

18 March 2004

Mr. Haim Kagan,  
 Manager – Wages Division  
 Bezeq, The Israel Telecommunications Corp. Ltd.  
 15 Hazvi Street  
 Jerusalem

Dear Sir,

Re: Reserve in respect of early retirement  
for the balance sheet as at the end of 2003

### Actuarial Qualifications

Name: David Engelmayer, Actuary  
 Education: Qualified actuary – Fellow of the Society of Actuaries in the USA  
 Member of the Academy of Actuaries in the U.S.A.  
 Full member of the Association of Actuaries in Israel  
 M.Sc. in Applied Mathematics, Columbia University, New York  
 Consent: The actuary consents to publication of the reserve for early retirement

### General

As requested, we have prepared a calculation for the liability of Bezeq with regard to future early retirements. Currently there remain 1,641 employees in the potential group, of whom 950 are transferred workers and 691 are not transferred workers. As directed by you, we used a table of remaining expected early retirement for 918 employees under the early retirement agreement reached with the Workers Committee. Of these 918 retirees, 166 will be non-transferred workers and 752 will be transferred workers.

This calculation does not relate to other types of retirement, such as retirement due to death or disability. The calculation was prepared on the basis of data supplied to us, relying on the data and principles of the calculation in the aforementioned agreement.

The retirement schedule for the 918 employees is:

Retirement Year	Retirees
2004	400
2005	150
2006	150
2007	100
2008	118
<b>Total</b>	<b>918</b>

The retirement of the transferred workers and non-transferred workers is proportional to the total (i.e. about 80% transferred and 20% not transferred), for each calendar year.

The actuarial obligation was calculated using a statistical model which reflects the average expected early retirement costs in each future year.

### **Effects of the pension reform**

The pension agreement provides two systems for determining pension rights for retirees among the transferred workers:

Track A – which was determined on the basis of the assessment pension rules in the civil service, i.e. the pension will be determined on the basis of the average of the grades in the last three years prior to the retirement and updated according to the rules for civil servants. The pension in this track is linked to the cost-of-living increments and the wage agreements in the economy.

Track B – was determined on the basis of the Makefet bylaws, i.e. it sets the pension according to a relative salary average called the "averages method", taking into account the best 25 years (hereinafter: "**the Averages Method**"). A pension in this track is linked to the CPI on the dates on which a cost-of-living increment was given in the economy.

In June 2003, as part of the reform of the pension funds, the Knesset passed a law that cancels agreements that benefit the workers and the employers. This included cancellation of the calculation formulae that had applied until the date of the reform between Bezeq and the Makefet Fund, which regulate the accounting in respect of a worker taking early retirement.

In the litigation between Bezeq, the Capital Market, Insurance and Savings Division of the Ministry of Finance and the Makefet Pension Fund, the parties reached consensus that for the population that retired up to 01.10.2003 (exclusive) the same cost calculation method would apply as for those who retired prior to 01.06.2003. Makefet, for its part, agreed to recognize the company's retirees after 1.10.2003 as pensioners of the Fund if the company would pay the costs in accordance with circulars 2000/1 and 2000/6 of the Capital Markets Division, and if the company would deposit a bank guarantee for 50% of the amount of the cost for covering any differentials there might be in view of the circular/directives of the Capital Markets Division for calculation of the costs of early retirement which is due to be issued in the near future.

Starting on 1.10.2003, the standard bylaws apply to members of the Makefet Fund, and the Makefet Fund, for its part, may not grant benefits beyond the standard bylaws. This includes the matter of CPI linkage.

Several principal points from the pension fund reform:

- Cancellation of the Bezeq-Makefet agreement (the alpha formulae).
- The retirement age for men and women will rise gradually to 67 and 64 respectively.
- Contributions will rise gradually, for the worker from 5.5% to 7% and for the employer from 12% to 13.5%.
- The rights of the workers will be calculated by the Averages Method according to the 35 best years only (cancellation of Track A).
- The worker will pay up to 1.75% management fees from any pension, on a graduated scale (this does not affect the cost of early retirement).
- The pension will be inflation adjusted only after a cumulative inflation increase of 4.25% or every two years – whichever is the earlier.

### **Calculation assumptions**

- Rami Dayan's circular for early retirement (formulae reflecting the circular are attached).

- Retirement age: rising gradually to 67/64
- Discount rate: 3.5%
- Management fees: 1.5% of total liability
- Mortality of active persons and disabled persons: as per circular 2000/1
- Persons who become disabled: as per circular 2000/1
- Marriage percentage: as per circular 2000/1
- Age differences: 4 years
- Orphans and parents: none
- Retirement grants according to an agreement between the Workers Committee and Bezeq from 2000
- Salary increases in Track A at 4% per year up to early retirement
- Salary increases in Track B at 1.5% per year up to early retirement
- A worker may take early retirement only if he has accumulated 20 years seniority and he is more than 48 years old.
- The distribution of transferred / non-transferred workers is 80% / 20% (respectively)
- Every year, the retirees retire on 1 July of that year
- Under the standard bylaws, the average wage in the economy does not continue to increase for the purpose of determining the pension of a "frozen" member of the pension fund.
- Accumulated pension in a pension fund for a "frozen" member: determined according to the accumulation table attached to the standard bylaws.

### **Results of the calculation**

The cost of early retirement in respect of 918 retirees who will retire between 2004 and 2008, based on the distribution in the table above, amounts to approximately NIS 1,191.7 million (NIS 919.8 million for Makefet; NIS 267.8 million for grants; NIS 4.0 million for standard deviation).

We have added one standard deviation to the assessment in respect of uncertainty of who are the workers who will actually retire and when during the year they will retire. We note that use of an average as a cost estimate is on the conservative side as the approach of Bezeq is to offer early retirement to the longer-serving employees in the potential population. The cost of early retirement for long-serving employees, despite the higher salary, is lower because the time to official retirement is shorter.

Penalty in respect of excess years: Rami Dayan's circular demands that if a worker who takes early retirement has attained 35 years seniority prior to the planned retirement, the pension fund should be compensated in an amount equal to the excess of contributions (in respect of those years) over the 35 year grant that the fund would have paid the retiree. This calculation was made on an assumption of full implementation of the reform – up to age 67/64, contributions of 20.5%.

### **Miscellaneous**

- Examination of the data of Makefet compared with the data held by Bezeq revealed that for the 363 workers who retired between 1 June 2003 and 1 October 2003, that the cost assessment deviated by 15%, where the assessment made on the basis of the Bezeq data was lower. After speaking with Avi Ayash, manager of the actuarial department, it transpired that the deviations stem mainly from differences of

retirement grades that were not foreseen, a factor which should not recur with regard to future retirees.

- Comparison of the base data for the present quarter and the previous quarter (the previous report was prepared by actuary Professor Yair Babad and Mrs. Lena Weissberg), reveals that there appears to be no material deviation between the data. Furthermore, reconstruction of the previous quarter calculation on the basis of data from the present quarter showed similar results between the calculations. Accordingly, we can say that the data basis and the calculation basis are consistent.
- There is a lack of clarity about the directives that the Capital Market Division is supposed to issue in connection with calculation of the cost of early retirement for employers. In conversations that the company has held with the Makefet Fund and the Capital Market Division, the company was told that the directives will not differ significantly from those issued in the 2000/1 circulars. We might have to update the calculations in the next quarter.

Yours sincerely,

David Engelmayer, Actuary

Appendix: Assessment of balance sheet reserve – discount interest 3.5%, circular of the Capital Market Division including a penalty in respect of excess years

**Bezeq - Early Retirement Reserves as of 31/12/2003**

S1 components discounted at 3.5%; S2 components discounted at 3.5% (i.e. assuming full CPI inflation linkage)

Potential Pool Of Early Retirees 1,641

*Scheduled Leaves:*

Retire Year	Total Leaves	Senior Management			Transferred Employees			Non-Transferred Employees			Total			
		Number	Reserve	Grants	Number	Reserve	Grants	Number	Reserve	Grants	Number	Reserve	Grants	Total
2004	400	0	0.0 M	0.0 M	1	0.7 M	0.2 M	0	0.0 M	0.0 M	1	0.7 M	0.2 M	0.9 M
2005	150	0	0.0 M	0.0 M	0	0.0 M	0.0 M	0	0.0 M	0.0 M	0	0.0 M	0.0 M	0.0 M
2006	150	0	0.0 M	0.0 M	0	0.0 M	0.0 M	0	0.0 M	0.0 M	0	0.0 M	0.0 M	0.0 M
2007	100	0	0.0 M	0.0 M	0	0.0 M	0.0 M	0	0.0 M	0.0 M	0	0.0 M	0.0 M	0.0 M
2008	118	0	0.0 M	0.0 M	0	0.0 M	0.0 M	0	0.0 M	0.0 M	0	0.0 M	0.0 M	0.0 M
<b>Total</b>	<b>918</b>	<b>0</b>	<b>0.0 M</b>	<b>0.0 M</b>	<b>1</b>	<b>0.7 M</b>	<b>0.2 M</b>	<b>0</b>	<b>0.0 M</b>	<b>0.0 M</b>	<b>1</b>	<b>0.7 M</b>	<b>0.2 M</b>	<b>0.9 M</b>

*Other Leaves:*

Retire Year	Total Leaves	Senior Management			Transferred Employees			Non-Transferred Employees			Total			
		Number	Reserve	Grants	Number	Reserve	Grants	Number	Reserve	Grants	Number	Reserve	Grants	Total
2004	400	0	0.0 M	0.0 M	337	374.4 M	107.4 M	62	25.9 M	13.2 M	399	400.4 M	120.6 M	521.0 M
2005	150	0	0.0 M	0.0 M	120	136.4 M	37.3 M	30	12.2 M	6.2 M	150	148.7 M	43.6 M	192.2 M
2006	150	0	0.0 M	0.0 M	120	137.9 M	36.7 M	30	11.4 M	5.9 M	150	149.3 M	42.5 M	191.8 M
2007	100	0	0.0 M	0.0 M	80	92.9 M	24.0 M	20	7.5 M	4.0 M	100	100.4 M	28.0 M	128.4 M
2008	118	0	0.0 M	0.0 M	94	111.5 M	28.2 M	24	9.0 M	4.7 M	118	120.4 M	32.9 M	153.4 M
<b>Total</b>	<b>918</b>	<b>0</b>	<b>0.0 M</b>	<b>0.0 M</b>	<b>751</b>	<b>853.1 M</b>	<b>233.6 M</b>	<b>166</b>	<b>66.0 M</b>	<b>34.0 M</b>	<b>917</b>	<b>919.1 M</b>	<b>267.6 M</b>	<b>1,186.8 M</b>

*Total Leaves:*

Retire Year	Total Leaves	Senior Management			Transferred Employees			Non-Transferred Employees			Total			
		Number	Reserve	Grants	Number	Reserve	Grants	Number	Reserve	Grants	Number	Reserve	Grants	Total
2004	400	0	0.0 M	0.0 M	338	375.1 M	107.6 M	62	25.9 M	13.2 M	400	401.1 M	120.8 M	521.9 M
2005	150	0	0.0 M	0.0 M	120	136.4 M	37.3 M	30	12.2 M	6.2 M	150	148.7 M	43.6 M	192.2 M
2006	150	0	0.0 M	0.0 M	120	137.9 M	36.7 M	30	11.4 M	5.9 M	150	149.3 M	42.5 M	191.8 M
2007	100	0	0.0 M	0.0 M	80	92.9 M	24.0 M	20	7.5 M	4.0 M	100	100.4 M	28.0 M	128.4 M
2008	118	0	0.0 M	0.0 M	94	111.5 M	28.2 M	24	9.0 M	4.7 M	118	120.4 M	32.9 M	153.4 M
<b>Total</b>	<b>918</b>	<b>0</b>	<b>0.0 M</b>	<b>0.0 M</b>	<b>752</b>	<b>853.8 M</b>	<b>233.8 M</b>	<b>166</b>	<b>66.0 M</b>	<b>34.0 M</b>	<b>918</b>	<b>919.8 M</b>	<b>267.8 M</b>	<b>1,187.7 M</b>