

**Israel: Detailed Assessment of Observance of International
Association of Insurance Supervisors Insurance Core Principles**

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FINANCIAL SECTOR ASSESSMENT PROGRAM

ISRAEL

INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS
INSURANCE CORE PRINCIPLES

DETAILED ASSESSMENT OF
OBSERVANCE

MARCH 2012

INTERNATIONAL MONETARY FUND
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GLOSSARY

CMISD	Capital Markets, Insurance and Savings Division
IAIS	International Association of Insurance Supervisors
LAT	Liability Adequacy Testing
LTS	Long-term Savings
LTC	Long-term Care
MBI	Motor, Bodily Injury Insurance
MMOU	Multilateral Memorandum of Understanding
MOF	Ministry of Finance
NIS	New Israeli Shekel
MOU	Memorandum of Understanding
QIS	Qualitative Impact Study
SLA	Service Level Agreement
SOX	Sarbanes Oxley

I. ASSESSMENT OF INSURANCE CORE PRINCIPLES

A. Introduction and Scope

1. **This report is a full assessment of Israel's compliance with the Insurance Core Principles (ICP's) of the International Association of Insurance Supervisors (IAIS), as adopted in October 2003.** The review was carried out as part of the 2011 Financial Sector Assessment Program (FSAP) Update with regard to the banking, securities and insurance supervisory systems in the country. This assessment update was conducted with regard to the circumstances in place and the practices employed in November 2011. The assessment was carried out by Rodolfo Wehrhahn, Technical Assistance Advisor, Financial Sector Oversight Division, Monetary and Capital Markets Division, IMF, and Lawrie Savage, Supervisory Consultant.
2. **Regulation and supervision of the insurance industry in Israel is the responsibility of the Capital Markets, Insurance and Savings Division (CMISD) of the Ministry of Finance (MOF).**
3. **The assessment is based solely on the laws, regulations, and other supervisory requirements and practices that are in place at the time of assessment.** Ongoing regulatory initiatives are noted by way of additional comments. **The assessment is largely based on the authorities' self-assessment** and other pertinent information provided. Assessors had access to a complete self assessment on the ICPs and responses to a detailed questionnaire that had been provided to CMISD prior to the commencement of the exercise. The assessors are grateful for the full cooperation extended by all and in particular for the outstanding support provided by CMISD.
4. **The level of observance for each ICP reflects the assessment of the essential criteria only.** Advanced criteria are not taken into consideration in assessing observance of the ICPs. Each ICP is rated in terms of the level of observance as follows:
 - **Observed**—where all the essential criteria are observed or where all the essential criteria are observed except for those that are considered not applicable.
 - **Largely observed**—where only minor shortcomings exist, which do not raise any concerns about the authorities' ability to achieve full observance.
 - **Partly observed**—where, despite progress, the shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance.
 - **Not observed**—where no substantive progress toward observance has been achieved.

B. Executive Summary

5. **The Minister of Finance (Minister) bears the political responsibility for supervisory oversight of the Israeli insurance system.** The insurance supervisor is the Commissioner of The Capital Markets, Insurance and Savings Division (“CMISD” or “the Division”) of the Ministry of Finance. The supervision of insurance companies in Israel is based on Israel insurance law, regulations, circulars and instructions. Legal requirements governing insurance companies originate in particular, in the company law and the insurance law. The principal legislation for the supervision of insurance is The Control of Financial Services (Insurance) Laws 5741-1981.

6. **CMISD oversees 23 insurance companies, 11 “new” pension funds, 18 “old” pension funds, 65 management fund companies, altogether having total assets of almost NIS 1 trillion as at June 30, 2011.** Five large insurance companies account for 90 percent of the insurance premium in the country. Most insurers are composite companies, i.e., they transact both, life and non-life business. This is a situation which is not considered to be best practice, mainly because regardless of the processes in place, it is difficult to ensure that if policyholders in one branch are suffering losses, they will not be subsidized by policyholders in the healthy branch. As well, few if any bankruptcy laws provide for the winding up of part of an insurer, so that policyholders of the failed branch of a composite insurer may be consigned to a legal limbo which may take many years to be resolved. All of the “big five” insurers are industry leaders in both life and non-life business.

7. **The Bachar reform began in mid-2005, forcing banks to divest most non-commercial banking activities, such as in mutual funds and provident funds.** The reform aimed at enhancing competition and reducing concentration in the financial sector. As a result, the non-bank financial sector has grown rapidly, now playing a larger role in credit markets. Managed assets in the long term savings business have been growing at an annual rate of more than 20 percent per annum over the past several years.

8. **Most life insurance sales are with regard to unit linked products where the purchaser bears the investment risk.** In general therefore the life insurance industry tends to have stability of income based on asset management fees. Traditional life insurance products such as term and endowment policies do not constitute a large part of the market.

9. **Non-life insurance accounts for about 50 percent of total premiums in the country and motor premium makes up about 50 percent of that total.** The latter class of business does not appear to be profitable although local accounting practices may have the effect of deferring income recognition and thereby reducing the apparent returns when premiums are growing.

10. **The Israeli insurance sector was hit hard by the financial crisis.** The Israeli stock market fell by 51 percent, sharply impacting companies’ earnings in 2008. However, the equity markets bounced back much more quickly than most other international markets and by the end

of 2009 had actually reached pre-crisis levels. An unanticipated impact of the financial crisis, however, was that a performance based fee arrangement, common in the Israeli market and applicable to significant blocks of run-off business, gave rise to a drag on life insurers' future earnings. A period of positive market performance will be required before fee income can be fully reestablished.

Main findings

11. **The review suggests that there is a high degree of compliance with the IAIS ICPs.** 19 of the 28 IAIS principles are assessed as observed. Six of the principles are largely observed, meaning that they currently do not present an immediate threat to the stability and development of the sector, while three require attention as they are deemed to be only partially observed. The partly observed ICP's relate to consolidated supervision, cross border supervision and fraud.

12. **CMISD exhibits best practices in several areas.** For example, with regard to ICP 14, Preventive and Corrective Measures, the Commissioner can issue instructions on virtually any topic, so that appropriate preventive or corrective measures can be put in place. Also in connection with ICP 26, Information Disclosure and Transparency Towards the Market, the amount of information required to be made public is very comprehensive and exceeds international standards. The CCMISD has made exceptional progress over the last three years or so in the implementation of a modern framework for insurance supervision. A risk-based approach is widely demonstrated and a formal insurer risk assessment process is well advanced. Staff members are motivated and have high levels of knowledge. The powers of the Commissioner are very comprehensive and they are frequently utilized to deal with instances of non-compliance and process improvement within companies.

13. **Supervisory cooperation and information sharing needs to be strengthened in order to attract foreign investors and to facilitate international expansion of local insurers.** It appears that on the domestic front there are reasonable structures in place to make sure that there will be adequate cooperation between Israeli supervisory agencies. However, cross-border information sharing needs to be developed to capture risks that could materialize from overseas. MoU's and regular communication with supervisors of jurisdictions with significant investment in the Israeli insurance sector should be in place. By the same token, communication channels should be established with supervisory agencies wherever Israeli insurers operate. This will allow CMISD to receive early warning signs of events that eventually could impact the financial soundness of the home insurer. During a crisis, well established relations are an essential aid to respond in an informed and practical way. The relevance of creating cross- border communication channels will grow as the effort to attract international participants in the market materializes.

14. **Current regulations provide insufficient tools to supervise groups effectively.** The importance of groups in the Israeli financial sector is a well known fact, as is the complex structure of some of the larger groups. At present, the CMISD does not have formal policies with

regard to group capital adequacy, reinsurance and risk concentration, internal control mechanisms and risk management systems, nor are there specific requirements for group wide reporting. Work is already underway to strengthen this aspect of the insurance supervisory system but we recommend that high priority be given to continuing these efforts. This will help to ensure that the supervisor is in a position to know with a high degree of certainty how risks may be developing throughout the ownership groups that include Israeli insurers. The law should be amended to provide CMISD with greater authority to access the holding companies and generally to more closely adhere to international standards relating to group-wide supervision.

15. The effort to advance supervision and regulation to a level of international best practice needs to be paced with the industry structures. The large number of positive reforms introduced in recent years and currently in the pipeline, including new investment rules, preparation for the introduction of Solvency II, harmonization of the supervision of long-term savings (LTS) providers, introduction of standardized language in several products, the requirements of levels of service, as well as the corporate governance compliance appears to be causing some stress in the industry sector, which could generate operational risk. Supplementing the supervisory staff with seasoned professionals with operational risk backgrounds would place CMISD in a better position to evaluate the operational difficulties and risks that have to be overcome by insurers in responding to new measures. Cost benefit assessment before the introduction of new substantial regulation is recommended.

16. A few additional areas where improvement would be desirable, are summarized below:

- Most insurers in the Israeli market are composite companies, i.e., transacting both life and non-life insurance. While the law requires careful separation of the two businesses within a single corporate entity, experience in other countries has demonstrated that when companies have to be liquidated, significant legal problems can arise under the composite company model. It is recommended that the law be changed to prohibit the composite structure and that a plan be put in place to deal with the existing situations, even if there has to be a lengthy period for implementation. An alternative would be to prohibit new composites and to strengthen the law so as to provide greater certainty about separation in the case of liquidation.
- Most insurance agents are employees of agencies that are owned by insurance companies. This can give rise to confusion in the public mind as to where the loyalties of these intermediaries may truly lie, even if the ownership relationship is disclosed. CMISD could consider increasing transparency by requiring changes to the current ownership structure or by requiring changes in the protocols for the labeling of various categories of intermediaries.
- Fraud is an area that CMISD has effectively addressed, but its actions have been limited to the situation of fraudulent activities within an insurance company. Fraudulent action by insurance consumers is common in most countries, resulting in measurably higher

costs for the insuring public. We suggest that the laws be amended to require more, and more effective, actions by insurers to limit the cost of insurance claim fraud.

C. Overview—Institutional and Macro Prudential Setting

Background

17. **After the founding of Israel in 1948, many insurers, mostly from the UK but also from the US and other parts of Europe, established operations in the country.** By the 1960's there were reported to be over 120 insurers operating within the country. In 1976 Avner Motor Vehicle Accident Victims Insurance was incorporated and in 1978, Clal Insurance Enterprises Holdings Ltd was established. These were two of the earliest established domestic insurers that would become major players in the Israeli insurance market. (But Avner was ultimately unsuccessful, having to be placed in run-off in 2003.) Consolidation continued over the period from the 1960's until around the year 2000.

18. **In 1981, the Israeli government introduced the insurance law, the insurance contracts law and the insurance business supervision law.** These laws, with various amendments over the years, continue to form the basis of the insurance supervisory framework. More extensive pension regulations were adopted in 1995, the same year that the National Health Insurance Law was adopted to delineate the state's responsibilities in providing health care to all residents of the country. New legislation in 2003 reformed the life insurance marketplace and in 2005 the Control of the Financial Services (Provident Funds) Law required significant changes in the manner in which retirement benefit plans were to be administered. The Mandatory Pension Order, which came into force on January 1, 2008, made it compulsory for employers to provide a pension for certain employees.

19. **The Bachar reform began in mid-2005, forcing banks to divest most non-commercial banking activities, such as in mutual funds and provident funds.** The reform aimed at enhancing competition and reducing concentration in the financial sector. As a result, the non-bank financial sector has grown rapidly, now playing a greatly expanded role in credit markets.

20. **The financial crisis of 2008 hammered Israel's economy and financial markets just as it did most other countries of the world, with the Tel Aviv 100 Stock Market Index down by 51 percent in 2008.**¹ However, 2009 saw a significant turnaround with Israel moving onto "a growth trajectory, with better economic performance than most developed markets: the real economy has been rebounding and Israeli capital markets have made rapid gains in share and bond prices, with a lower spread in the corporate bond market. Also, secondary market activity

¹ 2009 Annual Report of the Ministry of Finance, Capital Markets, Insurance & Saving Division, page 13.

reached pre-recessionary volumes, and the offering of shares and bonds has surged in number and scope.”²

21. **The strain suffered by the corporate bonds market during the crisis led to the establishment of the Hodek Committee and subsequent securities market and corporate governance reforms.** In February 2010, the Hodek Committee presented a set of recommendations to the government to improve market transparency, conduct, and the corporate governance of institutional investors. Insurers and pension funds are required either to implement the recommendations or alternatively, to explain at the board level why this has not been done.

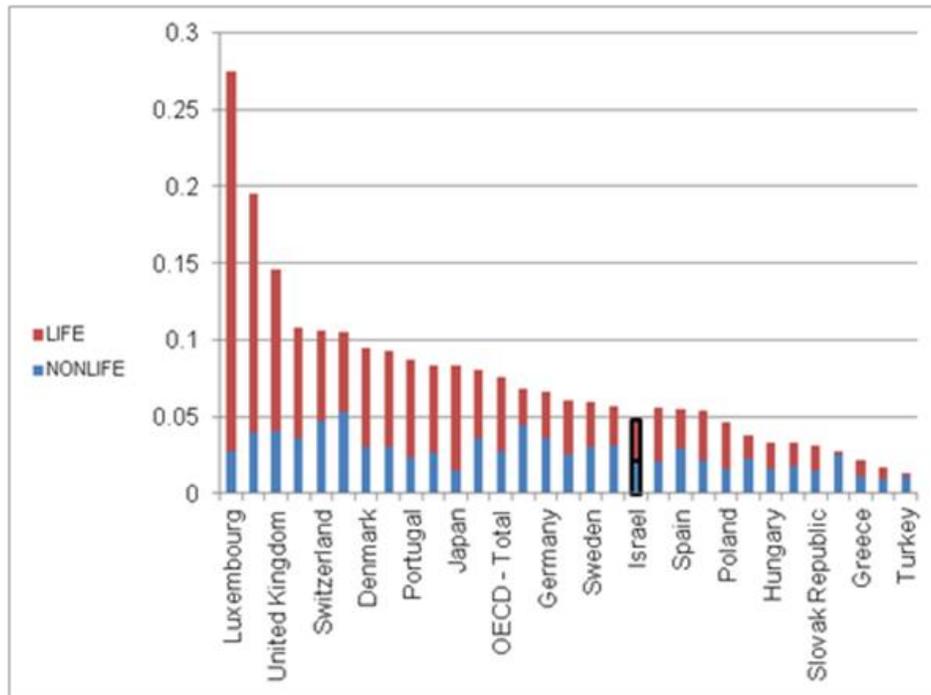
22. **While this turnaround has been gratifying, the crisis nevertheless highlighted certain weaknesses in the supervisory framework.** Israeli authorities indicate that in response, “the Division of Capital Markets, Insurance and Savings will deepen and increase its overseeing in its areas of responsibility in order to preserve and strengthen stability in Israel’s financial systems. In addition, the division will continue to foster development in the capital market. Additional human resources are being added to overseeing units and quantitative, multi-year goals are set so as to increase both the number and scope of audits of insurance companies and companies that manage retirement savings.”³ In addition a capital strengthening program for the insurance sector was introduced, leading to a 40 percent increment within 3 years.

Market size and structure

23. **With total premium of US\$11.2 billion, the Israeli insurance market is significant, both in absolute terms and also when measured as a percent of GDP (penetration).** Table 1, below, illustrates that the insurance market relative to total country GDP is quite comparable with a number of OECD countries. A relatively high level of insurance penetration demonstrates that insurance premiums are a significant driver of economic activity within the country.

² Ibid, page 5

³ Ibid

Table 1. Israel: Insurance Premiums as Percent of GDP (Insurance Penetration)

Source: CMISD/OECD Data base.

Table 2. Israel: Insurance Penetration over Time and by Life/Non-Life (Percent)

	2002	2003	2004	2005	2006	2007	2008	2009
Non-life insurance	3.3	3.3	3.2	3.0	2.9	2.8	2.7	2.7
Life insurance	2.7	2.7	2.6	2.6	2.6	2.6	2.7	2.6
Total	6.0	6.0	5.8	5.6	5.5	5.4	5.4	5.3

Source: Swiss Re Sigma No 2/2011, World Insurance in 2011.

24. **Insurance penetration in both life and non-life business has remained relatively level in recent years.** Table 2, above, shows that insurance penetration has tended to remain at a relatively constant level for both life and non-life insurance, in the range of from 2.6 percent to about 2.8 percent for each sector, although non-life insurance premium has typically been slightly higher than life insurance premium. The relatively stable percentages suggest that the growth rate for premiums in each of the insurance sectors has tended to fluctuate in line with the rate of change in the GDP.

25. **The insurance industry experienced significant consolidation during the 1960's and later but the consolidating trend has clearly abated in recent years.** As can be seen from

Table 3, below, over the past 9 years the number of insurers in total and those which are “active in life insurance” have been relatively constant over the entire period, with 24 or 25 active market players since 2003.

Table 3. Israel: Number of Insurers

	2005	2006	2007	2008	2009	2010
Total Number	25	24	24	25	25	23
Active in Life	14	13	13	13	13	14

Source: CMISD

Concentration and market shares

26. **The insurance market is concentrated.** As can be seen from Table 4, below, the insurance market is concentrated, although that is more the case for the life business compared to the non-life business: in 2010 the top five life insurers account for about 90 percent of the market compared with about 63 percent for the five largest general insurers.

**Table 4. Israel: Insurer Market Concentration
(In Percent)**

Market Segment	2006	2007	2008	2009	2010
Life Top 5	88.6	92.7	91.5	90.4	89.5
Non-life Top 5	64.6	65.0	64.5	62.9	62.6

Source: CMISD

27. **Main insurers participate in both life and non-life business.** Migdal dominates the life market with total premium of NIS6.6 billion, amounting to a 30 percent market share, far ahead of second ranked Clal, with a 20 percent market share. In the non-life market no one company has such a dominating position, although Harel is at 19 percent, six percentage points ahead of both Clal non-life and Phoenix non-life. Market shares are more balanced when viewed from a total company perspective, with Migdal at 19 percent followed closely by Harel and Clal, each having 17 percent of the total market. Based on data from CMISD there are 23 licensed insurance companies but only 14 of those have a market share of greater than 1 percent. An unusual aspect of the market is that the same five insurance companies are the market leaders in both life and non-life business. It is also worthwhile noting that, although Israel is not a large country in terms of population, the five largest insurers would be considered to be relatively sizeable in most markets of the world. For example, Migdal has total premium income of NIS8.2 billion, or US\$2.3 billion.

Table 5. Israel: Five Largest Insurance Groups
(Percentage Market Share)

	Life (NIS 1000)	Life in percent	Non-life (NIS 1000)	Non-life in percent	Total (NIS 1000)	Market in percent	Cumulative in percent
Migdal	6,558,569	30	1,645,447	8	8,204,016	19	19
Harel	3,316,932	15	3,836,197	19	7,153,129	17	36
Clal	4,317,765	20	2,696,214	13	7,013,979	17	53
Phoenix	3,392,965	16	2,706,778	13	6,099,743	14	67
Menorah	1,796,283	8	1,972,232	10	3,768,515	9	76
Total Market	21,645,295		20,547,287		42,192,582	76	

Source: CMISD.

Table 6. Israel: Life Insurance Gross Premium
(In NIS Million)

Product	2005	2006	2007	2008	2009	2010
Savings Policies	12,481	12,994	13,966	15,498	15,451	16,746
Term Risk Individual	630	739	824	1003	1158	1370
Term Risk Group	871	871	821	767	724	714
LTC Individual	357	410	457	520	583	664
LTC Group	516	569	643	800	1024	1264
Other	601	665	734	753	845	887
Total	15,457	16,249	17,444	19,341	19,785	21,645

Source: CMISD.

28. **Long term saving products dominate the life business.** As shown in Table 6 above, savings policies are by far the most important form of life insurance products, with NIS16.7 billion in premium in 2010, out of a total market of NIS 21.6 billion, or 77 percent of the total.

Table 7. Israel: Non-Life Insurance Gross Premium
(in NIS Million)

Product	2005	2006	2007	2008	2009	2010
MBI	4,117	4,114	4,234	4,429	4,738	4,415
Auto Prop	5,152	5,189	5,385	5,499	5,655	5,641
Property	1,767	1,808	1,620	1,604	1,735	1,748
Homeowners	1,377	1,368	1,457	1,494	1,521	1,578
Personal Accident	264	302	294	336	471	540
Medical	1,955	2,202	2,467	2,671	2,930	3,077
Other	3,026	3,319	3,218	3,292	3,488	3,548
Total	17,657	18,303	18,676	19,325	20,538	20,547

Source: CMISD

29. **Motor insurance accounts for half of the business.** The main product offerings in the non-life marketplace are shown in Table 7 above. The two sub-categories of motor insurance, i.e., bodily injury and property damage, together account for 48.9 percent of the total non-life market. This is quite typical of markets having compulsory motor, bodily injury coverage, as is the case with Israel. Nevertheless, although constituting the largest product type in terms of sales, growth in the motor line has been relatively flat, as would be expected with this type of product. On the other hand, growth in medical type coverage has been more significant and a number of insurers reported increased efforts directed towards sales in this line of business.

Assets and asset growth

30. **At June 30, 2011, CMISD was responsible for supervising institutions having total assets of NIS 958 billion** (source CMISD). Insurance industry assets have grown substantially over the last several years. As can be seen from the first line of Table 8, below, over the period from 2005 to 2010 total assets of life insurers have increased from NIS122 billion to NIS 210 billion, or 22 percent of total CMISD supervised assets. Pension plans and provident funds hold the bulk of the remaining assets. Since 2008 life insurance industry assets have grown by a compound annual rate of 20.5 percent, from NIS 144.8 billion to NIS 210.2 billion at the end of 2010.

Table 8. Israel: Total Assets Attributable to Life Insurance
(In NIS billion)

	2005	2006	2007	2008	2009	2010
Total assets	122.2	135.3	150.0	144.8	184.1	210.2
<i>of which</i>						
Intangible assets	2.3	2.4	2.4	2.6	2.6	2.7
Investments 1/ <i>of which:</i>	118.5	132.0	147.5	142.0	181.1	206.9
Government securities	50.5	48.7	47.9	58.0	61.0	65.6
Corporate securities	21.9	25.7	33.3	30.1	39.4	43.3
Equity	16.7	23.3	26.9	12.3	23.8	31.1
Real estate and real-estate related	2.0	2.8	3.9	5.9	5.9	6.9

Source: CMISD.

1/ Receivables including reinsurance receivables are not included.

Table 9. Israel: Total Assets Attributable to Non-Life Insurance
(NIS billion)

	2005	2006	2007	2008	2009	2010
Total assets	44.5	44.7	46.7	47.6	51.7	53.2
<i>of which</i>						
Intangible assets	0.9	0.9	1.0	1.3	1.4	1.3
Investments 1/ <i>of which:</i>	29.2	29.5	31.1	31.3	34.6	35.3
Government securities	9.9	9.5	8.6	9.3	11.6	12.2
Corporate securities	7.6	8.2	11.8	9.4	11.2	10.9
Equity	1.2	1.8	1.5	1.0	1.0	0.9
Real estate and real-estate related	0.2	0.1	0.3	0.5	0.5	0.5

Source: CMISD

1/ Receivables including reinsurance receivables are not included.

31. Assets related to non-life insurance have not enjoyed anything like the growth of the life insurance business, with an annual growth rate from 2008 to 2010 of only 5.7 percent.

Non-life business does not give rise to a large asset base because it is short term, cash in, cash out, business and there is considerable annual turnover in the customer base. Non-life insurers tend to have conservative, highly liquid investment portfolios because there is already considerable risk in the underwriting side of the business and because large claims may have to be paid with relatively little warning. The portfolio composition outlined in Table 9, above, indicates that Israeli non-life insurers recognize these realities and are investing accordingly.

32. Investment risk is distributed between insurers and policyholders. Table 10, below, illustrates that the largest share of asset risk rests with the purchasers of long term savings products, with NIS 835 billion of assets (or 87 percent of the total), compared to only NIS 122 billion of asset exposure (or 13 percent) for the insurance companies themselves. This has the benefit, at least from an insurance company solvency perspective, of ensuring that to a large extent, a declining market will not expose the institutions to significant investment losses. The other side of the coin is that it will expose the owners of the funds – consumers – to those same losses.

Table 10. Israel: Assets by Investment Risk

	NIS Billions	US\$ Billions	percent of Total
The savers bear the investment risk			
Provident Funds	296	83	35
Old Pension Funds	295	83	35
Participating life insurance policies	131	37	16
New Pension Funds	113	32	14
	835	234	100
The insurance companies bear the investment risk			
Guaranteed return life insurance policies ⁴	67	19	55
Non-life insurance and nostro	55	15	45
	122	34	100
Total assets supervised by CMISD	957	268	

Source: CMISD

33. **Few products offer investment guarantees.** In many countries, competitive forces within the financial industry have caused financial institutions to offer various types of guarantees on financial products. For example, while the purchaser of a unit-linked life insurance product may be responsible for bearing the investment risk in a general sense, the life insurer of record may be guaranteeing that the product will always be redeemable at, say, not less than 75 percent of the amount invested. Prior to 2008, when many world stock markets declined by close to 50 percent, such guarantees were not considered to pose any significant risk to the underwriters of the guarantee. With the 2008 experience, however, it became clear that in fact such guarantees can expose insurance companies to substantial losses. Therefore it is important that capital requirements take account of such risks, and that supervisors be satisfied that life insurer pricing and reserving methodologies are likewise including realistic estimates of the costs of such risks. The assessors are advised that the market share for these types of products in Israel is negligible and that in any case, there is a capital requirement for any such embedded guarantees.

34. **Investment portfolios are conservative as compared with OECD countries.** On average 15.2 percent of system assets are invested in equities and 22.6 percent in corporate bonds. Investments outside of the country account for 18.9 percent of total assets, but insurance

⁴ On some of these policies the government partially bears the risk.

companies actually have 27 percent of their assets falling into this category. (See Table 11, below).

Table 11. Israel: Investment Mix

Provident funds		Pension - New funds		Insurance - Participating		Total	
Percentage 2010		Percentage 2010		Percentage 2010		Percentage 2010	
Earmarked bonds	3.3%	Earmarked bonds	23.6%	Earmarked bonds	0.8%	Earmarked bonds	7.6%
Government bonds	26.0%	Government bonds	17.2%	Government bonds	15.3%	Government bonds	20.4%
Cash & Deposits	7.7%	Cash & Deposits	7.3%	Cash & Deposits	5.9%	Cash & Deposits	7.0%
Investment abroad	12.7%	Investment abroad	19.4%	Investment abroad	27.0%	Investment abroad	18.9%
Equity	16.4%	Equity	10.4%	Equity	17.2%	Equity	15.2%
Corporate bonds	27.5%	Corporate bonds	14.5%	Corporate bonds	22.4%	Corporate bonds	22.6%
Real estate	0.1%	Real estate	0.4%	Real estate	3.5%	Real estate	1.3%
Loans	1.5%	Loans	3.5%	Loans	4.3%	Loans	2.9%

Source: CMISD

35. **Membership in provident funds has displayed a downward trend but “new” pension fund participation has substantially increased.** Table 12, below, shows that the number of provident fund “policyholders” (number of accounts) declined from 9.026 million to 8.465 million, or 6.2 percent, from 2009 to the first quarter of 2011. The decline in provident fund account holders has been more than offset by a substantial increase in the number of “new” pension fund account holders, which increased from 2.267 million at the end of 2009 to 2.763 million at the end of the first quarter of 2011, or an increase of 21.8 percent over that fifteen month period. The contraction in the provident fund market is said to be the result of new rules requiring provident fund retirees to accept a life annuity rather than a lump sum withdrawal.

Table 12. Israel: Pension System Data

(In NIS billions, unless otherwise indicated)

	2005	2006	2007	2008	2009	2010	2011Q1
Number of pension funds							
Provident funds	104	108	101	87	66	66	65
"New" pension funds	18	13	13	13	10	10	11
"Old" pension funds	18	18	18	18	18	18	18
Number of policy holders							
Provident funds	7,289,456	7,626,339	7,906,090	8,105,132	9,026,200	8,319,882	8,465,937
"New" pension funds	1,050,840	1,181,694	1,356,445	1,870,874	2,266,524	2,657,837	2,762,646
"Old" pension funds	1,206,361	1,182,392	1,000,686	972,787	949,576	939,875	935,566
Financial indicators							
Gross contributions							
Provident funds	22	19	21	19	19	19	4
"New" pension funds	5	6	8	9	11	13	3
"Old" pension funds	15	8	6	7	6	6	2
Investment income	NR	NR	37	-46	103	60	-0.2
Payouts	29	29	30	42	31	33	9
Operating expenses	2	2	3	3	4	4	1
Total assets							
Provident funds	237	256	278	220	280	306	306
"New" pension funds	31	38	47	49	71	90	94
"Old" pension funds	157	164	177	259	289	309	319
of which:							
Government securities	231	217	194	296	319	342	357
Corporate securities	83	108	151	105	127	132	134
Equity	54	62	75	34	92	115	117
Real estate and real-estate related	1	1	2	2	2	2	3

Source: CMISD

Profitability and efficiency

36. **Profitability of the motor line has been poor but required accounting practices may have the effect of exaggerating the extent of the losses.** Motor business represents 59.2 percent of the total non-life market, having total premium of NIS 7.784 billion out of the total non-life market of NIS 13.133 billion. In terms of profitability, motor insurance has been subject to extreme competition, and indications are that margins are thinning, although conservative reserve methodology may mask true profitability. The claims ratio in this line of business was a very high 99 percent in 2010, while the combined ratio has been between 114 percent and 118 percent over the last three years. (Claims ratios and combined ratios by line of business are shown in Tables 13 and 14 below.) Several of the companies may be performing significantly worse than these averages. However, and contrary to what one would expect from the above figures, several of the larger motor underwriters reported that they have been able to generate a return of around 4 percent on the invested assets backing their reserves, which has been sufficient to generate an overall profit on their motor portfolios.

Table 13. Israel: Non-life Insurance Claims Ratio
(In percent of the Gross Premium)

Product	2005	2006	2007	2008	2009	2010
MBI	91%	78%	89%	99%	104%	99%
Auto Prop	72%	69%	69%	73%	75%	74%
Property	91%	37%	65%	47%	49%	65%
Homeowners	43%	47%	45%	46%	44%	42%
Personal Accident	69%	66%	63%	59%	58%	50%
Medical	52%	49%	50%	53%	55%	56%
Other	79%	63%	72%	80%	88%	82%
Total	75%	63%	69%	73%	76%	74%

Source: CMISD

Table 14. Israel: Non-life Insurance Combined Ratio
(In percent of Gross Premium)

Product	2005	2006	2007	2008	2009	2010
MBI	107%	95%	106%	114%	118%	115%
Auto Prop	99%	97%	96%	100%	101%	100%
Property	114%	58%	87%	69%	71%	88%
Homeowners	80%	85%	84%	84%	82%	79%
Homeowners	87%	90%	88%	87%	85%	81%
Mortgage	58%	62%	68%	71%	68%	70%
Personal Accident	101%	96%	96%	88%	90%	85%
Medical	87%	82%	81%	83%	83%	86%
Other	103%	86%	97%	104%	110%	105%
Total	100%	88%	95%	97%	100%	99%

Source: CMISD

Table 15. Israel: Non-life Insurance Profits before Tax
(In percent of Gross Premium)

Product	2005	2006	2007	2008	2009	2010
MBI	29%	22%	17%	-3%	25%	25%
Auto Prop	5%	5%	5%	1%	3%	2%
Property	-1%	-1%	0%	0%	5%	2%
Homeowners	7%	4%	5%	5%	8%	9%
Homeowners	7%	4%	5%	5%	8%	9%
Mortgage	7%	4%	5%	4%	7%	4%
Personal Accident	2%	8%	9%	9%	17%	40%
Medical	17%	18%	17%	15%	15%	19%
Other	6%	9%	6%	-6%	9%	11%
Total	12%	11%	9%	1%	12%	13%

Source: CMISD

37. **Life business has proven profitable and is a fast growing business.** As illustrated in Tables 16 and 17, below, life insurance savings products have been able to demonstrate exceptional stability and good profitability over time. Given their substantial market share, these products have provided Israeli life insurers with a reliable source of earnings. As can be seen from the last of the three tables below, with profits of NIS 1,174 out of total industry profits of NIS 1,742, life savings products produced almost 70 percent of total industry profit in 2010. These products bear low risk as in most cases the investment risk is borne by the policyholder. Term life appears too profitable attesting to good underwriting on average. The expenses reflect the type of asset management business with low risk transfer.

Table 16. Israel: Life Insurance Commissions
(In percent of the Gross Premium)

Product	2005	2006	2007	2008	2009	2010
Savings Policies	9%	9%	9%	9%	8%	8%
Term Risk Individual	20%	22%	23%	24%	27%	29%
Term Risk Group	20%	21%	16%	15%	15%	13%
LTC Individual	25%	24%	23%	21%	22%	21%
LTC Group	6%	5%	5%	5%	6%	5%
Other	20%	17%	14%	16%	14%	15%
Total	11%	11%	11%	10%	10%	10%

Source: CMISD

Table 17. Israel: Life Insurance Expenses
(In percent of the Gross Premium)

Product	2005	2006	2007	2008	2009	2010
Savings Policies	8%	8%	9%	8%	8%	9%
Term Risk Individual	19%	20%	17%	15%	15%	15%
Term Risk Group	3%	3%	4%	3%	3%	2%
LTC Individual	9%	9%	10%	8%	9%	10%
LTC Group	10%	10%	9%	9%	7%	8%
Other	6%	5%	8%	9%	9%	9%
Total	8%	9%	9%	9%	9%	9%

Source: CMISD

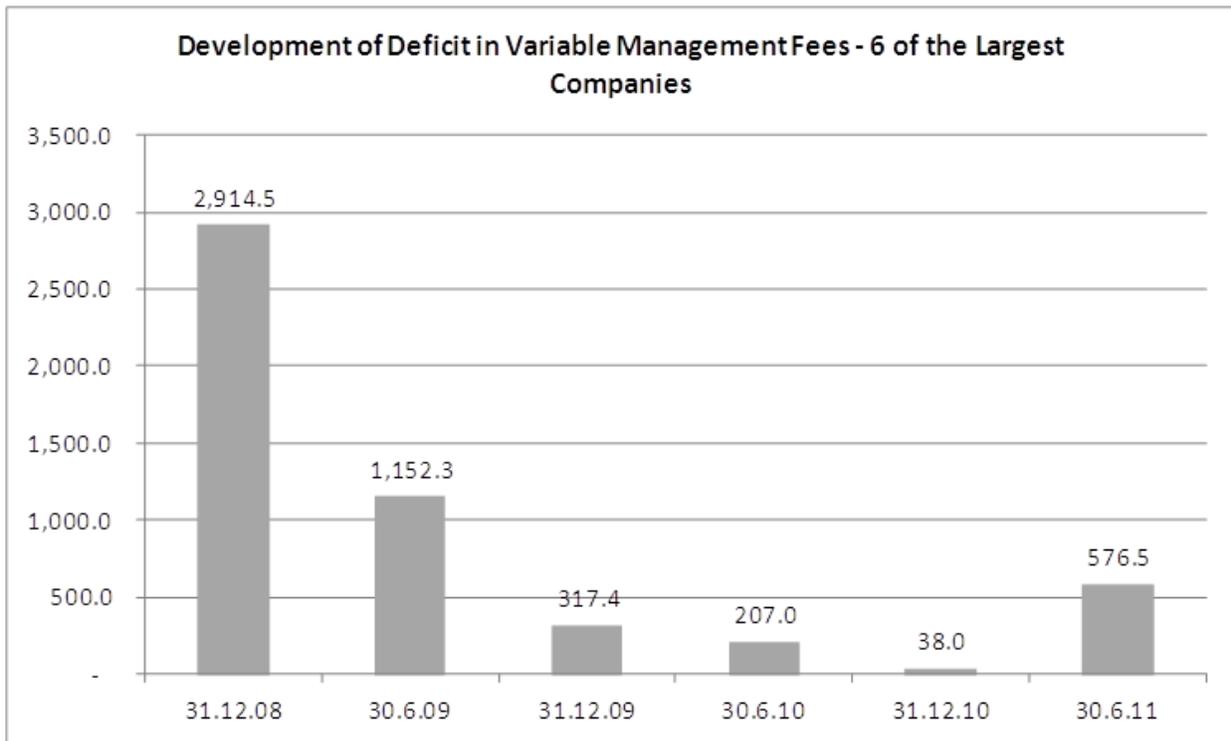
Table 18. Israel: Life Insurance Profits before Tax
(In NIS million)

Product	2005	2006	2007	2008	2009	2010
Savings Policies	1,931	1,483	933	-1,184	635	1,174
Term Risk Individual	123	154	208	253	342	418
Term Risk Group	-72	31	49	46	-5	23
LTC Individual	-18	15	12	-146	160	-4
LTC Group	-4	-7	22	-67	37	3
Other	120	147	125	-25	162	128
Total	2,080	1,823	1,350	-1,122	1,331	1,742

Source: CMISD

38. **While life insurance operations have generally been profitable, the financial crisis gave rise to a drag on future earnings, resulting from a performance-based fee arrangement that is common in the Israeli market.** The performance based fee system, when hit with an unprecedented fall in security values over a short period of time, requires life insurers to “make up” the lost performance before being able to earn a full measure of fee income. The potential impact of these contractual arrangements had not been contemplated, either by the industry or by the supervisors, but as can be seen from Table 19 below, they are substantial. The sharp rebound of the Israeli market helped to erase the impact of the negative development and by the end of 2010 most insurers had overcome the effect of the downturn on their income. However, as can be seen, the 2011 market downtrend has once again caused the variable management fee deficiency to increase.

Table 19. Israel: Impact of Performance Fees
(In millions of NIS)



Analysis of Financial Soundness

Capital adequacy and solvency

39. **The solvency requirement has been updated and significantly strengthened.** Over the past number of years the Israeli supervisor has been relying on an EU-type requirement with risk sensitive add-ons. These additional parameters were introduced after the crisis and resulted in an increment of around 40 percent to be met over the course of three years. Preparations for the

introduction of Solvency II are on target for an introduction in 2013. Past trends in capital adequacy over time are illustrated by Table 20 below.

Table 20. Israel: Capital Requirements and Surplus

Company	2010			2009			2008		
	Rate of capital surplus	Existing Equity	Minimum Equity Required	Rate of capital surplus	Existing Equity	Minimum Equity Required	Rate of capital surplus	Existing Equity	Minimum Equity Required
Hare'l group	17.9%	4,212,990	3,573,599	13.5%	3,331,573	2,936,294	0.7%	2,491,893	2,473,535
Clal group	29.9%	5,017,443	3,862,856	17.6%	4,100,727	3,486,140	9.3%	3,253,590	2,977,534
Menora group	30.2%	2,922,465	2,244,704	26.8%	2,510,974	1,979,782	4.3%	1,893,335	1,815,151
The Phoenix	49.0%	2,954,111	1,981,990	41.0%	2,276,775	1,614,209	0.3%	1,417,488	1,412,632
Migdal	30.9%	3,976,133	3,037,956	35.5%	3,472,604	2,563,747	12.8%	2,479,512	2,197,389
Ayalon	1.7%	681,839	670,739	18.4%	637,457	538,171	3.5%	521,338	503,719
Bitoah Yashir	47.9%	540,755	365,614	16.3%	358,223	308,015	4.8%	244,453	233,327
Hacsharat Hayeshov	1.4%	395,728	390,164	12.5%	385,186	342,260	11.8%	324,536	290,219
Eliyaho	56.5%	1,500,100	958,549	41.2%	1,332,542	943,877	29.1%	746,537	578,151
Shlomo Ins. Co.	0.2%	92,966	92,800	12.3%	83,819	74,610	1.5%	55,556	54,750
Bitoah Haklayl	4.5%	255,323	244,327	6.3%	230,057	216,466	0.1%	167,515	167,366
AIG	8.2%	375,218	346,642	76.9%	318,567	180,092	73.3%	244,097	140,849
Shirbit	13.4%	220,355	194,382	0.9%	169,875	168,355	7.7%	145,663	135,241
New B.S.S.H	201.1%	97,256	32,297	224.8%	97,256	29,947	263.6%	97,256	26,731
Ezer (EMI)	93.7%	341,756	176,450	38.2%	296,428	214,525	9.6%	214,754	195,992
Total	29.8%	23,584,438	18,173,069	25.7%	19,602,063	15,596,490	8.3%	14,297,523	13,202,586

Source: CMISD

40. **Some insurers remain challenged by the new capital requirement.** Significant variation in capital adequacy over time can be observed, no doubt reflecting the extreme volatility in investment markets over the period. For example, in 2008 we can see that the average rate of capital surplus was 8.3 percent, whereas that figure had sharply increased by the end of 2010, to 29.8 percent, even after taking account of the fact that total required industry capital substantially increased from NIS 13.2 billion to NIS 23.6 billion over the period. Several individual insurers had virtually no excess capital at the end of 2008. Several insurers, for example, Phoenix Group, substantially increased their paid in capital to remedy the shortfalls. The figures also illustrate, however, that not everyone has benefited equally from the turnaround in the investment markets: even at the end of 2010 there were still three insurers with less than 2 percent capital surplus.

Use of reinsurance

41. **Reinsurance is primarily being used in the Israeli market to provide earthquake protection and capital relief.** Israel has no domestic reinsurers and does not require licensing of foreign reinsurance companies accepting business from Israeli insurers. The large international insurers, particularly Munich Re and Swiss Re, have traditionally supported the local market. Retention levels in non-life are generally quite low, other than with regard to motor insurance where there are large numbers of homogeneous risks and therefore higher levels of retention do not give rise to undue levels of risk. The main catastrophic exposure is to earthquake risk.

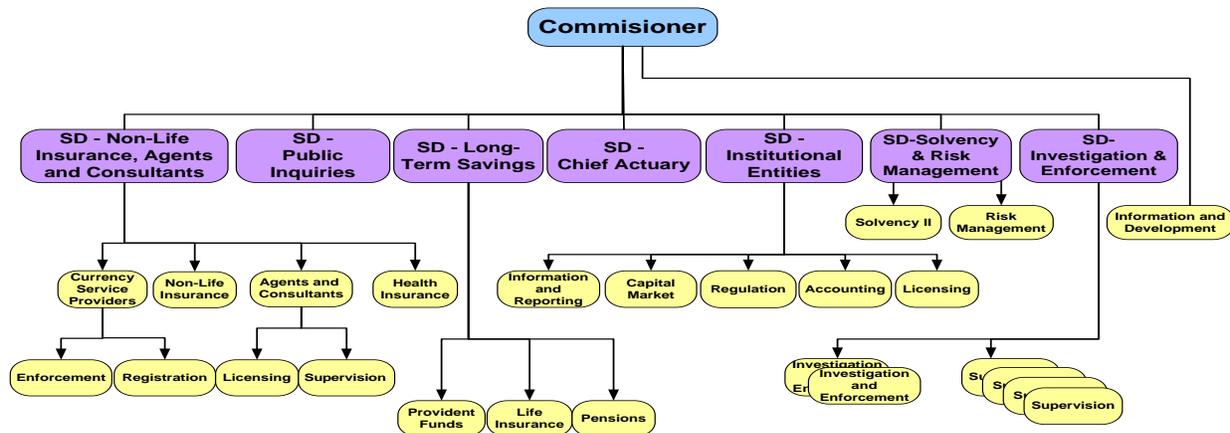
Sophisticated models are used to estimate probable maximum loss levels and to inform the purchase of reinsurance. Several block transactions have been effected to provide capital relief for the companies concerned. Close monitoring of these transactions is recommended.

Oversight and regulation

42. **The CMISD) of the MOF is responsible for the regulation and supervision of the insurance industry and the LTS sector.** The figure below depicts the overall organizational structure of CMISD. Total staff is 140. The Commissioner is appointed by the Minister of Finance for a five year term, which cannot be renewed. The Commissioner can only be removed from the position by the Government as a whole, i.e., the Knesset on the recommendation of the Minister of Finance. However, no Commissioner has ever been removed during his or her term of office.

43. **Budget is part of the budget of the MOF but it was indicated that in the past this has never been a constraint on CMISD’s operations.** The organization has not had difficulty in attracting the caliber of officers that it requires to carry out its duties. Virtually every Senior Deputy has at least two university degrees, often with additional professional qualifications, and several of the Senior Deputies had three or more degrees. As well, every such officer has had a reasonable number of years of experience. As an additional point with regard to the adequacy of resources, it was pointed out that Section 97 of the insurance law authorizes CMISD to retain outside experts and advisors at the expense of the insurer concerned, and that this section is frequently utilized. These advisors can assist with CMISD with special investigations, actuarial and other matters and so provide a significant adjunct to the internal resources of the organization.

Figure 1. Israel: Structure of the CMISD



44. **CMISD supervises pension funds (11 “new” funds and 18 “old” funds), 65 provident fund management companies and 23 insurance companies.** The assets of these institutions currently total about NIS 1 trillion (USD 277 billion). The focus of this review is insurance supervision. However, it is worth mentioning that provident funds are similar to 401k funds in the United States (and Registered Retirement Savings Plans in Canada), i.e., they provide a vehicle for tax efficient retirement savings. There are tax penalties for premature withdrawal of funds. Upon retirement the accumulated amount may be rolled into a life annuity or a lump sum may be withdrawn but there is a requirement for at least a minimum annuity of NIS 4,000 per month.

D. Summary of Compliance with the ICPs

Table 21. Israel: Summary of Compliance with the ICPs

Core Principle	Grading	Comments
1 Conditions for effective insurance supervision	O	The supervisory system and the legal system are very well integrated, to the benefit of insurance consumers. While improvements can always be made, conditions for effective supervision seem to be very well established.
2 Supervisory objectives	O	<p>The objectives of supervision cover prudential and market issues. Detailed objectives are communicated more directly to the public by way of the CMISD web site. These objectives are further broken down into a number of sub-goals, including transparency of products and fairness to the public, accountable institutions and distributors, stable institutions and markets, healthy competition and promoting financial awareness by consumers.</p> <p>The timeliness of the Report has not always been exemplary (the 2010 Report became available only in November of 2011) but the agency says that steps are being taken to improve this situation.</p> <p>Much financial information is readily available to consumers via the CMISD website.</p>
3 Supervisory authority	LO	Although CMISD has significant powers, many of which can be exercised in a relatively unfettered manner, the CMISD is not fully independent in the sense envisioned by the Standards. CMISD is a Division of the MOF, it does not have an independent budget or audited financial statements which could enhance the transparency of its operations.
4 Supervisory process	O	The CMISD has put in place clear and transparent processes with regard to its regulatory framework. The extent to which it makes information available to the insuring public is very good, both through its own web site and by its requirement for insurers to present key information to their clients.

Core Principle	Grading	Comments
		<p>In the course of discussion it was evident that, for most insurers in Israel, moral suasion is still an effective supervisory tool. Although the framework seems very comprehensive, the CMISD often finds that it does not have to resort to formal powers: if the supervisor makes it known to the managers or board of an insurer that it thinks changes are required, then that advice will be taken very seriously by the entity concerned.</p> <p>CMISD should, as part of its established internal processes and insofar as possible, conduct a cost/benefit analysis prior to recommending the adoption of new regulations and in judging how rapidly to phase them in.</p> <p>CMISD may want to consider the establishment of working groups with the professional associations of auditors and actuaries. The objective would be to ensure these groups are kept apprised of CMISD interests and concerns with regard to the professions and to encourage mutual solutions to important issues, including the development of professional standards which will enable CMISD to put greater reliance on the input from auditors and actuaries as part of the supervisory framework. From the other side, CMISD would benefit by being better informed of emerging issues for auditors and actuaries and being able to ensure that the professional organizations are taking account of the supervisory perspective.</p> <p>CMISD could also work to place greater reliance for research and other input on the insurance industry itself.</p>
5 Supervisory cooperation and information sharing	PO	<p>There are no established working relations with relevant international supervisors. This is deemed to be a limitation in the supervision.</p> <p>To ensure that collaboration with foreign supervisors is not overlooked, it is recommended that CMISD include in its various early warning procedures, an internal requirement that when an insurer that is a subsidiary of a foreign insurer reaches a certain level of risk (commonly measured by the company's position with regard to the capital adequacy requirement), the home supervisor will be contacted (1) to advise the home supervisor of the situation and (2) to ascertain the financial condition and soundness of the parent insurer.</p> <p>It is also recommended that CMISD require foreign owned insurers to submit on an annual basis a copy of the supervisory filing that is submitted to the home supervisor.</p>
6 Licensing	LO	<p>The law should be changed so that at least for the future, composite insurers will not be licensed.</p> <p>In the future, CMISD may want to require that business plans be reviewed by an experienced professional such as an actuary or independent auditor, who could attest to the reasonableness of the</p>

Core Principle	Grading	Comments
		underlying assumptions and to the fact that in his or her opinion the business plan could reasonably be attained. Such an approach would bring another set of eyes to the review process in support of the review to be carried out by CMISD.
7 Suitability of Persons	O	For the future, CMISD should seek an amendment of the law to include the independent auditor in the list of entities to which the fit and proper provisions apply.
8 Changes in control and portfolio transfers	O	In the limited number of situations with changes in control and transfers of business the CMISD has appropriately applied the regulation to protect consumer interests effectively.
9 Corporate governance	O	<p>The corporate governance requirements, covered by a series of circulars from the Commissioner, are very detailed, but this can sometimes be a disadvantage. When that is the approach taken, it is difficult to come up with a list that is truly exhaustive. It is therefore suggested that when possible, the law should be amended to supplement the detailed listing of requirements with some additional, more general principles for board compliance. An over-arching provision that has been found to be beneficial is a general duty of skill and care, set out in wording that is typically along the following lines:</p> <p><i>Every member of the board must:</i></p> <ul style="list-style-type: none"> • <i>act in good faith, honestly and reasonably;</i> • <i>exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.</i> • <i>act in the best interests of the insurer and policyholders, putting the interests of the insurer and policyholders ahead of his/her own interests;</i> • <i>exercise independent judgment and objectivity in his/her decision making, taking due account of the interests of the insurer and policyholders; and</i> • <i>not use his/her position to gain undue personal advantage or cause any detriment to the insurer.</i>
10 Internal Controls	O	The implementation of recent regulation strengthening internal controls and allocating accountability to the board is welcome. As the companies become more familiar with the new rules, a stronger focus on the supervision of the boards' role in this area should be given. This will become even more relevant with the introduction of Solvency II in 2013.

Core Principle	Grading	Comments
11 Market Analysis	O	The CMISD conducts sophisticated and thorough market analysis.
12 Reporting to supervisors	O	Outsourced activities are currently not subject to CMISD monitoring and we suggest that specifically with regard to core activities of institutions, this area should be monitored more closely.
13 On-site inspection	O	<p>While this area fully complies with international standards, we think that best practice could in the future include: (1) somewhat greater emphasis on comprehensive company-wide inspections and somewhat less emphasis on the highly targeted inspections that are mainly carried out at present, (2) closer cooperation and information sharing with the independent auditor, (3) holding an exit meeting with insurance company management after the inspection to ensure there have been no miscommunications, prior to commencing work on the Division's report. An additional suggestion is to improve efficiency and effectiveness by reducing the frequency of inspections that use relatively few person days but spread over a number of months, and instead applying most of the person days to a single, more extended visit at the company. Taken together, we think these changes would also help to reduce regulatory burden for industry members.</p>
14 Preventive and corrective measures	O	<p>The law's general empowerment of the Commissioner to issue any instructions that may be required to safeguard the position of policyholders provides a complete range of possible preventive and corrective measures. In the few cases where it can be argued that more specific powers are required (such as a requirement to increase the capital base of an insurer) there are plans to modify the law to include the desirable power. In addition, the assessors were provided with a number of recent examples to demonstrate that the preventive and corrective powers are actually being utilized to protect policyholders and members of the public.</p> <p>When possible, the law should be amended to allow CMISD to demand additional capital at any time the Commissioner believes that such action is necessary to protect the interests of policyholders.</p> <p>CMISD is working to develop a formal ladder of intervention which will include control levels that can trigger various types of intervention (i.e., preventive and corrective measures), escalating as an insurer's position becomes more serious. At present, with no general ability to require capital increases, and a lack of formally stipulated intervention measures related to overall financial viability, the agency is not able to exercise defined strategies that can be applied on a market-wide basis. The introduction of a ladder of intervention will also ensure greater consistency in the supervisory process and make the process much more transparent to market participants.</p>

Core Principle	Grading	Comments
15 Enforcement or sanction	O	<p>In light of the extensive powers granted to the Commissioner, the requirement to report annually to the Ministry of Justice is an important control instrument.</p> <p>For minor breaches of compliance, rather than imposing fines, companies are normally required to correct their procedures. For serious offences, significant fines can be levied; depending on the circumstances, they may include personal fines to officers and directors. These approaches help to reinforce a risk based approach to supervision. (See also ICP 23.)</p>
16 Winding-up or exit from the market	O	<p>The law takes account of the special nature of insurance contracts and the insurer's obligations to policyholders. Thus, policyholders rank ahead of other creditors and within the range of policyholder claimants, varying preferences are able to be established. Taken together, these provisions ensure that as far as practical there will be limited disruption to the provision of benefits to policyholders.</p> <p>The last insurance company wind-up was in 1991. Although the large market share of this failed insurer was over 30 percent, policyholders did not lose money and policies continued without interruption with other insurers.</p> <p>Notwithstanding the above, it should be borne in mind that some insurance companies belong to (nonfinancial) conglomerates. If such a conglomerate got into serious financial difficulties, its resolution may be complex and protracted. Hence, it may be useful to consider introducing amendments to legislation explicitly allowing the ring fencing of insurance companies belonging to a conglomerate that is being resolved. (See also ICP 15).</p>
17 Group-wide supervision	PO	<p>There are reasonable arguments why group wide supervision may be of less significance in Israel than is the case in many other markets. Nevertheless, one cannot know with any certainty that the issue of group interconnectedness will not suddenly become important in a particular case. At present there are a number of the Essential Criteria that are not satisfied with regard to this ICP. It appears that the situation will be rectified in the relatively near future as new laws and regulations are put in place to facilitate the Solvency II regime. However, there should be some level of supervisory authority with regard to holding companies, at least to the extent of providing CMISD with detailed financial and ownership information.</p> <p>It is suggested that in the future, CMISD require each of its supervised institutions to file a complete organizational chart for the group, showing every entity controlled by the institution's controlling shareholder, including both direct and indirect interests. This should form a part of the information that is sworn to by the company's signing officers in the affidavit that accompanies the filing. The receipt of this annual document</p>

Core Principle	Grading	Comments
		would provide CMISD with an authoritative source for all corporate inter-relationships and would help it to more effectively pursue the principles of group-wide supervision.
18 Risk assessment and management	O	<p>The focus on the role of the board will need further intensity as Solvency II is introduced.</p> <p>One of the Essential Criteria requires that the risk management policies and risk control systems be appropriate to the complexity, size and nature of the insurer's business. In a number of the circulars on different subjects there is specific provision for reduced scope of application for small companies. However, the circular with regard to the functions of the chief risk officer (CRO) does not seem to include any such differentiation. This could be remedied at a future date.</p>
19 Insurance activity	O	The quality of reinsurance is monitored not only through rating but also using other sources of information. The concentration and counterparty risks call for risk capital charges. The exposure to the reinsurers as well as the total exposure of each reinsurer to the market is followed and recommendations can be issued to address excesses.
20 Liabilities	O	<p>The use of Liability Adequacy Testing (LAT) to assess the level of liabilities is a positive initiative. However, the parameters and methodology needs to be defined and not freely left to the criteria of the companies that might use insufficient or inadequate methods. The LTS products that allow for a variable commission in dependence of the performance of the investments is an example where a liability provision for the adverse performance of the investments was missing.</p> <p>Although CMISD works closely with most of the life insurers using various stress testing methodologies, there is no legal requirement for companies to stress test their balance sheets under different economic scenarios. This should be remedied at a future date.</p>
21 Investments	O	The introduction of prudent person supervisory approach in tandem with a clear accountability of the board and the requirements of setting up a professional investment committee is a positive development.
22 Derivatives and similar commitments	O	Taking into consideration the current level of development of the derivatives market in Israel, a conservative supervisory approach is recommended. The current tight limitation of the use of derivatives for hedging purposes should be kept under review as the market develops.
23 Capital adequacy and solvency	LO	<p>The current solvency regime is an enhanced Solvency I regime that has some risk sensitive elements, like market consistent valuation of assets, market risk, reinsurance credit risk and concentration risk charges for example. However, calibration of the risks still needs attention.</p> <p>Stress testing needs further development and the introduction of</p>

Core Principle	Grading	Comments
		<p>standardized stress testing as well as technical provision stress testing is recommended.</p> <p>With the introduction of Solvency II planned for 2013, the full observance of this principle will be achieved.</p> <p>CMISD is working to develop a formal ladder of intervention which will include control levels that can trigger various types of intervention (i.e., preventive and corrective measures), escalating as an insurer's position becomes more serious. At present, with no general ability to require capital increases, and a lack of formally stipulated intervention measures related to overall financial viability, the agency is not able to exercise defined strategies that can be applied on a market-wide basis. The introduction of a ladder of intervention will also ensure greater consistency in the supervisory process and make the process much more transparent to market participants.</p>
24 Intermediaries	LO	<p>For agents owned by insurance groups, transparency in the interests represented should be enhanced. One approach to providing the insuring public with greater clarity regarding the interests of intermediaries, would be to require that consumers give "informed consent" when dealing with agents that are owned by an insurer and recommending a product that is underwritten by that insurer. More generally, CMISD could consider increasing transparency by requiring changes to the current ownership structure or by requiring changes in the protocols for the labeling of various categories of intermediaries.</p>
25 Consumer Protection	O	<p>Consumer protection provisions are generally strong. A cooling off period for products sold under pressure, such as direct sales and credit card or loan linked products, should be introduced.</p> <p>As best practice in the dealing with consumer complaints we suggest that the relevant circular be amended in future to include the following refinements:</p> <ul style="list-style-type: none"> • Board to appoint internal ombudsman who is a senior officer of the company; • All claimants notified of contact details for internal ombudsman when claim information is received by insurer, plus clearly shown on company web site; • Complainants to first approach insurer with complaint details. Insurer has fixed period to resolve (say up to 30 days); • If not possible to resolve within that period, insurer provides insured with "final position letter" explaining why insurer is not prepared to resolve to consumer's satisfaction, plus notice of

Core Principle	Grading	Comments
		<p>contact details for complaint to CMISD.</p> <ul style="list-style-type: none"> • Then, if contacted, CMISD investigates, offers mediation service along with other services offered at present. • Final resolution can be to the court system
26 Information, disclosure and transparency towards markets	O	The amount of information required to be made public is very comprehensive.
27 Fraud	PO	<p>Steps should be taken as soon as possible to deal in the law with consumer claim fraud. This should include the clear labeling of insurance consumer fraud as a criminal offence and should require boards of directors to put in place policies with regard to measures intended to detect and reduce claim fraud. In most countries over-stated claim filings, phony claims and similar misconduct, adds considerably to the cost of insurance, which must be borne by all policyholders.</p> <p>Consideration should be given to providing for more extensive use of industry data bases to detect insurance fraud, similar to the system that has been developed in connection with the Motor Bodily Injury product, with due regard for confidentiality.</p>
28 Anti-money-laundering, combating the financing of terrorism	LO	Anti-money-laundering, combating the financing of terrorism (AML/CFT) provisions and practice are generally of a high standard. A new regulation to complete and harmonize the regulatory framework was in the process of being issued at the time of the assessment.

Summary of Grading

Observed (O)	20
Largely observed (LO)	5
Partly observed (PO)	3
Not Observed (NO)	0
Total	28

Recommended action plan and authorities' response

Recommended action plan

Table 22. Israel: Recommendations to Improve Observance of the Insurance Core Principles

Core Principle	Recommendation
ICP 2 – Supervisory objectives	The time lag to publication of the Annual Report should be reduced.
ICP 3 – The supervisory authority	Consider an independent budget for the CMISD or audited financial statements which could enhance the transparency of its operations.
ICP 4 – Supervisory Process	<p>CMISD should, as part of its established internal processes, conduct a cost/benefit analysis prior to recommending the adoption of significant new regulations.</p> <p>CMISD could work to make greater reliance for research and other input on the insurance industry itself. Many jurisdictions have found that the establishment of industry/supervisory working groups, coordinated through the industry association, can have powerful benefits by increasing the knowledge base of the supervisor when addressing important industry issues.</p>
ICP 5 – Supervisory collaboration and info sharing	<p>A stronger working relationship with relevant international supervisors should be established.</p> <p>It is recommended that CMISD includes in its various early warning procedures, an internal requirement to communicate with international supervisors given certain conditions.</p> <p>It is also recommended that CMISD require foreign-owned insurers to submit on an annual basis a copy of the supervisory filing that is submitted to the home supervisor.</p>
ICP 6 – Licensing	<p>The law should be changed so that, at least for the future, composite insurers will not be licensed.</p> <p>Additional protection would be afforded investors in unit linked funds by requiring as a condition of licensing, formal segregation of assets by having them held by the insurer “in trust” for the investors.</p>
ICP 7 -- Suitability of persons	The law should be amended to include the independent auditor in the list of entities to which the fit and proper provisions apply.
ICP 9 - Corporate governance	An over-arching requirement of duty, skill and care should be implemented.

ICP 12 – Reporting to the supervisor and off-site monitoring	Regulation to more closely monitor outsourced providers should be introduced.
ICP 13 - On-site inspection	<p>The frequency of comprehensive inspections should be increased. Cooperation and information sharing with the independent auditor should be enhanced. An exit meeting with insurance company management after the inspection should be held, to ensure there have been no miscommunications, prior to commencing work on the Division's report.</p> <p>The frequency of inspections that use relatively few person days but spread over a number of months should be reduced, applying most of the person days to a single, more extended visit at the company.</p>
ICP 14 - Preventive and Corrective Measures	<p>Regulation that allows for a formal ladder of intervention should be introduced.</p> <p>The law should be amended so that, as a corrective measure, additional capital can be required at any time the supervisor deems it necessary, rather than only during the initial five years of operation.</p>
ICP 16 Winding-up or exit from the market	It may be useful to consider introducing amendments to legislation explicitly allowing the ring fencing of insurance companies belonging to a conglomerate that is being resolved.
ICP 17 - Group-Wide Supervision	<p>Regulation should be included to allow at least basic supervision of the holding companies of insurance companies.</p> <p>It is suggested that in the future, CMISD should require each of its supervised institutions to file a complete organizational chart for the group, showing every entity controlled by the institution's controlling shareholder, including both direct and indirect interests.</p>
ICP 18 - Risk assessment and management	<p>The focus on the role of the board will need to intensify as Solvency II is introduced.</p> <p>Proportionality principle should also apply to the CRO requirements.</p>
ICP 20 – Liabilities	Standards on the use of LAT should be developed and introduced.
ICP 22 – Derivatives and similar commitments	The current tight limitation of the use of derivatives for hedging purposes should be kept under review as the market develops.
ICP 23 - Capital adequacy and solvency	<p>Solvency II, adapted to Israel, should be introduced.</p> <p>Stress testing should be developed further, and standardized stress</p>

	testing as well as technical provision stress testing should be developed should be introduced.
ICP 24 – Intermediaries	<p>To provide the insuring public with greater clarity regarding the interests of intermediaries, consumers should provide “informed consent” when dealing with agents that are owned by an insurer and recommending a product that is underwritten by that insurer. With informed consent, the consumer signs a document indicating knowledge and understanding of the relationship between the agent and the insurer. In general, consider (1) changes to the current ownership structure, or (2) more clearly defined intermediary naming protocols (i.e., whether an agent mainly represents one insurer, with ownership or sponsorship ties to that insurer; broker represents more than one insurer but with no ownership or sponsorship connection), all to achieve greater market transparency.</p> <p>Standards regarding service levels to clients should be implemented vigorously.</p>
ICP 25 - Consumer Protection	<p>Introduce a cooling off period for products sold under pressure, such as health insurance and credit card or loan linked products, should be introduced.</p> <p>Insurers should be made more directly responsible for their products and actions by assigning them the initial responsibility for dealing with complaints; the CMISD would handle complaints which cannot be resolved by the insurers.</p>
ICP 27 - Insurance fraud	<p>Regulation to require boards of directors to put in place policies with regard to measures intended to detect and reduce claim fraud should be introduced.</p> <p>In keeping with best international practice, consideration should be given to providing for more extensive use of industry data bases to detect insurance fraud, similar to the system that has been developed in connection with the Motor Bodily Injury product, with due regard for confidentiality.</p>
ICP 28 – AML, CFT	The new regulation should be adopted and implemented.

Authorities’ response to the assessment

45. We would like to express our most sincere thanks for your efforts as the entire CMISD staff has found the FSAP process highly beneficial. Consequently, we expect the review to expedite ongoing development efforts and to be useful in designing future regulation and supervision processes. We have found the IMF staff’s comments comprehensive and knowledgeable, and would like to thank them for their intensive efforts and for the detailed and thoughtful report.

46. In general the CMISD agrees with the assessment. We would like, however, to clarify or to add comments on some specific points in the report:

- ICP 5 – Supervisory collaboration and information sharing: The CMISD works to improve supervisory cooperation and information sharing with counterparties. In particular the CMISD is already in the process of signing MOU's and joining the MMOU with foreign counterparties, and this year's work plan calls for the completion of the process within 2012.
- ICP 6 – Licensing: The CMISD is examining ring-fencing existing life insurance assets to enhance their protection according to the IMF-FSAP recommendations. Additionally, the CMISD is considering necessary changes to the law to allow full separation of life and non-life business in new insurance companies.
- ICP 12 - Reporting to the supervisor and off-site monitoring: The CMISD will release later this year outsourcing guidelines that, *inter alia*, will reflect the IMF-FSAP recommendations.
- ICP 17 - Group-Wide Supervision: The CMISD is aware of the necessity to improve its group supervision regulation. This issue will be dealt with as part of the adoption of Solvency II regulatory paradigm as the CMISD is waiting for a publication of global supervisory standards in this matter.
- ICP 23 - Capital adequacy and solvency: The CMISD is finalizing its regulatory procedures based on international standard and principles of Solvency II.
- ICP 24 – Intermediaries: The CMISD intends to improve transparency in pension and insurance distribution through strengthening the Advice Law and improving the information provided to pension savers.

II. DETAILED PRINCIPLE-BY-PRINCIPLE ASSESSMENT OF OBSERVANCE OF THE INSURANCE CORE PRINCIPLES

Conditions for Effective Insurance Supervision	
Principle 1.	Conditions for effective insurance supervision Insurance supervision relies upon: -a policy, institutional and legal framework for financial sector supervision. -a well developed and effective financial market infrastructure. -efficient financial markets.
Description	Israel has well developed financial markets and a highly developed legal and institutional framework. There are approximately 150 listings on the Tel Aviv Stock Exchange, although a significant proportion of the listed companies are not actively traded. Equity and

	<p>convertible trading volume per day amounts to around USD 600 million, and around USD 1,350 million in bonds. In addition a number of corporate bond issues are also traded on the over-the-counter market. This market is computerized and able to provide detailed trading statistics. Government bonds are available having maturities of up to 30 years and this is advantageous to life insurers and pension funds for purposes of asset/liability matching.</p> <p>The rule of law is well developed, followed closely and strictly enforced. For property damage cases involving motor insurance, all claims are first directed by the court to a mediation system, which can be followed by binding arbitration. Only if the claimants choose will the case come back before the court. This process considerably reduces the number of claims that actually have to be considered by the court.</p> <p>The CMISD also offers a complaint investigation system. If after investigation the agency concludes that a declined claim should have been paid, then the supervisor can actually require the insurer to make payment. Insurers have the option to object those decisions in court.</p>
Assessment	Observed
Comments	The supervisory system and the legal system are very well integrated, to the benefit of insurance consumers. While improvements can always be made, conditions for effective supervision seem to be very well established.
The Supervisory System	
Principle 2.	<p>Supervisory objectives</p> <p>The principal objectives of insurance supervision are clearly defined.</p>
Description	<p>The objectives of supervision are set out in the insurance law, albeit a bit indirectly, by describing the key supervisory responsibilities of the Commissioner with regard to insurance companies: “to assure their orderly operation and the protection of the interests of insured persons or of clients”. In order to carry out these responsibilities, the Commissioner is empowered, after consultation with the Advisory Committee (a “wise persons” group of independent, respected individuals, chaired by a retired judge), “to issue instructions about the way insurers and insurance agents, their officers and their employees shall operate and be managed.” This is a very broad mandate.</p> <p>Detailed objectives are communicated more directly to the public by way of the CMISD web site. Primary objectives consist of: (1) improving efficiency/effectiveness and (2) ensuring stability within a competitive market.</p> <p>These objectives are further broken down into a number of sub-goals, including transparency of products and fairness to the public, accountable institutions and distributors, stable institutions and markets, healthy competition and promoting financial awareness by consumers.</p> <p>The agency’s overall strategic plan is on the web site and is updated as required. During the recent financial crisis the web site also included information with regard to</p>

	<p>actions being taken by CMISD to enhance the position of policyholders during a turbulent period.</p> <p>On an annual basis, CMISD publicly reports on its activities over the course of the year, relating the key activities to the agency's overall objectives. This information is on the web site and also set out in the Commissioner's Annual Report. If changes have to be made, CMISD will explain why they are necessary.</p>
Assessment	Observed
Comments	<p>The timeliness of the Annual Report has not always been exemplary (the 2010 Report became available only in November of 2011) but the Division says that steps are being taken to improve this situation.</p> <p>Much amount of financial information is readily available to consumers via the CMISD website. (See ICP 26).</p>
Principle 3.	<p>Supervisory authority</p> <ul style="list-style-type: none"> - The supervisory authority: <ul style="list-style-type: none"> - has adequate powers, legal protection and financial resources to exercise its functions and powers; - is operationally independent and accountable in the exercise of its functions and powers; and - hires, trains and maintains sufficient staff with high professional standards; and treats confidential information appropriately
Description	<p>As mentioned in connection with ICP 2, CMISD has very broad legal powers. Although fundamental supervisory requirements are set out in the Control of Financial Services (Insurance) Law ("the law" or "the insurance law"), CMISD can issue circulars establishing requirements in virtually all areas. However, if a circular is such that its requirements may impinge on the occupation or other basic rights of individuals, it must be approved by Knesset before becoming law. Otherwise CMISD can proceed after consulting with the Advisory Committee. It was indicated to the assessors that because this committee can be relied upon as a source of sound advice, its recommendations are carefully considered by CMISD, sometimes resulting in the agency making changes to the proposals or going back for additional consultations with the industry. However, it is important to note that the law does not require CMISD to obtain the approval of the Advisory Committee.</p> <p>CMISD would normally seek the advice of the Ministry of Justice before deciding whether a proposed law would have to go to the Parliament or whether it could be proceeded with directly as a simple circular. For major policy changes, the Minister would approve the change although his signature is not formally required. Once the topic for a circular has been approved, the Minister is not able to intervene in the process.</p>

The insurance law was recently amended to further expand CMISD's supervisory powers. Whereas the law previously empowered the agency to obtain information from any regulated entity, the agency can now require information from any entity, provided that the requested information pertains to the regulated market. As well, the agency previously did not have the power to confiscate material that it might come across in a search or otherwise, but now it may do so. Powers are even more significant if there are reasons to believe that a contravention of the law has occurred. In that case the CMISD officers can enter any premises other than a dwelling to obtain information. The persons at CMISD who can exercise these powers have completed a comprehensive training program delivered by the police force. Persons can also be required to report to the CMISD premises to be interviewed under oath.

The new amendments also permit very stiff penalties for non-compliance, but with flexibility according to established criteria, including a proportionality feature which permits the size of a fine to take account of both the seriousness of the offence and the size of the institution involved. An interesting feature of these enforcement provisions is that fines can also be imposed personally on company officers, including the CEO, and individuals cannot be indemnified with respect to any such penalties.

With regard to budgeting, plans are set within the agency and then advised to others. The budget is derived from the plans and is presented to the person at Treasury who is responsible for budgets of government Divisions. Because CMISD collects significantly more than is required to fund CMISD activities and any excess collected goes to the Treasury budget, Treasury is not inclined to impose restraints. There is no requirement for the agency to meet with industry representatives to explain the budget.

It should be noted that the agency frequently makes use of the power given by section 97 of the law, enabling it to hire outside specialists as required and to charge insurers directly for these costs. This means that the CMISD budget is smaller than would otherwise be required.

The industry levy on premiums is linked to the consumer price index, so specific inflationary increases are not needed. However, the supervisor is empowered to change the rate of the levy if required. In doing so the supervisor is accountable to the courts.

A recent decree by the government required ministries to reduce their staffing complements by 2 percent as an austerity measure. However, CMISD was exempted from this provision on account of the self-funding nature of the agency. Enforcement used to be carried out by the individual CMISD divisions who might be involved with a particular situation. However, to better coordinate these activities a new division, Enforcement, has been established. It was estimated that approximately 30 persons would be required for this division. The request was approved and most of the required personnel have now been hired.

With regard to internal audit, the agency is audited by Treasury on an annual basis. As well there is a state auditor who is authorized to audit any government agency. The state auditor also carries out an annual audit. The Office of the Prime Minister also has the authority to audit any government Division. The results of audits are published and available to the public. Headcount information is also part of the public record.

<p>In that it is a division of the MOF, there is no audited financial statement for CMISD.</p> <p>Executive overrides of decisions by the Commissioner have not been an issue. This is partly because the Commissioner is clearly authorized by the law to take significant actions without Ministerial involvement. For example, CMISD can appoint a person to go in to a company and approve all significant actions before they can be executed. In a recent case a person was on the company premises for three years, approving or disapproving of all key actions. Alternatively the agency can actually take over the management of a company. (Again this would normally be done by appointing an outside professional who would act for CMISD at the expense of the insurer.) In this case the company must be given the opportunity to present its case to the Advisory Committee, which could counsel the agency to take some other action. However, once CMISD makes its decision, it can only be challenged in the courts. So the agency acts and only the court can override its decision.</p> <p>In an emergency situation the supervisor has the power to take any action required to protect policyholders, with hearings by the Advisory Committee to be held as soon as possible after the fact. The action of the supervisor is not stayed, either while waiting for an Advisory Committee hearing or for a court hearing. In 2003 there were 8 pension funds in default. CMISD appointed 8 managers on an emergency basis. Those managers were given the authority to decide whether to liquidate, sell parts of the businesses, etc. They could also decide to remove some or all of the office holders, appoint new board members or take any other actions they might deem to be necessary in the public interest.</p> <p>The agency can revoke the licence of an insurer after consulting with the Advisory Committee but as with other cases mentioned above, even if the Committee were to disagree, CMISD would not be precluded from acting.</p> <p>Being a part of the MOF, CMISD does not have a board.</p> <p>Also, it is not clear how the Commissioner would be removed because this is not specifically addressed in the law. The Commissioner is appointed by the government, so, according to legal advice, the government would decide upon removal. Because every government decision needs to be made public, it appears that any removal decision, along with the reasons therefore, would be made public, subject to national security considerations, but "good cause" does not have to be published. Appointment is for a five year period and the contract of an incumbent cannot be renewed for an additional term.</p> <p>Given the fact that the agency is within the MOF, one cannot avoid the situation of having insurers and other interested parties lobbying the Minister. The assessors were advised by the Commissioner that the Minister's office notifies him if someone wants to meet with the Minister on an insurance matter and he will be invited if he wishes to attend. Companies also lobby individual members of the Knesset and the Commissioner said that he is usually invited to attend these meetings as well.</p> <p>Government employees cannot be sued, even if they have acted beyond their powers. However, such an employee could be penalized by the government.</p> <p>A company would be entitled to go to court to prevent the agency from taking a</p>

	<p>particular action but that has never happened. CMISD action is not blocked by legal action against it; only upon the action actually being overturned by a court.</p> <p>There is a written code of conduct for the government employees, including employees of CMISD. Conflicts of interest are controlled and no employee can own shares of a regulated institution. The Commissioner advised that he had to put all his personal investments into a blind trust upon his appointment. The law requires strict confidentiality of information provided and any breach by an employee is grounds for dismissal.</p> <p>As mentioned, the agency frequently appoints outside experts to carry out particular activities on its behalf. These relationships are established by contract and confidentiality is a basic requirement. The assessors were advised that a breach of contract would be viewed as being contrary to law and as such subject to significant penalty.</p> <p>CMISD is bound by a general law applicable to all government agencies making them fully accountable to the public, except when there are security considerations.</p> <p>The agency does not report any difficulty in hiring appropriately qualified personnel. The current headcount of 140 is considered by the agency to be sufficient to oversee the 25 insurers for which it is responsible.</p> <p>Other criteria for ICP 3 are complied with.</p> <p>CMISD regularly confers with industry participants and has transparent processes and procedures for making supervisory decisions in a consistent manner. Material changes to the legislation or regulations are subject to prior consultation with market participants.</p>
Assessment	Largely Observed
Comments	<p>Although CMISD has significant powers, many of which can be exercised in a relatively unfettered manner, the Division is not fully independent in the sense envisioned by the Standards. CMISD is a Division of the MOF and it does not have an independent budget or audited financial statements which could enhance the transparency of its operations.</p> <p>Both the law and the market have some specific characteristics which significantly impact the supervisory resources that will be required by CMISD. First, banking and insurance are not permitted to be transacted within a single ownership group and the two types of institutions are completely segregated for both business and supervisory purposes. Thus there are no financial groups which include both an insurer and a bank. Perhaps because of this, bancassurance is not a feature of the Israeli market. Second, holding companies cannot have a market share of more than 15 percent in the areas in which they are active. So for example, if a group happened to have two insurance companies, among other types of companies, then in total the insurance companies could not control more than 15 percent of the market. Third, the actual number of insurance companies is relatively small. Fourth, there are no foreign branches active in Israel (other than Lloyds, which does not have a significant market share). And finally, CMISD much more than most supervisory agencies, relies heavily on the appointment of outside specialists to assist with particular supervisory activities (the cost being borne by</p>

	<p>the insurance companies affected).</p> <p>These factors, taken together, mean that the resources required for insurance supervision are significantly less than would typically be the case in a market with premiums of US\$11.2 billion.</p> <p>The question of independence is a complex one. It appears to the assessors that CMISD is about as independent as could be envisaged, while still being part of a government ministry. Nevertheless, it is believed that complete autonomy, with overall accountability to the government, would represent a more desirable state of affairs in terms of both real and perceived ability to act wholly in the interests of insurance consumers and the public generally.</p> <p>Clarification of the legal conditions with respect to removal of the Commissioner and an explicit requirement for publication of the grounds for his or her removal, would add to independence.</p>
Principle 4.	<p>Supervisory process</p> <ul style="list-style-type: none"> – The supervisory authority conducts its functions in a transparent and accountable manner.
Description	<p>CMISD has a well developed web site, although many of the features are available only in Hebrew so these could not be assessed first hand. However, the web site includes a comprehensive data base with regard to the legal foundations for the supervisory system, including not only existing laws, regulations and circulars, but also proposed regulations and other amendments to the law. All insurer annual reports are also posted on the site along with comparative financial data for the insurers. There are also a number of inter-active features. For example, individual pension savings can be monitored by plan members, upon entering of the proper confidential codes etc. In the compulsory motor insurance market, individuals can enter their personal risk parameters such as age, driving experience, annual mileage and so on, and the rates offered by individual insurers, ranked from lowest to highest, are presented. (This may be a factor contributing to the extremely competitive motor insurance sector, as commented on in the industry overview, above.) The web site also has extensive consumer information in the form of consumer buying guides and copies of all the standard policy forms (which are specified by law). The Commissioner's Annual Report, also available on-line, enables any person to register on the site and receive electronic notification whenever the site is updated.</p> <p>It was indicated that the agency is taking steps to ensure that the Commissioner's Annual Report be made public on a more timely basis than is currently the case. The 2010 Report has apparently just been completed and made public.</p> <p>The law requires insurers to provide significant amounts of information directly to policyholders. For example, certain information about savings and investment accounts must be mailed on a periodic basis directly to policyholders. Insurers must also provide on their company web sites personal information that can be accessed and updated by consumers as well as periodical updates on other specific matters. The web sites are</p>

	<p>actually monitored for compliance and insurers have been fined for contraventions.</p> <p>Laws and regulations apply to every insurer equally, but that the monitoring process is risk based, i.e., more supervisory resources will be allocated to insurers that are judged to be higher risk as opposed to lower risk. CMISD can take virtually any supervisory action in an emergency situation, including taking control of an insurer, but the situation has to be regularized later on by going through the formal processes of allowing for appeal and so on, all as specified in the law. These types of interventions have happened in practice. It was mentioned that when extreme measures are called for, CMISD would frequently nominate an outside advisor or specialist pursuant to the power of Section 97 referred to above.</p> <p>Although the Commissioner reports to the Minister of Finance, CMISD also has access to an Advisory Committee, which is required by law. The Committee has four independent members, appointed by the minister. These are highly respected members of the community, knowledgeable about the industry but having no conflicts of interest. For example, the chair of the Committee is a retired judge who formerly presided in a court that dealt significantly with insurance related issues. Another member is a respected Israeli professor of finance. In some cases, for example, when formulating new laws by circular (the equivalent of rule-making), CMISD is required to consult with the Advisory Committee and consider its views. The views of the Committee are not binding on the supervisor but its recommendations are taken seriously. For example in a recent case the Committee suggested some changes in a proposed circular. The supervisor went back to the industry and after further negotiation a compromise was reached that took account of the views of the Committee but still accomplished the objectives of CMISD. CMISD can consult with the Committee on any issue, not just matters prescribed by law, and the Commissioner said that this is frequently done.</p> <p>Fines are often imposed for contraventions and the assessors were given recent examples where very significant fines, in the order of millions of shekels, were levied. In addition, individual officers of insurance companies can be made personally liable for substantial fines and they cannot be indemnified against such penalties. A recent example was given where the CEO of an insurer had to pay a substantial fine in his own right. Significant penalties must be published by the insurers and CMISD also publishes information in this regard.</p> <p>As an additional aspect of transparency, insurers are treated as public companies in terms of their required filings, public notices and many other requirements, even though not all of them are actually listed on the stock exchange. The capital adequacy result for each company is also public information. The figures are often picked up by the media where comparisons are made of the capital positions of different insurers.</p>
Assessment	Observed
Comments	The CMISD has put in place clear and transparent processes with regard to its regulatory framework. The extent to which it makes information available to the insuring public is exemplary, both through its own web site and by its requirement for insurers to present key information to their clients.

	<p>In the course of discussion it was evident that, for most insurers in Israel, moral suasion is still an effective supervisory tool. Although the framework seems very comprehensive, the CMISD often finds that it does not have to resort to formal powers: if the supervisor makes it known to the managers or board of an insurer that it thinks changes are required, then that advice will be taken very seriously by the entity concerned.</p> <p>CMISD may want to consider the establishment of working groups with the professional associations of auditors and actuaries. The objective would be to ensure these groups are kept apprised of CMISD interests and concerns with regard to the professions and to encourage mutual solutions to important issues, including the development of professional standards which will enable CMISD to put greater reliance on the input from auditors and actuaries as part of the supervisory framework. From the other side, CMISD would benefit by being better informed of emerging issues for auditors and actuaries and being able to ensure that the professional organizations are taking account of the supervisory perspective.</p> <p>CMISD could also work to place greater reliance for research and other input on the insurance industry itself. Many jurisdictions have found that the establishment of industry/supervisor working groups, coordinated through the industry association, can have powerful benefits by vastly increasing the knowledge base of the supervisor when addressing important industry issues.</p> <p>CMISD should, as part of its established internal processes and insofar as possible, conduct a cost/benefit analysis prior to recommending the adoption of new regulations and in judging how rapidly to phase them in.</p>
Principle 5.	<p>Supervisory cooperation and information sharing</p> <p>The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements.</p>
Description	<p>The agency is authorized by Section 50(b) and 50(c) of the law to exchange information with other supervisory agencies in Israel without the need for a formal agreement, subject to being satisfied with regard to confidentiality considerations. Similar arrangements can be made with other jurisdictions by means of MOU. The Commissioner may provide information or documents to other supervisors if he is satisfied as to the validity of the request and as to the continuing confidentiality of the information.</p> <p>The CMISD work plan calls for the signing of the MMOU of the IAIS within 2012, making it one of only 20 or so jurisdictions to have signed the document.</p> <p>There is a formal committee of the three main financial supervisory agencies for Israel plus some other interested ministries of the government. This committee meets monthly and rotates from one agency to the other. The host agency will select a specific topic to discuss but at each meeting key developments within the supervised industries are also considered. Minutes of the meetings are kept, although for very confidential discussions they will sometimes agree that comments will not be included in the minutes. As well there are regular telephone discussions with regard to emerging issues and these are</p>

	<p>often purposely kept on a verbal basis to help ensure confidentiality.</p> <p>There is a joint committee between the bank supervisor and the Ministry of Justice on special matters having to do with wind-ups.</p> <p>One of the largest Israeli insurers is owned by a foreign insurer but CMISD does not have an established relationship or regular interaction with the home supervisor. There are a few small operations abroad of Israeli insurers, but again there are no established relationships or regular interactions with the host supervisors.</p> <p>As such there is no process in place by which CMISD would notify a home supervisor in the event that it was taking action against an Israeli subsidiary of a foreign insurer.</p>
Assessment	Partly Observed
Comments	<p>There are established protocols for inter-agency information sharing amongst the three main financial supervisory agencies, and the heads of those agencies meet on a regular basis. However, there are no established working relations with relevant international supervisors. This is deemed to be a limitation in the supervision.</p> <p>To ensure that this type of collaboration with foreign supervisors is not overlooked, it is recommended that CMISD include in its various early warning procedures, an internal requirement that when an insurer that is a subsidiary of a foreign insurer reaches a certain level of risk (commonly measured by the company's position with regard to the capital adequacy requirement), the home supervisor will be contacted (1) to advise the home supervisor of the situation and (2) to ascertain the financial condition and soundness of the parent insurer. This should not be a substitute for regular communications that might be established with relevant foreign jurisdictions.</p> <p>It is also recommended that CMISD require foreign owned insurers to submit on an annual basis a copy of the supervisory filing that is submitted to the home supervisor. (Translation will probably be required, at least of the key informational areas, but that could either be made a responsibility of the Israeli subsidiary or arranged by CMISD.)</p>
The Supervised Entity	
Principle 6.	<p>Licensing</p> <ul style="list-style-type: none"> – An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective and public.
Description	<p>The licensing decision rests with the Commissioner. An application is reviewed from the perspective of fitness and propriety of the sponsors and key functionaries (see review for ICP 7, Suitability of Persons). A business plan for the first three years of the proposed venture is also required. This is reviewed in detail by CMISD staff to ensure that it appears to be a realistic projection of what may be achieved. Forecast capital adequacy requirements are part of the business plan. Financial resources of the sponsors are closely reviewed to ensure that there will also be the potential for additional capital if required.</p>

	<p>All other key aspects of the proposed operation, including reinsurance, internal controls, IT systems and plans with regard to corporate governance are also reviewed carefully to ensure that they meet the standards specified by the supervisor. Products are reviewed and subjected to CMISD actuarial assessment.</p> <p>An interesting aspect of the Israeli rules for new insurers is that during the first three years of operation, all accumulated profits are retained as reserves (but they are “above the line” in the liability section of the balance sheet). This will preclude the payment of early dividends and thus help to ensure capital adequacy during the initial years. As well, the law specifically empowers the supervisor to require additional capital injections during the first five years of operation, in an amount of up to 50 percent of the initial requirement. It was mentioned that this provision has been used in the past.</p> <p>A licence will not be granted if the organizational structure of the group to which an insurer will belong is such as to, in the opinion of the Commissioner, hinder CMISD’s ability to effectively supervise the insurer.</p> <p>At the present time foreign branches are not active in Israel but in the case of a foreign branch or a request for the incorporation of an Israeli subsidiary of a foreign insurer, contact is made with the home supervisor to ascertain the status of the applicant in the home jurisdiction. (Subject to acceptable confidentiality provisions, CMISD is also prepared to provide information to host jurisdictions about any Israeli insurer that may apply for a licence outside of Israel. At present though, no Israeli insurers are licensed in other jurisdictions.)</p> <p>As part of the licensing process, the licensing officer involved will circulate the proposal to all Divisions of CMISD so that each has an opportunity to raise any questions that it might have. In addition, all products are reviewed for appropriateness of coverage and pricing.</p> <p>At present the agency has no established norms in terms of processing time for applications, saying that each is dealt with “as quickly as possible” but that circumstances can be quite different.</p> <p>An insurer cannot undertake business in another jurisdiction without the prior approval of CMISD.</p> <p>Licenses are granted only to limited liability insurance companies, i.e., no mutual or other structures are allowed.</p> <p>Most licensed insurers are presently composite companies. For a number of reasons having to do with difficulties in ring-fencing policyholders in the event of losses in one branch, and with potential legal difficulties for policyholders if one branch of an insurer has to be liquidated, it is considered best practice to require separate legal entities for life and non-life business.</p>
Assessment	Largely Observed
Comments	The law should be changed so that at least for the future, composite insurers will not be licensed. Other jurisdictions, faced with a similar situation of having a considerable

	<p>number of composite insurers, have provided lengthy transition periods for industry action, sometimes extending ten years or more. An alternative would be to prohibit new composites and to strengthen the law so as to provide greater certainty about separation in the case of liquidation. It appears that these changes are under consideration by CMISD.</p> <p>Additional protection would be afforded investors in unit linked funds by requiring as a condition of licensing, formal segregation of assets by having them held by the insurer “in trust” for the investors.</p> <p>The law should be amended so that additional capital can be required at any time the supervisor deems it necessary, rather than only during the initial five years of operation.</p> <p>In the future, CMISD may want to have the power to require, when considered appropriate, that business plans be reviewed by an experienced professional such as an actuary or independent auditor, who could attest to the reasonableness of the underlying assumptions and to the fact that in his or her opinion the business plan could reasonably be attained. The intention here is to ensure that someone has not just generated unfounded optimistic projections. In addition, it brings another set of eyes to the review process in support of the review to be carried out by CMISD.</p>
Principle 7.	<p>Suitability of persons</p> <ul style="list-style-type: none"> – The significant owners, board members, senior management, auditors and actuaries of an insurer are fit and proper to fulfil their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications
Description	<p>The fit and proper requirements apply to all board members and senior officers, the internal auditor, the chief actuary, the investment manager and the legal counsel. They also apply to owners who directly or indirectly, hold more than 5 percent of the “means of control”. The latter phrase includes shareholdings but if necessary can also be applied to more general situations such as the power to appoint a controlling number of the members of the board. Notice of intention to make a new appointment to one of these positions is required to be filed with the Commissioner at least 60 days prior to the proposed appointment. It was mentioned that in practice it is often the case that a proposal is floated informally with the Commissioner and if his reaction is not favorable, then another individual would be put forward. The law does not empower CMISD to review the fitness and propriety of the independent auditor. However, in practice the agency can appoint another auditor under Section 97 and request that a new audit be carried out. (But the auditor appointed by the company would continue to be the official auditor of the insurer.)</p> <p>On an annual basis companies have to make a filing to indicate that there has been no change in the fit and proper status of the relevant individuals, although immediate notification must also be given by the insurer if it believes there has been a change in status. Also, if CMISD becomes aware at any time that there may have been a change in status it can investigate and require a review for the individual concerned, after which action could be taken to remove the individual, if that appeared to the Commissioner to be necessary.</p>

	<p>It was indicated that in this area the rules for insurers are the same as those that apply to banks and securities firms.</p> <p>In terms specifically of fitness (i.e., competency), the agency has guidelines for internal use, to be interpreted on a common sense basis in the context of actual situations. Both education and prior experience are evaluated when considering the fitness of particular individuals. However for board members there is also a formal requirement with regard to the holding of a university degree. It is also required that individuals have no other appointments or positions that would interfere with their ability to perform. This is in addition to specific prohibitions against conflicts of interest. The latter is defined to include being a director of both a bank and an insurance company or being a director of more than one insurance company (unless it is part of the same group).</p> <p>Insurers are required to provide relevant training for every board member. The training regime is reviewed by CMISD as part of the on-site inspection program and the company may be required to make improvements if the Commissioner requires. As a minimum the training program must include the key legal requirements.</p> <p>The review for integrity applies to the same group of functionaries mentioned above with regard to fitness. In this case CMISD requires a criminal record check and a declaration from the individual as to the absence of any criminal record. When international entities are involved, similar information would be requested from international authorities as well. In addition to criminal record checks, references are also required. The information is assessed and if anything of a questionable nature is found, a decision would be made based on all the circumstances.</p>
Assessment	Observed
Comments	For the future, CMISD should seek an amendment of the law to include the independent auditor in the list of entities to which the fit and proper provisions apply.
Principle 8.	<p>Changes in control and portfolio transfers</p> <p>The supervisory authority approves or rejects proposals to acquire significant ownership or any other interest in an insurer that results in that person, directly or indirectly, alone or with an associate, exercising control over the insurer.</p> <p>The supervisory authority approves the portfolio transfer or merger of insurance business.</p>
Description	<p>All transactions that would result in a change of control including an increase in shareholding must be pre-approved by the Commissioner. Applications are reviewed in a manner similar to licence applications, described under ICP 6. Prior approval of the key functionaries is required in accordance with the fit and proper provisions discussed in connection with ICP 7.</p> <p>At present, control means at least 50 percent voting control, directly or indirectly. However consideration is being given to changing this requirement to be control in fact. So for example, if a single shareholder has 30 percent of the shares of an otherwise widely held insurer, that shareholder would likely have de facto control of the insurer and so the change in control requirements would have to be complied with if its shares</p>

	<p>were to be acquired by another party. The identity of beneficial owners must be disclosed.</p> <p>Criteria for the approval of portfolio transfers are prescribed on a case-by-case basis by the Commissioner, with prior approval being required. It was mentioned that such transactions have been very rare in Israel. In considering any such requests a key factor will be a comparison of the capital adequacy of the company accepting the transfer of business. The Commissioner indicated that if the capital adequacy of the accepting company were to be significantly lower than that of the company from which the business is to be transferred, the transfer would likely not be approved, unless there were special circumstances sufficient to overcome the prejudice that might otherwise result to policyholders being moved to a less financially sound insurer.</p>
Assessment	Observed
Comments	In the limited number of situations with changes in control and transfers of business, the CMISD has appropriately applied the regulation to protect consumer interests effectively.
Principle 9.	<p>Corporate Governance</p> <p>The corporate governance framework recognises and protects rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards.</p>
Description	<p>A series of circulars have been issued over the past several years for the purpose of strengthening corporate governance requirements. At present the legal requirements for corporate governance are quite extensive.</p> <p>Boards must have from 7 to 15 members and include no employees other than the CEO. At least one third of the board members must be independent. At least one half of the external directors must have a background in insurance or accounting. Every director must possess a university degree in insurance, law, economics or a number of other specified areas, or have other significant qualifications such as having served as the CEO of a company registered under the Securities Law. In order to be appointed, a director must swear that other occupational requirements will not interfere with the fulfillment of his or her duties as an insurance company director. A director must attend at least one half of the meetings of the board and may not be absent from more than four consecutive meetings.</p> <p>All directors must be fit and proper and free of any conflicts of interest. The Chair and the CEO cannot be the same person.</p> <p>Boards must meet at least 12 times per year and the legally required audit committee must meet at least 6 times per year. Minutes must be kept for every meeting and distributed to directors within 20 days of the meeting.</p> <p>In addition to their general responsibilities under the Companies Act, directors of insurance companies have responsibility for a wide range of topics which are set out in the insurance law. These include determining the general strategy of the company, determining the exposure policy of the insurer for various risks, determining the insurer's</p>

	<p>policy on reinsurance, determining the overall investment policy for the company, examining the insurer's capital adequacy, approving entry into new areas of activity, determining binding rules and provisions for the activities of the insurer's officers and employees, determining the policy with regard to information security and for maintaining the insurer's information systems, monitoring complaints and reporting thereon to the Commissioner, determining a policy for settling disputes and the fair handling of policyholders, preventing conflicts of interest and "any other issue of substantive importance for the insurer's activities or the supervision and control thereof".</p> <p>Insurers must provide training for the outside board members and CMISD reviews the directors' training program when conducting on-site inspections. There have been occasions when they have required insurers to strengthen their directors' training programs.</p> <p>The board must receive a monthly report from management covering matters which, as described in the Insurance Law, "are in accordance with the scope of the institution's range of activity, and with the variety and complexity of the activities in which it is engaged, and which allows the board of directors to carry out its duties in an appropriate fashion." The report must be received by board members within 30 days of each month-end.</p> <p>There are a number of provisions within the law to ensure proportionality of application of corporate governance requirements.</p> <p>Adherence to the corporate governance requirements are verified by CMISD during the course of on-site inspections, including a review of board minutes.</p> <p>Regulations include requirements that each insurance company board of directors put in place a compensation plan for senior managers which does not induce excessive or inappropriate risk taking, is in line with the identified risk appetite and long term interests of the insurer, and has proper regard to the interests of its stakeholders.</p> <p>Other criteria for this ICP are met.</p>
Assessment	Observed
Comments	<p>The corporate governance requirements, covered by a series of circulars from the Commissioner, are very detailed, but this can sometimes be a disadvantage. With this approach it is difficult to come up with a list that is truly exhaustive. It is therefore suggested that the law should be amended to supplement the detailed listing of requirements with additional, more general principles for board compliance. An overarching provision that has been found to be beneficial is a general duty of skill and care, set out in wording that is typically along the following lines: (example based on the newly adopted IAIS Insurance Core Principles)</p> <p><i>Every member of the board must:</i></p> <ul style="list-style-type: none"> • <i>act in good faith, honestly and reasonably;</i> • <i>exercise the care, diligence and skill that a reasonably prudent person would</i>

	<p><i>exercise in comparable circumstances.</i></p> <ul style="list-style-type: none"> • <i>act in the best interests of the insurer and policyholders, putting those interests of the insurer and policyholders ahead of his/her own interests;</i> • <i>exercise independent judgment and objectivity in his/her decision making, taking due account of the interests of the insurer and policyholders; and</i> • <i>not use his/her position to gain undue personal advantage or cause any detriment to the insurer.</i>
Principle 10.	<p>Internal Control The supervisory authority requires insurers to have in place internal controls that are adequate for the nature and scale of the business. The oversight and reporting systems allow the board and management to monitor and control the operations.</p>
Description	<p>As with corporate governance, CMISD circulars over the last several years have significantly increased supervisory oversight in this area. Also as in the case of corporate governance, the requirements include provisions to take account of proportionality, i.e., institutions with a “low level of activity” as set out in the law, are subject to a less demanding level of compliance.</p> <p>The law requires the board to approve a written document that sets out the details of the internal audit and risk management system. This includes a definition of the functions, goals and responsibilities of the internal audit function as well as the powers of the internal auditor. The latter includes the power to demand and receive any document or information held by the institution and the power to enter any premise of the institution’s properties in order to access required information. The full responsibilities of the internal auditor must also be detailed in the board approved document. Thus the board of directors is responsible for providing suitable prudential oversight and establishing a risk management system that includes setting and monitoring policies so that all major risks are identified, measured, monitored and controlled on an on-going basis. The risk management systems, strategies and policies are approved and periodically reviewed by the board of directors.</p> <p>The law also makes the chairman of the board responsible for supervising the internal audit function. The internal auditor must have the rank of a senior officer of the company and must be regularly invited to participate in all management meetings. The internal auditor must not be involved in carrying out other activities within the institution or for implementing operational controls. The assessors were therefore satisfied that the requirements for internal controls within insurers include arrangements for delegating authority and responsibility, as well as the segregation of duties. The internal controls address checks and balances; e.g. cross-checking, dual control of assets and double signatures.</p> <p>Boards must, under the provisions of the law, address safeguarding the rights of policy holders and set policies for the resolution and fair treatment of disputes. As a general rule, the Commissioner’s instructions require a minimum standard in all matters pertaining to the management and conduct of relations between institutions and policy holders in handling and resolving claims and requests. Thus the board of directors provides suitable oversight of market conduct activities.</p>

No person may be employed as part of the internal audit system of an institution, without the consent of the internal auditor. Members of the internal audit staff can only be instructed by the internal auditor. Employees of the internal audit division may not be engaged in any other institutional activities, with the exception of acting as an ombudsman for complaints from employees. Internal audit staff must be rotated through different audit areas.

Provisions of the law make specific reference to internal audits and to the resources that must be allocated to this area, depending on its size and its method of operation. In addition, the provisions set standards for the conduct of the internal audit unit, the nature of its results, as well as its independence and freedom of action within the financial institution.

The internal auditor is responsible for ensuring compliance with the legal provisions and with the internal audit procedures established by the institution.

Key internal functions such as internal audit and risk management are not permitted to be outsourced; otherwise outsourced activities must comply with Commissioner's rules. Legislation is now being revised to provide the Commissioner with broader powers with regard to outsourced activities.

Both the board of directors and senior management are responsible for ensuring that the internal audit system has the knowledge, skills, staff, means and resources that are required to carry out the internal auditing functions of the institution. All key operational areas of an insurance company are mentioned in the law as being specifically required to have the full attention of the internal audit staff. The internal and external audit, actuarial and compliance functions are part of the framework for internal control, and must test adherence to the internal controls as well as to applicable laws and regulations. The board receives regular reporting on the effectiveness of the internal controls. Internal control deficiencies, either identified by management, staff, internal audit or other control personnel, are required to be reported in a timely manner and addressed promptly.

Internal audit must be carried out in accordance with the provisions of accepted professional standards and accepted international standards.

The internal auditor must develop a detailed risk matrix for the institution, covering all key activities and risk areas, as well as residual risks. The risk matrix must be updated on an on-going basis. A full risk survey must be carried out on a basis to be established by the audit committee, but in no case less than once in each four years.

The law includes considerable detail with respect to the actual work programs that must be covered off by the internal audit system.

The internal auditor must submit copies of his or her reports to the chair of the board of directors, the chair of the audit committee and to the CEO. Copies of internal audit reports must also go to the independent auditor.

If the internal auditor is not satisfied with the actions that have been taken with regard to a situation that has been reported to the board, he or she is responsible for reporting the situation to the Commissioner.

	<p>Insurance companies in Israel are quite advanced in the process of becoming “SOX (Sarbanes-Oxley) compliant” and this process is being monitored by CMISD. Full compliance is expected to be achieved within the next year or so.</p> <p>If the internal auditor is terminated, a report detailing the circumstances of the termination must be included in the minutes of the board and a notice, along with the minutes of the board meeting, must be delivered to the Commissioner.</p> <p>At least once in each five years an independent body, appointed by the audit committee, must examine the activities of the institution’s internal audit system.</p> <p>Management is required to discuss every report of the internal auditor and instruct the appropriate parties to correct the deficiencies and to implement the recommendations.</p> <p>The law actually includes a table which specifies on a formula basis, an annual minimum number of internal auditing hours, which will be dependent on the size of the institution.</p> <p>CMISD indicates that the internal audit division is an important area for the attention of the on-site inspection group. The group makes use of the internal reports and other detailed information to help meet the objectives of the on-site work.</p> <p>CMISD has had meetings with the association that governs the internal auditing profession in Israel and indicates that the association’s cooperation has been of considerable assistance with the drafting of legal provisions and establishing on-site work procedures.</p>
Assessment	Observed
Comments	<p>The implementation of a recent regulation strengthening internal controls and allocating accountability to the board is welcome. As the companies become more familiar with the new rules, a stronger focus on the supervision of the boards’ role in this area should be given. This will become even more relevant with the introduction of Solvency II, planned for 2013.</p> <p>CMISD indicated in discussions that it follows a principle of proportionality, i.e. that more complex companies are expected to have more sophisticated systems of controls and governance. With this in mind, CMISD should not expect insurers with limited activities to meet all of the SOX requirements.</p>
Ongoing Supervision	
Principle 11.	<p>Market analysis</p> <ul style="list-style-type: none"> – Making use of all available sources, the supervisory authority monitors and analyses all factors that may have an impact on insurers and insurance markets. It draws the conclusions and takes action as appropriate.
Description	The CMISD continuously monitors insurance companies, the products they offer and the marketers of various products. The purpose of such monitoring is to identify on a pro-

active basis, developments in the market and to ensure stability of insurance companies. Monitoring of insurance companies is carried out in a number of ways:

- By employees of the CMISD who continuously monitor insurance companies' activities and their solvency, and maintain continuous contact with those insurers. As part of this activity, they assess various parameters, such as capital adequacy, actuarial provisions, corporate governance, and so on. The assessment is based on inspections of all activities, using financial statements and other data that are forwarded on a regular basis or per specific requests of the Commissioner. Each employee prepares a detailed annual report on each company for which he or she is responsible. The reports reflect the risks to which companies are exposed, their investment policies, composition of asset portfolios, capital adequacy, exposure to reinsurers and other factors.
- Requirement for an explicit approval of certain insurance products by the regulator, to the effect that the CMISD can estimate the unique risks to which companies are exposed, as well as trends in the insurance product markets.
- Results of an early warning system ("Compass" System) that uses quarterly accounting data of insurance companies. The system calculates 22 financial ratios for each insurance company, awards a grade from 1 (worst) to 5 (best) to each ratio. The financial ratios provide 6 indicators for the stability of insurance companies: capital adequacy, quality of assets, actuarial and reinsurance, liquidity, profitability and management performance.
- Results of a second early warning system that makes use of market related data such as share prices, book value/market value Model, Merton Model, and yield margins of traded capital instruments issued by insurance companies.

These processes for monitoring and overseeing risk are integrated by means of a system of reporting that includes graphical and statistical data which is closely tracked for evidence of increasing risk.

In addition to routine analyses, the CMISD conducts research and reviews various aspects of the insurance market, such as its structure, competitiveness in various sectors, risks etc. CMISD also monitors developments in the global insurance markets with a view of identifying trends, becoming aware of new products, methods and supervisory structures, and learning from the experience of other countries in implementing policies.

As part of augmenting its procedures based on the lessons from the recent economic crisis, the CMISD is improving its supervisory methodology and measures to improve its ability to identify risks in the insurance market at an early date. Efforts to develop methods to monitor systemic risks are carried out in collaboration with the Bank of Israel, it being the body charged with assessing and managing systemic risks in the Israeli economy.

Assessment	Observed
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Comments	The standard of market analysis is high.
Principle 12.	<p>Reporting to supervisors and off-site monitoring</p> <ul style="list-style-type: none"> – The supervisory authority receives necessary information to conduct effective off-site monitoring and to evaluate the condition of each insurer as well as the insurance market.
Description	<p>The supervisory arrangement in this area is built on an organizational structure by which every financial institution is assigned at least one referent (i.e., an on-site/off-site officer who is specifically charged with responsibility for a particular institution or institutions).</p> <p>Overall the approach is to first consider various sources of information such as financial statements, other financial and performance based information received from the institutions and finally, informal information that has become available to the referent. Based on all the information so gathered, an evaluation is made of board and management performance, organizational structure with respect to the effectiveness of responsibilities and authorities, compliance and control procedures, risk exposures and business results. A risk rating process is carried out, taking account of both inherent business risk of insurers as well as the effectiveness of their risk mitigation procedures and current financial strength.</p> <p>A decision to take action is made following consultation with parties internally within the CMISD to ensure efficient conduct of the process. Every referent is required to have an in-depth familiarity with the sectors of activity of the supervised entity. Monitoring by and actions of referents ensure the quality of the control and supervision process. Depending on the results of referents' reviews, an ongoing professional dialogue is held with companies, as well as instructing and directing them, and decisions on additional in-depth inspections or actions are made based on these discussions.</p> <p>The daily work of referents includes preliminary preventive actions along with reviews and analyses. Among the preventive actions are approval of principal officeholders and functionaries, investment approvals, approval of dividend distribution and monitoring capital levels of companies.</p> <p>Referents also make regular visits to offices of entities concerned to meet with key personnel (e.g., CEO, directors, actuary, division managers, and employees) and to monitor the company through various means of communication. Additionally, every referent reviews the reports of the company's internal auditor and the minutes of the board of directors and its committees. If necessary, the referent carries out additional investigations following findings of reviews of financial statements and other quantitative data. These analyses are conducted using structured auditing specifications, which enable the referent to compare results of various companies, split by activity sectors, over several periods, and examine indices and selected financial parameters.</p> <p>The sources of information that assist the referent in his work include annual and quarterly financial statements, actuarial reports, affidavits of officeholders, reports detailing compliance with capital requirements, detailed reports on sectors over several periods, and monthly reports submitted only to the referent, such as asset composition, cash flows from assets, receipts and payments and daily returns. There are also</p>

	<p>instructions governing situations that require immediate reports to the referent, such as suspected embezzlement and fraud. In addition, external sources of information are also available, such as stock exchange and media reports.</p> <p>Supervision is risk based (RBS). Accordingly, supervised institutions that are classified as high risk or of systemic importance are accorded higher priority than institutions that are assessed to have a lower risk profile. This means that the operating framework and procedures of enforcement reflect the risks that financial institutions are likely to face. The enforcement approach is proactive and systemic and is designed to prevent future failures.</p> <p>An early warning system (EWS) is employed that enhances forecasting ability for anticipated risks by insurers. The system, known as "Compass", is based on a two-tiered model of financial ratios and an econometric model that infers the stability levels of insurance companies. The ratios examine various areas pertaining to activities of insurance companies, including capital adequacy, asset quality, reinsurance exposure, actuarial aspects, management performance, profits and liquidity. The system assists in focusing supervision on companies where the likelihood of them getting into financial difficulties is higher than for other institutions. There are additional systems used by the CMISD referents in their work, such as the "Insurance Supervision" system to investigate and analyze information received from the companies, and the "Predictor" system to examine the composition of unit-linked asset portfolios.</p> <p>CMISD establishes the reporting standards, which include an annual audit opinion, and can require that any incorrect or inaccurate information be corrected.</p>
Assessment	Observed
Comments	Outsourced activities are currently not subject to CMISD monitoring. It is suggested that specifically with regard to core activities of institutions, this area should be monitored more closely.
Principle 13.	<p>On-site inspection</p> <p>The supervisory authority carries out on-site inspections to examine the business of an insurer and its compliance with legislation and supervisory requirements.</p>
Description	<p>Off-site and on-site inspection work is completely coordinated in that it is the same CMISD officers who are responsible for each area. (See discussion of ICP 12, Off-site Inspection.)</p> <p>The program for on-site inspections is developed significantly from the findings of the off-site inspection process. There is an appreciation by staff members that they have to move on site in order to obtain a real understanding of the issues and possible risk areas within an insurer.</p> <p>Section 97 of the law authorizes the supervisor to appoint outside experts to assist with investigations, with the cost of such experts being billed to the companies involved. CMISD routinely makes use of these outside experts to assist with the on-site inspection work. This practice has been adopted mainly because the supervision/on-site inspection</p>

group was only established in 2008. Over time the group has been increasing its head count and gaining expertise, with the result that the use of outsourced experts is declining over time. For example, in 2009, 37 percent of the 95 on-site inspections involved the use of outside experts. However, during the first three quarters of 2011, only 32 percent of the 172 inspections included outside experts. CMISD personnel are part of every on-site team. The Commissioner indicated that as the division continues to build its expertise there will be less and less reliance on outside assistance.

The persons who provide the outside assistance are recruited through a bidding process, which requires full independence and no conflicts of interest, as well as a guarantee of confidentiality. Once selected, the individual will become part of a resource pool and may be drawn upon as required by CMISD. An individual remains in the pool for three years. Actuaries are a typical resource that is recruited in this way. (Although CMISD has one fully qualified actuary with three actuaries-in-training.) Another source of expertise is forensic accounting firms.

When assessing managerial functions, including corporate governance, only CMISD officers are involved.

The on-site staff members are all CPA's and a number of them hold additional degrees such as MBA. Many have previous experience in other government Divisions such as IRS. An on-site team would typically include one outside expert and two supervisors. The work might take place on an intermittent basis over two months with each team member spending one third to one half of his or her time on the inspection.

The planning stage for an on-site visit is normally longer than the actual time on the insurer's premises.

Most of the on-site work is of the "targeted" variety, i.e., looking at a particular aspect or area of an insurer's business. Decisions as to target areas usually stem from off-site inspection findings but they also frequently relate to "theme areas" that CMISD would select as part of its annual planning process. For example, a year or two ago the agency noted that health insurance was becoming increasingly important to the population and a more significant line of business for insurers. As a consequence CMISD decided to make health insurance one of its themes, placing greater emphasis on determining whether or not insurers were following all key requirements with regard to the health insurance line. The subsequent inspections disclosed that a number of insurers had in fact not been following all of the requirements, with the result that consumers had been overcharged for certain products. Companies were forced to refund NIS24.8 million to policyholders and the offending insurers were fined a total of NIS4.6million.

Inspections can be extended to any intermediaries that might be relevant to an insurer's operations. At present CMISD does not have authority to visit the premises of outsource providers but this is in the process of being addressed by new legislation.

To assist with the on-site work CMISD makes use of sophisticated software of a type that is used by major auditing firms, but extensively customized for use by the agency. The software provides an overview of all work in process, details of work completed, automatic prompts for follow-ups and other information of a type that is helpful in managing and monitoring progress of the relatively large number of inspections that may be in progress. (For example, during the first three quarters of 2011, 172 on-site

	<p>inspections had been completed or were in progress.)</p> <p>A draft report is prepared to summarize findings and make recommendations. Most reports are completed within a month of the final visit to the company although sometimes a longer period may be required if there are complex issues to be considered. The draft report is provided to the insurer and then a meeting is held to discuss the report. Findings and recommendations are finalized after that. Follow up visits are scheduled if changes are required to the company's operations. CMISD's policy with enforcement is to give an insurer a reasonable chance to make improvements but if promised actions are not carried out, the policy is to be tough with sanctions.</p> <p>There is careful follow-up on all recommended actions.</p>
Assessment	Observed
Comments	<p>While the "targeted inspection" approach is valuable, and particularly during a start up period when staff members are learning new skills, it will be important over time to increase the frequency of company-wide inspections. It is important for the supervisor to gain an appreciation of how all divisions of an insurer are functioning together as a cohesive whole. (Insurers could still be selected for such reviews on the basis of the overall risk assessment carried out by CMISD officers.)</p> <p>It is recommended that prior to commencing an on-site inspection, particularly if it is to be a comprehensive, company-wide review, there should be a meeting between the inspectors and the independent auditor of the insurer. The inspectors should review the auditor's working papers and the management letter in which the auditor will have notified company management of any important findings or concerns. This pre-inspection work with the independent auditor would help the supervisor (1) to obtain an impression as to the quality of the audit work and its comprehensiveness, (2) to be aware of important audit findings, (3) to be able to assess the responsiveness of the insurer's management to any recommendations that have been made by the auditor, and (4) to be aware of the specific work that has been carried out by the auditor so that valuable supervisory resources are not wasted by duplicating work that has been satisfactorily performed by the auditor.</p> <p>At the present time it is not the established practice of CMISD to hold an exit meeting with senior management when the work at the insurer's offices has been completed. Such an approach is considered best practice. An exit meeting helps to ensure that prior to supervisory staff expending resources on the preparation of a report; there is agreement and a clear understanding as to the most significant supporting facts.</p> <p>Rather than sending a copy of the inspection report to the insurer, many jurisdictions prepare their on-site report but then use that report as the basis for a letter that is sent to the company, summarizing the findings of the on-site inspection and setting out recommendations for implementation by the company. The advantage of this approach, as opposed to sending a copy of the internal report, is that the agency can include more detailed information in the report without having to worry about how it might be interpreted by the insurer. As well, less time needs to be spent on "polishing" the report because it is purely an internal document. This procedure might also assist CMISD to</p>

	<p>reduce its time to completion for on-site inspections.</p> <p>It was mentioned that on-site inspections are typically carried out on an intermittent basis over several months. It is suggested that as an objective, a reasonable percentage of the inspections be carried out on an uninterrupted basis, perhaps with a larger team. For example, rather than having three persons expend 20 person days each spread over a two month period, have five persons spend 12 consecutive days, with perhaps 5 or 6 of those days spent consecutively in the company carrying out the review. We think that this more concentrated approach could help to provide better insights as to how the company is operating from a general risk perspective. Taken together, we think these changes would also help to reduce regulatory burden for industry members.</p>
Principle 14.	<p>Preventive and Corrective Measures</p> <p>The supervisory authority takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.</p>
Description	<p>Rather than identifying a range of specific supervisory powers, Israeli law provides the Commissioner with very broad general power to require compliance. Section 2 of the law stipulates that the Commissioner “may – for the exercise of his responsibility and after consultation with the Committee – issue instructions about the way insurers and insurance agents, their officers and their employees shall operate and be managed, all in order to assure their orderly operation and the protection of the interests of insured persons or of clients, and in order to prevent any detraction from an insurer’s ability to meet his obligations.” (The Committee referred to in Section 2 of the law is the Advisory Committee described in ICP 2. Note that the Commissioner is not required to seek the permission of the Committee but rather to consult with the Committee.)</p> <p>Thus the Commissioner is essentially unconstrained in terms of the specific instructions that might be issued and they could therefore be crafted to deal with almost any particular situation that might arise. For example, the Commissioner could require an insurer to modify the terms of a policy, or to stop writing a particular line of business, or to modify internal control processes, etc. The law contains additional provisions that make it clear that the Commissioner may also prohibit various actions such as payment of dividends and even payment of bonuses to executives.</p> <p>The power of the Commissioner to appoint a manager of an insurer provides further extension to the range of possible preventive and corrective measures which can ultimately be exercised. This is because once the Commissioner’s appointee pursuant to the law is in place, he or she will have full control of the insurer and will be able to implement any possible preventive or corrective measure.</p> <p>One power that is not currently available to the Commissioner is a requirement for an established insurer to increase its capital base. At present a request for additional capital can only be enforced during the first five years of an insurer’s history, and then only up to 50 percent of the amount of its original equity base. This will be remedied with a planned amendment to the regulations.</p> <p>Although appeal processes are always available, the Commissioner can always act immediately if that is necessary to protect the public interest. In such cases the appeal process is available after the fact. An action by the Commissioner could only be</p>

	<p>overturned later, in the event of a successful appeal.</p> <p>Section 50 of the law requires insurers and intermediaries to provide all information that is requested by the Commissioner. The law is about to be strengthened by extending the requirement to apply not only to licensed entities but also to all those who are significantly involved with the insurance market.</p>
Assessment	Observed
Comments	<p>The law's general empowerment of the Commissioner to issue any instructions that may be required to safeguard the position of policyholders provides a complete range of possible preventive and corrective measures. In the few cases where it can be argued that more specific powers are required, there are plans to modify the law to include the desirable power. In addition, the assessors were provided with a number of recent examples to demonstrate that the preventive and corrective powers are actually being utilized to protect policyholders and members of the public.</p> <p>CMISD is working to develop a formal ladder of intervention which will include control levels that can trigger various types of intervention (i.e., preventive and corrective measures), escalating as an insurer's position becomes more serious. At present, with no general ability to require capital increases, and a lack of formally stipulated intervention measures related to overall financial viability, the agency is not able to exercise defined strategies that can be applied on a market-wide basis. The introduction of a ladder of intervention will also ensure greater consistency in the supervisory process and make the process much more transparent to market participants.</p>
Principle 15.	<p>Enforcement or sanctions</p> <ul style="list-style-type: none"> – The supervisory authority enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.
Description	<p>The law was recently updated to substantially increase the potential size of monetary penalties that can be assessed by the Commissioner. CMISD has put in place various procedures to ensure that penalties will be consistently applied.</p> <p>When contraventions are noted, CMISD's general policy is that for relatively minor offences and on first occurrence, companies are required to immediately remedy the contravention and to put procedures in place to ensure that there is no repeat. However, when warnings have been given and not heeded, or when the contravention is of a serious nature, substantial penalties can be, and have been, levied.</p> <p>Notice of the results of enforcement actions are published by CMISD and are also required to be published by the insurance company involved.</p> <p>CMISD may also assess personal penalties – which are not subject to indemnification by D&O insurance or other means. This is a relatively unusual power but one which should have considerable power as a deterrent.</p> <p>It is also possible to deem any officer or director to be not fit and proper on the basis of an investigation of wrong-doing, with all of the implications that may have for the</p>

individual involved.

As an example of a recent case in which CMISD extensively utilized its powers of enforcement, one of the larger life insurers was fined NIS 12 million for improperly granting uncollateralized loans as a means of attracting new life insurance policyholders, with the funds coming from the existing pool of unit linked funds (which are essentially trust funds and not the property of the insurer). In that case a personal fine of NIS 12,000 was levied on the divisional manager in the insurance company and he was also branded as being not fit and proper for a period of five years. A fine of NIS 400,000 was imposed personally on the insurer's CEO. The funds in question were returned to the unit-linked pool.

As has already been mentioned in connection with ICP 14, CMISD has extremely broad powers to impose requirements on insurers. For example, the Commissioner may restrict business activities, may impose limits on premium writings, may direct insurers to cease practices that are unsound, may remove directors and managers and even appoint an individual to manage the insurer and if deemed necessary, to require the appointment of a new board.

One power that is not currently available to the Commissioner is a requirement for an established insurer to increase its capital base. At present a request for additional capital can only be enforced during the first five years of an insurer's history, and then only up to 50 percent of the amount of its original equity base. This will be remedied with a planned amendment to the regulations.

If CMISD considered it necessary to reinsure a block of business of an insurer, and if the insurer did not agree, the Commissioner could always appoint a manager along the lines just mentioned, who would then be in a position to ensure that the reinsurance transaction would be effected.

The wording of the law is sufficiently broad that it applies not only to the knowing provision of incorrect information, but also information that would be considered to be deliberately misleading.

There are also provisions having to do with the possibility of protecting policyholders when a member of a corporate group that includes an insurer, runs into financial difficulties. In this case, the law provides that the controlling shareholders of the group must put their owned shares of the insurance company into a blind trust, so that they will henceforth have no voting control over the insurer. This intended to reduce the possibility of assets being inappropriately removed from the insurer to finance the requirements of the group.

To ensure consistency in the application of the significant powers that rest with the Commissioner, CMISD must provide an annual report to the Ministry of Justice describing the enforcement actions over the prior year, along with underlying reasons in support thereof.

Although appeal processes are always available, the Commissioner can always act immediately if that is necessary to protect the public interest. In such cases the appeal process is available after the fact. An action by the Commissioner could only be

	overturned later, in the event of a successful appeal.
Assessment	Observed
Comments	<p>In light of the extensive powers granted to the Commissioner, the requirement to report annually to the Ministry of Justice is an important control measure.</p> <p>In the few cases where it can be argued that more specific enforcement powers would be desirable required, there are plans to modify the law to include the desirable power.</p> <p>For minor breaches of compliance, rather than imposing fines, companies are normally required to correct their procedures. For serious offences, significant fines can be levied; depending on the circumstances, they may include personal fines to officers and directors. These approaches help to reinforce a risk based approach to supervision. (See also ICP 23.)</p>
Principle 16.	<p>Winding-up and exit from the market</p> <ul style="list-style-type: none"> – The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines insolvency and establishes the criteria and procedure for dealing with insolvency. In the event of winding-up proceedings, the legal framework gives priority to the protection of policyholders.
Description	<p>An insurer's license must be cancelled when any one of the following conditions exist:</p> <ul style="list-style-type: none"> • the insurer violated a material condition of the license or a said condition ceased holding true for it; • the insurer violated provisions of an enactment or an administrative order made under the Law, in a manner that impairs its credibility; • cancellation of the license is justified by consideration of the interest of the insured public; and • the insurer does not meet the minimum required capital requirement. <p>The insurance law sets out the provisions that apply with regard to the winding up of an insurer, either voluntarily or because the insurer's licence has been revoked. The Commissioner is authorized under the insurance law to issue instructions and directives and these are considered by Israeli courts to be fully enforceable.</p> <p>The following provisions of the insurance law are particularly relevant:</p> <ul style="list-style-type: none"> • Section 64(b) stipulates that if an insurer's license has been cancelled, the Commissioner may, if he deems it necessary in order to safeguard the interests of insured persons, direct an insurer whose license was cancelled to act in a certain way in liquidating the business. • Section 70A empowers an administrator who has been appointed by the Commissioner to manage a distressed insurer, to define categories of claimants

	<p>and to establish payment rates for each category, including the possibility of providing for a preference of claimants for bodily harm over claimants for property damage.</p> <p>A Commissioner's order appointing a manager can be rescinded and the company restored to a regular manner of operation without damage to insured clients, if there is an opportunity for merger or sale.</p> <p>It is also important to note that the insurance law requires that assets of managed funds must be held in separate accounts, in trust for the clients. Consequently, creditors of an insolvent company have no access to these assets.</p> <p>As to company employees, under the general law on insolvency they are considered to be priority creditors in insolvency.</p>
Assessment	Observed
Comments	<p>The law takes account of the special nature of insurance contracts and the insurer's obligations to policyholders. Thus policyholders rank ahead of other creditors and within the range of policyholder claimants, varying preferences are able to be established. Taken together, these provisions ensure that as far as practical there will be limited disruption to the provision of benefits to policyholders.</p> <p>The last insurance company wind-up was in 1991. Although the large market share of this failed insurer was over 30 percent, policyholders did not lose money and policies continued without interruption with other insurers.</p> <p>Notwithstanding the above, it should be borne in mind that some insurance companies belong to (nonfinancial) conglomerates. If such a conglomerate got into serious financial difficulties, its resolution may be complex and protracted. Hence, it may be useful to consider introducing amendments to legislation explicitly allowing the ring fencing of insurance companies belonging to a conglomerate that is being resolved. (See also ICP 15).</p>
Principle 17.	<p>Group-wide supervision</p> <ul style="list-style-type: none"> – The supervisory authority supervises its insurers on a solo and a group-wide basis.
Description	<p>At the present time there is no formal definition as to what constitutes a financial group. However as part of the work on Solvency II, which is well underway, a formal definition will be developed.</p> <p>There is at present no direct regulation of holding companies. However, if a corporation owns 50 percent or more of an insurance company and insurance is the core business of the group, then the holding company is required to obtain an operating permit from CMISD. This enables CMISD to make the permit subject to conditions which could include regular financial reporting and other obligations on a group-wide basis, which gives CMISD significant power of oversight and control.</p>

	<p>It was pointed out by CMISD that the larger groups are almost all public so that a significant amount of group level information is available to CMISD even at present.</p> <p>Banks and insurers are not allowed to be under the same ownership so there are no group wide considerations involving banks and insurers.</p> <p>However, a holding company can have a mutual fund, a pension fund and an insurer within the same structure. Pension funds and insurers are both supervised by CMISD and where applicable these institutions would always be subjected to coordinated assessments by CMISD. Every insurer has been assigned a referent who is responsible for the insurer within the Division. When there is more than one supervised entity in a group only one referent has responsibility for the group. If a mutual fund is part of a group, ISD would be involved in the supervisory assessment for the group. Licensing officers at CMISD always collaborate with ISD if there is an ISD supervised entity that is part of a group that contains an insurer that is seeking a licence.</p> <p>At present CMISD does not have formal policies with regard to group capital adequacy, reinsurance and risk concentration, internal control mechanisms and risk management systems, nor are their specific requirements for group wide reporting.</p> <p>Related party transactions are essentially prohibited by the Israeli insurance law and this somewhat lessens the potential for unrecognized risks within a group.</p> <p>Plans are quite well developed with regard to a transition to a Solvency II regime and this will include group capital requirements and reporting, group risk concentration reports and intra-group transaction reports.</p> <p>The Division is authorized to refuse a licence or to require changes to be made if the group structure of an organization becomes so complex as to hinder CMISD's ability to properly supervise the insurance business of the group. To date no such intervention has been considered necessary.</p>
Assessment	Partly Observed
Comments	<p>There are reasonable arguments why group wide supervision may be of less significance in Israel than is the case in many other markets. Nevertheless, one cannot know with any certainty that the issue of group interconnectedness will not suddenly become important in a particular case. At present there are a number of the Essential Criteria that are not satisfied with regard to this ICP. The control permit approach is helpful but not equivalent to specific legal responsibilities for holding companies. It appears that the situation may be improved in the relatively near future as new laws and regulations are put in place to facilitate the Solvency II regime. In any case, there should be some level of supervisory authority with regard to holding companies, at least to the extent of providing CMISD with detailed financial information.</p> <p>It is also suggested that CMISD should require each of its supervised institutions to file a complete organizational chart for the group, showing every entity controlled by the institution's controlling shareholder, including both direct and indirect interests. This should form a part of the information that is sworn to by the company's signing officers in the affidavit that accompanies the filing. The receipt of this annual document would</p>

	provide CMISD with an authoritative source for all corporate inter-relationships and would help it to more effectively pursue the principles of group-wide supervision.
Principle 18.	<p>Risk assessment and management</p> <p>The supervisory authority requires insurers to recognise the range of risks that they face and to assess and manage them effectively.</p>
Description	<p>The risk management requirements for insurers were formally instituted in 2005 by means of a corporate governance based framework that makes the board of directors responsible for ensuring appropriate risk management policies across all key areas of an insurer's operations.</p> <p>The insurance law requires every insurer to appoint a fit and proper Chief Risk Officer (CRO), to be approved by the Commissioner based on qualifications and experience. The CRO must identify the insurance and financial risks that are material to the financial strength of the insurer or that policyholders face. The CRO must assess the manner of the management of risks and the potential impact of such risks on the company's financial capital and assets held against unit-linked policies, and verify that existing controls, measures and resources within the insurer are sufficient for the management thereof.</p> <p>The CRO is not only empowered by the law to obtain all required information from key functionaries, but key functionaries are required to report essential risk information to the CRO on at least a quarterly basis. These reports must be submitted to the CRO by the Chief Actuary, the Internal Auditor, the Investment Manager and the Reinsurance Division.</p> <p>In addition to reporting, a circular stipulates that companies' risk managers must verify that the controls, measures and resources existing in an insurer are sufficient for the management of risks, depending on the nature and extent of the insurer's activities.</p> <p>Boards of directors are required to define and set risk management policies across a range of key risk areas including market risk, credit risk, operational risk, underwriting risk and reinsurance exposures. The management policies must include exposure ceilings, the total level of risk exposure, approval of tools and controls for the measurement of risks and their management, and ways of dealing with risks and events that may arise in case of their realization. The board is also required by law to ensure that the risk management group has sufficient resources to carry out the functions for which it is responsible. The CRO must be present at any deliberations by the board with regard to the correction of any deficiencies that have been brought to the board's attention.</p> <p>Oversight of the risk management processes within the insurers is achieved in two main ways: (1) by supervisors of specific companies who continuously monitor the companies' activity by means of on-site and off-site inspections and (2) by the risk management Division of CMISD, which covers the entire market from a risk management perspective. CMISD staff members who are involved in assessing the risk management functions of supervised institutions are well trained and professional. Additionally, however, to provide the agency with greater depth of resources in this field,</p>

	<p>outside experts are routinely retained to provide consulting assistance with specific projects, also contributing to knowledge transfer and additional hand's on training for CMISD officers.</p> <p>The objective of the inspections and ongoing supervision risk management is to examine the way in which risks are managed by insurers and the assimilation of a risk management perspective within their business practices. In the course of inspections, compliance with supervisory provisions is examined, along with company structures, including separation of functions and the effectiveness of inter-divisional interactions with regard to risk management, managerial practices and the supervision thereof, the existence of appropriate risk management procedures, the manner in which material risks are treated, the computer systems that support risk management and the methods of control and monitoring the company's entire risk management system.</p> <p>If a material development has occurred, the CRO must immediately report to the relevant parties in the company.</p>
Assessment	Observed
Comments	<p>The focus on the role of the board will need further intensity as Solvency II is introduced.</p> <p>One of the Essential Criteria requires that the risk management policies and risk control systems be appropriate to the complexity, size and nature of the insurer's business. In a number of the circulars on different subjects there is specific provision for reduced scope of application for small companies. However the circular with regard to the functions of the CRO does not seem to include any such differentiation. This could be remedied at a future date.</p>
Principle 19.	<p>Insurance activity</p> <p>Since insurance is a risk taking activity, the supervisory authority requires insurers to evaluate and manage the risks that they underwrite, in particular through reinsurance, and to have the tools to establish an adequate level of premiums.</p>
Description	<p>CMISD requires boards of directors to establish policies with regard to standards of underwriting, pricing and reinsurance. There is a specific requirement for boards to discuss underwriting limits periodically.</p> <p>Whenever a new product is to be introduced an insurer must submit detailed product information, actuarial data and assumptions with regard to proposed pricing and reinsurance arrangements. The company's actuary must certify that the premiums have been calculated on the basis of sound actuarial principles and are expected to be sufficient to pay claims and expenses, taking account of the risks involved. Submissions normally include cash flow projections and in many cases the insurers are assisted in their analyses by their reinsurance companies. The actuarial division at CMISD scans each submission for completeness, reasonableness of assumptions and appropriateness of approach. If any irregularities or questions are raised by the initial review, the submission is reviewed in more detail and followed up with the insurer. In the case of an unusual line, or with regard to a product that would seem to present relatively</p>

	<p>higher risk, a full review would be carried out.</p> <p>The Commissioner requires boards of insurance companies to review and approve their reinsurance programs on an annual basis, including the quality of the reinsurers and the maximum exposure to any one reinsurer.</p> <p>Companies are required to submit the details of all their reinsurance arrangements, including reinsurers' ratings, to the Commissioner on an annual basis. Reinsurance arrangements are reviewed in detail by ad-hoc audits performed by CMISD and accounting for reinsurance transactions is also checked on a random basis. Each company reports its maximum possible loss on any one event as a percent of its capital base, with the average being only about 1.5 percent. Using aggregate information from insurer filings CMISD is able to monitor the exposure of specific reinsurance companies to the Israeli market.</p>
Assessment	Observed
Comments	The quality of reinsurance is monitored not only through rating but also using other sources of information. The concentration and counterparty risks call for risk capital charges. The exposure to the reinsures as well as the total exposure of each reinsurer to the market is followed and recommendations can be issued to address excesses.
Principle 20.	<p>Liabilities</p> <ul style="list-style-type: none"> – The supervisory authority requires insurers to comply with standards for establishing adequate technical provisions and other liabilities, and making allowance for reinsurance recoverables. The supervisory authority has both the authority and the ability to assess the adequacy of the technical provisions and to require that these provisions be increased, if necessary.
Description	<p>Every company must have an appointed actuary who is a fully qualified member of a recognized actuarial society, is fit and proper and considered by CMISD to have an appropriate level of experience.</p> <p>The company actuary must submit to the board of directors, management and CMISD, an annual report detailing the level of claims, including direct and indirect claim expenses, and fully explain the development from the previous period and any divergence from expected results. The report includes a signed declaration regarding the level of technical provisions. The actuary must be present at the board meeting at which the actuarial report and recommendations are to be discussed. Every insurer must carry out a full demographic study of its business at least once in each five years.</p> <p>Embedded values are required to be calculated annually by life insurers for submission to boards and CMISD. Also required is a comparative analysis of the current imbedded value versus that of the previous year, including explanation of major year-over-year changes.</p> <p>Non-life companies file detailed loss triangles covering a period of ten years and these are analyzed by CMISD staff.</p>

	<p>In relation to life and annuity business, CMISD establishes a minimum periodic mortality improvement based on its studies. Technical provisions are required to include a provision for adverse deviations. CMISD must be satisfied with the actuarial standards being utilized by appointed actuaries.</p> <p>The Commissioner is authorized to request any actuarial document or calculation from a supervised entity. CMISD reviews the actuarial functions of insurers by means of actuarial on-site inspections. Such inspections are carried out by members of the agency's actuarial division, often supplemented by outside experts retained by CMISD. In many cases there is a full review of the appointed actuary's calculations to compare methodologies and results. Insurers have been required to increase their technical provision levels, sometimes by substantial amounts.</p> <p>In terms of the data required to perform the valuation of liabilities, in their reporting to boards actuaries must provide full disclosure relating to the accessibility and quality of data received and checks that have been performed thereon, as well as any misgivings they may have regarding the data received. For life insurance the company actuary must check the technical provisions against adverse assumptions using LAT. However the adequacy and sufficiency of the methods is not determined. In non-life insurance technical provisions must be prudent. For defined benefit pension funds, the method is prescribed and assumptions must be chosen on a best-estimate basis.</p> <p>The Commissioner has powers to perform on-site inspections and this power is regularly exercised, with CMISD carrying out about five on-site actuarial inspections per year. An on-site review would typically consist of a fully independent assessment of an insurer's technical provisions by an external independent actuary retained by CMISD, working with members of the agency's Actuarial Division. Priorities for executing on-site inspections are established as part of CMISD's risk based supervision model. This includes information generated by the off-site review, including review of the annual report from the appointed actuary, additional actuarial reports submitted to the Commissioner, and the audited financial statements. The off-site review frequently generates follow up questions to insurers. The Commissioner may require increases to technical provisions as a result of the assessments and inspections described above and such increases have been required in the past, sometimes for substantial amounts.</p> <p>The appointed actuary is required to calculate the liability on both a gross and net of reinsurance basis, taking into account the expected recoveries, based on acceptable actuarial principles. All submissions to the Commissioner and publication in the financial accounts are both gross and net of reinsurance recoveries and are in accordance with IFRS.</p>
Assessment	Largely Observed
Comments	<p>The use of LAT to assess the level of liabilities is a positive initiative. However, the parameters and methodology need to be defined and not freely left to the discretion of the companies, which might use insufficient or inadequate methods. The LTS products that allow for a variable commission that depend on the performance of the investments are an example of a lack of a liability provision for the adverse performance of an investments.</p>

	<p>Although CMISD works closely with most of the life insurers using various stress testing methodologies, there is room for improvement in terms of requiring greater standardization of approaches.</p>
Principle 21.	<p>Investments</p> <ul style="list-style-type: none"> – The supervisory authority requires insurers to comply with standards on investment activities. These standards include requirements on investment policy, asset mix, valuation, diversification, asset-liability matching, and risk management.
Description	<p>Prior to 2002 CMISD supervised institutions were subject to a typical rule based investment regime comprised of many percentage based limitations across different investment categories. However in 2002 the agency adopted a prudent portfolio type approach with few specific limitations but where there is a significant responsibility on the board of directors to determine an appropriate investment policy for the institution. Accordingly, if the board of directors so wishes, it is free to provide for investments in sovereign debt, participate in derivative markets and so on, but always subject to the constraints of its own policies.</p> <p>It is not unusual for CMISD to require that a board of directors make changes or refinements to their investment policies.</p> <p>In support of the investment policies determined by the board of directors, CMISD has put in place detailed requirements that are applicable to investment committees and investment managers. All such requirements are further supported by a wide array of general requirements in respect of corporate governance, internal controls, internal audit procedures, reporting requirements, public disclosure and so on.</p> <p>The investment committee must appoint a credit committee which has to review proposed transactions and report back to the investment committee. Companies use internal models for assessing credit and these models are assessed for reasonableness by CMISD. Investment committee members are independent but appointed by the board and are responsible for executing the board's policies.</p> <p>To ensure that there is no conflict of interest between the treatment of the company's own funds and the policyholder funds, two investment committees are required for each company: one for the company's own funds and one for policyholder funds. A "Chinese wall" must be maintained between the two committees. Recently a member of an insurer's investment committee was personally fined a substantial amount for discussing a particular investment with a member of the parallel committee within the company. The internal auditor found evidence of the exchange of views and reported the matter.</p> <p>The board of directors must discuss investment matters at least annually, including levels of investment risk.</p> <p>Investments are valued at market values. For over-the-counter securities there are two professional valuation agencies that provide services to insurers and insurers are required to value any investment they engage in.</p> <p>In 2005 the Hodak Committee concluded that conditions in the Israeli bond market were</p>

such that market distortions could arise, possibly increasing market risk. The government adopted the recommendations of the Hodak Committee and took steps to increase market transparency, improve basic due diligence procedures for institutional investors in stocks and bonds, and to strengthen investor protection through stricter bond covenant requirements.

CMISD has in place many internal procedures in respect of both its on-site and off-site supervisor frameworks that are designed to assist with risk monitoring of the investment portfolios of supervised entities.

Two main types of requirements must be adhered to by institutions:

1. Quantitative rules concerning management of investments by the financial institution. Examples include provisions to diversify investments (e.g., single issuer restrictions and restrictions on investment in groups of associated companies), provisions to ensure the role of institutional investors as financial investors (e.g., provident and pension funds may hold no more than 20 percent of the means of control in a particular corporation), restrictions on where securities can be held, a required minimal level of liquidity, restrictions on investments in "associated parties" (now at 10 percent of equity but soon to be revised downwards to 5 percent of equity), restrictions that apply to certain types of assets (e.g., restrictions on investments in derivatives), and a restriction as to the maximum amount of securities that a financial institution can provide as collateral on certain types of transactions. Investments in sovereign debt must be rated at least A-. The proposed changes mentioned above will change the requirement to "investment grade".
2. Qualitative rules that apply to investment managers and members of investment committees. For example, there are provisions to establish certain standards of competence and fitness for investment committee members and the employees actually managing investments. Additionally, provisions have been made regarding functions of investment committees, the manner in which their meetings are conducted, and the financial institution's obligations in managing investments, including the duty to act faithfully, diligently, cautiously, and skillfully when managing investments of a financial institution. These attributes are checked by CMISD staff when on site, by reviewing minutes of committee meetings and interviewing staff and committee members.

It should be mentioned that some differences exist between the quantitative restrictions that apply to insurance companies and those that apply to provident and pension funds. This lack of uniformity is about to be resolved in a second draft of new investment regulations that were published in August of 2011.

The supervisory authority requires that insurers have in place contingency plans to mitigate the effects of deteriorating conditions.

Asset/liability matching policies for the insurer's own funds must be stipulated by the investment committee and exposure must be monitored and reported to the committee. Exposure limits are approved by the board. Stress testing is carried out by all companies under the direction of CMISD, but stress testing is not presently a legal requirement. (See recommendations for ICP 23.)

	<p>Details of all investment portfolios are actually published and required to be disclosed on companies' web sites.</p> <p>As mentioned in connection with ICP 17, group-wide supervision, the law does not require holding companies to provide financial data to CMISD. However a controlling shareholder does require a control permit and CMISD is usually able to leverage this requirement to gain access to annual financial information.</p> <p>Licensed companies do not hold assets: they are required to be in trust accounts with banks. Custodial agreements are overseen by ISA and the bank supervisor.</p>
Assessment	Observed
Comments	The introduction of a prudent person approach in tandem with a clear accountability of the board and the requirements of setting up a professional investment committee is to be welcomed.
Principle 22.	<p>Derivatives and similar commitments</p> <p>The supervisory authority requires insurers to comply with standards on the use of derivatives and similar commitments. These standards address restrictions in their use and disclosure requirements, as well as internal controls and monitoring of the related positions.</p>
Description	<p>An insurer's board of directors is required to set out the policy with regard to derivatives and other similar commitments.</p> <p>There are provisions in the Investment Regulations regarding investment in options and future contracts (restricting investment to 5 percent of the values of portfolios) and to exposure to underlying assets of derivatives. There are also restrictions capping the value of securities (up to 10 percent of the portfolio) that a financial institution may pledge in transactions in options, future contracts, and short selling, to limit the level of risk assumed by a financial institution.</p> <p>It should be emphasized that, apart from the specific provisions that apply to investments in options and future contracts, general provisions exist that apply to all investments, including in derivatives and their underlying assets, as outlined in the discussion of ICP 21. The general provisions include requirements for management of risks that are inherent in various investments, including derivatives, reporting requirements on investment in various assets, documentation requirements, and a requirement for internal self-monitoring and control. Additional restrictions that apply to investment in general, including derivatives, are limitations of exposure to a single corporation, limitation of exposure to a group of associated corporations, stability-related restrictions, restrictions on investment in associated parties, and so forth.</p> <p>The investment rules contain no specific limitations on derivative positions and if it is part of a board approved investment policy an insurer is able to invest in open option and derivative contracts (i.e., not only for hedging purposes).</p> <p>There is a legal requirement that companies must be able to value all of their</p>

	<p>investments so for certain types of derivatives an insurer would either have to have an internal model or go to an independent agency that has the technical expertise to value the items in question. As mentioned above, there are several Israeli companies that provide these types of services. Asset valuations are reviewed by CMISD officers during on-site inspections.</p> <p>Company's derivative and option positions are reported on their web sites on a quarterly basis.</p>
Assessment	Observed
Comments	The criteria of this principle are observed. However, taking into consideration the current level of development of the derivatives market in Israel, a conservative supervisory approach is recommended. The current tight limitation of the use of derivatives for hedging purposes should be kept under review as the market develops.
Principle 23.	<p>Capital adequacy and solvency</p> <p>The supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses.</p>
Description	<p>The law sets out the requirements with regard to an insurer's minimum shareholders equity capital requirement. Under the regulations, the capital components are classified as Tier 1, Tier 2, and Tier 3 capital, being distinct from each other according to the degree of permanence of capital components, their availability for loss absorption in going-concern and winding-up situations, and the degree of their subordination.</p> <p>In 2007 CMISD carried out a wide-ranging assessment of the local capital regime, including comparisons with a number of other jurisdictions. As a result of this assessment, in 2009 changes were made to the capital regulations which were to be implemented by the end of 2011. These changes increased the capital requirements of local insurers by 40 percent on average, and considerably improved the match between insurers' risk profiles and their capital requirements.</p> <p>Current capital requirements for life insurers are set according to the insurers' exposure to various risks, including insurance underwriting risk, operational risk, market and credit risk (including any imbedded guarantees), catastrophe-related risk, and so forth. The requirements in respect of insurance underwriting risks are calculated net of re-insurance, but they take into account the counterparty risk of reinsurers based on their international rating. The capital requirements prevent double gearing, and where there is a transfer of risks between related insurers, it will be expressed in the capital requirements of the insurer that effectively bears the risk. There are also full capital requirements reflecting holdings in subsidiary companies (see ICP 17).</p> <p>For non-life companies the current capital requirement is mainly based on the higher of two calculated values, one based on gross premiums written and one based on gross claims incurred over the previous three years, in both cases with a maximum permitted deduction to take account of reinsurance.</p>

	<p>If a company's capital position is greater than 115 percent of the requirement then it can distribute dividends. If the position is between 105 percent and 115 percent then permission of the Commissioner is required before payment of a dividend. If the position is less than 105 percent of the requirement then no dividend can be paid.</p> <p>At present there is no requirement in the law that permits the supervisor to order an insurer to increase its capital base, other than for recently established insurers where an increment of up to 50 percent of the original capital amount can be required during the first five years of operation.</p> <p>Pending the introduction of the Israeli equivalent of Solvency II, companies' own funds have requirements based on QIS5 (circular of March 2011) as follows: Tier 1 at least 60 percent of own funds of which hybrid funds cannot exceed 20 percent; Tier 3 at a maximum of 15 percent. Tier classifications are based on degree of subordination, loss absorbency, maturity date and encumbrances.</p> <p>Along with capital requirements, insurance companies are expected to examine the estimated effect of various stress scenarios on their stability. The results of such scenarios are considered by boards of directors and also their effects on risk management policies. Companies carry out exposure analyses, sensitivity tests, examination of sector-related profitability and examination of risk factors. These analyses must be submitted to boards for their review along with proposed management actions. The sensitivity tests are conducted in respect of the principal variables that affect insurers' activity (e.g., changes in interest rates). It should be noted that the capital requirements are about to undergo changes as part of the process the implementation in Israel of the Solvency II Directive (see comments below).</p> <p>At present, an insurer that does not meet its capital requirements is required to make up the shortfall by the date of publication of its financial statements, either raising new capital or reducing the level of its business, unless the Supervisor has granted a postponement. Regulatory changes are expected in this connection in the future, including calculation of various capital levels and adoption of a gradual scale of intervention (see comments below).</p> <p>CMISD monitors international regulatory developments and takes account of them when formulating the local requirements. Specifically, the decision to implement Solvency II in Israel has prompted CMISD to conduct a comprehensive gap analysis to identify the main differences between the existing regulatory regime and the new proposal. Additionally, in May 2011, the Israeli insurance companies submitted the results of QIS5 exercises, which are assisting CMISD to assess the impact of the planned new measures for the Israeli insurance market. The results of the gap analysis are still being analyzed but the results were generally quite satisfactory in terms of better understanding companies' risk exposures and capital requirements. However it was also apparent that insurers will have to further develop their modeling expertise before Solvency II can be formally implemented.</p>
Assessment	Largely Observed
Comments	The current solvency regime is an enhanced Solvency 1 regime that has some risk sensitive elements, like market consistent valuation of assets, market risk, reinsurance

	<p>credit risk and concentration risk charges for example. However calibration of the risks still needs attention.</p> <p>Stress testing needs further development and the introduction of standardized stress testing as well as technical provision stress testing is recommended.</p> <p>With the introduction and implementation of Solvency II planned for 2013, the full observance of this principle will be achieved.</p> <p>CMISD is working to develop a formal ladder of intervention which will include control levels that can trigger various types of intervention (i.e., preventive and corrective measures), escalating as an insurer's position becomes more serious. At present, with no general ability to require capital increases, and a lack of formally stipulated intervention measures related to overall financial viability, the agency is not able to exercise defined strategies that can be applied on a market-wide basis. The introduction of a ladder of intervention will also ensure greater consistency in the supervisory process and make the process much more transparent to market participants.</p>
Markets and Consumers	
Principle 24.	<p>Intermediaries</p> <p>The supervisory authority sets requirements, directly or through the supervision of insurers, for the conduct of intermediaries.</p>
Description	<p>All insurance and pension intermediaries are required to be licensed and after the licence has been granted, a period of internship is required. There is a criminal record check prior to the issuance of a licence. The licensing process includes professional exams which are set by CMISD and administered by the Israeli Association of Insurance Intermediaries. The percentage of candidates who pass the exam is said typically to be around 50 percent.</p> <p>Unlicensed persons are not able to sell in the marketplace because insurers are prohibited from paying commissions to any person who does not hold a licence. The insurers must maintain up-to-date records of the intermediaries with whom they have contracts to ensure that they are in fact licensed.</p> <p>There are 11,819 licensed intermediaries across all product categories. Of these, 10,461 are individual intermediaries working as pension agents, pension marketers and pension advisors. Marketers are employed by pension funds whereas agents may be individual licensees or employees of insurance agencies. Advisors are mostly with the banks. Advisors must provide unbiased advice.</p> <p>There is an active association of intermediaries, which has about 5,500 members. The Association sponsors an "intermediaries' college" which provides additional educational programs for intermediaries. There is currently no requirement for continuing education as part of the licensing requirement but the Association of Intermediaries said that its members average about ten days of training per year, mostly provided through the intermediaries' college.</p> <p>Premiums paid by the insured to intermediaries are required under the law to be treated</p>

	<p>as trust funds, lodged in a bank account that is kept separate from the funds of the intermediary. In addition, the law stipulates that payment by the insured to the intermediary constitutes payment to the insurer, so an insurer is not able to avoid a claim based on non-receipt of premium from the intermediary.</p> <p>However, by far the majority of premiums are paid by direct withdrawal from the policyholder's bank account to the insurer or pension fund. Thus there is little potential for misappropriation of funds by intermediaries.</p> <p>There is no E&O insurance requirement but action can be taken against any insurer with regard to the actions of one of its appointees.</p> <p>Most of the business is sold through insurance agencies that are owned by insurance companies. Although intermediaries are required to disclose any ownership ties they may have with insurance companies or other institutional entities, the relationships are in most cases only communicated to the consumer by a logo on a business card. Most of these tied agents also sell the products of more than one insurer, thus acting more like what would be called brokers in other jurisdictions. These circumstances give rise to an environment where there may be potential conflicts of interest among intermediaries and confusion for consumers.</p> <p>Most of the large insurers own their own distribution through insurance agencies they have purchased and expanded over time. However, intermediaries must disclose any ownership ties they may have with insurance companies or other institutional entities. A number of sources indicated to the assessors that while these ownership ties exist, intermediaries are not bound by them. For example, several of the larger insurers indicated that more than half the sales from their agencies are placed with other insurers.</p> <p>Intermediaries are also required to disclose which company provides them with the highest rate of commission that they may receive on a product. A CMISD circular enhances the disclosure requirements, mandating a formal "reasoning" document, which fully discloses determinants of a pension advice. This circular is under consideration for further enhancement of disclosures and to make it more transparent.</p> <p>Commissions for pensions are negotiable, with the result that for large group policies with many members, the rate of commission will be very low. On the other hand, an individual, lacking the buying leverage of a large employer or a union, may pay a rate of commission that is significantly greater. This gives rise to some issues of equity of treatment between different parties.</p> <p>The law forbids an unlicensed person to engage in insurance intermediation, to give pension advice or to market a pension product. Adequate powers (auditing, complaint investigation and resolution) and sanctions are prescribed.</p>
Assessment	Largely Observed
Comments	To provide the insuring public with greater clarity with regard to the interests being represented by the various intermediaries, consumers could be asked to provide "informed consent" when dealing with agents that are owned by an insurer and

	<p>recommending a product that is underwritten by that insurer. With informed consent the consumer signs a document indicating knowledge and understanding of the relationship between the agent and the insurer. Alternatively, CMISD could consider more broadly based changes that would provide consumers with greater market transparency, given the current ownership structure. In most international markets there is a clear delineation between intermediaries who primarily represent one insurer and have ownership (or sponsorship) ties with that insurer, (usually referred to as agents), and intermediaries who represent a number of different insurers and have no ownership (or sponsorship) ties with those insurers (usually referred to as brokers). This model is not necessarily recommended for Israel, but the assessors' view is that transparency under the current structure could be improved.</p> <p>More generally, CMISD could consider increasing transparency by requiring changes to the current ownership structure or by requiring changes in the protocols for the labeling of various categories of intermediaries.</p> <p>The CMISD is rightly considering establishing standards regarding service levels to clients, including time to payment for claims and continuing professional and commercial training for intermediaries.</p>
Principle 25.	<p>Consumer protection</p> <p>The supervisory authority sets minimum requirements for insurers and intermediaries in dealing with consumers in its jurisdiction, including foreign insurers selling products on a cross-border basis. The requirements include provision of timely, complete and relevant information to consumers both before a contract is entered into through to the point at which all obligations under a contract have been satisfied.</p>
Description	<p>The Commissioner may issue instructions to ensure the protection of policyholder interests and in fact companies are subject to a significant number of consumer protection initiatives. Boards of directors are required to establish procedures for the handling of consumer complaints and information on complaints must be reviewed regularly at the board level.</p> <p>Companies are also required to reasonably monitor the actions of their intermediaries to ensure they are complying with the law. CMISD devotes significant resources to consumer protection issues with 14 persons, including 9 lawyers (out of a total staff of 140) working in this area.</p> <p>When new products are being introduced or new licences requested, CMISD considers projected loss ratios to ensure they are not so low as to constitute unfair treatment of consumers.</p> <p>As part of their claim handling procedures insurers must request all information at one time and in written form. Insurers are not allowed to raise additional questions at a later date if they have not been included in the written questionnaire to claimants. If information regarding pre-existing conditions is not requested by an insurer, then the existence of such a condition can only be cause for rejection of a claim during the first year of a policy.</p> <p>For life insurance products there is also a compulsory requirement to provide</p>

	<p>policyholders with a written comparison of product and other features when policy replacement is being considered.</p> <p>The association of insurance intermediaries has a publication which rates the performance of insurers from a service perspective.</p> <p>A higher than market rate of interest must be paid to the claimant if a claim is not settled within a prescribed time.</p> <p>Consumers are able to track the handling of their claims as the claim progresses through the insurer's system. This is by means of "your personal zone" on the CMISD web site. The web site also permits prospective purchasers of compulsory motor insurance to view the rates of all companies based on their personal risk factors such as age, driving record, type of vehicle and so on.</p> <p>Each insurer must have full instructions for claim filing on its web site and as well the instructions must be sent to each applicant for coverage. Although not strictly required by law, every company has appointed an internal ombudsman. CMISD imposed a service level agreement (SLA) on insurers about one year ago.</p> <p>CMISD carries out on-site consumer service inspections of insurers and at that time they check to ensure that the terms of the SLA are being observed. Companies must file a report with CMISD which discloses the percentage of claims that were partially paid, the percentage of claims that were rejected as well as other claim related statistics.</p> <p>Israel has strong legal constraints with regard to the collection of personal information and for the most part these have prevented insurers from assembling data bases for risk assessment information, e.g., frequent claimants under homeowners' policies. However for compulsory motor bodily injury coverage the government agreed to the establishment of a data base that permits the pooling of data for the generation of industry wide statistics that are required for pricing.</p> <p>It is also worth mentioning that the law requires insurers to provide significant amounts of information directly to policyholders. For example, certain information about savings and investment accounts must be mailed on a periodic basis directly to policyholders. Insurers must also provide on their company web sites personal information that can be accessed and updated by consumers as well as periodical updates on other specific matters. The web sites are actually monitored for compliance and insurers have been fined for contraventions.</p> <p>Earthquake coverage is part of the prescribed homeowners' policy.</p> <p>CMISD maintains a service to assist consumers with the resolution of complaints. Insurers can challenge its findings in a 2nd level court.</p>
Assessment	Observed
Comments	A cooling off period for products sold under pressure, such as certain types of health insurance policies, credit card or loan linked products, should be introduced.

	<p>As an example of best practice in the dealing with consumer complaints, regulations might be amended in future to include the following refinements:</p> <ul style="list-style-type: none"> • Board to appoint internal ombudsman who is a senior officer of the company; • All claimants notified of contact details for internal ombudsman when claim information is received by insurer, plus clearly shown on company web site; • Claimants to first approach insurer with complaint details. Insurer has fixed period to resolve (say up to 30 days); • If not possible to resolve within that period, insurer provides insured with “final position letter” explaining why insurer is not prepared to resolve to consumer’s satisfaction, plus notice of contact details for complaint to CMISD. • Then, if contacted, CMISD investigates, offers mediation service along with other services offered at present. • Final resolution can be to the court system. <p>This process will place the initial onus for complaint resolution with the insurers, considerably reducing the number of complaints that must be dealt with by CMISD. In turn, this will permit CMISD to focus its resources on the more complex and difficult situations.</p>
Principle 26.	<p>Information, disclosure & transparency towards the market</p> <p>The supervisory authority requires insurers to disclose relevant information on a timely basis in order to give stakeholders a clear view of their business activities and financial position and to facilitate the understanding of the risks to which they are exposed.</p>
Description	<p>The insurance law requires all insurers to report as if they were public companies. Public company reporting in Israel is quite demanding, with the result that every insurer is responsible for extensive public disclosure. Companies are required to post on their web sites quarterly financial statements that have been subject to review by an independent auditor, and this is within three months of the quarter end. Audited annual financial statements are also required to be on their web sites within three months of each year end. Since 2008 IFRS has been required for all of these filings. As for all public companies, material adverse developments are required to be reported immediately and in the case of supervised institutions, this includes notice to the Commissioner.</p> <p>The annual filing is very extensive, including not only financial statements but also detailed information with regard to risk management. A sample filing provided to the assessors ran to 300 pages, with 61 pages devoted to details in respect of risk management.</p> <p>An even more detailed management discussion paper is also required to be posted on the web site and this contains considerable additional information on corporate governance practices, risk management processes, internal control systems and so on.</p>

	<p>The web site for CMISD also sets out detailed information for every licensed insurer, including such details as the actual investment portfolio as at the reporting date.</p> <p>Audits are required to be carried out on a joint basis by two audit firms.</p>
Assessment	Observed
Comments	The amount of information required to be made public is extremely comprehensive and, in the assessors' experience, must be considered world class.
Principle 27.	<p>Fraud</p> <p>The supervisory authority requires that insurers and intermediaries take the necessary measures to prevent, detect and remedy insurance fraud.</p>
Description	<p>The law requires insurers to report actual or suspected internal fraud to the supervisor.</p> <p>Current legislation does not allow the supervisor to intervene in cases of insurance fraud by consumers as this falls within the authority of the police. However, the Insurance Contract Law deals with the concealment of information and false statements of facts by insurance claimants and it exempts the insurer from payment to an insured where there has been an intention to defraud.</p> <p>The supervisor demands fairness in the conduct of insurance business both in insurers' activity vis-à-vis an insured and in maintenance of fair conduct by the insured and its agents in preventing the award of bonuses and perks that are likely to have a fraudulent motive. Requirements with regard to the fair treatment of policyholders and settlement of claims have been prescribed by circular. To maintain fairness in activities of insurers, provisions exist which relate, inter alia, to the remuneration of persons engaged in insurance.</p> <p>With regard to pension counselors and marketers, the law specifies permissible commissions and prohibits remuneration that might be construed as fraud on the part of the marketer or pension counselor.</p> <p>The supervisor requires boards of insurers to determine policies to deal with internal embezzlement and fraud and to allocate for such purpose the necessary resources and control systems.</p> <p>For compulsory motor vehicle insurance there is the possibility of insurers exchanging information with regard to policyholder fraud. Starting in 2005, a database was established for insurance fraud, containing information derived from companies' reports of claims. When a compulsory vehicle insurance certificate is issued, insurers are required to authenticate the underwriting data by checking the database.</p> <p>A system of exchange of information exists in cases of insurance fraud, when necessary, with the Securities Authority and the Israel Police, with the handling of the punishment aspects of fraud being entirely within the authority of the police.</p>

Assessment	Partly Observed
Comments	<p>Steps should be taken as soon as possible to deal in the law with consumer claim fraud. This should include the clear labeling of insurance consumer fraud as a criminal offence and should require boards of directors to put in place policies with regard to measures intended to detect and reduce claim fraud. In most countries over-stated claim filings, phony claims and similar misconduct adds considerably to the cost of insurance, which must be borne by all policyholders.</p> <p>In keeping with international best practice and with due regard for confidentiality, consideration should be given to providing for more extensive use of industry data bases to detect insurance fraud, similar to the system that has been developed in connection with the Motor Bodily Injury product. This can help to reduce the cost of insurance for the public as a whole.</p>
Principle 28.	<p>Anti-money laundering, combating the financing of terrorism (AML/CFT)</p> <p>The supervisory authority requires insurers and intermediaries to take effective measures to deter, detect and report money laundering and the financing of terrorism.</p>
Description	<p>The AML/CFT framework has been significantly strengthened in recent years and a number of important improvements have been included in a new Order which has been published and is expected to soon come into force.</p> <p>The legal framework is governed by the Prohibition of Money Laundering (Insurer's and Insurance Agents' Obligation of Identification, Reporting and Keeping Records), Order, 2001. The Order prescribes relevant requirements: authentication of the customer's identity, documentation, safeguarding and reporting money laundering to the AML Authority (corresponding to the FIU) in accordance with FATF criteria and recommendations as to the relevant insurance sector.</p> <p>A new draft Order has recently been published containing requirements adjusted to the changes in the FATF criteria and recommendations that have occurred in recent years, including a reduction in the threshold of the reporting of amounts to the anti-money laundering authority. In addition, the draft order includes the imposition of obligations in respect of anti-money laundering and financing of terrorism, on financial advisers, these being a new channel of distribution in Israel that only commenced operating in 2008.</p> <p>The draft Order requires insurers to exercise extra caution in contracting with a person that is defined as a foreign public personality or a politically exposed person, and reporting requirements to the anti-money laundering authority in respect of activity concerning loans of insurers that exceed a certain threshold or are deemed to be suspicious transactions.</p> <p>Also to be required is reporting of transactions with entities related to terrorism (per a listing maintained at an international level). To more clearly define suspicious transactions, the draft Order details a number of transactions that should be deemed suspicious. The following are several examples of the transactions included in the draft Order:</p>

	<ul style="list-style-type: none"> • An act the purpose of which appears to be to circumvent identification requirements; • An act that appears to lack business or economic logic in relation to the type of insurance contract; • An act due to which an insurer decides not to sign an insurance contract or to cancel it, due anti-money laundering or financing of terrorism considerations; • Cancellation of a life insurance contract by a policyholder or an insurer, immediately after there has been a deposit of a substantial sum. <p>CMISD has the power of supervision and the imposition of sanctions on insurers for the purposes of compliance with the AML/CFT requirements.</p> <p>Additionally, CMISD is in charge of approving the controlling owners of insurers, and thus has the power to prevent disqualified individuals from exercising control over insurers.</p> <p>The supervisor is also authorized to collaborate with the AML Authority on AML/CFT related matters and can join forces with other supervisory authorities, both in Israel and abroad.</p> <p>The supervisor is investing resources to help prevent money laundering and terrorism-financing activity from taking place within supervised institutions.</p> <p>The Prohibition of Money Laundering (Insurer's and Insurance Agents' Obligation of Identification, Reporting and Keeping Records), Order, 2001, prescribes requirements which are consistent with the 25 FATF recommendations. With respect to life insurance a new draft Order has been published recently, including with respect to loans by life insurance companies.</p> <p>Supervised institutions are required to maintain records for a period of 7 years.</p> <p>Over the last year, CMISD has inspected 3 insurers and 2 provident funds to assess AML/CFT compliance. There is a history of imposing fines and requiring corrective actions where infractions were found. For 2012, CMISD plans to carry out 6 AML/CFT inspections (3 in insurance companies and 3 in provident funds).</p>
Assessment	Largely Observed
Comments	The new Order should be adopted and implemented.