



ISRAEL

**REVIEW OF THE INSURANCE
SYSTEM**

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The OECD is a unique forum where governments work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies.

The OECD member countries are: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The European Union takes part in the work of the OECD.

OECD Publishing disseminates widely the results of the Organisation's statistics gathering and research on economic, social and environmental issues, as well as the conventions, guidelines and standards agreed by its members.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

Ce document et toute carte qu'il peut comprendre ne préjugent en rien du statut de tout territoire, de la souveraineté s'exerçant sur ce dernier, du tracé des frontières et limites internationales, et du nom de tout territoire, ville ou région.

FOREWORD

This review of Israel by the Working Party of Governmental Experts on Insurance 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.

TABLE OF CONTENTS

INTRODUCTION.....	9
EXECUTIVE SUMMARY.....	11
1. THE ISRAELI INSURANCE MARKET: MAIN FEATURES	17
1.1. Market structure: a highly concentrated market dominated by five composite insurance groups.....	17
1.2. Evolution of the insurance sector.....	21
1.2.1. General market trends	21
1.2.2. Evolution of the life insurance market: a new institutional structure giving insurance companies a key role in the financial sector	28
1.2.3. Evolution of the non-life insurance market: a decade marked by the opening of the motor vehicle insurance line to competition	34
1.2.4. Reinsurance.....	36
1.3. Distribution networks: the predominance of insurance agents	37
1.4. Corporate governance regime	38
1.5. Main risk exposure of the insurance sector	38
2. REGULATORY, SUPERVISORY AND TAXATION FRAMEWORK	42
2.1. A legal system revamped in the wake of the Bachar reform	42
2.1.1. Summary of recent policy and regulatory initiatives	42
2.1.2. Licensing process.....	43
2.1.3. Supervision of insurance products	43
2.1.4. Solvency requirements.....	44
2.1.5. Insolvency	52
2.1.6. Technical provisions	52
2.1.7. The liberalisation of investments	53
2.1.8. Risk management.....	55
2.1.9. Accounting, disclosure, and requirement to hire appointed actuaries.....	55
2.1.10. Consumer protection	56
2.2. Supervisory System: the challenges ahead	56
2.2.1. The institutional framework of the financial sector supervision.....	56
2.2.2. The issue of the independence of the CMISD.....	57
2.2.3. Enhanced cooperation with other regulatory and supervisory authorities	57
2.2.4. The CMISD's new structure and professional abilities, to adapt to a new financial landscape.....	58
2.2.5. Organisation of supervision (See Figure 10).....	60
2.2.6. Early intervention and insolvency management	61
2.2.7. Penalties and enforcement authorities.....	62
2.3. Taxation of insurance companies	63
2.3.1. General framework.....	63
3. INSURANCE MARKET ACCESS	64
3.1. Framework for foreign participation in domestic insurance markets	64
3.1.1. Treatment of foreign investors relative to domestic investors	64

3.1.2. Transparency of insurance regulation and market access process	64
3.1.3. Adherence to multilateral regional and bilateral trade agreements in respect of financial services in general and insurance and private pensions services in particular.....	65
3.2. Treatment of cross-border transactions.....	65
3.2.1. Treatment of cross-border insurance.....	65
3.2.2. Treatment of cross-border reinsurance.....	66
3.3. Establishment and operation of subsidiaries, branches or agencies of foreign entities	66
3.3.1. Establishment of subsidiaries, branches or agencies of foreign entities	66
3.3.2. Operation of subsidiaries, branches or agencies of foreign entities	68
3.3.3. Tax treatment	68
3.4. Israel proposed reservations under the insurance and private pensions related provisions of the OECD Code of Liberalisation of Capital Movements.....	70
3.5. Israel proposed reservations under the insurance related provisions of the OECD Code of Liberalisation of Current Invisible Operations.....	70
4. CONSISTENCY OF ISRAEL REGULATION AND SUPERVISION WITH OTHER OECD LEGAL INSTRUMENTS ON INSURANCE.....	72
4.1. Recommendation of the Council on Guidelines for Insurers' Governance: C(2005)45	72
4.2. Recommendation of the Council on Assessment of Reinsurance Companies: C(98)40	83
4.3. Recommendation of the Council on Good Practices for Enhanced Risk Awareness and Education in Insurance Issues: C(2008)22	84
4.4. Recommendation of the Council on the Establishment of a Check-list of Criteria to define Terrorism for the Purpose of Compensation: C(2004)63/REV2	89
4.5. Recommendation of the Council on Good Practices for Insurance Claim Management: C(2004)62.....	90
4.6. Recommendation of the Council concerning a Common Classification of the Classes of Insurance Recognised by the Supervisory Authorities of the Member Countries [C(83)178]	95
4.7. Recommendation of the Council concerning Institutional Co-operation between Authorities of Member Countries Responsible for Supervision of Private Insurance [C(79)195/Final]	100
ANNEX 1: CORPORATE GOVERNANCE REGIME	101
ANNEX 2: CALCULATION OF TECHNICAL PROVISIONS	109

Tables

1. The Market Segments of the 5 Leading Insurance Groups	17
2. Concentration ratios in Long Term Saving Market (2007)	18
3. Competition indicator (CR3) in Long Term Saving Market	18
4. HHI/10000: Competition Indicators in Long-Term Saving Market.....	19
5. Foreign investors market share (June 2008).....	21
6. Recent evolution of insurance density for life and non-life activities	22
7. Penetration Ratio, 1998- 2007.....	23
8. Annual Growth Rate of Premiums, 1998-2007	23
9. Main Financial Data of the Insurance Companies, 2003-2007	23

10. Evolution of assets and investment returns in life insurance, 2004-2008/9	27
11. Banks holdings in provident funds and mutual funds: transition measures	28
12. Coverage of catastrophic risks in Israel.....	41
13. Summary of major recent reforms in the insurance sector since 2000	42
14. Insurance products notification/approval	44
15. Linking the Israeli reform to the European Solvency II process	48
16. Capital requirements for investment assets and for exposure to reinsurers' credit risk ..	50
17. Insurer's current investment portfolio.....	54
18. Number of complaints 2001-2008.....	56
19. Breakdown of the audits that were conducted on insurance companies since 2005	60
20. Foreign Participation in the insurance sector, as of October 2008 (in per cent).....	64
21. Entrance of Foreign Investors - Insurance Companies.....	69
22. Comparison Between Israel's and OECD Classification	96
23. Ratio of Participating Policies to the Insurance Companies' Total Liabilities.....	108

Figures

1. Penetration and Density Ratios, 2006	22
2. Profits of insurance industry as compared to the Tel Aviv 25 index.....	26
3. The emergence of large financial groups	29
4. The emergence of large financial groups (2).....	30
5. Main life insurance products	31
6. Health insurance in Israel	36
7. Intermediaries by license type in the pension line.....	38
8. Ratio between the capital required according to Solvency 1 and the capital required according to the existing Israeli model – Israeli insurance companies involved in general and life insurance (December 2006 data)	47
9. Ratio between the capital required according to the British model and the capital required according to the existing Israeli model – Israeli insurance companies involved in life insurance only (December 2006)	47
10. Ratio between the capital required according to the Australian Model and the capital required according to the existing Israeli model – Israeli insurance companies involved in general insurance only (December 2006 data)	48
11. Capital Market, Insurance and Savings Division - Organization Chart	62
12. Insurance Control Law Structure.....	63

Boxes

Box 1. Why were RoE exceptionally high until 2007?	26
Box 2. The impact of the financial crisis	27
Box 3. Expansion of the non-bank credit market	29
Box 4. The Bachar Reform and its influence on the Israeli insurance system	32
Box 5. Small foreign presence in an open market offering high returns: towards the end of a paradox?	69

INTRODUCTION

This document has been prepared as part of the OECD's work in relation to Israel's application for accession to the Organisation. This document is meant to provide the basis for a discussion of the Israeli insurance market and its system of regulation and supervision, which will assist the Working Party of Governmental Experts on Insurance (WPGEI) in forming a view on Israel's commitment to the following core insurance principles as laid out in the Accession Roadmap:

- ensuring sound prudential regulation of insurance and reinsurance markets and protecting the rights of policy holders and beneficiaries, and
- relaxation of restrictions on cross-border trade, investment and establishment in insurance services as required under the OECD Codes of Liberalisation.

This view will form the basis of a Recommendation to the IPPC.

The current document contains:

- an executive summary,
- a description of the main features of the Israeli insurance market,
- a presentation of the insurance regulatory, supervisory and taxation framework,
- a review of market access issues, and an assessment of the compliance on Israel's laws, regulation and policies against OECD Codes of Liberalisation, and
- an assessment of the compliance on Israel's laws, regulation and policies against other insurance related OECD legal instruments¹.

This document has been prepared on the basis of the responses of Israel to the IPPC accession questionnaire (see document DAF/AS/ACS(2008)1/ADD2), replies to follow-up questions (most of which are reflected in documents DAF/AS/ACS(2008)1/ADD3 and 4), Israel's Initial Memorandum, the discussion held at the occasion of the first and second accession reviews meeting held by the WPGEI on December 3rd, 2008, and 1st April, 2009, work of the Investment Committee on Israel accession, as well as selected outside sources.

The Investment Committee has reviewed Israel's proposed position against the OECD's Codes of Liberalisation on 15 December 2008 and 17 June 2009. The Chair of the Investment Committee

¹ This chapter integrates the work that has been conducted so far by the Investment Committee on insurance issues.

subsequently sent two letters to Israel identifying a number of areas where Israel's proposed position under the instruments should be improved, including matters concerning insurance.²

Delegates are invited to conclude their deliberations by considering this draft report for adoption and submission to the IPPC in a closed session. The WPGEI will determine its overall assessment based on the past reviews, and on the ability and willingness of Israel to assume the obligations of OECD membership in the field of insurance and private pensions.

² See the Investment Committee's report on Israel (DAF/INV/ACS(2008)2/REV1), the 2 February 2009 letter of the Chair of the Investment Committee Accession Examinations to Israel (DAF/INV/ACS/M(2008)1) and Israel's response to this letter (DAF/INV/ASC/RD(2009)1).

EXECUTIVE SUMMARY

With about € 6 338 million premiums collected in 2007 for a population of over 7 million habitants, Israel ranked 18th of OECD countries in terms of penetration and 20th in terms of density. An increase in capital and technological requirements streamlined the market structure over the past ten years. The market is now characterised by its **concentration** around five composite insurance groups accounting for nearly 80% percent of total gross premiums, and a **low level of competition**.

Israel's insurance sector has undergone an ambitious set of reforms since the millennium. Most recently, the 2005 Bachar reform appears as a major endeavour towards a **wide-ranging modernisation of the framework in which financial institutions evolve**. It entails many new opportunities for Israeli as well as foreign-owned insurers, and mainly:

- a **significant increase in the scope of insurance companies' activities**, now including the management of mutual and provident pension funds. This involvement of insurance companies in investment and long-term savings management allows greater competition between the banks and other financial institutions as well as among long-term savings products. Insurance companies are now a central player in the financial sector, formerly dominated by the banks;
- the deepening of the Israel capital markets, their **integration into global capital market** and **a liberalisation of investment regulations**, allowing for more efficient investments of insurer assets, and greater involvement in foreign markets; and
- a **reduction of government involvement in the sector**.

Reforms in the insurance sector have been supported by:

- steady **economic growth** until 2007 (with a rate of 5,4 % for that year) – despite the resilience of Israeli economy so far, the worldwide financial crisis will nevertheless weigh on Israeli output growth for 2008 - 2009;
- **demographic trends** favorable to the development of health / long-term care insurance in particular; and
- a broadly **favorable regulatory regime**, increasingly open to foreign investors in order to encourage competition and enhance market efficiency.
- The competence of the CMISD's senior staff.

The important challenges and emerging risks entailed by these recent shifts in the financial landscape should, however, not be underestimated:

- The enlarged scope of activity of insurance companies, as well as the enhanced range of products in which they can invest, **challenge companies' risk management strategies and corporate governance structures**;
- They also call for **enhanced independence of the supervisor**, as well as a **commensurate upgrade of the regulatory and supervisory framework**. The progressive alignment with international standards in various regulatory areas is a promising step. The regulatory and

supervisory authorities should now focus on the **consolidation of reforms and close monitoring of their implementation**, to strengthen insurance companies' resilience in a context of global economic turmoil;

- The development of participating life insurance plans³ **shifted the investment risk**, formerly borne by insurers, **to the policyholders**, who need to receive adequate financial education and information on their exposure;
- The recent wave of mergers and acquisitions resulted in **high market concentration**, leaving **little room for competition within the insurance sector**; moreover, due to the financial crisis as well as several internal factors, such as the introduction of more stringent capital requirements, RoE (Return on Equity) have dropped sharply, in a market where **growth appears to have tailed off** in several insurance lines.

CONSISTENCY OF ISRAEL REGULATION AND SUPERVISION WITH OECD INSURANCE RELATED LEGAL INSTRUMENTS

1. Market access

Israel enjoys a broadly **favorable regulatory regime**, increasingly open to foreign investors in order to encourage competition and enhance market efficiency. There is no discrimination between foreign investors and local investors with respect to general property rights, shareholder rights, and disclosure and reporting requirements.

The supply of insurance services of all kinds **requires incorporation or registration as a branch** in Israel. Foreign investors wishing to operate through a subsidiary are granted an Israeli insurer's license, while branches of foreign insurers will obtain a foreign insurer's license.

Both the cross-border provision of insurance services (except for reinsurance and retrocession), and activities by foreign insurers in Israel aimed at advertising the cross-border provision of their services are prohibited in Israel. Israeli residents may nevertheless purchase abroad, at their own initiative, policies from non-admitted insurers.

Reinsurance operations by foreign companies established abroad are not supervised in Israel. There are no limits on reinsurance with non-established reinsurers. However, non-established foreign reinsurers are required to constitute deposits or collateral with direct insurers.

Four insurance companies are controlled by foreign insurers operating via subsidiaries, and two foreign insurers have branches in Israel. The market leader is 70% foreign-owned. More than 30% of Israeli non-life insurance and long-term savings are in companies in which foreign investors have substantial holding.

1. 2. Israel proposed reservations under the insurance and private pensions related provisions of the OECD Code of Liberalisation of Capital Movements⁴

List A, I/A Direct investment:

– In the country concerned by non-residents.

³ In Israel, this terminology refers to unit-linked products, and not to with-profits life insurance policies.

⁴ This paragraph as well as section 2) (Israel proposed reservations under the insurance and private pensions related provisions of the OECD Code of Liberalisation of Current Invisible Operations) reflect the work carried out by the Investment Committee in cooperation with the WPGEI and the WPPP (see document DAF/INV/ACS(2008)2/REV1).

Remark: The reservation applies only to:

- i) the requirement that a branch of a foreign insurer must invest at least 110% of its surplus of assets over the sum of (i) its insurance liabilities in Israel and (ii) its minimum required excess of assets over liabilities. The reservation will cease to apply by the end of 2009;*
- ii) Establishment of branches by non-resident private pension funds.*

1.3. Israel proposed reservations under the insurance and private pensions related provisions of the OECD Code of Liberalisation of Current Invisible Operations

D/2 Insurance relating to goods in international trade

Annex I to Annex A, Part I, D/2

Remark: The reservation does not apply to insurance services purchased abroad at the initiative of the proposer.

D/3 Life assurance.

Annex I to Annex A, Part I, D/3, paragraphs 1 and 3

Remark: The reservation under paragraph 1 does not apply to insurance services purchased abroad at the initiative of the proposer.

The reservation under paragraph 3 applies only to insurance contracts with saving components benefiting from tax deductions.

D/4 All other insurance.

Annex I to Annex A, Part I, D/4, paragraph 4

Remark: The reservation does not apply to

(i) Insurance services purchased abroad at the initiative of the proposer.

(ii) Non-compulsory railway insurance.

D/6 Conditions for establishment and operation of branches and agencies of foreign insurers.

Annex I to Annex A, Part III, General Remark

Remark: The reservation applies only to the requirement that a branch of a foreign insurer must invest at least 110% of its surplus of assets over the sum of (i) its insurance liabilities in Israel and (ii) its minimum required excess of assets over liabilities. The reservation will cease to apply by the end of 2009;

D/7 Entities providing other insurance services.

Annex I to Annex A, Part IV, D/7

Remark: The reservation applies only to the provision by non-residents of intermediation services in Israel.

The reservation does not apply to insurance services purchased abroad at the initiative of the proposer.

D/8 Private Pensions.

Annex I to Annex A, Part IV, D/8

Remark: The reservation does not apply to services purchased abroad at the initiative of the proposer.

2. Other OECD insurance related instruments: draft conclusions of the assessments

Israel accepts all insurance related OECD recommendations and substantially complies with them. Some departures from these OECD instruments are nonetheless noted below, and the WPGEI recommends that Israel consider changes. They are however not significant enough to change the WPGEI's opinion.

2.1. Recommendation of the Council on Guidelines for Insurers' Governance: C(2005)45

Israel complies with the OECD Recommendation of the Council on Guidelines for Insurers' Governance, with the exception of the requirement to separate audits in life insurance and general insurance. No such requirement exists in Israel due to the corporate structure of many insurance companies, which provide both life insurance and general insurance. The Control of Insurance Law requires that accounts be separated, and the separate identification of the size of assets, premiums, expenses, re-insurance, etc. The Commissioner of Insurance has also required that the insurance companies establish permanent internal auditing systems.

The internal audit systems are headquarter units which carry out audits at all stages of the insurance companies' activities. However, there is no express requirement of a separation, in terms of internal auditing, between life insurance and general insurance.

Also, considering the importance of participating life insurance policies in Israel, the special status of insureds holding such contracts may need to be more fully addressed in insurers' corporate governance framework (the current regulation provides for the creation of a separate investment committee devoted to the investment of risk-sharing plans).

2.2. Recommendation of the Council on Assessment of Reinsurance Companies: C(98)40

Israel complies with the Recommendation of the Council on Assessment of Reinsurance Companies.

2.3. Recommendation of the Council on Good Practices for Enhanced Risk Awareness and Education in Insurance Issues: C(2008)22

The wide array of tools and programmes developed by the CMISD in order to promote the education and adequate information of (potential) insurance consumers, and assist them in selecting the type coverage most adapted to their needs is consistent with the OECD Recommendation on Good Practices for Enhanced Risk Awareness and Education in Insurance Issues.

Initiatives do not, however, cover a number of the OECD' Recommendation good practices. In particular, little has been done to assess the degree of financial literacy and understanding of the population, nor to enhance risk awareness. Also, apart from the CMISD, other insurance stakeholders (responsible public bodies and authorities, associations of insurers, of intermediaries and of consumers, relevant institutes or foundations, etc.) and market players do not appear to be involved in what should be a national endeavour.

The CMISD should therefore consider setting up new initiatives targeted at risk awareness; moreover, Israel should endeavour to launch, within a definite time frame, specific horizontal projects aimed at promoting risk awareness and education on insurance issues. Action has become all the more urgent in Israel since the development of participating life insurance plans entailed by recent reforms shifted the investment risk, formerly borne by insurers, to the policyholders.

2.4. Recommendation of the Council on the Establishment of a Check-list of Criteria to define Terrorism for the Purpose of Compensation: C(2004)63/REV2

Israel complies with Recommendation of the Council on the Establishment of a Check-list of Criteria to define Terrorism for the Purpose of Compensation.

Regulation and practice of terrorism compensation in Israel is consistent with the two first parts of the

OECD Recommendation, which define the conditions for acts of terrorism to be compensated via non-insurance instruments, and insurability criteria.

The definitions of terrorism typically used in Israel by the various actors in charge of insurance or non insurance compensation are broad, to adapt to Israel's specific political situation. While they do not reflect most of the elements provided in the OECD Check-list, this does not prevent Israel from complying with the Instrument, the list of elements of definition of terrorism provided in the OECD Recommendation being illustrative and non-binding.

2.5. Recommendation of the Council on Good Practices for Insurance Claim Management: C(2004)62

Israel is in the process of being compliant with this Recommendation of the Council on Good Practices for Insurance Claim Management which is neither binding nor exhaustive.

The content of the latest draft CMISD circular on claim management is consistent with the OECD Recommendation and should provide a solid basis of guidance for insurers if it is implemented.

This draft circular does not, however, cover a number of the OECD's recommendation good practices. These good practices could be considered for the final drafting of the circular in order to make it as exhaustive and operational as possible. The detection and management of insurance fraud, among other issues, should be given special attention.

Israel may be invited to provide all necessary information related to the timing of the approval and monitoring of implementation of this draft circular (together with the 2009 draft circular on the publication of statistics on claim management).

2.6. Recommendation of the Council concerning a Common Classification of the Classes of Insurance Recognised by the Supervisory Authorities of the Member Countries : C(83)178

The classification of insurance lines in Israel is not fully consistent with the classification defined in the OECD Recommendation of the Council concerning a Common Classification of the Classes of Insurance Recognised by the Supervisory Authorities of the Member Countries.

Given the heavy cost and process, for the industry as well as for regulatory and supervisory authorities, that changes in Israel's classification would entail, it is suggested that only future changes in this classification take into account the OECD list. Meanwhile, practical arrangements will need to be considered in order for the OECD to be able to include Israel in the OECD statistical database on insurance.

2.7. Recommendation of the Council concerning Institutional Co-operation between Authorities of Member Countries Responsible for Supervision of Private Insurance [C(79)195/Final]

Israel complies with this Recommendation.

1. THE ISRAELI INSURANCE MARKET: MAIN FEATURES

1.1. Market structure: a highly concentrated market dominated by five composite insurance groups

An increase in capital and technological requirements streamlined the market structure over the past ten years. The current shape of the industry is the product of a wave of mergers and acquisitions: the number of insurers decreased from 37 in 1998 to 24 in 2007. The non-life insurance sector was most impacted: since 2001, there have been five fewer insurers operating in the non-life business, against only one fewer in the life business. Insurer involvement in both life and non-life business is a longstanding practice in Israel. Currently, 13 companies operate in both life and non-life insurance and 11 operate in non-life insurance only (there are no life only companies).

Five large groups reinforced their domination on the market, accounting for 79% of gross premiums (67% in general insurance, and up to 95% in life insurance): Clal, Migdal, Harel, Phoenix and Menorah-Mivtahim. 70.34% of market share is held by the top three firms in life insurance, against 45.2% in the non-life branch.

Table 1. The Market Segments of the 5 leading Insurance Groups (on the basis of insurance fee volume)

Company	Market segment in life insurance	Market segment in general insurance	Total market segment in the insurance industry
Migdal	31%	9%	19%
Clal	23%	18%	20%
Harel	17%	19%	18%
Phoenix	15%	12%	14%
Menorah-Mivtahim	9%	12%	11%

Source: The CMISD

There are two reasons for the large difference in the concentration of the two areas of activity: firstly, only 13 companies operate in the life insurance line, compared with 24 companies in the general insurance lines. In addition, the vehicle insurance lines (compulsory vehicle and vehicle property) yield over 50% of the insurance premiums in the industry. These lines are very competitive (the HHI index⁵ amounts to 960 in vehicle property and 940 in vehicle compulsory) compared with the

⁵ For the purpose of this note, the degree of concentration in the insurance industry is measured through two indices: the HHI (Herfindahl Hirschman Index) and the CR3 Index. The HHI is calculated by squaring the market share (expressed as percentages) of each firm competing in a market, and then summing the resulting numbers. The HHI number can range from close to zero to 10,000. The closer a market is to being a monopoly, the higher the market's concentration (and the lower its competition). If, for example, there were only one firm in an industry, that firm would have 100% market share, and the HHI would equal 10,000 (100²), indicating a monopoly. The CR3 index measures the relative shares of the three largest companies in the market. The higher the index, the higher the level of concentration.

other non-life insurance lines, which are highly concentrated and therefore biases the HHI index upward of overall general insurance activity. In this context, only two new licenses have been granted since 1998.

Table 2. Concentration ratios in Long Term Saving Market (2007)

Line	HHI	CR3 Index
General insurance	1100	0.46
Life insurance	2300	0.74
New pension funds	2780	0.32
Provident funds⁶	570	0.83

Source: The CMISD

The insurance industry in Israel is thus currently characterized by a high degree of concentration resulting in a relatively low level of competition, which impacts insurance rates. This is reflected in the business results of the life insurance and general insurance industries. In 2007, the premiums that were collected in the entire life insurance industry amounted to NIS 17.4 billion⁷ and the after-tax profit from life insurance business amounted to NIS 2.1 billion, which constitutes a 12% profit margin. In contrast, the premiums in the general insurance industry amounted to NIS 18.7 billion and the after-tax profit from general insurance business amounted to NIS 1.3 billion, which constitutes a 7% profit. This trend of relative profit levels in the two industries has been consistent over the last years.

Table 3. Competition indicator (CR3) in Long Term Saving Market

	2004	2005	2006	2007
Non-life	0.47	0.46	0.46	0.46
Life	0.75	0.74	0.74	0.74
Provident fund	0.49	0.47	0.37	0.32
Pension fund	0.74	0.71	0.84	0.83

Source: The CMISD

The private pension market, also dominated by insurance companies, is characterised by the same degree of concentration. Four insurance groups control the companies managing the four largest pension funds, and account for 93.5% of the pension line assets: the Menorah-Mivtahim group (43% of assets in the pension line), the Migdal group (25% of assets), the Clal group and the Harel group (respectively 15% and 10% of assets).

⁶ A provident fund is a “pure” savings instruments for retirement which do not include any insurance coverage. Each member of a provident fund has a separate account; the amount of his deposits, withdrawals, profit (or loss) with respect to his investment in the fund, as well as the management fees collected from his account (with a ceiling on management fees of 2% of the assets) are recorded. The return is divided among the fund’s members in proportion to their share in the fund’s assets. Provident funds include funds for benefits and severance pay, study funds and funds for other purposes. As of the end of 2007, there were 226 provident funds in Israel. (Source: The CMISD).

⁷ On November 2007 1 Israeli New Shekel = €5.7; On 26 June 2009, 1 Israeli New Shekel = €5.59 or USD 3.97.

Table 4. HHI/10000: Competition Indicators in Long-Term Saving Market

	2004	2005	2006	2007
Non-life	0.11	0.1	0.1	0.11
Life	0.23	0.23	0.23	0.23
Provident fund	0.1	0.09	0.07	0.06
Pension fund	0.29	0.26	0.29	0.28

Source: The CMISD

The ownership structure of insurance companies operating in Israel is as follows:

- ***Public sector involvement in the insurance industry:***

It has substantially decreased in the last few years of reforms and market liberalisation. Today, three companies operating in the general insurance lines are government-owned:

- The Natural Damage in Agriculture Fund (Kanat): the company insures all farmers in Israel with natural damage (crop) insurance and natural disaster insurance. The State of Israel holds 50% of the voting rights in the company;
- Inbal Insurance Co. Ltd. which insures government activity: the company provides consultancy services and insurance coverage in the maritime vessel and aircraft insurance lines (for war risks only), investment insurance for apartment-buyers, cargo insurance and property insurance, which are granted as requested by the Israel Government. Insurance coverage is only sold in cases where insurance cannot be purchased from a regular insurance company;
- Ashra (formerly the Israel Foreign Trade Risks Insurance Corporation): this “private” (not traded on the stock exchange) company is wholly owned by the Israeli Government. The company operates in credit insurance only, and insures or guarantees commercial and/or political risks in export transactions involving long-term credit. In 2006, the company's market segment amounted to 0.3% of the entire general insurance market and 40% of the credit insurance market.

The three above-mentioned companies are supervised by the CMISD like any commercial insurance company.

Apart from these entities, three specialized companies operate in the compulsory vehicle insurance line under government supervision:

- The Road Accident Victim Compensation Fund (“Karnit”): this statutory fund is a public corporation financed from private insurance companies’ premiums. It compensates road accident victims who are not entitled to receive compensation from an insurer : e.g. because responsible driver is unknown or not (sufficiently) insured, insurer responsible for compensation is in the process of being wound-up, the road accident occurred in an area or in territories for which the Palestinian Authority is responsible or in an airport.
- Avner Vehicle Victim Insurance Union Ltd: since the beginning of the millennium, as a result of the reform in the compulsory vehicle insurance line, Avner has been under the management of a special administrator appointed by the CMISD. Today, Avner only settles claims in respect of compulsory vehicle insurance policies that were sold until 31.2.02.
- The Compulsory Vehicle Insurance Pool Administration Corporation: in order to enable all vehicle owners to fulfil their obligation to purchase insurance, the law established the Compulsory Vehicle Insurance Pool Administration Corporation Ltd., which is obliged to

insure every applicant (principally those who fail to purchase a regular business insurance policy).

- ***Two insurers are not incorporated as a limited company:***

- The Agricultural Insurance (Bituah Haklai), which is associated as a cooperative association. This company was established in the 1930's as a mutual insurance fund for damage which private insurance companies refused to insure. Today, it is regarded as a regular Israeli insurer, and 35% of its income derives from the private sector.
- Omer, a small mutual insurance company that is in the process of closure.

- ***Four insurance companies are controlled by foreign insurers; they operate via subsidiaries with an "Israeli insurer's license":***

- Migdal is controlled by the Italian company Generali (dominant foreign insurer in Israel), which holds 70% of the Migdal insurance group, the largest insurance group in Israel. The Migdal group is dominant in life insurance and long-term savings (pension and provident). Migdal manages 25% of the assets in the pension line and 4.7% of the assets in the provident line, and also have major holdings in various non-life insurance lines (this group charges 9.1% of premiums in the industry).
- AIG Insurance Co. and EMI Insurance Co are controlled by the American AIG group, which wholly owns the two Israeli insurers. The Israeli AIG is a direct insurer, which operates mainly in the general insurance, vehicle compulsory, vehicle property and residential lines. The company's annual insurance premiums, in general insurance, account for nearly 3.5% of total activity in the general insurance line. The company also engages in life insurance to a minor extent. EMI is an insurance company that operates in the mortgage insurance line only, the only company operating in this line in Israel. It accounts for 0.57% of total insurance premiums in the general insurance line in Israel.
- The BSSH, the Israel Credit Insurance Corporation Ltd. is controlled by the French company Euler Hermes in partnership with two Israeli insurance companies. Euler Hermes purchased a joint controlling stake in BSSH, at the end of 2006. BSSH operates in the short-term credit insurance line, and is wholly owned in equal shares and in partnership by Euler Hermes, the Harel insurance group and Bituah Haklai. BSSH accounts for 38.52% of total annual insurance premiums in the credit insurance line in Israel and 0.52% of total insurance premiums in the general insurance line in Israel.

- ***Two insurers operate under a "foreign insurer licence", as branches of foreign insurers:***

Zurich, which has operated in Israel since the 1940's and is reinsurer for the activity of the Harel insurance group; and Delvag which holds a license to operate in the maritime insurance line and in the diamond insurance line, although in practice it operates only in the latter. Delvag's insurance fees totalled NIS 10,902,000 in 2007 (0.06% of insurance premiums in the line), while Zurich received NIS 48,390,000 million of premiums as Harel's reinsurer.

Table 5. Foreign investors market share (June 2008)

	Long Term Savings Assets	Non-Life Premiums	Credit Insurance Premiums
Migdal Group	14.3%	9.6%	-
AIG Israel	-	2.7%	-
Clal Credit	-	0.3%	25.0%
EMI	-	0.5%	58.0%
Harel Group	8.2%	18.0%	-
BSSH	-	0.5%	16.0%
Psagot Gadish	5.5%	-	-
Prisma	6.6%	-	-
Helman Aldobi	1.8%	-	-
Hadas Marcntile	0.9%		
Total	37.2%	31.6%	99.0%

Source: the CMISD

- As can be seen from the above table, more than 30% of Israeli non-life insurance and long-term savings are in companies in which foreign investors have substantial holding.
- *Only one insurance company, Hachsharat Hayishuv, is a public company (meaning that it is traded on the Tel Aviv Stock Exchange)*⁸.
- *The other insurance companies are controlled by individuals, directly or via their holdings in public or private holding companies.* 12 of them are controlled by a holding company that is listed for trading on the Tel Aviv Stock Exchange, and 6 of them are privately held. The 6 privately owned companies are 100% owned by their controlling share-holders. The five largest insurance groups are part of financial conglomerates centralizing operation in the insurance, pension funds, provident funds, portfolio management, mutual funds, underwriting and credit industries. Of these five groups, Clal and Phoenix form part of conglomerates that are not only involved in financial services.

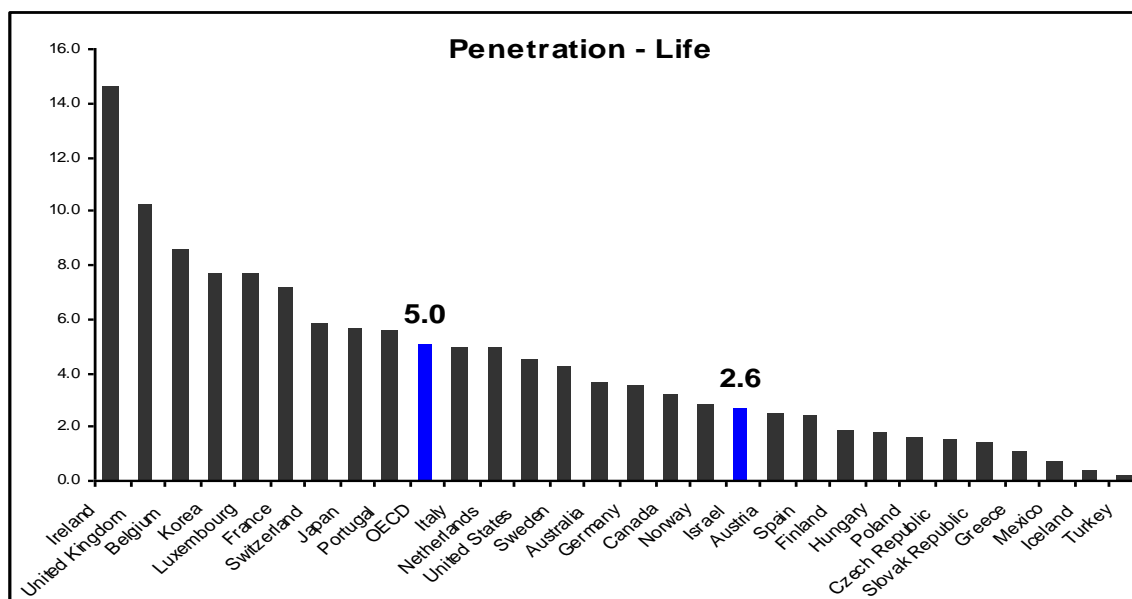
1.2. Evolution of the insurance sector

1.2.1. General market trends

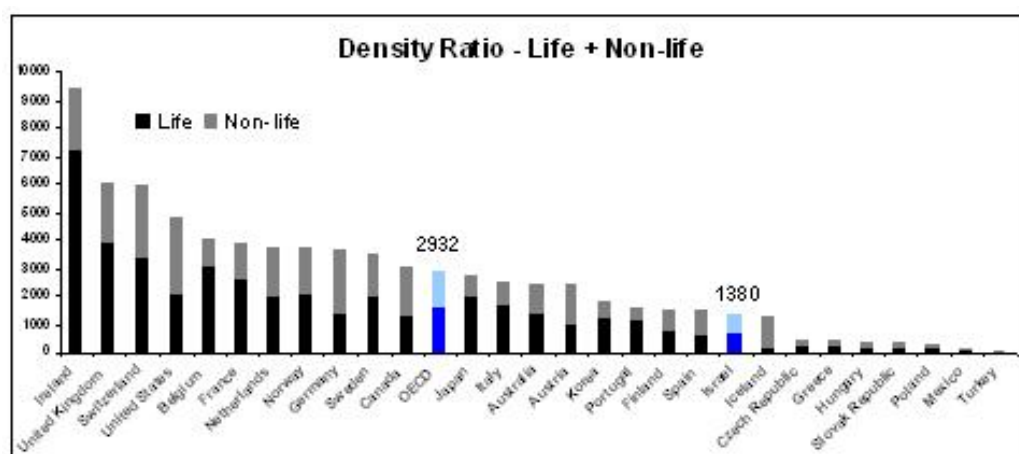
While penetration and density ratio are higher in Israel than in about one third of OECD countries, the penetration ratio has followed a downward trend since 1998, both in life and non-life insurance.

⁸ According to the CMISD, this does not raise specific issues/challenges for regulatory/supervisory authorities (e.g. regarding transparency requirements), since most private insurance companies in Israel are held by publicly-traded holding companies whose main activity is insurance activity. Moreover, the relevant provisions of the law stipulate that both private and publicly-traded insurance companies must disclose and report as if they were publicly-traded companies.

Figure 1. Penetration and Density Ratios, 2006



Source: OECD, Global Pension Statistics.



Source: OECD, Global Pension Statistics.

Table 6. Recent evolution of insurance density for life and non-life activities

Density Ratio 1997-2007 (NIS in 2007 Prices)											
Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Life	2049	2141	2204	2317	2446	2266	2204	2205	2286	2360	2407
Non-life	2645	2544	2481	2412	2565	2782	2773	2707	2608	2658	2580

Source: CMISD

Table 7. Penetration Ratio, 1998- 2007

Year	Life	Non-life
2007	2.62%	2.78%
2006	2.57%	2.89%
2005	2.63%	3.00%
2004	2.59%	3.17%
2003	2.64%	3.32%
2002	2.71%	3.33%
2001	2.98%	3.12%
2000	2.80%	2.91%
1999	2.87%	3.23%
1998	2.97%	3.52%

Source: CMISD

Table 8. Annual Growth Rate of Premiums, 1998-2007

Year	Life	Non-life	Total
2007	3.8%	-2.2%	6.0%
2006	5.1%	3.8%	4.4%
2005	5.5%	-1.9%	1.4%
2004	1.8%	-0.6%	0.5%
2003	-1.0%	1.4%	0.3%
2002	-5.6%	10.5%	2.6%
2001	7.9%	8.7%	8.3%
2000	7.9%	-0.3%	3.5%
1999	5.8%	0.2%	2.8%
1998	7.0%	-1.5%	2.2%

Source: CMISD

Table 9. Main Financial Data of the Insurance Companies, 2003-2007 (Amounts in NIS million)

Life Insurance	2003	2007	2006- 2007
Gross Premium	13,898	17,433	+7.3%
Reinsurance Premiums	840	770	
Net Premiums	13,058	16,664	
Commissions	2,250	1,833	
General Expenses	1,162	1,548	
Total Operating Expenses	3,412	3,381	
Claims (Death claims, Maturities, Pension)	3,028	4,214	
Surrenders	4,879	4,270	
Total Gross Claims and Surrenders	7,908	8,484	
Reinsurance Claims	533	455	
Net Claims	7,374	8,028	
Profit (Loss)	2,122	1,350	-28.4%

Non-Life Insurance	2003	2007	2006-2007
Gross Premiums	17,489	18,692	+2.1
Reinsurance	4,316	3,821	
Net Premiums	13,173	14,871	
Commissions	2,328	2,430	

Life Insurance	2003	2007	2006- 2007
General Expenses	1,881	2,340	
Reinsurance Commissions	672	595	
Total Net Expenses	3,537	4,175	
Gross Claims	12,594	12,959	
Reinsurance Claims	2,907	2,489	
Net Claims	9,687	10,470	
Profit (Loss)	2,196	1,690	-12.4%
Loss Ratio – Gross	74%	70%	
Loss Ratio - Net of Reinsurance	76%	72%	
Combined Ratio – Gross	98%	96%	
Combined Ratio - Net of Reinsurance	103%	101%	

Total	2003	2007	2006-2007
Gross Premiums	31,387	36,125	+4.6%
Reinsurance Premiums	5,156	4,590	
Net Premiums	26,231	31,535	
Commissions	4,577	4,262	
General Expenses	3,043	3,888	
Total Operating Expenses	7,620	8,150	
Gross Claims	20,501	21,443	
Profit (Loss)	4,317	3,040	-20.3%

Assets, Liabilities and Equity	2003	2007	2006-2007
Assets	148,719	215,963	+24.8%
Liabilities	139,831	203,441	+9.6%
Equity	8,888	12,522	+9.8%
Of the Liabilities:			
Technical Reserves – Total	130,875	191,062	+9.6%
Life	94,225	147,785	
Non-Life	36,650	43,277	

Profitability	2003	2007	2006-2007
Net Profit	2,791	3,511	+39.4%
Capital	8,888	12,522	+9.8%
ROE	31%	20.2%	--

Capital – Comparison with Solvency Requirements	2003	2007	2006-2007
Capital (including secondary capital)	8,459	15,482	+14%
Required Capital	6,771	13,541	+26.5%
Surplus	1,688	1,941	+32.4% ⁹

Main source: The CMISD

⁹ High surplus data are however related to low capital requirement levels (see paragraph 2.1.4.).

Growth has been mainly driven by the health¹⁰, group and personal liability insurance lines. The increase in life insurance premiums mainly derived from a growth in sales of new life insurance policies and the continued downtrend in policy cancellations compared with average life insurance reserves.

The decline in life insurance profitability after 2007 is mainly due to a decrease in income from investments held against profit-sharing policies, also eroding the insurers' revenues from management fees on these products. The growth in aggregate after-tax profit is largely attributed to a one-off accounting calculation: the abolition of the reserve for extraordinary risks for life insurance, which became part of the capital requirements. However, insurers may not have made the best use of such measures. The Bank of Israel concluded its 2007 analysis of insurance sector stating that "insurance companies appear to have missed an opportunity to expand their capital base and improve their capital ratios, an opportunity provided to them by their [still] high profitability in that year and by the accounting change in capital"¹¹.

The operating profits in life and/or non-life insurance of the three market leaders fell in the first three quarters of 2007. In this context, Israeli insurers have also recently started to look abroad for more expansion opportunities, and bought niche insurers overseas – such as the USA' Guard Financial acquired by Clal¹² in 2007. With the financial crisis, insurers are however being forced to scale back international expansion in the past few months.

¹⁰ Israel's male population has the third highest life expectancy rate in the world.

¹¹ Annual report, Chapter 4, Bank of Israel, 2007.

¹² Israel Insurance Report Q1 2008, Business Monitor International, February 2008.

Box 1. Why were RoE exceptionally high until 2007?

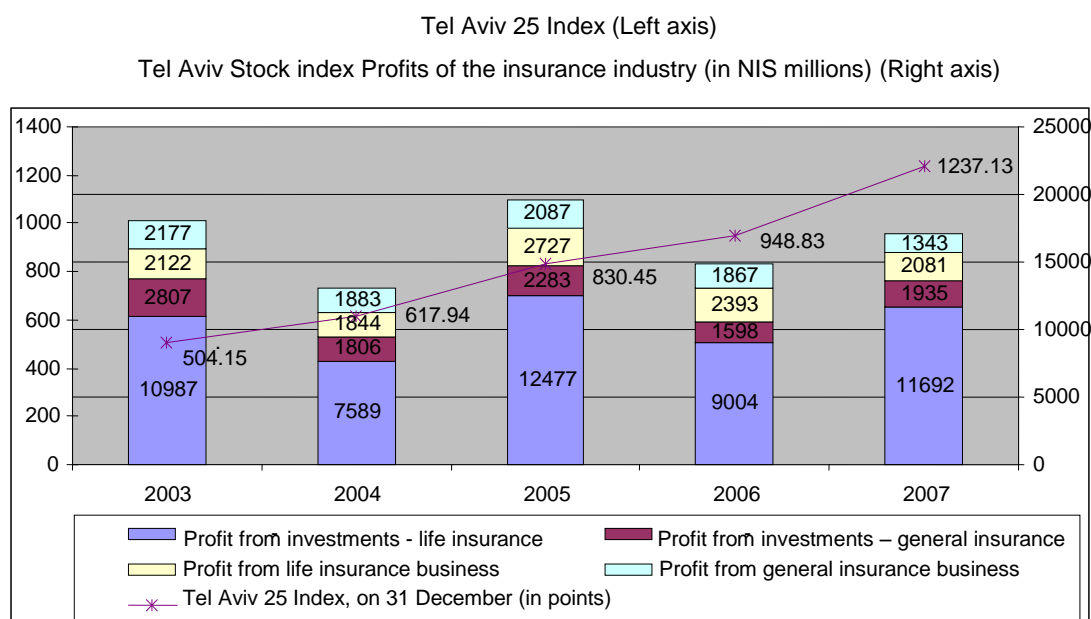
One of the striking features of the Israeli insurance market until recently was the exceptionally high ROE as compared to that of insurers established in OECD countries. High return result primarily from low competition as described above, low capital requirements¹³, and high capital gains from the capital market.

Over recent years, the Israeli economy had experienced continuing growth, supported by a large supply of credit and high liquidity in the markets. The 2001-2002 recession had entailed a sharp decline in the stock exchange and insurers' return on capital. The Tel Aviv 25 Index dropped by 40%. During this period, inflation increased significantly to reach 7%. When capital markets recovered in 2003, inflation dropped significantly to -2%, and the return on capital of institutional bodies rose from 13% to 32%.

The economic growth rate in the past six years was 5% on the average. A survey of the leading stock exchange indices shows that the Tel Aviv 25 Index increased five-fold in the years 2002-2007. Insurance companies' investments, both in life insurance and in general insurance, largely benefited from this massive growth. Over the years 2002-2007 the insurance companies therefore recorded strong profits both with regard to their insurance activity and their investment activity¹⁴.

The following graph combines the cumulative data for the entire insurance industry between the years 2003-2007 and the data from the Tel Aviv 25 Index for the same period. It shows the continuous rise in the Tel Aviv 25 Index as well as the high profits experienced by the insurance companies during these years.

Figure 2. Profits of insurance industry as compared to the Tel Aviv 25 index



Source: The CMISD

¹³ This issue is analysed in section 2.1.4. on capital requirements.

¹⁴ It should be added that until the year 2006, insurance companies were allowed to hold an - often significant - reserve for extraordinary risks. In 2006, the adoption of the IFRS required the recognition of an amount equal to 0.17% of the reserve as an amount at risk in companies' retained earnings. This slightly reduced the return on equity in 2006 and 2007.

Box 2. The impact of the financial crisis

As highlighted by the CMISD, the Israeli market has proved rather resilient to the crisis, due to the conjunction of a number of factors and characteristics of the Israeli economy, and in particular : increased growth rates in years prior to the financial crisis, high rate of personal savings, stable financial system, emerging non-banking credit market, low rate of bad debts prior to the financial crisis, low exposure to “toxic” assets, immature securitization and structure product market and stable real-estate market¹⁵.

Nevertheless, , the financial crisis has not spared the Israeli economy in the last few months..The real growth rate for 2008 was of 4% (as compared to 5.4% the year before). The Bank of Israel has downgraded its macro-economic forecast for 2009 following a number of global, but also internal, developments and the IMF anticipates a further decline in economic growth to ½ percent in 2009¹⁶. The CMISD has indicated that together with the reduction of economic activity worldwide, resulting in a reduction of economic activity in Israel during the last quarter of 2008, Israel had to face sharp decline in exports and in industrial manufacturing, as well as fiscal cost of the military operation in Gaza and its negative impact on the export of tourism services. The negative impacts were partially offset by the improvement in the external conditions for commerce (primarily due to the drop in oil prices) and an increase in public expenditure, which will have a positive impact on economic activity.

Israeli financial markets were strongly impacted by the economic downturn in 2008. Between 2007 and 2008, investment returns for life insurance policies fell from 9.5% to -9.3%. Insurers also suffered from a reduction in management fee income with the shrinkage of the unit linked policies market and of a reduction in capital (all companies supplemented required capital). So far however, there was no significant withdrawals from life insurance (or pension plans) schemes, because of tax penalties on premature withdrawals, and companies' solvency was not damaged.

As far as inflation is concerned, insurance companies are exposed to inflation risks with respect to yield guaranteed savings policies, but the risk is hedged by a high rate of holding of long-term CPI linked assets. These CPI's are held at a rate of some 84% of the value of assets and from which 61% are designated CPI-linked debentures with no redemption date. Insurance companies are also exposed to this risk through their long-tailed insurance liabilities in the liability insurance area, although this risk is hedged by an investment of some 42.5% of the total nostro assets in CPI-linked financial instruments. In the opinion of the CMISD, inflation fluctuations should therefore not have a significant impact on insurance companies' financial stability.

The CMISD has taken a wide range of initiatives in order to cope with the current financial turmoil. It intensified its monitoring of insurance companies' exposure to financial markets, structured financial instruments and investments abroad, and of their liquidity status as well as withdrawals and transfers in the long-term savings markets¹⁷. It also monitored the functioning of groups of borrowers, and attempted to raise public awareness on the potential consequences of the crisis. Annual forecasts regarding the quarterly growth rates indicate a decline during the first half of 2009, stabilization and beginning of growth in 2009, and a return to the potential growth rate only in the middle of 2010.

Table 10. Evolution of assets and investment returns in life insurance, 2004-2008/9

Year	Investment return	Assets, NIS, Billions
2004	8.7%	57,809
2005	14.9%	70,548
2006	8.7%	83,339
2007	9.5%	97,225
2008/2009	-9.3%	92,440

Source: The CMISD

¹⁵ CMISD, Presentation of the Israeli insurance market to the WPGEI, 1st April, 2009.

¹⁶ Israel: IMF, 2008 Article IV Consultation, February 2009.

¹⁷ See IMF, Israel: 2008 Article IV consultation, February 2009.

1.2.2. Evolution of the life insurance market: a new institutional structure giving insurance companies a key role in the financial sector¹⁸

The new profile of insurance companies

Further to the recommendations of the Bachar Committee¹⁹, banks have sold their holdings in provident funds and mutual funds to insurance companies. Under the transition directives related to the Bachar Reform, the banks have been permitted to continue holding means of control in provident funds and mutual fund managers as a function of their market segment, as below:

Table 11. Banks holdings in provident funds and mutual funds: transition measures

Last date for holding	Max. market segments (Bank Hapoalim and Bank Leumi) (%)		Maximum market segment (the other banks) (%)	
	Provident funds	Mutual funds	Provident funds	Mutual funds
August 2007	18	25	18	25
August 2008	0	12.5	10	12.5
August 2009		0	6	6
August 2011			0	6
August 2013				0

Source: The CMISD

Insurance companies had also acquired in 2004 most of the companies managing the “new” and “general” pension funds²⁰. The value of the financial asset portfolio of provident funds, pension funds and insurance companies rose by 10% in 2007, while banking intermediation continued to decrease. In 2007, the share of long-term saving assets managed by the insurance companies and companies that are controlled by insurance companies was estimated at 45% (it amounted to NIS 289 billion) compared with 28% at the end of 2004²¹. Insurance companies are now also involved in retail credit, although still marginally.

¹⁸ For details on the pension system, please refer to DAF/AS/ACS(2008)1/ADD2 (Israel’s response to the IPPC questionnaire).

¹⁹ See Box 4 and Table 13.

²⁰ Institutional investors supervised by the CMISD (insurers, pension and provident funds) were prohibited from purchasing corporations that are supervised by the Israeli Securities Authority or by the Supervisor of Banks. Therefore, insurance groups that wished to purchase the activity of mutual fund managers did so via holding companies involving insurers (which are not supervised by the CMISD). Provident funds’ activity was purchased mainly by the insurance companies and, in certain cases, by insurer-linked companies.

²¹ Insurance companies acquired significant rights in private pension funds and provident funds holding, while insurer-linked companies acquired 37% of total assets managed by mutual funds.

Box 3. Expansion of the non-bank credit market

The non-bank credit market in Israel received a major impetus when the Bachar Reform was applied in 2005. This reform resulted in the separation of the provident funds and the mutual funds from the banks, thereby reducing the problem of structured conflicts of interest in the banks' activity as credit suppliers and as managers of the public's money. This aimed at increasing the competition for the supply of credit, principally in the area of commercial credit, and to a lesser extent, in the area of retail credit. As of the end of 2007, part of the credit granted to businesses in the economy derived from institutional investors, mainly by means of their investments in corporate bonds.

Non-bank credit activity for individuals is still in its infancy in Israel. The CMISD is currently focusing on the removal of additional restrictions that are preventing the growth of the non-bank retail credit market. The principal measure in this respect is the amendment and expansion of the Credit Data Service Law, which has existed for several years and governs the manner in which it is possible to obtain information on any person with respect to the adherence to his financial obligations. As a result, every credit-granting entity will have access to all the information which it requires for the purpose of pricing credit in accordance with each borrower's level of risk.

The ratio of investment in retail credit to the total assets managed by the institutional assets is expected to increase over time, and for as long as the additional measures now being adopted in order to increase the sophistication of this market actually yield results.

Non-tradable credit granting activity, including retail loans, is regulated by circular number 2007-9-15 issued by the Supervisor of Banks, which concerns the management of credit risks in respect of investment activity, and in circular number 2000-9-16 issued by the Supervisor of Banks, which concerns the infrastructure for the managerial, professional and operational support required for the purpose of the institutional investors' extension of non-tradable credit. Under the regulation currently governing institutional investors, they are not restricted in the type of credit which they are permitted to supply.

With respect to the insurance companies' granting of loans to the government, the insurance companies in Israel invest a certain ratio of their nostro assets and the public's assets managed by them in bonds issued by the State of Israel. The insurance companies do not grant other types of loans to the government.

Figure 3. The emergence of large financial groups

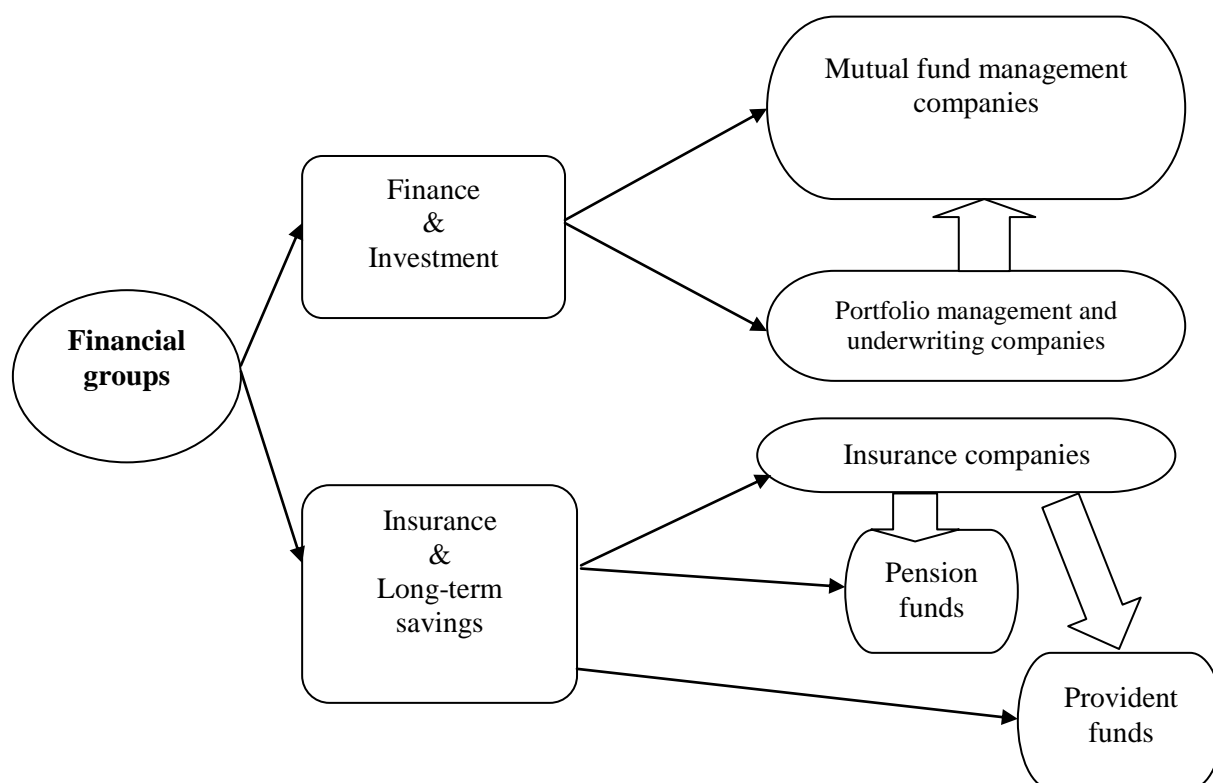
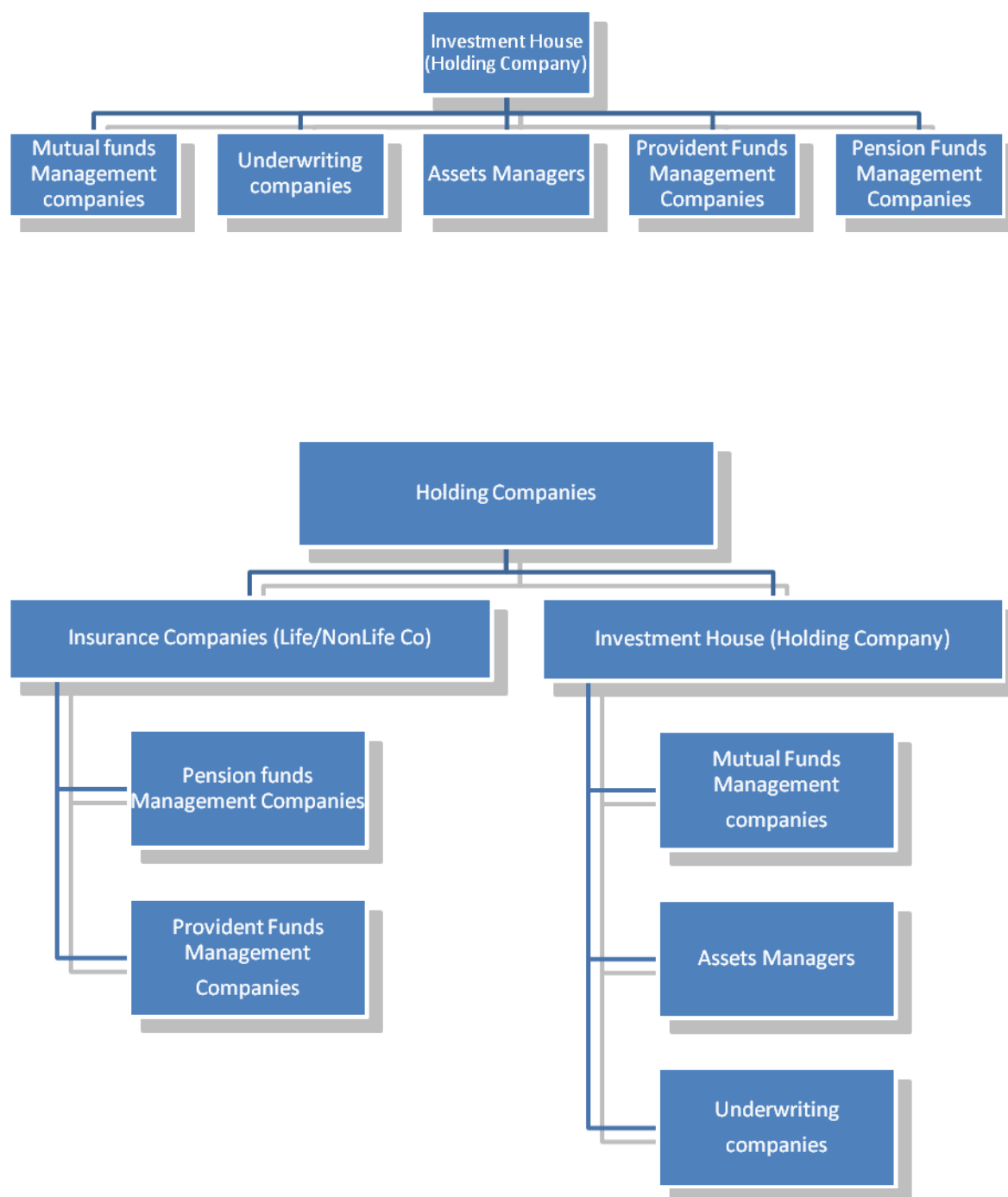
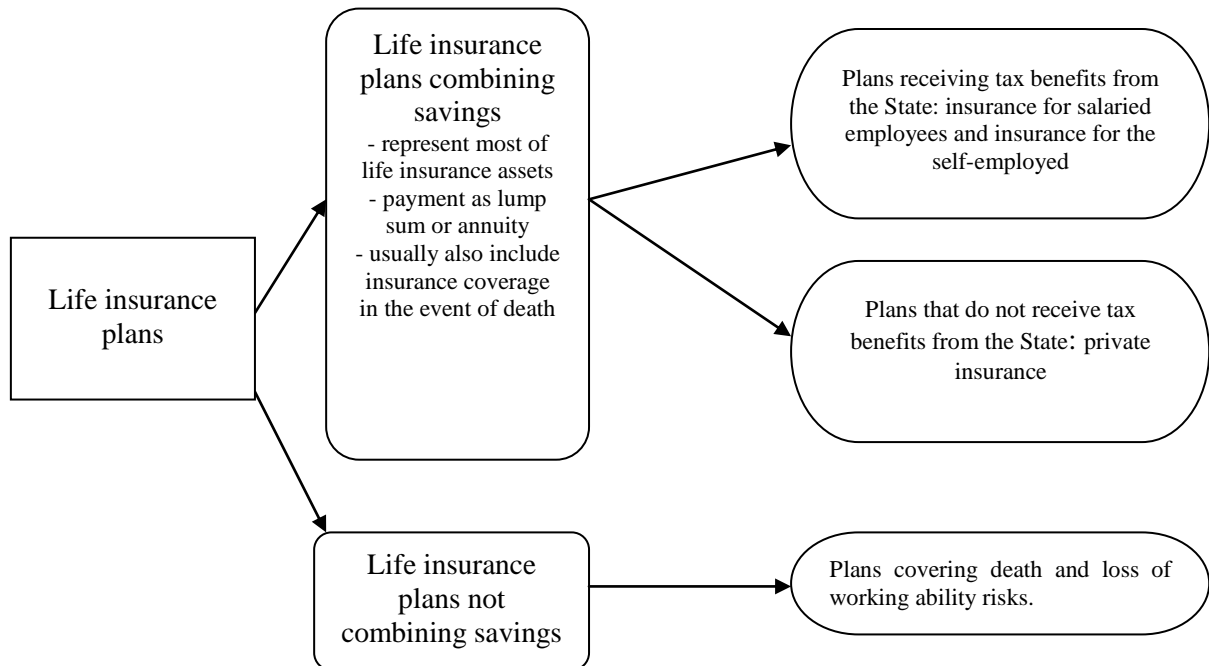


Figure 4. The emergence of large financial groups (2)



Source: CMISD

dFigure 5. Main life insurance products



Reforms in 2004 and 2007 were aimed at enhancing transparency and disclosure in the marketing of life insurance plans combining savings (introduction of distinction between the saving, insurance and expense component in particular), as well as allowing competition between these plans and pension saving products²². Life insurance has been substantially deregulated. A large part of life insurance products are now “participating” or profit-sharing plans, with no or low guarantees (some insurance companies offer policies which guarantee minimum rate and hedge the risk of inflation), so that investment risk is passed on to policyholders. Participating policies have expanded by an annual average of 20% in recent years²³. At the end of 2007, these plans accounted for 66% of the insurance industry’s assets.

In order to encourage individual saving for retirement age, the State of Israel grants tax benefits on insurance plans with saving components that result in the payment of an annuity. Tax benefits apply both at the time of deposit and when the annuity is received at retirement age. Tax benefits for all long-term saving instruments have also been equalised at the beginning of 2008, as part of a global effort to impose a level playing field across saving vehicles.

²² It should be underlined that the management fees on retirement insurance policies are typically higher than the management fees on pension funds products, while both types of products may now be offered by the same financial group.

²³ Annual report, Chapter 4, Bank of Israel, 2007.

Box 4. The Bachar Reform and its influence on the Israeli insurance system

The wide-ranging reform of the financial sector launched under the impulsion of the Bachar Committee was approved by the Knesset and embodied in a series of laws in 2005. This ambitious process led to a long list of sectoral regulatory reforms, many of which are still in the process of being adopted or implemented.

The rationale of the Bachar Committee

The entire reform aimed at reducing concentration and enhancing competition and market efficiency in a largely bank-centric financial system²⁴, as well as developing Israel's financial markets. To this end, the ownership structure of the Israeli financial sector was revamped, with commercial banks being required to progressively sell all of their holdings in provident and mutual funds to insurance companies. The Bachar reform therefore marked a turning point in the activity of the insurance companies that have acquired over the past three years the management rights in a number of private pension funds as well as a significant share of the assets of the provident funds and mutual funds²⁵. Most insurance groups now provide, on top of insurance, and through separate subsidiaries, services in the areas of investment management, underwriting and long-term savings. The five major insurance groups in particular – Migdal, Clal, Harel, Phoenix and Menorah have expanded their activity in the long-term savings market.

As a result, the structure of the financial sector is now more balanced around several “pillars” complementing the banking sector. Large financial groups have emerged that incorporate, under the umbrella of a single holding company, an insurance and long-term savings activity, and a financial and investment activity. Financial groups nevertheless remain under the supervision of a single authority. Accordingly, insurance companies (supervised by the CMISD) cannot have holdings in companies that manage mutual funds, portfolio management companies or underwriting companies whose activity is subject to the supervision of the Securities Authority and the disclosure requirements described in the Securities Law. Rather than being directly held by an insurance company, these companies are therefore usually held by a holding company that has holdings in the insurance company (to be supervised by the CMISD as well). It should also be underlined that several large groups include various financial concerns such as banks and insurance companies, but also entities operating in the non-financial sector, forming complex corporate conglomerates.

In this new financial framework, concentration is restricted (e.g. a single entity is prohibited from reaching a market segment exceeding 50% of the value of all long-term saving assets), while competition between the various payers is spurred (banks can act as pension advisors).

Overall, in line with the government expectations, the weight of institutional investors in domestic capital markets has grown substantially since 2005; insurance companies specifically are expected to play an ever greater role in the capital market, following the enactment of the Compulsory Pension Saving Law and the equalization of tax benefits for all long-term saving instruments at the beginning of 2008.

A major shift in the Israeli financial landscape that called for wide-ranging regulatory reforms

Changing ownership structures in the financial sector required the adoption of a long list of accompanying reforms in many diverse areas. Most of them were designed and adopted at an exceptionally rapid pace. They mainly concerned:

- Enhancement of the insurers corporate governance framework: development of internal and external control and supervision mechanisms, redefinition of the activity of the board of directors as the core of corporate governance²⁶, improvement of the internal auditing system²⁷, promotion of the role of the external auditor and

²⁴ See IMF report for the 2007 Article IV Consultation.

²⁵ The existing legal framework allows an insurance company that operates solely in the general insurance field to control a management company of provident funds and pension funds. However, general insurance companies and even composite insurers which are minimally involved in the life insurance field rarely seek to control management companies. The insurance companies that do operate in the provident funds and pension funds field are the experienced life insurers.

²⁶ Regulation on fit and proper requirements and functions of the board of directors and its committees were issued in July 2007.

appointed actuary²⁸, appointment of an investment committee for liabilities deriving from participating life insurance plans (yield-dependant investment committee) and an investment committee for the insurance company's nostro liabilities (non-yield-dependent investment committee) adoption of binding new requirements for the introduction of new insurance²⁹, creation of an infrastructure for the risk management system including the requirement to appoint a risk manager³⁰, increased disclosure requirements³¹;

- Re-organisation of insurance supervision, granting enhanced powers and budget to the CMISD (see paragraph 2.2.);
- Development of non-bank credit: most of the credit from the insurance companies' sources used to be granted to the government sector in Israel. Since the publication of the Bachar Committee's recommendations, a consistent growth has been recorded in the rate of credit from insurance company sources granted to the business sector in lieu of credit to the government sector;
- Development and diversification of products of financial saving products with an emphasis on the investment component;
- More generally, as a follow-up of the Bachar reform, investment rules were relaxed, and Israeli legislation gradually more aligned with international standards (adoption of the IFRS principles and endeavour to reform progressively the supervisory framework with a view to adopt Solvency II standards, at the same time as European countries if possible).

Have the Bachar reforms, and the many follow-up reforms adopted since 2005 provided an adequate reply the concerns outlined in the July 2004 self-assessment against the IAIS Insurance Core Principles and in the IMF report for the 2007 Article IV Consultation ?

The July 2004 self-assessment identified a number of items for which the level of observance of IAIS ICP was low:

- Supervisory cooperation and information sharing;
- Suitability of persons;
- Corporate governance;
- Internal control, risk assessment and management;
- Derivative and similar commitments.

Three years later, the IMF conclusions of the Article IV consultation report outlined the considerable progress achieved at rapid pace since the Bachar reform, as well as the following pending concerns:

- There is a risk that the rapid pace of regulatory change will prove inconsistent with high-quality implementation (major new initiatives should be submitted to cost-benefit analysis);
- Reforms require a commensurate strengthening of prudential policies and practices;
- Regulators' resources are not commensurate with challenges ahead, and more scope is needed to recruit highly qualified staff;
- Activities should be rebalanced from developing new regulation to on-site supervision;
- A more principles-based approach to regulation should be taken;
- Collaboration between the supervisors, notably with respect to crisis management and resolution, should be

²⁷ Guidelines issued in 2007 regulate the functions of the internal control system.

²⁸ A 2006 circular regulates the function of the actuary.

²⁹ A circular was published in 2006 regarding new insurance policies or the entry in new business fields.

³⁰ The requirement to appoint a Chief Risk Manager (CRO) was applied in 2005 insurance control law amendment.

A circular was published in 2006 regulating the interrelations between the CRO and other key position officers, his accessibility to information, work procedures and reports that he is obliged to submit. Detailed provisions relating to credit risk management were published in 2007..

³¹ A circular regarding the adoption of IFRS by institutional bodies was published in May 2007; insurance companies are reporting according to IFRS principles since January 2008.

enhanced;

- Formal independence should be given to the insurance supervisor, in line with good international practice, in particular to set solvency standards, enforce managerial changes in companies and resolve failing institutions, and perform group-wide supervision;
- Risk-based supervision should be further developed;
- Existing solvency requirements are inadequate;
- Insurance firms and their affiliates are assuming new or enhanced risks, including credit risk, with which they have less experience;
- Ongoing efforts to improve the quality of the risk management and controls of insurance companies should be pursued;
- Reporting standards for financial institutions should not deviate unnecessarily from international norms.

While most of the concerns raised by the July 2004 self-assessment against the IAIS Insurance Core Principles seem to have been addressed by four years of continuing reforms, some of the pending issues identified in 2007 by the IMF have not yet been resolved. For instance, the CMISD has recently accepted the IFRS, but delayed the adoption of these standards due to concerns related to sectoral reporting. Also, the implementation of selected regulatory changes, such as the adoption of more stringent capital requirements, has been delayed in order to preserve the resilience of insurance companies in a context of financial crisis. For other items however, implementation is on the way, and will need to be carefully monitored in the coming months.

1.2.3. Evolution of the non-life insurance market: a decade marked by the opening of the motor vehicle insurance line to competition

Liberalisation of the vehicle insurance line

The reform that opened the vehicle compulsory insurance line to competition aimed at enhancing economic efficiency and allowing risk-adjusted premiums while introducing incentives for prudent driving. Today, the non-life market is dominated by vehicle insurance that yields over 50% of the insurance premiums in the industry: 29% for vehicle property (coverage of property damage only, including damages caused to a third party), and 22% for compulsory vehicle (covering bodily harm to those travelling in the insured's vehicles and pedestrians who are hurt by a vehicle). Motor vehicle insurance, which is the principal compulsory insurance line in Israel, is organised along the following principles: no-fault responsibility, own and third party insurance requirement, and establishment of a fund for compensating road accident victims. In order to compensate road accident victims who are not entitled to receive compensation from an insurer, such as in the case of a hit-and-run accident, a statutory fund was established. Today, every person who buys a compulsory insurance policy pays an additional 1% on premium in order to finance the fund.

Fourteen insurance companies operate in the compulsory insurance line³². The State does not control and does not own shares in any insurance company operating in the compulsory vehicle insurance line. The activities of government-owned Avner Corporation, formerly in charge of providing motor vehicle insurance cover, were gradually wound down in order to open the line to private players.

Competition in the line resulted in a steep reduction in premium rates - which were reduced by a cumulative average of 22%. The stagnation in the total amount of premiums collected has weighed on non-life companies' profits over the last five years.

³² 2006 data.

Other non-life insurance products

The main other general insurance lines, mentioned by decreasing order of importance of premiums generated as a percentage of general insurance premiums in 2007, are the following: employers' liability (17.6%), sickness and hospitalisation (13.34%) and personal accident, other liability lines, such as product liability insurance, executive or professional liability insurance (9.28%), comprehensive dwelling unit, property loss and comprehensive business premises.

Private health insurance

Private health insurance deserves special mention, as a dynamic, relatively new market, characterised by the introduction of various new products, the expansion of activities of existing companies, and the entry of new players into the sector.

The Israeli health insurance market is composed of three layers of coverage:

- The basic layer, provided to all residents of Israel through health funds. The health funds' standard basic basket coverage is financed via the "health tax" on resident's incomes; it is charged by the National Insurance Institute.
- The complementary layer, provided in return for additional payment to those joining the supplementary health services programs of the HMOs (Health Maintenance Organisations, known as Shaban). According to data compiled by the Division for the Supervision and Control of the Health Funds and Additional Health Services, the number of those insured in the health funds in Israel at the end of 2007 amounted to 7.2 million persons. The number of those in supplementary health insurance plans amounted to 5.2 million persons, accounting for 72% of all insureds at the health funds³³.
- The private layer sold by commercial insurance companies (supervised by the CMISD, as opposed to the first two layers that are supervised by the Health Ministry). It includes the following sub-lines: medical expenses insurance (such as insurance for operations, medicines and transplants), long-term care insurance, insurance in the event of dread diseases, dental insurance, health insurance for foreign workers, overseas travel insurance and personal accident insurance.

Health insurance activity has increased continuously over the recent years. Gross insurance premiums for health insurance in the private layer were estimated at NIS 4.1 billion in 2007³⁴, an

³³ The current relationship between Dikla Insurance Company Ltd. - Israel's largest health insurer – and Sherutei Briut Clalit ("SBC") - Israel's largest public health fund raises serious concern. The Clalit health fund currently holds 35% of the means of control in the Dikla insurance company. In addition, Dikla has provided members of the Clalit health fund with collective long term care insurance for over 10 years. According to a recent agreement between the Insurance Commissioner and the Clalit health fund, the fund is now committed to sell its holdings in the Dikla insurance company by 1 August 09. In parallel, the Commissioner announced that the permit for the fund to hold means of control in Dikla has been revoked with effect from 1.8.09. It was also agreed that within three years, the Clalit health fund will issue a tender, and complete tender processes for the selection of an insurance company that will insure the members of the fund with collective long term care insurance. Israel is requested to provide update information on this process in the next few months in order to allow the monitoring of the implementation of above-mentioned commitments.

³⁴ Annual report 2006, The Capital Market, Insurance and Saving Division, December 2007.

increase of 42% compared to 2004³⁵. The medical expenses sub-line is the largest of the sub-lines in the area of private health insurance: insurance premiums in this sub-line account for 36% of gross insurance premiums for private health insurance. Following on from it is the long-term care sub-line, where insurance premiums account for 27% of gross insurance premiums for private health insurance.

With respect to compulsory insurance in Israel, the only line with an all-embracing insurance requirement is the compulsory vehicle insurance line. Compulsory insurance exists in another two niches, principally compulsory third party insurance for professionals or various businesses. This derives from the legislators' desire to ensure that a business will be able to pay compensation to a third party that has suffered damage.

Private health insurance expenditure per capita represented 30% of total health insurance expenditure per capita in Israel in 2006, compared with the 27% OECD average.

Figure 6. Health insurance in Israel



Source: Politics, Values and interests: The Debate over Supplemental Insurance in Israel, Prof. Revital Gross.

1.2.4. Reinsurance

Reinsurance is not a separate line of business and does not require a different license. Israeli companies assume an insubstantial amount of reinsurance from other Israeli companies, as the vast majority of reinsurance in Israel is being placed with companies abroad.

Reinsurance premiums have grown continuously over the past few years. In 2006, only 16% of reinsurance premiums came from life insurance business, although life insurance accounts for nearly half of total insurance premiums. Premiums for this branch are falling, since a large part of gross premiums in life insurance include a non-reinsured savings component.

In 2006, 370 reinsurers were active in Israel; more than 75% of exposure was in the hands of ten reinsurers, and half of it was shared between Munich Re, Swiss Re and Zurich Re. The Lloyd's is also an active player in the Israeli's market through its 19 underwriters. Premiums for the risks ceded by Harel and Clal only represent 51,4% of total general insurance reinsurance premiums³⁶ paid to reinsurers.

³⁵ Excluding premiums for work disability and personal accident sub-lines.

³⁶ Survey of Reinsurance in Israel 2006, the Insurance Commissioner, May 2007.

1.3. Distribution networks: the predominance of insurance agents

Information on policy terms and prices in the Israeli insurance market is widely available. Most consumers nevertheless prefer to use the services of an intermediary, in order to receive advice on how to adapt their policy to their specific expectations, as well as be informed on the quality of the companies' processing of claims.

Israel's distribution market consists of different distributors in non-life insurance line and in the life insurance line (pension line).

Intermediaries in the non-life line are:

1. Insurance agents
2. Direct insurers

Intermediaries in the life line are:

1. Insurance agents
2. Pension advisors (mostly banks)
3. Pension marketing agents (insurer, mutual fund or pension fund's employees).

Insurance agents can be either exclusive tied agents, representing a single insurer, or non-exclusive tied agents, representing more than one insurer. The latter is more common.

Insurance agents are the main distribution channel in all the insurance lines: the share of insurance agents in the total number of licensed distributors (insurance agents, pension marketing agents and pension advisors) in the pension line was 84% in 2006. Contracts sold by insurance agents represent approx. 95% of premiums earned in both life and non-life lines (insurance only, mutual funds and pension funds are excluded).

New "pension advisors" (or pension consultants in the graph below) are required to advise on all long term saving products and all providers, and therefore may be regarded as brokers in the pension line only. However, pension advisors in the banks³⁷ (the vast majority of pension advisors) receive uniform commission from the providers as well as commission from the client. Pension advisors were first licensed in 2006 as a result of the Bachar reform and on that year they consisted only 7% of the distributors in the pension line. Pension advising is an evolving market. By 2008 the total number of distributors in the pension line has raised in 18% and the share of Pension Advisors has reached 16% of all distributors in the pension line.

The majority of intermediaries in this channel are banks, which by law are restricted to acting as pension advisors alone in the distribution of insurance products. This distribution channel is expected to expand in the future. Direct insurance (whereby insurance companies sell directly to the public using exclusive agents or their own employees through the mail or via Internet) remains marginal. Decreasing commission fees, enhanced stringency of regulatory requirements as well as the competition of banks in the area of pension advice recently led to corporate mergers in the insurance distribution.

³⁷ Banks are restricted by law to acting as pension advisors alone in the distribution of insurance products.

Figure 7. Intermediaries by license type in the pension line



Source: CMISD

1.4. Corporate governance regime³⁸

Until the legislative amendments deriving from the Bachar Reform were implemented, the insurance companies were subject to the corporate governance principles applicable under the Companies Law, 5758-1999 (hereinafter – the Companies Law). In addition, there were specific directives concerning various matters on which the board of directors had to deliberate and decide (determining overall investment policy for example, or policy with respect to exposure to reinsurers). The Companies Law distinguishes between a public company and a private company. Although most of the provisions of the Companies Law apply to all the companies, special provisions relating to corporate governance and internal control and supervision apply only to publicly-traded companies.

Since the enactment of the Bachar reform, additional directives and regulations have been issued in order to strengthen internal control and supervision mechanisms and the maintenance of a suitable system of controls and balances at the insurance companies, in addition to the principles determined in the Companies Law concerning public companies, which constitute a minimum condition for the corporate governance framework in an insurance company. These directives and regulations cover the following areas: proficiency of key office-holders, the assurance of the independence of the control and supervision functionaries, assurance of corporate discipline, transparency, and disclosure, internal and external reporting, responsibility, accountability and compliance, internal auditing system, the external auditor and the appointed actuary. Special emphasis was put on the board of directors' position as the entity responsible for the leadership of the insurance company. These reforms are based on the generally accepted corporate governance principles applying to banks in Israel as well as on the generally accepted corporate governance principles applying to insurance companies worldwide. The CMISD emphasized that the new Israeli regulations on corporate governance in the bodies that it supervises were highly influenced by OECD's work in this field.

The detail of the Israeli corporate governance regime applicable to the insurance industry is provided in Annex 1. Compliance of the Israeli laws, regulation and policies with the Recommendation of the Council on Guidelines for Insurers' Governance is assessed in chapter 4 of this report.

1.5. Main risk exposure of the insurance sector

The Israeli insurance sector is vulnerable to four main types of risks:

³⁸ The compliance of Israeli insurers' corporate governance framework with the OECD *Guidelines for Insurers' Governance* is reviewed in the last chapter of this report.

- ***Risks streaming from the recent major change in insurers' range of activities.***

Recent reforms entailed a dramatic increase in the volume of assets under insurers' management (directly or indirectly through subsidiaries), as well as the sudden broadening of their scope of operations, which now includes the management of mutual and provident pension funds, as well as credit activities. The integration of Israel's financial market into global financial markets and the liberalisation of investment regulations³⁹ gave insurers access to a wide array of complex investment products. These evolutions challenge companies' risk management strategies and corporate governance structures, while requiring new expertise.

- ***A substantial improvement in life expectancy***

The most common type of individual life insurance policy sold in Israel is a deferred annuity contract allowing the conversion of savings to a life annuity. For these policies, insurance companies therefore bear the risk that policyholders' life expectancy may exceed the bases underlying the guaranteed conversion factors. Companies have provisioned this risk under best estimate assumptions reviewed by the CMISD who also set margins for adverse deviations to be taken into account in exposure assessment. It remains to be seen whether the models and their underlying assumptions are validated by the future developments in life expectancy.

- ***Crises in capital and financial markets***

Investment income has a major impact on the profits of the insurance companies in Israel, and in 2006 accounted for over 60% of their pre-tax earnings. Since investment restrictions have been relaxed, insurers have become more vulnerable to volatility on local and international capital markets, as illustrated by the recent losses incurred on capital markets, aggravated by the decline in the value of the dollar and the rise in the consumer price index. It should nevertheless be recalled that in participating insurance plans, which account for the majority of the insurance companies' assets⁴⁰ (NIS 94 billion out of NIS 181 billion managed assets), the investment risk is borne by the insured and not by the insurance companies, thus mainly exposed to the risk of a decline in income from management fees.

- ***High exposure to catastrophic risks: earthquake and war/terror attacks***

Lastly, the insurance industry in Israel is highly exposed to two major catastrophe risks: earthquake, and war and terrorist attacks.

³⁹ See paragraph 2.1.7 below.

⁴⁰ Insurance companies in Israel manage two types of liabilities that differ in the identity of the entity bearing the risk of investment, in the assets held against them, and in the extent to which losses stemming from the investment activity affect their solvency.

- Participating policies/Provident funds: in this type of policies/funds, the insured person or the participant bears the risk of the investment. There is a negligible direct impact on the solvency of the insurance company/provident fund managing company. The major part of the insurance companies' assets (more than NIS 94 billion in managed assets comprising in preponderant majority savings funds), are held against liabilities deriving from participating insurance policies.
- Nostro liabilities: unlike assets held against liabilities deriving from participating insurance policies, the investment risk inherent in assets held against nostro liabilities is imposed on the insurance companies themselves. However, these assets comprise less than one half of the assets managed by the insurance companies, and a substantial part (some NIS 30 billion) are invested in non-negotiable earmarked bonds that were issued to the insurance companies by the Government of Israel and that do not expose the insurance companies to market risks.

In February 2008, the strongest earthquake in a decade served as a reminder that the country, located along the African-Syrian Rift, one of the Earth's most seismically active systems, is at risk from earthquakes⁴¹. No special reserve is required to cover earthquake risk in non-life lines. Earthquake risk is however curtailed by the transfer of most of insurers' risk exposure to earthquakes (80%) to highly rated international reinsurers: more than 95% of the coverage is borne by reinsurers rated A and above, mostly in the framework of proportional reinsurance. For the self-retention level, the Israeli insurance companies tend to purchase Cat XL (Excess of Loss) reinsurance. In the homeowner's line and in other property lines (excluding auto property), which are characterised by a high spread and in which the insurance companies' major exposure to earthquake risk is concentrated, the deductible rates are high, standing as a default at 10% of the amount of the insurance cover. As of December 2006, the maximum possible loss which Israeli insurers will bear was thus limited in the bottom layer to less than two percent of the total equity in the industry, and to \$2.2 billion in the upper layer.

The services of international risk management firms (such as RMS, AIR, Equecat) are used by some Israeli insurance companies to assess their exposure to earthquake. Further work on earthquake risk management is also underway at the governmental level, e.g. on the establishment of benchmark rules for the MPL (Maximum Possible Loss) calculation, on a requirement for a certain amount of self-retention in the event of earthquake as well as on reinsurers' share in earthquake coverage, based on their rating.

Regarding the permanent threat of war and terror attacks, a system of victim compensation has been established in 1961 whereby compensation is provided through a dedicated fund financed by a tax on property.

Lastly, it should be mentioned that the State of Israel has a National Health Law that guarantees basic health services to the entire population of the country. The basket of services provided in Israel is very broad compared to other countries. Hence, it may be assumed that in the event of an exceptional occurrence, a large proportion of the population would be covered by the health funds in the framework of the National Health Law.

⁴¹ The Jerusalem Post, 26 February 2008.

Table 12. Coverage of catastrophic risks in Israel

	<u>Earthquake</u>	<u>War and terrorism</u>
<u>General insurance</u>	<p>Insured by commercial insurance companies only, without government intervention (exception: natural disasters affecting agriculture are covered by a fund jointly owned by the State and the farmers' associations).</p> <p>Homeowner's insurance policies and engineering insurance policies typically cover earthquake risks.</p>	<p>The State of Israel compensates its citizens (out of a special fund accumulated from property tax payments) for damage to property.</p> <p>The insurance policies sold by the insurance companies generally do not cover damage to property due to war or hostile acts.</p> <p>Some policies offer the possibility of purchasing additional cover for damage to property due to war or hostile acts, against the payment of an additional premium.</p>
<u>Life and health insurance</u>	<p>Health services are provided by the government through the health funds to all residents of the country within the framework of the health services basket, by virtue of the National Health Law, 5754-1994 (first pillar). It is also insured by commercial insurance companies (second pillar).</p> <p>Cat XL reinsurance typically covers the higher layer of damage.</p> <p>Earthquake risk is generally covered under insurance policies that cover mortality</p>	<p>Anyone injured in terrorist attacks or in a war is entitled to payment for therapy, convalescence, rehabilitation and benefits from the National Insurance Institute. In case of death, the compensation is paid to the deceased's family.</p>
Mortality risk	<p>Earthquake risk is generally covered under insurance policies that cover mortality</p>	<p>Insurance policies covering mortality usually cover the payment of insurance benefits or a survivors' annuity to beneficiaries in the event of the insured's death due to terrorist attacks or war, and on the insured's death the beneficiaries are paid insurance benefits as in any other mortality event.</p>
Other risks	<p>Earthquake risk is generally covered under private health insurance policies covering (mainly) occupational disability, accidental disability, operations, transplants, and hospitalization.</p>	<p>Insurance policies covering occupational disability, accidental disability, operations, transplants, hospitalization and any other type of cover under private health insurance policies differ regarding coverage for injuries due to war or hostile acts.</p> <p>Nevertheless, such coverage usually does not cover injuries received as a result of active participation in war or military activity or injuries occurred/incurred during military service.</p>

2. REGULATORY, SUPERVISORY AND TAXATION FRAMEWORK

2.1. A legal system revamped in the wake of the Bachar reform

2.1.1. Summary of recent policy and regulatory initiatives

The current organisation of the insurance sector is the result of a long reform and liberalisation process, that has accelerated over the past few years. The analysis of the self-assessment exercise conducted under the IAIS Core Principles and Methodology in 2004⁴², which described a far less developed insurance regulatory and supervisory system, evidences progress achieved.

Table 13. Summary of major recent reforms in the insurance sector since 2000

MAJOR RECENT REFORMS	MAIN OUTCOMES
Reform in the compulsory vehicle insurance line (2000)	The compulsory vehicle insurance line was opened to competition
Reform in the investment regulations (2001) (2007)	<ul style="list-style-type: none"> - investment quotas to the different groups of assets were abolished, - the list of admissible assets was considerably extended, subject to diversification restrictions, - stability-related restrictions were established in all matters concerning the extension of non-negotiable credit, - investment restrictions on derivatives were established, and - quantitative restrictions on investment abroad were removed (for countries rated A and above). <p>Additional restrictions on investment in a single issuer and borrower group were removed.</p>
Sale of the new pension funds to the insurance companies (2004)	All of the new pension funds were sold to insurance companies.
Reform in life insurance products (2004)	The selling of life insurance products combining savings that do not make a distinction between the level of expenses, the level of insurance coverage and that of savings was prohibited.
Bachar reform (2005)	<ul style="list-style-type: none"> - a significant segment of the provident fund market was sold to insurance companies. (Today, insurance companies hold 33% of total provident fund assets, compared with 2% in 2005). <p>A series of regulations have been issued aiming at strengthening insurers internal control and supervision mechanisms:</p>

⁴² See Insurance Core Principles Self-Assessment Programme, International Association of Insurance Supervisors, July 2004.

	<ul style="list-style-type: none"> - regulation of the corporate governance framework, - creation of an infrastructure for the risk management system, - regulation of the internal auditing system and the activity of the external auditor, - regulation of negotiable and non-negotiable credit activity connected with investment.
Mobility and compulsory pension (enforced in Oct.2008)	The mobility of pension saving funds was allowed.
Preparations for enforcement of: Solvency 2, IFRS disclosure principles , international SOX control principles.	<p>For the past two years:</p> <ul style="list-style-type: none"> - the risk management system and corporate governance were upgraded - the stringency of capital requirements was increased. - a requirement to publish the embedded value of long-term policies was imposed, - reporting and disclosure to the Commissioner and to the public (IFRS) were improved, - internal control mechanisms were strengthened (SOX Act)⁴³.

2.1.2. Licensing process

The CMISD delivers the licence required in order to engage in insurance activity in Israel. This license stipulates the insurance lines in which the license holder is permitted to engage. The CMISD is entitled to issue a license to a company that was incorporated in Israel or to a foreign corporation that engages in insurance in a foreign country and is subject to the supervision of the authorities of that country, providing that it is legally registered in Israel. Among the consideration guiding the CMISD's decision on whether an applicant should be granted a license is the public interest, and the extent to which issuing the license will contribute to competition in the capital market and in the insurance market. The control of more than five percent of particular types of means of control of a corporation is conditional upon receiving a permit from the Commissioner⁴⁴. Recent reforms mainly aim at limiting concentration in the financial sector. In this context, it was stipulated that a permit will not be granted for control in an insurance company if after the issue of the permit, the applicant would hold a market segment in excess of 15% of the total value of long-term savings assets in Israel.

Timetables for the conclusion of the licensing process are not prescribed under the law. Experience to date shows that the licensing process for a new institutional investor lasts for an average of three to five months, from the date of submission of the initial application documents until the issue of the license.

2.1.3. Supervision of insurance products

As a rule, the Insurance Supervision Department does not intervene with regard to the conditions or rates set by insurance companies, and new policies or changes to existing ones in many insurance lines are only submitted to notification requirements.

Nevertheless, express approval or rates/conditions is required in specific lines as detailed below:

⁴³ SOX 302 on the corporate responsibility for financial reports was fully implemented in 2006; the implementation of article 404 on the management assessment of internal controls has been postponed to 2010.

⁴⁴ Section 32 of the Supervision Law.

Table 14. Insurance products notification/approval

Insurance line	Intervention of the insurance supervisor
Life insurance	Express approval of the Commissioner is required for new insurance policies or changes in existing ones.
(1): Third party liability insurance (including employers' liability insurance), property loss insurance, health/personal accident insurance (except group health insurance)	The insurance policy may be marketed if the Commissioner has not made an objection within 30 days after receiving a notice about the general conditions of a new or amended policy. Notification of the rates of a new or amended policy must be submitted 10 days before their implementation
Insurance not referred to under (1)	Notification of the rates and general conditions of a new or amended policy must be submitted 10 days before their implementation

Moreover, with a view to policyholder protection, when the Commissioner considers that there is a market failure on specific insurance lines:

- The CMISD may issue guidelines defining the principles according to which insurance coverage should be priced, or
- The law may be amended in order to include:
 - a minimum level of coverage (e.g. for off-the-shelf product such as home insurance, or vehicle property insurance); new or modified policies have to conform to these “standard policies”. Work is under way to compile such standard policies in the compulsory vehicle line;
 - a maximum insurance premium (e.g. for vehicle compulsory insurance and building insurance for homes accompanying mortgages).

Lastly, some insurance lines may be subject to other specific requirements: for health insurance for instance, circulars define the content of the actuarial appendix that insurers are required to submit to the insurance Commissioner along with an application for approval of new health insurance policies or changes in the tariffs of existing ones.

2.1.4. Solvency requirements⁴⁵

Current capital requirements in Israel

The existing Israeli capital requirements for insurance companies refer primarily to the insurance risk in general insurance⁴⁶; they do not take into account any additional risks to which the companies are exposed. The capital requirements applicable to the insurance companies in Israel are established

⁴⁵ See Israel: 2007 Article IV Consultation, IMF, February 2008.

⁴⁶ And nursing care insurance.

in the Insurance Business Control Regulations (Minimum Equity Required Of Insurer), 1998 (hereinafter: “the Capital Regulations.”).

The Capital Regulations establish three tests for calculating the minimal equity required from insurance companies, with the minimal capital required from an insurance company being the highest of these:

a) Tier I capital

The minimal preliminary capital amount is the amount required of an insurance company at the time of its establishment, regardless of the scope of its activity. The following are the minimal preliminary capital amounts, with the amounts in parentheses being the current amounts as of December 2008:

- For insurance companies engaged in credit insurance only - NIS 20 million (NIS 27 million, adjusted);⁴⁷
- For insurance companies engaged in life insurance - NIS 35 million (NIS 47 million, adjusted);
- For insurance companies engaged in general insurance - NIS 40 million (NIS 53 million, adjusted);
- For insurance companies engaged in life insurance and general insurance - NIS 60 million (NIS 80 million, adjusted).

b) The insurance premiums test

A minimal capital amount which is a function of the insurance premiums collected for general insurance business in the 12 months preceding the report date.

1. 10% of the (gross) insurance premiums – up to a ceiling of NIS 55 million in insurance premiums (NIS 74 million, adjusted);
2. 5% of the (gross) insurance premiums – beyond the ceiling described in paragraph (1);
3. 7.5% of the insurance premiums in retained risk amount.

c) The outstanding claims test

A minimal capital amount is a function of the general insurance outstanding claims balance in retained risk amount.

4. 20% of the outstanding claims in the retained risk amount - up to a ceiling of NIS 300 million in claims (NIS 401 million, adjusted);
5. 12% of the outstanding claims in the retained risk amount – beyond the ceiling described in paragraph (1);

In addition to the requirements determined according to the above tests, insurance companies are required to provide additional capital for each of the following:

a) Deferred acquisition expenses

Deferred acquisition expenses, for life insurance and illness and hospitalization insurance (deferred acquisition expenses are expenses – such as commissions to agents – which are involved in the issuance of new insurance policies or of additions to existing insurance policies). For life

⁴⁷ All amounts indicated in this section are linked to the CPI for May 1997.

insurance, the total amounts required for this category may not be less than NIS 15 million (NIS 20 million, adjusted);

b) Unrecognized assets

6. Assets, the investment in which was in violation of the Investment Regulations;
7. Bad debts not attribute to expenses;

c) Guaranteed yield life insurance liabilities

Credit and market risks related to assets held against guaranteed yield life insurance liability, against all or some of which the company holds designated bonds, and the risk of reinvestment of the assets that are held against such liabilities (2% of the liability amount);

d) Nursing care insurance

The higher of the insurance premiums test and the outstanding claims test (described in sections (b) and (c) above) with respect to the company's nursing care insurance business, subject to the following changes:

1. The insurance premiums ceiling for the insurance premiums test with respect to nursing care insurance will be NIS 10 million, as opposed to NIS 55 million for general insurance (NIS 13 million and NIS 74 million, respectively, adjusted);
2. The outstanding claims ceiling for the outstanding claims test with respect to nursing care insurance will be NIS 50 million, as opposed to NIS 300 million for general insurance (NIS 67 million and NIS 401 million, respectively, adjusted).

e) The amount in the retained risk amount relating to insurance in the event of death

In connection with the amount at risk with respect to insurance in the event of death, the insurer is required to hold capital against its special risks reserve, according to the lower of the following:

1. The amount in the reserve for special events as recorded in the 2006 report.
2. 0.17% of the existing amount at risk for the insurer as of the date of the current report.

f) Controlled companies engaged in insurance business in Israel

An insurer controlling insurance companies or pension fund management companies in Israel is required to hold capital in an amount no less than the capital required for the controlled insurance companies/management companies multiplied by the relevant holding percentage, with the addition of the original allowance.

Currently, as emphasised in the last Article IV consultation procedure on Israel issued by the IMF, the existing insurance companies' regulatory capital and solvency requirements remain inadequate. The above capital required from insurance companies that are active in Israel is significantly lower than the capital these companies would be required, if they operated abroad. The charts below evidence the substantial gaps between the capital required in Israel and the capital required in selected other developed countries using progressive models.

Figure 8. Ratio between the capital required according to Solvency 1 and the capital required according to the existing Israeli model – Israeli insurance companies involved in general and life insurance (December 2006 data)

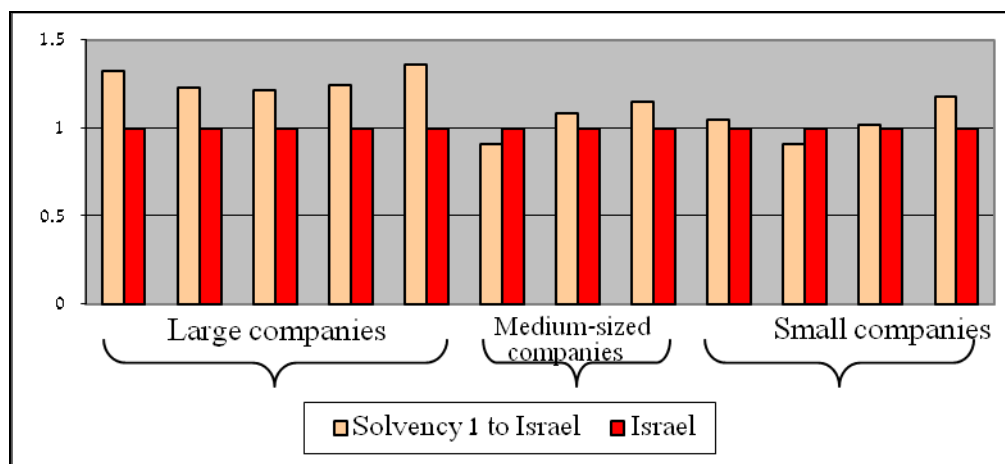


Figure 9. Ratio between the capital required according to the British model and the capital required according to the existing Israeli model – Israeli insurance companies involved in life insurance only (December 2006)

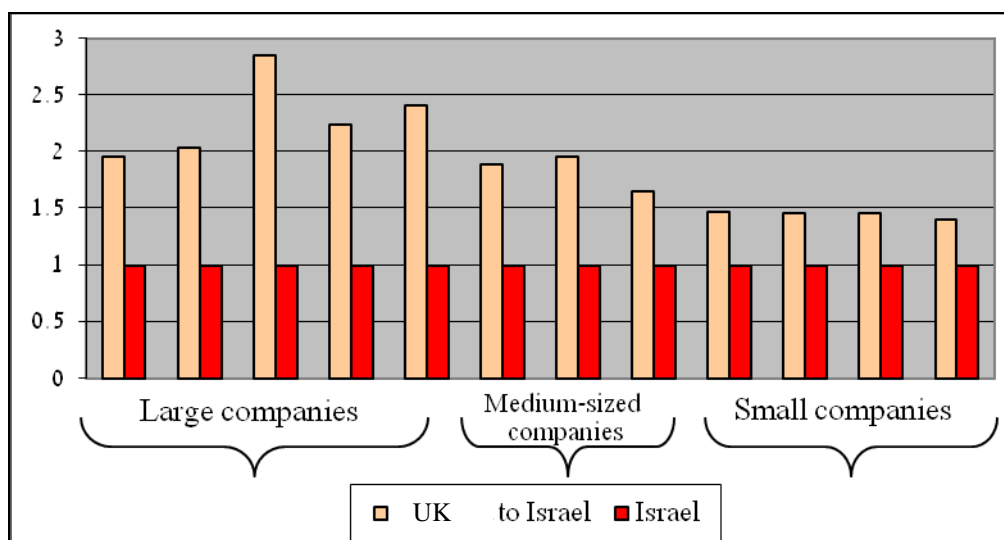
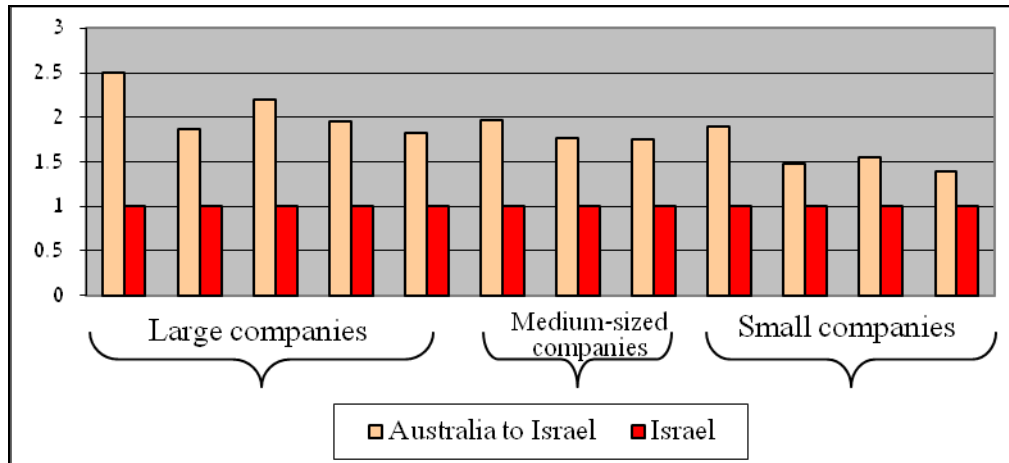


Figure 10. Ratio between the capital required according to the Australian Model and the capital required according to the existing Israeli model – Israeli insurance companies involved in general insurance only (December 2006 data)



Source of the three figures: the CMISD

Towards more stringent capital requirements

Significant efforts have therefore recently been made toward more stringent capital and solvency requirements, taking into consideration mortality and new investment risks in particular. In order to enhance further solvency standards over the next few years, the CMISD has decided to link the Israeli reform to the European Solvency II process: Israel being a small market, it had to adopt international standards, and the important exposure to European reinsurers, among other arguments, motivated the choice of the Solvency II regime. To this aim, the following steps have been taken so far:

Table 15. Linking the Israeli reform to the European Solvency II process

Oct. 2007	The CMISD examined the capital requirements for Israeli insurance companies as compared to the capital that would be required of them if they were operating in other developed countries with (see graphs above).
	<p>As a result, the Commissioner published a draft directive aimed at increasing the capital requirements for Israeli insurance companies. The draft directive proposed that in addition to the capital requirements already in place in Israel, additional capital requirements should be added in relation to:</p> <ul style="list-style-type: none"> investment assets held against liabilities that are not unit-linked, the credit risk embedded in the exposure to the financial strength of reinsurers, losses resulting from a single catastrophic incident (for general insurance business), including the amounts that are not held in self retention and that are covered by reinsurers, withstand operational risks and risks presented by long-lived insureds. <p>The examination of the implications of the implementation of the proposed provision for the insurance companies in Israel indicates that the capital to be required of them after the draft provision's implementation will be similar to the capital which would be required of them if the Solvency 1 Directive had been implemented in Israel. The draft provision has not yet been submitted for the approval of the Knesset Finance Committee.</p>

May 2008	Insurance companies were prevented from distributing dividends in amounts exceeding one half of the profits from regular operations since the beginning of 2008 (except with the prior approval of the Commissioner of Insurance), in order to adapt to future more stringent capital requirements as well as in light of the financial crisis.
July 2008	<p>The Commissioner's provision according to which the Solvency 2 directive should be implemented in Israel at the same time as it is implemented in Europe took effect. The directive included a road map for the attention of insurance companies, required to:</p> <p>Establish preparation teams and mechanisms within the companies regarding the implementation of the proposed Solvency 2 directive;</p> <ul style="list-style-type: none"> • Appoint a Board of Directors' committee to monitor and supervise the progress of the implementation; • Establish a multi-year work plan and allocate resources for the companies' preparation of the implementation of Solvency 2; • Calculate the implications of the quantitative requirements of the proposed Solvency 2 directive, according to a quantitative impact study. <p>To implement this draft provision, all of the insurance companies have appointed responsible parties, implementing teams and directors' committees, and have prepared action plans which have been submitted to the Commissioner's office.</p>
30 Sept. 2009	Submission by insurance companies of the report on the implications of the quantitative requirements of Solvency 2, in accordance with a quantitative impact study.

Source: CMISD

The 2007 draft directive

Below are further details on the 2007 draft directive which should introduce new capital requirements for risks that were not taken into account in the existing model.

- a. Capital requirements for investment assets and for the exposure to reinsurers' credit risk.

Insurers are required to hold capital in an amount reached by multiplying the value of the investment in the asset or the value of the exposure to a reinsurer's credit risk by the percentages determined pursuant to the following coefficients:

Table 16. Capital requirements for investment assets and for the exposure to reinsurers' credit risk

Type of asset	Capital percentage
- Loans given against life insurance policies - Designated bonds - Deferred acquisition expenses in general insurance	0%
-Cash and cash equivalents -Debt instruments issued by countries rated AAA and by central banks of such countries	0.5%
-Bonds issued by the State of Israel	1%
-Debt instruments issued by countries rated A- and higher and by central banks of such countries	2%
- Other debt instruments rated AA- or higher, including debt instruments of reinsurers that are so rated -Loans given to a borrowing agent, the security for which is the cash flow resulting from commissions expected to be paid to the agent by the insurer	2.5% or 2% for debt instruments with international rating
- Other debt instruments rated A- (or A2) or higher, including debt instruments of reinsurers that are so rated	5% or 4% for debt instruments with international rating
-Debt instruments rated BBB- (or A3) and higher, including debt instruments of countries and of reinsurers that are so rated	7.5% or 6% for debt instruments with international rating
-Debt instruments rated lower than BBB- or AAA, including debt instruments of countries and of reinsurers that are so rated, and debt instruments that are not rated	16%
- A housing loan for which a senior mortgage against the residence has been recorded as security for its repayment, provided that the ratio of the loan amount to the value of the collateral is less than 60%, or that such ratio, after providing insurance coverage through credit insurance for the residence secured by the mortgage, is less than 55%	5%
- Real estate rights - Productive real estate - Real estate for private use	10% 8%
Mutual funds, basket certificates – - Mutual funds, basket certificates for which the base asset is shares, goods or derivatives - Mutual funds, basket certificates for which the base asset is debt	14% According to the above coefficients, in accordance with the rating of the base asset
Negotiable shares – which are base assets for options and futures contracts, and for short positions- if calculated in delta terms, subject to rules given by the Commissioner regarding the types of base assets and regarding types of counter-parties	14%
-Non-negotiable shares -Non-negotiable investment funds - Receivables - Premiums due in arrears - Other assets	16%

b. Capital in general insurance against damages due to a natural disaster

Insurers are required to hold capital equal to the amount of costs it will bear in general insurance, due to damages resulting from a natural disaster, less the part of such exposure ceded to reinsurers.

c. The share of general insurance reinsurers in the exposure due to the occurrence of a natural disaster

Insurers are required to hold capital equal to the amount reached by multiplying the share of reinsurers in the natural disaster exposure amount in general insurance, by 25% of the rates indicated in the above table. In addition, insurers are required to hold capital with respect to the re-establishment costs of reinsurance policies for coverage of such events.

d. The capital requirement for risk relating to the re-investment of guaranteed-yield policies against which there are no designated bonds, in the amount of 2% of the liability, has been replaced by a requirement that capital be held in the amount of the differential between the current value of the assets and the current value of the liabilities for these policies.

e. Capital requirements for operational risks

Insurers are required to hold additional capital for operational risks. The capital requirement for operational risks will be calculated in accordance with the higher of the premiums earned test and the outstanding claims test, with the addition of 25% of the unit-link life insurance management and general expenses. A high risk margin of 30% of all existing requirements and those proposed in the draft regulations.

f. Capital requirements for longevity risk

Insurers are required to hold capital due to longevity risk for pension policies, for which the pension annuity factor reflect the insurance of life expectancy. The required capital is to be 25% of the differential between the following two amounts:

1. The difference between the current value of the assets and the current value of the liabilities for the pension policies (including policies that include a pension option);
2. The difference between the current value of the assets and the current value of the liabilities for the pension policies (including policies that include a pension option), after the liabilities have been increased by an assumption of a 25% decline in mortality;

In addition to these, insurers are asked to hold a risk margin in the amount of 30% of the capital requirements established in the existing and proposed regulations, unless it is proven, pursuant to the findings of a QIS4, that the insurers do not require additional capital.

These amendments of current regulation put forward by the 2007 draft directive would dramatically increase the capital requirements imposed on insurers. There is however so far no clear timing for the approval of this draft by the Knesset Finance Committee, and for subsequent implementation. Meanwhile, companies' reports to be submitted by the end of September 2009 will provide clearer indication of the degree of insurers preparedness to the implementation of Solvency II requirements as well as on the feasibility of the related timetable set by the CMISD.

2.1.5. Insolvency

In case of financial distress, an array of measures enables the protection of policyholders:

- under certain conditions, an insurance company can, on a voluntary basis, guarantee the liabilities of a failing company;
- the State of Israel, with the approval of the Knesset Finance Committee, may also provide a guarantee deemed “to develop or to encourage an economically important sector or assist in any other matter that is in the general interest”. The amount of the valid guarantee will not exceed 10% of the amount of the State budget for a given financial year.
- life insurance policyholders benefit from several specific protection mechanisms: assets for the coverage of liabilities in life insurance should be held separately from the insurer’s other assets; in case of winding-up, priority rights on remaining assets will be granted to life insurance policyholders; assets held against an insurer’s yield-dependant life insurance liabilities (profit-sharing policies) will be segregated from its other assets;
- lastly, the company’s controlling owners have recently been required to partly guarantee the insurers’ minimum equity capital in case of a catastrophe event. If negative capital has been accumulated, the obligation is up to 50% of the insurers required capital; in case of acquisition of existing insurer, the guarantee is up to 50% of the required capital of the insurer as it was required on the day of the acquisition. (For a provident/pension fund managing company, the obligation is 100% of the minimum capital required from the managing company if negative capital has been accumulated).

Although the issue of policyholder protection fund(s) against insurers’ insolvency appears from time to time on the public agenda, it has not given rise to legislation so far, since it is generally considered that existing mechanisms provide a reasonable solution to insolvencies for most types of policies. The only insurance line for which a specific fund has been established is the compulsory vehicle insurance (Karnit protection fund).

With respect to health insurance, under the National Health Law every resident of Israel is covered by basic health insurance by one of the health funds, and the insurance companies’ health insurance policies constitute an additional layer for expanded health services. Accordingly, should a health insurance company become insolvent, policyholders would still be covered by a rather generous first layer health insurance scheme.

For the life lines, life insurance payments are given priority in case of insolvency. As regards insolvency by a pension fund managing company, since the members’ assets are kept separate from the managing company’s assets, they will not be affected by its collapse.

There is however no general policyholder protection funds operating in Israel. The only protection fund, “Karnit”, exclusively compensates for bodily harm to road accident victims.

2.1.6. Technical provisions

Actuaries are left with a ample margin for manoeuvre in the way they compute the technical provisions. There are no detailed guidelines regarding the method to be used in calculating the general insurance reserve or the required safety margin in general insurance, nor for the health insurance reserve. In life insurance, there are no actuarial bases set by the regulator which the company’s actuary must adhere to.

Annex 2 describes the framework requirements relative to the calculation of technical provisions for general insurance, health insurance and life insurance.

2.1.7. The liberalisation of investments

The deregulation of insurance companies' investments preceded the recent wave of reforms in the financial sector. Until 1991, the insurance companies offered life insurance plans on which the yield was guaranteed. These were backed by earmarked bonds issued by the State.

From 1992, the issuance of earmarked bonds to the insurance companies was stopped, and the companies began to offer unit-link policies. The investment regulations applying to the insurance companies were changed accordingly and investment quotas were determined in three groups of assets – at least 50% of assets were to be invested in government bonds, up to 26% in marketable stocks and up to 30% in other, non-marketable assets.

In 2001, a comprehensive reform was implemented in the investment regulations:

- The investment quotas in the different groups were abolished,
- The list of admissible assets was considerably extended subject to diversification restrictions (up to 10% in a single issuer and up to 15% in a borrower group, depending on the issuer's rating),
- Restrictions were imposed on the holding of means of control in the companies (up to 20%),
- Stability-related restrictions were established in all matters concerning the extension of non-negotiable credit (BBB grade and above or adequate surety),
- Investment restrictions in derivatives were established⁴⁸
- Quantitative restrictions on investment abroad were removed, subject to the investment being in the securities of corporations that are issued or traded in countries rated at A and above. (The change was made following the reform in the Foreign Currency Control Law). The reform was backed by the progressive integration of Israel capital markets⁴⁹ - formerly under government control - into the global capital market, where investors can allocate their sources according to consideration of yield, risk and liquidity.

Additional restrictions were removed in 2007. *Inter alia*, investment can now be made in a single issuer and borrower group up to the rate of 10% and 15% respectively, regardless of the body's rating, and investment was permitted in countries rated at BB and above. However, the investment restrictions on related parties to an insurance company were increased, especially with respect to

⁴⁸ An insurer is entitled to invest in derivatives providing that the value of the premium for all the derivatives (long position) does not exceed 5% of the amount of each separate liability and the exposure to the underlying asset does not exceed the restrictions applying under these regulations (single issuer restriction, borrower group restriction, investment diversification index, etc). The new directives also prescribe a restriction whereby the collaterals in respect of derivative transactions must not exceed at any time 10% of the amount of each separate type of liability. Despite the aforementioned, it is stipulated that an insurer must not invest in options and futures contracts against guaranteed-yield life insurance policies in which the investment risk is imposed on the insurer. Apart from these liabilities, an insurer is entitled to invest in derivatives against each of his other liabilities, subject to the above-mentioned restrictions.

⁴⁹ See address by the Governor of the Bank of Israel to the Annual Capital Markets conference held by the Annual Capital Markets Conference held by TheMarker, 13 June 2007.

liabilities on which the insured bear the investment risk⁵⁰. As a result of this progressive liberalisation, insurers' investment mix has evolved considerably since the 90s, to encompass less government bonds and more stocks, marketable and non-marketable bonds and loans to companies⁵¹. Such evolution is obviously not devoid of risks. The recent price slide in the financial markets has evidenced the increased dependency of insurance companies on the behaviour of the markets, due to "the rise in the ratio of marketable assets in profit-sharing life insurance plans and in the nostro portfolio (including general insurance)", as well as to "the requirement to value non-marketable assets in profit-sharing life insurance plans on the basis of market value"⁵².

02/2009	01/2009	Table 17. Insurer's current investment portfolio
5.0%	4.3%	Cash and cash value
18.9%	19.0%	Earmarked bonds
19.0%	19.2%	Government bonds
13.2%	13.2%	Negotiable corporate bonds
7.9%	8.0%	Shares
9.5%	9.2%	Non-negotiable corporate bonds
6.6%	6.6%	Deposits
1.4%	1.5%	Mutual funds
2.5%	2.7%	ETFs
6.0%	6.0%	Loans
10.0%	10.2%	Other
100.0%	100.0%	Total

02/2009	01/2009	Life insurance participating portfolio
4.3%	3.6%	Cash and cash value
1.2%	1.2%	Earmarked bonds
22.7%	23.0%	Government bonds
17.0%	17.0%	Negotiable corporate bonds
13.8%	13.9%	Shares
11.8%	11.5%	Non-negotiable corporate bonds
5.3%	5.3%	Deposits
2.1%	2.2%	Mutual funds
4.7%	5.1%	ETFs
5.3%	5.2%	Loans
11.8%	12.2%	Other
100.0%	100.0%	Total

⁵⁰ The main change introduced by the new regulations is the application of investment restrictions in related parties to companies controlled by an interested party in the insurer. Under previous regulations, an insurer was restricted in its investments in a party holding 20% or more of it. Under the new regulations, investment in a party controlling the insurance company and transactions with that party are prohibited, and investment in all those defined as related parties is restricted to 10% of the insurer's equity capital.

In participating life insurance plans, investment in related parties will be limited to 5% of the plan's assets (draft provision still to be approved by the legislative body).

⁵¹ Evolution of investments assets for life-insurance schemes between 2004 and 2006: from 5.6% to 9.5% for investments abroad, from 7.7% to 10.6% for shares, from 53.1% to 43.5% in government bonds. See Israel: 2007 Article IV consultation, IMF, February 2008.

⁵² Annual report, chapter 4, Bank of Israel, 2007.

2.1.8. Risk management

Segregation between life and non-life insurance business in composite insurance companies.

While the Israeli legislation allows insurance companies to operate in life and non-life insurance, a number of regulations aim at separating life and general insurance business in composite insurers. This is all the more important in Israel that composite insurers represent more than half on the companies established in the country.

- The Insurance Control Regulations (Ways of Investing an Insurer's Capital and Funds and Managing its Liabilities), 5761-2001, define the different types of an insurer's liabilities and make a distinction between liabilities deriving from life insurance activity, and liabilities deriving from general insurance activity, with the result that specific assets which can be identified and managed separately are held against each type of liability.
- Section 54 of the Financial Services Supervision Law (Insurance), 5741-1981, stipulates that a separation of accounts and assets must be maintained between life insurance activity and non-life insurance activity. An insurer must manage a separate system of accounts, separate assets for covering its life insurance activities, and must take out separate reinsurance for these activities.
- The Insurance Control Regulations (Ways of Separating an Insurer's Accounts and Liabilities in Life Insurance), 5744-1984, define and expand the separation requirement with respect to companies engaged in life insurance, and oblige them, *inter alia*, to hold accounts at separate banks, to distinguish and denote investments held against life insurance liabilities, and prohibit offsets between the activities and the use of assets connected with life insurance activity for purposes other than life insurance.

Most recent evolution of the risk management regulation

Significant steps have recently been taken to improve insurers' risk management, such as the introduction of new requirements for:

- The management of the assets held against liabilities deriving from participating life insurance plans (for which the investment risks is borne by the insureds);
- The appointment of a risk manager⁵³, whose duties include identifying material risks to which the insurance company is exposed, including financial and insurance risk as well as a catastrophe risks, assessing the potential impact of the risks, examining whether the existing measures at the insurance company are adequate for the purpose of risk measurement and monitoring and for facilitating risk diversification, limiting risk to a predefined level, offsetting or transferring of risks to another entity, and submitting the management and board of directors immediate and periodic reports.

2.1.9. Accounting, disclosure, and requirement to hire appointed actuaries

The Finance Minister and the CMISD acquired the authority to instruct the insurance companies regarding the types of reports which they must send and the timing of these reports. Since 2007, insurers are required to publish the embedded value of their long-term policies, as well as to adopt the IFRS to improve reporting to the Commissioner and to the public.

⁵³ Some of the larger companies had already established risk management functions.

According to circulars issued in 2007 for life and non-life insurance, and 2005 for health insurance, insurers are required to nominate a qualified and experienced “appointed actuary” for each line of insurance in which they engage and to receive the regulator’s approval for this appointment. The main function of the appointed actuary is to recommend the board of directors and the general manager the amount of the insurer’s insurance liabilities, and to report to the company’s management, the Commissioner and the public on the provision specific to each line of insurance.

2.1.10. Consumer protection

The main regulatory provisions and policies aimed at improving the protection of policyholders are described in various chapters of this report (various degrees of supervision of rates and terms of insurance policies, improvement of solvency requirements and enhancement of insurers’ corporate governance regime, protection mechanisms of life insurance policyholders in case of insolvency, Karnit protection fund in the compulsory vehicle insurance line, establishment of more stringent requirements in terms of disclosure, reporting, and claim management process, etc.).

Among most recent measures taken to enhance consumer protection, one should mention that the Attorney-General was given the authority to sue, at the CMISD’s request, an office-holder in an insurance company due to damage caused to assets held against liabilities deriving from participating life insurance plans, and due to damage caused to insureds’ in these liabilities.

Policy holder satisfaction is carefully monitored by the CMISD. The CMISD's Consumer Ombudsman Unit regularly processes public complaints relating to insurance companies, insurance agents as well as pension funds and provident funds. This data constitute a key indicator of policyholder satisfaction. 2008 witnessed a surge in complaints, which may partly result from unexpected losses on unit-linked products.

Number of Table 18. complaints 2001- 2008	2001	2002	2003	2004	2005	2006	2007	2008
Insurance	2236	2307	2801	3123	3108	3480	2929	3112
Pension	51	98	235	224	388	417	395	625
Provident funds	129	164	170	153	236	272	331	1343

Source: The CMISD

2.2. Supervisory System: the challenges ahead⁵⁴

2.2.1. The institutional framework of the financial sector supervision

Israel has currently opted for a sectorial model of supervision, whereby insurance, pension and provident funds on one side, and banks on the other side, are supervised by separate entities⁵⁵. The

⁵⁴ In order to avoid duplication with work developed in other fora, the OECD has not conducted an assessment of insurance companies’ solvency requirements nor of the supervisory system in Israel. Part 2.2 therefore mainly relies on past assessments exercises conducted under IMF and IAIS standard procedures.

work of supervising insurance businesses in the State of Israel is governed by the Commissioner of the Capital Market, Insurance and Savings at the Ministry of Finance and Capitalization (CMISD). To avoid situations in which the same activity is supervised by different authorities, insurance companies are not allowed to have holdings in companies that manage mutual funds, portfolio management companies or underwriting companies (whose activity is subject to the supervision of the Securities Authority, and disclosure requirements described in the Securities Law). These companies can be held by a holding company that has holdings in the insurance company.

2.2.2. The issue of the independence of the CMISD

The CMISD makes decisions independently of the Finance Minister. However:

- The Finance Minister has the power to appoint and dismiss the Commissioner of Insurance⁵⁶,
- Many regulatory issues (e.g. equity capital requirements, appointment or suspension of administrators and office-holders, rate of insurance fees which an insurance company is entitled to charge, terms of an insurance contract and wording of these terms, directives concerning the structure and format of an insurance policy, type of policies whose management or change require prior approval from the CMISD, and the type of plans whose management or change is conditional on notification to the CMISD) require the Finance Minister's approval,
- The CMISD's budget is not independent: the CMISD uses the Finance Ministry's resources – site, office equipment, communication facilities; its budget is determined within the framework of the State budget, as are the salaries of the CMISD staff.

The last Article IV consultation procedure on Israel issued by the IMF⁵⁷ emphasized the need for a comprehensive reform of the framework in which the CMISD operates. The IMF recommended that the CMISD be made independent from the Ministry of Finance, in line with international practice: the insurance supervisor needs independence to set solvency standards, enforce managerial changes in companies and resolve failing institutions, as necessary. It also recommended that the CMISD be granted enhanced powers, e.g. to perform group-wide supervision. Finally, the IMF advised that the budget devoted to the CMISD be increased, to allow more recruitment of highly qualified staff, so as to match insurance companies' new role in the financial sector and adapt to a more complex financial environment.

2.2.3. Enhanced cooperation with other regulatory and supervisory authorities

The supervision of financial service providers in Israel is governed by three separate supervisory authorities, according to the type of service supplier:

- The CMISD (for insurance companies, provident fund and pension fund management companies) ;

⁵⁵ Consideration is being given to the creation of a single financial supervisory authority, encompassing insurance, banking and securities transactions. See the Address by the Governor of the Bank of Israel to "TheMarker" Capital Markets Conference, 21 May 2008.

⁵⁶ There are however controls in place that limits the abuse of the power to dismiss, among which the independency of the legal advisor of the governmental office and of the commissioner of the civil services, as well as a safely preserved tradition of maintaining the independency of CMISD commissioner, and an independent legal system.

⁵⁷ See Israel: 2007 Article IV consultation, IMF, February 2008

- The Securities Authority (for mutual fund management companies, portfolio management companies and stock exchange members that are not banks);
- The Supervisor of Banks.

The expansion of large financial groups calls for greater cooperation between supervisors. In Israel, most of the insurance groups operating in the long term savings market are active in other financial areas such as asset, trust fund and exchange traded note (ETN) management. These activities are commonly undertaken through a subsidiary, which is supervised by the Israeli Securities Authority. Other than that, insurance groups, such as Clal and Phoenix, constitute a part of wider holding groups. These groups are also involved in sectors such as communications, real estate, retail, energy, transportation, industry, etc. Many of these activities are carried out through subsidiaries which are not subject to supervision by the regulators. The existing legal framework does not provide the Commissioner with extensive supervisory authority with regard to the insurers' holding companies.

The CMISD is therefore focusing its efforts on setting conditions and limitations through the control permits given to the controlling shareholders of these groups. The financial crisis is also an incentive for the CMISD to work on updating the existing legislation so as to expand the supervision and enforcement authority of the Commissioner over holding companies that control institutional entities, as well as to include authority with regard to corporate governance, capital requirements, leverage limitations or reporting requirements.

During the past year, a memorandum of understanding was signed between the three supervisory authorities concerning the creation of a framework for cooperation and information exchange between the entities supervising the financial markets in Israel. It was decided to create a coordinating committee that should convene as necessary and at least once a month, to ensure cooperation and information exchange among the supervisors. Joint working teams also worked on the development of capital markets, custodial matters, the use of financial instruments for the purpose of transferring credit risk, or the activity of the external auditor. Meanwhile, the CMISD was conferred additional authorities for sending information to the Securities Authority and to the Supervisor of Banks, as well as to supervisory authorities in a foreign country, subject to an undertaking to maintain confidentiality and to protect the security of the State.

The licensing department is currently drafting a position paper on group supervision, which will be submitted to the CMISD management in 2009. This position paper is based, in part, on the IAIS' "Guidance Paper on the Role and Responsibilities of a Group-wide Supervisor" published in October 2008.

2.2.4. The CMISD's new structure and professional abilities, to adapt to a new financial landscape

The wide ranging reform of the financial sector required a **new approach in the organisation of supervision**. It was decided to establish an Institutional Entities Department encompassing all the departments that deal with the supervision of institutional entities – the insurance companies among them. In parallel, another department was set up to cover the supervision of existing pension products (pension funds, provident funds and life insurance policies) under a single roof.

The structure of the Division reflects the interconnection between the supervision of pension funds, insurance companies, and provident funds. Corporations are supervised by the Institutional Entities Supervision Department, and saving products and pension funds are supervised by the Pension Saving Department. (See Figure 6).

In parallel to this reforms, a number of initiatives have been taken to enable the CMISD to fulfill its new mission. The enlarged field of competence of the CMISD called for **increase in its staff**, which allowed the assignment of a representative for each supervised body (or a team of representatives, according to the size of the body). These representatives have started to become familiar with the companies for which they are responsible. Representatives carry out an ongoing analysis of the various financial reports that are submitted to the Division, the company's financial statements the audits and examinations carried out within the company. Representative's work is collected in an annual report which collects and analyzes all the company's performance and conduct. The report also indicates the company's problems and weaknesses to which attention needs to be paid and related recommendations for handling these problems.

The **Department's competence has been enhanced**. A new Chief Actuary has been brought into the Division (this post had been vacant for several years). The Division's personnel training processes have been upgraded and various workshops on relevant supervisory objectives have been organised. It should also be noted that the Division's involvement in the handling of the financial crisis during the last months required thorough assessments and reviews of financial institutions and analysis of their investment profiles, in order to determine the crisis' impact on the supervised bodies and their exposure to risk. In this context, the Division greatly improved its familiarity with the characteristics of the various institutional bodies' investments patterns, and its ability to identify risks involved.

Lastly, the **budget of the CMISD has been extended**. The CMISD's personnel budget, by means of which it will be possible to increase salaries as well as the number of employees and their quality in accordance with their seniority and expertise, rose by 13% in the past year. It amounted to NIS 26 million (€ 5 millions) in 2008⁵⁸.

The Division's general budget, which allows improving expertise and know-how by instruction and by means such as the computerized audit plan, rose by 15% in that period.

The use of Section 97 of the Financial Services Supervision Law (Insurance), 5741-1981, which makes it possible for the CMISD to carry out audit work whose cost is imposed on the audited entity itself, by the use of specialists and the ability to finance the audit activity which they carry out, increased by 145% compared with the average audit hours conducted and by 128% compared with the cash amount involved.

Consequently, in the last years, the CMISD was able to significantly increase the resources allocated for audits and enforcement alongside regulation, and the number of audits conducted on insurance companies.

⁵⁸ This amount is largely devoted to paying the salaries of the CMISD's employees and as stated; it does not include payment for resources supplied to the Division by the Finance Ministry, such as high rental, office equipment and communication facilities.

Table 19. Breakdown of the audits that were conducted on insurance companies since 2005

Subject	Year			
	2005	2006	2007	2008
Full Scale				
Institutional evaluations	1	2	2	2
Focused Audits				
Reinsurance	0	0	2	1
Investments	1	3	4	15
Information systems	3	3	2	2
Underwriting, claims and actuarial audits	1	1	5	6
Total	6	9	15	26

2.2.5. Organisation of supervision (See Figure 10)

Regarding the conduct of insurance companies' supervision, the last Article IV consultation procedure on Israel issued by the IMF concluded that the capacity of regulators to manage and resolve financial stress needed to be strengthened, activities had to be rebalanced from developing new regulation to on-site supervision, and that a more principles-based approach to regulation had to be promoted.

If the Israeli regulators remain at an early stage of introducing risk-based supervision, many initiatives aimed at enhancing the risk-based approach have been launched since the IMF assessment end of 2007, and in particular:

- Implementation of a computer program providing a quantitative analysis of the financial data of the insurance companies. It allows the definition of an aggregated index for all relevant financial ratios and the identification of companies' weaknesses to be monitored.
- Implementation of computer programme monitoring audits. This system allows the determination of a quantitative grade to the various audit results, and industry-wide comparisons on various specific issues. Audits on the following main issues have so far been fed into the system: institutional assessments, risk survey, actuarial issues, financial statements, revaluation profit-participation portfolio management, reinsurance, information systems, members' rights and credit.
- A comprehensive examination of the insurance companies' nostro investments was carried out at the start of 2008. Additionally, because of the financial crisis, insurance companies are now required to submit monthly financial reports which are scrutinized by the CMISD.
- A risk assessment survey has been conducted in recent months in selected insurance companies. The companies received questionnaires relating to different aspects of risk management, which allowed the CMISD to establish recommendations to address identified weaknesses.
- The actuarial area has been identified as a problematic issue within Israeli companies; related supervision has been intensified over the last year. The use of focused actuarial audits within the companies was greatly expanded, along with reliance on external actuarial consultants.

2.2.6. Early intervention and insolvency management

After a number of failures in the insurance sector, and especially that of Hasneh Israel insurance Co., the former largest insurer in the country, in the early 1990s the stringency of CMISD policy towards the supervised entities was enhanced, as well as the resources made available to the CMISD.

The Supervision Department carries out analysis of the company's reports to the CMISD and the public, computerized processing of the company's data, initiation of on-site and off-site audit, and risk based audit work.

Early-warning system

The Supervision Department has recently established an early-warning system which in order to detect companies that are in pre-financial distress stages.

The model used provides an answer for three main questions: (1) what indexes are likely to serve as effective preliminary indicators for estimating the risk of insurance companies encountering financial distress; (2) What is the relative importance of these factors – What weight should be assigned to selected financial ratios and forecasting financial difficulties; (3) Does the financial stability analysis of the companies indicate differences between them. Insurance companies' financial stability is rated in accordance to the findings, allowing the CMISD to focus on companies that are likely to encounter financial distress and use efficiently its limited budget.

Insolvency and winding-up regime

The CMISD has been legally conferred authorities for intervening in an insurer's business activity if the insurer encounters difficulties. Section 2(b) of the Supervision of Financial Services (Insurance) Law, 5741-1981 states that: "the Commissioner is entitled, for the purpose of discharging his function, and after consultation with the committee, to issue directives concerning the mode of operation and management of insurers and of insurance agents, of office-holders at them, and of any person who is employed by them, all this in order to assure the propriety of their management and to protect the interests of the insured or of the customers, and in order to prevent an insurer's ability to fulfil his obligation from being impaired".

The Law also confers the CMISD with authorities for maintaining an insurer's stability and:

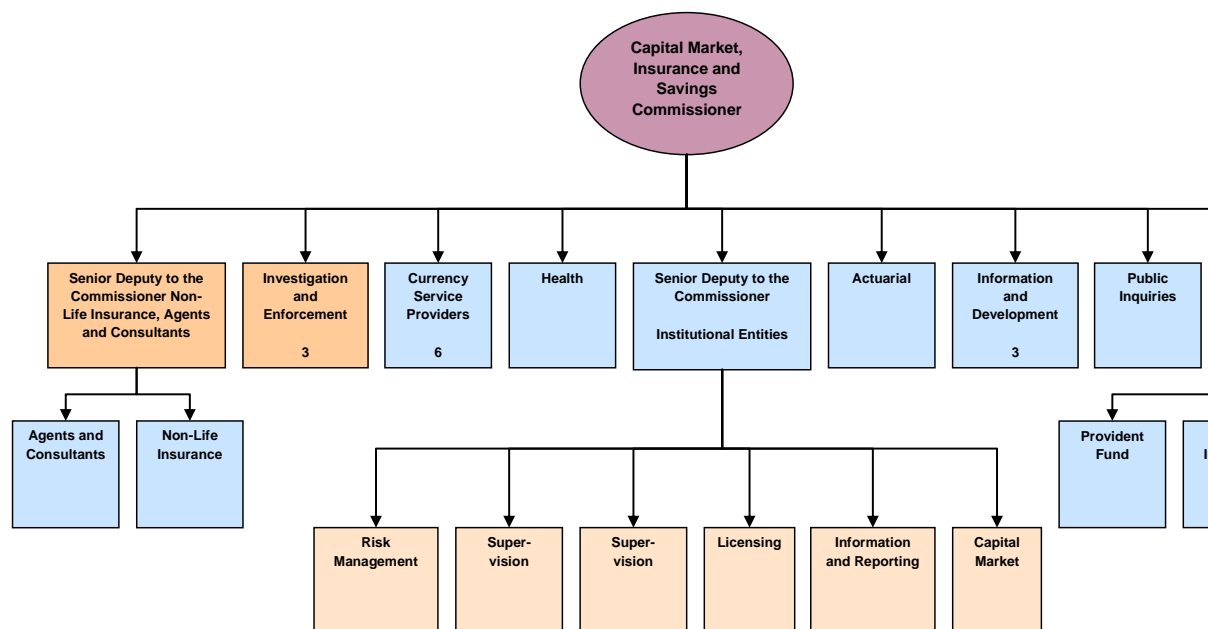
- To condition or to limit the authority of an office-holder or another employee of the insurer.
- To suspend an office-holder at an insurer for a period that will be determined, or to remove him from his function, after he has been given an opportunity to present his position.
- To appoint an administrator for managing the insurer's business activity.
- To appoint a special supervisor for the insurer who will supervise its management.
- To order an insurer to act according to the CMISD requirements in business winding-up and to require remedial action for a deficiency that is discovered in the management of the insurer's business activity.

Protection of the insureds

Section 54 of the Law provides protection for policy-holders over the insurer's other creditors, stating that "assets and rights that are held for covering an insurer's liabilities in life insurance, and

reinsurance for these liabilities will be used to cover the insurer's liabilities in life insurance. Assets remaining after the fulfilment of the insurer's liabilities in life insurance will be used for covering the insurer's other liabilities".

Figure 11. Capital Market, Insurance and Savings Division - Organization Chart



Source: the CMISD 2.3. Taxation of insurance companies

2.2.7. Penalties and enforcement authorities

A civil penalty framework has been established, concurrent with the criminal penalty framework, which was expanded: the CMISD now has the option of imposing civil fines and monetary sanctions instead of a criminal penalty in the event of a violation of the provisions of the law and the administration.

The basic amount of monetary sanctions which is set in the regulation is 150,000 NIS (35,714\$). CMISD will reduce this amount by 75% in the event of mitigating circumstances (such as first violation etc). The basic amount will be increased by 50% in the event of repetition of the same violation. The basic amount of a civil penalty for an insurer is 484,800 NIS (115,429\$). Since 2006 and until now, fines totalling NIS 3.3 billion have been imposed.

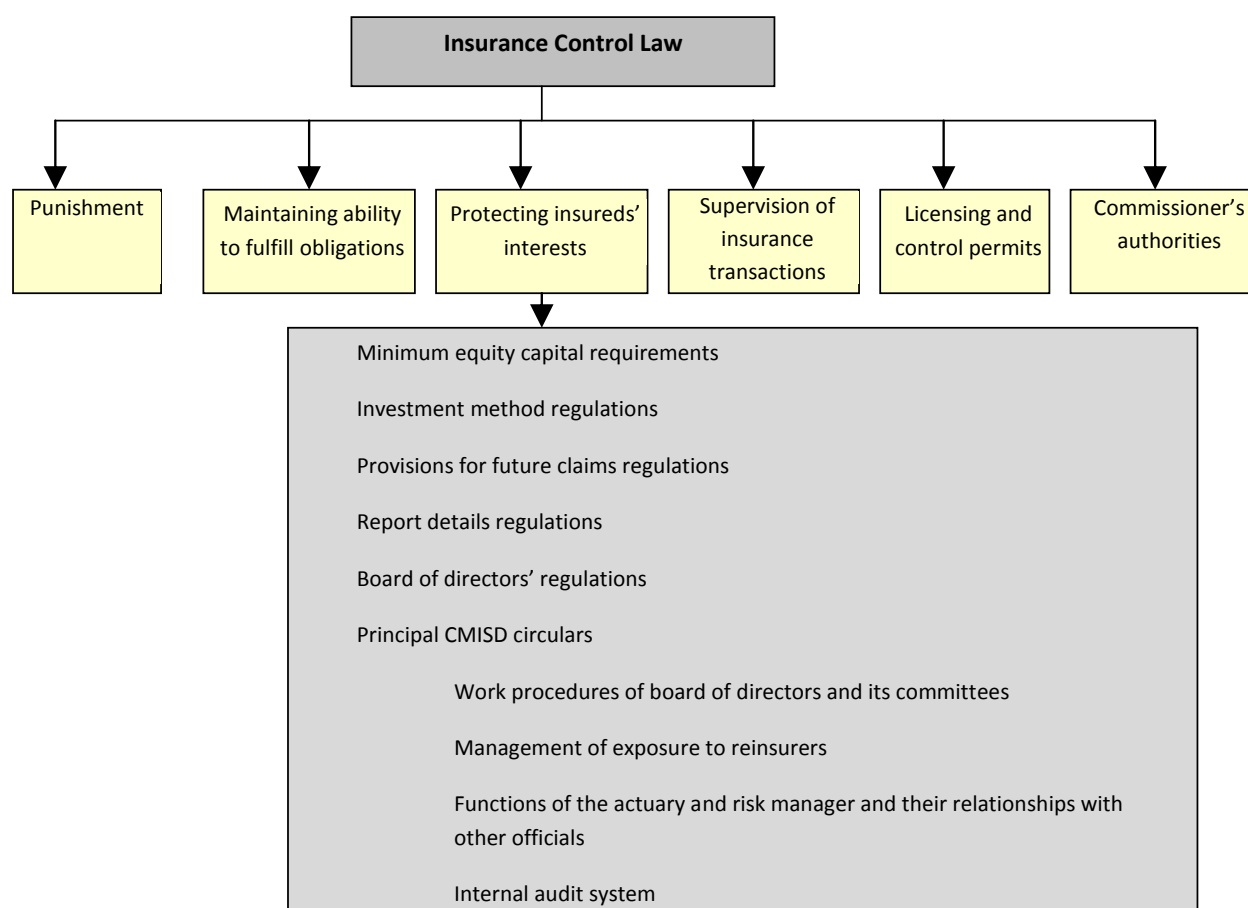
In case the commissioner has reason to assume that a director or a senior employee of the insurer operated in a way that might damage the proper management of the insurer, the law allows him to require suspension of that individual.

2.3. Taxation of insurance companies

2.3.1. General framework

Under the Income Tax Ordinance, insurance companies are defined as “a financial institution”. The statutory tax applying to “financial institutions” is comprised of company tax and profit tax. The profit tax is a substitute for the tax on transactions (V.A.T.) that is paid by “financial institutions”. Profit tax is comprised of tax on the financial institution’s profits and tax on the salaries of the company’s employees (payroll tax). In respect of activities that are conducted via subsidiaries or via sectors of activity that do not constitute “a financial institution”, company tax only applies. Increases and decreases in reserves are recognized for tax purposes as expenses and revenues, respectively.

Figure 12. Insurance Control Law Structure



Source: the CMISD

3. INSURANCE MARKET ACCESS

3.1. Framework for foreign participation in domestic insurance markets

The insurance regulatory framework has been modernised during the last few years, with a view *inter alia*, to make the sector more attractive to foreign investors so as to reduce the insurance risk, develop the local insurance market and improve its efficiency. Several foreign companies have made investments in the insurance sector in the last three years, either based on full ownership of companies or in partnership with resident investors. As a result, five foreign insurers operate currently in Israel. Three of them have been granted an Israeli insurer's license to operate in the form of subsidiaries. Generali, the dominant insurer in Israel, holds 70% of the largest domestic insurance group. The two other insurers operate through branches, which are subject to the same capital requirements as resident insurers (including subsidiaries of foreign insurance companies).

Table 20. Foreign Participation in the insurance sector, as of October 2008 (in per cent)

Insurance line	Share of assets (percentage)
Life insurance	31
General insurance	15

Source: CMISD

3.1.1. Treatment of foreign investors relative to domestic investors

According to the CMISD, there is no discrimination between foreign investors and local investors with respect to general property rights, shareholder rights, and disclosure and reporting requirements. The only provision that is likely to be regarded as discriminatory against foreign investors is the requirement of the Securities Authority in Israel regarding "public" companies (traded on the Tel Aviv Stock Exchange only), whereby holders of means of control in these companies who wish to recommend the appointment of an external director to the corporation are obliged to recommend a candidate who is a resident of Israel. Currently, this provision appears to concern one insurer only.

3.1.2. Transparency of insurance regulation and market access process

A number of practical measures aim at facilitating market access for foreigners. Foreign investors may submit the documents required for licensing and for the issue of permits in English, and meet with CMISD representatives to obtain clarifications on the licensing process or purchase of means of control. More generally, the introduction of new insurance or private pension regulation gives rise to extensive consultation with market participants before promulgation. Draft regulation is sent to institutional investors, published on the CMISD's Internet site, and meetings are held if problems arise.

3.1.3. Adherence to multilateral regional and bilateral trade agreements in respect of financial services in general and insurance and private pensions services in particular.

Israel joined GATT in 1962. It has submitted a proposal for initial obligations and has held negotiations with the European Union, the USA and Canada. It has been subsequently invited to propose obligations in excess of the initial proposal in a number of areas. Israel is also a founding member of the WTO. It participates, on a voluntary basis, in a number of multilateral initiatives as well as bilateral agreements going beyond the trade benefits under the WTO agreements. In recent years, the main service agreement that Israel has been joining is the 1995 Association Agreement between the European Union and Israel (enforced in 2000). The agreement focuses on the opportunity for establishing firms in each other's territory, and the liberalization of the supply of firms' services from one party to the service consumers of the other party. Restrictions on capital movements between the sides were prohibited, apart from exceptional circumstances, and discrimination in capital movement on the basis of nationality of domicile of their citizens or the location in which capital is invested was prohibited.

3.2. Treatment of cross-border transactions⁵⁹

3.2.1. Treatment of cross-border insurance

Both the cross-border provision of insurance services (except for reinsurance and retrocession), and activities by foreign insurers in Israel aimed at advertising the cross-border provision of their services are prohibited in Israel. Israeli residents may nevertheless purchase abroad, at their own initiative, policies from non-admitted insurers, provided that the policies are not issued in Israel. A number of large Israeli corporations purchase such non-life coverage from insurers abroad.

These restrictions give rise to reservations to all D items except items D/1 (transfers relating to social security and social insurance) and D/5 (Transactions and transfers in connection with reinsurance and retrocession).

Concerning item D/1, according to the Israeli authorities, there are no restrictions on the transfer abroad of insurance benefits by the proposer (insured). Transfers of premiums which are payable in another country and to an insured person or beneficiary residing in another country or, for their account, to a social security or social insurance authority in that country are free. This is without prejudice to the fact that the underlying transaction to which payments and transfers are related needs to be recognized by countries, including through mutual recognition arrangements.

Regarding item D/2 (insurance relating to goods in international trade), Israeli residents may acquire any insurance abroad to cover events in Israel and outside. However, foreign insurers are not permitted to market these services in Israel (except through establishment in Israel). In response to the request by the Investment Committee, the Israeli authorities indicated their willingness to ease the restrictions on the cross-border provision of insurance relating to goods in international trade, at least for corporate and sophisticated proposers. The details and the timetable of this revision are, however, not available yet and Israel therefore maintains the proposed reservation under item D/2 of the CLCIO.

In their response to the Committee, the Israeli authorities confirmed that they apply restrictions on the cross-border provision of life assurance services. The restrictions concern the fact that: (i) only insurance services purchased abroad at the initiative of the resident proposer are liberalised and (ii) tax

⁵⁹ Parts 3.2 to 3.5 reflect the work carried out by the Investment Committee in cooperation with the WPGEI and the WPPP (see document DAF/INV/ACS(2008)2/REV1).

benefits are accorded only to (specific) insurance products issued by insurers established in Israel, which have savings components and which – as all the other life insurance products issued in Israel – have been approved by the supervisor. The restrictions on the cross-border provision and the tax treatment of life assurance services give rise to a proposed reservation under item D/3.

Concerning item D/4 (all other insurance), restrictions also apply, except if the risk cannot be covered in Israel, in which case a resident may obtain insurance from a foreign insurer. The tax treatment of these insurance services is the same, because whenever the premiums are allowed to be deducted totally or partially for tax purposes, the same benefits accrue whether the contract has been concluded with an insurer established in Israel or abroad. Thus, the proposed reservation covers only Annex I to Annex A, Part I, D/4, paragraph 4. Events which call for compulsory insurance under the motor vehicle insurance ordinance and covering compulsory railway insurance must be insured by established insurers licensed by the Israeli authorities. The Israeli authorities have confirmed that non-compulsory railway insurance may be provided on a cross-border basis; hence the reservation under this item of the CLCIO can be narrowed. For all other compulsory insurance (air and ship) Israeli residents may avail themselves of the services of non-resident insurers. Compulsory insurance, however, falls outside the scope of item D/4. Transfers related to allowed insurance transactions are free.

Israel proposes reservations under items D/7 (entities providing other insurance services) and D/8 (private pensions) because these services may not be provided on a cross-border basis. In response to the Investment Committee's request, the Israeli authorities have confirmed that the reservation under item D/7 should cover only intermediation services (and not other services also falling under this item, like auxiliary and representation services). The tax advantages enjoyed by residents for contracting with resident pension funds are not extended to non-resident providers of the same service, which is also reflected in the proposed reservation to item D/8. No authorisation is required to establish a representative office in Israel to promote, on behalf of the parent enterprise, cross-border insurance services allowed in Israel.

3.2.2. *Treatment of cross-border reinsurance*

Reinsurance operations by foreign companies established abroad are not supervised in Israel. There are no limits on reinsurance with non-established reinsurers. However, non-established foreign reinsurers are required to constitute deposits or collateral with direct insurers. 40% premium deposits for most non-life lines (and 30% for maritime) are required from all foreign reinsurers for proportional treaty reinsurance. The deposit is required for as long as there are unearned premium reserves. In the event of proportional reinsurance for liability lines, a deposit equal to a percentage of the insurance liabilities (reserves and claims pending) is required. The percentage of the deposit varies according to the rating of the reinsurer. In lieu of a deposit, a reinsurer may submit a letter of credit from a bank rated AA or higher equal to 100% of the outstanding insurance liabilities.

3.3. Establishment and operation of subsidiaries, branches or agencies of foreign entities

3.3.1. *Establishment of subsidiaries, branches or agencies of foreign entities*

The supply of insurance services of all kinds requires incorporation as a resident company or registration as a branch in Israel. Foreign investors wishing to operate through a *subsidiary* are granted an *Israeli insurer's license*, while *branches* of foreign insurers will obtain a *foreign insurer's license*.

There is no prohibition for a foreign bank or bancassurer to establish a licensed insurer in Israel through a subsidiary or a branch.

In scrutinising the application for a license, the Insurance Commissioner takes into consideration a variety of factors, including: ensuring the stability of the insurer; the financial means and business background of the entities requesting the license or the permits; competition in the insurance sector and the level of service in the sector; prevention of suspicion of conflict of interest; ensuring proper management of the insurer and additional considerations for the good of the policy holders and the advancement of the insurance sector, the government's economic policy, public welfare. The Israeli authorities have committed not to apply a market needs test and confirmed that competition and other additional considerations mentioned in the law only refer to ensuring compliance with existing non-discriminatory laws in accordance with Article 5 of the Code on controls and formalities. There has been no use of this clause as grounds for refusal of requests for an insurance license.

There are no requirements for reciprocity on the part of foreign insurers' country of origin with respect to the host country.

In view of the fact that foreign insurers wishing to operate in Israel have already go through the licensing process in their country of origin, exchange of information between the supervisor of the home country (at least for supervisory authorities considered as "advanced" – such as all OECD members' supervisory authorities) and Israel should allow to shorten the licensing process in Israel. The average length of the review/approval process is three months. The same fit and proper tests apply for office-holders of a local and a foreign insurer.

The Law on Supervision of Insurance Services of 1981 lays down the conditions for issuing the insurance licence and requires that the acquisition of more than 5% of the capital of an insurance company be conditional upon receiving a permit from the Insurance Commissioner. These permits are granted to each person (natural or legal) individually, are non-transferable and apply to both foreign and domestic investors. Until recently, a condition for granting a permit for the acquisition of ownership in an insurance company was that the investor should maintain a stable controlling interest up to five years. Following this period, the permit holder could sell the means of control, but only if the transfer was of all the controlling interest or the transfer was of a portion of the controlling interest to an entity that continuously cooperated with the rest of the group's components and a lawful permit was obtained initially. This rule did not appear in legislation, but was based on internal guidelines. While the requirement did not intend to discriminate against non-residents and could be waived on a case-by-case basis, this kind of requirement is not usually applied internationally. The Israeli authorities also appreciated that no OECD country maintains reservations under item II/B (liquidation of direct investment). In November 2008, they have decided not to apply this requirement any longer and to use other methods of achieving their legitimate prudential objectives.

Capital and surplus requirements

The capital requirements applying to a foreign insurer wishing to operate in Israel, whether via a subsidiary *or by opening a local branch*, are the same as the capital requirements applying to a local insurer. However, the provisions of the law concerning capital requirements from foreign insurers are more lenient, for as long as the volume of their activity is low. While an Israeli insurer is required to maintain capital of NIS 55 million in general insurance, regardless of the volume of its activity, a foreign insurer whose annual insurance premiums do not exceed NIS 13.4 million will be required to hold equity capital at a rate of 50% of its total liabilities in Israel, or NIS 2.68 million, whichever is higher.

All the restrictions applying to a foreign entity operating in Israel that has been granted a foreign insurer's license (branch of foreign-owned insurer) are the same as the restrictions applying to an Israeli resident entity. The only exception concerns investment regulations, which require branches of foreign insurance companies to maintain in Israel a surplus of assets over liabilities determined as a function of the activity, i.e. at least 110% of its surplus of assets over the sum of: (1) its insurance liabilities in Israel and (2) its minimum required excess of assets over liabilities⁶⁰. These assets must be tangible and may not be guarantees from third parties. At the request of the Investment Committee, Israel has however prepared a draft legislative amendment to eliminate the aforementioned requirement and replace it with the same investment regulations applicable to Israeli insurers. The legislative process concerning this proposed amendment is foreseen to be completed before the end of 2009⁶¹.

Once the amendment is in force, it will lead to the narrowing of the reservation under item I/A of the CLCM in the area of insurance services and allow the elimination of the reservation under D/6 of the CLCIO.

3.3.2. Operation of subsidiaries, branches or agencies of foreign entities

The regulation of insurer's activity at the product, operational or reporting level, is the same for holders of an Israeli insurer and holders of a foreign insurer licence. An insurer is required to submit for the CMISD's approval, in Hebrew, the insurance products which he wishes to market. A foreign insurer is required to ensure that the office-holders stated in the provisions of the law are approved by the CMISD before taking up office. There are no directives requiring office-holders to live in Israel, to hold Israeli citizenship or to understand the language. A foreign insurer will be required to recruit employees who understand the local language. During the last three years, a number of foreign investors have also made investments in Israel, as exclusive controlling shareholders or in partnership with Israeli investors both in local insurance companies and in managing companies. Most foreign investors in Israel are representatives of foreign institutional investors rather than private individuals. In the last three years however, individual investors have made investments in both the insurance area and the provident funds activity.

3.3.3. Tax treatment

There is no difference between the taxes applying to local insurers, foreign insurers operating via local subsidiaries and foreign insurers operating via foreign branches, except the tax advantage for residents contracting certain types of insurance with resident service providers, as mentioned above.

⁶⁰ The minimum excess of assets over liabilities requirements are equivalent to an Israeli local insurer's minimum capital requirements.

⁶¹ See Israel's response to the letter of 2 February 2009 from the Chair of the Investment Committee Accession Examinations, DAF/INV/ACS/RD(2009)1, p.5.

Box 5. Small foreign presence in an open market offering high returns: towards the end of a paradox?

The Israeli insurance market appears to be open from a regulatory viewpoint and high profit margins of around 30 per cent returns to equity (before the economy was hit by the financial crisis) suggest competition is limited. Meanwhile, only three insurance companies are controlled by foreign insurers, operating via subsidiaries, and only two insurers operate via branches of foreign insurers.

The CMISD explains this apparent paradox by pointing out at two of the Israeli insurance sector characteristics that may deter foreign investors from entering the market:

- Market structure: five main insurance groups control 62% of the non-life insurance premiums and managing approximately 55% of the long-term savings instruments. These insurance groups, one of whom is controlled by the Italian Generali group, are responsible for the major brokerage channels in the field, making it difficult for new players to enter the field.

- Market size: Israel is a small country, in terms of land as well as population, but its characteristics are those of a western world country. The market's potential for growth may well appear less attractive than in emerging markets.

In the future, the penetration of foreign investors in the Israeli insurance market will be impacted by various factors. On the one hand, ROE in the insurance sector have already decreased. High ROE resulted in recent years from a conjunction of low capital requirements and high capital gains from the capital market. The perspective of the adoption of Solvency II principles/Risk Based Calculation will lead to gradual increase in capital requirements (a related directive has already been published, but implementation has so far been delayed due to the financial crisis). Meanwhile, the insurance companies' income from life insurance lines, which is substantially dependent on developments in the capital market, has fallen sharply. The change in management fees collected on profit participating policies is also impacting the ROE.

On the other hand, the liberalisation and modernisation of the Israel's financial markets confirmed by the Bachar reform since 2005 may foster the penetration of foreign investors. The last couple of years have already witnessed an increase in the involvement of foreign investors in insurance companies (as in the management companies of provident and pension funds), as can be seen on the table below.

The withdrawal of the requirement imposed on investors to maintain their controlling interest in insurance companies for five years, in order to comply with the OECD's Code of Liberalisation of Capital Movement, will be one further incentive for foreign investors to consider investment in the Israeli insurance market.

Table 21. Entrance of Foreign Investors - Insurance Companies

Year	Israeli Insurer	Controlling Share Holder	Interested Party
1996	Migdal Group	Generali (70%)	
1998	AIG Israel	AIG Group (51%)	
1999	Cophas (branch)	Cophas	
2000	Clal Credit		Gerling Namur-Re (20%)
2000	EMI	AIG (100%)	
2005	Harel Group	Mr. Putera Sampoerna (20%)	
2006	BSSH	Euler Hermes (33%)	

3.4. Israel proposed reservations under the insurance and private pensions related provisions of the OECD Code of Liberalisation of Capital Movements

List A, I/A Direct investment:

- In the country concerned by non-residents.

Remark: The reservation applies only to:

- i) *the requirement that a branch of a foreign insurer must invest at least 110% of its surplus of assets over the sum of (i) its insurance liabilities in Israel and (ii) its minimum required excess of assets over liabilities. . The reservation will cease to apply by the end of 2009;*
- ii) *establishment of branches by non-resident private pension funds ;*

3.5. Israel proposed reservations under the insurance related provisions of the OECD Code of Liberalisation of Current Invisible Operations

D/2 Insurance relating to goods in international trade

Annex I to Annex A, Part I, D/2

Remark: The reservation does not apply to insurance services purchased abroad at the initiative of the proposer.

D/3 Life assurance.

Annex I to Annex A, Part I, D/3, paragraphs 1 and 3

Remark: The reservation under paragraph 1 does not apply to insurance services purchased abroad at the initiative of the proposer.

The reservation under paragraph 3 applies only to insurance contracts with saving components benefiting from tax deductions.

D/4 All other insurance.

Annex I to Annex A, Part I, D/4, paragraph 4

Remark: The reservation does not apply to

- (i) insurance services purchased abroad at the initiative of the proposer.*
- (ii) non-compulsory railway insurance.*

D/6 Conditions for establishment and operation of branches and agencies of foreign insurers.

Annex I to Annex A, Part III, General Remark

Remark: The reservation applies only to the requirement that a branch of a foreign insurer must invest at least 110% of its surplus of assets over the sum of (i) its insurance liabilities in Israel and (ii) its minimum required excess of assets over liabilities. The reservation will cease to apply by the end of 2009;

D/7 Entities providing other insurance services.

Annex I to Annex A, Part IV, D/7

Remark: The reservation applies only to the provision by non-residents of intermediation services in Israel.

The reservation does not apply to insurance services purchased abroad at the initiative of the proposer.

D/8 Private Pensions.

Annex I to Annex A, Part IV, D/8

Remark: The reservation does not apply to services purchased abroad at the initiative of the proposer.

4. CONSISTENCY OF ISRAEL REGULATION AND SUPERVISION WITH OTHER OECD LEGAL INSTRUMENTS ON INSURANCE

In accordance with the Roadmap for the Accession of Israel to the OECD Convention, Israel's position in relation to the following insurance-related instruments should be assessed:

- Key instruments which have specific policy implications requiring an assessment of the candidate country's position through a review by the IPPC and the subsidiary bodies concerned:
 1. Recommendation on Guidelines for Insurers' Governance [C(2005)45];
 2. Recommendation on Assessment of Reinsurance Companies [C(98)40];

The following Recommendation, which was approved by the Council after the adoption of the Roadmap, should also be reviewed by the IPPC:

3. Recommendation on Good Practices for Enhanced Risk Awareness and Education in Insurance Issues [C(2008)22];
- Instruments that are primarily of technical or operational nature, and for which the position of the candidate country will be assessed through a technical review by the Secretariat:
 4. Recommendation on the Establishment of a Check-list of Criteria to Define Terrorism for the Purpose of Compensation [C(2004)63/REV2];
 5. Recommendation on Good Practices for Insurance Claim Management [C(2004)62];
 6. Recommendation Concerning a Common Classification of the Classes of Insurance Recognised by the supervisory Authorities of the Member Countries [C(83)178].
 7. Recommendation of the Council concerning Institutional Co-operation between Authorities of Member Countries Responsible for Supervision of Private Insurance [C(79)195/Final]

Israel accepts all insurance related OECD recommendations and substantially complies with them. Some departures from these OECD instruments are nonetheless noted below, and the WPGEI recommends that Israel consider changes. They are however not significant enough to change the WPGEI's opinion.

4.1. Recommendation of the Council on Guidelines for Insurers' Governance: C(2005)45⁶²

Israel accepts this Recommendation with the following observation: Israel accepts the recommendations in the document, with the exception of the requirement to separate audits in life insurance and general insurance.

⁶² Further information on the compliance of the Israeli regulation with this Recommendation can be found in the document DAF/AS/ACS(2008)1/ADD2 pages 35 to 44 and in the document DAF/AS/ACS(2008)1/ADD3 (See answers to the questions related to page 35 to 44).

The table below provides a self-assessment of the degree of implementation of the Recommendation by Israel.

Principle	OECD guidance	Israeli Regulations
1. Identification of responsibilities	Within an insurance entity, the responsibilities of every corporate body must be stipulated clearly.	<p>The companies act specifies the responsibilities of the board of directors in general and specifies which committees the company must establish. Furthermore, the act specifies the responsibilities of each committee that was established according to the act. The commissioner had published a circular that stipulates the roles and responsibilities of the board of directors and the committees that the insurance company or the managing company of pension funds were obliged to establish according to the insurance control law.</p> <p>The companies act requires each company to establish control committee, the responsibilities of the committee are: to control and inspect failing procedures and processes. To approve the internal audit annual audit plan.</p> <p>The insurance control law requires, besides the control committee, the insurance companies (the same requirement is required by the Provident funds control law) to establish an investment committee. The regulations that were legislated by the minister of finance by virtue of the control law stipulated the duties of the investment committee. The main duties are: to determine the investment policy of the institutional body in accordance with the general policy that was determined by the board of directors, approving certain transactions, guidance to office holders that take part in the investment activity.</p> <p>The commissioner had published a circular that stipulates the investment activity of the institutional body while performing its the regular activities. The circular obligates institutional bodies that manage a large volume of assets to appoint credit committee that will perform its duties under the investment committee. The duties and responsibilities of this committee will be determined by the investment committee.</p>
2. Board structure	The structure of the governing body should be defined, along with the responsibilities of each entity. These responsibilities should be consistent with the insurer's core objective of providing benefits pursuant to its contracts. The governing body is ultimately responsible and should not be allowed to completely absolve itself of its responsibilities by delegating certain functions to subcommittees or external service providers.	<ol style="list-style-type: none"> 1. In order to increase the efficiency of the work of the board of directors, the Insurance Control Law places a restriction on the minimum and maximum number of members in the board of directors, from at least seven to a maximum of fifteen. 2. In order to ensure the board of directors' independence, the Insurance Control Law stipulates that as with a publicly-traded company, at least two external directors must serve on an insurance company's board of directors. The following rules apply to the external directors: <ol style="list-style-type: none"> a) A person with a business affiliation to the company or to a controlling owner in it cannot be appointed as an external director. b) Only a person with professional proficiency <u>or</u> a

		<p>person with accounting and financial specialization will be appointed as an external director. Under the provisions of the Law, at least one of the external directors must have accounting and financial specialization. (The terms and the tests for a director with accounting and financial specialization are defined in the regulations prescribed by the Companies Law.)</p> <p>c) The board of directors' regulations prescribes additional arrangements concerning the strengthening of the independence, professionalism of the board of directors of an insurance company, apart from the conditions determined in the Companies Law regarding a publicly-traded company:</p> <p>i) The proportion of external directors on the board of directors of an insurance company was increased to 1/3 of the members (resulting in a minimum number of external directors of 3 – 1/3 of at least seven).</p> <p>ii) At least half of the external directors must have accounting and financial specialization, and at least half of the external directors must have experience or specialization in insurance and in similar financial bodies.</p> <p>iii) The rules governing affiliation constituting a barrier to service on the board of directors have been extended to include a person holding 10% or more of a specific type of means of control in the insurance company and not only its controlling owners.</p> <p>The board of directors is entitled to establish board of directors' committees and to determine their authorities. However, the board of directors is not entitled to delegate to a committee its authorities and responsibility for determining policy on matters that are essential for the company's activity, as determined in the Law and its provisions, but it is entitled to establish a committee in these areas for the purpose of issuing recommendations. The provisions of the law applying to insurance companies prescribe the types of statutory committees which an insurance company must establish:</p> <p>1. <u>Audit committee</u></p> <p>The board of directors of an insurance company must appoint an audit committee from among its members, in which all the external directors will be members. The board of directors' regulations stipulates that the majority of the audit committee's members must be external directors and that at least half of its members must have accounting and finance specialization.</p> <p>The audit committee's functions include:</p> <ul style="list-style-type: none"> • Ascertaining deficiencies in the company's business management.
--	--	---

		<ul style="list-style-type: none"> • Approving the internal auditor's annual work program. • Recommending the appointment of an external auditor and discussing financial reports. • Assuring the independence of the external auditor and the internal auditor. <p>The board of directors' regulations stipulates that the audit committee must hold discussions at the request of control functionaries, including the risk manager, the appointed actuary, the external auditor, the internal auditor and the compliance officer.</p> <p>2. <u>The investment committee</u></p> <p>board of directors of an insurance company must appoint two investment committees (members' simultaneous service on two committees is prohibited) that are responsible for determining the allocation in the investment portfolios, for approving material transactions, and for the control and monitoring of the investment portfolio:</p> <ul style="list-style-type: none"> • The investment committee must invest the insurance company's nostro funds ("non-yield-dependent investment committee"). • The investment committee for the investment of the money of profit-sharing life insurance plans ("yield-dependent investment committee"). <p>The majority of this committee's members and its chairman must have proficiency to serve as external directors.</p> <p>The insurance company's board of directors is not entitled to take on the committee's authorities.</p> <p>The investment regulations applying to the insurance companies stipulate proficiency rules for the members of the investment committees, including requirements for financial education, experience in the capital market and principles for maintaining ethical standards and integrity. Also stipulated are rules for the prevention of conflicts of interest in the service of a member of the yield-dependent investment committee arising from his other activities.</p> <p>3. <u>The credit committee</u></p> <p>As a result of the Bachar Reform and the development of the non-bank credit market, the extension of marketable and non-marketable credit in connection with investment has increased and is becoming a significant area of the insurance companies' business activity. As part of the CMISD's deployment for strengthening the control and supervision mechanisms at the insurance companies in all matters concerning the extension of credit, insurance companies with extensive credit activity have been required to appoint a credit transactions approval committee as a sub-committee of the investment committee. A circular issued by the CMISD stipulates that those with substantial specialization and experience in the area will serve on the credit committees (see the</p>
--	--	---

		circular on credit risk management in connection with investment activity).
2. Governing body (pension)	<p>Every pension fund should have a governing body <i>1)</i> vested with the power to administer the pension fund and who is ultimately responsible for ensuring the adherence to the terms of the arrangement and the protection of the best interest of plan members and beneficiaries. The responsibilities of the governing body should be consistent with the overriding objective of a pension fund which is to serve as a secure source of retirement income. The governing body should not be able to completely absolve itself of its responsibilities by delegating certain functions to external service providers. For instance, the governing body should retain the responsibility for monitoring and oversight of such external service providers.</p>	

3. Functions and responsibilities	The Board's main responsibilities should cover those functions essential to good governance	<p>The Companies Law prescribes in general a series of matters on which the board of directors must deliberate and decide. Those matters are valid for all companies no matter their size or aim. The main matters are:</p> <ul style="list-style-type: none"> a) Establish and determine the company's strategy, and funding principals. b) Stand on the company's financial situation. c) Determine the organizational structure. d) Responsible for financial reports and approves it. e) Report to the general assembly on general and financial issues that relate to the company's conditions. f) Employ and discharge the executive manager. g) In public companies- determine the minimum number of directors in the board that acquires financial proficiency. <p>Determined in the board of directors regulations are additional matters that are essential for the proper functioning of the insurance companies, including:</p> <ul style="list-style-type: none"> a) Formulation of risk exposure policy (including credit risk, market risk, insurance risk, operational risk, catastrophe risk, liquidity risk and concentration risk), risk appetite and risk tolerance, as well as means for the management and control of risks. b) Formulation of overall investment and credit policy. c) Formulation of policy for exposure to reinsures. d) Approval for entry into new areas of activity. e) Determination of standards for ethical behaviour. f) Determination of ways for assuring that the provisions of the law are observed and the appointment of a person accountable for the matter. g) Determination of policy for the remuneration of the office-holders in the insurer, while ensuring that the remuneration mechanism promotes the insurance company's objectives and draws attention to the risks accompanying the company's activity. h) Preparations for crisis situations.
3. Expert advice (pension)	Where it lacks sufficient expertise to make fully informed decisions and fulfil its responsibilities, the governing body could be required by the regulator to seek expert advice or appoint professionals to carry out certain functions.	
4. Composition and suitability	The number of board members, how they are selected and a fair balance between executive and non-executive directors should be specified in the by-law or legal status of the entity or in documents associated with any of these.	<ol style="list-style-type: none"> 1. In order to increase the efficiency of the work of the board of directors, the Insurance Control Law places a restriction on the minimum and maximum number of members in the board of directors, from at least seven to a maximum of fifteen. 2. In order to assure the board of directors' independence, the Insurance Control Law stipulates that as with a publicly-traded company, at least two

		<p>external directors must serve on an insurance company's board of directors. The following rules apply to the external directors:</p> <ul style="list-style-type: none"> a) A person with a business affiliation to the company or to a controlling owner in it cannot be appointed as an external director. b) Only a person with professional proficiency or a person with accounting and financial specialization will be appointed as an external director. Under the provisions of the Law, at least one of the external directors must have accounting and financial specialization. (The terms and the tests for a director with accounting and financial specialization are defined in the regulations prescribed by the Companies Law.) c) The board of directors' regulations prescribes additional arrangements concerning the strengthening of the independence, professionalism of the board of directors of an insurance company, apart from the conditions determined in the Companies Law regarding a publicly-traded company: <ul style="list-style-type: none"> i) The proportion of external directors on the board of directors of an insurance company was increased to 1/3 of the members (resulting in a minimum number of external directors of 3 – 1/3 of at least seven). ii) At least half of the external directors must have accounting and financial specialization, and at least half of the external directors must have experience or specialization in insurance and in similar financial bodies. iii) The rules governing affiliation constituting a barrier to service on the board of directors have been extended to include a person holding 10% or more of a specific type of means of control in the insurance company and not only its controlling owners. <p>The regulations issued by the Finance Minister prescribe arrangements concerning the proficiency terms of the members of the board of directors from the aspect of professional experience, education, ethics and integrity, as well as arrangements for the prevention of conflicts of interest connected with the service of the members of the board of directors. The main principals mentioned in the regulations are:</p>
5. Accountability	Board members are accountable to the entity's shareholders and/or policyholders, or participating policyholders and/or to the competent authorities. To ensure that accountability, board members are legally liable for their	<p>Under the provisions of the Law (Section 105 of the Insurance Control Law), an office-holder is subject to the requirement for supervisory accountability, violation of which constitutes a criminal offense.</p> <p>If the company or one of its employees violates the provisions of the law, it is as if the office-holder in the company had violated the supervision requirement, unless</p>

	actions and decisions.	<p>he proved that he did everything possible to prevent the violation.</p> <p>According to the companies act a director at a company is defined as "office-holder". Section 59 of the act authorizes the general assembly of the shareholders to appoint directors to the board; this power holds the board of directors accountable to the body that appointed it. Section 92 of the same act specifies the powers and duties of the board of directors. Needless to say, not complying with those duties requires actions to be taken against the directors. Section 252-264 to the companies act defines and specifies the duties and responsibilities towards the company. The sections specifies, <i>inter alia</i>:</p> <ol style="list-style-type: none"> 1. Requirements of prudential responsibility towards the company. 2. Perform his duties in acceptable proficiency level. 3. Fiduciary responsibility towards the company. In case the office-holder did not comply with the fiduciary responsibility, he will be held accountable for not respecting a contract according to the "Contracts Act".
6. Actuary	The insurer should nominate an actuary who reports to the Board and management — at least in the case of a life insurance entity, and who should be able to act in an independent way. The use of actuarial standards in non-life insurance entities should be promoted as well. This actuarial function should preferably be fulfilled by an appointed actuary. It may also be performed by any manager of the entity who should have the possibility to report directly to the Board, or by an external consultant.	<p>Under the legislative amendments deriving from the implementation of the Bachar Reform, the Insurance Control Law stipulates that an insurer must appoint an actuary for each insurance line in which it engages, the actuary's functions include making recommendations to the board of directors and the CEO regarding the level of the insurer's insurance liabilities.</p> <p>Issued in 2006 were regulations (which have yet to be finally approved) that contain rules concerning the appointed actuary's and the qualified actuary's eligibility to sign statutory reports, including rules concerning professional development. Also published was a circular concerning the appointed actuary's functions, authorities and modes of operation, and concerning the network of relationships between him and the insurer's other office-holders. The circular stipulates that at least once a year, the appointed actuary must submit in writing to the insurer's board of directors and CEO his recommendations concerning the estimate of the insurer's insurance liabilities in the lines for which he was appointed, for the purpose of preparing financial reports, and will participate in the board of directors' meeting at which his recommendations are discussed.</p>
7. External Auditors	An external auditor <i>independent</i> from the insurance entity, its management and its board(s) should be appointed to certify the entity's accounts on at least an annual basis. His/her term of office should be limited and renewable under specific conditions.	<p>As a rule, an insurance company's external auditor is subject to the provisions of domestic law concerning an external auditor, his proficiency and his independence.</p> <p>The Insurance Control Law section 41(G) stipulates requirements for the external auditor to report to the audit committee, the CEO and the CMISD in circumstances in which he is aware of a material violation of the provisions of the Law or administrative directives.</p> <p>Draft directives issued by the CMISD prescribe additional</p>

		arrangements for assuring the independence of the external auditor, of the basis of inter alia SOX directives on this matter, including assurance of rotation between partners, the determination of additional services which the external auditor is prohibited from supplying, and the specification of mechanisms for enabling the external auditor to state his opinion on whether the financial reports accurately reflect the insurer's insurance liabilities and to achieve a reasonable degree of certainty regarding the propriety of the assessment of the liabilities.
6. Custodian (pension)	Custody of the pension fund assets may be carried out by the pension entity, the financial institution that manages the pension fund, or by an independent custodian. If an independent custodian is appointed by the governing body to hold the pension fund assets and to ensure their safekeeping, the pension fund assets should be legally separated from those of the custodian. The custodian should not be able to absolve itself of its responsibility by entrusting to a third party all or some of the assets in its safekeeping.	
8. Internal controls	Appropriate controls should be put in place to ensure that all persons and entities with operational and oversight responsibilities act in accordance with the objectives for each class of business that are set out in the insurers' by-law, statutes, contracts or in documents associated with any of these, and that they comply with the law.	During 2005-2006 the commissioner had published circulars instructing insurance companies and provident funds managing companies and pension funds managing companies to adopt the requirements of section 302 of the SOX act. Starting the financial reports of the year ended by December 2006 the declarations according to SOX 302 will be included according to the circulars provisions. In addition, in a circular that was published during 2006 for all institutional bodies the discloser format regarding the efficiency of the internal controls and the procedures were established. The circulars also specify the provisions that aim to implement the requirements of SOX 404 which refers to the responsibility of the senior management for the internal controls.
9. Reporting	Reporting channels between all the persons and entities involved in the administration of the insurer should be established in order to ensure the effective and timely transmission of relevant and accurate information.	All entities and persons at an insurer is obliged to present a periodic report, whether it is quarterly required, annually required or an immediate report. The reporting channels usually are directed from bottom up and in many cases it goes in the opposite direction. The commissioner published a circular requiring chief risk officer to report to the board of directors in a timely manner the exposures and weaknesses of the risk management policies, controls and procedures. On the other hand, he will receive from the different departments of the insurers reports that describes the exposures and the changes in the risk profile that every department is witnessing. The CRO on his turn

		form the platform of the reporting process to the managers of the departments. The internal auditor is required, according to circular that was published in 2007, to report to the board of directors, to the audit committee and to the CEO annually specific points that are listed in the circular. The companies act requires the internal auditor to report to the management entities of the company annually and in cases where an immediate reporting is essential. The chief actuary will report to the board of directors and the senior management annually.
Stakeholders' protection	The governance framework of insurance entities should ensure an appropriate protection of the rights of stakeholders through disclosure and redress mechanisms and the compliance with the basic rights of shareholders or participating policyholders in the case of mutual insurers.	
10. Protection of participating policyholders in the case of mutual insurers	In the case of mutual insurers, the governance framework should also accurately protect the rights of participating policyholders	
11. Disclosure	Insurance entities should disclose relevant information on a clear and timely basis in order to give stakeholders (including policyholders, shareholders or participating policyholders, supervisory authorities, etc.) a proper view of their business activities and financial position and to facilitate the understanding of the risks to which they are exposed. However, information on risk management procedures should be provided with due respects of data protection and confidentiality obligations and should avoid limiting the competitiveness of insurance entities.	<p>The disclosure requirements from institutional bodies are divided into two levels, disclosure to participants and policyholders' requirements and disclosure to the CMISD. And there is the information that is disclosed by the CMISD itself to the market in general.</p> <p>The information disclosed by the institutional bodies to policyholders and participants varies between financial periodic reports to performance and outcome disclosed information.</p> <p>Financial reports: each institutional body is required to present financial reports that describes the institutions balance sheet and outcome of its activities, those reports are edited and performed according to the CMISD requirements and must be published and presented to the market (public and CMISD) in their web-site according to the format that CMISD determined no matter if the company was publicly owned (issued in the stock exchange market) or privately owned. Insurance companies and Pension funds holding companies are required to present financial report for each pension fund that is managed by the company and for the managing company itself every quarter. Where a provident funds managing company will present only the company's financial report every quarter and the provident funds' financial reports will be presented only once a year.</p> <p>Outcome and performance reports: the commissioner had published a circular that specifies the information that an institutional body is required to present on its web-site, the</p>

		<p>institutional bodies are obliged to present a monthly report on their web-site that discloses the funds or policies outcomes, the assets the fund or policy had invested in (to the level of investment group) and the amount of assets that were accumulated during that period. Besides to all those reports, insurance companies and pension funds are required to distribute to the active policyholders or participants a report that describes the amount of funds that they have deposited into their account, the profits that were accumulated, the fees that were collected and any other information that is relevant and requires reporting. Once a year such a report is distributed to all members regardless of them being active or not.</p> <p>Besides the publicly or private disclosure that the companies are required to reveal, there are reports that are limited to and distributed only to the commissioner's office. The platform for those reports is set by the commissioner and the companies are required to fill in the information from their systems. Those reports are in addition to the regular financial reports, and they usually enhance the disclosure level beyond what is being reported in the financial reports. Those reports enable the commissioner to assess and follow the development of the companies' business and it reveals the level of risk the companies are exposed to.</p> <p>The CMISD had developed 4 comparative instruments for the use of the general public. Those instruments are posted on the CMISD's web-site and are freely accessed by the public. The instruments allow the public to compare between provident funds, pension funds, participating policies and compulsory motor vehicle insurance.</p>
12. Redress	<p>Policyholders and participating policyholders should be granted access to statutory redress mechanisms through at least the regulatory/supervisory authority or the courts, which can assure prompt redress.</p>	<p>The fourth tier of the Law is concerned with protection of the interests of insured persons, including a prohibition on giving a misleading description, responsibility for giving a misleading description in an advertisement, prohibition on making insurance in a certain branch conditional on insuring in another branch, and prohibition on taking unfair advantage.</p> <p>The Law authorizes the Commissioner to investigate complaints by the public and to direct the person complained against to correct the defect that was brought to light by the investigation. In the framework of the legislative amendments for implementing the Bachar Reform, the Attorney General was given authority to prosecute, at the Commissioner's request, an officer in an insurance company for damage caused to assets held against liabilities deriving from participating insurance policies and for damage caused to insured persons who are covered by these liabilities.</p>

- Israel complies with the OECD Recommendation of the Council on Guidelines for Insurers' Governance, with the exception of the requirement to separate audits in life insurance and general insurance. No such requirement exists in Israel due to the corporate structure of most insurance companies, providing both life insurance and general insurance. The Control of

Insurance Law requires that accounts be separated, and the separate identification of the size of assets, premiums, expenses, re-insurance, etc., The Commissioner of Insurance has also required that the insurance companies establish permanent internal auditing systems. The internal auditing systems are headquarter units which carry out audits at all stages of the insurance companies' activities. However, there is no express requirement of a separation, in terms of internal auditing, between life insurance and general insurance.

- Also, considering the importance of participating life insurance policies in Israel, the special status of insureds holding such contracts may need to be specifically addressed in insurers' corporate governance framework.

4.2. Recommendation of the Council on Assessment of Reinsurance Companies: C(98)40⁶³

Israel accepts this Recommendation

The Council Recommendation consists of two parts: it first invites *insurance companies* under their supervision to take all appropriate steps to assess the soundness of reinsurance companies to which they cede or propose to cede business having regard to the contents of its Annex. The quantitative and qualitative definition of information required for such assessment is left to the responsibility of the insurance companies, although the Recommendation provides list possible items to be reviewed.

Also, it invites *reinsurance companies* under the concerned country supervision, or established within its territory, to provide, on request, information to insurance companies, which will assist the latter in making assessments.

Insurance Circular 2006-1-14 (section 6C(2)) on risk management appears to answer the first recommendation, by requiring that the reinsurance department reports periodically to the **risk manager** in charge of the company's reinsurance policy on :

- The listing of the major reinsurers that company is using and their ratings;
- The financial strength of the main reinsurers according to *internal* rating (of the insurance company) and other information that may be deemed important on the part of the insurer;
- The corporate structure of the reinsurer, to the extent this information is available to the insurer;
- The spread of risk of the main reinsurers to other reinsurers, to the extent this information is available to the insurer.
- More generally, circular 2006-1-14 also requires the reinsurance department to report to the risk manager on :
- The identification of the major risks which may affect the financial stability of the company
- The description of the methodology used in calculating the company's MPL for natural catastrophes
- The availability of reinsurance and cost factors

⁶³ Further information on the compliance of the Israeli regulation with this Recommendation can be found on page 79 to 80 of document DAF/AS/ACS(2008)1/ADD2.

- The description of the company's retention for the various coverage
- The description of the security that the company has received from reinsurer's (deposits, letters of credit).

Also, the Insurance Bulletin 2003/17 requires the companies to develop a reinsurance strategy which has to be approved by the **company's board of directors**. The strategy must be approved periodically by the board and should include details on the *selection of reinsurers* and on reinsurance limits according to the various types of insurance. The management of the company will oversee the reinsurance cessions while complying with the framework defined by the board. The management is required to report to the board periodically on the company's reinsurance, the outstanding exposure by reinsurer, and any outstanding balances which are past due.

Lastly, since 2004, insurance companies are required to send annually to the **Commissioner** a breakdown, according to reinsurance companies' rating, of premiums written during the year, (as of year-end), portion of reserves and claims pending, deposits retained by the ceding company and letters of credit received as collateral (the investment regulations require premium deposits for proportional treaty coverage). Should a reinsurer represent more than 10% of the reinsurance exposure as of the reporting date, it should also be disclosed to the CMISD.

Moreover, it should be reminded that the vast majority of the reinsurance undertaken by the Israeli insurance companies is currently with reinsurers rated A and above⁶⁴, most of which being major international reinsurers have developed long term relationships with direct insurers established in Israel. Although reinsurers' size and ratings are by no mean absolute or sufficient guarantee of financial soundness, "the nature and extend of the assessment may [obviously] vary, according to (...) the nature and importance of the parties concerned", as reminded in paragraph 2 of the Annex to the Recommendation.

The second requirement of the Recommendation on Assessment of Reinsurance Companies has not direct applicability in Israel, since there are currently no Israeli reinsurers, and no such companies are expected to be created in the future. The Capital Market Division is nevertheless examining the nature of the contractual engagement between Israeli companies and foreign reinsurers, and is working to expand its cooperation and exchanges of information with entities overseas in the reinsurance field. In this respect, Insurance Bulletin 2003/17 promoted **expanded reporting requirements for the reinsurance company to the regulatory authorities** on their reinsurance exposures.

- | |
|--|
| <ul style="list-style-type: none"> • Israel complies with the Recommendation of the Council on Assessment of Reinsurance Companies. |
|--|

4.3. Recommendation of the Council on Good Practices for Enhanced Risk Awareness and Education in Insurance Issues: C(2008)22

Israel accepts this Recommendation.

Growing awareness of the impact of demographic trends and the importance of long-term savings, the increasing sophistication of the financial markets, and the free accessibility of information

⁶⁴ For 2006, according to insurance companies reports, 95.7% of reinsurance premiums were transferred to reinsurers rated A or higher. As of 31.12.06, the overall exposure of the insurance industry to reinsurers rated A or higher was 93.2%. More than 80% of the reinsurance liabilities are currently in the hands of 15 companies, with the two largest companies representing 45% of outstanding liabilities.

on savings and consumption have prompted policy-makers in Israel to recognize the need for financial education at an early age. The CMISD has taken the lead in the development of risk awareness and financial education programmes, partly in conjunction with the Ministry of Education. The CMISD emphasized that recent initiatives to enhance risk awareness and education in insurance issues in Israel were highly influenced by OECD's work in this field.

The table below presents the OECD Good Practices for Enhanced Risk Awareness and Education in Insurance and various CMISD initiatives developed over the last few years that comply with these good practices.

OECD good practices	Israeli legislation on financial education and related initiatives
<p>I. Risk awareness and education on insurance issues: framework, definition and objectives</p> <p>Taking into account national circumstances, risk awareness and education on insurance issues should be specifically encouraged, whether as part of the wider financial education effort or through distinct programmes. Such education programmes should be conducted in a coherent and transparent manner between main insurance stakeholders.</p>	<p>Over the last years, the CMISD has been very active in promoting education in insurance issues, through three main channels: the provision of extensive information on insurance, the design of various tools, put at the disposal of (potential) policyholders, to help them to select the risk cover most adapted to their needs, and the launching of relevant education programmes, in cooperation with the Ministry of Education.</p>
<p>Within this context, education on insurance issues should help to promote two core objectives:</p> <p><input type="checkbox"/> <i>first, to heighten awareness and responsibility vis-à-vis the potential risks to which individuals are exposed and the means by which insurance can best cover those risks;</i></p> <p><input type="checkbox"/> second, to enable citizens to develop the knowledge, understanding, capacities and confidence needed to adequately appraise and understand the policies they require, to know where to look for additional information, objective advice or help if they need it, to take informed decisions about how to protect themselves and their relatives and to adopt a proactive and responsible behavior as regards their risk exposure and insurance coverage.</p> <p>Education on insurance issues should be taken into account within the insurance regulatory and supervisory framework and considered as a tool to enhance social and economic growth and well-being through reliable, transparent, efficient and competitive insurance markets along with prudential regulation and consumer protection. Education on insurance issues does not substitute but rather complements prudential regulation and policyholder protection. These are especially needed in the insurance sector to protect consumers' rights and to promote market efficiency and symmetrical information.</p> <p>In this respect, specific measures to be considered within</p>	<p>At this stage, efforts of Israeli public authorities have focused on the provision of financial education and information for the selection of the most appropriate risk cover. Current programmes do not directly address the enhancement of risk awareness.</p> <p>The CMISD primarily endeavours to increase public's access to information as well as awareness of the full extent of their rights. It provides the public with extensive information on insurance products, carriage, tariffs and coverage, and publishes on its Internet site other extensive information that is of use to the insureds, such as:</p> <ul style="list-style-type: none"> Questions and answers on insurance subjects; Explanations on the mechanisms governing the settlement of claims (vehicle property appraisals, for example); Statistical analyses of vehicle compulsory tariffs; Legislative matters; CMISD circulars; Statements of opinion issued by the Attorney-General; CMISD position papers reviewing the industry's activity; Press releases on monetary sanctions and fines that have been imposed on supervised entities as the result of malpractice; The CMISD's annual reports. <p>Among other initiatives to increase population access to information, the CMISD has expanded the reporting requirements for institutional investors</p>

<p>a jurisdiction concerning education on insurance issues should first take account of the regulatory framework, in particular as regards provision of quality information before, during and after the conclusion of contracts (disclosure rules), legal requirements or codes of conducts applicable to intermediaries or selling practices, as well as compulsory or voluntary mediation mechanisms in place.</p>	<p>(including the insurance companies) and increased the frequency of reporting. Institutional investors are currently required to send quarterly reports to their members and to insureds, and to present on their Internet sites information which the CMISD defines as important for the public.</p> <p>Another major regulatory measure implemented by the CMISD to secure the rights of policyholders concerns the regulatory coverage of the claim settlement process. Policyholders' rights in this respect should be clearly disclosed. In particular, when an insured announces his intention to submit a claim, the company should send him/her explanations on the claim process, including a list of documents that are necessary to clarify the claim</p>
<p>II. Main stakeholders' responsibilities and roles Public Action</p> <p>As a rule, public promotion of education on insurance issues, should be considered taking into account the jurisdictions' circumstances and policy choices, especially when lack of risk awareness and of insurance capabilities may involve particularly damaging consequences for citizens in the long run, and where no effective alternative (private) education initiatives are available or under consideration.</p> <p><i>Governments' involvement in this education process should be mainly aimed at enhancing awareness of major risks and the need for adequate protection, including through various insurance instruments, and at enabling individuals to attain a sufficient level of knowledge, understanding and skills in order to adopt a responsible stance and make sensible choices as regards insurance issues.</i>⁶⁵</p> <p>In this respect, Governments should ensure that citizens are appropriately educated – possibly as part of school curricula- to be knowledgeable, capable and responsible in risk and insurance issues, as early as possible and on an on-going basis at key points through an individual's life (changes in family, occupational and property situation).</p> <p>In this connection, a series of actions should be encouraged, including:</p> <p>1. Promoting a “culture” of responsibility for personal protection, in particular by educating people about notions relating to risk, risk mitigation and compensation including possibilities offered by insurance tools and basic insurance mechanisms and products:</p> <p>School curricula, in particular at the secondary level, should encompass more specific notions relating to risk and insurance (taught separately or within finance or</p>	<p>The CMISD acts with the Ministry of Education to incorporate financial contents in the curriculum of the local schools. Accordingly, in 2007, under an agreement between representatives of the CMISD and representatives of the Education Ministry, a decision was made to introduce financial education in the programs for the acquirement of life skills for elementary school students. Under this program, a number of lessons will be dedicated to the subject in the course of the year. These lessons will involve <i>inter alia</i> the development of astute consumerism and management of the personal budget as part of the students' decision-making process. The objective of the program is to provide students with tools that will help them to be astute consumers who are aware of their financial environment, while developing personal responsibility in this respect and increasing their civic involvement in this important area.</p> <p>As an accompanying measure to the CMISD's activity for increasing policy-makers' awareness of the matter of financial education, the division's employees have become involved in the <i>Osim Kesef</i> (“Making Money”) program of the <i>Shiur Acher</i> (“Other Lesson”) curriculum. In this respect, the division's employees have volunteered to teach an enrichment course for elementary school students and for other educational institutions. The course includes the discussion of matters concerning the value of money and other resources, budgetary apportionment, savings and investments.</p>

⁶⁵ Recommendations that are not reflected in the Israeli legislation or by specific initiatives are highlighted in italics.

economics classes), including, inter alia, basic insurance mechanisms and products and the major dynamics and components of the insurance market;	
Higher-level studies and courses at universities and/or specialised institutes in the insurance field should be promoted and publicised through different communication approaches including competitions and special events;	During the past year, the CMISD cooperated with the Education Ministry in order to expand also the program for high-school students in the next academic year (2009) and to include the matter of financial education as part of civil and mathematics studies.
Specialised teaching, training and prevention/information centers on risks and insurance issues should be promoted and/or developed; In this respect, educators should be appropriately qualified and trained to feel confident when instructing young people about risk and insurance issues.	The Osim Kesef (“Making Money”) program and the Shiur Acher (“Other Lesson”) curriculum, concern both elementary school students and other educational institutions. employees of the CMISD They are taught by the themselves
<i>2. Promoting and developing prevention and information programmes and campaigns regarding seriously damaging risks, vulnerable populations, innovative or complex insurance products and products implying a greater transfer of risks to individuals- such as unit-linked-, possible underinsurance, overlapping and/or over insurance, key contract clauses and conditions as well as applicable rights and obligations of consumers as regards insurance products and insurance market players.</i>	To our knowledge, such programmes and campaigns targeted on specific risks and products have not been developed at this stage.
This promotion could involve the development of specific websites or a sub-site of the supervisory authority dedicated to consumers’ information. Public action should also consider the development, at the national level, of appropriate specialised structures – possibly within the framework of existing authorities- which would be in charge of promoting and coordinating risk awareness and education on insurance issues	The CMISD mostly informs the public through its website, which presents detailed information regarding activities and rights of savers and counterparts, as well as financial information regarding insurance companies and pension funds. The website also contains regulations concerning insurance companies and pension funds, advice for the choice of a relevant investment channel and a link to the annual Reports which contain extensive knowledge on supervised institutions. During the past year, The CMISD expanded the information banks provided to members, including the already existing Pension Net and Bituach (“Insurance”) Net as well as Gemel (“Provident”) Net. These make it possible to compare between the performances of the different entities that supply long-term savings, to the benefit of the members/insureds. In addition, indexes have been developed for assessing the investment risks in long-term saving channels. The development of these indexes is intended to provide the saver with a measurement tool that will be advertised on the division’s online reporting system for comparing the performance and assessing the risks inherent in investment in the institutional entity via which he saves, and for comparing the performance and risks inherent in investments in other institutional investors of the same type. The indexes are also a device for enabling institutional investors’ to estimate the level of risk to which

	<p>savers' money is exposed, and an effective supervisory tool for the regulator.</p> <p>Also, the CMISD provides on its Internet site various calculators allowing potential policyholders to calculate the price of coverage. Such calculators are provided for life insurance, pension activity, provident activity and vehicle compulsory insurance. Any person can enter these calculators, input his characteristics, and obtain the insurance tariffs offered by all the insurers operating in the chosen insurance line with respect to his specific criteria.</p>
--	--

While the CMISD is developing a wide range of tools and programmes to promote financial education in the insurance (and pension) areas, the information available does however not evidence the same degree of involvement from other major actors in the insurance sector. An important part of the OECD Recommendation is addressed to other insurance stakeholders and market players (i.e. underwriters and sellers, association of insurers, intermediaries, relevant institutes and foundations, etc.), as well as other social and business partners (associations of insurance market players, consumers' associations, employers, trade unions, other NGOs and institutes specialised in insurance issues), but no initiatives from these various parties have been reported. Except for terrorism risk, there is, to our knowledge, no specific solution (such as default mechanism or innovative insurance products) to address most severe risks or highly vulnerable segments of the population. Lastly, there appears to be neither assessment of the population/policyholders level of literacy and need for education, or wide-ranging programmes (except from the CMISD) to raise risk awareness and strengthen education on insurance issues, that would involve for instance broad media coverage.

- The wide array of tools and programmes developed by the CMISD in order to promote the education and adequate information of (potential) insurance consumers, and assist them in selecting the type coverage most adapted to their needs is consistent with the OECD Recommendation on Good Practices for Enhanced Risk Awareness and Education in Insurance Issues.
- It does however not cover a number of the OECD good practices identified in the above table. In particular, little has been done to assess the degree of financial literacy and understanding of the population, nor to enhance risk awareness. Also, apart from the CMISD, other insurance stakeholders and market players do not appear to be involved in what should be a national endeavour.
- The CMISD should therefore consider setting up new initiatives targeted at risk awareness; moreover, Israel should endeavour to launch, within a definite time frame, specific horizontal projects aimed at promoting risk awareness and education on insurance issues, in order to pursue further the achievements of the CMISD in this respect. Action has become more urgent in Israel since the development of participating life insurance plans entailed by recent reforms shifted the investment risk, formerly borne by insurers, to the policyholders.

4.4. Recommendation of the Council on the Establishment of a Check-list of Criteria to define Terrorism for the Purpose of Compensation: C(2004)63/REV2⁶⁶

Israel accepts this Recommendation.

The Recommendation on the Establishment of a Check-list of Criteria to define Terrorism for the Purpose of Compensation is divided into three parts: one that defines the conditions for acts of terrorism to be compensated via non-insurance instruments, according to each country specific policy concerns, one that relates to the factors of insurability and one that enumerates possible elements of definition of terrorism acts. Along these lines, the Israeli system of terrorism acts compensation can be summarised as follows:

Legislation in Israel that standardizes the compensation granted by government agencies to victims of terrorism is in line with the general criteria in the document.⁶⁷ The Israeli state compensates for property damage resulting from hostilities through property tax⁶⁸, which provides a solid and large financial basis adapted to Israel's public policy objectives: allowing a wide ranging and efficient coverage of all Israeli citizens against terrorism. In return for a special payment to the Property Tax Commission, the amount of compensation specified in the Law can be increased. The State also compensates for bodily harm resulting from hostility⁶⁹. Under domestic law, a person harmed by acts of terrorism or war is entitled to treatment, convalescence, rehabilitation and remuneration from the National Insurance Institute. In the event of a fatality, compensation will be paid to the family members of the person who was killed. In any event, the State Health Insurance Law provides medical coverage for every resident of the State of Israel including in a case when he was harmed by hostilities.

Along with government compensation, terrorism risks are also covered in Israel by private policies, priced according to the risk level, consistently with the general criteria listed in the OECD Recommendation (assessability, randomness, mutuality, as well as economic and legal insurability criteria). The insurance companies usually distinguish between war damage and terror damage. In most cases, damage to property caused by hostilities or terror damage is excluded from insurance policies. Sometimes however, it is possible to purchase it as additional coverage for payment of an additional premium. Insurance policies covering the event of death do not exclude the payment of insurance indemnity/survivors' allowance to beneficiaries in the event of death resulting from acts of terror or war. Insurance policies covering loss of working ability, disability as the result of an accident, operations, transplants, hospitalizations and other private health insurance policies do not usually contain coverage against harm caused by war or hostilities.

⁶⁶ Further information on the compliance of the Israeli regulation with this Recommendation can be found on page 52 of document DAF/AS/ACS(2008)1/ADD2.

⁶⁷ Israeli legislation involving compensation due to [acts of] terrorism:

- a. The Property Tax and Compensation fund Law, 5721-1961, regulates compensation from the State for property damage due to acts of hostility. Through the framework of the law, it is also possible to increase in advance the amount of the compensation, for the payment of property tax. The classification of an incident as an act of hostility is done by the Minister of Defense; similarly, the Minister of Finance, with the approval of the Knesset Finance Committee, can declare an area as having been damaged by an act of hostility.
- b. The Compensation to Victims of Acts of Hostility Law, 5730-1970 regulates the receipt of compensation from the state for personal injuries resulting from acts of hostilities.

⁶⁸ See The Property Tax and Compensation Law, 1961.

⁶⁹ See The Remuneration for Victims of Hostilities Law, 1970.

Regarding the elements of definition of terrorism acts, the OECD Recommendation refers to specific means, effects and intention criteria. In Israel however, the geopolitical context has lead to the adoption by of a broad definition of (war and) terrorism, in order to allow for a rapid and efficient compensation process. Since it is often difficult to distinguish between war and terrorism, domestic law makes no distinction. Similarly, insurance policies do not refer to a standard and binding definition of war and terrorism. This approach is however not inconsistent with the elements of definition provided in the OECD Recommendation, meant as “illustrative, and neither binding nor exhaustive”, so as to “be adapted by the various parties concerned to mirror specific market and regulatory frameworks or policy objectives”⁷⁰.

- Israel complies with Recommendation of the Council on the Establishment of a Check-list of Criteria to define Terrorism for the Purpose of Compensation.
- Regulation and practice of terrorism compensation in Israel is consistent with the two first parts of the OECD Recommendation, which define the conditions for acts of terrorism to be compensated via non-insurance instruments, and insurability criteria.
- The definitions of terrorism typically used in Israel by the various actors in charge of insurance or non insurance compensation are broad, to adapt to Israel’s specific political situation. While they do not reflect most of the elements provided in the OECD Check-list, this does not prevent Israel from complying with the Instrument, the list of elements of definition of terrorism provided in the OECD Recommendation being illustrative and non-binding.

4.5. Recommendation of the Council on Good Practices for Insurance Claim Management: C(2004)62⁷¹

Israel accepts this Recommendation.

The Recommendation on claim management invites public authorities and insurance companies to ensure the efficient and fair management of insurance claims through a detailed checklist of good practices for claims handling. While some of these good practices are not yet explicitly addressed by the Israeli legislation nor implemented by insurance companies, the Insurance Supervisor is in the process of expanding regulation in this area. A “Principles for the Verification and Settlement of Claims” circular, formulated in reference to the OECD document with adjustments to the local market, was issued in 2007. The CMISD has adopted in November 2008 a second draft circular that determines a set of rules for claim settlement. It should be implemented in 2010. This draft circular covers most of the guidelines listed in the OECD Recommendation, although in a less detailed format. The table below highlights the main gaps in the draft circular guidelines as compared to the guidelines listed in the OECD Recommendation. It also lists a number of other rules and regulations which already address various provisions of the OECD Good Practices for insurance claim management.

⁷⁰ See *OECD check-list of criteria to define terrorism for the purpose of compensation, Recommendation of the Council*, 2004.

⁷¹ Further information on the compliance of the Israeli regulation with this Recommendation can be found in the document DAF/AS/ACS(2008)1/ADD2 page 53-54 and in document DAF/AS/ACS(2008)1/ADD3 (See answers to the questions related to page 53).

	OECD guidance not addressed by the Israeli draft circular on claim settlement	Comments
1. Claim reporting	<p>The insurance company writes insurance policies in easily understandable language. Policies spell out what is covered and what is not covered. If necessary, plain language explanations could be an addendum to the legal language. The insurance company draws the attention of the policyholder/claimant/beneficiary both when he/she signs a policy (for policyholders only) and when he/she reports a loss on his/her duties related to claim reporting which include:</p> <ul style="list-style-type: none"> • To try to minimise losses; • To report claims in a timely fashion; • To co-operate in the investigation by providing the company with all relevant information and, in particular, copies of official documents regarding the damage (accident, loss, etc.); • To authorise the company to handle necessary inspections and assess the extent of the damage prior to any repairs or replacement; 	<p>There is no direct reference in the draft circular to the requirement for the institutional investor to explain its obligations to the insured at the claim stage when a contract is being completed. This issue is dealt with indirectly by requiring institutional investors to publish claim settlement procedures on their Internet site. Also, on demand, the insurer must deliver, in writing, his internal claims procedures including all details regarding the documents needed and forms that must be fulfilled.</p> <p><i>Other regulation:</i> Section 22 of the insurance policy law, 5741-1981 determines that the insured has to immediately inform the insurer about any event, and section 23 (B) determines that the insured will forward, within reasonable time the required information in order to clarify the insurance obligation. Moreover, section 24 of the law mentions what will happen in case the insured fails to act as above.</p>
4. Fraud detection and prevention	<p>In order to curb the growth of fraudulent claims and the rise in premium costs that results from them, companies take the following steps:</p> <ul style="list-style-type: none"> • They establish compliance programs for combating fraud and money laundering appropriate to their exposure and vulnerabilities. • In the claim filing phase, they discourage fraudulent practices by making the policyholder/claimant/beneficiary aware of the consequences of submitting a false statement (which in particular could be liable to prosecution) and/or an incomplete statement. To this end, insurance companies place a notification on their claims forms referring to the appropriate law, statute or insurance regulation that addresses the filing of fraudulent or incomplete claims. 	<p>The draft circular does not address fraud prevention⁷². The only related issue that has so far been regulated is the use of a polygraph in the course of the claim settlement.</p> <p>The CMISD is however cooperating with the Ministry of Justice in order to expand the current insurance fraud database to include vehicle property insurance. Such database should provide to insurance companies the information necessary to make it easier for them to catch those committing fraud during underwriting and claims settlement. The database should be ready to be used by the companies for vehicle property insurance in 2010.</p>

⁷² Insurance fraud has been addressed only very recently in Israel. In 2006, a circular entitled “fraud by factors from within and out of the organization” determined the basic principles and ways for insurance undertakings to deal with fraud and theft that are not performed by the insured or beneficiary. A special fraud data base for compulsory vehicle insurance is operational since 2006. The expansion of the data base to include other insurance lines is being considered. There is so far no statistical information on the extent of insurance fraud.

	<ul style="list-style-type: none"> Where legally possible, companies participate in relevant databases where claims susceptible to be fraudulent would be reported. Moreover, public authorities may encourage or take steps to initiate the creation of a public or private bureau of insurance fraud. Besides, companies provide their claims department staff with adequate training on fraud indicators. 	
5. Claim assessment	<p>General issues:</p> <ul style="list-style-type: none"> Any method of taking into account specific factors such as depreciation, discounting or negligence on the part of the victim is clearly outlined in the claim file. Any loss evaluation methods used by the company are reasonable and coherent. The insurance company uses internal methods for assessing claim values based on the applicable law of the jurisdiction. <p>The role of claims adjusters: Companies that use claims adjusters or intermediaries will need to ascertain their competence qualifications. Moreover, if these claims adjusters/intermediaries were to commit any errors or misappropriation of funds affecting their policyholders, claimants or beneficiaries within the framework of the contract² with the insurance company, the latter would be held responsible. Consequently, companies may decide to limit the scope of action of claims adjusters and intermediaries (for example, by setting ceilings on the number of claims they can handle).</p>	<p>The draft does not address the issue of claim assessment methods and process, except for the notification to the claimant of the involvement of external actors, such as loss adjusters.</p> <p><i>Other regulation</i> The insurance supervisor published a number of circulars on claim assessment methods and process. For example, insurance circular 2007-1-8 entitled “Car Insurance Assessment (property and third party)” regulates the way that the insured selects a car assessor for the insurance case, the assessors obligation to forward the fixing quotation with his fees to the insured, orders preventing the insurance company’s influence on the car assessor, insurance agencies, garages or insured. The position of the attorney general, that was adopted by the commissioner of insurance, in matters of insureds negligence, is that contributory fault should not be attributed to the insured in cases where insureds negligence caused the accident. Insurance circular 2000/12 states that the insurer must give, when insurance is offered, full details regarding the special factors that may affect price of the vehicle (such as number of previous owners costs, types of previous owners, high mileage etc.) for calculating the benefit of insurance in cases of total loss. If the insurer does not provide the above, he cannot use the special factors for calculating the benefit in such cases.</p>
6. Claim processing	<ul style="list-style-type: none"> A company’s claim procedures are gathered together in a manual for internal use. At least, one staff member should be responsible for ensuring that the manual is kept up to date and additions/amendments are made when necessary. 	<p>In reference to the third item, it should be mentioned that the draft circular does not provide guidance for the management of complex claim settlement processes, involving several insurance companies, claimants that</p>

	<ul style="list-style-type: none"> Regular internal audits are carried out for all claims not settled in their entirety. Internal audits apply to all stages of the claims management process. Peer reviews (where the claims department staff review each others' files) could also be carried out. In case of claim settlement procedures involving several insurance companies, policyholder indemnification is a priority: the claim should be compensated in an appropriate time period while potential disputes between insurers are resolved at a later stage. For the most common insurance claims (related to motor insurance, for instance), specific agreements are concluded between insurers to accelerate and simplify claims settlement procedures involving several insured parties. 	<p>are not the policyholder, etc. The draft circular states that the claimants that are not the policy holder have equal rights to the policy holder, in the claim settlement procedure.</p> <p><i>Other regulation</i> section 23(A) of the insurance policy law determines that the insurer has to immediately take the necessary actions to clarify his obligations</p>
7. Timely claim processing	<ul style="list-style-type: none"> After an agreement has been reached between the company and the policyholder/claimant/beneficiary on the amount of compensation, the payment is effected within a reasonable amount of time. Insurance companies implement and update their own statistical database tracing their performance in the timely settlement of claims as well as in trends in settlements and expenses. A proper procedure for the coding and statistical processing of losses is developed for this purpose. 	<p>The draft circular on claim management does not cover the issue of statistics collection; However, another draft circular has been issued in July 2008 that goes far beyond the OECD guidelines. While the OECD recommendation advises that insurers establish their own statistics on claim, the 2008 Israeli draft aims at the publication of industry indexes, for general insurance (principally vehicle and property insurance), health insurance and pension saving lines, on the length of time in which each institutional investor settles a claim, the amount of claims that are accepted, partially accepted or rejected, the amount of claims that are settled within an arbitration framework or in court, and the results of the court proceedings. Such public indexes are meant to provide a key tool for policyholders in the choice of an insurer. This initiative is in line with the following assertion of the OECD Recommendation: "Quick claims settlement as well as high-quality and punctual information provided to the policyholder/claimant/beneficiary are key competition features for insurance companies".</p> <p>Another draft was issued on may 2009 and a final circular is expected to be published on July 2009.</p> <p><i>Other regulation</i></p>

		Section 27 of the law determines that the insurance compensation will be paid within 30 days from the day that the insurer received all the necessary information and documents in order to clarify his obligations.
9. Supervision of claims-related services	<p>The insurance supervisory authorities may conduct examinations on claims management services especially where problems are suspected. In these cases, the following elements are taken into account:</p> <ul style="list-style-type: none"> • Possible access to non-confidential claims data for all open and closed files within a specified time frame (e.g. for the current year and the two preceding years); • Maintenance of sufficient and appropriate information on claims files; • Use of the appropriate type of claim form for the type of insurance; • Proper qualification of the claims department's employees based <i>inter alia</i> on the applicable insurance code; • Valuation of claims payments according to company procedures; • Appropriate tracking of the nature and number of complaints related to claim management process; • Monitoring of the proportion of claims that result in litigation; • Compliance with procedures for combating fraud and money laundering; • Regular internal audit practices on claims files; • Appropriate internal claims procedure manuals; • Proper procedure for coding and statistical reporting of losses; • Performance in terms of the speed of claim settlements (as assessed according to the statistical database implemented by virtue of item 7). 	While the current draft does not refer to the supervision of claims-related services, the establishment of industry indexes is also meant to be used by the Insurance commissioner as a tool to review the behaviour of the institutional investors in the management of claims. These indexes will for instance allow the CMISD to monitor the proportion of claims that result in litigation, and compare performance in terms of the speed of claim settlements.
10. Market practices	The terms of remuneration of insurance company employees or other services in charge of claim management do not give incentives to disadvantageous treatment of policyholders/claimants/beneficiaries, as regards the handling or the outcome of claims.	No reference to the terms of remuneration of insurance company employees or other services in charge of claim management is made in the draft circular.

- Israel is in the process of being compliant with this Recommendation of the Council on Good Practices for Insurance Claim Management which is neither binding nor exhaustive.
- The content of the 2008 draft circular is consistent with the OECD Recommendation and should provide a solid basis of guidance for insurers.
- This draft circular does however not cover a number of the OECD good practices listed in the above table. These good practices could be considered for the final circular in order to make it as exhaustive and operational as possible. The detection and management of insurance fraud, among other issues, should be given special attention.
- Israel may be invited to provide all necessary information related to the timing of the approval and monitoring of implementation of this draft circular (together with the 2009 draft circular on the publication of statistics on claim management).

4.6. Recommendation of the Council concerning a Common Classification of the Classes of Insurance Recognised by the Supervisory Authorities of the Member Countries [C(83)178]

Israel accepts this Recommendation with the following observation:

a) The existing classification in Israel is not fully consistent with the classification recommended by the OECD.

b) Changing the classification in Israel will require the examination of sectoral classification systems adopted by other markets that do not use the OECD's proposed classification (Australia, Canada, and the US), and will require investments of extensive resources in the industry, updates to computerized systems, and legislative and regulatory changes related to the sector's licensing procedures.

The classification of insurance lines in Israel is not fully consistent with the classification recommended by the OECD. Unlike the classification proposed by the OECD, the Israeli classification does not distinguish between life insurance lines and general insurance lines. Also, in Israel, the vehicle insurance lines are divided into property damage and bodily injury, whereas OECD recommendations distinguish between personal damage and third-party damage.

Moreover, a number of insurance lines of the OECD classification have no equivalent in Israel : insurance for marriage or birth, permanent health, capital redemption operations, railway rolling stock, fire and natural forces, other damage to property such as hail, frost, or theft, aircraft liability, liability for ships, miscellaneous financial loss such as employment risk and legal expense. Some of them could only be included under other insurance classes.

In addition, the following lines of Israel's classification are not listed in the classification proposed by the OECD:

- Insurance against employers' liability
- Comprehensive insurance for residences and businesses, including glass insurance
- Insurance against loss of property, including the insurance included in the lines mentioned in sub-paragraphs (9) to (13) and including glass insurance
- Agricultural insurance, excluding insurance against natural damage in agriculture
- Engineering insurance
- Glass insurance only

- Insurance against natural damage in agriculture
- Foreign trade risks insurance.

Set out below is a comparison between the OECD classification of insurance lines as included in the Recommendation of the Council concerning a Common Classification of the Classes of Insurance Recognised by the Supervisory Authorities of the Member Countries, and the classification determined by the Israeli Finance Minister in the Supervision of Insurance Businesses (Insurance Lines) Decree, 5745-1985⁷³.

Table 22. Comparison Between Israel's and OECD Classification

COMPARISON BETWEEN ISRAEL'S AND OECD CLASSIFICATION	
OECD classification	Israel's classification
A. LIFE INSURANCE⁷⁴	
1. LIFE ASSURANCE, in particular⁷⁵:	
<ul style="list-style-type: none"> • Death; Survival; Death or Survival (ordinary endowment); Life assurance with return of premiums 	2. Life insurance – risk only
<ul style="list-style-type: none"> • Annuities 	1. Comprehensive life insurance – all types of life insurance, with or without risk, including severance pay insurance and annuity insurance, where the amount of the annuity is calculated on the basis of the accrual as at the commencement of the annuity payment, except for pension insurance as stated in sub-paragraph (3).
<ul style="list-style-type: none"> • Supplementary insurance, in particular: <ul style="list-style-type: none"> ○ Personal injury, including incapacity for employment ○ Accidental death ○ Disability due to accidents or to sickness. 	1.
2. MARRIAGE INSURANCE, BIRTH INSURANCE	
3. THE INSURANCE referred to in 1 a) and b) above linked with investment funds	1.
4. PERMANENT HEALTH INSURANCE (in those countries where such insurance is included in the long-term class)	
5. TONTINES	4. Mutual collective life insurance.
6. CAPITAL REDEMPTION OPERATIONS (based	

⁷³ Numbers mentioned in square parentheses refer to the Israeli classification. It corresponds to the numbering in Section 1(a) in the Supervision of Insurance Businesses (Insurance Lines) Order, 5745-1985.

⁷⁴ Lines of insurance of the OECD classification for which there is no parallel in Israel are in italics.

⁷⁵ For each of the column, numbers refer to those attributed to each insurance line in the OECD/Israeli classification.

on actuarial calculation)

7. LIFE: MISCELLANEOUS

B. NON-LIFE INSURANCE

1. ACCIDENT (including industrial injury and occupational diseases)

5. Insurance against personal accidents.

- Fixed pecuniary benefits
- Benefits in the nature of indemnity
- Combinations of the two
- Injury to passengers

2. SICKNESS

6. Insurance against sickness and hospitalization.

- Fixed pecuniary benefits
- Benefits in the nature of indemnity
- Combinations of the two

3. LAND VEHICLES (other than railway rolling stock): All damage to or loss of:

9. Motor vehicle insurance – property (own and third party), including all types of motor vehicles.

- Land motor vehicles
- Land motor vehicles other than motor vehicles

4. RAILWAY ROLLING STOCK: All damage to or loss of railway rolling stock

Included in 9: Motor vehicle insurance – property (own and third party).

5. AIRCRAFT: All damage or loss of railway rolling stock.

10. Aircraft insurance, including responsibility to a third party.

6. SHIPS (SEA, LAKE AND RIVER AND CANAL VESSELS): All damage to or loss of

10. Aircraft insurance, including responsibility to a third party.

- River and canal vessels
- Lake vessels
- Sea vessels

7. GOODS IN TRANSIT (including merchandise, baggage and all other goods): All damage to or loss of goods in transit or baggage, irrespective of the form of transport.

13. Cargo-in-transit insurance.

8. FIRE AND NATURAL FORCES: All damage to or loss of property (other than property included in classes 3, 4, 5, 6 and 7) due to:

- Fire
 - Explosion
 - Storm
 - Natural forces other than storm
-

<ul style="list-style-type: none"> • Nuclear energy • Land subsidence 	
9. OTHER DAMAGE TO PROPERTY: <i>All damage to or loss of property (other than property included in classes 3, 4, 5, 6 and 7) due to hail or frost, and any event such as theft, other than those mentioned under 8.</i>	Can be included in: <p>15. Insurance against loss of property, except for insurance included in the lines mentioned in sub-paragraph (9) to (13), and including glass insurance,</p> <p>Together with 12. Comprehensive residential and business insurance, including glass insurance.</p> <p>17. Agricultural insurance, except for insurance against natural damage in agriculture.</p> <p>18. Engineering insurance.</p> <p>19. Glass insurance only.</p>
10. MOTOR VEHICLE LIABILITY: All liability arising out of the use of motor vehicles operating on land (including carrier's liability).	8. Insurance against the requirements of the Motor Vehicle Insurance Order (New Version), 5730-1970.
11. AIRCRAFT LIABILITY: <i>All liability arising out of the use of aircraft (including carrier's liability)</i>	Included in 10. Aircraft insurance, including responsibility to a third party.
12. LIABILITY FOR SHIPS (SEA, LAKE AND RIVER AND CANAL VESSELS): <i>All liability arising out of the use of ships, vessels or boats on the sea, lakes rivers, or canals (including carrier's liability)</i>	Included in 11. Maritime vessel insurance, including responsibility to a third party.
13. GENERAL LIABILITY: All liability other than those forms mentioned under 10, 11 and 12.	<p>14. Insurance against liability to a third party, excluding such insurance that is included in the lines mentioned in sub-paragraphs (7) to (11).</p> <p>Together with 7. Insurance against employer's liability.</p>
14. CREDIT	<p>23. Credit insurance</p> <p>Together with 16. Insurance of apartment buyers' investments in accordance with the requirements of the Law of Sale (Apartments) (Assurance of the Investments of Apartment Buyers), 5735-1974., apart from buyers' investments</p> <p>20. Issue of guarantees.</p> <p>26. Credit insurance for mortgage-secured residences (as a monoline</p>
<ul style="list-style-type: none"> • Insolvency (general) • Export credit • Installment credit • Mortgages • Agricultural credit. 	
15. SURETYSHIP	22. Insurance against liability for blemished product.
<ul style="list-style-type: none"> • Suretyship (direct) 	

<ul style="list-style-type: none"> • Suretyship (indirect). 	
16. MISCELLANEOUS FINANCIAL LOSS	Partly included in
	21. Insurance against natural damage in agriculture.
	24. Foreign trade risk insurance.
<ul style="list-style-type: none"> • Employment risks 	
<ul style="list-style-type: none"> • Insufficiency of income (general) 	
<ul style="list-style-type: none"> • Bad weather 	
<ul style="list-style-type: none"> • Loss of benefits 	
<ul style="list-style-type: none"> • Continuing general expenses 	
<ul style="list-style-type: none"> • Unforeseen trading expenses 	
<ul style="list-style-type: none"> • Loss of market value 	
<ul style="list-style-type: none"> • Loss of rent or revenue 	
<ul style="list-style-type: none"> • Indirect trading losses other than those mentioned above 	
<ul style="list-style-type: none"> • Other financial loss (non-trading) 	
<ul style="list-style-type: none"> • Other forms of financial loss. 	
17. LEGAL EXPENSES	
<ul style="list-style-type: none"> • Legal expenses and costs of litigation. 	
18. MISCELLANEOUS	25. Insurance against other risks.

- The classification of insurance lines in Israel is not fully consistent with the classification defined in the OECD Recommendation of the Council concerning a Common Classification of the Classes of Insurance Recognised by the Supervisory Authorities of the Member Countries.

- Given the heavy cost and process, for the industry as well as for regulatory and supervisory authorities, that changes in Israel's classification would entail, it is suggested that only *future* changes in this classification take into account the OECD list. Meanwhile, practical arrangements will need to be considered in order for the OECD to be able to include Israel in the OECD statistical database on insurance.

Annex II to the OECD Recommendation mentions that in order to facilitate and simplify procedures, authorization may, if need be, be granted simultaneously for several classes of non-life insurance:

- Classes No. 1 and 2, it shall be named "Accident and Health Insurance"
- Classes No. 1 (fourth indent), 3, 7 and 10, it shall be named "Motor Insurance"
- Classes No. 1 (fourth indent), 4, 6, 7 and 12, it shall be named "Marine and Transport Insurance"

- Classes No. 1 (fourth indent), 5, 7 and 11, it shall be named "Aviation Insurance"
- Classes No. 8 and 9, it shall be named "Insurance against fire and other damage to property"
- Classes No. 10, 11, 12 and 13, it shall be named "Liability Insurance"
- Classes No. 14 and 15, it shall be named "Credit and Suretyship Insurance"
- All classes, it shall be named at the choice of the Member country concerned.
- Israel does not mention this possibility.

4.7. Recommendation of the Council concerning Institutional Co-operation between Authorities of Member Countries Responsible for Supervision of Private Insurance [C(79)195/Final]

Israel accepts this Recommendation.

Legislation in Israel allows transfers of information to authorized government agencies in foreign countries that supervise insurers or insurance mediators in those countries, subject to confidentiality duties, provided that the information is required for the fulfilment of the duties of the authorized agency.

The Recommendation is made of two parts:

- in a first part, Member countries are invited to “require their administrative authorities responsible for supervision of private insurance, whenever they receive a request from the supervisory authority of another Member country, to exchange directly between themselves information of a general character relating, inter alia, to legislative, regulatory and administrative requirements in the field of insurance, in order to allow comparisons between countries such as might promote voluntary alignments of the relevant national provisions”;
- in a second part, Member countries are invited to “conclude in the light of the developments of their economic relations in the insurance sector, bilateral conventions, using the [] model [provided in the Recommendation as a basis], in order to enable their authorities responsible for supervision of private insurance concerns to communicate to each other information needed by them in order to exercise their function of supervision and to lend one another assistance reciprocally”.

Israel complies with the first part of the Recommendation: the legislative infrastructure, from which the recommendation can be implemented, exists in Israel, since the Israeli legislation allows the transfer of information to foreign supervisors (with appropriate restriction that are also reflected in the OECD Recommendation). Moreover, according to the CMISD, Israel is working to expand its cooperation and exchanges of information with supervisors overseas. Concerning the second part of the Recommendation, Israel may wish to take into consideration this framework convention when drafting such bilateral agreement on exchange of information between supervisors in the future.

Israel complies with this Recommendation.

ANNEX 1: CORPORATE GOVERNANCE REGIME

1. Requirement for appointing a chairman and CEO and the separation of their functions.

Insurance companies are required to appoint a chairman of the board of directors and a CEO. An insurance company's CEO is not entitled to serve as chairman of the board of directors.

2. The board of directors and its committees

Proficiency of the members of the board of directors

In order to assure the proficiency of the members of the board of directors of an insurance company, the regulations issued by the Finance Minister prescribe arrangements concerning the proficiency terms of the members of the board of directors (professional experience, education, ethics and integrity, as well as arrangements for the prevention of conflicts of interest connected with the service of the members of the board of directors).

Composition of the board of directors

- In order to increase the efficiency of the work of the board of directors, the Insurance Control Law places a restriction on the minimum and maximum number of members in the board of directors, from seven to fifteen.
- In order to promote the independence of the board of directors, the Insurance Control Law stipulates that as with a publicly-traded company, at least two external directors must serve on an insurance company's board of directors. The following rules apply to the external directors:
- A person with a business affiliation to the company or to a controlling owner in it cannot be appointed as an external director.
- Only a person with professional proficiency or a person with accounting and financial specialization can be appointed as an external director. Under the provisions of the Law, at least one of the external directors must have accounting and financial specialization. (The terms and the tests for a director with accounting and financial specialization are defined in the regulations prescribed by the Companies Law.)
- The board of directors' regulations prescribe additional arrangements concerning the strengthening of the independence, professionalism of the board of directors of an insurance company, apart from the conditions determined in the Companies Law regarding a publicly-traded company:
 - The proportion of external directors on the board of directors of an insurance company was increased to 1/3 of the members (resulting in the minimum number of external directors to be 3 – 1/3 of at least seven).

- At least half of the external directors must have accounting and financial specialization, and at least half of the external directors must have experience or specialization in insurance and in similar financial bodies.
- The rules governing affiliation constituting a barrier to serve on the board of directors have been extended to include a person holding 10% or more of a specific type of means of control in the insurance company and not only its controlling owners.

Matters on which the board of directors must deliberate and decide

The Companies Law prescribes a series of matters on which the board of directors must deliberate and decide. Determined in the board of directors regulations are additional matters that are essential for the proper functioning of the insurance companies, including:

- Formulation of risk exposure policy (including credit risk, market risk, insurance risk, operational risk, catastrophe risk, liquidity risk and concentration risk), risk appetite and risk tolerance, as well as tools for the management and control of risks.
- Formulation of overall investment and credit policy.
- Formulation of policy on exposure to reinsurers.
- Approval for entry into new areas of activity.
- Determination of standards for ethical behaviour.
- Determination of ways for assuring that the provisions of the law are observed and the appointment of a person accountable for the matter.
- Determination of policy for the remuneration of the office-holders in the insurer, while ensuring that the remuneration mechanism promotes the insurance company's objectives and draws attention to the risks accompanying the company's activity.
- Preparations for crisis situations.

Committees of the board of directors

The board of directors is entitled to establish committees and to determine their mandate. However, the board of directors is not entitled to delegate to a committee its authorities and responsibility for determining policy on matters that are essential for the company's activity, as determined in the Law and its provisions, but it is entitled to establish a committee in these areas for the purpose of issuing recommendations to the board. In order to assure the involvement of the external directors, the board of directors' regulations stipulate that at least one external director will serve on a board of directors' committee, except on committees for which it is explicitly determined that the majority of the members in them will be external directors.

The provisions of the law applying to insurance companies prescribe the types of statutory committees which an insurance company must establish:

- Audit committee: The board of directors of an insurance company must appoint an audit committee from among its members, in which all the external directors will be members. The board of directors' regulations stipulates that the majority of the audit committee's members must be external directors and that at least half of its members must have accounting and finance specialization.

The audit committee's functions include:

- Ascertaining deficiencies in the company’s business management.
- Approving the internal auditor’s annual work program.
- Recommending the appointment of an external auditor and discussing financial reports.
- Assuring the independence of the external auditor and the internal auditor.

The board of directors’ regulations stipulates that the audit committee must hold discussions at the request of control functionaries, including the risk manager, the appointed actuary, the external auditor, the internal auditor and the compliance officer.

- The investment committee: The board of directors of an insurance company must appoint two investment committees (members’ simultaneous service on two committees is prohibited) that are responsible for determining the allocation in the investment portfolios, for approving material transactions, and for the control and monitoring of the investment portfolio:
 - The investment committee for the investment of the insurance company’s nostro funds (“non-yield-dependent investment committee”).
 - The investment committee for the investment of the money of profit-sharing life insurance plans (“yield-dependent investment committee”).

The majority of this committee’s members and its chairman must have proficiency to serve as external directors.

The insurance company’s board of directors is not entitled to take on the committee’s authorities. The investment regulations applying to the insurance companies stipulate proficiency rules for the members of the investment committees, including requirements for financial education, experience in the capital market and principles for maintaining ethical standards and integrity. Also stipulated are rules for the prevention of conflict of interests in the service of a member of the yield-dependent investment committee arising from his other activities.

- The sub-credit committee

As a result of the Bachar Reform and the development of the non-bank credit market, the extension of marketable and non-marketable credit in connection with investment has increased and is becoming a significant area of the insurance companies’ business activity. To strengthen the control and supervision mechanisms of insurance companies in all matters concerning the extension of credit, insurance companies with extensive credit activity have been required to appoint a credit transactions approval committee as a sub-committee of the investment committee. A circular issued by the CMISD stipulates that those with substantial specialization and experience in the area will serve on the credit sub-committees (see the circular on credit risk management in connection with investment activity).

Modes of operation of the board of directors

In order to increase the efficiency of the work of the board of directors and to remove the constraints under which it operates, directives have been determined in respect of the following:

- Specification of a study program for a director who is appointed at an insurance company for the first time.
- Management of meetings by use of communications media and the taking of decisions without convocation.

- Management of board of directors meetings – frequency of board of directors meetings, manner of scheduling meetings, notification of meetings and minutes of meetings.
- Periodic reports to the board of directors (see the circular on modes of operation of the board of directors and its committees)

3. Personal proficiency of office-holders

In addition to the proficiency conditions determined for the members of the board of directors, directives issued by the Finance Minister also stipulate proficiency conditions concerning the experience, education, integrity and independence (inasmuch as it is relevant) with respect of the risk manager, the appointed actuary and the qualified actuary (draft regulations), the internal auditor (draft regulations), the investment manager and a member of the investment committee (investment regulations). The Controller of Insurance regulations also stipulate proficiency conditions with respect of the information systems manager and draft regulations have been compiled on the suitability conditions of the external auditor (particularly on independence and resources).

Under the provisions of the Insurance Control Law, the Controller of Insurance must express no objection to the service of an office-holder (director, CEO, internal auditor, chairman of the non-yield-dependent investment committee, member of the yield-dependent investment committee, finance manager, actuary, risk manager, information systems manager and legal counsel).

4. Accountability

An office-holder is subject to supervisory accountability, the violation of which constitutes a criminal offense.

If the company or one of its employees violates the provisions of the law, it is as if the office-holder in the company had violated the supervisory requirement, unless he can prove that he did everything possible to prevent the violation.

5. Changes in the holding of means of control

A holding of 5% or more of a particular type of means of control in an insurer requires the receipt of a permit for the holding of means of control from the Controller. When considering the granting of such a permit, the Controller has to take into account the applicant's suitability (integrity), background and financial ability. A permit holder must report once a year to the insurance company on the matter of his holding.

6. Internal audit

The Internal Audit Law in Israel requires government companies to appoint an internal auditor. The Companies Law requires an internal auditor to be appointed at all publicly-traded companies, and applies to them the provisions of the Internal Audit Law, which are intended inter alia to assure his proficiency and independence.

Under the Insurance Control Law, an insurance company is required to appoint an internal auditor. (This provision exists since 1992). The appointment of an internal auditor at an insurance company is subject to the provisions of the Companies Law concerning the internal auditor at a public company, including rules regarding his proficiency, his subordination, his independence and his modes of operation.

A circular issued by the CMISD adopted the principles applying to banking corporations in Israel concerning the internal auditing systems, and additional rules have been determined, including in connection with the following:

- An examination by the CMISD for the purpose of comparing the number of internal auditing hours at insurance companies in Israel indicated that the number of these hours is too low. On the basis of the parameters that were examined, a minimum number of auditing hours at insurance companies was prescribed as a function of revenue, assets volume and the number of the company's employees.
- Assuring the internal auditor's accessibility to every insurance business.
- Requiring insurance companies to maintain permanent internal control systems.
- Rules for assuring the independence of the internal control system; assuring the internal auditing system's resources in the insurance company's core areas.
- Basing the annual and multi-year work programs on an outline of activities and a risk review, and the construction of a risk matrix; rules regarding internal auditing system procedures.
- The internal auditor's reports to the board of directors and independent audit of the internal auditing system.

7. Risk manager and risk management system

Under the legislative amendments deriving from the implementation of the Bachar Reform, the Insurance Control Law stipulates that an insurer must appoint a risk manager whose functions are inter alia to advise the board of directors and the CEO on the risks facing the insurer and facing every pension fund under its management. During 2006, a circular and regulations were issued (the regulations have yet to be approved) that create an infrastructure for a risk management framework and culture at insurance companies, including rules concerning the risk manager's proficiency, functions, authorities and modes of operation, and concerning the network of relationships between him and other office-holders at the insurer. The circular covers:

- The types of reports which office-holders – including the investment manager, the official responsible for reinsurance, the internal auditor and the appointed auditor – must send to the risk manager.
- The types of reports which the risk manager must send to the board of directors and the investment committees regarding the investment of the funds in profit-sharing life insurance plans.
- Content of the risk manager's reports: quantification of the exposure and an assessment of the potential effect of market risks, credit risks and insurance risks, and an assessment of the controls, means and resources existing at the insurer for the purpose of measuring and monitoring the risks.
- Requirement that the risk manager assess the economic capital which the company needs for the purpose of bearing market, credit and insurance risks (assessment to be completed by December 2009). The insurance companies have been required to report to the CMISD on key stages in their preparations for applying the provisions of the directive.

8. Appointed actuary

Under the legislative amendments deriving from the implementation of the Bachar Reform, the Insurance Control Law stipulates that an insurer must appoint an actuary for each insurance line in which it engages. The actuary's functions include making recommendations to the board of directors and the CEO regarding the level of the insurer's insurance liabilities.

2006 regulations (which have yet to be finally approved) contain rules concerning the appointed actuary's and the qualified actuary's eligibility to sign statutory reports, including rules concerning professional development. Another circular was published, which concerns the appointed actuary's functions, authorities and modes of operation, and the network of relationships between him and the insurer's other office-holders. The circular stipulates that at least once a year, the appointed actuary must submit in writing to the insurer's board of directors and CEO his recommendations concerning the estimate of the insurer's liabilities that will be used for the preparation of financial reports, and participate in the board of directors' meeting at which his recommendations are discussed.

9. External auditor

As a rule, an insurance company's external auditor is subject to the provisions of domestic law concerning an external auditor, and his proficiency and independence. The Insurance Control Law stipulates requirements for the external auditor to report to the audit committee, the CEO and the CMISD in circumstances in which he is aware of a material violation of the provisions of the Law or administrative directives. Draft directives issued by the CMISD prescribe additional arrangements for assuring the independence of the external auditor, on the basis of inter alia SOX directives on this matter, including assurance of rotation between partners, the determination of additional services which the external auditor is prohibited from supplying, and the specification of mechanisms enabling the external auditor to state his opinion on whether the financial reports accurately reflect the insurer's insurance liabilities and to achieve a reasonable degree of certainty regarding the propriety of the assessment of the liabilities.

10. Immediate reports on cessation of service

As stated above, under the Insurance Control Law, notification to the CMISD and no objection on his part is required for the appointment and service of certain office-holders (director, CEO, internal auditor, chairman of the non-yield-dependent investment committee, member of the yield-dependent investment committee, finance manager, actuary, risk manager, information systems manager and legal counsel). A circular issued by the CMISD prescribes the manner in which an application for the appointment of an office-holder is to be submitted, and a questionnaire which the candidate for service must complete. The circular also stipulates that an insurance company must report to the Controller within 14 days from the date on which an office-holder ceases to serve.

More specific directives apply to the cessation of the service of the internal auditor and the appointed actuary:

- According to the CMISD circulars, an immediate report to the CMISD, within three business days from the date of the decision, is required in the event of a decision on the cessation of service or suspension of an appointed actuary and internal auditor, as well as on the resignation of an appointed actuary and internal auditor. If a publicly-traded company is involved, the provisions of the Securities Regulations (Immediate Reporting) also apply with respect to the cessation of the service of an office-holder (up to 13:30 on the same trading day; up to 9:00 on the next day).

- An internal auditor who wishes to terminate his service is required to report to the Controller within three days of the circumstances relating to the cessation of his service.

11. Rules for preventing conflict of interests

Insurance companies are subject to mechanisms for the approval of transactions with related parties and office-holders (audit committee, board of directors and general meeting, as relevant), which apply under the Companies Law, with a distinction being made between the rules applying to a publicly-traded company and the rules applying to a private company.

The investment regulations applying to insurance companies specify additional mechanisms concerning the prevention of conflict of interests. Under the existing investment regulations, an insurance company is prohibited from investing in a party holding 20% or more of a particular type of means of control of this insurance company, and the investment in a party holding 10% or more of a particular means of control of this insurance company is restricted to marketable securities only.

In a recently published draft directive that is up for approval by the Finance Committee, a distinction has been made between transactions with related parties from the funds of participating life insurance plans, and transactions as said from nostro funds:

- With respect to nostro funds, the prohibition on investing in a party controlling or holding 20% or more of a particular means of control in the company and on conducting transactions with it has been retained, the investment in other related parties (including office-holders) is restricted to 10% of an insurance company's equity capital; it was stipulated that transactions with related parties require the approval of the audit committee.
- With respect to the funds in participating life insurance plans, rules similar to those for provident funds and pension funds were stipulated since the insured also bears the investment risk, as detailed below:
 - Investment in an office-holder, in a party controlling and in a party holding 20% or more of a particular type of means of control in an insurance company, and conducting transactions with it from the funds as said are prohibited.
 - The investment in related parties to the insurance company and to its controlling owner is restricted to 5% of the amount of liabilities deriving from participating life insurance plans.
 - The investment in securities for which an underwriter related to the insurance company served as an underwriter in their issue is restricted to 5% of the issue, and in the event that an amount of liabilities exceeding NIS 10 million is involved, to 10% of the issue.
 - An insurance company's transaction with a party related to it (which does not hold or control in it over 20% of a particular type of means of control) requires the approval of 2/3 of the external representatives on the investment committee for the investment of the funds of participating life insurance plans.

12. Volume of participating policies and policy-holders' functions in the corporate regime

The bulk of the insurance company's assets (NIS 98 billion out of NIS 210 billion of assets) is held against liabilities deriving from participating life insurance plans, in which the insureds bear the investment risk. The losses deriving from investment activity in these assets and from volatility in the capital and financial markets do not endanger the stability of the insurance companies and their ability

to fulfil their obligations to the insured, and their impact is reflected in the companies' income from management fees and in their profits.

Under the provisions of the law, policy-holders⁷⁶ are entitled to file a class action against an insurance company in the name of a group of persons for any reason and against any respondent that can be sued in a personal claim.

Table 21 describes the division between total liabilities at all the insurance companies in the economy and the participating liabilities (in NIS million).

Table 23. Ratio of Participating Policies to the Insurance Companies' Total Liabilities (in NIS Million)

Period	Total liabilities	Life insurance/participating policies	Participating policies' share in total liabilities
2007	210,086	98,845	47%
2006	197,064	85,565	43%
2005	182,966	74,226	41%
2004	162,563	61,300	38%
2003	148,719	53,132	36%

Source: CMISD

⁷⁶ The guideline is not specific to participating policies.

ANNEX 2: CALCULATION OF TECHNICAL PROVISIONS

1. Reserve requirements and their calculation for general insurance

For each financial statement (annual and quarterly), the actuary must prepare a report providing details of his work in valuing the allowances, drafted according to the Commissioner's guidelines. There are no detailed guidelines regarding the method to be used in calculating the general insurance reserve or the required safety margin. Actuaries generally use the triangles method, according to paid claims, incurred claims, or average claims – all in accordance with the distribution by year of damage/underwriting/report.

Most actuaries customarily capitalize the reserves and add a given percentage reflecting the standard deviation. Others choose not to capitalize and by doing so leave security margins for valuation. Additionally, some actuaries do not use explicit security margins, using instead more conservative assumptions in the model, such as selecting a method that provides the highest result among all methods. The assumptions used by the actuary in constructing the reserve are generally gathered from the company's experience.

In addition, there are a number of insurance lines (i.e., the liability insurance lines) for which the Commissioner requires an additional reserve for the last 3 or 5 years of underwriting, according to the surplus of revenues over expenses method. (Most companies calculate the surplus over 3 years). For each underwriting year, the reserve is released as profit after 3 or 5 years. The reserve is calculated as follows:

- The revenues are the amount of premiums in the retained-risk amount, re-insurer fees, deferred acquisition costs, and revenues from investments (3% in real terms).
- The expenses are claim payments, fee expenses, general and administrative expenses, outstanding claims, and a reserve for risks that have yet to occur.
- The difference between revenues and expenses is saved as a reserve.

The main items contained in the Actuary's Report are:

- Actuary's declaration - The actuary signs a professional opinion regarding the valuation of the allowances. The format of the declaration is determined by the Commissioner and deviations from this format are prohibited. The declaration is attached to the financial statements as an integral part of these statements and is made publicly available. In the declaration, the actuary provides details regarding, inter alia, his professional connections to the insurer.

The actuary attaches to the declaration quantitative data regarding:

- An allowance for outstanding claims and direct expenses resulting from these claims at the gross and net retained risk levels. The actuary must decide for each insurance line whether it is statistical or not. If the line is a statistical one, then the valuation will be for the specific line, whereas if it is not, the professional opinion is given for all the lines on

a collective basis. Generally, the industries that are not statistical are property loss [insurance], engineering insurance, agriculture insurance, comprehensive place of business insurance, and director/manager liability;

- Allowance for indirect expenses to settle claims, at the gross and net retained risk levels;
- Allowance for premiums deficiency reserve at the net retained risk levels for vehicle compulsory insurance, vehicle property insurance and houses insurance.

In addition, the actuary must provide, at the end of the declaration, comments and explanations regarding his professional opinion, and substantial changes in assumptions and approaches, and the existence of additional insurance lines in which the insurer operates, for which it is not possible to conduct an actuarial valuation and the reasons for this inability to carry out valuations.

- A listing of issues requiring special attention such as exceptional or new phenomena. (This part is reported to the Commissioner only.)
- A report of the development of the valuation of outstanding claims - in this report, the actuary must specify the reasons for substantial surpluses/deficits in the actuarial valuations. Accompanying forms describing the claims development at the gross and net-retained risk levels are attached to this report.
- An analysis of the valuation for each insurance line - the actuary must provide details, for each line, regarding the data and their sources, the methods and assumptions that he used, the reduction for capitalization and the discount rate used for each line.

Similarly, the actuary must provide details regarding the reasons for separating the industries into those that are statistically determined and those that are not statistically determined, and must provide details regarding the industries for which a partial valuation was performed.

- An analysis of the allowance valuation for indirect expenses for claims settlement - the actuary must provide details regarding the expenses taken into account, how the valuation model was constructed, and the amount of the allowance for each insurance line.
- An analysis of the valuation of the allowance for premiums deficiency reserve – The actuary must provide details regarding the industries for which there is such an allowance, the amount of the allowance, and the investigations he performed for determining the need for such an allowance and the model he used.

Likewise, in the financial statements, the company must provide details regarding the central assumptions and methods used by the actuary in constructing valuations for the company's significant industries.

2. Reserve requirements and their calculation for health insurance

For each financial statement (annual and quarterly), the actuary must perform a valuation of the allowances for health insurance drafted according to the Commissioner's guidelines. There are no detailed guidelines regarding the method by which the health insurance reserve is to be calculated.

Actuaries generally use methods such as the gross premium reserve to calculate the reserve resulting from the contractual terms (contract reserve) and payment triangles or payments and estimates triangles for purposes of estimating the outstanding claims. The assumptions used by the actuary in constructing the reserve are generally put together from the company's experience, in accordance with the company's accumulated experience or that of its re-insurers.

The health insurance line is segmented into 6 sub-lines coverage's

- Medical expenses
- Foreign workers
- Severe illnesses
- Dental
- Travel abroad
- Personal injuries

In the financial statements, the data regarding activity in the short-term health insurance industries are reported under the category of general insurance, and data regarding activity in the long-term health insurance industries are reported under the category of life insurance. To the extent that activity in the health insurance industry constitutes a substantial portion of the company's commercial activities – according to criteria set by accounting standards – it is reported as a separate line of activity.

The main topics included in the Actuary's Report are:

- Actuary's declaration - The actuary signs a professional opinion regarding the valuation of the allowances. The format of the declaration is determined by the Commissioner and deviations from this format are prohibited. The declaration (unlike other chapters of the Actuary's Report) is attached to the financial statements as an integral part of these statements and is publicly available; the actuary provides details regarding, *inter alia*, his professional connections to the insurer.

To this declaration, the actuary attaches the amounts of the allowances separately for the amounts reported in general insurance transactions and for the amounts reported in life insurance, and divided according to individual and group policies, at the gross and net retained risk levels. The quantitative data reported includes:

- The allowance for outstanding claims and the resulting direct expenses - reserve for unpaid losses (incurred but unpaid claims) and unpaid allocated loss adjustment expenses (including IBNR).
- The allowance for indirect expenses for claims settlement – reserve for unpaid allocated loss adjustment expenses.
- The allowance due to terms of the insurance contract – the contract reserve. This allowance includes the required allowance when a portion of the premium collected in earlier years during the contract term is earmarked for providing future coverage at a later date, such as allowance for a fixed premium, insurables and policy continuity; in addition, this allowance also includes an allowance for premiums deficiency reserve.
- The allowance for profit participation policies.
- Moreover, the actuary must provide details regarding the influence of various changes on the allowances. These changes include changes resulting from differences between the basic assumptions for the premium and the basic assumptions for the allowance or from differences in actuarial methods, or changes due to assumptions regarding the premiums that are expected to be actually collected or changes due to other adjustments.

- A listing of points requiring special attention such as exceptional or new phenomena. (This part is reported only to the Commissioner.)
- A report of the development of the valuation of outstanding claims - in this report, the actuary must detail the reasons for a substantial surplus/deficit in the actuarial valuations. The actuary must attach an explanation as to how he distinguished between substantial and insubstantial surpluses for each of the sub-lines of coverage. Accompanying forms describing the claims development at the gross and net retained risk levels are attached to this report. (This part is reported only to the Commissioner.)
- An analysis of the valuation for each sub-industry - the actuary must provide details, for each sub-industry, regarding the data and their sources, the methods and assumptions that he used, and the discount capitalization used for each sub-industry.

Similarly, the actuary must provide details regarding the influence of the following changes on the allowances:

- For policies going into effect after the final date in the last annual financial reporting period – the amount of the allowance adjustment resulting from differences between the assumptions used for calculating the allowances and the assumptions used for setting the rates stated in the insurance policies.
- For policies going into effect prior to the final date in the last annual financial reporting period –
 - The amount of the allowance adjustment resulting from changes in the demographic or economic assumptions, between those used in the current financial statements and the assumptions on which the allowances valued for the last published annual financial statements were based.
 - The amount of the allowance adjustment resulting from changes in the method used to calculate the allowances, between those used in the current financial statements and those used to calculate these allowances in the last published annual financial report.
 - The amount of the allowance adjustment resulting from differences between the future premium level taken into account for the last published annual financial statements and the level of the premiums expected to be actually collected. The level of the premiums expected to be actually collected will be estimated on the basis of all of the following: the premium levels indicated in the insurance policies; the premiums actually collected; the expected decline in the rate of premiums to be collected in the future; and any future increase in the premiums approved by the Commissioner.
 - The amount of the allowance adjustment resulting from error corrections.

The actuary must attach a detailed explanation for each significant amount described in accordance with the provisions of this section. (This part is reported only to the Commissioner.)

Additionally, the actuary must provide details regarding the sub-industries upon which a partial valuation was performed and the reasons for such. (This section is provided in a separate form.)

- The analysis of the allowance valuation for indirect expenses for claims settlement - the actuary must provide details regarding the expenses taken into account, how the valuation model was constructed, and the amount of the allowance for each sub-line. (This part is reported only to the Commissioner.)

- A review of the refunds of the balance of deferred acquisition expenses - the actuary must provide details of the activities performed for reviewing the refunds of the balance of the deferred acquisition expenses in the illness and hospitalization industry (including all sub-industries except for personal injuries), the assumptions used in his work, and the conclusions derived from his review. (This part is reported only to the Commissioner.)

Similarly, in the financial statements, the company must provide details regarding the central assumptions and methods used by the actuary in constructing the valuation models for the company's main industries. Moreover, in its financial statements, the company must provide separate disclosure, for the total amount reported in general insurance business and the total amount reported in life insurance business, as well as separately for individual and group policies, with regard to each inconsistency between the valuations detailed in the actuary's declaration and the allowances taken into account for purposes of the financial statements. This disclosure will include: the amount of the allowance in the statements, the difference between the valuation and the allowance, and an explanation of the reason for the difference.

An insurer for whom it is impossible to comply with these instructions for any given health insurance sub-industry must disclose this fact in the notes to the financial statements, along with the reasons for such inability to comply.

3. Reserve requirements and their calculation for life insurance.

The regulations in the field of assessment of insurance liabilities impose on a company's appointed actuary responsibility for recommending the amount of the insurance liabilities (as set in regulation 2007-1-2). To this end he must assess the company's insurance liabilities, applying generally accepted actuarial principles (such as the IAA principles) and exercising professional judgment regarding the methods, assumptions and work procedures employed by him. He must also verify that the information used by him in the assessment is reliable, up-to-date and relevant.

In addition, the regulation in this field imposes on the company's management and on the company officers in charge of overall control responsibility for ascertaining that the company has adequate insurance reserves. Accordingly, these officials are required to examine and evaluate the quality of the assessment process, to apply controls to the processes, methods and assumptions used in the assessment and to assess their suitability, in order to ensure the fair presentation of the company's insurance liabilities.

There are no actuarial bases set by the regulator which the company's actuary must adhere to in the field of life assurance. A committee consisting of actuaries representing the major companies together with a representative of the regulator has been established to make recommendations regarding guidelines to be followed in the assessment of suitable actuarial bases.

The customary underlying reserve regime used for calculating most liabilities is the net level premium basis. This usually uses the premium basis and, by definition, makes no specific allowance for future expenses; this is assumed to be covered by the difference between the gross and the net premium. In order to allow for the high rate of initial expenses including first-year commissions, a Zillmer adjustment was made until 1999. After that, the reserves are adjusted by deferred acquisition expenses (DAC), subject to regular testing of DAC recoverability.

Early policies were written using English Assured Life tables such as A49/52 which contained a considerable mortality margin. Competition has since brought about the introduction of more up to date mortality tables together with allowance for male/female and smoker/non-smoker rates, usually

based on reinsurer's experience which is heavily relied upon. In addition the interest assumptions in the reserve bases incorporate healthy profit margins.

For current policies where the savings element can be identified, the reserve being held is the accumulated value of the investments.

The dangers to insurance companies of improvements in mortality in annuity business were recognized at an early stage. A position paper was issued by the Actuary of the regulator setting out the increase in reserve requirements for this class of business. Since then company actuaries have been required to monitor their experience on a regular basis and justify the use of their actuarial bases.

PHI policies were written for many years based on the Manchester Unity tables published in England; the reserves held were similarly based upon this table. Following the introduction of YRT policies, the portfolio ceased to be in a steady state and the Manchester Unity approach produced inadequate reserves. YRT premium rates were based upon studies carried out by the reinsurance companies who produced incidence and continuance tables using the market experience of the insurance companies. These tables are now used by the insurance companies in determining their reserves, both for old business (written using the Manchester Unity table) and for later business. The method requires active life reserves as well as specific claim reserves.

In a similar way, long-term care products were developed, the reserve basis being the incidence and continuance tables produced by the reinsurers, unless the actuary deemed it necessary for these to be augmented based on actual company experience.

The regulations require the company's appointed actuary to present the following:

- Actuarial Assessment: The Actuary is required to prepare an assessment on every financial statement (annual and quarterly) and to relate therein to the provisions for the insurer's liability due to life insurance contracts and inter alia to each amount according to gross and retention value.
- Actuarial Report: The Actuary must prepare an actuarial report as of December 31 every year, detailing his work in the assessment of all the specified provisions. This report must be submitted to the insurer's CEO and board of directors and attached to the financial reports submitted to the Commissioner. The actuarial report must include at least the following matters, in the format specified below:
- Table of Contents

If one or more of the subjects detailed in the following sections is not included in the report, this must be indicated in the table of contents.

- Part A: Actuary's Statement – Statement signed by the Actuary, including his professional opinion with respect to the assessment of the provisions.
- Part B: The Actuary must refer to points in the report requiring the reader's special attention, such as unusual or new phenomena, as well as to material aspects of the structure of the insurer's reinsurance.
- Part C: Analysis of Life Insurance, including –
 - Specification of the methods and assumptions used by the Actuary for calculating the provisions, from the raw data to the recommended reserve, such as mortality and

morbidity tables and discount interest rate, also noting the portion of the reserve calculated according to each of the different assumptions.

- Specification of the methods and assumptions used by the Actuary for reviewing the reserve adequacy, including identification and quantification of the margin for adverse deviation.
- Part D: Examination of Recoverability of the Balance of Deferred Acquisition Costs – In this part the Actuary must specify the actions taken by him to examine the recoverability of the balance of deferred acquisition costs in life insurance. In addition, the Actuary must detail the assumptions used by him in his work, the conclusions that arose from his examination, and the method of classification of the different policies for the purposes of this calculation.
- Part E: Asset-Liability Management – In this part the Actuary must detail the actions taken by him to examine the compatibility of the liability amounts with the management of the assets for life insurance (asset-liability matching), after consulting with the company's risk manager. If the company does not take such actions, this fact should be noted in this part.
- Part F: Movement in Reserves – In this part the Actuary must detail the change in the insurance reserves (including the loss reserve).
- Part G: Review of Death, Occupational Disability and Long-Term Care Claims – In this part the Actuary must give details of research on the incidence of death among insureds in life insurance, as well as research on the incidence of claims and the duration of claim payments in the occupational disability and long-term care lines. This part is to be attached once in five years.