State Comptroller of Israel | Aspects of Dealing with the Cost of Living | January 2024

The Capital Market, Insurance, and Savings Authority

The Capital Market Authority's Supervision of Institutional Entities Managing Long-Term Savings

The Capital Market Authority's Supervision of Institutional Entities Managing Long-Term Savings

Background

"Institutional entities that manage long-term savings" are companies that manage the public's medium-term and long-term savings by various tracks, such as pension funds, provident funds, life insurance policies, and study funds. Their activities are supervised by the Capital Market, Insurance, and Savings Authority, established in November 2016 as an independent authority. In 2010–2022, there was an average annual increase of about 8% in the scope of the assets managed by the institutional entities supervised by the Capital Market Authority, and in 2022, their value amounted to NIS 2.180 trillion. Given the significant scope of these assets, which are managed for the general public, the Authority's close supervision and control over the activity of the institutional entities is critical to protect the interests of policyholders and savors.

Key Figures

NIS 2.180 trillion
the scope of the public's savings managed by the institutional entities by the end of 2022 (about 130% of GDP)

about 90%
of the public's pension savings is held by 8 institutional entities

NIS 358 billion
total of alternative investments[1] of the institutional entities in 2021

12 years
after the Authority's work on the Regulation Codex[2] began, it was not completed

only 4 financial sanctions
were imposed by the Authority over 7 years (2015–2022) for pensions and provident funds under Supervision of Financial Services Law (Provident Funds), 2005. The sanctions amounted to NIS 4.2 million

only 35%, 13% and 20%
the rates of the Authority's engagements in 2020–2022 (respectively) from the scope of the annual budget it defined for engagements to perform audits at the institutional entities

NIS 0.36 million
the budget for an employee in the Capital Market Authority, which is about half of the budget for an employee in the Israel Securities Authority (NIS 0.71 million) and about a third of the budget for a Bank of Israel employee (NIS 1.17 million)

only 13 audits
the Authority has conducted on cyber risks, of which only 3 were completed

---

1 Investments in non-tradeable assets outside the capital market, including real estate, infrastructures, commodities, private loans, technology companies and alternative funds (hedge funds, private investment funds, venture capital funds).

2 A regulations guide designated to facilitate familiarity with the Authority's instructions and to serve as an effective means for the Authority to enforce its instructions, to supervise the institutional bodies and to protect the owners of insurance policies and savings accounts.

Audit Actions

From September 2022 to March 2023, the State Comptroller Office examined the Capital Market Authority's supervision of the institutional entities that manage the public's long-term savings, including provident funds, severance pay funds, study funds, pension funds, and insurance companies' funds[3]. The audit focused on the Authority's supervision of the institutional entities' management of the public's medium and long-term savings. The audit was carried out at the Capital Market Authority. Supplementary examinations were conducted at the Israel Securities Authority, the Competition Authority, and the Bank of Israel. In addition, meetings were held with selected institutional entities' representatives and questionnaires were sent to institutional entities – insurance companies, investment houses, and provident funds. By the audit end date, 35 of 55 institutional entities responded to the above questionnaire.

Key Findings

The Capital Market Authority's Resources, the Structure of Financial Supervision, and the Interactions Between the Authority and Financial Regulators

The Status of the Capital Market Authority – the original budget allocated to the Capital Market Authority in 2022 was low compared to parallel regulators, even though the scope of assets supervised by it is the largest (about NIS 2.180 trillion) and is constantly growing. The considerable gap between the authorities' budgets originates from the differences in the number of employees each employ and the salary levels. As of 2022, the average salary at the Capital Market Authority was about NIS 16,800, the average salary at the Israel Securities Authority was about NIS 28,600, and the average salary at the Bank of Israel was about NIS 35,700.

The Capital Market Authority Budget – in 2022, the execution of the Capital Market Authority's budget was NIS 54.75 million out of NIS 142.62 million (amended budget), which means that 38.39% of the amended budget was utilized. The total fees collected by the Capital Market Authority in 2022 was about NIS 20.5 million, compared to the Israel Securities Authority, which collected about NIS 189.78 million. The budget proposal documents for 2023 submitted by the Authority specify the need to increase its

3 With the exception of the old pension funds – provident pension funds that are not insurance funds that were first approved according to the provident funds regulations, prior to January 1st, 1995.

overall budget, among other things, by changing the fee model. However, as of the audit end date, the Authority has not yet adopted a new model for collecting fees from the various supervised entities.

- **HR Standardization –** in 2022, the standard was 204.5 employees, while the actual staffing was 158 employees[4], which means 77.3% staffing. The pay gaps between the Capital Market Authority and other financial regulators, such as the Bank of Israel and Israel Securities Authority, make it difficult for the Authority to recruit employees, particularly employees with relevant skills, and to fulfill its tasks. For example, the original budget for 2022 for an employee at the Capital Market Authority was NIS 0.4 million, about half of the budget for an employee at the Israel Securities Authority and about a third of the budget for a Bank of Israel employee.

- **The Interactions Between the Authority and the Financial Regulators and the Structure of Financial Supervision –** the Committee[5], which was established by a government decision in August 2021, to examine the structure of financial supervision, to improve the structure, and increase competition in the financial markets, did not complete its work and did not submit its recommendations to the Minister of Finance and the Governor of the Bank of Israel within 300 days from the date of its establishment.

Centralization and Competition Between Institutional Entities

- **Centralization and Competition Between the Institutional Entities –** the long-term savings market in Israel is characterized by great dominance: 8 institutional entities hold about 90% of the public's savings, about NIS 2 trillion. The fact that the institutional entities have a considerable part of the companies in the Israeli market and that the entities' investment mixes are relatively identical raises concerns about the inefficient allocation of resources in the market and lateral risks. Moreover, there is a risk of simultaneous movement of financial assets and their simultaneous realization when exposed to shocks. I.e., in the event of financial instability, entities with similar holdings will act similarly, thereby deepening the consequences of the situation.

- **Mobilization of Public Funds Between the Institutional Entities –** although there is a possibility of mobility between the funds, most requests for money transfers between different pension funds and different provident funds were made by members who were recruited by agents (50%–65% in pension funds and 57%–85% in provident funds);

---

4 It should be noted that there is a discrepancy between the Budgets Department's data and the Capital Market Authority's data regarding the actual staffing of positions.

5 A committee established by the Minister of Finance in collaboration with the Governor of the Bank of Israel. Committee members: Director General of the Ministry of Finance (Chairman of the Committee), the Deputy Governor of the Bank of Israel, the Chief of Staff to the Governor of the Bank of Israel, the head of the Budgets Department at the Ministry of Finance, the Deputy Attorney General, a representative of the National Economic Council and public representatives.

the agents are remunerated for recruiting new customers, and therefore this does not necessarily indicate a competition that is beneficial for the customers.

- **Competition Among Different Institutional Entities in Investment Products for the Public's Idle Money –** despite their name, savings policies are not used as an insurance instrument but as a short and medium-term investment with no limit on the funds deposited each year. The tax benefits embodied in the provident fund for investment give it an advantage over the savings policy, but, its deposit ceiling puts it at a disadvantage vis-à-vis the policy in amounts beyond the first level of investment. Since only the insurance companies are allowed to market savings policies, the competition between them and the investment houses may be adversely affected. Furthermore, the average management fee in savings policies is 0.94%, while the average management fee in investment provident funds is 0.64% – a substantial difference of 0.3% percentage points; therefore, the lack of competition at the high investment level (above the deposit ceiling for funds) is reflected in the management fees.

The Capital Market Authority Supervising the Institutional Entities

- **The Regulation Codex –** upon the audit end date, about 12 years after the Capital Market Authority had started working on the Regulation Codex, it was not completed, though it was intended to be completed by the end of 2013. Many chapters are still missing from the Codex, and it does not include all the Commissioner's instructions given over the years. The Authority continues to publish circulars separately from the Codex and does not publish amendments to the various chapters of the Codex as it has committed to. Thus, the institutional entities have to follow both the Codex provisions and the circulars issued separately from it.

- **The Authority's Relations with the Institutional Entities –** about half (54%; 19 out of 35) of the institutional entities that answered the State Comptroller Office questionnaire (which are part of the group of insurance companies and investment houses) expressed moderate or lower satisfaction with the level of professionalism of the referents who handle their funds at the Capital Market Authority. About 40% of the institutional entities that responded to the questionnaire indicated that they had not received a response to the inquiries or requests they sent to the Authority in the last five years. Moreover, the Capital Market Authority does not have a service charter regulating the service provided to the institutional entities; thus, service levels, including the method of application, measurement of response time, and the response format, were not set. The authority has no preliminary decision procedure ("pre-ruling") except for accounting issues, and usually, according to the institutional entities, the Authority's response to their inquiries is given orally rather than in a written form.

- **Imposing Financial Sanctions by the Authority on the Institutional Entities –** for 7 years (2015–2022) 4 sanctions were imposed on companies that manage the public's pension savings funds for pensions and provident funds violations under the

Supervision of Financial Services (Provident Funds) Law, 2005; about 13% of the total sanctions imposed in these years (the rest of the sanctions were imposed in the insurance sector, on financial service providers and agents). The total number of sanctions was NIS 4.2 million after a reduction of 60.8% (estimated at NIS 10.96 million), which was 7.7% of the total number of sanctions after the reduction. The low number of sanctions imposed on the institutional entities over the years impairs the Authority's ability to deter the supervised entities from violating the provisions of the law. It should be noted that the Authority has additional deterrence tools that can be used, including the Commissioner's authority to order the restitution of funds as part of investigating public complaints against institutional entities.

The Risk Management System – the supervisory evaluation process, intended to serve, among other things, as a basis for the evaluation of risk management conducted at institutional entities, was implemented only by insurance companies and was discontinued in 2020 at the former Commissioner's request. No other process had been implemented from that point until the audit end date. Nor has a parallel evaluation process been formulated in institutional entities other than insurance companies, despite its great importance and the fact that it is included in the Authority's work plan for 2022. Moreover, the main part of the Authority's examination of the risk management system regulation was based on questionnaires that focused on implementing the Authority's positions as part of the RBS procedure. However, the Authority has not conducted individual audits of all the institutional entities' risk management systems since the publication of a comprehensive document in 2016, and has not examined whether its positions were implemented to rectify the deficiencies. The Capital Market Authority has no comprehensive and updated situation report about the risks inherent in each of the institutional entities activity, and it does not usually demand regular updates on the results of the risk management process, particularly from institutional entities that are not insurance companies.

Supervision of Cyber Risks

- The Capital Market Authority has no information on how the institutional entities implement the cyber risk procedure or parts of it and does not have an established, frequently updated assessment of the risk profile of each of these entities. The Authority does not require information from the entities regularly, which might have helped it assess the cyber risk profile of each entity. However, it requests information only in case of a cyber incident or technological failure, even though it indicates missing applications. Without the information above, the Authority cannot produce an updated situation report of the institutional entities' ability to defend themselves effectively against cyber incidents and cannot assess the implementation of the cyber risk circular procedures and their effectiveness. The Authority's ability to point out specific and lateral failures to focus inputs on improving the protection against the realization of cyber risks is also impaired.

- The Authority carried out a limited number of audits (19 audits, of which 7 were completed) in 2017–2022 to assess the readiness of the institutional entities for cyber incidents and information technology management, and most of them were not completed. Moreover, due to the Authority's technology and cyber risk management policy, no significant tools that could have helped the institutional bodies defend against cyber risks and improve their defense and preparedness mechanisms were made available to them. This was reflected in incomplete applications relative to those promoted by other financial regulators to strengthen the protection against the realization of technology and cyber risks.

- Since 2016, the Capital Market Authority has held 4 round table meetings (one meeting was held in May 2023) and 3 professional meetings that focused on cyber issues. The meetings were not held regularly, despite the inherent benefits of sharing information to improve defensive capabilities against cyber incidents, and no summaries of the meetings were prepared for distribution to the representatives of the institutional entities.

- Contrary to the Banking Supervision Department, the Authority does not have data on the number of institutional entities included in the Financial CERT[6]. This is despite the inherent importance of joining the Financial CERT to receive information to which access is limited or impossible.

- The Authority did not regulate sectoral cyber exercises and periodic extreme testing, the main tools financial regulators use to evaluate and optimize defense capabilities against cyber incidents.

The Capital Market Authority's Information Systems – the systems that are currently used for organizational knowledge management at the Authority is not updated, the systems used for providing services to the general public are outdated and require updating, and the systems used for analyzing the data received from the institutional entities are deficient. It was further found that the internal computing system available to the Investment Division for processing institutional entities' reports does not allow for retrieval of data using search questions according to the Division's needs and cannot monitor deviations from the investment rules, identify specific and systemic exposure points and send red flag alerts.

Capital Market Authority's Audits and Enforcement at the Institutional Entities – as of the audit end date, the Authority did not have an overall situation report of its audits. Thus, multiple audits are conducted at one institutional entity, and very few audits conducted at other entities do not correspond with the risks inherent to the

6 Israel National Cyber Directorate, in collaboration with the relevant government ministries, has established 7 national sub-centers for the management of cyber incidents that provide a response against unique cyber threats and are divided into sectors. The Financial CERT (Computer Emergency Response Team), managed by the Ministry of Finance, serves as the state's protective shell for financial entities.

institutional entities. The Authority does not have a systematic methodology for prioritizing audit subjects and institutional entities based on a systematic supervisory evaluation process, despite the scope of the entities and the areas supervised by it. It has no mechanism to monitor the rectification of deficiencies found in its audits, nor does it organize and access information regarding the extent of deficiencies rectification by the audited institutional entities. The average Authority's audit duration in 2017–2022 was 37.2 months – over 3 years.

Intelligence Capabilities of the Capital Market Authority – the computerized work environment of the Authority's Intelligence Unit is deficient and outdated. The information systems are not linked and do not allow the Intelligence Unit (which includes one manager) to locate different parties under investigation and to cross information from all the systems. Moreover, the Unit lacks advanced technological equipment due to insufficient manpower at the Authority in general and at the Intelligence Unit in particular and the lack of a computerized system to manage inquiries. There is concern that under these circumstances, the Authority's ability to deter potential capital market offenders is impaired.

Core Issues of the Institutional Entities' Activities and Their Supervision

Supervision of Alternative Investments – the Capital Market Authority does not have regular procedures for examining alternative investments. Moreover, only 21% of the Authority's audits in 2017–2022 on investments (out of 53 audits in the field of investments) dealt with alternative investments, even though their rate in the portfolio has doubled in the last decade and even though it is necessary to strengthen the supervision in this field given the expected increase, due to, among other things, the designated bonds reform.

Responsible Investments and ESG Risks[7] – the ESG circular were interpreted in different ways by different institutional entities in terms of the duties and expectations derived from it; therefore, some of the entities considered the circular as binding, while others considered it as a collection of guiding principles – a gap that led, among other things, to different forms of implementation.

Submitting Applications for the Approval of Officials at the Institutional Entities – to approve the appointment of an official, the institutional entities submit a detailed application accompanied by various documents to the designated referent at the Capital Market Authority. Automating the application process at the institutional entities will help the Authority's referents check the applications and cross the information about the candidates based on the information accumulated in the various systems. In practice, the Authority did not prioritize establishing such a system. Despite the scope of the institutional

7 ESG – responsible investments that consider social welfare in addition to economic profit considerations. They focus on values of environmental friendliness, social justice and corporate governance.

entities subject to its supervision (including sectoral provident funds), this process is carried out using manual forms that are scanned into the system and do not allow cross-checking of information or background checks of candidates by computerized tools, but only by relying on organizational memory.

Frequency of Investment Regulations Review – although the investment regulations, regulating investments at institutional entities and creating uniformity in pension savings products, were established in 2012 and updated in recent years, the Capital Market Authority did not define the need for a periodic review of the regulations considering changes in the markets.

Establishment of a Hotline – the State Comptroller's Office commends the establishment of a hotline by the Capital Market Authority.

Regularization of Publication of New Regulations in the Arrangement Law by the Capital Market Authority – the State Comptroller Office commends the regularization of publication of new regulations by the Capital Market Authority under the principles outlined in the Arrangement Law, 2021, to optimize regularization of government bodies and public corporations, so that they achieve clear goals anchored in the powers of the regulator, without excess regulatory burden.

Key Recommendations

Given the increase in the volume of assets managed by the institutional entities supervised by the Authority, at about NIS 2,180 billion, it is recommended that the Budgets Department at the Ministry of Finance, in collaboration with the Authority, examine the resources that are required for the Authority to fulfill its tasks, and if adjustments are needed – increase its resources, including fees, and provide it with adequate budgets and HR standardization. Staffing of positions at the Authority is required, given additional roles and powers that have been assigned to it over the years. In addition, it is recommended that the Capital Market Authority, in collaboration with the Ministry of Finance, examine the process of transferring the fees to the Authority to utilize them during the current year.

Given the disputes between the various parties, the Minister of Finance, in collaboration with the Governor of the Bank of Israel, should advance agreements with the financial regulators regarding the structure of the financial regulation. Thus, it will help resolving difficulties in areas such as duplication of regulation, regulatory arbitrage, lack of uniformity in regulation, etc.

- It is recommended that the Ministry of Finance consider establishing a designated follow-up committee to examine the extent of the institutional entities' substantial holdings in companies in the Israeli market and the similarities in the entities' investment mixes, according to the recommendations of the Centralization Team, since these are the long-term savings of the Israeli public, managed by the institutional entities, and their financial volume is considerable and continues to grow every year.

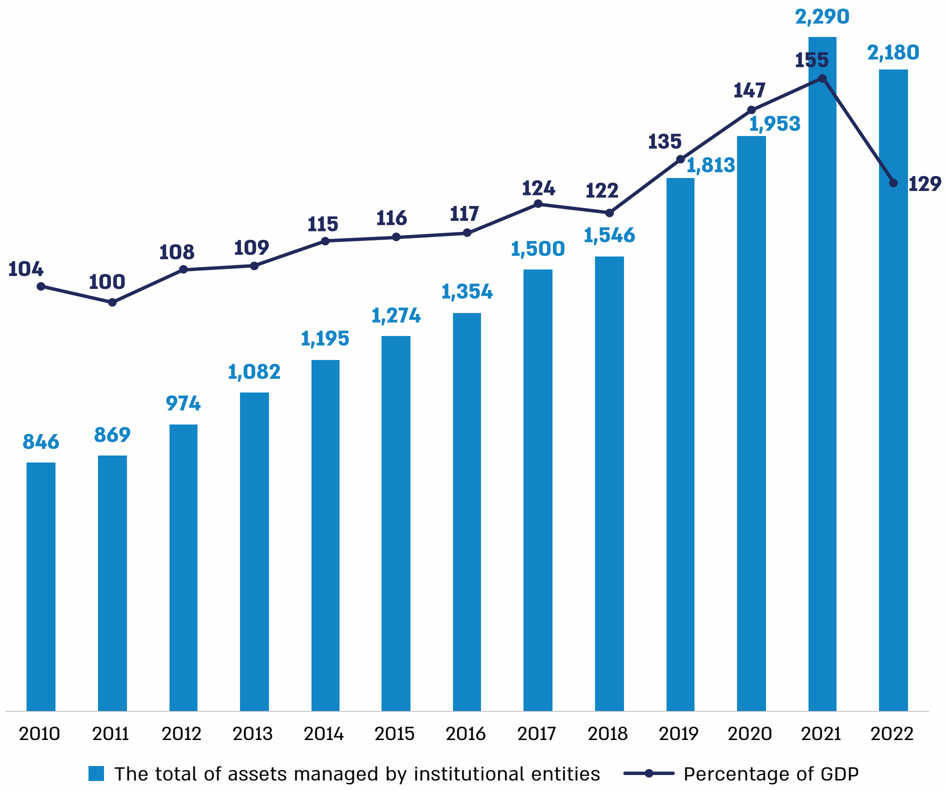
- The Authority should complete the Regulation Codex 2012 in an accessible way so that users can conduct advanced searches in different sections. In addition, the Authority should continue the issuance of circulars by updating the Codex.

- It is recommended that the Capital Market Authority publish its professional positions, as other regulators do, and even consider establishing a pre-ruling mechanism to share its positions on various issues with the institutional entities to assist them in making decisions. Moreover, the Capital Market Authority should consider conducting a satisfaction survey of its service to the institutional entities to improve this service.

- It is recommended that the Capital Market Authority consider increasing its involvement in the supervision of technology and cyber risk management at institutional entities to improve the security systems formulated in the sector. In this context, it is recommended that the Authority consider frequently meeting with a professional forum of institutional entities to share and distribute information and knowledge, continue to encourage institutional entities to join the Financial CERT and monitor their joining, as well as advance further cooperation with the Israel National Cyber Directorate to ensure the transfer of essential information to the institutional entities and utilize the inspection tools. It is further recommended that the Authority consider integrating sectoral exercises and extreme testing on cyber in its work and define the time frame for their execution, increase the number of audits on cyber according to the risk profile of each institutional entity, and examine ways to receive frequent and complete information on how the cyber risks circular is applied, hence supporting the development of a risk profile for each institutional entity and the optimization of the actions to protect against cyber incidents.

- The Capital Market Authority is recommended to establish the Digital Technologies and Information Division to provide all the Authority's units with the computerized services required for supervising the institutional entities. It is further recommended that the Digital Technologies and Information Division advance IT and cyber risk surveys of the Capital Market Authority and systems' penetration testing. The Capital Market Authority should examine the resources it needs in this area according to its goals and work plans and utilize the budgets allocated to it to fulfill its mission. It is recommended that the Capital Market Authority develop a comprehensive system to supervise all the Authority's audits, including all its audits by external auditors and employees, as well as the relevant analyses, thus informing the Authority's management of all the audits carried out. This could assist in devising an annual work plan, streamlining the audits, and increasing their effectiveness. Comprehensive monitoring of all audits will allow the Authority to examine the number of audits conducted in the same supervised entity during the year and the necessity of additional audits in the same field. It will also allow it to monitor the number of hours set for the auditor, the total scope of the audits, the total expenses that year on each supervised entity, the duration of the audit, and the time of sending the payment request, as well as the management of tender budgets and their distribution among the auditors.

The Total Assets Managed by the Institutional Entities and Their Share of the GDP, 2010–2022 (in billions of NIS)



According to the Central Bureau of Statistics, processed by the State Comptroller Office.

Summary

For years, the Capital Market Authority operated as a division of the Ministry of Finance (Capital Market, Insurance, and Savings Division) until it was established as an independent authority in 2016 under the law. However, it remained dependent on the Ministry of Finance. Compared to other financial regulators, the Authority has poor resources (the budget for an employee at the Capital Market Authority is about half of the budget for an employee at the Israel Securities Authority and about a third of the budget for an employee at the Bank of Israel), mainly due to the significant expansion of its duties, affecting the nature and scope of the supervisory activities. The lack of resources raises concerns that the Authority's inputs will not match all the areas of activity required and undermine its ability to monitor the funds of long-term savers effectively. Therefore, it is necessary to consider ways to ensure that the Authority has the professional capacity and adequate resources and that its inputs are used efficiently to empower the Authority as the gatekeeper of the insured and savers.

The audit raised that the institutional entities are highly dominant in the Israeli market (the scope of the assets managed by the institutional bodies as of 2022 is about 130% of GDP) and that there is a considerable similarity between their investment portfolios, which raises concerns about inefficient allocation of market resources. It was further found that the Capital Market Authority does not use the budget sufficiently and that its computer systems are outdated and deficient. In addition, it was found that there were gaps between the various financial regulators and that the Authority's regularization processes were inadequate, including the non-completion of the Regulation Codex. Deficiencies were also found in the risk management supervision system, particularly in cyber, and in the Authority's audits and enforcement program – an essential part of the mechanism to deter and supervise the institutional entities.

Given the increase in the scope of assets managed by the institutional entities supervised by the Authority and given the assignment of additional duties to the Authority over the years (for example, supervision of companies and individuals operating in the field of regulated financial services), it is recommended that the Minister of Finance consider empowering the Authority to fulfills its tasks. It is further recommended that the Budgets Department, in collaboration with the Authority, examine the resources required for the Authority and, if adjustments are needed – provide it with appropriate budgets and HR standardization according to its mandate and similar to other regulators. The Authority should be able to properly fulfill the roles assigned to it under law, and its duty towards the public of saving and insured citizens. Furthermore, the Authority should utilize its allocated budget to supervise the institutional entities' activities properly.