Chapter 5
Institutional Investors

The proportion of the public’s savings with institutional investors—provident and severance pay funds (henceforth, provident funds), advanced study funds, pension funds and life insurance plans—remained stable during 2001 at the levels of the previous two years, and amounted to 31 percent at the end of December 2001.

The proportion within the public’s asset portfolio of mutual fund holdings continued to rise and reached 5.3 percent in December 2001 compared with 4.1 percent in December 2000, mainly due to the positive accrual in them and especially in the shekel-oriented funds. In 2001, the public chose to withdraw money from the provident funds—long-term channels of saving—and to direct most of it to short-term channels of saving—mutual funds and shekel deposits. This was a reflection of the public’s structural adaptation of their asset portfolio, a development that resulted *inter alia* from the increased risks in the market and particularly in long-term tradable saving instruments.

Despite the withdrawal of money from the provident funds, the proportion of institutional investors in medium and long-term saving is continuing to rise, mainly due to the increased proportion of profit-sharing type life insurance plans, advanced study funds and new pension funds, in which a positive accrual\(^1\) was recorded. It should be emphasized, however, that the proportion of institutional saving in the asset portfolio and in total medium and long-term saving is very low relative to its proportion in the middle of the previous decade.

Institutional investors directed their funds at unindexed shekel holdings during 2001, mainly at the expense of their investments in shares. The background to this adjustment process was the consolidation of the low inflation environment, the expectations of a reduction in the Bank of Israel’s interest rate and the actual reduction in the interest rate, which created expectations of high returns on

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\(^1\) Although there are no data on the accrual in life insurance plans, it can be assumed that the plans recorded a positive accrual during 2001 on the basis of the 10 percent real increase in their assets.
tradable shekel investments, and the large drop in prices in the equity market.

A notable development in the regulatory procedures governing the institutional system in 2001 was the enactment of new investment regulations for the insurance companies (profit-sharing policies) and the provident funds. These regulations reflect a new concept of major liberalization, meaning everything is permitted except for what is expressly prohibited. This concept has led to the abolition of most of the quantitative restrictions alongside an increase in the stability-oriented restrictions or in other words, a move from direct and individual supervision to indirect supervision. Institutional investors have been given almost complete freedom in their investment decisions concurrent with minimal intervention by the supervisory authorities. New investment regulations for the pension funds are at an advanced stage of preparation at the Ministry of Finance. The prevailing concept in this respect is freedom in choosing the “unrestricted” part of the pension funds’ assets, as with the regulations applying to the provident funds. During 2001, a number of changes were made to the regulations for joint trust investments. These changes concern activity in derivatives, short sales and the leasing of securities.

A decision was taken within the framework of a joint Bank of Israel and Ministry of Finance program for structural changes in the financial markets to increase institutional investors’ permitted rate of investment abroad from the present level of 5 percent to 20 percent, and to remove this ceiling at the end of 2002. The change will enable institutional investors to disperse their assets more widely.

1. INTRODUCTION

Pension funds—institutional investors with a long-term investment horizon—are still lacking in the Israeli capital market. Their absence impairs the functioning of the market and as a result, the financial stability of the Israeli economy. A reform in this area was started at the beginning of the previous decade, leading to the termination of issues of earmarked bonds to the provident funds and to the life insurance plans’ new members, and to the establishment of pension funds for new savers in which the required rate of investment in earmarked bonds is lower than in the old pension funds. Although these changes have increased the involvement of the provident funds and insurance companies (with the profit-sharing type policies) in the capital market, most of the money held in long-term saving is still outside this market. This is apparent from the fact that despite the reform in the pension industry in 1995, issues of earmarked
bonds for the pension funds increased from NIS 5.8 billion when the reform was first implemented in 1995 to NIS 10.6 billion in 2001.

Some progress was made during the 1990s with respect to institutional investors’ holdings abroad, and it was decided that the ceiling on their investments abroad would be abolished at the end of 2002. These changes were intended to enable institutional investors to disperse their assets more widely. But this opportunity will not be exploited until the tax discrimination between their investments in Israel and their investments abroad is abolished. (Currently, only insurance companies are not liable to tax on capital gains abroad.) A comprehensive overhaul of the tax system is therefore required that will put an end to the entire range of tax discriminations between different instruments, between different investors and between different markets.

Another measure for reforming the regulatory procedures governing institutional investors’ activity in the Israeli capital market was implemented in 2000, with the introduction of new investment regulations for the insurance companies (with profit-sharing type policies) that reflect a new concept of major liberalization. From now on, everything is permitted except for what is expressly prohibited. The change implemented with respect to the provident funds is similar.

The completion of the reform process in the area of institutional saving, as part of the reform of the financial markets, is essential for developing a broad capital market—in itself a vital condition for sustained growth. The pension funds that have opened since 1995 should be closed to new members and funds that will operate only in the market should be opened. Members should be offered maximum mobility between funds, and information and advice mechanisms should be established for members.

### Table 5.1
**Institutional Investors: Main Developments, 2000-2001**

<table>
<thead>
<tr>
<th></th>
<th>% of asset</th>
<th>Net accrual</th>
<th>Real yield %</th>
<th>% of asset</th>
<th>Net accrual</th>
<th>Real yield %</th>
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<td>123.8</td>
<td>10.4</td>
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<td>Advanced study funds</td>
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<td>3.8</td>
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<td>3.6</td>
<td>48.0</td>
<td>4.0</td>
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<td>Pension funds, established</td>
<td>105.4</td>
<td>9.4</td>
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<td>109.4</td>
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<td>Pension funds, new</td>
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<td>Guaranteed yield</td>
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<td>Total</td>
<td>391.6</td>
<td>35</td>
<td>7.1</td>
<td></td>
<td>432</td>
<td>36.4</td>
</tr>
</tbody>
</table>

**SOURCE:** Monetary Department, Bank of Israel.
2. THE MUTUAL FUNDS

a. The Development of assets

The balance of the mutual funds’ assets totaled NIS 63 billion in December 2001, a real increase of 36 percent compared with December 2000 following respective real increases of 28 percent and 55 percent in 2000 and 1999 (Table 5.1). This increase was the continuation of a trend that began in 1997 following three years of decrease (1994 to 1996), at the end of which the funds’ assets reached NIS 15 billion.

The increase in the funds’ asset balance during 2001 derived from a positive accrual of NIS 15.4 billion, which was centered among funds that specialize in investment in unindexed shekel assets (henceforth, the shekel funds) and among funds that specialize in bond investments (Table 5.1, Figure 5.1). The positive accrual in the mutual funds came as a continuation of the trend of the previous four years. The extent of the accrual in 2001 was greater than in 2000 (Figure 5.1).

The influx of money into the mutual funds during 2001 was not uniform: Most of the accrual was centered in the shekel funds, in the funds specializing in bond investments, in the funds specializing in foreign currency investments and in those specializing in investments abroad while a negative accrual was recorded in funds that invest in shares (‘share,’ ‘flexible,’ and ‘mixed’ funds) (Figure 5.1). This change resulted from developments in the money and capital markets.

(1) Shekel funds

The large accrual in shekel funds during recent years derived from the fall in the inflation environment and from the increased expectations of a reduction in the Bank of Israel’s interest rate. These led to high rates of return on tradable unindexed shekel assets, and thereby increased the attractiveness of investment in these funds while the risk involved decreased. The main reasons for the flourishing of the shekel funds during recent years are: the increased supply of unindexed bonds; the tax advantages for firms that invest in these funds; the low rate of management fees and especially the minimal purchase fees, which have made them more liquid and therefore preferable to the other funds; and their substitutability for deposits at the banks.

Major changes recorded in the accrual trends in the shekel funds during 2001: Until June 2001, expectations of an interest rate cut prevailed, increasing the attractiveness of the investment in unindexed shekel bonds via the shekel funds, and leading to an improvement in their yield relative to shekel deposits. This development resulted in a large accrual in the shekel funds that totaled NIS 13 billion in the first half of the year, following an accrual of NIS 15 billion during the years 1999 to 2000. During the months July to September when uncertainty rose, as reflected by the rise in yields in the capital market and the rise in inflation expectations, the attractiveness of investment in tradable unindexed shekel holdings decreased. As a result, the trend of accrual in the shekel mutual funds changed completely and during the period NIS 10.5 billion were
withdrawn from them. Of this amount, NIS 2.5 billion were withdrawn from the long-term funds, in which the chance of losing during a period of expectations of a rise in interest rate is greater. When the wave of withdrawals began, the shekel funds preferred to finance them by selling shekel deposits and cash and only when the withdrawals increased, during August and September, were the shekel funds forced to sell their holdings in treasury bills and Shahar bonds. In October, when the capital markets became calmer and the level of inflation expectations fell, the wave of withdrawals ceased.

At the end of December 2001, when the Bank of Israel cut the interest rate on its sources by 2 percent, as a result of which the shekel depreciated by 2 percent until the end of the year, the positive accrual in the shekel funds fell heavily due to the transition of money to funds that invest in foreign currency, to funds that invest abroad and to the share-oriented funds.

(2) Distribution of the mutual funds’ asset portfolio
The proportion of unindexed shekel assets in the portfolio continued to rise during 2001, concurrent with an increase in the proportion of investment in CPI-indexed and foreign currency assets (Figure 5.2). The proportion of shares in the portfolio fell heavily because of the effect of the recession in world capital markets on share prices in Israel, from 21 percent in December 2000 to 12 percent in December 2001 (Figure 5.2). The proportion of unindexed assets in the mutual funds’ asset portfolio now greatly exceeds the proportion of the other components, compared with the opposite situation in the first half of the 1990s. This development balances out the situation of the long-term channels of institutional investment.

Treasury bills were the preferred form of investment in unindexed shekel assets during 2001 compared with Gilon and Shahar bonds in 2000, a development that shortened the average term-to-maturity of the unindexed assets in the portfolio. This development was reflected by a growth in the funds’ share of the treasury bill market from 32 percent in December 2000 to 43 percent in December 2001, and by a decrease in the funds’ share of the unindexed government bond market from 32 percent in 2000 to 28 percent in 2001.
The change in the mutual funds’ asset specialization reflects the change in the distribution by form of investment: The proportion of shekel funds has increased since 1995 concurrent with a decrease in the market share of funds specializing in other assets, particularly the share-oriented funds and funds that specialize in government bonds (Figure 5.3). Shekel specialization is currently the predominant form of specialization in the mutual fund industry, and eleven of the largest funds are shekel funds.

b. Yield developments

The mutual funds yielded a positive real return of 3.8 percent in 2001, compared with 23.5 percent in 1999 and 4.4 percent in 2000 (Figure 5.4). The funds’ real return reflects a positive real yield in all specialization bases except for shares (the ‘share-oriented,’ ‘mixed,’ and ‘flexible’ funds) and investments in securities abroad (Figure 5.4). The share-oriented funds took a relatively high risk in the management of their asset portfolios because they invested during periods of an actual downturn in prices, when this downturn was expected to continue. The share-oriented funds achieved very low returns compared with the other funds. The best performing funds were those investing in foreign currency, CPI-indexed bonds, government bonds and the shekel funds.

Although the mutual funds with a flexible investment policy might have been expected to have an advantage over the other funds, these funds actually recorded a negative real return during the last two years (13 percent in 2000 and 12 percent in
2001 compared with the positive real return on part of the other funds. This was because the majority of the ‘flexible’ funds’ assets are invested in shares, which yielded negative returns during those years. In contrast to the declared policy in their prospectuses, these funds do not appear to be managed in a dynamic and flexible manner.

The mutual funds’ yield volatility declined in 2001 reflecting the risk inherent in investing via these funds. After amounting to 4 percent in the previous year, the nominal implied volatility of the yields recorded in each month of the last 12 months fell to one and a half percent, mainly due to the reduced component of share investment in the funds’ asset portfolios.

c. Developments in the mutual fund industry

(1) Structural developments

The proportion to total mutual fund assets of fund assets managed by the banks rose from 83 percent at the end of 1999 to 89 percent at the end of 2001 (the increase began in 2000), following a consistent decrease since the beginning of the previous decade. A situation in which the banks manage the majority of the mutual funds’ assets represents a structure of imperfect competition, which hinders the entry of additional entities into the Israel capital market and thereby restricts the development of the market. The banks’ ownership of the funds should therefore be gradually abolished.

![Figure 5.3 Composition of the Mutual Funds' Assets Portfolio According to Specialization, 1995–2001](image)

**Figure 5.3**
Composition of the Mutual Funds’ Assets Portfolio According to Specialization, 1995–2001

SOURCE: Monetary Department, Bank of Israel.
The number of funds operating in the mutual fund industry increased considerably during 2001 when 77 new funds were established, 46 of them in December 2001 due to marketing considerations. Most of the increase was in funds that specialize in investment in shekel assets, shares and foreign securities. Two new specialization bases were apparent among the new funds that were issued in December 2001: investment in the euro and investment in bonds in the international markets. Four new fund managers joined the industry in the course of the year—Clal, Mercantile Discount Bank, Bank Massad and Bank Yahav.

(2) Regulatory procedures
A number of changes were made in the regulations governing joint investments in trust during 2001. The changes relate to options, futures contracts and short sales, and mainly concern the development of a mechanism that is intended to limit the risk of losing money due to the fund manager’s activity in the derivatives market, and the minimization of the restrictions on activity. The new regulations provide the fund managers with greater flexibility than in the past with respect to the activities in question, and are intended to ensure that investment committees monitor their activity more closely. The framework of the new regulations is also more universal. As an example, a fund manager can include securities of different types in the calculation of collateral, and not only liquid assets as was the case under the old regulations.
3. THE PROVIDENT FUNDS AND THE ADVANCED STUDY FUNDS

a. Asset developments

Net withdrawals of money (members’ withdrawals minus members’ deposits) from the provident funds were maintained at a large scale during 2001, a trend that began in 1994. This phenomenon reflects a structural adaptation in the public’s asset portfolio, which is apparent from the transfer of savings from the provident funds to fixed-yield short-term shekel investments, such as shekel deposits and mutual funds. This preference is attributed to the fall in prices in the equity market, which adversely affected the provident funds’ yields, the high level of the interest rate expected on short-term shekel investments, and the funds’ lack of dynamic management. The increased volatility of the provident funds’ yields was also a major reason for the public’s increased awareness of their level of risk, which was expressed by the scale of the negative accrual in the funds. (See the Monetary Department’s Annual Survey for 1998 and 1999.)

The balance of the provident funds’ assets totaled NIS 124 billion in December 2001, a real decrease of 1.7 percent compared with 2000 when the balance fell by 2.2 percent in real terms (Table 5.1). The decrease in 2001 mainly resulted from net withdrawals of money. The real yield on the provident funds’ investments in 2001 amounted to 6.4 percent, compared with 13.5 percent in 1999 and 3.4 percent in 2001 (Table 5.1).

A total of NIS 4.2 billion in 2001 and NIS 38 billion since 1994 were withdrawn from the provident funds (Table 5.1). It should be noted that the year 2001 was notable for both a growth in deposits and a larger increase in withdrawals compared with 2000. As a result, the proportion of the provident funds in the public’s asset portfolio, and in medium and long-term saving decreased (Table 5.1). However, the funds remain an important component of long-term saving due to the tax benefits granted to those saving in them.

The balance of the advanced study funds’ assets totaled NIS 48 billion in December 2001, a large real increase of 12 percent compared with 2000 (Table 5.1). The increase is attributed mainly to a net surplus of deposits of NIS 2.5 billion, and partly to the positive return of 6.9 percent yielded by the funds’ assets (Table 5.1).

Since 4.5 percent of a self-employed member’s taxable income deposited in an advanced study fund was recognized for tax purposes in 1998, the advanced study funds have become one of the most attractive investments for the self-employed. The funds constitute a medium-term form of investment, in which part of the money is liquid, and confer tax benefits at the deposit and withdrawal stages.

*Distribution of the provident funds’ and advanced study funds’ asset portfolio:*

The proportion of tradable government bonds, which are an important component of the funds’ asset portfolio (47 percent) increased during 2001 concurrent with an increase in the proportion of corporate bonds (mainly non-tradable bonds), principally at the expense of the share component of the portfolio (Figure 5.5). The decrease in the
proportion of shares in the funds’ asset portfolio resulted from the reduced value of shares in the market, and not from a large active decrease in their share holdings. The increased proportion of corporate bonds and particularly non-tradable corporate bonds in the funds’ asset portfolio is attributed to the recent growth in private issues in the economy (see Chapter 4).

The changes in the advanced study funds’ asset portfolio were similar to those in the provident funds’ portfolio. But while the tax benefits on both these forms of investment are similar, the funds differ in other aspects – in the saving horizon, in the saver’s eligibility (the self-employed compared with salaried employees) and in the extent of liquidity.

b. Developments in the provident fund industry

(1) Structural developments

The provident fund industry is notable for the high concentration of the banks, which manage the majority of the funds’ assets: The three largest banks together hold 73 percent of all provident fund assets; the remainder are managed by the Histadrut (Labor Federation), enterprises, and other organizations. This situation impairs the competitiveness and efficiency of the capital market as a whole and the tradability of the local bond market in particular, and creates a potential for conflicts of interest (see Box 4.2). One of the reasons for this problematic situation is the banks’ control of the provident funds distribution system and the limited opportunity—only once a year—
for moving from fund to fund. Since hardly anything has been done to reduce concentration in the industry until now, action should be taken to gradually reduce the banks’ ownership of the funds.

(2) Regulatory procedures
In 2001, the Ministry of Finance issued new draft investment regulations (henceforth, the regulations) for the provident funds that were due to be submitted for approval by the Knesset Finance Committee at the beginning of 2002. The regulations reflect a new concept whereby everything is permitted except for what is prohibited, namely a move from direct and individual supervision to indirect supervision, with a fund being permitted to make investment decisions and manage its assets and liabilities subject to minimal intervention by the authorities responsible for supervising the capital market.

To date, the Finance Ministry has defined the types of assets and the holding ratios permitted for the provident funds. Under the new regulations, the funds are permitted to invest in any asset, subject to a number of stability-related restrictions and restrictions relating to the control of corporations. The regulations do not place a quantitative restriction on investment abroad. The current restriction in this respect (5 percent of total assets) is stipulated by the Controller of Foreign Currency. The funds do not utilize the entire investment potential permitted to them (Figure 5.5), because of the tax discrimination between local investments and investments abroad.

Under a joint program of the Bank of Israel and the Ministry of Finance concerning structural changes in the financial markets, it was decided to raise the provident funds’ permitted rate of holding from the current level of 5 percent to 20 percent and to abolish this ceiling at the end of 2002. But until the problem of tax discrimination is solved, the funds will not be able to realize their investment potential.

4. THE PENSION FUNDS

a. The pension funds for established members

The asset balance of the pension funds for established members totaled NIS 109 billion in December 2001, a real increase of 2.4 percent compared with 2000 (Table 5.1) due to the guaranteed yield on earmarked bonds. NIS 2.9 billion were redeemed from the pension funds for established members in 2001, compared with NIS 2.1 billion in 2000. The pension funds for established members have actuarial deficits that were estimated at NIS 56 billion2 at the end of 2000. Since 1995, new members have only been allowed to join the new pension funds and not the established pension funds. As a result, the provisions for the former are gradually decreasing concurrent with a growth in the amount of remuneration paid to existing members.

The pension funds for established members must invest at least 93 percent of their assets in Miron earmarked bonds, which provide an effective annual interest rate of 5.6

2 On the basis of the pension funds’ actuarial reports.
percent. As in the past therefore, 95 percent of their assets were invested in these bonds during 2001 (Figure 5.6).

b. The pension funds for new members

The asset balance of the pension funds for new members totaled NIS 11 billion in December 2001, a real increase of 39 percent compared with 2000, and the net accrual in them amounted to NIS 2.6 billion compared with NIS 2.0 billion in 2000 (Table 5.1).

Since 1995, when the government decided to close the established funds to new members, the proportion of the funds for new members has increased in the public’s asset portfolio and in medium and long-term saving, mainly due to the number of new members joining these funds (Table 5.1).

Approximately sixty six percent of the assets of the pension funds for new members are invested in earmarked bonds, 17 percent are invested in tradable government bonds, 3 percent in shares and the rest in other assets (Figure 5.6). The funds are utilizing the entire investment potential permitted to them in Arad earmarked bonds that bear an effective annual real interest rate of 5.05 percent—70 percent of the net accrual each month. Since the reform in the pension industry, issues of earmarked bonds to the new pension funds rose from NIS 87 million in 1995 to NIS 1,928 million in 2001.
c. Developments in the Pension Fund Industry

(1) Structural developments
Eighteen pension funds for established members and 17 new pension funds were operating at the end of 2001. Three ‘guaranteed yield’ funds ³ (which are similar to defined contribution funds), and another six funds of this type are due to open in 2002. Despite the pension arrangement that began in 1995 and led to the opening up of the pension fund industry to competition and while private pension funds operate to a limited extent, the majority of pension fund assets in the economy (99 percent of the funds’ total assets) are still held by Mivtahim, the largest fund that is managed by the Histadrut. The three largest new pension funds together hold 76 percent of the funds’ total assets. Most of the new funds are managed by the organizations that also manage the established funds. The main reason for the high degree of concentration in the industry is the lack of freedom of choice, and the limited opportunity for moving from fund to fund. The concentration in the industry should therefore be reduced by abolishing the arrangements that assure a new monopoly on financial saving.

(2) Regulatory procedures
The Ministry of Finance has almost completed new draft investment regulations concerning the unrestricted part of the pension funds’ assets, namely that part of the accrual which is not invested in earmarked bonds. The new regulations are similar to those applying to the provident funds [see Paragraph 5.3.2(2)].

Box 5.1
The Problematic Nature of Government Arrangements Concerning the Issue of Earmarked Bonds to the Pension Funds

Under the existing pension arrangements, the government requires the pension funds in Israel to invest the majority of savings accrued with them in earmarked government bonds, which yield a fixed real return that is not dependent on returns in the market. This arrangement impairs the functioning and the efficiency of the local capital market, thereby detracting from the economy’s ability to achieve a course of sustained growth and the ability to integrate in worldwide capital markets. The main implications of these arrangements are as follows:

1. Impairing the economy’s ability to achieve its growth potential over time: Since the local capital market is small and the tradability in it is relatively low, it is unable to function as an effective meeting place between savers and investors. The business sector’s ability to raise capital in this market is therefore relatively low, which is reflected by the high costs of raising capital.

³ A fund that guarantees a member at least old age and inheritors’ rights that are derived from the monetary accrual, and which change on the basis of this accrual.
2. The government’s limited flexibility in managing its debt: The future liability that the government has taken on itself in the existing pension arrangements that are not budgeted in advance, is a persistent impediment to the management of fiscal policy, which limits the government’s ability to determine the extent and the composition of its borrowing requirements.

3. The local capital market’s ability to integrate into worldwide capital markets: The absence of the pension funds – which are institutional investors with large volumes of assets and that have a long investment horizon – from the local capital market impairs the tradability, competitiveness and efficiency of the secondary market, which are essential conditions for encouraging foreign investors’ entry to the market.

4. The adverse effect on the capital market as a whole and on the tradable government bond market in particular: Extensive issues of earmarked bonds impair the tradability of the local capital market because a large part of government borrowing is external to the bond market. This situation is artificially reflected in the level of long-term real yields and the interest rates on mortgages, for which the long-term real interest rate serves as a benchmark. The adverse affect on the tradable market is increasing because of the decrease in the government’s borrowing requirements over time as the budget deficit is reduced, concurrent with the requirement to issue earmarked bonds. The situation is also impeding the development of the corporate bond market, which is an important part of the bond market as a whole (see Box 4.2).

The pension fund arrangements need to be changed in view of the damage that they have caused. Even many years after their implementation, it should be noted, the pension funds have been suffering from large actuarial deficits which have led to doubts as to their ability to pay pensions to those eligible. The desired change should take the form of an end to the issue of earmarked bonds for new savers, and the direction of new savers’ money to the capital market. The successful reform of the insurance industry a decade ago should be taken as an example in this respect. In addition, it is important that members be assured of convenient mobility from fund to fund, and they should be provided with an advice and current information network that will help them to make decisions concerning the form of financial saving that is suited to them.

5. THE LIFE INSURANCE PLANS

a. The guaranteed-yield life insurance plans

The asset balance of the ‘guaranteed-yield’ life insurance plans was estimated at NIS 42 billion in December 2001, a real increase of 2 percent compared with 2000 (Table 5.1). These plans were closed to new members in 1991, with the result that their
proportion to total life insurance plans in the public’s asset portfolio has been declining since then (Table 5.1). Plans of this type are entitled to issues of Hetz earmarked bonds that bear a CPI-indexed rate of interest of between 4 percent and 6.2 percent, on 86 percent of the funds accrued in them. Accordingly, the majority of the assets are invested in earmarked bonds and only the remainder are invested in other assets (Figure 5.7).

When real yields fell in 2001 the volume of tenders for the early redemption of earmarked bonds held by these insurance plans contracted. The small amount of NIS 0.5 billion of bonds were redeemed, and the average interest rate at the tenders was in the region of 4 percent. This is in addition to the NIS 2.9 billion that the Finance Ministry redeemed in the previous two years (see the box in Chapter 4 of the Monetary Department’s annual survey for 1999). In 2002, further tenders for the early redemption of earmarked bonds are expected. This will serve as a means for the Finance Ministry to rid itself of an expensive and non-tradable long-term debt. Tradable bonds were issued instead. This process is contributing to the increased sophistication of the local capital market, and should be applied to the pension funds as well as the insurance companies (Box 5.1). The process should also be speeded up as part of the desirable measure of rolling-over the debt.
b. The profit-sharing life insurance plans

The proportion of ‘profit-sharing’ life insurance plans (which have existed since 1991) has gradually increased during recent years, both in the public’s asset portfolio and in total life insurance plans (Table 5.1).

The asset balance of ‘profit-sharing’ life insurance plans was estimated at NIS 35 billion in December 2001, a real increase of 15 percent compared with 2000. Since these plans are entitled to invest in earmarked bonds, most of the accrual of funds in them is invested in the tradable capital market (Figure 5.7). Their share in the securities markets (6 percent of the tradable government bond market, and 12 percent of the tradable corporate bond market) is therefore larger than that of the guaranteed-yield plans. However, their proportion in the equity market is still relatively low at 2 percent. In 2001, the profit-sharing plans were permitted to invest abroad, and their actual investments abroad totaled NIS 1.4 billion.

The proportion of tradable assets in the profit-sharing plans’ asset portfolio declined during 2001: The proportion of non-tradable corporate bonds and long-term deposits increased, at the expense of the proportions of tradable bonds and shares, which fell.

c. Developments in the insurance industry

In 2001, the Knesset Finance Committee approved new regulations for the insurance companies’ investments. The new regulations are essentially similar to those applying to the provident funds—see Paragraph 5.3.2(2).