Maalot
S&P Global Ratings

The Phoenix Insurance Company Ltd.
The Phoenix Holdings Ltd.
The Phoenix Capital Raising (2009) Ltd.

April 21, 2020

Research Update

The Phoenix Insurance Company Ltd. Rating Affirmed At 'ilAA+', Outlook Revised to Stable from Positive on Adverse Economic Conditions'; The Phoenix Holdings Rating Affirmed at 'ilAA-', Outlook Stable

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Contents

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Rating Action Summary

- We believe the coronavirus outbreak and its effects on the local economy, including the rise in unemployment and high market volatility, could adversely affect the profitability of The Phoenix Insurance Company Ltd. (“Phoenix Insurance”) and its local peers. This is due to an expected contraction in premiums and decline in long term savings deposits, and a decline in investment income.
- However, we believe Phoenix Insurance’s market position is well established as one of the three largest insurance groups in Israel, and its operations are well diversified. We also believe its capitalization will be sufficient to absorb the negative impact of capital market volatility amid worsening economic conditions on the company’s assets under management and profitability.
- At the same time we expect stability in The Phoenix Holdings Ltd.’s (“Phoenix Holdings”) liquidity assessment and ability to serve its debt from its own sources, following structural changes made in the past two years.
- We are therefore affirming our rating on Phoenix Insurance at ‘ilAA+’ and revising its outlook to stable from positive, and affirming our rating on Phoenix Holdings at 'ilAA-' with a stable outlook.

Rating Action

On April 21, 2020, S&P Maalot affirmed its 'ilAA+' rating on The Phoenix Insurance Company Ltd. and revised the outlook to stable from positive. At the same time, S&P Maalot affirmed its 'ilAA-' rating on The Phoenix Holdings Ltd., the outlook is stable.

Rating Action Rationale

The affirmation of our rating on Phoenix Insurance despite the economic adverse effects on its business environment due to the coronavirus pandemic, reflects our view of the resilience of Phoenix Group’s capital assessment as measured by S&P Global Ratings’ Risk-Based Capital Model. We believe Phoenix Insurance’s capital cushion is sufficient to absorb the expected worsening in operating performance stemming mostly from investment losses amid turbulent capital markets and expected slowdown in business operations. We believe Phoenix Group is facing the coronavirus crisis from a strong position. Our view is supported by the group’s high consolidated profitability from its diversified sources, reflected in its high average ROE of 10% in the past five years, compared with about 8% on average among local peers. In addition, changes in the group’s organizational structure implemented in recent years, including placement of “AD-120” under Phoenix Insurance and placing

Phoenix Agencies under Phoenix Holdings, strengthened Phoenix Insurance's capital. Our assessment takes into account both Phoenix Insurance's stand-alone capital assessment and the group's consolidated capital assessment.

We view Phoenix Insurance's diversified business model as key strength. This view is supported by the company's sound operating performance in recent years, reflected in its high ROE compared with peers. The strengthening of its direct distribution channel in recent years, in particular in the P&C segment, could support its business activity in current business conditions. However, due the challenging economic environment posed by the coronavirus outbreak and the uncertainty regarding the recovery path towards the normal state of business, we estimate in our base case scenario that premium accumulation will slow down for Phoenix Insurance and its local peers, and that Phoenix Insurance's operating performance will weaken. We now forecast a ~5% decline in Phoenix Insurance's gross premiums in 2020, in the face of growing unemployment and expected negative GDP growth. We expect most of this decrease to be in pension savings deposits (pension and life insurance). In the P&C segment, where competition is already high and premium growth in normal state of business is slower than in other segments, we expect a mixed effect on profitability as measured by the net loss ratio (total Insurance claims to net premiums) and the net combined ratio (total insurance claims plus expenses to net premiums). On the one hand, movement restrictions on the general population are likely to reduce the number of claims, and management has also reduced its expenses by putting about 20% of the workforce on temporary leave, but on the other hand, premiums are expected to decline due to softer business environment. In addition, the value of the group's assets under management in life insurance, provident funds and pension funds has decreased by ~10.8% in the Q1 2020, and there is currently an uncertainty with regards to its recovery due to continuous capital market turbulence. In addition, the company can no longer charge variable management fees on life insurance policies until it recovers the NIS 562 million loss to policyholders due to negative investment returns, which is also expected to curb profitability. Investment losses in Q1 2020 amounted to about NIS 635 million after tax, and may increase following revaluation of non-tradable assets. Despite some recovery since late March, we expect global capital markets to remain turbulent in the next 12 months, leading to very limited visibility on 2020 investment and variable fee income.

Phoenix Insurance's solvency ratio as of June 30, 2019, was 110% assuming full Solvency 2 implementation, compared with 134% at year-end 2018. The weakening was mainly due to the effect of the decline in the risk-free yield curve on solvency requirements in life and long-term care insurance. We expect the solvency ratio under the current regime to decrease further in 2019, due to the need to adjust life insurance reserves following the increase in life expectancy, and due to the sharp decline in the yield curve in 2019, which will be partly mitigated by the release of P&C insurance reserves following the revocation of Winograd Committee recommendations in Q3. However, we believe that the amendments introduced by the Insurance and Capital Markets Authority in March 2020 to the Solvency 2 adoption framework, mainly those related to spreading the capital requirements for long term life insurance reserves over 16 years, are expected to positively impact Phoenix Insurance's solvency ratio if they are approved. According to the published circular, changes are expected to be reflected in year-end 2019 solvency report which is due to be published in August 2020. We expect the company's solvency ratio after the amendment to be materially above 100% considering transitional requirements. However, much uncertainty exists with regards to the nature and timing of the change, which is subject to approval by the Knesset finance committee. We believe dividend distribution by Phoenix Insurance is unlikely as long as uncertainty remains regarding the implementation of the proposed Solvency 2 adoption framework.

In addition, regarding insurance companies' accounting profitability assessment, the Insurance and Capital Markets Authority made a material amendment to the treatment of LAT (liability adequacy test) reserves calculation in life and long-term care insurance, which came into effect in March 2020. This amendment is expected to reduce the effects of risk-free yield curve volatility on the adjustment of life insurance reserves, and therefore reduce volatility in the accounting profit of Phoenix Insurance and its local peers due to frequent reserve adjustments. This amendment should result in the life insurance LAT reserves reinstated in Q1 2020 financial statements through a NIS 380 million release back to shareholders equity. In the future we expect a more moderate adjustment of life insurance reserves, but long-term care insurance adjustment may continue to fluctuate in line with the 25-year risk free yield curve.

The rating on Phoenix Insurance reflects its well established business position as one of the three leading insurance groups in Israel. Phoenix Insurance is the main company in the Phoenix group and represents the majority of the group's earnings and equity, and its rating is the benchmark from which we derive our rating on Phoenix Holdings.

The rating on Phoenix Holdings reflects our view of its capacity to serve its ongoing cash requirements. Our assessment reflects a dividend stream from non-regulated sources, mainly Phoenix Agencies and Excellence, compared with Phoenix Holdings' cash needs, which include ongoing SG&A costs and principal and interest payments on its outstanding bonds. The assessment reflects a ratio of at least 1.2x on an annual basis between sources and uses over the next 18-24 months. Our assessment is also supported by Phoenix Holdings' liquid assets, which are sufficient to cover its cash needs (by at least 1.5x on an annual basis over the next 18-24 months).

Outlook

The stable outlook on Phoenix Insurance reflects our view that its current capital buffers will contain the negative impacts from worsening economic conditions and turbulent capital markets on its profitability in the next 18-24 months.. We believe Phoenix Insurance will maintain its leading business position through the challenging adverse market conditions supported by its diversified business model and sound operating performance, which supported its capital accumulation in recent years.

The stable outlook on Phoenix Holdings reflects our expectation that it will maintain an adequate level of liquid sources, at least 1.2x of its uses, which allow it to serve its liquidity needs in the next 18-24 months at the least.

Upside Scenario

We may raise our rating on Phoenix Insurance in the next 18-24 months if its gross insurance premium accumulation pace remains similar to the period prior to the coronavirus outbreak and its operating performance remains sound such that its stand-alone and consolidated capital assessment are strengthened beyond our expectations, or if we estimate that its market position has materially strengthened compared with local peers. However, an upgrade would only be possible if, in addition to its capital management policy, Phoenix Insurance sets clear financial goals, e.g. target leverage and a clear dividend policy, that provide us with more certainty regarding its prospective capital levels.

An upgrade on Phoenix Holdings in unlikely in the next 18-24 months.

Downside Scenario

We may lower the rating on Phoenix Insurance in the next 18-24 months in case of a marked deterioration in operating performance that would erode its capital buffer and jeopardize its loss absorbing capacity, thus materially weakening its capital adequacy. We may also downgrade Phoenix Insurance if its gross premium accumulation decreases more than expected and faster than local peers, leading us to conclude that its business position in the Israeli market has weakened.

We may downgrade the Phoenix Holdings in the next 18-24 months in case of deterioration in its capacity to serve its liquidity needs from its own sources. A negative rating action on Phoenix Insurance could also lead to a similar action on Phoenix Holdings.

Related Criteria And Research

- Use Of CreditWatch And Outlooks, September 14, 2009
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2020
- Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings, October 24, 2013
- Principles For Rating Debt Issues Based On Imputed Promises, December 19, 2014
- Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Group Rating Methodology, July 1, 2019
- Insurers Rating Methodology, July 1, 2019
- S&P Global Ratings Definitions, July 5, 2019

Ratings List

Rating Details (As of 21-April-2020)

The Phoenix Insurance Company Ltd.

Issuer rating(s)

Local Currency LT	ilAA+/Stable

Issuer Rating history

Local Currency LT	
21-April-2020	ilAA+\Stable
07-Oct-2018	ilAA+\Positive
19-Feb-2017	ilAA+\Stable
13-Nov-2015	ilAA+\Negative
19-May-2014	ilAA+\Stable
18-Nov-2012	ilAA+\Negative
17-July-2012	ilAA+\Watch Neg
11-Oct-2011	ilAA+\Stable
25-Aug-2010	ilAA\Stable
17-Aug-2009	ilAA-\Negative
19-March-2009	ilAA-\Watch Neg
08-Feb-2009	ilAA\Watch Neg
24-May-2004	ilAA

The Phoenix Holdings Ltd.

Issuer rating(s)

Local Currency LT	ilAA-/Stable

Issue rating(s)

<u>Senior Unsecured Debt</u>

Series 2, 3, 4, 5	ilAA-

Issuer Rating history

Local Currency LT	
06-Oct-2019	ilAA-\Stable
07-Oct-2018	ilA+\Positive
19-Feb-2017	ilA+\Stable
13-Nov-2015	ilA+\Negative
19-May-2014	ilA+\Stable
18-Nov-2012	ilA+\Negative
17-July-2012	ilA+\Watch Neg
12-Jan-2012	ilA+\Stable
25-Aug-2010	ilA\Stable
19-March-2009	ilA\Negative
16-Nov-2008	ilAA\Watch Neg
14-March-2007	ilAA\Stable

Rating Details (As of 21-April-2020) (Cont.)

The Phoenix Capital Rating (2009) Ltd.

Issue rating(s)

<u>Hybrid Subordinated Debt</u>

Series D,E,F,H,I,J,K	ilAA-

Other Details

Time of the event	11:51 21/04/2020
Time when the analyst first learned of the event	11:51 21/04/2020
Rating requested by	Issuer

Credit Rating Surveillance

S&P Maalot is the commercial name of S&P Global Ratings Maalot Ltd. S&P Maalot conducts surveillance activities on developments which may affect the creditworthiness of issuers and specific bond series which it rates, on an ongoing basis. The purpose of such surveillance is to identify parameters which may lead to a change in the rating.