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INSURANCE IN THE ISRAELI ECONOMY

Yehuda Kahane¹

I. INTRODUCTION

As a modern western country, Israeli citizens and companies have available to them a wide range of insurance. Compulsory social security/social insurance programs are administered by a government agency, while the private sector provides general coverage and life insurance, often with a savings component. This chapter examines both social security/social insurance and private-sector insurance coverage in Israel.

II. THE PUBLIC SECTOR

Social security programs in Israel are administered by the National Insurance Institute (NII), a governmental authority, which was created by a special law enacted in 1954. Although Israeli citizens contribute to NII, NII's transfer payments still require substantial funding from the government. In fact about a quarter of the government's budget goes to social security and health services.

The NII offers a broad spectrum of compulsory coverage for the entire population (mainly on residency basis) against a variety of risks, covering both the employed and the self-employed. It is the governmental agency responsible for the execution of a variety of social laws: coverage for work-related injuries, nursing care at home for old and disabled persons, maternity leave pay and child allowances. The Institute also handles other functions such as payments for victims of hostile activities (war and terrorism), payment of salaries to citizens during military reserve service, an unemployment insurance program, alimony guarantee, etc.

The very diversified programs carried by the NII support people in all stages of life. The NII provides perinatal benefits (e.g., risky pregnancy benefit, maternity leave and maternity grant and allowance). It assists families (e.g., large family al-

1. Yehuda Kahane, B.A. [Economics and Statistics], MA [Business Administration and Actuarial Studies], Ph.D. [Finance] (Jerusalem), is Dean at the Academic School of Insurance, and Professor of insurance, finance and actuarial studies at The Faculty of Management, Tel Aviv University. Dr. Kahane has taught at universities abroad (including Wharton School, University of Texas, University of Florida, and University of Toronto) and serves as a consultant to many organizations.

lowance, child allowance, disability, orphans). It treats people during the working period (e.g., medical treatment for work injuries and their rehabilitation, disability pensions, widows' allowances, unemployment insurance, insurance in case of employer insolvency or bankruptcy, military reserve service insurance, alimony guarantee). And it protects people during old age (e.g., old age pensions, income maintenance, long-term home care).

Since January 1995, the NII is also responsible for the collection of health insurance premiums per a new national health insurance law. It allocates these premiums to the health service providers (mainly four sick funds, which were originally formed by workers' unions) on a capitation age formula. The health insurance program takes care of a wide basket of medical services, excluding mainly certain dental procedures, most geriatric care, most psychiatric care, and some supplementary services (special "hotel" services in hospitals, etc.).

The NII is financed by compulsory contributions of employers and employees, and by full contributions of the self-employed. The aggregate premium rate to the NII ("contributions") is about 21.8% of most components of salary or income, up to a ceiling of four times the average wage in Israel (the average monthly wage in 1996 was about \$1,500). Although there are some exceptions, employers pay 4.9% of the contributions, employees pay 9.7%, and the government pays 7.2%. About 45% of the total sum so contributed is dedicated to health insurance (60% of the employer's contribution, 50% of the employer's and 27% of the government's).

The coverage for the major risks (old age, survivors, and disability pensions) is quite uniform and independent of the individual's income prior to the event. It is based on approximately 16% of the average monthly wage for a single person (24% for a couple). Most people are eligible after 60 monthly contributions. The basic pension is increased according to the period of participation, and according to an income test. Most benefits are adjusted periodically to compensate for changes in the consumer price index.

III. THE PRIVATE SECTOR

1. General

Since Israel numbers among the developed countries, and can even be considered a post-industrial state, it is not surprising that its insurance market is quite developed. Insurance premiums comprise about 6% of GNP, and the 1994 per capita premium stood at approximately \$750. Israel is ranked among the top 20-30 countries in the world by its consumption of insurance, excluding contributions to pension funds, health insurance and social security. Total gross 1994 premiums in the general lines reached NIS 7.2 billion, while life insurance premiums reached NIS 5.8 billion. About 5,000 people are employed by insurance companies, and there are also some 5,000 agents.

Insurers in Israel are permitted to handle both life and general insurance lines under the same management, and most insurers, and all the leading insurers, do

operate in both life and non-life lines. Most insurers in Israel are domestic companies, and very little business is carried by mutual and foreign companies. Some Lloyd's licensees are active, but their market share is small. There are some government companies acting in special lines (a captive for the government risks, a company dealing with political and foreign risks, etc.). More than 95% of the entire premium volume, and almost all life insurance, is handled by domestic companies.

A few domestic companies hold the lion's share of the business in most lines. The concentration is even larger when subsidiaries are grouped together. The three leading groups are Clal (including Clal, Ararat, Aryeh and Eithan), Migdal (including Migdal, Shimshon and Sela), The Israeli Phoenix (Phoenix, Hadar, Dolev, Lanational). The emerging fourth leader is Hamishmar Harel group (Harel, Shiloh, Sahar). These groups handle about 75% of total market premium volume.

Insurance is sold by insurance agents. Recently, a direct insurer entered the market, and a few others applied for licenses. There are more than 3,000 agent members in the agents' association, and many more which are licensed but not members of the association. Israeli insurance law does not distinguish between agents and brokers. An insurance agent is regarded as the long arm of the insurer, except for certain circumstances, when the agent is treated — as a result of a formal request by the insured — as the representative of the insured.

Due to Israel's size, the potential exposures are substantial, in comparison to the equity of all domestic insurers. (The aggregated equity capital of all firms is approximately \$0.7 billion). It is, therefore, not surprising that the Israeli market relies heavily on reinsurance, purchased mainly from the world's leading reinsurers. In the past, Israeli insurers tried to diversify their portfolios by participating in incoming insurance from abroad, but activities ceased due to poor experience in this field. Currently, only The Israeli Phoenix has a subsidiary insurance company abroad (in London). In 1996, two leading reinsurers (the Munich-Re and the Swiss-Re) opened liaison offices in Tel Aviv, likely as a result of the Middle East peace process.

2. Life and Pension Insurance

In order to encourage long-term savings in Israel, the Government has since the late 1950s issued special bonds that are partially or fully linked to the consumer price index. Other institutions issue similar bonds, often with the Government guaranteeing the indexing. Life insurers, pension funds and special long term savings programs are eligible to purchase these bonds at preferred real interest (typically 5.6%) and with full tax exemption. This enabled the offering of attractive schemes to savers, with additional tax advantages, although the issuance of these bonds for new savers declined and then stopped towards the end of the 1980s.

Most employees and self-employed in Israel are insured in these programs, which are often financed jointly by the employer and employee. The employer is responsible for severance payments (usually one month's salary for each year of employment) and, therefore, a sum equivalent to 8.33% of the employee's current salary is often saved by the employer in a special fund. In addition, 5% of the employee's

salary, matched by the employer, is set aside for a savings, pension, or insurance scheme.

A popular program is based on 17.5% of the employee's salary: 5.5% by the employee and 12% by the employer.

Such programs are managed by the Histadrut's² pension funds and insure about 600,000 employees — especially in firms which have signed collective employment and wage agreements. These pension funds suffer from substantial actuarial deficits. In March 1995, the Government announced a new pension policy, which, in essence, prevented these funds from accepting new insureds, and gave a government guarantee for their liabilities to current members, subject to some financial measures to reduce the deficits.

Recently, new, actuarially-balanced pension funds have been introduced in the Israeli market. After a long period, during which the establishment of new pension funds had not been approved by the Commissioner of Insurance, about ten funds were established at the beginning of 1996, some of them owned by insurance companies. These new pension plans are often marketed by life insurance agents.

Pension funds and bank trust funds compete with life insurance companies in these areas. The competition is quite fierce, with significant lobbying by industry groups attempting to change insurance and banking regulation in their favor.

It is noteworthy that the Government's exit from the special bonds arrangements led to a major reform in life insurance products. The sale of traditional, index-linked policies, which have been the bread and butter of the industry for three decades, has been discontinued. The new policies are universal life policies, which participate in the investment income of the insurance companies.

3. Compulsory Classes of Insurance

Every car owner must hold, and present upon request, a valid policy that covers bodily injuries resulting from traffic accidents. The policy is essentially unlimited, and covers on a pure no-fault basis. There is a ceiling for the loss of income benefit (2.5 times the average wage), and limits on the compensations to be paid for pain and suffering.

Under the no-fault system, introduced in 1976, the policy covers the driver and passengers riding in the vehicle (including the policyholder) and pedestrians hit by the car. Uninsured victims are compensated through a special fund (Karnit). The insurers operating in this line are reinsured and co-insured by "Avner," a pool established for that purpose. A typical passenger car policy costs the equivalent of about \$600.

2. The Histadrut, the General Federation of Workers in Israel, is Israel's major trade union association and, though it is a declining role, the Histadrut is also a major employer through its large member-owned enterprises.

4. Government Regulation

The insurance industry is subject to the control of a Commissioner of Insurance, an official of the Ministry of Finance. The commissioner operates according to the *Insurance Regulation Law, 1981*, and is advised by an industry-based Insurance Council. The Commissioner's office is responsible for the license and control of insurance companies and agents. All insurers must submit annual reports, and they are sometimes subject to more detailed examination. The Commissioner must approve insurance policies, forms and rates, an impossible mission at present due to the lack of manpower and poor statistical data bases. The Commissioner of Insurance is also responsible for the savings and capital markets. This reflects the old concept that insurance is an instrument for raising money for the government.

Despite the office of Commissioner of Insurance, several companies have become bankrupt in recent years. One, Hasneh Group, which at one time collected up to 40% of all premiums in Israel, collapsed in December 1992. Most of its portfolios were purchased by Clal and Migdal, and policyholders, fortunately, were almost unaffected.

Insurers are, of course, subject to the internal revenue system regulation. The Union of Life Insurers reached certain agreements concerning the calculation of life insurance reserves, which affect tax liabilities. More sophisticated loss reserving techniques are slowly penetrating the life market, as they also are with respect to general lines (especially the long tail business).

Life insurance accounts are separated from general insurance accounts, and premiums are subject to special regulation concerning their investment.

5. Insurance Lines

The organizational structure of an Israel insurance company and the lines of business and policy forms are quite similar to those in other western countries. Therefore, we shall discuss here only some particular aspects which may be of some interest.

Due to rapid inflation of the early 1980s, most policies are indexed. Non-life policies are often linked to the dollar or to the consumer price index. Large firms often buy their coverage directly abroad, or through fronting arrangements with local insurers. Many large commercial policies are co-insured by several insurers. These policies are often arranged by large agencies which specialize in commercial and industrial insurance and which often employ consultants.

Israel is regarded as a mild earthquake risk. Due to supply and demand problems, large firms cannot purchase earthquake and natural risks insurance to the full value of their property, and often must purchase coverage which is subject to loss limits.

Most Israelis live in apartments they own (which are part of a condominium arrangement) and many of them buy a standard homeowner policy, which until recently included automatic coverage for earthquake risks. Since 1994 this coverage is optional. Many policies are sold in connection with mortgage arrangements, often

through a mortgage bank agency.

Automobile property damage and third-party property damage insurance is not compulsory. There is a standard policy. About one-third of premiums collected are paid to cover losses due to theft, reflecting a severe theft problem where 2.5% of all cars are stolen annually. The high theft rate is attributed to the relationships with the occupied territories and the Palestinian Authority.

The professional liability crisis is gradually reaching Israel, but is far from reaching the North American level. Medical malpractice claims and class action claims against firms have caused dramatic increases in the premium rates for these types of insurance.