



ISRAEL

**REVIEW OF THE PRIVATE
PENSIONS SYSTEM**

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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FOREWORD

This review of Israel by the Working Party on Private Pensions is part of a series of reviews of national policies undertaken for the OECD Insurance and Private Pensions Committee (IPPC). It was prepared as part of the process of Israel's accession to OECD membership.

The OECD Council decided to open accession discussions with Israel on 16 May 2007 and an Accession Roadmap, setting out the terms, conditions and process for accession, was adopted on 30 November 2007. In the Roadmap, the Council requested a number of OECD Committees to provide it with a formal opinion. In light of the formal opinions received from OECD Committees and other relevant information, the OECD Council decided to invite Israel to become a Member of the Organisation on 10 May 2010. After completion of its internal procedures, Israel became an OECD Member on 7 September 2010.

The IPPC was requested to examine Israel's position with respect to core principles related to insurance and private pensions systems. The examinations were carried out by the Working Party of Governmental Experts on Insurance (WPGEI) and Working Party on Private Pensions (WPPP). The present report was finalised on the basis of information available in July 2009. It is released on the responsibility of the Secretary General of the OECD.

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INTRODUCTION

This document has been prepared as part of the OECD's work in relation to Israel's application for accession to the OECD. The purpose of this document is to assist the Working Party on Private Pensions form an opinion on Israel's ability and willingness to meet the requirements of membership in the field of private pensions as set out in Appendix A.VIII of the Accession Roadmap for Israel adopted by the Council [C(2007)102/Final]. Accordingly, Israel will be assessed against the two core principles referred to in the Roadmap:

- ensuring sound prudential regulation of private pension systems and protecting the rights of members and beneficiaries; and
- relaxation of restrictions on cross border trade, investment and establishment of pension services as required under the OECD Codes of Liberalisation.

The Working Party reviewed the first core principle of the Roadmap (except supervisory matters) at its meeting in December 2008 on the basis of a first draft of this report. Following that meeting, the Chair sent a letter to the Israeli Delegation (dated 21 January 2009) including a set of questions for clarification. Israel responded in written (letter dated 31 March 2009 included in DAF/AS/PEN/ACS(2008)1/REV1/ADD4), providing detailed answers to all the questions.

A report on private pension supervision was prepared to support the discussion at the July meeting [DAF/AS/PEN/ACS(2008)1/REV1/ADD3], including draft recommendations on supervision. The Israeli Delegation provided comments on supervision during this meeting [DAF/AS/PEN/ACS(2008)1/REV1/ADD5].

In this revised report, particular attention has been paid as to how regulations, supervision and market-practice in Israel measure up in relation to the OECD Recommendation on Core Principles of Occupational Pension Regulation [C(2009)57], using the Methodology developed for this purpose [DAF/AS/PEN/WD(2008)1/REV2]. The detailed assessment and the main recommendations made by the Working Party are contained in the executive summary.

The report also addresses compliance with the "OECD Recommendation on Good Practices for Financial Education relating to Private Pensions" [C(2008)23]. Market access issues and the Codes of Liberalisation are addressed by the Working Party of Governmental Experts (WPGEI) which assists the Investment Committee in these matters.

The document contains two main sections: the executive summary contains a summary of the assessment of the implementation of the OECD Recommendation on Core Principles of Occupational Pension Regulation in Israel. It highlights the main points of convergence and divergence of the Israeli private pension system with the OECD Recommendation. Any differences with the OECD Recommendation, outstanding questions and areas for further discussion have been categorized and described under the appropriate OECD Core Principle. A reference is also made to the OECD

Recommendation on Good Practices for Financial Education relating to Private Pensions. The second section of this document contains a brief description of the Israeli pension system.

Four additional documents support the analysis and recommendations in this report:

- A detailed assessment of the Israeli Private Pension System in relation to the OECD Consolidated Core Principles of Occupational Pension Regulation (DAF/AS/PEN/ACS(2008)1/ADD1). The format for this assessment follows the format prescribed in the “Methodology for Assessing the Implementation of the OECD Consolidated Core Principles of Occupational Pension Regulation” (DAF/AS/PEN/WD(2008)1/REV2);
- A detailed assessment of the Israeli private pension supervisory framework against the IOPS Principles of Private Pension Supervision (DAF/AS/PEN/ACS(2008)1/REV1/ADD3), included as Principle 7 of the OECD Recommendation on Occupational Pension Regulation;
- The original submission by the Israeli authorities in response to the Questionnaire prepared by the Working Party on Private Pensions (DAF/AS/PEN/ACS(2008)1/ADD2);
- The response by the Israeli Delegation to the WPPP’s chair containing various questions for clarification (DAF/AS/PEN/ACS(2008)1/REV1/ADD4).

EXECUTIVE SUMMARY

Overview of the Israeli private pension system

The Israeli private pension system consists of five main types of pensions savings vehicles: old pension funds, new pension funds, new general pension funds, provident funds and life insurance. The main differences between them arise from the type of risks they insure against. For instance, new pension funds are required to provide members with death and disability benefits collectively financed by plan members. Provident funds, on the other hand, do not provide death and disability benefits. The two however, are subject to similar regulations. All pension savings are managed by external funds and providers.

The Israeli private pension system is supervised and regulated by the Capital Market Insurance and Savings Division (the CMISD), which is a division within Israel's Ministry of Finance. In 2008, Israel implemented mandatory pension coverage for all workers not covered by collectively bargained pensions. Members entitled to a mandatory pension or to a collectively bargained pension may choose to invest their pension savings in a new pension fund, a provident fund or a life insurance policy.

Pension assets are held by external pension managing entities and are completely segregated from employers. The pension managing entities are associated as limited companies holding insurance licenses and are entitled to operate solely in two areas of activity: pension fund and provident fund management.

Special regulations apply to the old pension funds and they are regulated differently than other pension savings vehicles. Some of the old pension funds are financially supported by the government, and these are managed by the non-profit organisation Amitim. The manager of the old pension funds under the government rescue program is appointed by the Israeli government.

Position of Israel with regards to the OECD Legal Instruments

In its Initial Memorandum and its presentation to the Working Party on Private Pensions, Israel formally stated that it accepted all six OECD legal instruments in the field of private pensions, highlighting that there is consistency in regard to policy and partial consistency in regard to legislation and implementation of the Core Principles.

The Working Party finds that Israel is largely compliant with the OECD Core Principles of Occupational Pension Regulation and the related Guidelines. Regulation is comprehensive and generally well designed. The country also has all the main features of a sound supervisory framework as stated in the Core Principles.

At the same time, the Working Party finds that there are some areas where further initiatives by policymakers would be appropriate to improve the operation of the private pension system. These initiatives include:

- Providing greater guidance and support to the supervised entities over their new responsibilities arising from recent legislative and regulatory changes [*Core Principle 1*];
- Reviewing the requirement to invest a minimum of 30% of assets in non-tradeable earmarked government bonds which applies both to the old and the new funds. Even though the floor was reduced in 2004 from a much higher level and the bonds have in the past provided high and stable yields, it represents a form of captive government financing and may interfere with the diversification objective [*Core Principle 4*];
- Assessing the suitability of different life-cycle investment strategies prior to their implementation as default options for pension savings products. A related issue to consider is whether the floor on government bond investments could be lifted for younger (or new) participants as they may be expected to invest more in equities and forego the government's investment performance commitment on the bonds. [*Core Principle 4*];
- Reviewing the fiduciary responsibilities and the conflict of interest restrictions of the external directors to promote their role in protecting the interest of the pension plan members. This should include strengthening accountability to plan members, especially in new funds where plan members bear all risks [*Core Principle 6*];
- Reviewing the legislation under which the CMISD operates to strengthen its independence, powers and to enhance its transparency [*Core Principle 7*].

The Israeli delegation has stated its general agreement with these recommendations and briefed the group on their planned implementation at the July meeting [DAF/AS/PEN/ACS(2008)1/REV2/ADD5].

The Working Party also finds that Israel is aware of the importance of financial education in the field of pensions and that it has launched useful initiatives, such as the Pension Handbook published by the CMISD which aims at assisting consumers in understanding their needs when they reach retirement age and to introduce them to the different savings channels and investment strategies available. Another important initiative is the one led by the CMISD and the Ministry of Education to incorporate financial contents in the educational programmes of local schools and the planned CMISD interactive website dedicated to pensions, whose purpose will be to increase awareness and involvement of consumers in their decisions in the context of pensions.

- The Working Party recommends furthering the implementation of the “OECD Recommendation on Good Practices for Financial Education relating to Private Pensions” [C(2008)23] via appropriate financial education programmes relating to private pensions.

Implementation of the OECD Core Principles of Occupational Pension Regulation

The following section provides a summary assessment of the Israeli private pension system against the OECD Recommendation on Core Principles for Occupational Pension Regulation, using the methodology developed for this purpose (DAF/AS/PEN/WD(2008)1/REV2). This section highlights the main points of convergence and divergence of the Israeli private pension system with the OECD Recommendation. Any differences with the OECD Recommendation, outstanding questions and areas for further discussion have been categorized and described under the appropriate Core Principle.

Core Principle 1: Conditions for effective regulation and supervision

The operation of pension plans is governed by a comprehensive regulatory system and the supervision of the Capital Market Insurance and Savings Division (the "CMISD"), a division of Israel's Ministry of Finance. The legal provisions define fiduciary responsibilities, investment restrictions, tax incentives, contribution rates, funding rules for deficits and surpluses, actuarial standards, financial reporting requirements, minimum and maximum ancillary benefits, conversions between defined benefits and account balances, etc.

Overall, the Israeli pension system is well regulated. A comprehensive reform of the pension system has transformed a system of significantly underfunded pension funds driven by a collective bargaining into a system of mainly individual defined contribution accounts with various levels of collective risk sharing. Banks have been forced to divest their provident funds under management. In 2008, portability was established between all pension savings vehicles. Further, tax rules have been equalized between the various long-term savings products, promoting a more easily comparable playing-field between the different products.

Core Principle 2: Establishment of pension plans, funds and fund managing companies

Israel has a fully-fledged and well-developed licensing framework for pension fund managing entities including most of the requirements of the Core Principle. The Commissioner of the CMISD has the power to give, modify and withdraw an insurer's license. In some cases, the Commissioner must consult with the CMISD's Consulting Committee in order to get a recommendation before making his final decision. Should the insurer disagree with the Commissioner's final decision, then the insurer can appeal the matter in the Supreme Court.

The Control of Financial Services (insurance) law also grants the applicant entity the right of a hearing with the commissioner. The Consulting Committee plays the role of independent review of the Commissioner's final decisions with respect to the licensing process as it is composed of individuals who are external to the CMISD.

Core Principle 3: Pension plan liabilities, funding rules, winding up, and insurance

The Israeli private pension system has been transformed into a defined contribution system with collective risk-sharing elements of varying degrees. In particular, the old pension funds that were defined benefit in nature are now completely member-financed. Only a few employer-sponsored funds remain (like the one of the electricity company).

In the old pension funds, members accrue pension benefits according to a traditional percentage of career average pay formula. However, if the funding status of these plans deteriorates or improves, then the member's accrued benefits are adjusted accordingly. The distribution of any adjustment to

member's accrued benefits is made at the discretion of the entity managing the old pension funds. The CMISD is considering issuing guidance on how adjustments should be made to ensure standardised practice between all the old pension funds.

For this reason, many of the implementing guidelines under this Core Principle are not applicable. In particular, there is no requirement for further employer contributions to the member-financed old pension funds.

Core Principle 4: Asset Management

Asset management regulations have been largely reformed and liberalized in recent years. Most quantitative investment limits have been abolished. An important restriction remains, namely the requirement on both the old and the new funds to invest a minimum of 30% of assets in non-tradeable, earmarked government bonds. This restriction may interfere with the diversification objective and the planned introduction of member choice of investments and is discouraged by the OECD Core Principles.

The non-tradeable government bonds are generally viewed by the Israeli public as a government subsidy of the old and new pension funds, returning a relatively high and stable return of approximately 4% plus inflation annually. This subsidy may distort the market in favour of new pension funds at the expense of other forms of pension savings available through provident funds and life insurance policies.

The regulation does not currently allow for investment choice and default options. This is a particularly important issue since the private pension system is mandatory. Some of Israel's defined contribution pension plans allow member-directed investments. In the funds where no such member-directed investment is allowed, there is only one investment track for all fund members. No consideration is taken to individual member age or risk profile. It is important to note, however, that given the collective risk sharing inherent in the new pension funds, care must be taken that such risk-sharing is fairly and consistently applied in the event members are given personal choice as to their preferred asset allocation and personal investment risk/return profile.

The Israeli government decided at the end of 2008 to carry out a reform which would introduce a requirement for a life-cycle strategy in pension savings products. According to the reform various investment tracks would be established with age-based investment profiles which would serve as default options for savers who do not make an investment choice on their own initiative.

Core Principle 5: Rights of members and beneficiaries and adequacy of benefits

The rights covered by the Core Principles are generally reflected in the Israeli regulation. In particular, disclosure requirements are very comprehensive and there is full and immediate vesting and portability.

A lack of broad financial knowledge among plan members has been raised as an area of concern. This issue will become even more important when investment choice by participants is implemented.

Core Principle 6: Governance

The governance requirements for pension funds in Israel are strong, in particular because they are under the responsibility of dedicated providers, the managing entities, which are subject to strict licensing requirements (see discussion on licensing above). However, since the managing entities are commercial providers, there is a potential for conflicts of interest emerging as these institutions are ultimately accountable to their shareholders.

Under this set-up, there is no requirement for member representation on the governing body of the pension funds (through e.g. oversight committees) or their managing entities. This limits the extent of accountability to plan members. Plan sponsors do not play a role in governance either as the choice of managing entity is made by the member.

The main source of internal protection of the interests of the pension fund members are the so-called external directors, who may not have a business affiliation with the pension entity nor be a controlling shareholder. The Insurance Control Law stipulates that at least a third of the members of the board of directors must be external directors. Recent regulations by the Finance minister have further stipulated that at least half of the external directors must have experience or specialization in the area of pension activity or at similar financial bodies. In addition, the CMISD is currently promoting two initiatives for strengthening the status of the external directors: the first is by means of increasing the external directors' remuneration, and the second is by means of a new directive whereby a majority of two thirds of the external directors on the investment committee of provident funds, pension funds and yield-dependant life insurance plans is required in order to approve transactions with related parties.

Core Principle 7: Supervision

Israel has a fundamentally sound system of pension supervision, which fully or broadly complies with all the International Organisation of Pension Supervisors (IOPS) Principles of Private Pension Supervision.

The CMISD has objectives prescribed in its governing legislation that are high level and relate to proper fund management and the protection of pension fund members' and beneficiaries' interests. While they are not specific to pension funds, they are sufficiently broad to cover pension activity.

Although the CMISD is a division within Israel's Ministry of Finance, the role of its head (Commissioner) is established in a statute, as is its Advisory Committee. The Commissioner exercises most powers in his own name and is in that sense operationally independent.

CMISD is developing a framework for risk-based supervision with assistance from the Toronto Centre. Its objectives are, however, already consistent with applying a risk-based approach. Furthermore, a considerable degree of risk orientation can be discerned in CMISD's actions.

While there is no governance manual or procedures manual as such, there is some documentation of internal procedures. CMISD is considering bringing together all the relevant conditions applying to staff in a specific code of conduct, bringing together in one place the circulars it has issued to supplement the more general Government code that already applies to all staff.

While the Commissioner frequently gives evidence before the Knesset, there are no external reports on the performance of CMISD, nor published performance measures although, as part of the annual planning round there is an internal report to the Commissioner on how CMISD has actioned the previous plan. CMISD applies the Finance Ministry's internal controls but has no risk management process.

DESCRIPTION OF THE ISRAELI PENSION SYSTEM

I. The Israeli Public Pension System

Old-age insurance is one of the most important insurance lines in the National Insurance Institute's social insurance system, and is intended to guarantee that Israeli residents obtain a fixed monthly income in their old age, irrespective of their income level. Under the National Insurance Law, those who have reached the qualifying age are entitled to receive an old-age allowance, providing that they were insured for the period of time required under the Law and insurance fees were paid on their behalf as required under the Law. Those claiming to be Israeli residents must prove that their life is centred in Israel, for example by virtue of permanent place of residence, family place of residence, place of children's education, principal place of work, or place of education.

A major reform recently enacted with respect to national insurance has been the raising of the retirement age for recipients of old-age allowance from the National Insurance Institute from 65 for men and 60 for woman, to 67 for men and 64 for women.

Payment of national insurance fees:

The National Insurance Institute in Israel operates under the Pay-As-You-Go method, whereby during the period of work (from the age of 18 to retirement age) every person is required to pay in fixed rates of his or her income as specified in the following table:

Salaried employees			
	Employer	Employee	Total
Part of earnings up to 60% of average wage			
National insurance fees	3.85%	0.40%	4.25%
Part of earnings above 60% of average wage			
National insurance fees	5.43%	7.00%	12.43%
Self-employed			
Part of earnings up to 60% of average wage			
National insurance fees	6.72%		
Part of earnings above 60% of average wage			
National insurance fees	11.23%		
Non-working with income			
Part of earnings up to 60% of average wage			
National insurance fees	4.61%		
Part of earnings above 60% of average wage			
National insurance fees	7.00%		
Non-working		NIS 141	

Rates of old-age allowance from the National Insurance Institute:

The average monthly allowance to recipients of old-age allowances from the National Insurance Institute is approximately 30% of the average wage in the economy.

Since every worker in the State of Israel is legally obliged to deduct a monthly payment from his earnings to the National Insurance Institute, coverage by the National Insurance Institute is provided to the entire working-age population in Israel.

II. The Israeli Private Pension System

II.1 Types of Private Pension Plans

The Israeli pension system consists of five main types of pensions savings vehicles. All pension savings are managed by external funds and providers.

- The old pension funds;
- The new pension funds;
- The new general pension funds;
- Provident funds
- Life insurance

The Israeli pension system is supervised and regulated by the Capital Market Insurance and Savings Division (the CMISD). The CMISD is a division within Israel's Ministry of Finance.

Historically, pension funds in Israel have been established through collective agreements between employee organisations and employers. The first pension funds were established by the Histadrut labour federation during the 1940's, and were first intended to insure pension savings for salaried workers only. In the past, the obligation imposed on employees in various branches of the economy to join the Histadrut pension funds was established in the collective agreements signed by the workers' representatives, the employers and the funds, some of which were expanded so that they covered additional populations, through expansion orders published by the Minister of Labour and Welfare. In the middle of the 1980's, the first pension plan for independent workers was established, and a number of additional funds were established during the early 1990's – funds which were not connected to the Histadrut, which also took in independent workers.

In 2008, Israel implemented mandatory pension coverage for all workers not covered by collectively bargained pensions. Members entitled to a mandatory pension or to a collectively bargained pension may choose to invest their pension savings in a new pension fund, a provident fund or a life insurance policy.

Non-Tradeable Earmarked Government Bonds

Both the old and new pension funds are required to invest in 30% non-tradeable earmarked government bonds. These bonds have returned a relatively stable and high yield of approximately 4% plus inflation. They are generally viewed by the Israeli public as a government subsidy of the old and new pension fund systems. General new pension funds, provident funds and life insurance policies do not have access to these types of bonds.

II.2 Old Pension Funds

The old pension funds were established as not-for-profit entities (cooperative associations) and provided benefits that were mainly defined benefit in nature to workers in different occupational sectors. Large actuarial deficits emerged in these defined benefit pension plans in the 1980's and 1990's. Due to these actuarial deficits, these plans were closed off to new insureds in the beginning of 1995, and new plans were opened which took in new insureds that joined the pension market after that date. Pre-1995 members would continue to accrue benefits in these plans, termed "old pension funds". However, all pension plans established in 1995 and after would be primarily defined contribution in nature. These plans are termed "new pension funds" and are described later in this paper.

Some of the old pension funds were defined contribution in nature. These plans have also been closed to new members.

Government Rescue of the Old Pension Funds

The 1995 Government Resolution established a general outline for rescuing the old pension funds from their actuarial deficits and for the implementation of a recovery program. However, this program was not put into effect for several years when the actuarial deficits had worsened.

The total deficit in 2002 reached NIS 109 billion. Under these circumstances, the government decided to take a series of steps in order to bring about the recovery of the old pension funds, to limit their actuarial deficits and to ensure their professional management. The main measures taken to bring about the recovery of the old pension funds, the limitation of their actuarial deficits and the securing of professional management were the following:

- Government assistance of some NIS 80 billion to be paid over a period of 35 years (plus 4% interest on the payments). No further government assistance would be made for these plans.
- The raising of the retirement age from 65 to 67 for men and from 60 to 64 for women.
- The appointment of special professional managers by a public committee, for the management of the funds;
- The establishment of a mechanism for a uniform set of rights, through the establishment of uniform by-laws for all funds in the arrangement;
- Modification of the method of calculating the pension – the transfer of all insureds to the career average method;
- Raising the total contribution rate from 17.5% of the member's salary to 20.5%;
- The financial responsibility of the old pension funds was transferred to the plan members;
- The collection of pension management fees.

Some, but not all the old funds participated in the federal recovery program.

Benefit and Contribution Levels

Although the old pension funds were closed to new members in 1995, existing members at the time of the change are entitled to continue accruing benefits. For each year in a fund, a member accrues on average rights equivalent to 2% of his determinant earnings for pension. Accordingly, a worker who paid into an established fund for 20 years will have accrued rights amounting to 40% of the determinant earnings as a pension once he or she retires. These earnings are set as the average for the last three years of work or as an average of wages in the economy.

The rates of contribution required at most of the old pension funds are:

Employee	Employer	Employer's provisions for severance pay
7%	7.5%	6%

The Israeli government is solely obliged to make the remaining payments on the NIS 80 billion that was committed in the original rescue package. All remaining financial responsibility of the old pension funds rests with the plan members. If the old pension funds experience a cumulative actuarial loss or gain that exceeds approximately 5%, then pension benefits are decreased or increased accordingly. Beyond the government commitment of NIS 80 billion to be paid over 35 years as part of the rescue package, no further funding of these plans will be made by the government or the employers.

None of the old pension funds has yet had to reduce member pension benefits due to excess cumulative losses. Should such a benefit cut be required, the individual old pension funds have discretion as to how the benefit cuts be distributed among members. The CMISD is considering issuing centralized guidance on how such benefit cuts should be distributed.

II.3 New pension funds

In the beginning of 1995, in the context of the Government Resolution closing the old pension funds to new members, the Government also resolved to establish new pension funds. The new pensions are open to the entire population, such that every person is given the opportunity to enjoy the benefits of a pension.

Similarly, any entity meeting the criteria established by the Commissioner of Insurance and by the statutory provisions, and who obtains the required licenses and approvals may engage in the management of a pension fund. This was an important development which transformed pensions into an accessible product and, for any entity meeting the regulatory criteria, it opened up the opportunity of engaging in this field.

The principles of the new pension funds are as follows:

- The funds operate as defined contribution, with the funds accumulated in the individual member accounts determined as the total member and employer contributions, plus investment return, less fees deducted by the management company. At retirement, member account balances must be withdrawn in the form of a life annuity of at least a minimum level, whereas any remaining funds may be withdrawn in the form of a lump sum;
- Any person, salaried employee or independent worker, can join a fund either by virtue of an agreement with a corporation or entity or a collective agreement, or on an individual basis, in contrast to the situation regarding the old pension funds, in which membership was on the basis of collective agreements;
- The new funds are established in the framework of a single legal personality – a management company limited by shares, and the fund itself is managed as a system of accounts within the framework of the company, with the pension assets legally separated from those of the managing entity;
- The size of the insured salary is not greater than two times the average salary within the economy;
- The funds may not accept one-time deposits;
- A pension in a new fund may only be a comprehensive one – i.e., it must offer the insured insurance coverage for disability and death, as well as a savings component;

- The management company may deduct management fees from the pension fund that it manages only out of the benefit amounts and the assets balance;
- The risk for the death and disability benefits, as well as the risk associated with the annuitisation of benefits is fully and collectively borne by the fund members. In order to keep the funds fully funded, the funds prepare an actuarial balance sheet each year, and the account balances of the members and the benefits paid to pensioners are increased or decreased in accordance with any funding surplus or deficit that may have emerged over the course of the year.

Benefit and Contribution Levels

The rates of contribution existing at most of the new pension funds are:

Employee	Employer	Employer's provisions for severance pay
5 - 5.5%	5 - 6%	6% - 8.33%

The Israeli pension funds pay a lifetime benefit to each member when he or she retires. If a member has accumulated an amount that grants him or her an old age pension that is larger than the minimum pension (which currently amounts to NIS 3,850), then the member may withdraw the balance of the funds as a lump-sum payment.

As mentioned above, the new pension funds are fully self-insured. If death and disability experience creates actuarial gains or losses within the pension fund, then individual account balances are adjusted accordingly for the active members in order to bring the pension fund into financial balance. Similarly, if actuarial gains or losses are experienced with respect to annuity payments, then adjustments are made to the account balances of active and deferred members and adjustments are made to pension benefits for pensioners in order to bring the pension fund into financial balance. Such balancing is required on an annual basis and keeps the funds fully funded.

II.4 New General Pension Funds

On 17 January 1999, a new form of pension funds was given a legal framework – the new general pension funds. Pension funds of this type are not entitled to purchase earmarked debentures.

A new general fund is intended to provide a solution for savers wishing to save only for purposes of an old-age pension, without acquiring comprehensive insurance which provides disability insurance and survivors' pensions, in addition to an old-age pension. These funds also provide solutions for savers with salaries that are higher than twice the economy's average monthly salary for salaried workers. The general pension funds are the only pension funds in which one-time deposits can be made.

In 2005, directives were enacted regarding the management of these funds, which allowed them to provide insurance against loss of earning capacity and life insurance. Currently, several of these funds do include these tracks as well.

II.5 Provident Funds

A provident fund is a saving instrument for retirement. These are “pure” savings instruments which do not include any insurance coverage for the fund member. In the provident funds, each member has a separate account in which are recorded the member’s deposits into the account, his withdrawals from the account, the profit (or loss) with respect to his investment in the fund, and the management fees collected from his account. The return is divided among the fund’s members in proportion to their share in the fund’s assets. As of the end of 2007, there were 226 provident funds in Israel.

Through the end of 2005, independent workers who saved in this type of instrument were entitled to withdraw their funds as a lump sum at the end of 15 years from the date the account in the fund was opened, regardless of their age, but since 2006, the rules were amended and were equalized with the withdrawal rules for salaried fund members, such that the funds may be withdrawn only when the member reaches age 60.

Savings that are deposited in Provident Funds must be withdrawn at retirement in the form of an annuity up to a minimum which currently amounts to NIS 3,850. Above this minimum annuity, the rest of the savings may be withdrawn as a lump sum.

The recent legislative reform which requires provident fund assets to remain invested until age 60 and the requirement to withdraw savings at least as a minimum annuity have brought the terms of the provident funds into more close alignment with those of the new pension funds. Furthermore, provident funds may not invest in the non-tradeable earmarked government bonds which make up 30% of the new and old pension fund investments. These non-tradeable earmarked government bonds are seen by many Israeli’s as a government subsidy of the new (and old) pension funds given their relatively high and stable rates of investment return and as such, give the new pension funds a relative financial advantage over the provident funds in attracting members savings. For these reasons, it is believed by some industry experts that provident funds will become a less popular savings product in the future in relation to the new pension funds.

II.6 Life Insurance Policies

Israelis may also choose to save for retirement using true life insurance policies. In contrast with the new pension funds, life insurance policies offer traditional insurance for such risks as death and disability. Provident funds offer no death or disability insurance, and members of such funds may choose to seek insurance for the risk of death or disability through separate life insurance policies.

Life insurance companies in Israel started marketing life insurance policies even before the establishment of the State. Over the years, the structure of the policies has been modified, including through the introduction of an ability to separate between a part of the payment of benefits which is designated for insurance coverage (death benefits and/or loss of earning capacity) and a part of the payment which is designated for savings and is paid to the insured upon his retirement. As of the current time, the life insurance sector can be divided into two main types of instruments.

- Life insurance programs with a savings component – most of the amounts held in life insurance programs are to be found in this category, which is divided into programs which provide tax benefits from the State and constitute pension savings instruments (an insurance fund for salaried workers and an insurance fund for independent workers) and programs which do not receive tax benefits from the State (individual insurance). The manner in which the savings component is paid at the end of the insurance period (usually at the age of

retirement) is either a lump-sum payment or through a periodic annuity, at the choice of the insured. Usually, these programs also include insurance coverage in the event of death or the loss of earning capacity.

- Life insurance programs without a savings component – the programs provide coverage for insurance risks only, without a savings component, for death or for loss of earning capacity.

Life insurance policies may not invest in the non-tradeable earmarked government bonds that make up 30% of the investment of the old and new pension funds.

II.7 Mandatory pension

Beginning on 1 January 2008, according to an agreement signed by the trade union the New Histadrut and the Coordination Office of the Economic Organizations, the “Pension for Every Worker” process went into effect. After the Minister of Industry, Trade, and Labour signed an expansion order for the said agreement, every salaried worker in the economy became entitled to receive pension set-asides to be carried out by the employee himself and by his employer.

Due to this reform, all salaried employees in the economy are expected to have some kind of pension coverage within several years. The compulsory pension agreement and the extension order also apply to all the self-employed.

Under the provisions of the compulsory pension agreement, an employer is obliged to insure an employee up to the level of the average wage in the economy. If the employer wishes to do, there is nothing preventing him for insuring an employee at a higher wage level. Moreover, tax benefits for pension saving are granted for a wage of up to four times the average wage in the economy.

The employee’s and employer’s contribution rates as a percentage of pensionable salary under the compulsory pension agreement will be as detailed in the following table:

With effect from...	Employer’s provisions	Employee’s provisions	Employer’s provisions for severance pay	Total
With effect from 1.1.2008	%0.833	%0.833	%0.834	%2.500
With effect from 1.1.2009	%1.660	%1.660	%1.680	%5.000
With effect from 1.1.2010	%2.500	%2.500	%2.500	%7.500
With effect from 1.1.2011	%3.330	%3.330	%3.340	%10.000
With effect from 1.1.2012	%4.160	%4.160	%4.180	%12.500
With effect from 1.1.2013	%5.000	%5.000	%5.000	%15.000

The provisions of the law stipulate that the maximum rates of contribution to a pension fund will be as follows:

Employee	Employer	Employer’s provisions for severance pay
7%	7.5%	8.33%

The compulsory pension agreement does not apply to workers covered by collective agreements, pension arrangements or personal agreements under which the rates of provision exceed those in the compulsory pension agreement (beneficiary agreements). These workers will continue to make provisions at the rates prescribed in the agreements on which they are signed, while workers who do not have pension insurance or an insurance agreement as said will make provisions as prescribed in the compulsory pension agreement.

A member covered by the mandatory pension may choose to invest his or her pension savings in a new pension fund, a provident fund or a life insurance policy.

III. Regulatory and Supervisory Framework

The legislative framework in which the CMISD operates includes laws, regulations and circulars. These describe the CMISD's mandate and functions, including its authority to determine directives concerning the modes of operation and management of pension managing entities, their office-holders and their employees.

The main laws governing the private pension system in Israel are as follows:

- The Supervision of Financial Services (Insurance) Law, 5741-1981 and regulations by virtue of it.
- The Supervision of Financial Services (Provident Funds) law, 5765-2005 and the regulations by virtue of it.
- The Income Tax Regulations (Principles for the Approval and Management of Provident Funds), 5724-1964.
- CMISD circulars.
- The Insurance Contract Law, 5741-1981 (latest amendment on 29/3/01).

The regulations applying to provident funds and the new pension funds are similar because these are long-term saving instruments with similar purposes. Differences do arise, however, as new pension funds are required to provide members with death and disability benefits collectively financed by plan members. Provident funds do not provide death and disability benefits.

Pension assets are held by external pension managing entities and are completely segregated from employers. The pension managing entities are associated as limited companies holding insurance licenses and are entitled to operate solely in two areas of activity: pension fund and provident fund management.

Special regulations apply to the old pension funds and they are regulated differently than other pension savings vehicles. Some of the old pension funds are financially supported by the government, and these are managed by the non-profit organisation Amitim. The manager of the old pension funds under the government rescue program is appointed by the Israeli government.

IV. Main Indicators of the Private Pension System

IV.1 Assets

There are 18 old pension funds operating in the market. Together they manage some NIS 165 billion worth of assets (as of the end of 2007). Although the old funds are closed to new members, they continue to hold most of the accumulated capital in the pension fund market in Israel.

There are 25 new pension funds operating in the market. Together, they manage some NIS 47 billion worth of assets (as of the end of 2007).

As of December 2006, there were 13 companies licensed to engage in life insurance, of which 1112 market policies that include a savings component. As of the end of 2007, the insurance companies were managing some NIS 145 billion worth of assets, of which some 67% is in the framework of a profit sharing portfolio. Most of the assets in the portfolio are for insurance programs that are approved as provident funds, and the remainder covers insurance programs that are not approved as provident funds (individual policies).

The total pension assets in thousands NIS from the old pension funds and the new pension funds are as follows:

Type of program	Number of funds	As a %	Number of members	As a %	Total assets	As a %
Defined benefit old pension programs	12	28%	894,640	%44	148,175,000	72%
Defined contribution old	6	%14	76,360	%4	11,269,000	%5
Defined contribution new pension programs	25	58%	1,038,295	52%	47,272,000	23%

IV.2. Asset Allocation

The asset allocation of pension assets in Israel has not been provided.

IV.3. Investment Return

The average gross nominal yields of pension funds in Israel, in recent years, have been the following:

Year	2001	2002	2003	2004	2005	2006	2007	Average
Gross Yield	8.75%	8.35%	7.60%	7.08%	10.88%	6.75%	9.01%	8.35%

IV.4. Fees

The mechanisms for collecting management fees in pensions savings product are the following:

Product	Management Fees as a percentage of Deposits	Annual Management Fees as a Percentage of Accumulated Savings
New Pension Funds	Up to 6%	Up to 0.5%
Old Pension Funds in the Arrangement	According to actual results	
Balanced Old Pension Funds	Separate mechanism for each fund	
Insurance Collection only from accumulated funds	None	Up to 2%
Mixed collection track (fixed)*	Up to 7%	Up to 1.4%
Mixed collection track (variable)*	Up to 13% and dropping to 5% in general over 12 years	Up to 1%
Provident funds	None	Up to 2%
Old Pension Funds in the Arrangement	1.75% of the paid annuities	

Source: CMISD

* There is a wide variety of possibilities for management fee collection in insurance and the tracks presented here are the most common ones. A full description can be obtained in the document that compares policies between companies on the website of the Capital Markets, Insurance and Savings Division.

IV.5. Coverage

Some 53% of the elderly population in Israel currently has some form of pension coverage, as do 63% of salaried workers. The coverage of the active workforce is expected to significantly increase over the next few years given the recent introduction of the mandatory pension system.