AIG Israel Insurance Company Ltd

Interim Financial Report

(Unaudited)

As of March 31, 2016

Contents

Directors' report
AIG Israel Insurance Company Ltd ("the Company")
for the period ended March 31, 2016

The directors' report on the business of the Company as of March 31, 2016 ("**the directors' report**"), reviews the Company and developments in its business in the first quarter of 2016 ("**the reported period**"). The information in this report are as of March 31, 2016 ("**the date of report**") unless otherwise is indicated explicitly.

The Company is an "insurer" as this term is defined in the Supervision of Financial Services Law (Insurance), 1981. Therefore, this report is prepared based on Regulations 68-69 and the Second Addendum to the Insurance Business Supervision Regulations (Report Information), 1998 ("the Reporting Regulations") and according to the guidance issued by the Supervisor of Capital Markets, Insurance and Savings in the Israel Ministry of Finance ("the **Supervisor of Insurance**" or "**the Supervisor**"). This directors' report was prepared assuming that the user is also holding the Company's 2015 periodic report.

The financial information in this report is in reported amounts. All financial information is in thousand NIS unless otherwise is indicated.

The business of the Company is in fields that require considerable professional knowhow that involves many professional terms that are essential for understanding the business of the Company. To present a description of the corporation that is as clear as possible, those professional terms are used along with an explanation, to the extent possible.

This directors' report is an integral part of the interim financial statements, including all its parts and should be read as one unit.

Forward looking information

This chapter in the periodic report, describing the Company, the development of its business and its fields of operations may contain forward-looking information, as this term is defined in the Israel Securities Law, 1968 ("the Securities Law"). Forward looking information is uncertain information about the future, based on the information available to the Company on report date and includes the subjective assessment of management based on assumptions and estimates of the Company and/or its intentions as of the date of this report. Providing such information is not a commitment for accuracy or completeness, and actual activity and/or results of the Company may be different than those presented in the forward looking information presented in this report. It is possible in certain cases to detect passages that contain forward looking information by the use of words such as: "the Company assesses", "the Company believes", "it is the intention of the Company", etc., but it is possible to see such information presented using other language or it may be specifically indicated that as a forward-looking information.

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1. <u>Condensed description of the Company:</u>

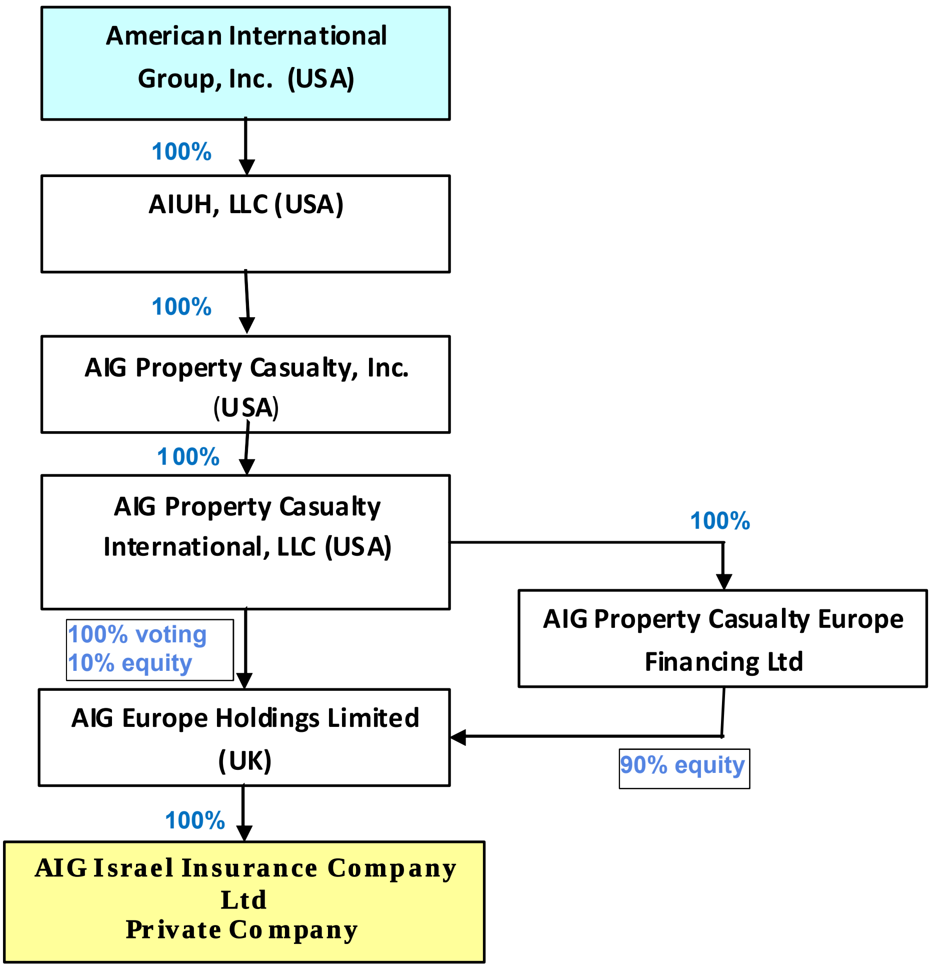
1.1 <u>Organizational structure</u>

AIG Israel Insurance Company Ltd ("**the Company**") was incorporated in Israel on March 27, 1996, as a private limited liability company. The Company began its insurance activity in May 1997. The company does not hold any subsidiaries or related companies. The Company has no activity outside of Israel through branches and associates.

The ultimate parent of the Company is American International Group Inc. (hereinafter: "**the global AIG corporation**"). The global AIG Corporation is a leading global insurance and financial services corporation, rated A- according to Standard & Poor's (S&P).

The shareholder of the Company is AIG Europe Holdings Limited, which holds the entire issued share capital of the Company, and is part of the global AIG corporation.

The following is the holding structure of the Company:



The Company was granted licenses by the Supervisor of Insurance to practice as an insurer in general insurance and life insurance as follows: motor vehicle insurance, compulsory motor vehicle insurance, comprehensive home insurance, health insurance (disease, hospitalization, personal injury coverage and travel insurance), commercial insurance (property loss, business comprehensive insurance, engineering insurance, employers' liability insurance, third-party liability insurance and product liability insurance), cargo in transit insurance, other risk insurance (limited to crime and fraud damages), comprehensive life insurance, and foreign business insurance for different insurance types.

The Company is operating in three business divisions (individual insurance, life and health insurance and commercial insurance), headquarters, sales and customer service.

The Company is marketing and selling retail insurance policies directly to customers (without insurance agents) through call centers and online. Customers are being serviced mainly through a central service call center. Most business of the Company in commercial insurance, and some of the retail insurance business, is done through mediation of insurance agents. As a result of the above marketing methods, the organizational structure of the Company is based on activity through a head office in Petach Tikva.

1.2 Areas of activity

The Company mostly provides coverage to individual customers. The main business areas of the Company are as follows:

- General insurance: property vehicle insurance
- General insurance: compulsory vehicle insurance
- General insurance: home insurance
- General insurance: commercial insurance
- Health insurance: health insurance
- Life insurance: Life insurance, risk only

1.3 Dependency on customers or marketing entities

The Company has no dependency on any single customer in most business activities. For more information see Sections 2.1.3, 2.2.3, 2.3.3, 2.4.3, 2.5.3 and 2.6.3 in Chapter A (description of company's business) in the company's 2015 periodic report.

1.4 Developments or material changes in reinsurance agreements

For information about reinsurance see Section 4.5 in Chapter A (description of company's business) in the company's 2015 periodic report.

1.5 Event outside the ordinary course of company's business since last financial statements

No exceptional events have taken place since balance sheet date.

2. Description of business environment:

General

In accordance with data published by the division of Capital Market, Insurance and Savings at the Israel Ministry of Finance, there are more than 15 Israeli insurance companies currently active in Israel; most of these companies are engaged in general insurance. In accordance with these data, as of September 30, 2015, insurance fees from the general insurance business amounted to NIS 15,697 million (excluding Karnit); the share of the 5 largest insurance companies – Harel, Clal, Phoenix, Migdal and Menorah – amounted to NIS 9,328 million, which constituted 59% of the total premiums in the Israeli general insurance sectors.

For further details regarding the competition in the different lines of business of the company and regarding the measures taken by the company to face competition in this competitive market, see Sections 2.1.2. 2.2.2, 2.3.2, 2.4.2, 2.5.2 and 2.6.2 in Chapter A (description of company's business) in the company's 2015 periodic report.

Developments in the company's macro-economic environment

The company invests a considerable part of its investment portfolio in the capital market; therefore, the yields arising from different routes of investments in the capital market have a significant effect on company's profits.

The following are data on the changes in the marketable securities indexes in the stock exchange:

	Jan-Mar 2016	Jan-Mar 2015	2015
Government bonds indexes			
General government bonds	1.4%	4.3%	1.6%
Linked government bonds	1.8%	4.9%	(0.2%)
NIS government bonds	1.2%	4.2%	2.8%
Corporate bonds indexes			
Tel Bond 60	0.8%	1.6%	(0.4%)
Tel Bond NIS	0.6%	2.9%	4.7%
Shares indexes			
Tel-Aviv 100	(4.9%)	10.0%	2.0%

For information regarding the composition of the Company's investments see financial investment asset list in note 6 to the condensed financial statements.

For information on general trends in the insurance sector and their effect on company's business, see Section 4.3 in Chapter A (description of company's business) in the Company's 2015 periodic report.

Characteristics and developments in principal insurance lines of business

For information about characteristics and developments in principal insurance lines of business of the Company, see Sections 2.1.2, 2.2.2, 2.3.2, 2.4.2, 2.5.2, 2.6.2, 4.1, 4.5 and 4.7 in Chapter A (description of company's business) in the company's 2015 periodic report.

The impact of new laws, regulations and directives on the business of the Company in the reported period and financial statements information

The following is a summary of major regulatory changes and the key issues that are relevant to the activity of the Company, as published by the Supervisor of Insurance in circulars and drafts during the reported period until shortly before the date of issuing this report:

Legislation

The Compensation to Office Holders of Financial Institutions (Special Approval and Non-Deductibility for Tax Purposes of Excessive Compensation), 2016 was published in the official gazette on April 12, 2016. The law caps the salary to office holders of financial institutions at NIS 2.5 million. Any amount paid in salaries to such office holders in excess of the NIS 2.5 million cap will not be deductible for tax purposes. The law also determines that the salary of any employee of a financial institution will not exceed an amount equal to 35 times the salary of the lowest-paid employee of that financial institution.

Circulars

- In January 2016 the Supervisor published circular 2016-1-1 "Amendment of the Consolidated Circular in the Compulsory Vehicle Insurance Sector" ("The Amendment to Codex – Compulsory Vehicle Sector"). As part of the said amendment, the Supervisor regulated the following issues: (1) updating the insurance fees of private vehicles in residual insurance; (2) An identical risk premium shall be set to drivers of the same risk regardless of whether the person is insured under a collective insurance policy or not. (3) Allowing insurance companies to refund premiums to careful drivers at the end of the insurance period; and (4) cancellation of the automatic linkage of compulsory vehicle insurance premiums to the CPI. Most of the provisions of the circular shall apply to vehicle insurance policies, the insurance period of which commences on March 1, 2016 and thereafter.

- In January 2016 the Supervisor issued Institutional Entities Circular 2016-9-2 on "Annual and Quarterly Reports to Members and Policyholders of Institutional Entities". The objective of the circular is to set an annual and quarterly reporting format regarding life insurance products, among other things; it aims to extend the disclosure obligations that apply to institutional entities and to simplify the information to be presented in the report so that members and policyholders can use the reports as a control and monitoring tool.

- Part 3 Heading 6 to the regulation codex, which is titled "Provisions regarding Health Insurance and Plans" was issued in January 2016. This part includes provisions which are specific to health insurance policies and plans. The provisions came into effect at the beginning of March 2016.

- In January 2016 the Supervisor issued a position paper titled "Risk Management in Financial Institutions – Across the Board Comparative Review". The paper reviews the findings that were collected by the Supervisor regarding risk management in insurance companies following an across-the-board review of insurance companies; (the review was aimed to assess the risk management infrastructure in insurance companies). The paper set out the Supervisor's position in connection with certain findings that have arisen in the course of the review and in connection with the appropriate application of her provisions in the field of risk management.

- In February 2016 the Supervisor issued Financial Institutions Circular 2016-9-5 on "Investment Rules Applicable to Financial Institutions". The objective of the circular is to set detailed provisions on the following issues: (a) Exceeding investment rates, (b) Appointment of a member of a board of directors by virtue of the financial institution holding the means of control in the corporation (c) Specialized investment track; (d) specialized index tracking investment; (e) investment in a partnership and in in real-estate right through a corporation which is not a partnership (f) providing loans, lending of securities and investment in non-marketable debt assets; (g) transaction with or through a related party; (h) investment in a related party and in an interested party; (i) control and holding means of control by an insurer.

- In March 2016, the Supervisor issued Insurance Circular 2016-1-4, titled "Amendment of Provisions of the Consolidated Circular – Chapter 1 in Part 2 Heading 5 – Measurement". The circular includes amendments the measurement chapter and provides that certain provisions shall be applied by insurers in their Q1 2016 financial statements at the latest.

- In April 2016, the Supervisor issued an in-principle ruling regarding the marketing of personal injury insurance policies. Among other things, the ruling sets out specific provisions for correction of irregularities in marketing of personal injury policies, including issuance of notices to those insured under such polices, repayment of insurance premiums in certain cases as required under the law and reporting to the Supervisor.

Drafts

- In January 2016 the Supervisor published a draft circular titled "The Amendment of the Provisions of the Consolidated Circular in the Compulsory Vehicle Insurance Sector". The draft circular aims to update the premiums in residual insurance (the Pool), which are applicable to private vehicles in order to increase competition in the compulsory vehicle insurance sector. The draft also aims to create better correlation between the insurance premiums collected by the Pool and the risk of the insured person and of the vehicles, based on the safety systems installed in the vehicle. Under the provisions of the draft, the insurance premiums shall be updated commencing January 1, 2017.

- In January 2016 the Supervisor issued Draft Insurance Circular 2015-181 titled "Amendment of the Consolidated Circular – Heading 6 Part 2 – Provisions Applicable to the Home Insurance Sector". The draft seeks to regulate home insurance issues related to water damage in order to improve the service provided to the clients upon the occurrence of an insurance evet. Among other things, it is suggested in the draft that the client will elect the manner in which service will be provided to him if a water damage insurance event takes place. The alternatives suggested in the draft are: selecting any plumber or selecting a plumber who works on behalf of the insurance company where selection will be made from an extended list, which will also include plumbers who are not employed by a plumbing company.

- The draft of Supervision on Financial Services Regulations (Insurance) (Restrictions on the Appointment and Tenure of Senior Office Holders in Financial Institutions), 2016 was published in January 2016. The objective of the said draft is to increase the effectiveness of the control and supervision mechanisms in financial institutions, reduce potential conflicts of interests, strengthen the independence of the financial institution and its senior office holders and ensure the reliability of senior office holders. Among other things, it is suggested in the draft to forbid a controlling shareholder of a financial institution or a relative thereof from serving as a senior office holder of that financial institution (with the exception of service as a member of the board of directors); it is also suggested that a person will carry out any of the responsibilities of a senior officer holder in a financial institution only if he/she was lawfully appointed to the job; it is also suggested that the independent judgment and discretion of a senior office holder shall not be undermined.

- In February 2016 the Supervisor issued a draft titled "Appendix to Circular on Processing and Settlement of Claims and Handling Communications from the Public – Draft". The draft includes provisions that are apply generally to all insurance sectors and provisions that apply specifically to insurance sectors. The draft is designed to establish a detailed set of rules to guide settlement of claims.

- In March 2016 the Supervisor issued a draft circular on the requirement to perform IQIS5 in 2015. The circular provides guidance on performance of IQIS5, including a number of changes and updates compared to IQIS4. The main changes in the draft relate to stabilization of risk free interest rate curves by using extrapolation to the ultimate forward rate, composition of recognized equity, lower equity requirements in connection with investment in infrastructure (equity and debt), updating the formula used to calculate the equity requirement in respect of the premiums and reserves risk in general insurance and updating the guidelines regarding a special auditors' report which will focus on best estimate and risk margin. The IQIS5 is the last quantitative survey before the application of the new solvency regime which is based on the provisions of the Solvency II directive; insurers will be required to file the IQIS5 in August 2016.

- In March 2016, the Supervisor published draft circular titled "Report to the Supervisor on Rates in Life Insurance Plans". The purpose of the draft is to regulate the manner in which insurance companies will disclose the insurance rates in order to present them in an online calculator for life insurance rates. The circular determines the maximal premium that can be collected from a new client; it also stipulates that the insurance companies shall report to the Supervisor on actual insurance premiums collected in the life insurance sector; this report will be filed on a quarterly basis.

- In April 2016 the Supervisor issued a draft circular titled "Management of Cyber Risks in Financial Institutions". The purpose of the circular is to set out principles for the protection of the assets of financial institutions in order to ensure securing the rights of insurance customers by maintaining confidentiality, completeness and availability of information assets, information technology systems, business processes and proper functioning of the financial institution. The circular defines, among other things, the principles for management of cyber risks in a financial institution and the duty of financial institutions to manage those risks, based on cyber protection principles.

Vinograd Committee

On June 8, 2014, the Vinograd Committee was appointed, with the mandate to examine whether the data used by the Israel National Insurance Institute (NII) to calculate benefits for workplace injuries are up-to-date, and whether modifications are needed in life expectancy tables and interest rates used in discounting NII workplace injury benefits. Recommendations of the committee were published in March 2016, and include, among other things, recommendations for updating payments according to the current, higher, life expectancy and discounting one-off payments using 2% interest rate, rather than 3%, given the lower interest rate in recent years.

As of March 31, 2016, the recommendations of the committee did not have material impact on the liability for insurance contracts of the Company.

Entry into and marketing of new lines of business

The Company did not enter any new lines of business during the reported period.

3. Financial information on the Company's lines of activity

The following is balance sheet highlights (in thousand NIS):

	March 31 2016	March 31 2015	December 31, 2015
Other assets	322,336	315,796	291,454
Deferred acquisition expenses	151,131	154,961	149,675
Financial investments and cash	1,676,142	1,691,547	1,633,451
Reinsurance assets	568,455	800,544	548,150
Total assets	**2,718,064**	**2,962,848**	**2,622,730**
Shareholders' equity	836,607	722,052	827,686
Liabilities in respect of insurance	1,470,014	1,848,579	1,417,989
Other liabilities	411,443	392,217	377,055
Total equity and liabilities	**2,718,064**	**2,962,848**	**2,622,730**

The following is comprehensive income highlights (in thousands of NIS)

	Jan-Mar 2016	Jan-Mar 2015	2015
Gross earned premiums	251,219	232,331	988,885
Premiums earned by reinsurers	(42,287)	(39,060)	(160,623)
Premiums earned in retention	**208,932**	**193,271**	**828,262**
Net investment revenue and financing revenue	1,673	40,682	18,616
Fee revenue	12,039	11,122	37,061
Total revenue	**222,644**	**245,075**	**883,939**
Payments and change in liability for insurance contracts, in retention	(129,907)	(120,563)	(420,867)
Total other expenses	(79,986)	(74,465)	(319,010)
Income before income taxes	**12,751**	**50,047**	**144,062**
Taxes on income	(3,830)	(18,902)	(53,971)
Income for the period and total comprehensive income for the period	**8,921**	**31,145**	**90,091**

Shareholders' equity and capital requirements

As of March 31, 2016, the Company's shareholders' equity exceeds the shareholders' equity required as of that date under the Insurance Business Regulations (Minimum Capital Required from an Insurer), 1998 by NIS 306.1 million.

For details regarding the amounts of equity required from the Company and the existing amounts in accordance with the minimum equity regulations, see note 5 to the financial statements.

For information about a NIS 105 million dividend distribution after balance sheet date, see section 8 below.

4. Results of operations

The Company continued during the first quarter of 2016 to increase gross premiums, by 10.8% compared with gross premiums in the first quarter of 2015. Total gross premiums in the reported period amounted to NIS 293.3 million compared with NIS 264.7 million in the corresponding period in 2015.

In the reported period, total premiums earned in retention amounted to NIS 232.1 million compared with NIS 220.0 million in the corresponding period in 2015 (a 5.5% increase).

Premiums by key insurance business segments (NIS in thousands):

Jan-Mar 2016	Life insurance	Health insurance	General insurance	Total
Gross	31,513	53,003	208,816	293,332
In retention	25,640	52,272	154,190	232,102
% of total gross	10.7	18.1	71.2	100.0
% of retention	11.0	22.5	66.5	100.0

Jan-Mar 2015	Life insurance	Health insurance	General insurance	Total
Gross	30,307	52,355	182,061	264,723
In retention	24,258	51,728	144,018	220,004
% of total gross	11.4	19.8	68.8	100.0
% of retention	11.0	23.5	65.5	100.0

Jan-December 2015	Life insurance	Health insurance	General insurance	Total
Gross	123,116	215,596	674,376	1,013,088
In retention	100,026	213,188	532,461	845,675
% of total gross	12.2	21.3	66.5	100.0
% of retention	11.8	25.2	63.0	100.0

The following is principle information on comprehensive income by key lines of business (in thousand NIS):

	Jan-Mar 2016	Jan-Mar 2015	Jan-Dec 2015
Income from compulsory vehicle activity	8,047	11,910	59,882
Income (loss) from property vehicle activity	(10,504)	3,538	(11,742)
Income from home insurance activity	4,518	3,916	9,419
Income from commercial insurance activity	2,786	2,978	5,795
Income from health insurance activity	11,088	6,844	58,356
Income from life insurance activity	1,034	986	11,607
Other - Income (loss) not attributed to any line of business	(4,218)	19,875	10,745
Income before taxes	**12,751**	**50,047**	**144,062**
Taxes on income	(3,830)	(18,902)	(53,971)
Income for the year and total comprehensive income for the year	**8,921**	**31,145**	**90,091**

Additional information on key segments – see note 4 to the condensed financial statements.

The following is explanation on the development in some items:

a. Net investment income was NIS 1.7 million, compared with NIS 40.7 million in the corresponding period of 2015. The sharp decrease in investment income resulted from lower investment returns on shares, government bonds and corporate bonds in the Israeli capital market compared with the corresponding period in 2015 (see section 2 above).

b. The income of the Company from compulsory vehicle insurance in the reported period was NIS 8 million compared with NIS 11.9 million in the corresponding period in 2015. The decrease in income mainly resulted from decrease in investment income. On the other hand, income from underwriting in the compulsory vehicle sector increased in the reported period and amounted to NIS 6.3 million compared with NIS 3.1 million in the corresponding period in 2015. The increase in income from underwriting in the compulsory vehicle sector is attributed to a decrease of the claim and expense ratios. Please note that the reported period is the first reporting period in which business results in the compulsory vehicle sector are calculated without calculating the reserve for excess of income over expenses "accrual".

c. Company's loss from property vehicle insurance in the reported period was NIS 10.5 million, compared with a profit of NIS 3.5 million in the corresponding period in 2015. The transition from profit to loss started in 2015 and this trend continued in the reported period as well. The main reason for the loss from this activity is a significant increase in the average amount of paid claim both in the case of property vehicle insurance products sold directly to clients and with such products sold through insurance agents. The Company has examined the causes of this increase thoroughly and it uses all measures available to it to reduce the claim ratio. As a result of the transition to loss, the Company recorded for the first time a reserve for premium deficiency at the total amount of NIS 11.3 million in its 2015 periodic report. This reserve remains virtually unchanged as of March 31, 2016.

d. The income of the Company from home insurance in the reported period was NIS 4.5 million compared with NIS 3.9 million in the corresponding period in 2015. The increase in profitability is mainly a result of an improvement in claim ratio due to the fact that no significant natural disaster events occurred in the reported period, whereas the results of the first quarter of 2015 were impacted by natural disasters.

e. The income of the Company from professional liability insurance in the reported period was NIS 0.3 million compared with an income of NIS 0.4 million in the corresponding period in 2015.

f. The income of the Company from other property liability insurance in the reported period was NIS 1.2 million compared with a loss of NIS 0.5 million in the corresponding period in 2015. The increase in income is mainly a result of a decrease in claims ratio.

g. The income of the Company from other liability insurance in the reported period was NIS 1.3 thousands compared with an income of NIS 3.1 million in the corresponding period in 2015. The decrease in income is mainly a result of a decrease in investment income.

h. The income of the Company from health insurance in the reported period was NIS 11.1 million compared with NIS 6.8 million in income in the corresponding period in 2015. The increase in income mainly resulted from a decrease in claim ratio and expense ratio.

i. The income of the Company from life insurance in the reported period was NIS 1.0 million compared with NIS 1.0 million in the corresponding period in 2015.

5. <u>Cash flows and liquidity</u>

Net cash provided by operating activities in the reported period was NIS 75.6 million, compared with NIS 15.7 million provided by operating activities in the corresponding period in 2015.

Net cash used in investing activities in the reported period amounted to NIS 4.5 million, compared with NIS 2.9 million in the corresponding period in 2015.

As a result of the above, the balance of cash and cash equivalents in the reported period increased by NIS 71.1 million and amounted NIS 133.4 million as of March 31, 2016.

6. Sources of funding

All of the Company's operations are funded using its own resources and capital. As of the date of approving this report, the Company does not use any external funding sources.

7. The effect of external factors

For more information, see section 2 above.

8. Material subsequent events

On April 19, 2016, the Company's Board of Directors approved a NIS 105 million dividend distribution to the sole shareholder of the Company – AIG Europe Holdings Limited. The capital surplus of the Company considering the dividend distribution compared to the required capital is NIS 201.1 million, and is about 138% over the required capital.

9. **<u>CEO and CFO Disclosure regarding the effectiveness of controls and procedures applied to company's disclosures</u>**

Controls and procedures applied to disclosure

The Company’s management, with the collaboration of the Company’s CEO and CFO, assessed as of the end of the period covered by this report the effectiveness of the controls and procedures with respect to the Company’s disclosure. Based on this assessment, the Company’s CEO and CFO concluded that as of the end of this period the controls and procedures with respect to the Company’s disclosure are effective in order to record, process, summarize and report the information that the Company is required to disclose in the quarterly report pursuant to the provisions of the law and the reporting provisions issued by the Commissioner of Capital Markets, Insurance and Savings, and on the date set in these provisions.

Internal controls over financial reporting

In the course of the quarter ending on March 31, 2016, no change has occurred in the internal control of the Company over financial reporting that materially affected or is reasonably expected to materially affect the Company’s internal control on financial reporting.

For purposes of this paragraph, "the covered period" is the reported financial quarter.

Management's statements as to the adequacy of the financial data presented in the Company's financial statements and the existence and effectiveness of internal controls relating to the financial statements are attached hereunder.

The Board of Directors wishes to thank the Company’s employees and management for their contribution to its business achievements.

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Ralph Mucerino	Shay Feldman
Chairman of the Board of Directors	CEO

May 24, 2016

AIG Israel Insurance Company Ltd

Declarations relating to the Financial Statements

Declaration

I, Shay Feldman hereby declare that:

1. I reviewed the interim report of AIG Israel Insurance Company Ltd. (hereafter – "the insurance company") for the quarter ended March 31, 2016 (hereafter – "the report").

2. Based on my knowledge, the report does not include any misstatement of a material fact or omit to disclose a material fact the presentation of which in the report is necessary for the purpose of ensuring that under the circumstances in which those presentations are included, they will not be misleading regarding the period covered by the report.

3. Based on my knowledge, the quarterly financial statements and other financial information included in the report reflect fairly, in all material respects, the financial position, results of operations, changes in shareholders' equity and cash flows of the insurance company for the date and periods covered by the report.

4. The Company's other certifying officers and I are responsible for establishing and maintaining controls and procedures relating to disclosure[1] and internal controls over financial reporting of the insurance company; and -

   (a) Accordingly, we have designed such disclosure controls and procedures, or have had such disclosure controls and procedures established under our charge, designed to ensure that material information relating to the insurance company is made known to us by others in the insurance company particularly during the period in which the reports were prepared;

   (b) We designed internal controls over financial reporting, or supervised the design of such internal controls designed to provide a reasonable assurance regarding the reliability of the financial reporting and assurance to the effect that the financial statements are drawn up in accordance with International Financial Reporting Standards (IFRS) and in accordance with the directives of the Supervisor of Insurance.

   (c) We assessed the effectiveness of controls and procedures regarding the disclosure of the insurance company and presented our conclusions regarding the effectiveness of disclosure controls and procedures as of the end of the period covered in the report, based on our estimate; and

   (d) We disclosed in the report any change in the insurance company's internal controls over financial reporting which took place in this quarter and had a material effect or is expected to have a material effect on the insurance company's internal controls over financial reporting; and

[1] As defined in the provisions of the Institutional Bodies Circular regarding internal controls over financial reporting – declarations, reports and disclosures.

5. The insurance company's other certifying officers and I have disclosed to the insurance company's auditors, the insurance company's board of directors and its audit committee, based on our most recent evaluation of internal controls over financial reporting, the following:

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the insurance company's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether material or not, that involves management or other employees who have a significant role in the insurance company's internal controls over financial reporting.

There is nothing in the aforesaid to derogate from my responsibility or the responsibility of any other person, pursuant to any law.

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Shay Feldman - CEO

May 24, 2016

Declaration

I, David Rothstein hereby declare that:

1. I reviewed the interim report of AIG Israel Insurance Company Ltd. (hereafter – "the insurance company") for the quarter ended March 31, 2016 (hereafter – "the report").

2. Based on my knowledge, the report does not include any misstatement of a material fact or omit to disclose a material fact the presentation of which in the report is necessary for the purpose of ensuring that under the circumstances in which those presentations are included, they will not be misleading regarding the period covered by the report.

3. Based on my knowledge, the quarterly financial statements and other financial information included in the report reflect fairly, in all material respects, the financial position, results of operations, changes in shareholders' equity and cash flows of the insurance company for the date and periods covered by the report.

4. The Company's other certifying officers and I are responsible for establishing and maintaining controls and procedures relating to disclosure[1] and internal controls over financial reporting of the insurance company; and -

   (a) Accordingly, we have designed such disclosure controls and procedures, or have had such disclosure controls and procedures established under our charge, designed to ensure that material information relating to the insurance company is made known to us by others in the insurance company particularly during the period in which the reports were prepared;

   (b) We designed internal controls over financial reporting, or supervised the design of such internal controls designed to provide a reasonable assurance regarding the reliability of the financial reporting and assurance to the effect that the financial statements are drawn up in accordance with International Financial Reporting Standards (IFRS) and in accordance with the directives of the Supervisor of Insurance.

   (c) We assessed the effectiveness of controls and procedures regarding the disclosure of the insurance company and presented our conclusions regarding the effectiveness of disclosure controls and procedures as of the end of the period covered in the report, based on our estimate; and

   (d) We disclosed in the report any change in the insurance company's internal controls over financial reporting which took place in this quarter and had a material effect or is expected to have a material effect on the insurance company's internal controls over financial reporting; and

[1] As defined in the provisions of the Institutional Bodies Circular regarding internal controls over financial reporting – declarations, reports and disclosures.

5. The insurance company's other certifying officers and I have disclosed to the insurance company's auditors, the insurance company's board of directors and its audit committee, based on our most recent evaluation of internal controls over financial reporting, the following:

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the insurance company's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether material or not, that involves management or other employees who have a significant role in the insurance company's internal controls over financial reporting.

There is nothing in the aforesaid to derogate from my responsibility or the responsibility of any other person, pursuant to any law.

____

David Rothstein - CFO

May 24, 2016

Directors and Management's Report Regarding Internal Controls over Financial Reporting

Management, with the supervision of the Board of Directors of AIG Insurance Company Ltd. (hereafter the "the Insurance Company") are responsible for setting and maintaining effective internal control over financial reporting. The internal controls system of the insurance company was planned in order to provide reasonable assurance to management and Board of Directors to the effect that the financial statements are prepared and presented fairly in accordance with International Financial Reporting Standards and in accordance with the directives of the Supervisor of Insurance.

All internal controls have inherent limitations regardless of the quality of planning. Therefore, even if it is determined that these controls are effective they can only provide a reasonable measure of assurance regarding the preparation and presentation of financial statements.

Management, supervised by the Board of Directors, maintains a comprehensive control system designed to ensure that transactions are carried out in accordance with management’s authorization, assets are protected, and accounting records are reliable. In addition, management with the Board of Directors' supervision takes measures in order to ensure that the information and communications channels are effective and monitor implementation, including implementation of the internal control procedures.

The Insurance Company’s management with the supervision of its Board of Directors evaluates the effectiveness of the internal control of the Insurance Company over financial reporting as at March 31, 2016, based on criteria set in the internal control model of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation management believes that as at March 31, 2016 the internal control of the Insurance Company over financial reporting is effective.

________________	_______________	_______________
Mr. Ralph Mucerino	Mr. Shay Feldman	Mr. David Rothstein
Chairman of the Board	CEO	CFO

Date of approval of financial statements: May 24, 2016

AIG ISRAEL INSURANCE COMPANY LTD.

FINANCIAL INFORMATION FOR INTERIM PERIOD
(Unaudited)

MARCH 31, 2016

AIG ISRAEL INSURANCE COMPANY LTD.

FINANCIAL INFORMATION FOR INTERIM PERIOD
(Unaudited)

MARCH 31, 2016

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Auditors' review report to shareholders of AIG Israel Insurance Company Ltd.

Introduction

We have reviewed the attached financial information of AIG Israel Insurance Company Ltd ("the Company"), which is comprised of the condensed statement of financial position as of March 31, 2016 and the condensed statements of comprehensive income, changes in equity and cash flows for the three-month periods ended on that date. The Board of Directors and management are responsible for the preparation and presentation of the financial information for this interim period in accordance with the provisions of International Accounting Standard No. 34, 'Interim Financial Reporting'(hereafter "IAS 34"), and they are also responsible for the preparation of the financial information for this interim period in accordance with the disclosure requirements of the Supervision of Financial Services (Insurance) Law, 1981 and the regulations promulgated thereunder. Our responsibility is to express a conclusion with respect to the financial information for this interim period, based on our review.

Scope of review

Our review was conducted in accordance with the provisions of Review Standard No. 1 of the Institute of Certified Public Accountants in Israel, 'Review of financial information for interim period undertaken by the entity's auditor.' A review of financial information for an interim period consists of the making of enquiries, in particular, of those officials responsible for financial and accounting matters, and of the application of analytical and other review procedures. A review is substantially lesser in scope than an audit conducted in accordance with auditing standards generally accepted in Israel and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, no matter has come to our attention that causes us to believe that the above financial information is not prepared, in all material respects, in accordance with IAS 34.

In addition, based on our review, no matter has come to our attention that causes us to believe that the above financial information does not comply, in all material respects, with the disclosure provisions of the Supervision of Financial Services (Insurance) Law, 1981 and the regulations promulgated thereunder.

Tel-Aviv, Israel	Kesselman & Kesselman
May 24, 2016	Certified Public Accountants (Isr.)
	A member firm of PricewaterhouseCoopers International Limited

AIG ISRAEL INSURANCE COMPANY LTD.

CONDENSED STATEMENTS OF FINANCIAL POSITION

AS OF MARCH 31, 2016

	March 31		December 31,
	2016	2015	2015
	(Unaudited)		(Audited)
	NIS in thousands		
Assets			
Intangible assets	27,115	20,870	26,397
Deferred acquisition costs	151,131	154,961	149,675
Property and equipment	11,810	10,071	11,469
Reinsurance assets	568,455	800,544	548,150
Premiums collectible	231,551	204,009	206,867
Current tax assets	-	39,465	3,250
Other receivables	51,860	41,381	43,471
	1,041,922	1,271,301	989,279
Financial investments:			
Marketable debt instruments	1,236,152	1,258,448	1,200,998
Non-marketable debt instruments	192,144	170,087	203,935
Marketable shares	-	100,736	92,851
Other	114,410	66,329	73,424
TOTAL FINANCIAL INVESTMENTS	1,542,706	1,595,600	1,571,208
CASH AND CASH EQUIVALENTS	133,436	95,947	62,243
TOTAL ASSETS	2,718,064	2,962,848	2,622,730

Ralph Mucerino	Shay Feldman	David Rothstein
Chairman of the Board of Directors	C.E.O	C.F.O

Date of approval of financial information for interim period by the Board of Directors of the Company: May 24, 2016

AIG ISRAEL INSURANCE COMPANY LTD.

CONDENSED STATEMENTS OF FINANCIAL POSITION

AS OF MARCH 31, 2016

	March 31		December 31,
	2016	2015	2015
	(Unaudited)		(Audited)
	NIS in thousands		
EQUITY AND LIABILITIES			
EQUITY:			
Share capital	6	6	6
Share premium	250,601	250,601	250,601
Capital reserves	11,084	11,084	11,084
Retained earning	574,916	460,361	565,995
TOTAL EQUITY ATTRIBUTABLE TO COMPANY SHAREHOLDERS	836,607	722,052	827,686
LIABILITIES:			
Liabilities in respect of insurance contracts and investment contracts that are not yield dependent	1,470,014	1,848,579	1,417,989
Liabilities in respect of deferred taxes, net	2,760	18,604	8,141
Retirement benefit obligation, net	2,433	3,108	2,781
Liabilities to reinsurers	295,318	285,043	279,347
Liabilities for current taxes	32,502	-	-
Payables	78,430	85,462	86,786
TOTAL LIABILITIES	1,881,457	2,240,796	1,795,044
TOTAL EQUITY AND LIABILITIES	2,718,064	2,962,848	2,622,730

The accompanying notes are an integral part of these condensed financial statements.

AIG ISRAEL INSURANCE COMPANY LTD.

CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE THREE-MONTH PERIOD ENDED MARCH 31, 2016

	Three months ended March 31		Year ended December 31,
	2016	2015	2015
	(Unaudited)		(Audited)
	NIS in thousands		
Gross earned premiums	251,219	232,331	988,885
Premiums earned by reinsurers	(42,287)	(39,060)	(160,623)
Premiums earned in retention	208,932	193,271	828,262
Investment income, net and financing income	1,673	40,682	18,616
Commission income	12,039	11,122	37,061
TOTAL INCOME	222,644	245,075	883,939
Payments and change in liabilities with respect to insurance contracts, gross	(151,866)	(231,515)	(480,825)
Share of reinsurers in increase of insurance liability and payments for insurance contracts	21,959	110,952	59,958
Payments and change in liabilities with respect to insurance contracts, retention	(129,907)	(120,563)	(420,867)
Commission, marketing expenses and other acquisition costs	(58,675)	*(54,878)	(239,888)
General and administrative expenses	(20,547)	*(20,295)	(82,884)
Financing income (expenses), net	(764)	708	3,762
TOTAL EXPENSES	(209,893)	(195,028)	(739,877)
INCOME BEFORE TAXES ON INCOME	12,751	50,047	144,062
Taxes on income	(3,830)	(18,902)	(53,971)
INCOME FOR THE PERIOD AND TOTAL COMPREHENSIVE INCOME FOR THE PERIOD	8,921	31,145	90,091
BASIC EARNINGS PER SHARE:			
Basic income per share	1.56	5.44	15.72
Number of shares used in calculating basic income per share	5,730	5,730	5,730

* After reclassification due to change in accounting policy – see note 2u to the 2015 annual financial statements of the Company.

The accompanying notes are an integral part of these condensed financial statements.

AIG ISRAEL INSURANCE COMPANY LTD.

CONDENSED STATEMENTS OF CHANGES IN EQUITY

FOR THE THREE-MONTH PERIOD ENDED MARCH 31, 2016

	Share capital	Share premium	Other reserves	Retained earnings	Total
	NIS in thousands				
BALANCE AS OF JANUARY 1, 2016 (audited)	6	250,601	11,084	565,995	827,686
Change during the three months ended march 31, 2016 (unaudited) - total comprehensive income in the three months ended March 31, 2016				8,921	8,921
BALANCE AS OF MARCH 31, 2016 (unaudited)	6	250,601	11,084	574,916	836,607
BALANCE AS OF JANUARY 1, 2015 (audited)	6	250,601	11,084	429,216	690,907
Changes during the three months ended March 31, 2015 (unaudited) - total comprehensive income in the three months ended March 31, 2015				31,145	31,145
BALANCE AS OF MARCH 31, 2015 (unaudited)	6	250,601	11,084	460,361	722,052
BALANCE AS OF JANUARY 1, 2015 (audited)	6	250,601	11,084	429,216	690,907
CHANGES DURING THE YEAR ENDED DECEMBER 31, 2015 (audited)					
Accumulated net tax impact, at December 31, 2015, of elimination of retention and first-time implementation of the "best practice"				81,688	81,688
Total comprehensive income				90,091	90,091
Transaction with shareholders, recognized directly in equity – dividend				(35,000)	(35,000)
BALANCE AS OF DECEMBER 31, 2015 (audited)	6	250,601	11,084	565,995	827,686

* For more information on this change in accounting policy, whose accumulated impact fully arise from elimination of accumulation in vehicle and liabilities business - see note 2r(1)(d)(5) to the 2015 annual financial statements.

The accompanying notes are an integral part of these condensed financial statements.

AIG ISRAEL INSURANCE COMPANY LTD.

CONDENSED STATEMENTS OF CASH FLOWS

FOR THE THREE-MONTH PERIOD ENDED MARCH 31, 2016

	Three months ended March 31		Year ended December 31,
	2016	2015	2015
	(Unaudited)		(Audited)
	NIS in thousands		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net cash provided by (used in) operations (Appendix A)	36,800	(32,236)	10,261
Interest received	12,069	13,000	44,813
Dividend received	137	277	2,480
Income taxes received (paid), net	26,547	34,669	(22,941)
Net cash provided by operating activities	75,553	15,710	34,613
CASH FLOWS FROM INVESTING ACTIVITIES:			
Changes in assets covering equity and non-insurance liabilities:			
Acquisition of property and equipment	(1,697)	(623)	(6,019)
Acquisition of intangible assets	(2,777)	(2,228)	(13,423)
Net cash used in investing activities	(4,474)	(2,851)	(19,442)
CASH FLOWS FROM FINANCING ACTIVITIES - dividend paid to shareholders	-	-	(35,000)
Net cash used in financing activities	-	-	(35,000)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	71,079	12,859	(19,829)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	62,243	83,087	83,087
IMPACT OF FLUCTUATION IN EXCHANGE RATE ON CASH AND CASH EQUIVALENTS	114	1	(1,015)
CASH AND CASH EQUIVALENTS AT END OF PERIOD	133,436	95,947	62,243

AIG ISRAEL INSURANCE COMPANY LTD.

CONDENSED STATEMENTS OF CASH FLOWS

FOR THE THREE-MONTH PERIOD ENDED MARCH 31, 2016

	Three months ended March 31		Year ended December 31,
	2016	2015	2015
	(Unaudited)		(Audited)
	NIS in thousands		
APPENDIX A - CASH FLOWS FROM OPERATIONS -			
Income before taxes on income	12,751	50,047	144,062
Adjustments for- Income and expenses not involving cash flows:			
Change in liabilities with respect to insurance contracts that are not yield dependent	52,025	*133,318	(134,592)
Change in reinsurance assets	(20,305)	*(81,573)	139,009
Increase in deferred acquisition costs	(1,456)	(6,747)	(1,461)
Change in retirement benefits obligation, net	(348)	39	(288)
Depreciation of property and equipment	1,356	1,215	5,213
Amortization of intangible asset	2,059	1,768	7,436
Losses (gains), net, on financial investments:			
Marketable debt instruments	3,312	(17,507)	26,506
Non-marketable debt instruments	1,009	7,012	7,154
Marketable shares	4,162	(8,873)	(825)
Marketable index fund certificates	1,407	(2,000)	(329)
Impact of fluctuation in exchange rate on cash and cash equivalents	(114)	(1)	1,015
	43,107	26,651	48,838
Changes in operating assets and liabilities:			
Liabilities to reinsurers	15,971	4,445	(1,251)
Investments in financial assets, net	18,612	(80,754)	(110,236)
Premiums collectible	(24,684)	(10,672)	(13,530)
Receivables	(8,389)	(1,232)	(3,322)
Payables	(8,355)	(7,444)	(6,118)
Current tax assets	(7)	-	(889)
	(6,852)	(95,657)	(135,346)
Adjustments for interest and dividend:			
Interest received	(12,069)	(13,000)	(44,813)
Dividend received	(137)	(277)	(2,480)
	(12,206)	(13,277)	(47,293)
Net cash provided by (used in) operations	36,800	(32,236)	10,261

Cash flows from operating activities include those stemming from financial investment purchases and sales (net) that relate to operations involving insurance contracts.

* Reclassified

The accompanying notes are an integral part of these condensed financial statements.

NOTE 1 - GENERAL

AIG Israel Insurance Company Ltd. ("the Company") was incorporated in Israel on March 27, 1996 as a private company in which the shareholders have limited responsibility. The Company commenced its insurance operations in May 1997. The Company does not hold any subsidiaries or related companies. The Company has no foreign operations through branches and investees.

The ultimate parent company is American International Group Inc. (hereafter – "AIG Global Corporation" or "AIG"), which is a leading international insurance and financial concern.

The Company's shareholder is AIG Europe Holdings Limited, which holds all the issued share capital of the Company. AIG Europe Holdings Limited is a member of the AIG Global Corporation.

The registered address of the Company's office is 25 Hasivim St. Petah-Tikva.

DEFINITIONS:

1) The Company – AIG Israel Insurance Company Ltd.

2) The parent company – AIG Europe Holdings Limited

3) Supervisor - Supervisor of Insurance (Commissioner of the Capital Market, Insurance and Savings at the Israel Ministry of Finance).

4) The Supervision Law – The Supervision of Financial Services (Insurance) Law, 1981.

5) Investment contracts – policies that do not constitute insurance contracts.

6) Reinsurance assets – the reinsurer's share in the reserves for insurance contracts and in the contingent claims.

7) CPI - The Consumer Price Index published by the Israeli Central Bureau of Statistics.

8) Known CPI - The CPI known at the end of the month.

9) Related parties - as defined in IAS 24 "Related Party Disclosures".

10) Interested party - as defined in the Israeli Securities (Financial Statements) Regulations, 2010.

11) Life insurance fund - Actuarial fund calculated in accordance with the principles generally accepted for this purpose in Israel.

12) Unexpired risks fund - Funds calculated in accordance with the Regulations for Calculation of General Insurance Funds.

NOTE 1 - GENERAL (continued):

13) Outstanding claims - Known outstanding claims, with the addition of the expected progression of claims that have been incurred but not enough reported (I.B.N.E.R.) plus claims that have been Incurred but not reported (I.B.N.R).

14) Details of account regulations - Supervision of Insurance Businesses (Details of account) Regulations, 1998.

15) The Investment Regulations – The Supervision of Financial Services (Provident Funds) (Investment Rules Applicable to Financial Institutions) Regulations, 2012.

16) Shareholders' Equity Regulations - The Supervision of Insurance Business Regulations (minimum shareholders' equity required from an insurer), 1998 and amendments as amended.

17) Account Segregation Regulations in Life Insurance - The Supervision of Insurance Regulations (Method of Segregation of Accounts and Assets of Insurer in Life Insurance), 1984.

18) Regulations for Calculation of General Insurance Funds - The Supervision of Insurance Businesses Regulations (Method of Calculation of Provisions for Future Claims in General Insurance) 1984, and amendments as amended.

19) Exposure to reinsurers - debit balances with the company’s reinsurers, including the reinsurer’s share in the company’s outstanding claims and unexpired risks fund, all being net of the reinsurer’s deposits with the company and the amount of documentary credits granted against the debt of the reinsurer.

20) Insurance contract - A contract under which one party (the insurer) takes a significant insurance risk from another party (policyholder), by agreement to indemnify the policyholder if an uncertain a defined future event (insurance event) negatively affects the policyholder.

21) Liability for insurance contracts - Insurance reserves and outstanding claims.

22) Premiums - Premiums including fees and proceeds for related services

23) Premiums earned premiums that relate to the reporting period.

NOTE 2 - BASIS OF PREPARATION OF FINANCIAL STATEMENTS:

a. The Company’s condensed financial information as of March 31, 2016 and for the three-month interim period ended on that date (“the interim financial information”) has been prepared in accordance with the provisions of IAS 34 'Interim Financial Reporting" (hereafter – "IAS 34") and is in compliance with the disclosure requirements of the Supervision of Financial Services (Insurance) Law, 1981 (“the supervision law”) and the regulations promulgated there under. The interim financial information should be read in conjunction with the Company's annual financial statements as of December 31, 2015 and for the year ended thereon including the accompanying notes (hereinafter - the 2015 annual financial statements), which are in compliance with International Financial Reporting Standards, which are standards and interpretations published by the International Accounting Standards Board (hereafter – "IFRS").

NOTE 2 - BASIS OF PREPARATION OF FINANCIAL STATEMENTS (continued):

The interim financial information has been subject to review only and has not been audited.

b. Estimates

The preparation of interim financial statements requires management to exercise its judgment and also requires use of accounting estimates and assumptions that affect the application of the Company's accounting policy and the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Significant judgments exercised by management in preparation of these condensed interim financial statements as well as the uncertainty involved in the key sources of those estimates were identical to the ones used in the Company's annual financial statements for the year ended December 31, 2015.

In this context, we note that on June 8, 2014, the Vinograd Committee was appointed, with the mandate to examine whether the data used by the Israel National Insurance Institute (NII) to calculate benefits for workplace injuries are up-to-date, and whether modifications are needed in life expectancy tables and interest rates used in discounting NII workplace injury benefits. Recommendations of the committee were published in March 2016, and include, among other things, recommendations for updating payments according to the current, higher, life expectancy and discounting one-off payments using 2% interest rate, rather than 3%, given the lower interest rate in recent years.
As of March 31, 2016, the recommendations of the committee did not have material impact on the liability for insurance contracts of the Company.
Note that, in light of the above, there is uncertainty, at this stage, over the impact, if any, of the update on the liability of the Company, and therefore, it is possible that future claims will unfold significantly differently than Company estimates, and that the Company will later be required to update its estimates.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES:

The significant accounting policies and the computational methods applied in the preparation of the interim financial information are consistent with the policies and methods applied in the preparation of the annual financial statements of the Company, except for the following matters:

a. Taxes on income for the reported interim period are accounted for on the basis on management's best estimate of the average tax rate applicable to the projected annual profits.

b. New accounting standards:

1) New IFRS and amendments to existing standards that came into effect and are mandatory for reporting periods commencing on January 1, 2016:

Amendment to IAS 1 "Financial Statements Presentation" (hereinafter - IAS 1 Amendment):
IAS 1 Amendment deals with the following topics: materiality and its impact on disclosures in the financial statements, presentation of subtotals, order of note presentation in the financial statements and disclosure of accounting policies.

IAS 1 Amendment did not have material impact on the financial statements of the Company.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (continued):

2) New IFRS and amendments to existing standards, which have not yet become effective and have not been early adopted by the Company.

In its annual 2015 financial statements, the Company specified new IFRS and additional amendments to existing IFRS, which have not yet become effective and have not been early adopted by the Company.

Since the date of issuance of the Company's annual financial statements through the date of approval of these interim financial statements, no new standards of amendments to existing standards were issued that may have material impact on the Company's financial statements.

NOTE 4 - SEGMENT INFORMATION

The Company’s chief operational decision-makers review the Company’s internal reports for the purposes of evaluating performance and deciding upon the allocation of resources. Management has established operating segments on the basis of these reports. Segment performance is assessed by measuring pre-tax profit and the profit before investment income and tax and by considering particular ratios, such as the claims ratio and the expenses ratio.

The Company operates in the general insurance segment, the health insurance segment and the life assurance segment, as follows:

1) Life assurance segment

The life assurance segment provides cover for life assurance risk only as well as coverage of other risks such as disability, occupational disability and other health related services

2) Health insurance segment

All the Company’s health insurance operations are concentrated within this segment. The segment provides personal accident cover, severe illness cover and foreign travel cover.

3) General insurance segment

The general insurance segment encompasses the property and liability sectors. In accordance with the directives of the Supervisor of Insurance, the segment is divided into the following sectors: the compulsory motor vehicle sector, the motor vehicle property sector, the apartment's insurance sector, property and others sectors, the professional liability sector and other liability sectors

- **Compulsory motor vehicle sector**

The compulsory motor vehicle sector focuses on the provision of cover, the purchase of which, by the owner or driver of a vehicle, is compulsory by law. This insurance provides cover for bodily injury occasioned to the driver of the vehicle, any passengers therein or pedestrians as a result of the use of an engine vehicle.

- **Motor vehicle property sector**

The motor vehicle property sector focuses on the provision of cover for property damage occasioned to the motor vehicle of the insured and for property damage that the motor vehicle of the insured causes to a third party.

NOTE 4 - SEGMENT INFORMATION (continued):

- **Home insurance sector**

  The apartment's insurance sector focuses in providing coverage for damages caused to apartments and includes coverage in respect of damages caused by earthquake.

- **Professional liability sector**

  The professional liability sector provides cover to practitioners of the various liberal professions for any claims that may be made against them in relation to injury occasioned to a third party as a result of a mistake or professional negligence. Insurance coverage to directors and office holders in respect of an unlawful act or oversight carried out by the directors and office holders in their professional capacity and funds misappropriation damages.

- **Property and others sectors**

  Property and others sectors provide cover with respect to those property lines which are not connected with the motor vehicle or liability sectors. Cover is principally provided with respect to property insurance, subcontractors and mechanical breakdown insurance.

- **Other liability sectors**

  Other liability sectors provide cover for the liability of the insured with respect to damage that the insured causes to a third party. Amongst the liabilities covered by these sectors are third party liability, employer’s liability and product liability.

NOTE 4 - SEGMENT INFORMATION (continued):

	For 3-month period ended March 31, 2016 (unaudited)				
	Life assurance	Health insurance	General insurance	Not attributed to operating segments	Total
	NIS in thousands				
Gross earned premiums	31,608	53,028	166,583		251,219
Premiums earned by reinsurers	(5,873)	(734)	(35,680)		(42,287)
Premiums earned in retention	25,735	52,294	130,903		208,932
Investment income (loss), net	1	529	4,123	(2,980)	1,673
Commission income	929	129	10,981		12,039
Total income	26,665	52,952	146,007	(2,980)	222,644
Payments and change in liabilities with respect to insurance contracts (gross)	(11,494)	(22,709)	(117,663)		(151,866)
Payments and change in liabilities with respect to insurance contracts, in retention	2,145	1,024	18,790		21,959
	(9,349)	(21,685)	(98,873)		(129,907)
Commissions and other acquisition costs	(11,881)	(13,562)	(33,232)		(58,675)
General and administrative expenses	(4,401)	(6,617)	(9,529)		(20,547)
Financing income (expenses), net	-	-	474	(1,238)	(764)
Total comprehensive income (loss) before taxes on income	1,034	11,088	4,847	(4,218)	12,751
Liabilities with respect to insurance contracts, gross, as of March 31, 2016	52,543	111,498	1,305,973		1,470,014

NOTE 4 - SEGMENT INFORMATION (continued):

	For 3-month period ended March 31, 2015 (unaudited)				
	Life assurance	Health insurance	General insurance	Not attributed to operating segments	Total
	NIS in thousands				
Gross earned premiums	30,159	52,207	149,965		232,331
Premiums earned by reinsurers	(6,046)	(629)	(32,385)		(39,060)
Premiums earned in retention	24,113	51,578	117,580		193,271
Investment income (loss), net and financing income	(1)	2,614	18,902	19,167	40,682
Commission income	982	119	10,021		11,122
Total income	25,094	54,311	146,503	19,167	245,075
Payments and change in liabilities with respect to insurance contracts (gross)	(12,149)	(28,054)	(191,312)		(231,515)
Share of reinsurers in increase of insurance liabilities and payments for insurance contracts	4,354	1,929	104,669		110,952
Payments and change in liabilities with respect to insurance contracts, in retention	(7,795)	(26,125)	(86,643)		(120,563)
Commission and other acquisition costs *	(11,048)	(13,711)	(30,119)		(54,878)
General and administrative expenses *	(5,265)	(7,631)	(7,399)		(20,295)
Financing income, net	-	-	-	708	708
Total comprehensive income before taxes on income	986	6,844	22,342	19,875	50,047
Liabilities with respect to insurance contracts, gross, as of March 31, 2015	54,609	145,242	1,648,728		1,848,579

* After reclassification due to change in accounting policy – see note 2u to the 2015 annual financial statements of the Company.

AIG ISRAEL INSURANCE COMPANY LTD.

NOTES TO CONDENSED FINANCIAL STATEMENTS (continued)

NOTE 4 - SEGMENT INFORMATION (continued):

	For the year ended December 31, 2015 (audited)				
	Life assurance	Health insurance	General insurance	Not attributed to operating segments	Total
	NIS in thousands				
Gross earned premiums	123,046	216,421	649,418		988,885
Premiums earned by reinsurers	(23,095)	(2,408)	(135,120)		(160,623)
Premiums earned in retention	99,951	214,013	514,298		828,262
Investment income, net, and financing income	-	1,236	8,617	8,763	18,616
Commission income	3,907	565	32,589		37,061
Total income	103,858	215,814	555,504	8,763	883,939
Payments and change in liabilities with respect to insurance contracts (gross)	(40,010)	(76,333)	(364,482)		(480,825)
Share of reinsurers in increase of insurance liabilities and payments for insurance contracts	11,939	2,805	45,214		59,958
Payments and change in liabilities with respect to insurance contracts in retention	(28,071)	(73,528)	(319,268)		(420,867)
Commission and other acquisition costs	(44,998)	(53,411)	(141,479)		(239,888)
General and administrative expenses	(19,182)	(30,519)	(33,183)		(82,884)
Financing income (expenses)	-	-	1,780	1,982	3,762
Total comprehensive income before taxes on income	11,607	58,356	63,354	10,745	144,062
Liabilities with respect to insurance contracts, gross, as of December 31, 2015	49,140	115,230	1,253,619	-	1,417,989

NOTE 4 - SEGMENT INFORMATION (continued):

Additional information relating to general insurance segment:

	For 3-month period ended March 31, 2016 (unaudited)						
	Compulsory motor vehicle	Motor vehicle property	Home	Professional liability	Other property Sectors*	Other liability Sectors*	Total
	NIS in thousands						
Gross premiums	40,644	86,404	28,094	20,803	19,077	13,794	208,816
Reinsurance premiums	(568)	(29)	(5,948)	(18,266)	(18,426)	(11,389)	(54,626)
Premiums in retention	40,076	86,375	22,146	2,537	651	2,405	154,190
Change in balance of unearned premiums, in retention	(5,003)	(15,025)	(2,338)	(421)	(93)	(407)	(23,287)
Premiums earned in retention	35,073	71,350	19,808	2,116	558	1,998	130,903
Investment income, net	1,738	847	279	519	102	638	4,123
Commission income	-	-	1,805	4,294	2,627	2,255	10,981
Total income	36,811	72,197	21,892	6,929	3,287	4,891	146,007
Increase in insurance liabilities and payments for insurance contracts	(26,121)	(65,936)	(10,853)	(5,280)	(7,789)	(1,684)	(117,663)
Share of reinsurers in increase of insurance liabilities and payments for insurance contracts	4,835	-	1,718	3,784	7,729	724	18,790
Increase in liabilities for insurance contracts in retention	(21,286)	(65,936)	(9,135)	(1,496)	(60)	(960)	(98,873)
Commission, marketing expenses and other acquisition costs	(5,986)	(13,098)	(5,199)	(4,705)	(1,807)	(2,437)	(33,232)
General and administrative expenses	(1,492)	(3,844)	(3,334)	(416)	(219)	(224)	(9,529)
Financing income, net	-	177	294	3	-	-	474
Total expenses	(28,764)	(82,701)	(17,374)	(6,614)	(2,086)	(3,621)	(141,160)
Total comprehensive income (loss) before taxes on income	8,047	(10,504)	4,518	315	1,201	1,270	4,847
Liabilities with respect to insurance contracts, gross, as of March 31,2016	486,253	229,731	72,416	158,265	90,927	268,381	1,305,973
Net liabilities with respect to insurance contracts, retention as of March 31, 2016	391,524	229,731	62,352	27,633	3,288	37,212	751,740

* The results of property and others sectors reflect mainly the results of engineering insurance sectors with 54% of the total premiums attributable to these sectors. The results of other liability sectors reflect mainly the results of the third party liability insurance sector, with 34% of the total premiums attributable to these sectors.

NOTE 4 - SEGMENT INFORMATION (continued):

Additional information relating to general insurance segment:

	For the 3-month period ended March 31, 2015 (unaudited)						
	Compulsory Motor Vehicle	Motor vehicle property	Home	Professional liability	Property and others sectors*	Other liability sectors*	Total
	NIS in thousands						
Gross premiums	41,297	74,860	29,131	16,858	8,652	11,271	182,069
Reinsurance premiums	(583)	(29)	(5,738)	(14,300)	(8,250)	(9,142)	(38,042)
Premiums in retention	40,714	74,831	23,393	2,558	402	2,129	144,027
Change in balance of unearned premiums, in retention	(6,974)	(13,991)	(4,464)	(435)	(88)	(495)	(26,447)
Premiums earned in retention	33,740	60,840	18,929	2,123	314	1,634	117,580
Investment income, net	8,819	2,897	1,380	2,738	354	2,714	18,902
Commission income	-	-	1,475	4,000	2,241	2,305	10,021
Total income	42,559	63,737	21,784	8,861	2,909	6,653	146,503
Increase in insurance liabilities and payments for insurance contracts	(25,715)	(47,575)	(12,257)	(85,843)	(12,078)	(7,844)	(191,312)
Share of reinsurers in increase of insurance liabilities and payments for insurance contracts	2,584	-	2,391	82,478	10,547	6,669	104,669
Increase in liabilities for insurance contracts in retention	(23,131)	(47,575)	(9,866)	(3,365)	(1,531)	(1,175)	(86,643)
Commission, marketing expenses and other acquisition costs **	(6,292)	(11,901)	(5,041)	(3,688)	(1,350)	(1,847)	(30,119)
General and administrative expenses **	(1,226)	(723)	(2,961)	(1,443)	(482)	(564)	(7,399)
Financing expenses, net	-	-	-	-	-	-	-
Total expenses	(30,649)	(60,199)	(17,868)	(8,496)	(3,363)	(3,586)	(124,161)
Total comprehensive income (loss) before taxes on income	11,910	3,538	3,916	365	(454)	3,067	22,342
Gross liabilities for insurance contracts as of March 31,2015	677,230	185,792	71,003	348,244	96,061	270,398	1,648,728
Net liabilities with respect to insurance contracts as of March 31, 2015	522,083	185,792	61,818	53,249	4,619	41,069	868,630

* The results of property and others sectors reflect mainly the results of the property insurance sectors with 83% of the total premiums attributable to these sectors.
The results of other liability sectors reflect mainly the results of the third party liability insurance sector, with 48% of the total premiums attributable to these sectors.

** After reclassification due to change in accounting policy – see note 2u to the 2015 annual financial statements of the Company.

NOTE 4 - SEGMENT INFORMATION (continued):

Additional information relating to general insurance segment:

	Compulsory motor vehicle	Motor vehicle property	Home	Professional liability	Other property sectors *	Other liability sectors *	Total
	For the year ended December 31, 2015 (audited)						
	NIS in thousands						
Gross premiums	146,782	284,177	102,246	62,239	40,167	38,765	674,376
Reinsurance premiums	(2,051)	(116)	(16,991)	(52,726)	(38,212)	(31,819)	(141,915)
Premiums in retention	144,731	284,061	85,255	9,513	1,955	6,946	532,461
Change in balance of unearned premiums in retention	(1,013)	(15,292)	(1,595)	328	(207)	(384)	(18,163)
Premiums earned retention	143,718	268,769	83,660	9,841	1,748	6,562	514,298
Investment income, net and financing income	4,212	1,257	484	1,209	162	1,293	8,617
Commission income	-	-	4,138	13,571	7,436	7,444	32,589
Total income	147,930	270,026	88,282	24,621	9,346	15,299	555,504
Payments and change in liabilities with respect to insurance contracts (gross)	4,888	(216,420)	(48,644)	(72,636)	(1,855)	(29,815)	(364,482)
Share of reinsurers in increase of insurance liabilities and payments for insurance contracts	(58,572)	-	8,177	70,834	(207)	24,982	45,214
Payments and change in liabilities with respect to insurance contracts in retention	(53,684)	(216,420)	(40,467)	(1,802)	(2,062)	(4,833)	(319,268)
Commissions, marketing expenses and other acquisition costs	(27,511)	(58,625)	(27,432)	(15,077)	(5,162)	(7,672)	(141,479)
General and administrative expenses	(6,853)	(7,368)	(12,097)	(4,251)	(1,384)	(1,230)	(33,183)
Financing income, net	-	645	1,133	-	-	2	1,780
Total expenses	(88,048)	(281,768)	(78,863)	(21,130)	(8,608)	(13,733)	(492,150)
Total comprehensive income before taxes on income	59,882	(11,742)	9,419	3,491	738	1,566	63,354
Gross liabilities for insurance contracts as of December 31,2015	475,386	206,560	70,551	155,586	77,626	267,910	1,253,619
Net liabilities with respect to insurance contracts as of December 31, 2015	384,669	206,560	61,654	27,338	3,496	36,772	720,489

* The results of property and others sectors reflect mainly the results of the property insurance sector, with 83% of the total premiums attributable to these sectors.
The results of other liability sectors reflect mainly the results of the product liability insurance sector, with 44% of the total premiums attributable to these sectors.

NOTE 4 - SEGMENT INFORMATION (continued):

Additional information relating to life insurance segment:

Data pertaining to three months ended March 31, 2016 (unaudited) (ILS in thousands):

	Policies not containing savings element		Total
	Risk sold as single policy		
	Private	Group	
Gross risk premiums	31,513	-	31,513
Payments and change in liabilities for gross insurance contracts	11,494	-	11,494

Data pertaining to three months ended March 31, 2015 (unaudited) (ILS in thousands):

	Policies not containing savings element		Total
	Risk sold as single policy		
	Private	Group	
Gross risk premiums	30,307	-	30,307
Payments and change in liabilities for gross insurance contracts	12,149	-	12,149

Data pertaining to year ended December 31, 2015 (audited) (ILS in thousands):

	Policies not containing savings element		Total
	Risk sold as single policy		
	Private	Group	
Gross risk premiums	123,116	-	123,116
Payments and change in liabilities for gross insurance contracts	40,010	-	40,010

NOTE 4 - SEGMENT INFORMATION (continued):

Additional information relating to healthcare segment:

Data pertaining to three months ended March 31, 2016 (unaudited) (ILS in thousands):

	Long-term	Short-term	Total
Gross premiums	43,427	9,576	* 53,003
Payments and change in liabilities for gross insurance contracts	16,592	6,117	22,709

* Includes mainly policies issued to individuals

Data pertaining to three months ended March 31, 2015 (unaudited) (ILS in thousands):

	Long-term	Short-term	Total
Gross premiums	42,936	9,419	* 52,355
Payments and change in liabilities for gross insurance contracts	20,654	7,400	28,054

* Includes mainly policies issued to individuals

Data pertaining to year ended December 31, 2015 (audited) (ILS in thousands):

	Long-term	Short-term	Total
Gross premiums	172,613	42,983	* 215,596
Payments and change in liabilities for gross insurance contracts	65,506	10,827	76,333

* Includes mainly policies issued to individuals

NOTE 5 - SHAREHOLDERS' EQUITY AND CAPITAL REQUIREMENTS:

a. Dividend declared after balance sheet date

On April 19, 2016, the Company's board approved a NIS 105 million dividend, representing about 42% of issued capital (share capital and premium) of the Company as of March 31, 2016. The dividend per share is NIS 18,325.

b. Capital management and requirements

The table below provides information with respect to the capital requirements in the Supervision of Financial Services Regulations (Insurance) (Minimum Required Capital of Insurers), 1998 (hereinafter - capital regulations), and guidance of the Supervisor.

Company's capital in accordance with the Shareholders' Equity Regulations:

	March 31		December 31,
	2016	2015	2015
	(Unaudited)		(Audited)
The amount required under capital regulations and supervisor guidelines (a)	530,082	534,304	515,769
Existing amount calculated under shareholders' equity regulations:			
Primary capital	836,607	722,052	827,686
Total existing capital calculated under shareholders' equity regulations	836,607	722,052	827,686
Surplus	306,525	187,748	311,917
Amount of investments that is required to be provided against capital surplus, under the Supervisors guidance, and therefore represent detained surplus.	-	-	-
Subsequent events - dividend declared			
Surplus after consideration of subsequent events	306,525	187,748	311,917
Subsequent events - dividend declared	(105,000)	-	-
Surplus after consideration of subsequent events	201,525	187,748	311,917

(a) The required amount covers capital requirements for:

	March 31		December 31,
	2016	2015	2015
	(Unaudited)		(Audited)
	NIS in thousands		
Operations in general insurance	106,654	125,897	106,236
Exceptional life assurance risks	37,988	32,996	36,790
Deferred acquisition costs related to life assurance	82,343	84,845	84,452
Investment assets and other assets	49,937	66,133	44,547
Catastrophe risks related to general insurance	226,660	191,004	218,294
Operating risks	26,500	33,429	25,450
Total full amount required under capital regulations	530,082	534,304	515,769

NOTE 5 - SHAREHOLDERS' EQUITY AND CAPITAL REQUIREMENTS (continued):

c. Solvency II

For information about the Solvency II (hereinafter - the directive) - based regimen (hereinafter - the directive), as issued by the Supervisor, and the IQIS exercises, which are designed to calibrate the model (simulations of the effect of the directive on the insurer's equity given its existing business mix and balance sheet) - see note 12(d) to the 2015 annual financial statements. According to the guidance issued as above by the Supervisor, insurance companies will be required to comply with the new capital requirements, which will replace the existing ones beginning from the 2016 annual financial statements.

As indicated in that note, according to the results of the IQIS4 exercise that the Company performed regarding 2014, capital surplus as of December 31, 2014 increased when calculated in accordance with the directive, compared to capital surplus based on the existing israeli regimen.

On April 21, 2016, the Supervisor issued guidance for performing an IQIS regarding 2015 (hereinafter - IQIS 5).

The guidance to perform IQIS 5 includes several changes and updates relative to IQIS 4. Those mainly include, among other things, stabilization of risk-free interest curves through extrapolation up to the Ultimate Forward Rate, recognized capital composition, lower capital requirement when investing in infrastructures (capital and debt), update of formula for calculating capital requirement for general insurance premiums and reserves risk, and update of guidelines on special auditor's special report focusing on Best Estimate and risk margin.

The guidance further indicates that IQIS 5 calculation, which would be the last quantitative review before implementing the new directive and replacing the existing solvency regimen, will contribute to compliance preparations by insurance companies and the drafting of final guidance. It also indicates that the boards of insurance company will be required to discuss the findings of IQIS 5 as would be reflected in reports to be submitted by management to the board, according to the guidance, prior to filing to the Supervisor.

According to the directive, insurance companies are required to file the results of the planned exercise to the Supervision through August 7, 2016 in a detailed format, as indicated in the guidance, accompanied by a special report by the independent auditor, also in compliance with the guidance, and with the presentations and documents submitted to the board as above. In addition, insurance companies will file to the Supervisor, by September 7, 2016, a copy of the minutes of their boards discussions on the issue.

NOTE 6 - FINANCIAL INSTRUMENTS AND FINANCIAL RISKS:

a. Fair value disclosure

Following the discussion in note 10(g) to the Company's 2015 annual financial statements, during the 3-month period ended March 31, 2016, no transfers were made between level 1 and level 2.

b. The fair value of financial assets and financial liabilities:

1) The financial statements balances of cash and cash equivalents, premiums collectible, accounts receivables, and accounts payable are equal to or approximate their fair value.
2) For details on the fair value of financial investments, see d. below.

c. In the three-month period ended March 31, 2016, no material changes have occurred in the financial risk management policy of the Company, compared to the policy it reported in its 2015 annual financial statements.

d. Composition of financial investments:

	As of March 31, 2016 (unaudited)		
	Measured at fair value through profit or loss	Loans and receivables	Total
	NIS in thousands		
Marketable debt instruments(1)	1,236,152	-	1,236,152
Non-marketable debt instruments(2)	-	192,144	192,144
Marketable shares(3)	-	-	-
Other(4)	114,410	-	114,410
Total	1,350,562	192,144	1,542,706

	As of March 31, 2015 (unaudited)		
	Measured at fair value through profit or loss	Loans and receivables	Total
	NIS in thousands		
Marketable debt instruments(1)	1,258,448	-	1,258,448
Non-marketable debt instruments(2)	-	170,087	170,087
Marketable shares(3)	100,736	-	100,736
Other(4)	66,329	-	66,329
Total	1,425,513	170,087	1,595,600

	As of December 31, 2015 (audited)		
	Measured at fair value through profit or loss	Loans and receivables	Total
	NIS in thousands		
Marketable debt instruments(1)	1,200,998	-	1,200,998
Non-marketable debt instruments(2)	-	203,935	203,935
Marketable shares(3)	92,851	-	92,851
Other(4)	73,424	-	73,424
Total	1,367,273	203,935	1,571,208

NOTE 6 - FINANCIAL INSTRUMENTS AND FINANCIAL RISKS (continued):

d. Composition of financial investments (continued):

1) **Composition of marketable debt instruments** (designated upon initial recognition to the fair value through profit or loss category):

	As of March 31, 2016 (unaudited)	
	Carrying amount	Amortized cost
	NIS in thousands	
Government bonds	584,954	570,308
Other debt assets:		
Other non-convertible debt assets	651,198	647,225
Other convertible debt assets	-	-
Total marketable debt assets	1,236,152	1,217,533

	As of March 31, 2015 (unaudited)	
	Carrying amount	Amortized cost
	NIS in thousands	
Government bonds	651,228	626,375
Other debt assets:		
Other non-convertible debt assets	607,158	598,270
Other convertible debt assets	62	62
Total marketable debt assets	1,258,448	1,224,707

	As of December 31, 2015 (audited)	
	Carrying amount	Amortized cost
	NIS in thousands	
Government bonds	589,845	587,667
Other debt assets:		
Other non-convertible debt assets	611,153	615,487
Other convertible debt assets	-	-
Total marketable debt assets	1,200,998	1,203,154

NOTE 6 - FINANCIAL INSTRUMENTS AND FINANCIAL RISKS (continued):

d. Composition of financial investments (continued):

2) Composition of non-marketable debt instruments

	As of March 31, 2016 (unaudited)	
	Carrying amount	Fair value
	NIS in thousands	
Bank deposits	96,984	98,107
Other non-convertible debt assets	95,160	98,878
Total non-marketable debt assets	192,144	196,985

	As of March 31, 2015 (unaudited)	
	Carrying amount	Fair value
	NIS in thousands	
Bank deposits	97,032	98,157
Other non-convertible debt assets	73,055	77,025
Total non-marketable debt assets	170,087	175,182

	As of December 31, 2015 (unaudited)	
	Carrying amount	Fair value
	NIS in thousands	
Bank deposits	97,714	97,661
Other non-convertible debt assets	106,221	108,560
Total non-marketable debt assets	203,935	206,221

NOTE 6 - FINANCIAL INSTRUMENTS AND FINANCIAL RISKS (continued):

d. Composition of financial investments (continued):

3) **Shares** (designated upon initial recognition to the fair value through profit or loss category):

	As of March 31, 2016 (unaudited)	
	Carrying amount	Cost
	NIS in thousands	
Marketable shares	-	-

	As of March 31, 2015 (unaudited)	
	Carrying amount	Cost
	NIS in thousands	
Marketable shares	100,736	88,516

	As December 31, 2015 (audited)	
	Carrying amount	Cost
	NIS in thousands	
Marketable shares	92,851	88,989

4) **Composition of other financial investments** (designated upon initial recognition to the fair value through profit or loss category):

	As of March 31, 2016 (unaudited)	
	Carrying amount	Cost
	NIS in thousands	
Marketable financial investments	114,410	114,270

	As of March 31, 2015 (unaudited)	
	Carrying amount	Cost
	NIS in thousands	
Marketable financial investments	66,329	64,394

	As December 31, 2015 (audited)	
	Carrying amount	Cost
	NIS in thousands	
Marketable financial investments	73,424	73,867

NOTE 7 - TAXES ON INCOME:

a. Calculating the income tax for the interim period is based on the best estimate of the weighted income tax rate expected for the full fiscal year. The expected weighted average annual tax rate, as above, for the year ending December 31, 2016 is 35.90%, see also b below (2015 - 37.58%).

b. Changes in corporate tax rate that came into effect on January 1, 2016:

In January 2016, the Law for the Amendment of the Income Tax Ordinance (No. 216), 2016 was passed into law and published, enacting a reduction of corporate tax in 2016 and thereafter from 26.5% to 25%. As a result of lowering the tax rate as above, which was reflected for the first time in the financial statements of the Company for the 3-month period ended on March 31, 2016, the liability for deferred taxes decreased by a negligible amount, which was recognized in deferred tax income.

c. Industry specific tax agreements for 2013-2015 signed on January 13, 2016:

On January 13, 2016, the Insurance Companies Association and the Israel Tax Authority signed industry-specific agreements regarding the 2013-2015 tax years. Under the industry-specific agreement referring to the 2014 tax year, some changes were made in the allocation rates of expense to preferred income and a mechanism was established for spreading out some of the movement in the provision for indirect expenses for claim settlement in subsequent years to the one in which the expense is registered. Under the industry-specific agreement for the 2015 tax year, commencing 2015, DAC expenses in life insurance are deductible for tax purposes over a 10-year period (instead of 4 years previously).

Since those agreements were signed during the course of January 2016, their implementation (including for previous tax years) was reflected for the first time in the financial statements of the Company for the 3-months period ended March 31, 2016.

Following the implementation of those agreements in the financial statements of the Company, the financial information for the three months ended March 31, 2016 included net tax income for previous years amounting to NIS 0.9 million.

NOTE 8 - CONTINGENT LIABILITIES - CLASS ACTION:

a. In December 2012, a lawsuit and a motion for certification as a class action were filed against the Company and 7 other insurance companies in December 2012. According to the plaintiffs, in 2007 the Transportation Ordinance was changed to the effect that the classification of the plaintiffs' vehicle was changed from a commercial vehicle to a private vehicle. Despite the change in classification as above, the insurance companies allegedly continued to classify the plaintiffs' vehicles as commercial vehicles for purposes of collection of comprehensive insurance/third party insurance and compulsory vehicle insurance, thereby collecting a higher premium. The premium was only collected in respect of vehicles through 2007, whereas for vehicles from 2008 and thereafter a lower premium was collected.

According to the legal claim, the insurance companies are required to price the premium in accordance with the classification set in the Transportation Ordinance and since they have not done so they should refund the insured persons and entities with the amounts collected in excess of the lawful premiums. The class includes individual and entities the classification of the vehicles of which was changed in the last seven years.

NOTE 8 - CONTINGENT LIABILITIES - CLASS ACTIONS (continued)**:**

Total damages claimed from the Company in respect of property insurance amount to NIS 22,296,660. The legal claim does not provide an estimate of the amount collected in excess of the amount legally due for compulsory vehicle insurance.

The Company filed its reply to the motion to certify the claim as a class action on June 2, 2013; the claimant filed its reply to the said application on July 7, 2013.

On July 10, 2013, a pretrial hearing was held, resulting in a court decision that the Company and all other defendants may file complementary responses to the motion for class action certification through October 6, 2013. The court also ruled that to the extent the plaintiffs are interested to file a specific discovery, they will have to do so within 30 days, with a response to the motion filed within 14 days and the counter-response within 7 days (court holiday are counted). In addition, a cross-examination of declarants was scheduled for February 24, 2014 and March 6, 2014.

The plaintiffs filed a motion for discovery and a motion to respond to a questionnaire. The Company filed its objection to the motion and the court has not given a decision.

Cross-examinations of the parties' witnesses took place on February 24, 2014 March 6, 2014 and March 25, 2014. At the end of the examinations, the court recommended the claimant to consider whether to continue pursuing the case.

On June 8, 2014, the plaintiffs filed a notice to the effect that they maintain their position that the motion to certify the claim as a class action shall be heard by the court. In accordance with the plaintiffs' notice, the court set a date for a summary hearing. Recently, summaries by the plaintiffs and the insurance companies were filed. After receiving an extension, the plaintiffs filed their response summaries on February 1, 2016. The court has yet to hand down a decision.

Based on the opinion of its legal counsels, Company management believes that it is more likely than not that the claim will be rejected.

b. A legal claim and a motion to certify a class action were filed on June 23, 2014 against the Company and 6 other insurance companies (hereafter – "the respondents") to the Jerusalem District Court (hereafter – "the court") by eight persons insured by the respondents (hereafter – "the applicants"). In the motion to certify the claim as a class action, it was claimed that the amount from which the mortgage life insurance premium has been derived by the respondents exceeded the actual balance of the loan with the lending bank and, as a result, the premiums paid the applicants were higher than the premiums they should have paid.

According to the applicants, the group of claimants in the class action includes all persons insured by the respondents under a life insurance policy for the purpose of securing a mortgage loan in the course of the seven year-period prior to filing the application and who paid to any of the respondents premiums which were higher than the premiums they should have paid since the amount from which the mortgage life insurance premium has been derived by the respondents exceeded the actual balance of the loan with the lending bank.

The causes of the claim according to the applicants are contravention of Sections 55 and 58 to the Supervision of Financial Services (Insurance) Law, 1981, breach of statutory duty, and breach of duty of good faith, negligence and unjust enrichment.

NOTE 8 - CONTINGENT LIABILITIES - CLASS ACTIONS (continued)**:**

The applicants seek to repay the persons included in the group the amount of difference between the insurance premiums that they were supposed to pay and the insurance premium they paid in practice with the addition of compensation for mental anguish. The applicants request that the court orders the respondents to update the amount of the insurance premium on a monthly or semi-annual basis based on exact mortgage loan data; they also request that the court orders the respondents to provide persons they insure an explanation regarding the option to provide the respondents with an updated balance of the loans with the lending banks (where no exact mortgage loan data is available).

The amount of the individual claim filed by the applicants against the Company is NIS 272 thousands and the amount claimed by the group of persons insured by the Company amounts to NIS 5,784,187.

On January 6, 2015, the respondents filed their reply to the motion to certify the claim as a class action. In their reply, the respondents claimed, among other things, that neither the law nor the insurance policy requires them to reduce the insured amount on their own accord and to adjust it to the updated balance of the loan. On the contrary, the insurance policy informs the insured individuals of the potential difference between the balance of the loan and the insured amount and in any case the updated insured amount is presented in the annual statements posted to all insured individuals; the respondents claim that without a specific request of the insured individual (to which an approval of the lending bank should be attached) they cannot reduce the insured amount since this will be considered breach of the provisions of the insurance policy; the respondents claim that they are unable to reduce the insured amount so that it corresponds to the balance of the loan since this information is subject to the bank secrecy duty; the respondents claim that the insured amount is covers not only the repayment of the principal of the loan but also the repayment of other related amounts, the existence and scope of which are not known to the insurance company in the course of the insurance period (such as payment arrears). Also, the balance of the loan is subject to changes taking place in the course of the loan period as a result of changes or revaluations carried out the borrower or the lending bank; the respondents claim that upon the occurrence of an insurance event, the respondents repay the mortgage loan and the related amounts to the lending bank and the remainder of the insured amount is paid to the other beneficiaries whose identity is determined by the insured individual; thus, according to the respondents the premiums paid the applicants are not higher than the premiums they should have paid. The respondents also claim that the underlying assumptions on which the applicants relied in their application is not shared by all applicants and that the applicants themselves acted in contradiction to those assumptions. The respondents claim that the non-disclosure claims that underlies the motion to certify the claim as a class action is a specific and individual claim, which should not be debated as part of a class action.

On April 19, 2015, the applicants filed their reply to the motion to certify the claim as a class action. The applicants reject the claims raised in the reply to the application. A preliminary hearing to discuss the application was held on June 14, 2015. In the course of this hearing, the Court informed the parties that it intends to address questions arising from the motion to certify the claim as a class action to the Supervisor of Insurance; the Court asked the parties to provide it, by July 16, 2016, with questions that will be addressed to the Supervisor of Insurance. On July 16, 2015, the parties filed the Court some questions they wish to refer to the Supervisor of Insurance as above.

A further preliminary hearing was held on July 20, 2015, in which the Court ordered to refer questions to the Supervisor of Insurance.

NOTE 8 - CONTINGENT LIABILITIES - CLASS ACTIONS (continued)**:**

On December 21, 2015, the Supervisor of Insurance notified the court that it sent the questions of the court to the Supervisor of Banks.

On March 23, 2016, the Supervisor of Insurance submitted its position, after reviewing the issues, with the help of the Supervisor of Banks. The regulatory position allegedly supports in principle the arguments that the respondents raised in their arguments to the motion to certify ("the Supervisor's position").

On April 7, 2016, the respondents filed their comments to the Supervisor's position, in which they argued, among other things, that the Supervisor's position supports their own arguments to the motions to certify, and that given the Supervisor's position, the plaintiffs should withdraw their motion to certify and the claim against the Company. The plaintiffs also filed their comments to the Supervisor's position.

On April 10, 2016, an additional pretrial hearing was held, in which the court ordered to plaintiffs' attorney, following the Supervisor's opinion, to notify the court whether he agrees to focus the claim and the motion to certify on the issue of the scope of informing customers on the method of insurance amount revaluation (interest rates) on the date of preparing the insurance contract. In this regard, the plaintiffs' attorney will also notify whether he withdraw his claims in relation to policy lifespan. The plaintiffs' attorney is required to file his position to the court by May 11, 2016.

Another pretrial was scheduled to May 16, 2016.

Based on information and data that was received, at this preliminary stage, the Company's management believes, based on the opinion of its legal advisors, that it is more likely than not that the court will not certify a class action.

c. A legal claim and a motion to certify a class action were filed in May 2015 against the Company and 5 other insurance companies. The plaintiffs claim that the insurers do not pay to insured people/entities and/or third parties the VAT component applicable to the cost of damages in cases where the alleged damages were not repaired in practice.

The plaintiffs rely in their legal claim on the Supreme Court's ruling in the Zlutzin vs. Diur La-Olle case (civil appeal 17229/99) according to which even where repairs were not carried out in practice, the defendant (who caused the damage in the said case) should bear the VAT component. The plaintiffs also rely on In-Principle Ruling 2014-46025 titled "In-Principle Ruling on Payment of VAT and Depreciation of Unrepaired Vehicle". This in-principle ruling states that even if the customer did not repair the vehicle in practice the insurer must pay the customer insurance benefits including, among other things, VAT applicable in this matter.
At this stage it is not yet clear whether the claim shall be heard in its current form since the class action plaintiff also filed an individual claim against the Company (including in connection with the VAT component) at the same time the class action motion was filed; the class action plaintiff requested the Court which hears the plaintiff's individual claim against the Company to allow him to withdraw the VAT component from this individual claim and to file a motion to certify a class action in respect of this component. On January 2, 2016, a decision was handed down, rejecting the motion by the plaintiff. Given that, the plaintiff has a number of procedural alternatives to continue to proceedings.

The total amount of damages claimed from the Company is NIS 40,211,388.

A pretrial is scheduled for June 26, 2016.

At this stage of the proceedings, the Company's management and its legal counsel wait to see which alternative the plaintiff will choose for continuing the proceedings in order to assess the relevance of the claim against the Company and its likelihood in court.

NOTE 8 - CONTINGENT LIABILITIES - CLASS ACTIONS (continued)**:**

d. A legal claim and a motion to certify a class action were filed on October 19, 2015 against the Company and another insurance company. The plaintiffs claim that in many cases the defendants breach the provisions of Insurance Circular 2007-1-8 "Vehicle Appraisal (Property and Third Party)" by ignoring or reducing the repair quotes or appraisals carried out by external appraisers and using appraisals issued by appraisers, who work on behalf of the Company, rather than by issuing notice and referring the case to a deciding appraiser at the dates specified in the Insurance Circular.

The class includes any insurance customer or third party whose car was damaged in a car accident in the course of the last seven years, to whom the defendants are required by law to pay damages and where an external appraiser, who is included in the list of external appraisers as specified in the Insurance Circular, prepared a repair quote or appraisal and the case was not referred to a deciding appraiser but rather, the appraisal of repairs and/or insurance compensation was carried out in practice by appraisers, who worked on behalf of the defendants, and those repair quotes and/or appraisals specified lower amounts and varied from the quotes and/or appraisals of the external appraisers; this group of plaintiffs includes insured, who signed statements of waiver as a condition for receipt of compensation from the defendants.

In the motion to certify, the applicants ask the Court to order the defendants to refund the difference between the compensation received by members of the above group – whether this compensation was in the form of insurance funds, repairs made to the car or any other compensation to which members of the group were eligible under a repair quote and/or appraisal of the external appraiser; the applicants also asked the Court to issue a mandatory injunction ordering the defendants to follow the provisions of the Insurance Circular by the letter, including honoring any repair quote and/or appraisal, which was prepared by an external appraiser, and which was not referred to a deciding appraiser in accordance with the provisions of the Insurance Circular; the applicants also asked the Court to set measures for the enforce the said injunction. The applicants also asked the Court to order the defendants to pay them individual compensation as well as the fees of their attorneys, as determined by the Court.

The Company negotiated with the attorney of the applicants out of court in attempt to reach agreements that will make a redundant a court proceeding or decide on the disputes underlying the motion to certify. However, the parties reached agreements as above. The Company is required to file its response to the motion by May 25, 2016.

An additional pretrial hearing is scheduled to July 6, 2016.

In light of the information provided, at this preliminary stage, the Company's management and its legal advisors believe it is more likely than not that the court will not certify a class action.

e. On December 17, 2015, the Reserve Forces Association filed an application to certify a class action against the Company and another insurance Company.

The applicants claim that the defendants charge reservists for full insurance premiums but only provide them with a partial and deficient insurance coverage, whose value is lower than the value of the premiums collected from reservists. According to the applicants, this situation is caused since the defendants do not insure the reservists during reserve-service periods but still charge the reservists for premiums in respect of those periods.

The class includes anyone who had an insurance policy which included an exclusion regarding reserve-service periods and who paid the defendants insurance premiums in respect of reserve-service periods in the seven years prior to the filing the class action application.

NOTE 8 - CONTINGENT LIABILITIES - CLASS ACTIONS (continued)**:**

A similar class action is heard in the District Court (Center District) against other insurance companies, in which a motion for consolidation of cases was filed between the motion to certify and the other proceeding.

In January 27, 2016, the Central District Court approved the consolidation of cases.

On April 14, 2016, the respondents filed to the Central District Court a mutually agreed motion to extend the deadline for filing response for the motion to certify.

On April 14, 2016, the Central District Court approved the respondents' motion, and the date for filing their responses was set to June 1, 2016.

The date for filing responses to the motion to certify was set to June 5, 2016.

The date of the hearing on the motion to certify was scheduled to September 6, 2016.

At this preliminary stage the legal advisors and management of the Company are looking into the matter; once they are familiarized with the details they will be able to assess the chances of the Court's approving the motion to certify a class action.

f. A legal claim and a motion to certify a class action were filed against the Company on December 17, 2015. The applicant claimed that the Company breaches the provisions of its comprehensive car insurance policy, which includes the AIG EXTRA compensation clause since it does not pay the insured an extra compensation of up to 15% of the value of the insured car. The applicant claimed that the causes of action are breach of agreement, breach of disclosure obligations, misleading and unjust enrichment.

The class includes any insurance customer of the Company who has a comprehensive car insurance policy, which includes an AIG EXTRA clause, but when the conditions of the clause were met did not receive the AIG EXTRA compensation.

On April 3, 2016, the Court rejected a motion to dismiss outright that was filed by the Company.

On April 13, 2016, the Company and the applicant reached a settlement, whereby the Company will pay the applicant NIS 1,500 within 15 days from the date a court decision, the lawsuit will be rejected and the motion to certify will be withdrawn. At that date, the Company will pay the applicant attorney NIS 11,500 in legal fees, and all subject to court approval ("the agreement").

On May 5, 2016, the applicant and the Company issued an agreed motion to withdraw the class action in which they presented settlement details.

On May 8, 2016, the court rejected the agreed motion for withdrawal and ruled that the parties are required to respond by May 16, 2016 whether they ask the applicant to withdraw the motion under Section 16 to the Class Action Law, 2006 ("the Law") or, alternatively, ask to settle the dispute under Section 18 to the Law ("the ruling").

On May 9, 2016, the parties filed a joint motion to extend the deadline to respond to the ruling to May 30, 2016 and extend the date to file the response to the motion to certify to June 14, 2016.

The time of filing the response to the motion to certify was set to June 4, 2016.

NOTE 8 - CONTINGENT LIABILITIES - CLASS ACTIONS (continued):

At this preliminary stage, management of the Company and its legal counsel are still looking into the matter and it is not possible to estimate the likelihood of the motion to certify a class action.

g. During the first quarter of 2016, a lawsuit and a motion to certify a class action was filed against the Company. The claim argues that the Company calculates compulsory vehicle premiums based on incorrect vehicle data, which leads to higher premiums than those approved by the Supervisor and that presented on the Supervisor's website that compares prices of different insurance companies.

The amount of personal damages claimed from the Company is negligible. The plaintiff did not specify the amount of damages of the class, but it estimated it at several million NIS.

At this preliminary stage, management of the Company and its legal counsel are still looking into the matter and it is not possible to estimate the likelihood of the motion to certify a class action. An initial pretrial hearing was scheduled to July 14, 2016.

Set forth below are the details of the applications for approval of legal claims as class actions:

	Number of claims	The amount claimed NIS in thousands
Pending applications for approval of legal claims as class actions - an amount relating to the Company was specified	7	* 68,292

* The above amount of claims includes only the claims for which the Company has an estimate of the total amount of the claim.

NOTE 9 - SUBSEQUENT EVENTS

On April 19, 2016, the board of director approved a NIS 105 million dividend distribution to the Company's shareholder. See also note 5a above.

Embedded value reporting

of

AIG Israel Insurance Company Ltd

As of December 31, 2015

Date issued: May 24, 2016

Table of contents

1. General

1.1 Background and scope of disclosure

Under a circular of the Israel Supervisor of Insurance dated August 12, 2007 (Insurance Circular 2007-1-11) ("**the Circular**"), insurance companies are required to disclose annually, along with the financial information for the first quarter of each year, information about their embedded value ("**embedded value**" or "**EV**") of long-term insurance policies (life insurance and health insurance) for the end of previous year. In compliance with the circular, AIG Israel Insurance Company Ltd ("**the Company**") discloses below the embedded value of its long-term insurance business as of December 31, 2015.

This report was prepared in accordance with the rules and principles set by the Supervisor of Insurance, who adopted the rules and principles proposed by a joint committee of insurers and the Supervisor of Insurance, which was assisted by Israeli and international advisors (hereinafter: "**the Committee**" and "the Committee Report"), except for the treatment of certain risks that are depicted in paragraph 1.5.3 below, and all as elaborated in that paragraph.

The disclosure in this report is in accordance with the general disclosure rules in the Committee Report and the provisions presented in a draft "disclosure format" that was prepared by the Committee in coordination with the Supervisor. The draft "disclosure format" has yet to be published by the Supervisor as an addendum to the Circular.

The rules and principles set in the Committees report are presented in the website of the Ministry of Finance – Financial Markets, Insurance and Savings Department (www.mof.gov.il).

1.2 Forward-looking statement

Determining the embedded value and the value of the new business (as this term is defined below) was based on projections, assessments and estimates about uncertain future events and that are not under the control of the Company, and should be seen as "forward-looking information" as defined by Section 32A to the Israel Securities Law, 1968. Those projections, assessments and estimates may not materialize or materialize in a different way than presented in the embedded value report and, and thus, actual results may be different than projected.

1.3 The main chapters in this document

- An overview and explanation of the computation methodology
- Assumptions that underlie the computation
- Results of the embedded value and value of new business
- Sensitivity analyses of embedded value results
- Analysis of change in embedded value

1.4 Definitions

The following definitions present a summary explanation to clarify key terms in this report.

Full descriptions and explanations can be found in the rules and principles in the Committee Report.

Present value of future profits (PVFP)	Discounting of future expected profit stream arising from covered in-force businesses (see paragraph 2.5.2 below).
Adjusted net worth (ANW)	The net worth of the company after a number of adjustments to make it consistent with the value of the in-force portfolio (see paragraph 2.5.1 below)
Cost of required capital (CoC)	The cost of required capital is the impact, from shareholders perspective, on embedded value due to the requirement mandating the Company to hold a minimum capital (see paragraph 2.5.3 below)
Value of in-force (VIF)	The value of the in-force portfolio is the present value of future profits less the cost of required capital
Embedded value (EV)	The embedded value is the aggregate of the following two components: Value in-force (VIF) and adjusted net worth. Note that the adjusted net worth is the equity relating to the operations of the entire company and not only those covered within the scope of EV. Also note that the value of in-force does not include: General insurance business (elementary) The ability to create additional business in the future (goodwill).
Value of new business (VNB)	The present value from the time of sale to the end of policy lifetime of expected profits for the covered businesses that were sold during the reported year.
Covered businesses	The businesses covered in the computation of in-force value: Long-term personal policies within the life insurance and health insurance portfolio in force as of December 31, 2015, including future premium increases

1.5 Comments, clarifications and limitations

1.5.1 General

As discussed above, the embedded value was computed based on the methodology, rules and principles in the Committee Report. The assumption in the model are the "best estimated assumptions", i.e. assumptions that are the result of applying existing experience to the future within the environment where insurance companies operate and excluding prudence. Naturally, since those are long-term future estimates, actual results are expected to be different than those estimated when calculating the embedded value.

Variations from the factors and assumptions in projected embedded value may have material impact on outcomes. Those include among other:

1. Economic factors (e.g. discount rate, returns)
2. Demographic factors (e.g. change in mortality and morbidity)
3. Legislation and legislative arrangements relating to relevant topics
4. Taxation
5. Changes in the business environment

Future results that vary from the assessments made based on the best estimated assumptions are normal and expected even if no change will take place in the above factors. Therefore, it is anticipated that actual results in each year will be different than those projected in the embedded value model, and even due to normal random fluctuations.

1.5.2 Reforms and legislation

There is uncertainty around the expected impact of recent legislation reforms, including the following:

a. Possible future changes in the capital requirements based on drafts/opinion papers issued by the Ministry of Finance.

   In April 2013, the Minister of Health announced the appointment of the Advisory Board for Strengthening the Public Health System ("the German Committee").

   As mandatory provisions, the findings of the German Committee do not have an effect on the health insurance activities as well as the embedded value of this activity for businesses sold through December 31, 2015.

The calculation of embedded value does not include the impact of the following events, and other developments that have yet to materialize in actual data, and where the Company is unable at this time to assess their impact on the business results and the embedded value or any other uncertain scenario.

Given the above, sensitivity analyses are included that assess the sensitivity of calculation results to changes in various factors that may occur following such events. Note that it is not possible to infer from the sensitivity analysis on Company assessments on the potential impact of regulatory changes that the Company is currently unable to assess their impact prior to their full implementation.

1.5.3 Addressing risk

The following are limits relating to the embedded value listed in this report, which arise from the way the Company calculated the embedded value:

- Assumptions used in calculating embedded value – In divergence from the Committee Report, extreme risks with very low probability, which the Company is unable to estimate their probabilities and effect on the Company, such as operating risks, were not taken into account.

Additionally, the demographic assumptions underpinning the model were mainly arrived at based on studies and analyses that rely on the Company's experience over the last few years, where no extreme events occurred. Therefore, there is a possibility of extreme scenarios that the Company did not account for in making the assumptions underlying the model, despite the attempt to set realistic assumptions that correspond to actual long-term experience.

- The model is based on the assumptions that there is no correlation between model assumptions on non-market and market risks, which may significantly affect embedded value. In divergence from the Committee Report, due to insufficient data for testing this correlation, this assumption was not tested by the Company.

- Under assumptions and rules of the Committee, the assumptions are made, among other things, in a way that results in the expected value of embedded value to shareholders. In the absence of significant statistical data that are suitable for estimating the distribution of embedded value among all demographic and operating factors, the Company used realistic assumptions of each factor individually, based on the expected value of each relevant factor.

- The embedded value is founded on the theory that investors do not need compensation for non-market risks as long as they can spread uncertainty by holding a distributed and diversified portfolio and on the assumption that uncertainty can be distributed as above. In practice, some of the demographic and operating risks may not be distributed. In the absence of a liquid and deep market that allows estimating market pricing for those risks, and without an agreed-upon methodology for quantifying the notional market price for those risks, we did not lower the embedded value for those risks.

- It should be indicated that in 2011 the committee engaged foreign actuarial advisors to set up a proper and practical methodology to adjust the embedded value to reflect the cost of non-hedgeable risks. It is expected that such adjustment shall reduce the embedded value, both with respect to the VIF and with respect to the VNB so that they will better reflect all risks, including non-hedgeable risks, in accordance with normal practice of reporting embedded value. As of the date of publication of this report, the said actuarial advisors have not yet issued detailed or final recommendations; therefore, the committee has not yet set an orderly methodology with regard to this matter. In light of the above, it is not possible to effect the adjustment in this report.

To reflect the assessment of risks that were not taken into account as above, readers of this report can adjust the presented embedded value, at their own judgment, using the sensitivity analyses in paragraph 3.5, as well as the sensitivity to changes in the discount rate vector. Note that, as indicated above, the Company is unable to quantify objectively and scientifically the effect of the above issues on the embedded value, and therefore, the sensitivities presented are not representing such an estimate, but provide a tool for users of the report for estimating the effect of the issues at their own judgment.

1.5.4 Asset valuation at fair value

According to the rules and principles in the Committee Report, the accounting values of all Company assets were not adjusted to fair value, but only the assets corresponding to the business included in the embedded value.

1.5.5 The embedded value is not supposed to represent the economic or market value of the Company or its parent.

Note that as discussed above, the value of in-force does not include general insurance business (elementary and overseas travel), except for long-term health business, which is covered.

Also, the embedded value does not cover certain risks that are specified in 1.5.3 above.

It follows, then, that the embedded value does not represent the market value or the overall economic value and market value of the Company.

2. Embedded value calculation methodology

2.1 General

The principles of computing the embedded value are in accordance with the rules and principles in the Committee Report, except for the treatment of certain risks as described in section 1.5.3 above, and all as specified in that section. The assumptions in the model are best estimate assumptions, i.e. without a prudence margin. The model does not include the value of future sales, but the calculation assumes continued business activity in terms of expenditure level and so on.

2.2 Treatment of risks

Financial risks (or markets risk) – Market risks are taken at their cost embedded in market prices using a financing technique called certainty equivalent approach. In this technique, the expected return is reduced to the risk-free level. After this adjustment, the expected cash flows are discounted using risk-free interest without a need to add a risk premium to the discount rate.

As part of the committee's consultation with the foreign advisors as above, they set out to formulate a methodology which will reflect the fact that in practice it is possible to assume excess returns over risk free interest, in light of the fact that it is possible to invest in non-marketable assets against non liquid insurance liabilities and it is therefore possible to assume a premium over risk free interest which will be applied to marketable assets ("the lack of liquidity premium") in accordance with normal practice of EV reporting and with other areas of the global insurance sector. The adjustment of the risk free interest rate due to "the lack of liquidity premium" is expected to increase the embedded value. As of the date of publication of this report the committee has not yet issued detailed and final recommendations; therefore the "lack of liquidity premium" is not reflected in this report.

Non-market risk – The calculation of the embedded value is based on the financial theory that investors do not need additional compensation in the discount interest for non-market risks as long as they can spread uncertainty using a distributed and diversified portfolio. Therefore, assuming this condition is satisfied, accounting for non-market risks is done through the use of best estimate assumptions and discounting cash flows using the risk-free interest rate.

2.3 General assumptions

2.3.1 Return, discount interest and inflation:

The future return and discount interest is determined using the risk-free interest linked to the cpi. Risk-free interest rates (spot) as of 2015 year-end are:

Year-end	Interest rate	Year-end	Interest rate	Year-end	Interest rate
2016	0.45%	2026	0.77%	2036	1.41%
2017	0.41%	2027	0.86%	2037	1.44%
2018	0.22%	2028	0.95%	2038	1.48%
2019	0.10%	2029	1.02%	2039	1.51%
2020	0.14%	2030	1.09%	2040	1.54%
2021	0.23%	2031	1.16%	2041	1.56%
2022	0.32%	2032	1.22%	2042	1.59%
2023	0.43%	2033	1.27%	2043	1.61%
2024	0.54%	2034	1.32%	2044	1.63%
2025	0.66%	2035	1.37%	2045	1.65%

Note that there is no need for an explicit assumption of future inflation as all amounts in the model are CPI-linked. When a certain parameter is expected to change in divergence from future inflation, an explicit assumption was taken of variation from future inflation.

2.3.2 Tax

- Tax rate on financial institutions (including profit tax)

Year	2015	2016	+2017
Tax rate	37.58%	37.18%	37.18%

2.4 Demographic and operating assumptions

All the assumptions above with material impact on the embedded value were set based on the best estimates of the Company for each demographic and operating factor, and reflect the anticipation of the Company for the future developments in those factors.

2.4.1 Demographic assumptions

The demographic assumptions, included in the computation were taken from internal studies of the Company, when available, and conclusions that resulted from exercising professional judgment, based on both the relevant experience and a combination of information from external sources, such as information from reinsurers and mortality and morbidity tables that were issued.

2.4.2 Future administrative and general expenses

Administrative and general expenses were calculated based on the results of an internal pricing model on expenses related to associates, including allocation of expenses to the various sectors (life insurance, health insurance) and loading expenses on different activities (production, ongoing management, investments, etc.)

2.5 Computation method

2.5.1 Adjusted net worth (ANW)

The amount of net worth is taken from the December 31, 2015 financial statements of the Company. This amount was reduced by the amount of deferred acquisition expenses based on the related balance sheet information, less the allowance for deferred tax in their respect and less the expected tax benefit for the part of the deductible deferred acquisition cost.

For a list of the adjustments, see the tables presented above in section 3.3.

2.5.2 Present value of future profits (PVFP)

The present value of future profits was calculated using an actuarial model that is based on insurance policy and other data that are available to the Company. This model allows for projecting future cash flows and their discount.

2.5.3 Cost of required capital (CoC)

A projection of the required capital for the covered businesses was made based on existing requirements and future reductions of the covered businesses. The cost of required capital is the discounting of the tax on investment return on the capital required for the covered businesses.

2.5.4 Value of new business (VNB)

As indicated above, the value of new business is calculated as the present value of profits from the time of sale to the end of policy lifetime. The present value of profits is calculated using an actuarial model that is based on policy data and other data to reflect the contribution of this year's profit to the embedded value.

The calculation of VNB was made for the following populations:

- All policies underwritten in the reported year
- New coverage that was underwritten during the reported year as an addition to policies underwritten before the reported year.

Note that the present value of future profits (PVFP) includes the value profits from the reporting year-end and thereafter for new business.

2.6 Treating options and financial promises

The covered business does not include options and financial promises to insurance clients.

2.7 Analysis of change in EV and EV-based profit

The tables in section 3.4 below present the change in the embedded value, broken down into the adjusted capital components and the in-force value (less equity cost), including transfers between those two components. All amounts are presented after tax. The change is mapped into the different affecting factors, as follows:

1. Adjustments to embedded value as of December 31, 2014 – This item includes amendments relative to opening data, including changes to the calculation methodology. In 2015, some technical revisions to the model were made, with overall impact of NIS (-32) million.

2. Changes in operating and demographic assumptions – The Company revises annually the assumptions used for estimating the embedded value. The revisions were made according to new data arising from actual experience and changes in expectations of management.

   a. Life insurance: decrease in the overall portfolio value due to update of the rates of cancellations and increase of expenses rate of NIS 38 million.

   b. Health insurance: increase of portfolio value due to decrease of expenses rate and update of the cancellation rates at the total amount of NIS 1.9 million.

3. Expected profit on the embedded value – The embedded value is expected to yield profit even if the Company would not have sold new business and would not have been active in additional businesses that are not covered by EV. These profits arise from 3 sources:

   a. Expected return on the value of in-force portfolio – This anticipated income is based on the real rate of return expected at the beginning of the year (adjusted to actual CPI) including margins above risk-free interest that were expected to be received.

   b. Expected return on adjusted net worth – Income from expected investments from assets against adjusted net worth. This expected income is based on the real rate of return expected at the beginning of the year, including margins above the anticipated risk-free interest rate.

   c. Profit expected to go from in-force portfolio to adjusted net worth during 2015 – In 2015, the expected profit for 2015 was transferred from the value of in-force to adjusted net worth, such that in total this source does not affect total embedded value as a whole. According to the method of determining adjusted net worth, this profit does not include the impact of reducing DAC, except for the tax credit and tax deduction on DAC.

4. The impact of variations from operating and demographic assumptions in 2015 – Naturally, actual experience around claims rates, cancellations, expenses etc., were different during the period from those assumed at the beginning of the year for the purpose of calculating embedded value. Those variations have impact on expected profits after year-end and also profits for that year itself, and the impacts are presented in this section separately for in-force portfolio and adjusted net worth, respectively. In addition, this section includes the effect of a number of factors that each is considered by the Company to immaterial, including, changes in existing insurance policies, reinsurance terms or commission agreements with agents.

5. Profit from new business – The embedded value does not include the value that is expected to be added from new business that will be sold in the future. Therefore, this item presents the addition to embedded value at the end of the previous period, for the sale of new insurance policies during the year. The addition is divided into the actual impact of the new business on profit in the period itself (presented under adjusted net worth) and into expected profits from future new business (presented under value of in-force).

6. Development expenses not covered in EV – This presents the impact of exceptional expenses that were not included in embedded value, but attributed to future sales, on actual profits in the year. In 2015, no expenses were excluded from EV.

It is common to call the sum of the changes in paragraphs 2 to 6 "embedded value operating profit". This amount reflects the value that was added to the embedded value or profit in terms of value that arises from operating activity of the Company, except for the impact from businesses not covered by EV (such as elementary insurance) and before the impact of unexpected economic factors, such as unexpected changes in market interest rates, the financial markets and inflation.

7. Profit from exceptional items – This section presented the net accumulated impact as of December 31, 2015 of elimination the accumulation and first-time implementation of the "best practice" – total release of NIS 81.7 million.

8. The effect of inflation in 2015 – This item includes the effect of inflation in the reported year (-0.9%) on the opening balance. The following paragraphs present the effect of real returns on top of CPI.

9. Profit from variation from economic assumptions in 2015 and changes in economic assumptions – this item includes two components:

   a. The effect on the value of in-force resulting from changes in economic assumptions that are based on market interest rates. Those assumptions include discount interest and expected returns.

   b. The effect of actual variations of economic factors during the year vs. the underlying assumptions for calculating embedded value as of the end of last year. The impact is in two components of EV:

      - In adjusted net worth – due to the impact on profit, mainly from different-than-expected returns on Company assets against capital and against insurance reserves for covered businesses.

   c. One-off impact on value in force due to changes in future tax rates on profits. At the end of the reported year, corporate tax rates increased relative to those in effect in the previous year. This caused an increase of VIF by NIS 2.0 million.

   It is common to call the sum of changes in section 2 to 9 "embedded value-based profit on covered business". This amount reflects the value that was added to embedded value, or profit in terms of value, that arose in the operating activity of the Company, including effects of economic factors and exceptional items, but excluding the effect of businesses not covered by EV (such as elementary insurance).

10. Profit from non-covered business – The total embedded value includes the entire equity of the Company, and therefore, some of the increase/decrease in embedded value is explained by the profits/losses of business that is not covered by the in-force.

11. Capital movements – This item presents the change in embedded value that results from capital movements during the year. A NIS 35 million was distributed in 2015.

2.8 Sensitivity tests

The sensitivity tests presented in 3.4 and 3.5 below were prepared while adopting the following approaches:

1. Sensitivities refer to all covered business unless otherwise is indicated
2. Sensitivity tests refer to each assumption separately, without aggregated or offsetting effects, or changes derived from other factors, etc.
3. Sensitivity for new business relates to changes from the end of 2015 and thereafter, and not to the period from the time of sale through the end of 2015.
4. Mortality – mortality sensitivity tests (including accidental death).
5. Morbidity – the sensitivity test includes all claims that are not deaths, which are included in subsection 4 above, including morbidity of serious illness, accidental disability, etc.
6. Interest – the results of the sensitivity test include:
   a. The effect of change in interest rate used as discounting interest and the expected return on investments of Company assets over the present value of future profits (PVFP).
   b. The effect of change in interest rate on the value of assets bearing NIS or CPI-linked interest that back the covered business.

3. Results

3.1 The embedded value as of December 31, 2015

Million NIS	**EV on covered business in life and health insurance**
Adjusted net worth (see 3.3 below)	754.2
Present value of future profits, net of tax	602.4
Less cost of required capital	-15.3
Embedded value	**1,341.8**

3.2 Value of new business from sales in 2015

Million NIS	**VBN on covered business in life and health insurance**
Value of new business before cost of required capital	95.6
Cost of required capital on new business	-4.8
Total value of new business	**90.8**

3.3 Reconciliation of adjusted net worth to equity in the financial statements

	Million NIS
Equity (Company balance sheet)	827.7
Revaluation of assets corresponding to covered business and presented in the financial statements at cost to fair value less tax	0
Less deferred acquisition costs (DAC to balance sheet)*	-84.5
Add - reserve for deferred tax on DAC	11.4
Less value of acquired insurance accounts and goodwill thereon, included in equity, net of tax	0
Adjusted net worth on covered business	754.6

* The deduction of tax for this adjustment is partially presented as an addition to the allowance for deferred tax in this table and partially in adjusting the present value of future profits (see 2.5.2).

3.4 Analysis of change in EV and EV-based profit (million NIS)

	Section	**Adjusted net worth**	**Value of in-force**	**Embedded value**
Embedded value as of December 31, 2014		**637.6**	**588.8**	**1,226.5**
Adjustments to embedded value as of December 31, 2014	2.7.1	-	-32.2	-32.2
Adjusted embedded value as of December 31, 2014		**637.6**	**556.6**	**1,194.3**
Operating profit from inforce as of December 31, 2014:				
Change in operating and demographic assumptions	2.7.2	-	-36.1	-36.1
Expected real growth	2.7.3	14.3	5.0	19.3
Total profit expected to move from inforce to net worth in 2015	2.7.3	70.2	-70.2	-
Effect of variation from operating and demographic assumptions in 2015 and other changes to inforce	2.7.4	-6.9	-4.0	-10.9
Total		**77.6**	**-105.3**	**-27.7**
Profit from new business	2.7.5	-43.3	134.1	90.8
Development expenses not included in EV	2.7.6	-	-	-
Embedded value operating profit		**34.3**	**28.8**	**63.1**
Profit from exceptional items	2.7.7	81.7	-	81.7
Effect of inflation in 2015	2.7.8	-3.6	-5.0	-8.6
Income from variation from economic assumptions in 2015 and change in economic assumptions	2.7.9	-4.6	6.6	2.1
Total embedded value profit		**107.8**	**30.5**	**138.3**
Profit from non-covered business	2.7.10	44.2	-	44.2
Total embedded value profit of all Company business		**152.0**	**30.5**	**182.5**
Movements in equity	2.7.11	-35.0	-	-35.0
Total change in EV		**117.0**	**30.5**	**147.5**
Embedded value as of December 31, 2015		**754.7**	**587.1**	**1,341.8**

3.5 Reconciliation of the movement in adjusted net worth to net income of the Company

The following are details on the gap between the movement in adjusted net worth and net income of the Company (million NIS):

Net income	171.8
Items transferred through equity reserve	-
Comprehensive income (after tax)	**171.8**
Change in DAC before tax	1.0
Tax on change in DAC	-20.8
Change in asset valuation at fair value net of tax	0.0
Net change in value of inforce/goodwill on the balance sheet	0.0
Comprehensive income adjusted to basis of embedded value	152.0
Movement in equity	-35.0
Total change in adjusted net worth	**117.0**

3.6 Sensitivity analysis for covered business in accordance with Circular requirements

	See section	**Change in embedded value**		**Change in value of new business**	
		Million NIS	**%**	**Million NIS**	**%**
Basic result		1341.8		90.8	
0.5% reduction in riskfree interest	**2.8.7**	25.2	1.88%	7.1	7.82%
10% increase in administration and general expenses		-30.5	-2.27%	-6.6	-7.28%
10% increase in cancellation rate		-55.3	-4.12%	-20.2	-22.27%
10% increase in mortality rate	**2.8.4**	-29.1	-2.17%	-6.1	-6.70%
10% increase in morbidity rate	**2.8.6**	-56.8	-4.23%	-11.2	-12.39%

Michal Burger F.IL.A.A
Life Insurance Appointed Actuary

Ernst Segal F.IL.A.A
Health Insurance Appointed Actuary