Economic Solvency Ratio Report of Harel Insurance Company Ltd.

As at December 31, 2021

This English translation from the Hebrew version of the report (published on May 30, 2022), is for convenience and information purposes only.
In case of any contradiction or discrepancy between this English translation and the original Hebrew version, the Hebrew version shall be the binding version.
The Company makes no representations as to the accuracy and reliability of the financial information in this English translation.

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Harel Insurance Company Ltd.

As at December 31, 2021

Somekh Chaikin
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03-6848000

To:
The Board of Directors of
Harel Insurance Company Ltd.

Re: Review of the implementation of certain instructions issued by the Commissioner of the Capital Market, Insurance and Savings with respect to the Economic Solvency Requirement of Harel Insurance Company Ltd. ("the Company") as at December 31, 2021

We have reviewed the Solvency Capital Requirement ("SCR") and the Own Funds of Harel Insurance Company Ltd. as at December 31, 2021 ("the Information"), which is included in the Company's Economic Solvency Ratio Report attached hereto ("the Report").

The Board of Directors and Management are responsible for the preparation and presentation of the Information prepared in accordance with the instructions of the Commissioner of the Capital Market, Insurance and Savings ("the Commissioner") with respect to the Economic Solvency of insurance companies based on Solvency II, as included in Insurance Circulars 2020-1-15 and 2020-1-17 dated October 14, 2020, in the updates and clarifications to these circulars and in accordance with the Commissioner's instructions regarding the principles for calculating the Transitional Measures on Technical Provisions ("TMTP") in an Economic Solvency regime based on Solvency II dated October 15, 2020 ("the Instructions").

The calculations, forecasts and assumptions that formed the basis for preparation of the Information are the responsibility of the Board of Directors and Management.

Our review was conducted in accordance with International Standard on Assurance Engagement ISAE 3400 - Review of Prospective Financial Information and in accordance with the Commissioner's directives, as included in Appendix B to Insurance Circular 2017-1-20 dated December 3, 2017, detailing instructions with respect to the audit of an Economic Solvency Ratio Report.

We did not review the reasonability of the TMTP as at December 31, 2021, as presented in Section 3.A of the report, other than to check that the TMTP amount does not exceed the expected discounted amount of the Risk Margin and the Solvency Capital Requirement in respect of life and health insurance risks for existing business in the transitional period, based on the pattern of future development of the required capital that affects calculation of the expected capital release, as well as release of the projected Risk Margin, as specified in the provisions concerning calculation of the Risk Margin.

Except for the foregoing regarding the reasonability of the TMTP amount, based on the review of the evidence supporting the calculations, forecasts and assumptions, as mentioned below, which were used by Company's Board of Directors and Management in preparing the Information, nothing has come to our attention that might cause us to believe that the forecasts and assumptions, in their entirety, do not provide a reasonable basis for the Information in accordance with the Instructions. Furthermore, in our opinion, the Information, including the method of determining the assumptions and forecasts, was prepared, in all material respects, in accordance with the Instructions, and presented, in all material respects, in accordance with the Instructions.

It should be emphasized that the forecasts and assumptions are based mainly on past experience, as arising from actuarial studies conducted from time to time. In view of the reforms in the capital market, insurance and savings, and changes in the economic environment, past data do not necessarily reflect future performance. In some cases, the Information is based on assumptions about future events and management activity as well as patterns of the future development of the SCR and Risk Margin that will not necessarily materialize or that may materialize differently from the assumptions that formed the basis for the Information. Additionally, actual results might differ significantly from the Information, given that the combination of scenarios of events might materialize in a significantly different manner from the assumptions in the Information.

We draw attention to Section 1.G - comments and clarifications in the Economic Solvency Ratio Report, regarding the uncertainty stemming from regulatory changes and exposure to contingent liabilities whose effect on the Solvency Ratio cannot be estimated.

Tel Aviv, May 30, 2022

Sincerely,

Somekh Chaikin
Certified Public Accountants

1. Background and Disclosure Requirements

A. Solvency II based Economic Solvency Regime

The information set out below was calculated in accordance with the provisions of Insurance Circular 2020-1-15 dated October 14, 2020, on "Amendment of the Consolidated Circular concerning Implementation of an Economic Solvency Regime for Insurance Companies Based on Solvency II" ("Economic Solvency Regime Provisions") and based on the additional directives and stipulations of the Commissioner concerning implementation of an Economic Solvency Regime.

The information was prepared in accordance with the provisions of Chapter 1, Part 4 Section 5 of the Consolidated Circular, Insurance Circular 2020-1-17 dated October 14, 2020, on "Amendment of the Consolidated Circular concerning Disclosure of an Economic Solvency Regime Economic Solvency Regime and based on the additional directives and stipulations of the Commissioner concerning disclosure regarding an Economic Solvency Regime ("the Disclosure Provisions").

The Economic Solvency Regime Provisions prescribe a standard model for calculating Eligible Own Funds and Solvency Capital Requirement ("SCR"), with the purpose of ensuring that insurance companies hold a buffer to absorb losses arising from the materialization of unforeseen risks to which they are exposed. **The Solvency Ratio is the ratio between the Eligible Own Funds and the Solvency Capital Requirement.**

Eligible Own Funds for the purpose of an Economic Solvency Regime , is composed of Tier-1 and Tier-2 capital. Tier-1 capital includes equity calculated by evaluating an insurance company's assets and liabilities based on Economic Solvency Regime Provisions and ancillary Tier-1 capital. Ancillary Tier-1 capital and Tier-2 capital include capital instruments with loss-absorbing mechanisms, including subordinated Tier-2 capital instruments, hybrid Tier-2 capital and Tier-3 capital that were issued before the commencement date. Economic Solvency Regime Provisions place limitations on the composition of Own Funds in relation to SCR (see below) so that the components included in Tier-2 capital shall not exceed 40% of the SCR (in the transitional period, specified below in Section 1.B, it is stipulated that the components included in Tier-2 capital shall not exceed 50% of the SCR in the transitional period).

The eligible Own Funds should be compared with the required capital, where there are two levels of capital requirement:

- Capital required to maintain an insurance company's solvency ("SCR"). The SCR is risk-sensitive and based on a forward-looking calculation of the materialization of various scenarios, while taking into account the level of correlation of the different risk factors, based on the guidance in the Economic Solvency Regime Provisions. The purpose of this requirement is to ensure precise and timely intervention by the supervisory authorities.
- Minimum Capital Requirement ("MCR" or "Capital Threshold"). Under the Solvency provisions, the capital threshold equals the amount derived from the level of insurance reserves and premiums (according to their definition in the Solvency provisions) within a range of between 25% and 45% of the SCR.

Eligible Own Funds and SCR are calculated using data and models that are based, among other things, on forecasts and assumptions relying primarily on past experience. These calculations are highly complex.

B. Provisions in the Transitional Period

The Economic Solvency Regime Provisions include, among other things, transitional provisions that prescribe the transitional period in which the following directives are to be implemented:

(a) Transitional Measure in Technical Provisions ("TMTP")

In accordance with the Economic Solvency Regime Provisions, insurance companies may, after obtaining the Commissioner’s approval, include a deduction from the insurance reserve in the calculation of the insurance reserves in the transitional period, (“the Deduction”). The Deduction is calculated in accordance with the Commissioner’s directives in a letter to insurance company executives dated October 15, 2020, setting out the principles for calculating the TMTP (“Deduction Principles Letter”) which is decreased gradually until December 31, 2032.

According to the principles for calculating the TMTP, the TMTP in the transitional period will be calculated according to an allocation into homogenous risk groups, for policies that were issued prior to December 31, 2016. This TMTP will be calculated as the difference between insurance reserves in retention in the Economic Balance Sheet, including the Risk Margin associated with them (net of adjustment for the fair value of designated bonds) and the insurance reserves in retention according to the financial statements. The company must ensure that the value of the TMTP in the transitional period is calculated in a cautious, conservative manner and at each reporting date it is consistent with the anticipated rate of growth of the solvency ratio, where it is calculated excluding the TMTP in the transitional period and the adjustment for equity risk.

The Company is required to recalculate the TMTP in the transitional period in subsequent periods every two years, if there has been a material change in the Company’s risk profile or business structure, or if required by the Commissioner. A recalculation might result in a change in the value of the Deduction.

Given that two years have passed since the TMTP was first calculated at December 31, 2019, the Deduction was recalculated as at December 31, 2021 and a linear subtraction was also performed on 2/13 of the Deduction amount for the transitional period.

The Company’s Board of Directors approved the Deduction amount that was recalculated and on May 18, 2022, the Commissioner announced that he has no objection to the Deduction recalculation as at December 31, 2021, as requested by the Company.

(b) Reduced capital requirements for certain categories of investments held by the insurer at each reporting date, where this requirement will increase gradually over 7 years, from 2017, until the capital requirement for these investments reaches its full rate.

(c) Regarding the composition of the Eligible Own Funds, it was determined that the maximum scope of Tier-2 capital in the transitional period will be 50% of the SCR.

Clarification concerning forward-looking information in this report

The data included in this Economic Solvency Ratio Report, including the Eligible Own Funds and Solvency Capital Requirement, are based, among other things, of forecasts, assessments and estimates of future events, the materialization of which is uncertain and that are beyond the Company's control, and should be treated as "forward looking information", according to its definition in Section 32A of the Securities Law, 1968. Actual results may differ from the way they are expressed in this Economic Solvency Ratio Report, due to the fact that all or part of these forecasts, assessments and estimates materialize or may materialize in a manner other than forecast, in part with respect to actuarial assumptions (including mortality and morbidity rates, recovery rates, cancellations, expenses, annuity take-up rates and the rate of underwriting profit), assumptions regarding future management actions, the future development of Solvency Capital Requirement and the Risk Margin, risk-free interest rates, yields in the capital market, future revenues and loss in catastrophe scenarios.

C. Disclosure and reporting instructions in relation to an Economic Solvency Ratio Report

Among other things, the disclosure instructions stipulate that an Economic Solvency Ratio Report shall be published on the Company's website and shall be included within the periodic report subsequent to the date of the calculation. An Economic Solvency Report for data at December 31 every year shall be audited by the Company's external auditors. Furthermore, the disclosure instructions include provisions relating to the format of the Economic Solvency Ratio Report, its approval by the Company's appropriate organs, an audit of the report by the Company's auditors and disclosure requirements regarding the auditor.

Under the disclosure instructions, insurance companies are required to include information about Solvency Ratio sensitivity tests with respect to various risk factors that are material to the company. The sensitivity tests should be performed gradually, so that the report on sensitivity to changes in the interest rate applies from the Economic Solvency Ratio Report as at December 31, 2020 and the report on sensitivity to changes in the other material risk factors will apply from the Economic Solvency Ratio Report as at December 31, 2021.

From the Economic Solvency Ratio Report as at December 31, 2021, insurance companies are also required to include quantitative information about movements in relation to the economic Solvency Ratio, explaining the key factors responsible for year-on-year changes in the capital surplus. The structure of the "Report on Changes in the Capital Surplus" was set out in Insurance Circular 2022-1-8 dated March 13, 2022, and it is intended to properly reflect the effects on the capital surplus.

Regarding calculation of the Solvency Ratio as at December 31, 2021, the auditors performed an audit in accordance with the Commissioner's instructions. The audit was conducted in accordance with ISAE 3400 - International Standard on Assurance Engagement - Review of Prospective Financial Information.

D. Provisions on the subject of Own Risk and Solvency Assessment ("ORSA")

On January 5, 2022, a letter of principles and an amendment to the Consolidated Circular were published on the subject of implementing an Own Risk and Solvency Assessment (ORSA) by insurance companies ("ORSA Guidelines"). One of the main principles of ORSA is to create a connection between business strategy, risks and capital management. Insurance companies that manage their risks in accordance with this principle will create understanding and clarification of their ability, over time, to bear the risks to which they are exposed as a result of applying their business strategy.

According to Section 7.4.28 of Chapter 3, Part 4, Section 5 in the Consolidated Circular, entitled “Reporting to the Commissioner of the Capital Market”, insurance companies shall submit a report of their ORSA to the Commissioner once a year, in January. The application will be gradual beginning partially on January 1, 2023, with supplements on January 1, 2024. The Company is preparing to apply the provisions based on the defined time schedule.

E. Definitions

The Company	-	Harel Insurance Company Ltd.
The Commissioner	-	Commissioner of the Capital Market, Insurance and Savings Authority.
Economic Solvency Regime Provisions	-	The provisions of Commissioner’s Circular 2020-1-15 on “Amendment of the Consolidated Circular concerning Implementation of an Economic Solvency Regime for Insurance Companies Based on Solvency II” including its stipulations.
Best Estimate	-	Expected future cash flows from insurance contracts and investment contracts throughout their duration, without conservatism margins, discounted by an adjusted risk-free interest rate.
Long-term health insurance (SLT)	-	Similar to Life Techniques. Health insurance that is managed similarly to life insurance.
Short-term health insurance (NSLT)	-	Non-Similar to Life Techniques. Health insurance that is managed similarly to non-life insurance.
Basic Solvency Capital Requirement (BSCR)	-	The capital required from an insurance company to maintain its solvency, calculated in accordance with the Economic Solvency Regime Provisions, without considering the equity required for operational risk, adjustment for the Loss Absorbing Capacity of Deferred Taxes and the required capital for management companies.
Solvency Capital Requirement (SCR)	-	Solvency Capital Requirement. The capital required from an insurance company to maintain its solvency, calculated in accordance with the Economic Solvency Regime Provisions.
Eligible Own Funds	-	Tier-1 and Tier-2 capital of an insurance company, after deductions and amortization in accordance with the provisions of Section B of the Appendix to the Solvency Circular.
Basic Tier-1 capital	-	Excess of assets over liabilities in the Economic Balance Sheet, net of unrecognized assets and dividends that were declared after the reporting date and before initial publication of the report.
Ancillary Tier-1 capital	-	Perpetual capital note, non-cumulative preference shares, hybrid Tier-1 capital instrument, ancillary Tier-1 capital instrument.

Tier-2 capital	-	Tier-2 capital instruments, subordinated Tier-2 capital instruments, hybrid Tier-2 capital and hybrid Tier-3 capital - valued in accordance with the provisions of Part A of the Appendix to the Solvency Circular.
Diversification effect among the risk components	-	Effect of the partial correlation among different risks in the Standard Model on their amounts. If the risks are well distributed among the operating segments in the portfolio, then the effect of the correlation will be greater and the overall risk is reduced.
Solvency Ratio	-	The ratio between the insurance company's Eligible Own Funds and its SCR.
Adjustment for equity risk	-	Reduced capital requirement for certain types of investment that will gradually increase until 2023 when the capital requirement for these investments reaches its full rate.
Economic Balance Sheet	-	The Company's balance sheet where the value of the assets and liabilities is adjusted in accordance with the provisions of Section 1 of the Appendix to the Solvency Circular.
Risk margin (RM)	-	An amount over and above the Best Estimate that reflects the overall cost of capital that is expected to be required by another insurance company or reinsurer require for assuming the Company's insurance liabilities.
Volatility Adjustment (VA)	-	Volatility Adjustment. An anti-cyclical component that reflects the spreads of an insurance company's representative debt assets portfolio and is added to the adjusted interest rate curve based on the Economic Solvency Regime Provisions.
Transitional measure on technical provisions (TMTP)	-	After receiving the Commissioner's approval, insurance companies may apply a transitional deduction to technical provisions, based on the principles prescribed by the Commissioner. The maximum portion deductible shall decrease on a linear basis at the end of each year until 2032.
Minimum Capital Requirement (MCR)	-	Minimum Capital Requirement. The minimum capital required from an insurance company.
Expected Profits Included in Future Premiums (EPIFP)	-	Expected Profit in Future Premiums. Future profit factored into the liabilities for existing life and health insurance contracts attributable to future premiums.
UFR	-	Ultimate Forward Rate. The latest forward interest rate derived from the expected long term real interest rate and from long term inflation expectations, to which the adjusted interest rate curve converges, based on the Economic Solvency Regime Provisions.

F. Calculation Methodology

The Economic Solvency Ratio was calculated and prepared in accordance with the Economic Solvency Regime Provisions. Following are the key instructions:

Economic Balance Sheet

The economic balance sheet is calculated in accordance with the detailed instructions published by the Commissioner which are based on the European Solvency II standards, with adjustment for the nature of the products and economic environment in Israel. The purpose of the standards is to reflect the economic value of the balance sheet items according to the Commissioner's approach. According to the instructions, the insurance liabilities are calculated on the basis of a Best Estimate of all expected future cash flows from existing business, without a margin for conservatism, and plus a Risk Margin, which represents the addition to the insurance liabilities that another insurance company would be expected to require for assuming an insurance company's insurance liabilities. According to the instructions, the Risk Margin is calculated using the cost of capital method, at a rate of 6% per year of the expected required capital, in respect of insurance risks, over the life of the existing business. The Economic Balance Sheet is prepared on the basis of the Company's separate financial statements. The Economic Balance Sheet does not include the economic value of deferred acquisition costs and intangible assets, other than insurtech assets recognized by the Commissioner.

Transitional Measure in Technical Provisions

The deduction in the transitional period is calculated in accordance with the Deduction Principles Letter, as described in Section 1.B.(a) above.

Solvency Capital Requirement (SCR)

Calculation of the capital required for Solvency is based on an assessment of the exposure of the economic Own Funds to the following risk components prescribed in the Economic Solvency Regime Provisions: life insurance risks, health insurance risks, non-life insurance risks, market risks and counter-party risks. These risk components include sub-components with respect to specific risks to which the insurance company is exposed. Exposure of the economic Own Funds to each sub-component is assessed on the basis of a defined scenario set out in the guidance. Determination of the Solvency Capital Requirement is based on a sum of the capital requirements for the said sub-risk components, net of the effect of diversification between the Company's risks according to correlation factors attributed to them according to the instructions, and net of adjustment for the absorption of losses for deferred tax, as specified in the Economic Solvency Regime Provisions. Calculation of the SCR also includes components of capital required in respect of operational risk, intangible assets and management companies.

It is emphasized that the results of the models applied in calculating the Eligible Own Funds and SCR are extremely sensitive to the forecasts and assumptions included therein as well as to the way in which the guidance is applied. The economic solvency ratio is highly sensitive to market and other variables and it may therefore be volatile. The capital requirement for each risk is calculated based on the Company's exposure to this risk and taking into account the parameters defined in the instructions. According to the instructions, the amount of required capital represents the volume of own funds that will enable the insurance company to absorb, in the coming year, unforeseen losses and to meet its obligations to policyholders and beneficiaries in a timely manner, with a 99.5% level of certainty.

Adjustment for loss absorbing capacity for deferred taxes

Under the Economic Solvency Regime Provisions, insurance companies may recognize adjustment for loss absorption capacity for deferred taxes up to the net amount of the outstanding reserve for deferred taxes recorded in the Economic Balance Sheet, plus a deferred tax asset held to cover future profits that meet all the following conditions:

- The insurance company is capable of showing the Commissioner that future tax-liable profits can reasonably be available and that the tax assets held to cover them are exercisable;
- It derives exclusively from non-life insurance activity or NSLT health insurance activity;
- Its value does not exceed 5% of the BSCR.

G. Comments and Clarifications

1. General

Among other things, the Solvency Ratio includes a forecast based on assumptions and parameters in line with past experience, as emerges from actuarial studies conducted from time to time, and with the Company's assessments regarding the future, to the extent that the Company has relevant and concrete information on which to base it. The information and studies are the same as those which formed the basis for the Company's 2021 annual reports. Any information or studies compiled after the publication date of the Company's 2021 annual reports, were not taken into account. It is emphasized that in view of the reforms in the capital market, insurance and savings, and changes in the economic environment, past data do not necessarily indicate future performance and the Company is unable to reliably estimate the impact of these reforms and changes. In some cases, the calculation is based on assumptions about future events and management activity that may not necessarily materialize or that will materialize differently from the assumptions on which the calculation was based. Moreover, actual results might differ significantly from the calculation, given that the combined scenarios of events could materialize in a significantly different manner from the assumptions in the calculation. The model in its current format is extremely sensitive to changes in market and other variables, and the capital position it reflects could therefore be extremely volatile.

2. Future effects of legislation and regulations known on the date of publication of the report and exposure to contingent liabilities

(a) In recent years, the insurance industry has been exposed to frequent changes in legislation and regulations. In this context, see Sections 2.1, 2.2, 2.3 in Section B of the chapter on the corporation's business in the 2021 Periodic Report.

The laws and regulations affect the Company's profitability and cash flows and as a direct consequence, its Economic Solvency.

Calculation of the Solvency Ratio does not include all the future possible repercussions of these laws and regulations, as well as other developments that are not yet reflected in the data at the practical level, given that at the date of this report, the Company is unable to estimate the impact on its business performance and on the Solvency Ratio.

(b) According to the Solvency instructions, the value of the contingent liabilities in the Economic Balance Sheet is determined according to their value in the accounting balance sheet, based on the provisions of IAS 37. This measurement does not reflect their economic value. It is impossible to estimate the implications of the uncertainty stemming from the exposure to contingent liabilities, as described in Note 39A to the 2021 annual financial statements, including its impact on future profit and on the Solvency Ratio.

(c) On March 13, 2022, the Commissioner published a draft letter to insurance company executives (CM. 2021-6993-) concerning an "Update no. 3 to the implementation and disclosure of an insurance company's Economic Solvency Regime" ("Questions and Answers file"). Among other things, the draft Questions and Answers file stipulates that the actuarial model for dealing with premium discounts that were given for a specified period, should be addressed at the end of the discount period, and subject to materiality considerations, similar to the other operating assumptions, using generally accepted actuarial practices (e.g. a study based on experience with continuity of discounts) or alternatively based on the business practice. An updated version of the Questions and Answers file is expected to be published either as a final version or as a second draft (if additional questions are added) after the date of publication of the Economic Solvency Ratio Report as at December 31, 2021.

2. Solvency Ratio and MCR

A. Economic Solvency Ratio

	December 31	
	2021	**2020**
	(Audited)	
	NIS million	
Own Funds for the purpose of SCR - see Section 4	**17,873**	15,478
Solvency Capital Requirement (SCR) - see Section 5	**10,236**	9,717
Capital surplus	**7,637**	5,761
Economic Solvency Ratio	**175%**	159%
Effect of material capital transactions that took place in the period between the date of the calculation and the publication date of the Economic Solvency Ratio Report:		
(Redemption) capital (*)	**-**	(46)
Own Funds for the purpose of SCR	**17,873**	15,432
Capital surplus	**7,637**	5,715
Economic Solvency Ratio	**175%**	159%

(*) On May 31, 2022, an early redemption of Series 8 bonds is expected in the amount of NIS 239 million. This redemption will not affect the capital surplus and Economic Solvency Ratio since at December 31, 2021 there is an unutilized Tier-2 capital balance of NIS 360 million over and above the limitation for Tier-2 capital.

Key changes that occurred compared with comparison figures in main items

Section 8 below includes quantitative information about changes in the capital surplus of key components, based on the Commissioner’s directives in Insurance Circular 2022-1-8 dated March 13, 2022, which updates the disclosure instructions.

The Company’s capital position at the end of 2021 was affected by its ongoing business developments, distribution of a dividend, changes in market variables, revised demographic and operational assumptions, revised regulatory instructions and ongoing model updates.

- In January 2022, the Company's Board of Directors approved the distribution of a dividend in the amount of NIS 250 million. The dividend was paid on February 3, 2022.
- In December 2021, the Company raised NIS 694 million as part of a public offering of a new series of bonds (Series 18). The issued bonds were recognized by the Commissioner of the Capital Market, Insurance and Savings Authority as a Tier-2 capital instrument held by the Company, all as detailed in the Shelf Prospectus and in the Shelf Offering Report.
- During the Reporting Period, the risk-free, linked Shekel interest rate curve decreased in a manner that caused an increase in the value of the insurance liabilities in the savings and long-term care products, increasing the capital requirements for some of the insurance scenarios and reducing the capital surplus. In contrast, the lower interest rate contributed to an increase in the value of the investments and an increase in the capital surplus. In aggregate, these changes gave rise to a deterioration of the Company’s capital surplus and Economic Solvency Ratio.

- Positive yields over and above the risk-free interest rate in the Company's proprietary investment portfolio and in the unit linked portfolios (that positively impact the Company's income from management fees) caused an increase in the Company's Tier-1 capital, and in contrast increased the market risks capital requirement. In aggregate, these yields had a positive impact on the Company's capital surplus and Economic Solvency Ratio.
- In December 2021, the Company drew up a reinsurance agreement with the purpose of providing partial protection against a scenario of mass cancellations in health insurance business. The transaction caused an increase of the Company's capital surplus and Economic Solvency Ratio.
- Within the framework of the calculations, several updates were made to the demographic and operating assumptions that affected the Company's capital position at December 2021. Among others, these changes included the revision of a study relating to the cost of claims in the personal lines health sector. In aggregate, these changes caused an increase of the Company's capital surplus and Economic Solvency Ratio.
- On July 13, 2021, the Commissioner published a letter to insurance company executives (CM. 2021-740) on "Principles for the recognition of investments in Insurtech in the calculation of economic solvency". According to the letter, insurance companies may apply to the Commissioner for recognition of intangible assets due to an investment in insurtech. The capital required for intangible assets in respect of an investment asset in insurtech that was recognized will be 50%. On May 10, 2022, the Company received the Commissioner's approval for recognition of an insurtech asset. Recognition of the insurtech asset had a positive impact on the Company's capital surplus and Economic Solvency Ratio.
- On May 13, 2021, the Commissioner published Update no. 2 to the Questions and Answers file on implementation and disclosure of an insurance company's Economic Solvency Regime. The Questions and Answers file provided clarification relating to the contract boundary in savings policies without a guaranteed annuity option (GAO) that were sold after 2013. The clarification stipulates that the contract boundary is the date of the conversion factor guarantee, so that the option to receive a GAO and the cash flows arising from exercising that option will not be reflected in the policy's contract boundaries. Application of the clarification negatively impacted the Company's capital surplus and Economic Solvency Ratio.
- On February 17, 2022, a circular was published on an "Amendment to the provisions of the Consolidated Circular on the measurement of liability - illiquidity premium" updating the formula for calculating the illiquidity premium. According to the Circular, the methodology for calculating the Volatility Adjustment component which is currently applied within the framework of an Economic Solvency Regime (Solvency II), should be used for calculating the illiquidity premium. The Company applied the provisions of the Circular in its financial statements at December 31, 2021, as a change in the accounting estimate in accordance with International Accounting Standard (IAS) 8. The effect of applying the circular on illiquidity premium was to increase the amount of the Deduction for the transitional period as at December 31, 2021, and to increase the capital surplus calculated in the transitional period. In the calculation as at December 31, 2021, the Deduction amount was deducted on a linear basis , according to the instructions.

For information about the Solvency Ratio without applying the transitional provisions to the transitional period and without adjustment for equity risk and regarding the capital surplus target and limitations that apply to the Company with respect to distribution of a dividend, see Section 10 below.

B. Minimum Capital Requirement (MCR)

	December 31	
	2021	**2020**
	(Audited)	
	NIS million	
MCR - see Section 6.A	**2,735**	2,429
Own Funds for the purpose of MCR - see Section 6.B	**13,302**	11,105

3. <u>Information about the Economic Balance Sheet</u>

The fair value of the assets and liabilities in the Economic Balance Sheet was calculated in accordance with provisions included in the chapter on measurement of assets and liabilities for the purposes of the financial statements in the Consolidated Circular (Chapter 1, Part 2, Section 5) ("Measurement Chapter in the Consolidated Circular"), except for items prescribed otherwise in the Economic Solvency Regime Provisions, as follows:

(1) **<u>Consolidated Balance Sheet</u>**

The data in the Economic Balance Sheet are presented on the basis of the Company's separate financial statements.

(2) **<u>Assets</u>**

(a) Intangible assets - pursuant to Part A, Chapter 2, subsection (a), insurance companies will assess the value of intangible assets at zero. On July 13, 2021, the Commissioner published a letter to insurance company executives (CM. 2021-740) on "Principles for the recognition of investments in Insurtech in the calculation of Economic Solvency". According to the letter, insurance companies may apply to the Commissioner for recognition of intangible assets due to an investment in insurtech.

(b) Deferred Acquisition Costs - pursuant to Part A, Chapter 2, subsection (a), insurance companies will assess the value of acquisition costs at zero.

(c) Investment in investees that are not insurance companies - pursuant Part A, Chapter 2, subsection (b), the calculation was made according to the adjusted equity method, based on the provisions of the Circular regarding investees that are not insurance companies. Accordingly, the Company's share in the investees was included on the basis of its proportionate share of their surplus assets over their liabilities, calculated in accordance with the economic value of the assets and liabilities according to the Circular, which is calculated on the basis of their financial statements after writing off the intangible assets. In investees where the economic balance sheet reflects a surplus of liabilities over assets, the value of the investment will be zero rather than a negative amount, when its value in the accounting balance sheet is positive. The economic value of the investees does not include the profits inherent in these companies. In management companies, 35% of the balance of the original difference attributed to this company is added to the economic value.

(d) Non-marketable debt assets - pursuant to Part A, Chapter 1, the fair value of non-marketable debt assets is calculated using the discounted cash flow model where the discounting interest rates are determined by a company that provides price and interest rate quotes for financial institutions.

(e) Designated bonds - pursuant to Part A, Chapter 2, subsection (e), insurance companies adjust the value of designated bonds to the Economic Balance Sheet.

(3) **<u>Liabilities for insurance contracts and investment contracts, Risk Margin (RM) and reinsurance assets</u>**

Liabilities for insurance contracts and investment contracts are calculated, pursuant to Part A, Chapter 4 of the Economic Solvency Regime Provisions, on a Best Estimate (BE) basis, based on assumptions that are mainly the result of projecting present experience with respect to past events onto the future, in the environment in which the Company operates and without conservatism factors. Life and health insurance liabilities (SLT) were generally calculated according to the method of calculating the Embedded Value (EV) for insurance contracts in Israel, and the non-life insurance liabilities were calculated on the basis of the share relating to the BE - in the chapter on measurement in the Consolidated Circular relating to best practice for calculation of insurance reserves in non-life insurance for the purpose of financial reporting.

Measurement of the insurance liabilities in the Economic Balance Sheet is based on discounting the expected future cash flows, including future profit, at a risk-free interest rate plus VA and taking the UFR into account, on the basis of a best estimate that does not include conservatism margins, where the risk is reflected in the RM component which is a separate liability. This, unlike the financial statements in which the insurance liabilities are assessed with conservatism margins using the methods and discounting rates describe in Note 3C to the annual reports.

The insurance liabilities for long-term life and health insurance were calculated by discounting the Company's expected future cash flows, using a model applied to information in the Company's operating systems, with respect to the insurance coverages, and to numerous demographic, economic and behavioral assumptions. The expected cash flows include, for example, projected premiums in light of the anticipated cancellation rates, net of the expenses that the Company will incur for the coverages, including commissions paid to agents, anticipated claims, etc.

This cash flow is discounted according to an interest rate curve determined by the Commissioner and which is based on the yield to maturity of Israel Government bonds ("risk-fee interest rate"), that in the long term converges to a fixed rate of 2.6% (UFR) plus a margin (VA) determined by the Commissioner.

Calculation of the liabilities does not include cash flows in respect of future sales, but it does include an assumption that premiums will continue to be received for existing business (other than for policies without an insurance risk, including investment contracts). Additionally, the calculation assumes that the business will continue to operate as a "going concern", i.e. that the Company's structure will not change and therefore some of the fixed expenses in the future will not be attributed to the present portfolio, but rather to new business which is expected to be sold in the future.

It is fair to assume that the actual cash flows will differ, in one way or another, from the estimates prepared on the Best Estimate basis, even if the parameters underlying the calculation remain unchanged. See also Section 1.G above - Comments and clarifications.

Limitations and reservations in calculating the Best Estimate

- The assumptions underlying the models were generally formulated on the basis of studies and analyses based on the Company's experience over the past few years, that did not include extreme events. Although there is a low probability that extreme events will take place, the Company is unable to estimate either this probability or the extent of the impact of those events. Accordingly, such events were not taken into account in determining the assumptions on which the models are based.
- Due to insufficient data, in calculating the Best Estimate, no assumption was made and the Company did not examine the correlation between the demographic and operating assumptions and those pertaining to market conditions (such as the interest rate), that might have significantly affected the Best Estimate.
- Determination of the Best Estimate should be based on an estimate of the distribution of the possible estimate results. In the absence of adequate statistical data which correspond with the estimated distribution and Best Estimate for all the demographic and operational factors in life and health SLT insurance, the Company used real assumptions for each and every parameter, according to the expected value of each relevant factor and without taking into account any dependence or correlation between the different assumptions or between the assumptions for exogenous economic parameters such as taxation, interest or employment levels in the economy.
- In many cases, the future cash flows refer to many years in the future. The studies on which the assumptions underlying the cash flows are based, are based on management's best knowledge, mainly in line with events in recent years. There is a considerable degree of uncertainty as to whether the assumptions underlying the cash flows will in fact materialize.

Assumptions applied in calculating the insurance liabilities

The assumptions underlying the calculation were determined according to the Company's best possible estimates regarding relevant demographic and operational factors, and they reflect the Company's expectations for the future regarding these factors. The demographic assumptions included in the calculation were taken from the Company's internal studies, to the extent that there are any, and are based on relevant experience and/or on a combination of information from external sources, such as information received from reinsurers and mortality and morbidity tables published by the Commissioner.

The operational assumptions (general and administrative expenses) were calculated according to the results of an internal pricing model prepared by the Company for expenses associated with the relevant insurance liabilities, including: allocation of the expenses to the different operating segments and activities (production, ongoing management, investments, claims management, etc.) and assumptions relating to their future development (in line with the CPI, volume of premiums, number of coverages, volume of assets, etc.).

Following are the key assumptions on which we based the calculations:

(a) Economic assumptions

- Discounting interest rate - a risk-free interest rate curve which is based on the yield to maturity of CPI-linked Israel Government bonds ("risk-fee interest rate"), that in the long term converges to a fixed rate of 2.6% (UFR) plus a margin (VA) calculated by the Capital Market, Insurance and Savings Authority, all as determined by the Commissioner.
- The yield on the assets backing the unit-linked life insurance products is the same as the discounting interest rate.
- Designated bonds are evaluated at their fair value, taking into account their specified interest rate and the Best Estimate of the Company's future eligibility to acquire them.

(b) Operational assumptions (for life and health insurance)

General and administrative expenses - the Company analyzed the expenses associated with the relevant insurance segments in the financial statement and allocated them to different products and types of cover, and to different operations such as ongoing operation of the coverages, management of investments, claims handling, payment of annuities, etc. A study of the expenses is revised periodically and the different categories of expenses are loaded on to the future cash flow with respect to the relevant variables, such as number of coverages, quantity of premiums, reserves or number of claims. Determination of the future expenses and their allocation to future cash flows include the Company's estimates and numerous considerations that affect the total liabilities.

(c) Demographic assumptions

- Cancellations (discontinued premium payments, policy surrenders, withdrawals)
- Mortality of insureds and pensioners
- Morbidity (rate and length of claims) in long-term care products, work disability and health
- Annuity tracks and take-up rate

(d) Non-life insurance assumptions

Cost of claims, for future losses and outstanding claim based on the Company's past experience in the different lines of business in relation to the percentage of claims, amount of the claims and rate of payment of claims in long-tail branches.

(4) **Risk Margin**

In addition to the insurance liabilities on a Best Estimate basis, a Risk Margin component is calculated reflecting the overall cost of capital that another insurance company would be expected to require in order to assume the insurance company's insurance liabilities, calculated on a Best Estimate basis, in full. The Risk Margin is calculated according to the Commissioner's instructions based on a cost of capital of 6% and discounted at an adjusted risk-free interest rate, but excluding the VA component. The future capital requirement is calculated according to the "risk factor method" by changing the capital requirement components calculated at the reporting date, except for a capital requirement for market risks, based on the projected development of the risk factors associated with them. These factors are designed to reflect development of the risks over time.

Limitations and reservations in calculating the Risk Margin

As noted above, the Risk Margin is calculated using the cost of capital method, at a rate of 6% per year of the expected required capital for insurance risks, over the life of the existing business. This method of calculation was defined by the Commissioner and does not necessarily reflect the overall cost of the capital that another insurance company or reinsurer would be expected to require for assuming the Company’s insurance liabilities. Additionally, the capital requirements are based on the Best Estimate, including its limitations as described above.

Furthermore, the extreme scenarios and correlations defined in the standard model for calculating the capital requirements are based on a series of scenarios and assumptions that were defined by the Commissioner and they in no way reflect the Company’s actual experience.

(5) **Other liabilities**

(a) **Contingent liabilities -** on the value of contingent liabilities included in the Economic Balance Sheet, see Section 1.F.2(b) above.

(b) **Deferred tax liabilities, net** - pursuant to Part A, Chapter 2, subsection (c), the calculation is based on the difference between the value attributed to the assets and liabilities in the Economic Balance Sheet and the value attributed to them for tax purposes according to the instructions for the recognition, measurement and presentation in International Accounting Standard 12 (IAS 12). Deferred tax assets may be recognized only if the Company passes the tests in the Solvency directives, in addition to the tests included in the aforementioned accounting standard. The balance also includes a deferred tax liability arising from the Deduction in the transitional period.

(c) **Trade and other payables -** pursuant to Part A, Chapter 1, some of the retained amounts in this section were calculated in accordance with the general principles applicable to the Economic Balance Sheet.

(d) **Financial liabilities -** pursuant to the principles set out in the Solvency Directives and subject to the instruction in Part A, Chapter 3, according to which changes that occurred in the Company’s risk should not be taken into account other than for changes in the risk-free interest rate. In other words, the discounting interest rate is a risk-free interest rate plus the capital spread on the date of issue.

(6) **Value of the TMTP in the transitional period as at December 31, 2021**

The Deduction in the transitional period was calculated in accordance with the provisions in the Solvency Circular and in the letter to insurance company executives: “Principles for calculating a deduction for the transitional period in an Economic Solvency Regime based on Solvency II, dated October 15, 2020 (“Deduction Principles Letter”).

The Deduction, which at December 31, 2021 amounted to NIS 5,079 million (after a reduction of 2/13), was calculated as the sum of the positive differences between insurance reserves in retention in the Economic Balance Sheet, including the Risk Margin (net of adjustment for the fair value of designated bonds) and the insurance reserves in retention according to the financial statements at that date. These differences were calculated by groups of products and in accordance with the instructions in the letter of principles.

A. Economic Balance Sheet	December 31, 2021		As at December 31, 2020	
	Balance sheet according to accounting standards	Economic balance sheet	Balance sheet according to accounting standards	Economic balance sheet
	NIS million	NIS million	NIS million	NIS million
Assets:				
Intangible assets	**1,052**	**187**	799	-
Deferred Acquisition Costs	**2,316**	**-**	2,208	-
Fixed assets	**1,346**	**1,346**	1,341	1,341
Investments in investees that are not insurance companies				
Management companies	**27**	**27**	30	30
Other investees	**1,167**	**1,166**	1,111	1,110
Total investments in non-insurance company investees	**1,194**	**1,193**	1,141	1,140
Investment property for unit-linked contracts	**1,963**	**1,963**	1,802	1,802
Investment property - other	**2,163**	**2,163**	1,971	1,971
Reinsurance assets	**5,148**	**1,861**	4,216	1,482
Trade and other receivables	**1,168**	**1,094**	1,160	1,074
Financial investments for unit-linked contracts	**73,850**	**73,850**	64,607	64,607
Other financial investments				
Marketable debt assets	**12,699**	**12,700**	10,179	10,180
Non-marketable debt assets, other than designated bonds	**7,547**	**8,604**	7,549	8,598
Designated bonds	**4,779**	**8,105**	5,147	7,957
Shares	**1,635**	**1,635**	1,520	1,520
Other	**3,183**	**3,183**	2,518	2,518
Total other financial investments	**29,843**	**34,227**	26,913	30,773
Cash and cash equivalents for unit-linked contracts	**5,012**	**5,012**	3,452	3,452
Other cash and cash equivalents	**2,202**	**2,202**	2,351	2,351
Other assets	**1,373**	**1,373**	1,244	1,244
Total assets	**128,630**	**126,471**	113,205	111,237
Total assets for unit-linked contracts	**81,548**	**81,614**	(*) 70,690	(*) 70,746
Capital				
Basic Tier-1 capital	**6,031**	**12,625**	4,831	10,247
Total equity	**6,031**	**12,625**	4,831	10,247

Liabilities				
Liabilities for non-unit-linked insurance contracts and investment contracts	**30,430**	**16,098**	(*) 28,030	(*) 16,502
Liabilities for unit-linked insurance contracts and investment contracts	**80,532**	**75,348**	(*) 69,847	(*) 64,428
Risk margin (RM)	**-**	**12,044**	-	10,965
Transitional Measure in Technical Provisions (TMTP)	**-**	**(5,079)**	-	(4,630)
Deferred tax liabilities, net	**1,202**	**4,628**	987	3,803
Trade and other payables	**4,590**	**4,499**	3,703	3,622
Financial liabilities	**5,562**	**6,025**	5,498	5,991
Other liabilities	**283**	**283**	309	309
Total liabilities	**122,599**	**113,846**	108,375	100,990
Total equity and liabilities	**128,630**	**126,471**	113,205	111,237

* Reclassified

B. - Liabilities for insurance contracts and investment contracts

	December 31, 2021		
	Best Estimate (BE) for liabilities		
	Gross	Reinsurance	Net
	(Audited)		
	NIS million		
Liabilities for non-unit-linked insurance contracts and investment contracts			
Life insurance contracts and long-term health insurance (SLT)	**5,990**	**(1,557)**	**7,547**
Non-life insurance contracts and short term health insurance (NSLT)	**10,108**	**3,164**	**6,944**
Total liabilities for insurance contracts and non-unit-linked investment contracts	**16,098**	**1,607**	**14,491**
Liabilities for insurance contracts and unit-linked investment contracts - life insurance contracts and long-term health insurance contracts (SLT)	**75,348**	**254**	**75,094**
Total liabilities for insurance contracts and investment contracts	**91,446**	**1,861**	**89,585**

	December 31, 2020		
	Best Estimate (BE) for liabilities		
	Gross	Reinsurance	Net
	(Audited)		
	NIS million		
Liabilities for non-unit-linked insurance contracts and investment contracts			
Life insurance contracts and long-term health insurance (SLT)	7,971 (*)	(1,310)	9,282
Non-life insurance contracts and short term health insurance (NSLT)	8,530	2,577	5,953
Total liabilities for insurance contracts and non-unit-linked investment contracts	16,501 (*)	1,267	15,235
Liabilities for insurance contracts and unit-linked investment contracts - life insurance contracts and long-term health insurance contracts (SLT)	64,428 (*)	216	64,212
Total liabilities for insurance contracts and investment contracts	80,929 (*)	1,482	79,447

* Reclassified

Key changes that occurred compared with comparison figures in main items

Most of the increase in total liabilities for insurance contracts and investment contracts in 2021 is attributable to positive yields over and above the discounting interest rate and current deposits in unit-linked insurance contracts and investment contracts.

4. Own funds for the purpose of SCR

	December 31, 2021			
	Tier-1 capital			
	Basic Tier-1 capital	Ancillary Tier-1 capital	Tier-2 capital	Total
	(Audited)			
	NIS million			
Own funds	12,625	480	5,479	18,584
Deductions from Tier-1 capital (A)	(350)	-	-	(350)
Subtractions (B)	-	-	-	-
Deviation from quantitative limitations (C)	-	-	(361)	(361)
Own funds for the purpose of SCR	**12,275**	**480**	**5,118**	**17,873**
Of which - Expected Profits Included in Future Premiums (EPIFP) after tax	11,902			11,902

	December 31, 2020			
	Tier-1 capital			
	Basic Tier-1 capital	Ancillary Tier-1 capital	Tier-2 capital	Total
	(Audited)			
	NIS million			
Own funds	10,247	443	5,248	15,938
Deductions from Tier-1 capital (A)	(71)	-	-	(71)
Subtractions (B)	-	-	-	-
Deviation from quantitative limitations (C)	-	-	(389)	(389)
Own funds for the purpose of SCR	**10,176**	**443**	**4,859**	**15,478**
Of which - Expected Profits Included in Future Premiums (EPIFP) after tax	9,211			9,211

(a) Deductions from Tier-1 capital - in accordance with the definition of "Basic Tier-1 capital" in the Appendix to subsection B, Chapter 2, Part 2 of Section 5 of the Consolidated Circular - Economic Solvency Regime ("Economic Solvency Regime Appendix"). These deductions include the sum of the assets held to cover liabilities for non-unit linked insurance contracts and investment contracts, in contrast with the Investment Rules, the amount of repurchase of ordinary shares and dividend declared after the reporting date and before the report is first published.

(b) Subtractions - in accordance with the provisions in Chapter 6, Part B - "Provisions Concerning the Own Funds of Insurance Companies" to the Economic Solvency Regime Appendix.

(c) Deviation from quantitative limitations - in accordance with the provisions in Chapter 2, Part B in the "Provisions Concerning the Own Funds of Insurance Companies" to the Economic Solvency Regime Appendix.

4. Own funds for the purpose of SCR (contd.)

(d) Composition of own funds for the purpose of SCR

	December 31	
	2021	**2020**
	(Audited)	
	NIS million	
Tier-1 capital:		
Basic Tier-1 capital	**12,275**	10,176
Ancillary Tier-1 capital		
Hybrid Tier-1 capital instruments	**480**	443
Total Ancillary Tier-1 capital	**480**	443
Total Tier-1 capital	**12,755**	10,619
Tier-2 capital:		
Tier-2 capital instruments	**3,151**	2,525
Hybrid Tier-2 capital instruments	**1,524**	1,938
Hybrid Tier-3 capital instruments	**804**	784
Net of the subtraction for deviation from quantitative limitations	**(361)**	(389)
Total Tier-2 capital	**5,118**	4,859
Total own funds for the purpose of (SCR)	**17,873**	15,478

For reasons that produced material changes compared with comparative figures in key items, see Section 2.A above.

For details concerning information about own funds for the purpose of SCR without application of the transitional provisions for the transitional period and without adjustment for equity risk, see Section 7 "Effect of Application of the Instructions on the transitional period" below.

5. Solvency Capital Requirement (SCR)

	December 31	
	2021	**2020**
	(Audited)	
	NIS million	
Basic Solvency Capital Requirement (BSCR)		
Capital required for market risk component (*)	**5,294**	4,858
Capital required for counterparty risk component	**319**	275
Capital required for life insurance underwriting risk component	**4,419**	3,984
Capital required for health insurance underwriting risk component (SLT + NSLT)	**9,834**	9,153
Capital required for non-life insurance underwriting risk component	**2,046**	1,860
Total	**21,912**	20,130
Effect of the diversification among the risk components	**(7,175)**	(6,550)
Capital required for market intangible assets risk component	**94**	-
Total BSCR	**14,831**	13,580
Capital required for operational risk	**429**	392
Adjustment for loss-absorbing capacity of deferred taxes	**(5,044)**	(4,275)
Capital required on account of management companies:		
Tzva Hakeva Saving Fund - Provident Funds Management Company Ltd.	**10**	10
Leatid Pension Funds Management Company Ltd.	**10**	10
Total capital required on account of management companies	**20**	20
Total SCR	**10,236**	9,717

(*) Capital required for market risk including adjustment for equity risk

For information about SCR without application of the transitional provisions for the transitional period and without adjustment for equity risk, see Section 7 "Effect of Application of the Instructions on the transitional period" below.

Material changes that occurred compared with comparison figures

Changes in the SCR from one year to the next are affected by the release of the capital requirements for existing insurance products, which reduces the SCR and in contrast the sale of new products which increases the SCR.

For the reasons that produced material changes compared with comparative figures in key items, see Section 2.A above.

6. MCR

(A) MCR

	For the year ended December 31	
	2021	**2020**
	(Audited)	
	NIS million	
MCR according to the MCR linear formula	**2,735**	2,348
Lower boundary (25% of SCR in the transitional period)	**2,559**	2,429
Upper boundary (45% of SCR in the transitional period)	**4,607**	4,373
Minimum Capital Requirement (MCR)	**2,735**	2,429

(B) Own funds for the purpose of MCR

	December 31, 2021		
	Tier-1 capital	**Tier-2 capital**	**Total**
	(Audited)		
	NIS million		
Own funds for the purpose of solvency capital requirement (SCR) (after deductions and subtractions)	**12,755**	**5,478**	**18,233**
Deviation from quantitative limitations due to MCR (*)	**-**	**(4,931)**	**(4,931)**
Own funds for the purpose of MCR	**12,755**	**547**	**13,302**

	December 31, 2020		
	Tier-1 capital	**Tier-2 capital**	**Total**
	(Audited)		
	NIS million		
Own funds for the purpose of solvency capital requirement (SCR) (after deductions and subtractions)	10,619	5,248	15,867
Deviation from quantitative limitations due to MCR (*)	-	(4,762)	(4,762)
Own funds for the purpose of MCR	10,619	486	11,105

(*) In accordance with the provisions in Chapter 3, Part B to the Economic Solvency Regime Appendix, Tier-2 capital shall not exceed 20% of MCR.

7. Effect of application of the instructions in the transitional period

	December 31, 2021				
	Including application of the transitional provisions in the transitional period and adjustment for equity risk	Effect of inclusion of the Deduction in the transitional period	Effect of the adjustment for equity risk	Effect of a rate of 50% Tier-2 capital in the transitional period	Without application of the transitional provisions in the transitional period and adjustment for equity risk
	NIS million				
Total insurance liabilities, including Risk Margin (RM)	**98,411**	**(5,079)**	**-**	**-**	**103,490**
Basic Tier-1 capital	**12,275**	**3,343**	**-**	**-**	**8,932**
Own funds for the purpose of SCR	**17,873**	**2,648**	**(134)**	**1,023**	**14,336**
Solvency capital requirement (SCR)	**10,236**	**(1,737)**	**(335)**	**-**	**12,308**

	December 31, 2020				
	Including application of the transitional provisions in the transitional period and adjustment for equity risk	Effect of inclusion of the Deduction in the transitional period	Effect of the adjustment for equity risk	Effect of a rate of 50% Tier-2 capital in the transitional period	Without application of the transitional provisions in the transitional period and adjustment for equity risk
	NIS million				
Total insurance liabilities, including Risk Margin (RM)	87,265	(4,630)	-	-	91,895
Basic Tier-1 capital	10,176	3,047	-	-	7,129
Own funds for the purpose of SCR	15,478	2,414	(113)	971	12,206
Solvency capital requirement (SCR)	9,717	(1,583)	(283)	-	11,583

For information about the reasons that produced material changes compared with comparative figures in key items, see Section 2.A above.

8. Changes in the capital surplus

	Own funds for the purpose of SCR	Solvency capital requirement (SCR)	Capital surplus (deficit)
		(Audited)	
		NIS million	
January 1, 2021	**15,478**	**9,717**	**5,761**
Adjustment for the transitional provisions in the transitional period and equity risk	(3,272)	1,866	(5,138)
At January 1, 2021, without application of the transitional provisions in the transitional period and adjustment for equity risk	**12,206**	**11,583**	**623**
Effect of operating activity (A)	1,158	(588)	1,746
Effect of economic activity (B)	512	1,183	(671)
New business (C)	1,055	802	253
Effect of declared dividend (D)	(250)	-	(250)
Effect of changes in deferred taxes	(345)	(672)	327
At December 31, 2021, without application of the transitional provisions in the transitional period and	**14,336**	**12,308**	**2,028**
Effect of the transitional provisions in the transitional period	3,537	(2,072)	5,609
December 31, 2021	**17,873**	**10,236**	**7,637**

A. This section includes the effect of:
   1. The projected cash flow factored into the opening balance and was expected to be released in the reporting year
   2. Deviations from demographic and operational assumptions in the reporting year
   3. Regulatory changes
   4. Changes in the demographic and operational assumptions compared with those applied at the time of the previous report
   5. Model updates
   6. New insurance contracts (non-life and health insurance (NSLT) underwritten in the reporting year, and insurance portfolios in these sectors that were acquired or sold in the year of the report.
   7. Investment in intangible assets
   8. Other changes not included in the other items

B. This section includes the effect of ongoing economic activity, including:
   1. Changes in the value of investment assets
   2. Changes in equity required for market risk, including changes in the symmetric adjustment (SA) component
   3. Effect of inflation
   4. Effect of changes in the risk-free interest rate curve for solvency.

C. This section includes the effect of new insurance contracts (life and health insurance (SLT) underwritten in the year of the report, and insurance portfolios in these sectors that were acquired or sold in the reporting year, excluding the effect of market risks, counter-party risk and operational risk.

D. This section includes capital activity, including the issue and redemption of Tier-1 and Tier-2 capital instruments as well as dividends declared after the date of publication of the solvency report at December 31, 2020 and up to the date of publication of the report as at December 31, 2021.

The order of the sections does not necessarily represent their order of calculation. Notably, the order in which the calculations are made has a material impact on the numbers.

Notably, the changes were made on the economic balance sheet.

Explanations of material effects included in the different items appear in Section 2.A above.

9. Analysis of sensitivity to changes in risk factors

The following presents sensitivity analyses of the economic solvency ratio to various risk factors at the report date, taking into account the transitional provisions in the transitional period and with adjustment for equity risk. This analysis reflects the effects of the change on own funds, including the quantitative limitations applicable to the own funds and to SCR. The sensitivity tests reflect the direct effects only, assuming that all other risk factors are constant and do not include secondary effects or changes deriving from other risk factors. The sensitivity tests relate to both unit-linked and non-unit-linked assets and liabilities.

Notably, the sensitivities are not linear, so that sensitivities at other rates cannot necessarily be calculated by a simple extrapolation of the sensitivity tests presented.

	December 31, 2021
	Effect on economic solvency ratio
Decrease of 50 base points in risk-free interest rate (a)	**(19%)**
25% decrease in value of capital assets (b)	**(14%)**
5% increase in morbidity rate (c)	**(12%)**
5% decrease in mortality rate (c)	**(14%)**

A. An increase of 50 basis points in the risk-free interest rate will increase the economic solvency ratio by 15%. The tests of sensitivity to interest cover all the debt assets sensitive to interest, marketable as well as non-marketable, including designated bonds, reinsurance assets and the insurance liabilities. In calculating tests of sensitivity to changes in the interest rate, a new risk-free interest rate curve was created which represents a corresponding change of 50 basis points down/up to the Last Liquid Point (LLP) followed by a Smith-Wilson extrapolation up to the Ultimate Forward interest rate (UFR). The effect of changes in the interest rate on a recalculation of the Deduction amount was not taken into account.

B. A test of sensitivity to an impairment of capital assets covers marketable and non-marketable shares, investment funds, asset companies and strategic assets. The sensitivity test also takes into account the effect on the Symmetric Adjustment component in calculating the required capital.

C. Tests of sensitivity in morbidity and mortality rates cover all the health and life products that are sensitive to these risk factors.

10. <u>Restrictions on dividend distribution</u>

It is the Company's policy to hold a robust capital base to ensure its solvency and ability to meet its obligations to policyholders, to maintain its ability to continue its business activity and so that it is able to produce a yield for its shareholders. The Company is subject to the capital requirements and defined regulations with respect to the distribution of dividends.

On November 30, 2020, the Company's Board of Directors approved the revised capital management plan and at this stage, threshold conditions were determined for the distribution of a dividend, which include a minimum economic solvency ratio of 135%, taking the transitional provisions into account, and a minimum solvency ratio of 105%, without taking the transitional provisions into account,.

On February 28 ,2021, the Company's Board of Directors approved the distribution of a dividend of at least 35% of comprehensive income as long as Harel meets the minimum targets for Solvency.

The threshold conditions are intended to allow Harel Insurance to cope with crises without significantly compromising its operations and its compliance with the applicable capital requirements. Nonetheless, the foregoing is not intended to ensure that the Company will remain in compliance with the prescribed threshold conditions at all times.

According to a letter published by the Commissioner in October 2017 ("the Letter"), insurance companies may distribute a dividend only if, following the distribution, the company has a solvency ratio, based on the Economic Solvency Regime, of at least 100%, calculated without taking the transitional provisions into account and subject to the solvency ratio target set by the Company's Board of Directors. This ratio will be calculated without the relief provided in respect of the original difference attributed to the purchase of provident fund activity and management companies.

Below is information about the Company's economic solvency ratio, calculated without the transitional provisions and based on the solvency ratio target determined by the Company's board of directors with respect to the solvency ratio calculated without taking the provisions in the transitional period into account and after adjustment for equity risk, as required in the letter. This ratio is in compliance with the solvency ratio required according to the letter.

Without applying the transitional provisions to the transitional period and without adjustment for equity risk:

	December 31	
	2021	**2020**
	(Audited)	
	NIS million	
Own funds for the purpose of SCR	**14,336**	12,206
Solvency capital requirement (SCR)	**12,308**	11,583
Capital surplus	**2,028**	623
Solvency ratio (in percent)	**116%**	105%
Effect of material capital transactions that took place in the period between the date of the calculation and the publication date of the solvency ratio report:		
Raising of capital instruments (*)	**-**	-
Own funds for the purpose of SCR	**14,336**	12,206
Capital Surplus	**2,028**	623
Solvency ratio	**116%**	105%
Capital status after capital transactions in relation to the Board of Directors target:		
Economic solvency ratio target set by the Board of Directors	**105%**	105%
Capital surplus in relation to the target	**1,412**	44

(*) On May 31, 2022, an early redemption of Series 8 bonds is expected in the amount of NIS 239 million. This redemption will not affect recognized Tier-2 capital.

For information about the reasons that produced material changes compared with comparative figures in key items, see Section 2.A above.

May 30, 2022			
Date	Michel Siboni Chairman of the Board of Directors	Nir Cohen CEO	Adva Inbar Chief Risk Officer