MOODY'S
INVESTORS SERVICE

CREDIT OPINION
16 November 2021

Update

Rate this Research

RATINGS

First International Bank of Israel

Domicile	Israel
Long Term CRR	A1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Type	Senior Unsecured - Fgn Curr
Outlook	Not Assigned
Long Term Deposit	A2
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Source: Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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First International Bank of Israel Ltd.

Update to credit analysis

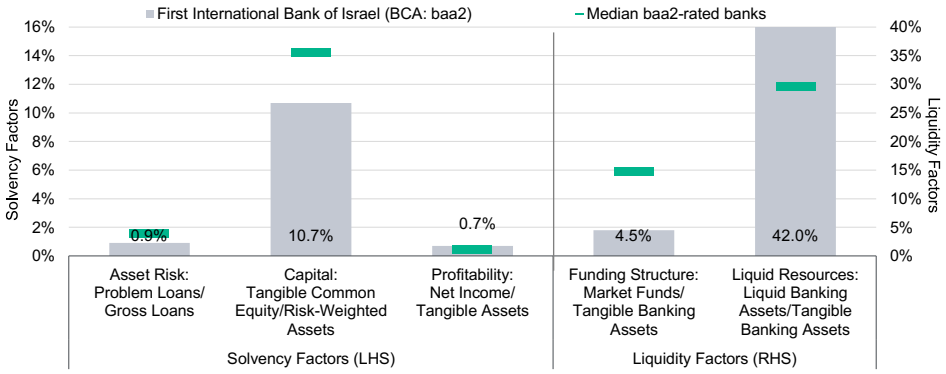
Summary

First International Bank of Israel Ltd. (FIBI)'s A2 long-term deposit ratings reflect (1) the bank's baa2 Baseline Credit Assessment (BCA); and (2) three notches of rating uplift based on our assessment of a very high likelihood of support from the Government of Israel (A1 stable), in case of need.

FIBI's baa2 BCA reflects the bank's (1) strong asset quality, with problem loans (defined as impaired loans and loans that are more than 90 days overdue) at 0.9% of gross loans as of June 2021; (2) stable retail deposit funding base and comfortable liquidity; and (3) strong presence in niche segments that has benefited it with consistent business opportunities.

At the same time, the bank's BCA also captures (1) adequate but modest capital buffers with a tangible common equity (TCE)/risk-weighted assets (RWAs) ratio of 10.7% as of June 2021, which are below those of similarly-rated international peers, mainly reflecting Bank of Israel's (BoI) more conservative risk weighting, as well as, (2) downside risks from a significant exposure to the Israeli property market and potential geopolitical tensions. FIBI's efficiency remains relatively weak, but ongoing management measures have successfully reduced costs and increased revenue sources, resulting in consistent improvement.

Exhibit 1
Rating Scorecard - Key financial ratios



These are our Banks Methodology scorecard ratios. Asset risk and profitability reflect the weaker of either the latest figure and the three-year and latest figure average. Capital is the latest reported figure. Funding structure and liquid resources reflect the latest fiscal year-end figures.
Source: Moody's Investors Service

Credit strengths

» Stable mostly retail deposit-based funding structure and comfortable liquidity

» Strong asset quality, supported by a relatively low-risk loan portfolio structure

» Strong presence in niche segments provides stable business growth

» Very high likelihood of government support, in case of need, underpins the deposit ratings

Credit challenges

» Modest risk-weighted capitalisation and leverage

» Moderate profitability, but ongoing initiatives will further reduce the bank's relatively high operating costs

» Concentration in real estate and geopolitical tensions remain downside risks

Outlook

The stable outlook on the bank's long-term deposit ratings reflects our expectation that the bank's low-risk loan book structure and sound funding profile balance downside risks from exposure to the property market and modest but adequate capitalisation.

Factors that could lead to an upgrade

» FIBI's ratings could be upgraded following both (1) materially stronger capitalisation and (2) a sustained improvement in the bank's efficiency and profitability without an increase in the credit risk profile, in combination with stronger sovereign creditworthiness.

Factors that could lead to a downgrade

» Downward pressure could be exerted on FIBI's ratings if deteriorating operating conditions lead to a material weakening in asset quality. Lower capital levels, an increase in the bank's asset risk profile or any sustained reduction in the bank's recurring earnings power may also put pressure on the ratings.

» There could also be negative rating pressure if we consider that the government's willingness or capacity to provide support in case of need has materially declined.

Key indicators

Exhibit 2
First International Bank of Israel Ltd. (Consolidated Financials) [1]

	06-21[2]	12-20[2]	12-19[2]	12-18[2]	12-17[2]	CAGR/Avg.[3]
Total Assets (ILS Million)	173,028.0	167,778.0	141,110.0	134,120.0	135,717.0	7.2[4]
Total Assets (USD Million)	53,100.5	52,254.3	40,854.1	35,892.2	39,092.9	9.1[4]
Tangible Common Equity (ILS Million)	9,504.0	8,804.0	8,252.0	7,863.0	7,467.0	7.1[4]
Tangible Common Equity (USD Million)	2,916.7	2,742.0	2,389.1	2,104.2	2,150.9	9.1[4]
Problem Loans / Gross Loans (%)	0.9	0.9	1.1	0.8	0.9	0.9[5]
Tangible Common Equity / Risk Weighted Assets (%)	10.7	10.3	10.0	9.8	9.5	10.0[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	7.8	7.9	10.4	8.1	9.3	8.7[5]
Net Interest Margin (%)	1.6	1.7	1.9	1.9	1.8	1.8[5]
PPI / Average RWA (%)	2.1	1.9	1.9	1.8	1.5	1.8[6]
Net Income / Tangible Assets (%)	0.8	0.5	0.7	0.6	0.5	0.6[5]
Cost / Income Ratio (%)	58.4	60.4	62.4	65.0	69.0	63.0[5]
Market Funds / Tangible Banking Assets (%)	4.7	4.5	2.8	2.8	2.9	3.6[5]
Liquid Banking Assets / Tangible Banking Assets (%)	41.7	42.0	34.0	33.2	36.9	37.6[5]
Gross Loans / Due to Customers (%)	65.7	65.4	74.6	76.2	71.5	70.7[5]

[-] Further to the publication of our revised methodology in July 2021, for issuers that have "high trigger" additional Tier 1 instruments outstanding, not all ratios included in this report reflect the change in treatment of these instruments. [1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; LOCAL GAAP. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.
Sources: Moody's Investors Service and company filings

Profile

FIBI is the fifth-largest banking group in Israel by assets with an 8.4% market share and total consolidated assets of NIS173 billion ($53 billion) as of June 2021. As a universal bank, FIBI provides banking services to individuals, small businesses, corporations and high net-worth clients. The bank also provides capital market, foreign currency, global trade and corporate finance services.

FIBI maintains a strong market presence in specific niche retail segments in Israel, including the armed forces, teachers and the ultra-orthodox, as well as, in the capital market.

The bank's common stock trades on the Tel Aviv Stock Exchange (ticker: FIBI). As of June 2021, FIBI Holdings Ltd. held a 48.3% stake in FIBI, with the Bino-Liberman Group in turn, owning 51.9% of the shares in FIBI Holdings Ltd.

Detailed credit considerations

Strong asset quality supported by a relatively low-risk loan book structure; concentration in real estate and geopolitical tensions remain downside risks

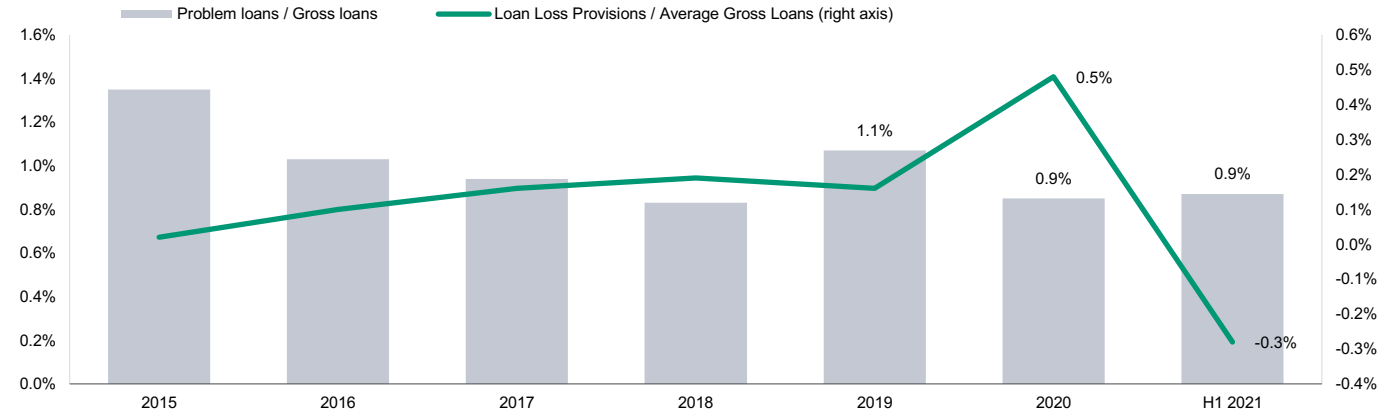
Our assigned baa1 Asset Risk score reflects FIBI's strong asset quality, supported by the relatively low risk structure of the bank's loan book and conservative underwriting standards. These have translated into more contained credit costs than its domestic peers through past economic cycles. Concentration in Israel's real estate market along with high property prices and potential geopolitical tensions continue to present downside risks for the bank's asset quality.

Problem loans were 0.9% of gross loans as of June 2021, lower than their pre-pandemic level (2019: 1.1%, see Exhibit 3). We expect the bank's asset quality to remain strong, following the sharp decline in loans subject to payment deferrals, supported by Israel's strong economic recovery after last year's downturn. Only 0.2% of loans have not yet returned to repayment as of June 2021, down from a peak of 8.0% as of June 2020, with FIBI maintaining the lowest level of such loans across its domestic peers since the onset of the crisis.

Exhibit 3

Problem loans are below their pre-pandemic level

Asset quality evolution



Loan loss provisions exclude those relating to off-balance sheet items

Source: Moody's Investors Service

Following the reopening of the economy, the pick-up in economic activity and the sharp reduction in loans under payment deferral, the bank reversed some of the collective provisions it booked during 2020. FIBI reported loan loss reversals equivalent to 0.3% of average gross loans in the first half of 2021. Credit costs (loan loss provision expenses to average gross loans) increased to 0.5% in 2020, driven entirely by collective provisions and reflecting macroeconomic expectations and risks in specific sectors, up from an average of just 0.1% for the period 2015-2019.

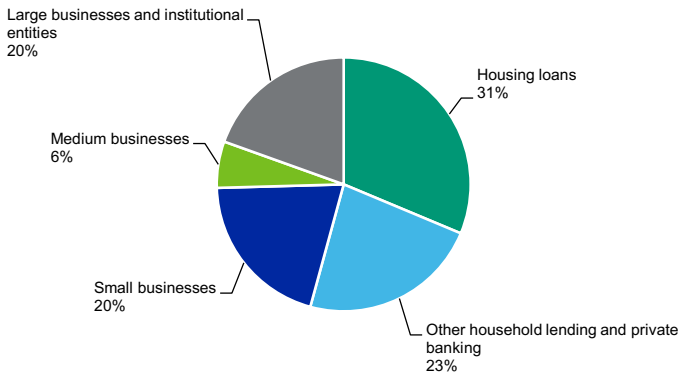
We expect FIBI's credit costs to normalize in the following quarters, but continue to remain more contained than its peers in line with historical performance. FIBI demonstrated a strong asset quality performance through a complete economic cycle and reported the second-lowest cost of risk during 2020 out of the five large Israeli banks.

The bank's loan book is diversified, with residential mortgages accounting for 31% of total loans, while medium and large businesses (including institutional entities) for 26% as of June 2021 (see Exhibit 4). Other retail and consumer loans were 23% of total, but a significant portion of the unsecured retail portfolio is salary-assigned and the bank's client base is mainly higher-income, wealthier individuals. Borrower concentration levels have reduced in recent years, with the bank's total on balance sheet exposure to its six largest borrowers equivalent to 33% of TCE as of June 2021, with no individual exposure exceeding 15% of the bank's capital as of the same date.

Exhibit 4

FIBI's loan book is relatively diversified

Loan book breakdown as of June 2021 (supervisory segments)



Source: Bank's financial reports

FIBI's asset quality, similarly to other Israeli banks, remains vulnerable to persistent geopolitical tensions that could compromise business confidence and economic activity. In addition, the bank has significant exposure to residential mortgages and the real estate sector that render its asset quality susceptible to developments in the Israeli property market.

In addition to the mortgage exposure mentioned above, construction and real estate made up a further 13% of total lending as of June 2021. Rising house prices expose banks to a potential house price correction and banks are also exposed to potentially higher risk in the mortgage book from unexpectedly higher interest rates and a rise in unemployment. For housing loans, risks are mitigated by the low overall level of household debt in the economy, macroprudential measures[1], which enforce tight underwriting standards and high capital buffers against mortgages. House prices have continued to increase despite last year's economic downturn and a structurally limited supply of new housing units provides price support. We see higher risk in the office space market and commercial real estate. Credit secured by commercial property accounted for 30% of the bank's total credit risk to the construction and real estate sectors as of June 2021.

Adequate but modest risk-weighted capitalisation and leverage

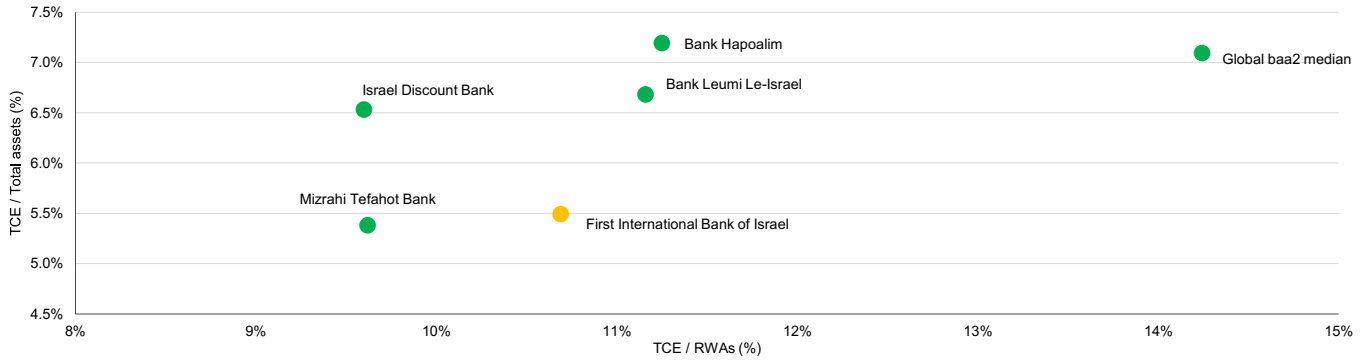
We view FIBI's risk-weighted capitalisation and leverage as adequate but modest. However, FIBI's loss-absorption buffers are supported by relatively conservative regulatory risk-weights, especially on mortgage lending. We expect the bank's capital ratios, which have increased to their highest level in recent years, to decline slightly following the resumption of profit distribution to shareholders and sustained loan growth, but to remain comfortably above regulatory requirements.

FIBI's TCE/RWAs ratio was 10.7% as of June 2021, below that of similarly-rated international peers (see Exhibit 5). However, the BoI maintains a conservative approach to risk-weighting that results in higher loss-absorption buffers than capital ratios show. Banks use the standardised approach to risk-weighting and mortgages are risk-weighted according to loan-to-value, resulting in an average risk weight of over 50% in Israel, against much lower risk weights applied by banks using the internal ratings-based approach and even the 35% normally used in the standardised approach. The bank's TCE-to-total assets ratio was 5.5% as of June 2021, at the same level as its Basel III leverage ratio that was above the 4.5% minimum regulatory requirement.

Exhibit 5

FIBI's risk-weighted capitalisation is lower than global peers driven by conservative risk weights

Risk-weighted capitalisation and leverage of Israeli banks and the global median



Data as of June 2021

Source: Moody's Investors Service

FIBI reported a Common Equity Tier 1 (CET1) capital ratio of 11.7% as of June 2021, exceeding the 8.3% minimum regulatory requirement that applied at that time by 3.4 percentage points, the highest buffer across the five large Israeli banks. In September, the BoI extended its leniency on lower banks' capital requirements by 1 percentage point until the end of 2021. This leniency was initially provided in March 2020 and reduced FIBI's minimum CET1 ratio requirement from 9.3% as of the end of 2019.[2] The BoI also lifted its earlier guidance on suspension of profit distributions, but has asked banks to adopt a conservative approach on dividends in the coming quarters, not exceeding 30% of 2020 and 2021 profits. Following this, FIBI has distributed 30% of 2020 earnings.

Moderate profitability, but ongoing initiatives will further reduce relatively high operating costs; strong presence in niche segments provide stable business growth

A relatively high cost base and a prolonged low interest rate and inflation environment have translated to a moderate profitability for FIBI in recent years. However, strong revenue growth, supported by the bank's presence in niche segments, which provides ample business opportunities, and continued cost-reduction initiatives have driven significant operating efficiency gains for FIBI, paving the way for higher sustainable profitability and strengthening its ability to adapt and resist growing competition. FIBI's cost-to-income ratio improved to an adjusted 58.4% in the first half of 2021.

FIBI reported record net profits in the first half of 2021, equivalent to an annualised 0.8% of tangible assets, up from 0.5% in 2020. Stronger profitability was driven by the aforementioned provision reversals, strong revenue growth because of loan growth and higher CPI, which was negative in 2020. For 2021 as a whole we expect these trends to be sustained and provision expenses to normalise in 2022 but remain contained supporting bottom-line profitability. Over the medium term, with long-term yields rising in Israel, a potential shift in the interest-rate and inflation cycle also bodes well for the bank's profitability.

FIBI's strong presence in niche markets, which include capital markets activity and teachers, armed forces and religious segments, coupled with high customer satisfaction, have resulted in consistent credit and revenue growth in recent years, with a compound annual growth rate of 5% for loans and 4% for revenues for the period 2015-2020, rising further by an annualised 8% and 6% respectively in the first half of 2021.

At the same time, management's ongoing initiatives to improve cost efficiency by reducing headcount, optimising the branch network and reducing real estate space have been successful, consistently improving the bank's operating expenses to assets ratio to 1.5% in 2020[3] and in the first six months of 2021, from 2.2% in 2015. Over the period 2015-2020, the bank reduced personnel numbers by 20%, and the number of branches by 16%. As a result of the consistent revenue growth and these efficiency initiatives, the bank's cost-to-income ratio dropped to below 60% in the first half of 2021 from above 75% in 2015. We expect the bank to continue to pursue digitalisation and cost-reduction initiatives, aided by an enabling regulator.

Stable mostly retail deposit-based funding structure and comfortable liquidity

FIBI benefits from a sound funding profile supported by a large and stable customer deposit base in Israel, which comfortably funds its loan portfolio, helped by Israel's strong savings culture. FIBI's net loans-to-deposits ratio stood at 65% as of June 2021, improved from 74% as of the end of 2019, following a significant inflow of deposits.

Further, 55% of total deposits from the public were relatively granular household and small business deposits (excluding private banking deposits). However, our assessment of FIBI's funding structure also considers that 21% of total deposits from the public, as of June 2021, were sourced from institutional and capital markets investors that could be more vulnerable to a loss in depositor confidence. This relatively high share of institutional investor deposits is partly driven by the bank's significant capital market activity. Nevertheless, FIBI's deposit base has proven to be stable during past shocks in Israel.

The bank is a net lender in the interbank market and has a low reliance on potentially more confidence-sensitive market funding at just 4.7% of tangible banking assets as of June 2021.

The bank also maintains a comfortable level of liquidity, with liquid assets to total assets ratio of 42% as of June 2021. The bank's liquid assets portfolio is also conservatively structured, with 33% of total assets held in cash and deposits with banks, and 9% invested in securities of which 84% is made up of A1-rated Israeli government securities. FIBI reported a strong Liquidity Coverage Ratio of 137% as of June 2021.

Source of facts and figures cited in this report

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

ESG considerations

In line with our general view for the banking sector, FIBI has a low exposure to Environmental risks, see our Environmental risks heat map for further information. Although Israel is exposed to environmental risk through rising temperatures, drought episodes and water scarcity given its geographical location in a semiarid climate zone, the authorities have taken a number of steps to address these risks, including through seawater desalination and wastewater recycling.

Overall, we believe banks, including FIBI, face moderate Social risks, see our Social risks heat map. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy which is partly mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage due to product misselling or other types of misconduct is a further social risk.

Societal trends are also relevant in a number of areas, such as shifting customer preferences towards digital banking services, increasing information technology cost, aging population concerns in several countries, impacting demand for financial services or socially driven policy agendas that may translate into regulation that affects banks' revenue base. Specifically in Israel, authorities are taking measures to promote competition in the banking system and to reduce the cost of financial services for households and small business, which will weigh on the banks' profitability.

Further, strict labour laws and strong banking employee unions in Israel limit staffing flexibility and drive up staffing costs. However, the banks have reduced employee posts through successive early retirement plans and have implemented stringent cost control, which has allowed them to mitigate these challenges.

Governance is highly relevant for FIBI, as it is to all players in the banking industry. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven, and for FIBI we do not currently have material governance concerns. Nonetheless corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Government support considerations

FIBI's A2 deposit ratings incorporate three notches of government support uplift from the bank's baa2 Adjusted BCA because of our expectation of a very high probability of support from the Israeli authorities, in case of need. This assumption is based on FIBI's systemic importance as one of the country's five large banking groups and the Israeli government's long standing practice of injecting capital into systemically important banks in case of need.

Counteparty Risk (CR) Assessment

FIBI's CR Assessment is A1(cr)/P-1(cr)

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

Counteparty Risk Ratings (CRRs)

FIBI's CRR is A1/P-1

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

Methodology and scorecard

About Moody's Bank scorecard

Our Bank Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong

divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity

Rating methodology and scorecard factors

Exhibit 6

First International Bank of Israel Ltd.

Macro Factors		
Weighted Macro Profile	**Strong**	**100%**

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.9%	aa3	↓	baa1	Sector concentration	Expected trend
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	10.7%	baa3	↓	ba1	Nominal leverage	Expected trend
Profitability						
Net Income / Tangible Assets	0.7%	baa3	↔	baa3	Return on assets	
Combined Solvency Score		baa1		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	4.5%	aa3	↔	a2	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	42.0%	a1	↓↓	a3	Expected trend	
Combined Liquidity Score		aa3		a2		
Financial Profile				baa2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				A1		
BCA Scorecard-indicated Outcome - Range				baa1 - baa3		
Assigned BCA				baa2		
Affiliate Support notching				0		
Adjusted BCA				baa2		

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	1	0	baa1	3	A1	A1
Counterparty Risk Assessment	1	0	baa1 (cr)	3	A1(cr)	
Deposits	0	0	baa2	3	A2	A2

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

Source: Moody's Investors Service

Ratings

Exhibit 7

Category	Moody's Rating
FIRST INTERNATIONAL BANK OF ISRAEL LTD.	
Outlook	Stable
Counterparty Risk Rating	A1/P-1
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	A1(cr)/P-1(cr)

Source: Moody's Investors Service

Endnotes

1 The measures include loan-to-value limits, a monthly repayment cap at 40% of a borrower's month salary and limit on the variable-rate of interest part of the mortgage.

2 In November 2020, the authorities also lowered the bank's leverage ratio requirement to 4.5%, from 5% previously.

3 Benefitting also from lower provision from bonuses.

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