extraordinary income and expense as well as with respect to the significant release of hidden reserves

For the year under review valuation adjustments and provisions had been increased by CHF 21.1 million. This increase was created in connection with the alleged unauthorized transactions of a former management member as identified in 2001.

Under the extraordinary income there is a release of hidden reserves in the amount of CHF 0.7 million.

6. Sundries

Informations regarding market risks in the trading book – Bank

(12 months average in 1000 Swiss Francs)

	2005	Preceding year	Changes
Debt instruments including derivatives	29 083	23 602	5 481
Participation certificates including derivatives	2 992	753	2 239
Foreign currency positions including derivatives	12 592	4 476	8 116
Precious metal positions including derivatives	236	69	167

Report of the statutory auditors
to the general meeting of
Bank Leumi le-Israel (Switzerland)
Zurich

As statutory auditors, we have audited the accounting records and the financial statements (balance sheet, income statement and notes / pages 31 to 40) of Bank Leumi le-Israel (Switzerland) for the year ended 31 December 2005.

These financial statements are the responsibility of the board of directors. Our responsibility is to express an opinion on these financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with Swiss Auditing Standards, which require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the financial statements. We have also assessed the accounting principles used, significant estimates made and the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accounting records and financial statements comply with Swiss law and the company's articles of incorporation.

We recommend that the financial statements submitted to you be approved.

PricewaterhouseCoopers AG



Thomas Romer



Stefan Wüest

Zurich, 27 March 2006

Enclosures:

- Financial statements (balance sheet, income statement and notes)

The Israeli Economy in 2005

Economic growth

In 2005, economic growth was still dominated by exports that contributed to an increase of GDP by 5.2 % and of the business sector product by 6.6 %. In the last two years the economy has returned to its growth potential after three years in which the economy did not expand (2001 through 2003), in 2004–2005 the economy registered an average annual growth rate of 5 %.

Despite the improvement in the labor market, private consumption increased, by only 4.0 % in 2005, compared to a 5.0 % increase in 2004. Other indicators on private consumption show more significant rates of increase during the year.

The rate of growth of exports indeed slowed to 7 %, but as note above, it still drove growth in the economy. Particularly notable was the rapid growth in the export of services – increasing by 11 %, affected by a significant increase in the export of tourist services – compared to a slower rate of growth in the increase in the export of goods, against the backdrop of a certain economic slowdown in Israel's main trading partners.

Growth in the business sector, which amounted to 6.6 %, was based on the trade, food and hospitality services sectors (+8.1 %); and in the transportation, storage, and communication sectors (+9.2 %).

The government's fiscal accounts

The 2005 government budget deficit amounted to NIS 10.8 billion (1.9 % of GDP), compared to a planned budget deficit of NIS 18.9 billion (3.4 % of GDP). The reason for the difference between the actual and planned deficit figures is rooted primarily in the underperformance of expenditures – that is to say, expenditures by government ministry offices, as well as interest rate payments, were below original forecasts.

In contrast, government revenues were just slightly above original expectations, despite the fact that the tax revenues component was below the forecasts. In particular, revenues from indirect taxes – customs and VAT – recorded a certain weakness. Overall, state revenues from taxes increased by close to 9 % in 2005, in real terms, primarily due to a sharp rise in revenues from direct taxes.

Inflation, the exchange rate and monetary policy

The Consumer Price Index rose in 2005 by 2.4 % – close to the middle of the price stability target set by the government at 1–3 %. Price hikes during the year were significantly in-

fluenced by energy prices worldwide, which contributed, both directly and indirectly, to price hikes in Israel. Also, the depreciation of the shekel vis-à-vis the US dollar, contributed to a 5.9 % increase in the housing component of the CPI.

During 2005, price stability prevailed in the economy, enabling the Bank of Israel to lower the interest rate early in the year to 3.5 %, a level maintained from February 2005 through September. For each of the months of October and November, however, the interest rate was raised by 25 basis points to a level of 4.0 % and in December to 4.5 %. The explanation given by the Bank of Israel for its change of policy was its assessment that the world was moving towards a more restrictive monetary policy stance due to fears of a rising rate of inflation – affected by energy prices and prices of commodities, and its assessment that the real short-term interest rate in the economy was too low, given the accelerated rate of growth and the possible effect of the depreciation of the shekel against the dollar on the rate of inflation.

Foreign trade

The import of goods into Israel amounted to approximately US\$ 44.4 billion in 2005, and exports amounted to approximately US\$ 36.4 billion. Thus, Israel's trade deficit amounted to approximately US\$ 7.9 billion, about US\$ 1.4 billion more than in 2004, reflecting the impact of higher global oil prices. (in nominal \$ terms). Exports and imports, which expanded throughout the year by approximately 7.7 % and 9.9 %, respectively.

International capital flows

Overseas investments by Israelis peaked in 2005, and so did FDI in Israel. The increase in investments in Israel by foreign residents was notable in direct investments (FDI), which amounted to US\$ 5.7 billion, a peak level even when compared to 2000 (US\$ 5.1 billion). The improvement in the economic and geo-political situations stood in the background behind these strategic decisions.

In 2005 Israeli institutional investors increased their overseas investments from US\$ 0.9 billion in 2004 to US\$ 2.5 billion in 2005, primarily due to the desire to diversify risks with the removal of tax limitations that had previously existed. Also, households increased their holdings of mutual funds that specialize in foreign currency instruments, for similar reasons, from US\$ 0.2 billion in 2004 to US\$ 0.9 billion in 2005.

The Israeli capital market in 2005

The public's financial assets

The public's portfolio of financial assets amounted to NIS 1.78 trillion at the end of November 2005, representing an increase of NIS 263 billion (13.8 %) compared to the value at the end of 2004. A significant part of the increase in the

portfolio is explained by the impact of the valuation of assets, primarily against the backdrop of the increase in prices of stocks and bonds on the markets. However, in 2005 there was a notable component of new savings flows by households and companies, due to the improvement in the economy that was allocated to the acquisition of financial assets in Israel and abroad.

The increase in the value of shares, which represented half of the overall increase in the value of the portfolio of financial assets, brought the balance of foreign and domestic shares to 29.1 % of the total portfolio (compared to 25.3 % at the end of 2004). Only in 1994 and in 2000 was the proportion of shares in the public's portfolio of financial assets higher. In contrast, the non-linked and CPI-linked components within the portfolio decreased compared to their levels from the end of 2004; whereas the foreign currency linked component actually increased, as a result of the shekel's depreciation and the growth in deposits.

The stock market

The year 2005 was the third year in a row in which the Israeli stock market yielded positive returns for investors. The General Share Index of the Tel-Aviv Stock Exchange (TASE) registered a sharp gain of 33 % during the year, similar to the increase seen in the TA-25 index of blue chip shares (33.3 %), and just above the performance of the TA-100 index of most actively traded shares (29.4 %).

The price gains in 2005 were led by the banking shares, which spiked upwards by 55 %, as well as by chemical companies, investment companies, and real estate, all of which registered nice gains of over 40 %. The positive trend that characterized the market in 2005 was dampened by technology shares, which fell 5 % during the year, and also by shares in the electricity and electronics sector, which gained less than 1 %. The index of oil shares indeed rose 8 %, but compared to the other share indices this can be considered only a moderate gain.

The strength of the market last year was supported by a number of factors, including: the publication of positive company reports; the continued growth of the Israeli economy and positive macroeconomic data; the improvement in the political and security situations in the country; and the government's economic policies, which included two important reforms that affected the capital market and were intended to, among other things, improve market conditions. The first reform was the equalization of the capital gains tax rate on profits from overseas investments made by Israelis with that of profits on domestic investments, which was intended to neutralize the tax considerations in investment decisions and to increase the competition between the Israeli capital market and overseas markets. And

indeed, in 2005 investments in overseas equities (shares and non-bank private sector debentures) by Israeli residents amounted to approximately US\$ 6.2 billion, compared to only approximately US\$ 1.5 billion in 2004. The second reform included the "Bachar Committee" recommendations, which caused the banks to begin selling off their mutual funds and provident funds toward the end of the year.

The final integration of the principles of the "Bachar Committee" recommendations in the second half of 2005 and their implementation by the banks were apparently some of the factors that affected bank shares in 2005. Also, the completion of the sale of the controlling interest in Bank Discount and Bank Leumi by the government contributed to the price gains in the banking shares. From the beginning of July through the end of 2005 the value of these shares increased approximately 50 %, compared to only a slight gain of approximately 5 % in the first half of the year.

The price gains registered in the chemical, investment, and real-estate shares were, in contrast, more or less consistent and occurred across all of last year. The impressive performance of the chemical companies, headed by Israel Chemicals Ltd., the shares of which increased in value by 85 % last year, were supported by price increases in the global potash market due to high surplus demand. In contrast, the weakness in technology shares in the Israeli stock market was, among other things, against the backdrop of weakness in the sector in the US stock market, as demonstrated by the only slight gain of 1.5 % in the NASDAQ index. Similar findings regarding the declining strength of the global high-tech sector are reflected as well in the industrial exports of high-tech companies (excluding pharmaceuticals), which show only a slight increase of 0.4 % in 2005, compared to 2004.

The year 2005 was also a peak year for investments by foreigners in equities traded on the Tel Aviv Stock Exchange (TASE). Such investments amounted to approximately US\$ 2.6 billion in 2005, compared to US\$ 0.5 billion in 2004. Most investments in the TASE by foreign residents, which represented approximately 30 % of the volume of trade in shares in 2005, were concentrated in five shares within the TA-25 index, which accordingly contributed to the increase in the index during the year. In addition, HSBC became a member of the TASE, alongside UBS and Deutsche Bank, both of which have been members of the TASE for a number of years now. The addition of foreign entities as members of the TASE has been made possible by, among other things, steps taken by the TASE to encourage foreign investments both in the technology area and also in more traditional areas. These steps are likely to lead to a continuation of the flow of investments to Israel by foreigners also in the coming years.

Bank Leumi-le Israel Group

Bank Leumi le-Israel B.M.

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Foreign Resident and Tourist Centres

Tel Aviv
Jerusalem
Haifa
Netanya
Herzliya Pituach
Bat Yam
Ashdod

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(28 branches)

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FAX: 00972 (3) 514 12 75

Bank Leumi le-Israel Trust
Company Ltd.
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