



State Comptroller of Israel | Annual Report 72a – Part Two | 2021

Systemic Issues

Investments Management at Various Entities



Investments Management at Various Entities

Background

The management of investments of various entities in the public sector (institutional entities, government companies, statutory corporations and local authorities) may have an impact on their financial stability and ongoing activities. These entities are required to implement a comprehensive investments policy that will address the entity's methods of investment in a suitable way for its activities, its exposure to risks and its business strategy, alongside managing the risk of liquidity according to cash flow forecasts. The investments funds serve the entities for different time ranges, and are invested according to the entity requirements or for the funds designated objectives.



Key figures

**NIS 9.4
billions**

The value of current investments on 30.6.20 of institutional bodies, government companies and statutory corporations (government entities) audited.

**NIS 6.4
billions**

The value of investments designated for pensions on 30.6.20 of the government entities audited.

3.83%

The average annual yield for 2017–2019 of current investments of the audited institutional bodies.

3.25%

The average annual yield between years 2017–2019 of current investments of the audited government companies and statutory corporations.

3.91%

The average annual yield between years 2017–2019 of pension investments at the audited government companies and statutory corporations.

46%

Authorities hold long-term investments portfolios¹ (31.12.19).

**NIS 4.9
billions**

The value of the long-term investments of the audited local authorities (30.6.20).

2.4%

The average yield for years 2017–2019 of long-term investments of the audited local authorities.

Audit actions



From June to December 2020 the State Comptroller's Office audited aspects of the financial investments management in several institutional bodies, government companies, statutory corporations and local authorities with significant investment extents. The investments can be current self-made (nostro) or investments designed to cover pension liabilities. The audit was conducted at the following bodies: Kanat – The Insurance Fund for Natural Risks in Agriculture Ltd; Karnit – The Road Accident Victims Compensation fund; Ashra – The Israel Foreign Trade Risks Insurance Corporation Ltd; The Israel Electric Company Ltd; The Haifa Port Company Ltd; The Ashdod Port Company Ltd; The Israel Airports Authority; The Quarries Rehabilitation Fund. The audit was also conducted at the Ministry of the Interior and at 50 local authorities through a

¹ The investments portfolios include tradable securities (long-term investments portfolio).



questionnaire. Supplementary audits were conducted at the Government Companies Authority and at the capital market Insurance and Savings Authority; At the Federation of Local authorities and at the Local Government Economic Services Ltd. (Mashcal).

Key findings



Institutional bodies – Kanat, Karnit and Ashra



The composition of the institutional bodies investments portfolios – there are differences in the portfolio composition of the various bodies audited – Kanat, Karnit, Ashra. The government institutional bodies invest 69%–79% of their assets in bonds and do not invest in an alternative channel of investment funds.



The yields of investments portfolios – there are differences in the institutional bodies yields for the period from 2017 to June 2020, and between them and the advanced study funds and additional tradable indexes. These differences derive from the diversity in the portfolio components and their variant risk profiles as expressed, among others, in the exposure percentage to various assets and the different investment horizon needed for flow purposes of each body. Following is the data regarding the yields of the various bodies:

The body	2017	2018	2019	1–6.20
Audited bodies				
Kanat	4.22%	-1.06%	7.78%	-4.31%
Karnit	1.28%	2.47%	5.58%	-1.62%
Ashra	5.01%	-1.17%	10.36%	2.08%
Comparative indexes				
Advanced study funds	6.90%	-1.22%	11.94%	-5.10%
TA 125	6.87%	-2.44%	21.20%	-18.18%
Tel Bond 60	5.79%	-0.79%	7.37%	-5.49%

The source: the data of the audited bodies, data from net provident systems and data from the stock exchange processed by the State Comptroller's Office.



ESG investments² – the institutional audited bodies did not include ESG rules in their investments policies. Moreover, whereas they are not defined as institutional investors, the draft circular written by the Capital Market Authority on the subject is not expected to apply on them.

² Environmental, Social and Governance.



Administrative issues in the work of the investments committee – the investments committees of both Kanat and Karnit convened properly once a month, whereas from June 2018 to June 2020 the Ashra committee convened only seven times, but not each quarter; in all the audited bodies, despite having the required quorum³ directors were absent from a significant portion of the investments committees⁴; a review of the various bodies protocols indicates that the Ashra protocols content is lacking, whereas at the Kanat and Karnit companies the protocols properly reflect the discussions held by the investments committees and enable comprehension of the considerations that formed the basis for the committee decisions. It was further found that the members of the Ashra company investments committee who are company employees are not signed on any declaration to prevent conflict of interests concerning their activities on the investments committee.

Professional issues in the work of investments committees – in 2000, in the absence of a quorum, the board of directors of the Ashra Company, did not approve the investments policy; Ashra does not compare the performance of the various portfolio managers in reference to yield related to various risk indexes ; it was only in March 2018 that a risks manager was appointed for Karnit; in the audited period no internal audits were conducted on the subject of investments at the Ashra company.

Government companies and statutory corporations – the Israel Electric Company, Haifa Port, Ashdod Port, the Airports Authority and the Quarries Rehabilitation Fund.

Composition of investments portfolios – there are differences in the portfolio compositions of the audited bodies in both current and pension investments portfolios. However, it should be stated that the investment percentage of audited bodies in government and concern bonds ranges from 69%–98% and they do not invest in alternative channels, such as investment funds.

The yield of current investments portfolios – there are differences in the yields of government companies and statutory corporations for the period from 2017 to June 2020, and between the advance study funds and other selected indexes. These differences derive from the diversity in the portfolio components and their variant risk profiles as expressed, among others, in the exposure percentage to various assets and the different investment horizon required for flow purposes of each body. Following are the yields data of the various bodies:

³ Legal quorum.


⁴ In 44% of the Kanat meetings one member was absent; in 32% of the Karnit meetings one member was absent; In Ashra – only five out of sixteen meetings there were two directors present.




The body	2017	2018	2019	1-6.20
Audited bodies				
Haifa Port	4.82%	-1.85%	9.30%	-4.71%
Ashdod Port	3.27%	-0.62%	5.60%	-1.36%
Airports Authority	3.60%	-0.93%	6.60%	-0.60%
Quarries Rehabilitation Fund	3.35%	-0.43%	6.23%	-1.65%
Comparative indexes				
Advanced study funds	6.90%	-1.22%	11.94%	-5.10%
TA 125	6.87%	-2.44%	21.20%	-18.18%
Tel Bond 60	5.79%	-0.79%	7.37%	-5.49%

The source: the audited bodies data, data from net provident systems and data from the stock exchange processed by the State Comptroller's Office.

Moreover, the Airports Authority and the Quarries Rehabilitation Fund do not publish data regarding the current yields of their investments portfolios.

 **Administrative issues in the investment committee's work** – the investments committee of the Airports Authority convenes at least twice each quarter and the investments committee of the Haifa Port convene sometimes each month and sometimes only once in several months; at the Haifa Port and the Quarries Rehabilitation Fund there was no required quorum at the investment committee meetings for some of the period from January 2017 until June 2020; a review of these bodies protocols indicates that, except for the Airports Authority, the content of the protocols of the remaining bodies does not properly reflect the discussions and does not enable understanding of the considerations that formed the basis for the committee decisions. It was also found that as of the audit completion date, the investments committee members at the Haifa Port and the Airports Authority did not sign declarations to prevent conflict of interests, and that at the Haifa Port, the Ashdod Port and the Israel Electric Company the matter is not regulated by a procedure.




 **Professional issues in the work of the investment committee** – the Quarries Rehabilitation Fund management did not approve the investment policy in 2017 and the Electric Company board of directors does not approve the investment policy of the investment for pension portfolio; the Electric Company, contrary to all other audited ⁵ bodies, does not use the services of a financial advisor, despite it being possible by

⁵ The investments portfolio of funds in trust designated for coverage of actuary liabilities for pension payments to employees for salary components that are not pensioned and liabilities related to termination of employer-employee relations.



internal procedure and despite the major investment amounts in its investments for pension portfolio. The Electric Company, Airports Authority and Quarries Rehabilitation Fund do not use various risks indexes to compare the performances of their portfolio managers; the Electric Company and the Quarries Rehabilitation Fund did not conduct a risks analysis of their investments portfolio in the audited period; the Haifa Port, Electric Company and Airports Authority did not conduct any internal audit on the subject of investments in the audited period.

Local Authorities

-  **The Monitoring of the Ministry of Interior over the Local Authorities investments management** – the Ministry of Interior does not have information concerning local authorities that manage an active portfolio and local authorities that do not manage active investment portfolios. Moreover, it was found that the Ministry of Interior does not monitor the existence of active investment portfolios in the various local authorities. Moreover, the monetary data that is reported by the local authorities to the Ministry of Interior and the public financial statements do not reflect the activity of the local authorities investments portfolios, and it is impossible to identify the extent of the investment portfolio, the yield gained from it and the portfolio investment channels.
-  **Distribution of the Investment portfolio holdings divided by the authority cluster** – there is a significant difference between local authorities with high socio-economic ranking and local authorities with low socio-economic ranking. For example, 82% of high ranking local authorities hold an active investment portfolio, whereas only 28% of low ranking local authorities hold an active investment portfolio. Furthermore the average long-term investments portfolio of top decile municipalities (not including Tel Aviv-Jaffa) totaled NIS 113 million, compared to NIS 30 million in low decile municipalities.
-  **The long-term investments portfolio yield** – the average accrued yield of local authorities for 2017–2019 totaled 2.4% and was low compared to the yields of advance study funds and the central compensation funds, which totaled 5% – 6% in the said period. The said differences derive from the diversity of portfolios compositions and different risk profiles.



The body	2017	2018	2019	1–6.20
Audited bodies				
Local Authorities audited - with long terms investments for the years 2017–2019 (average yield)	3.4%	-1.3%	5.2%	-1.6%
Comparative indexes				
Advanced study funds	6.9%	-1.2%	11.9%	-5.1%
Principle compensation funds	6.4%	-1.3%	10.9%	-5.0%

Administrative issues in the work of the investments committee – 34% of the audited local authorities (17 out of 50) did not have an active investments committee as of 31.12.2019. Moreover, between years 2017–2019, 22% to 33% of local authorities with long-term investments portfolios did not hold meetings of the investments committee at the required frequency.

Ministry of Interior directives – despite the professional advantages the Ministry of Interior did not set any directives regarding the obligation of the local authorities to create marker portfolios and/or contract professional financial advisors to determine policy, manage and review the performance of their investments portfolios. Moreover, the Ministry did not define any directives for the necessary supervision and control of budgetary pension funds of the local authorities employees.

Monitoring the investments committee activities – in 2017–2019 78% of the audited local authorities that had active investment portfolios (14 out of 18 local authorities) did not hold discussions at management level on the investment committee activities⁶, although until the publication of circular 02/2020 the local authorities were not obliged to hold such annual discussions. Moreover, despite the risk and the significant extent of the local authorities investments portfolios, only at 4 out of the 50 local authorities that answered the questionnaire, the internal auditor conducted an audit of the investments committee activities. In addition, the Ministry of Interior did not conduct any initiated audit on the local authorities investments committees to fully and extensively examine the local authorities adherence to its directives. The Ministry did not

⁶ Of 18 local authorities with active investment portfolios during 2017–2019, two local authorities held annual discussions and two held discussions in some of the years.



review the monitoring and control of the local authorities investments committees over the pension funds.



Approval of the investment policy – in most audited government entities the investment policy is approved annually.





Procedure regulating the investment committee activity – in most of the audited government entities there is a procedure regulating the activities of the investments committee. In addition, the Ministry of Interior published and updated directives to local authorities on this matter as part of the CEO circulars⁷.

Using a marker portfolio to compare investments portfolio performances – most audited government entities and some local authorities use marker portfolios to compare performances of investment portfolios.

Conducting internal audits to minimize risks – the Kanat company internal auditor prepared an internal audit report on the subject of reviewing investment houses internal audit reports in order to minimize the Company's exposure to risks of investment houses.




Key recommendations

Public Institutional Bodies – Kanat, Karnit and Ashra





-  In order to examine the portfolio managers performances, it is appropriate to define a relevant comparative attributing index and use a variety of comparative attributing indexes, to maximize yields of investments portfolios.
-  It is recommended that Karnit, Kanat and Ashra continue to periodically examine their investment policies, the yields and investment diversity including a comparison to parallel institutional investors and customary indexes in the market, in order to achieve optimal yields from their investments portfolios.
-  It is recommended that all public bodies audited as part of this audit examine including ESG rules in their investment policy.
-  The Minister of Economy and Industry and the Minister in charge of The Companies Authority, should act to complete the appointment of directors in Ashra as required by law.

⁷ Rules for investing temporary surpluses accrued in the development funds and other temporary surpluses, memos: 08/94, 04/2008 and 02/2020.

Government companies and statutory corporations – the Israel Electric Company, Haifa Port, Ashdod Port, the Airports Authority and the Quarries Rehabilitation Fund.

-  In order to increase transparency of managing the funds of government companies for the public eye, it is recommended that the Government Companies Authority consider instructing government companies to regularly publish their investments portfolio yields in order to reflect the investment policy and the company considerations.
-  It is recommended that the Airports Authority and Quarries Rehabilitation Fund consider publishing the yields of their investments portfolios regularly.
-  In view of the large investment funds being managed, some of which are managed through investment managers, it is recommended that the Haifa Port, the Electric Company and the Airports Authority conduct internal audits on investments.

local Authorities

-  The local authorities that have an active investment portfolio should act to hold the discussions of investments committees as required and issue letters of appointment for investment committee members. It is also recommended that the Ministry of Interior, the local authorities and the Federation of Local authorities establish periodical training for the local authorities investment committee members to ensure they have the required and updated professional knowledge to execute their roles as members of the investments committee.
-  The Ministry of Interior should update its directives to include designated and detailed directives on supervision of investments committees, on management of local authorities employees' pension funds, including investment policies, methods for selecting provident funds and the tools to supervise and control its performance.
-  It is recommended that the Ministry of Interior examine the use of tools and relevant reference indexes, and the contribution and services of the financial advisors to the investments committee, particularly on all matters pertaining to local authorities that manage large portfolios, and adjust its directives accordingly. In addition, it is recommended that the Federation of Local authorities and the Local Government Economy Company Ltd assist the local authorities in improving their investments activity and in creating advantages to size in managing the investments portfolios, such as establishing a database of portfolio managers, professional external investments advisors and in professional training for the investments committee members.
-  It is recommended that the Ministry of Interior Audit Department include in its audits of local authorities an examination of attributing yields from investment portfolios and ensure the fulfillment of the directive. Moreover, all local authorities holding long-term investments portfolios with finances designated for development funds including Tel Aviv-Yafo, Holon, Rishon Lezion, Kfar Sava, Elad, Shafir, Carmel Coast, Sderot, Ofakim,

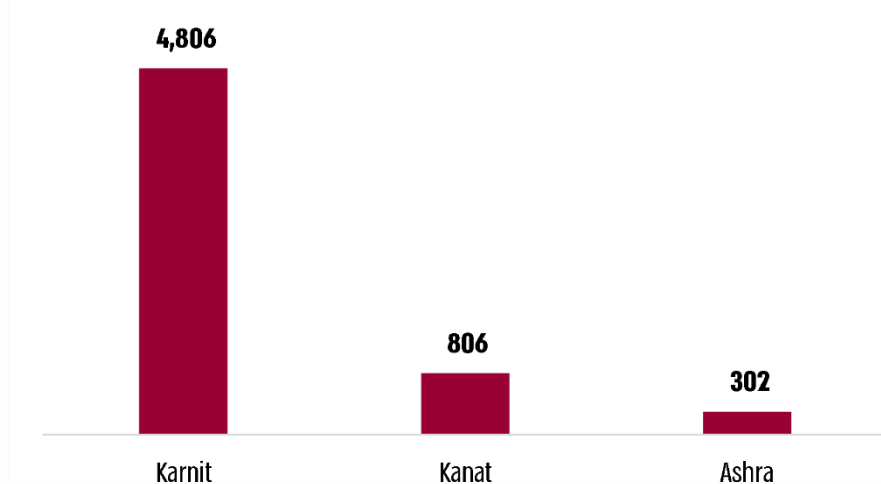


Bat Yam, Arad, Tirat Hacarmel, Tel Mond, Segev Shalom, Hadera, Haifa, and Mateh Asher should act to attribute yields in favor of the development funds.



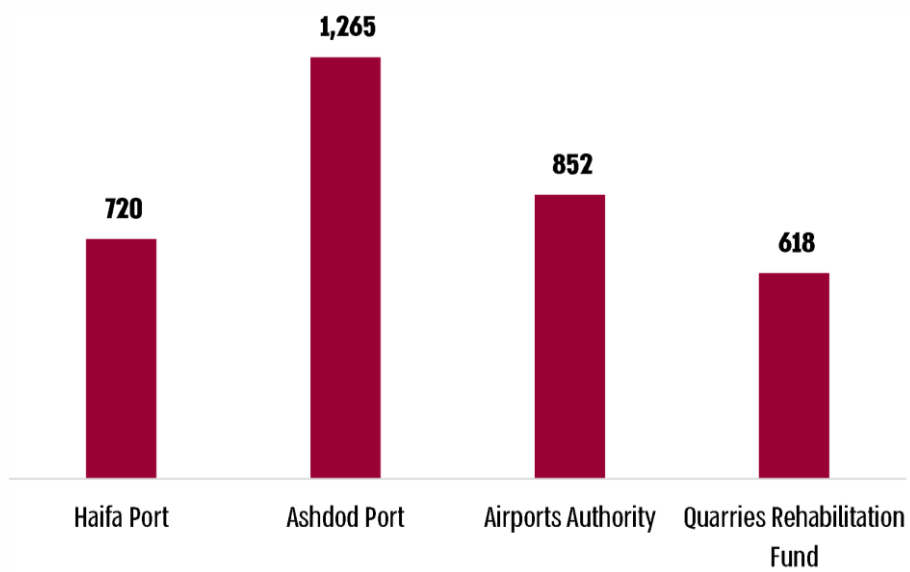
In view of the large portfolio managed by a number of external portfolio managers in the audited local authorities, it would be appropriate that the Ministry of Interior and the auditors of the relevant local authorities conduct periodical audits to improve the authorities upholding of the Ministry directives and to examine and improve performances, in order to increase the local authorities benefit from the investment portfolio.

Total investments portfolios of the institutional bodies in millions of NIS in 30.6.20



Source: data from the said bodies, processed by the State Comptroller's Office.

Total current investments portfolios of government companies and statutory corporations in millions of NIS in 30.6.20*

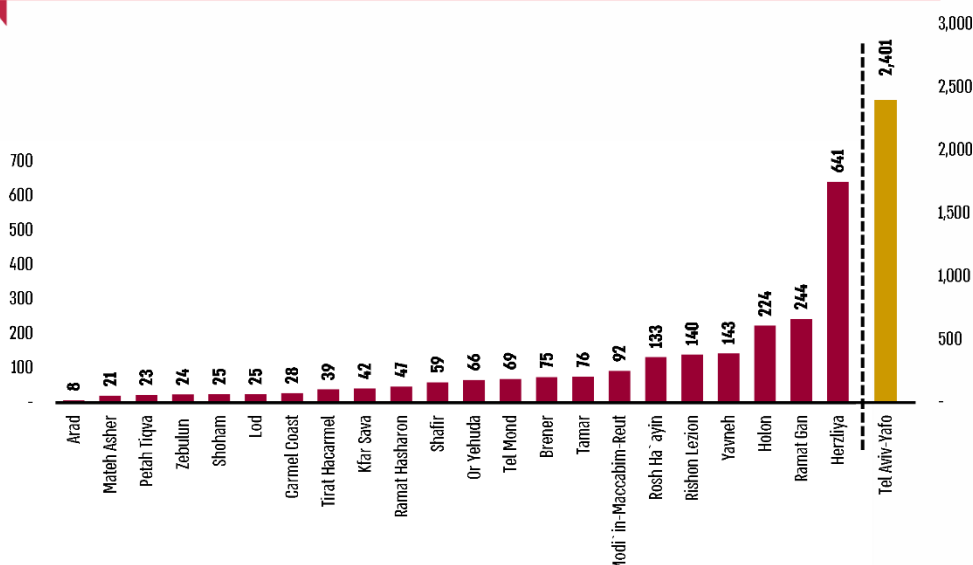


Source: data from the said bodies, processed by the State Comptroller's Office.

* The Electric Company does not have a current investments portfolio.



Total long-term investments portfolios of the audited local authorities in millions of NIS in 30.6.20



Source: answers of 50 local authorities to the State Comptroller's questionnaires, October 2020.

Summary

Rational investment management by local authorities and public sector entities – including determining a suitable investment policy taking into account financial gain considerations or maintaining realistic value of the investment, investment periods and risks – will maximize the inherent benefits of the funds held by the entity. The findings of this report indicate that there are deficiencies in the administrative and professional aspects of the investments committees activities in these entities. Increasing the supervision and control on investments in these entities, among others through the investments committees and educated risk management, is significantly important in times of crisis, where capital markets fluctuations can erode the investments portfolio.