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

October 21, 2020

Primary Credit Analyst:

Ben Shiran, 972-3-7539751 ben.shiran@spglobal.com

Additional Contact:

Lena Schwartz, 972-3-7539716 lena.schwartz@spglobal.com

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Phoenix Insurance Ltd.

Issuer Credit Affirmed	ilAA+/Stable

The Phoenix Holdings Ltd.

Issuer Credit Affirmed	ilAA-/Stable

Phoenix Capital Raising (2009) Ltd.

Overview

Key Strengths	Key Risks
• Established business position as one of the three largest insurance groups in Israel. • Diversified income sources and distribution channels. • Strong profitability compared with most local peers, measured by an average ROE of 10% in the last five years.	• Low interest environment triggering profit volatility due to frequent strengthening of life and health insurance reserves. • Capital market volatility which may trigger volatility in investment income and overall profitability. • Challenging economic condition and business environment as a result of the coronavirus pandemic.

Phoenix Insurance Ltd. ("Phoenix Insurance" or "the Company") will continue to benefit from its leading business position in the Israeli insurance industry and from its diversified business model. As one of the three largest insurance companies in Israel, Phoenix Insurance holds a market share of 16% of total premiums as of December 31, 2019. We assume that in the next two years, Phoenix Insurance will continue diversifying its controlled distribution channels, in addition to traditional distribution activity through insurance agents. This trend is expected to support the Company's efforts to continue strengthening its profitability and its business position in the industry.

We expect Phoenix Insurance's total premiums to decline, mainly in the health segment and on unit-linked life insurance policies. On the other hand, we expect growth in the group's pension fund and provident fund deposits. The expected decline in health insurance premiums will result mainly from a decrease in travel insurance activity as a result of the coronavirus pandemic effects, and from the termination of the Meuhedet Health Fund's long term care insurance contract following Phoenix's win in the bid for Maccabi Health Fund's contract. In the life insurance and long term savings segment, we expect pension and provident funds deposits to continue growing at the expense of unit linked life insurance policies premiums, as a result of the regulatory change to unit-linked life policies structure, which made them, in our view, a less attractive product.

The Company will continue to benefit from its sound underwriting profitability in its PC lines in the next two years. Our view is supported by Phoenix Insurance's pricing strategy, which is positively affected by its technological capabilities, advanced use of its databases, and their use in underwriting procedures. Our view is also supported by the Company's consistent focus on growth in more profitable lines, such as motor and property. These are the main contributors for the Company's good underwriting profitability, as measured by a 91% average net combined ratio over the past five years.

The Phoenix Holdings' liquidity will remain sufficient, as well as its ability to serve its debt from its own resources. Our assessment is supported by Phoenix Holdings' actions to increase its business diversification. We believe cash flow streams from non-regulated entities, in particular subsidiaries Phoenix Agencies and Excellence, will be sufficient to cover Phoenix Holdings' ongoing cash requirements. We believe Phoenix Holdings will focus on accelerated growth in these activities to further increase non-regulatory cash flows and decrease its dependence on dividend streams from Phoenix Insurance.

Phoenix's capitalization, both on group and standalone basis, reflects stability compared with its on balance sheet risks. The group's capital assessment, according to S&P global ratings risk based capital model, reflects its strong total profitability in recent years and our expectation that it will maintain stable average profitability in 2020-2022.

We acknowledge a high degree of uncertainty about the evolution of the coronavirus pandemic. The current consensus among health experts is that COVID-19 will remain a threat until a vaccine or effective treatment becomes widely available, which could be around mid-2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research on S&P Maalot website and on S&P Global Ratings) website. As the situation evolves, we will update our assumptions and estimates accordingly.

Outlook

The stable outlook on Phoenix Insurance reflects our assessment that its current capital buffers is sufficient to contain the risk of volatility in its operating performance in the next 18-24 months, due to the expected slowdown in premium accumulation as a result of the weakening business environment, severe market volatility and the low interest rate environment. We believe The Phoenix's stable business position as a leading insurance group in Israel will support its ability to weather the challenging conditions in the next 18-24 months. Our assessment is supported by Phoenix Insurance's diversified business model and by its good operating performance, which supported its capital accumulation in recent years.

The stable outlook on Phoenix Holdings reflects our expectations that it will maintain an adequate level of liquid sources, at least at the current level of 1.2x of uses, which will allow it to serve its liquidity needs at least 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 capitalization. We may also downgrade Phoenix Insurance if its gross premium accumulation materially decreases, beyond our expectations 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 a 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.

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 capitalization 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 will provide us with more certainty regarding its prospective capital levels.

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

Key Assumptions

Key Assumptions

- A ~5.5% contraction in real GDP in Israel in 2020 due to the coronavirus pandemic, and recovery in 2021 with ~6.5% growth.
- A ~0.3% increase in CPI in 2021.
- An increase in the unemployment rate to about 9.5% in 2020 due to the coronavirus crisis, and a decrease to about 6% in 2021.

Phoenix Insurance Key Metrics

Financial Metric	2016	2017	2018	2019	2020F
Gross premiums (Mil. NIS)	8,922	9,826	10,136	11,382	>10,500
Net Income (Mil. NIS)	420	558	547	27	~300
Return on Equity	14.08%	15.11%	11.62%	0.6%	~5.7%
Net combined ratio	99.4%	91.2%	88.2%	84.9%	>88%

F - forecast

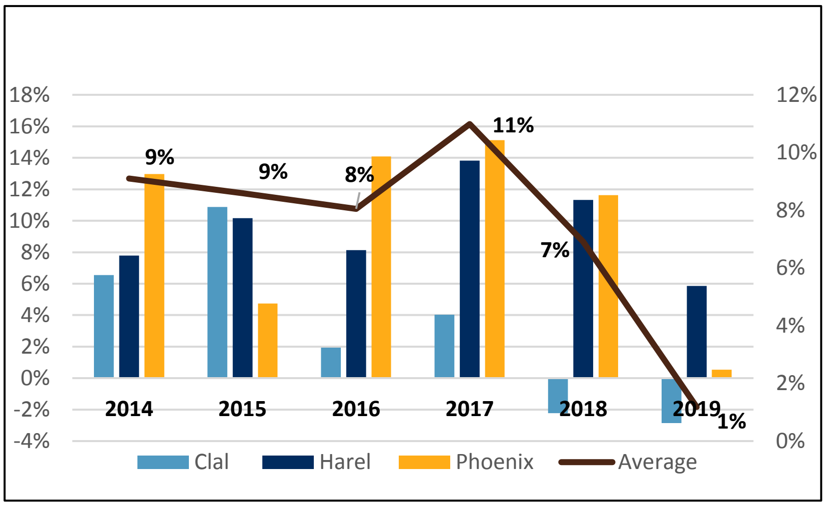
Business Risk

Phoenix Insurance is one of the three largest insurance groups in Israel, and has an established business position, with a market share of about 16% of total premiums in the Israeli insurance industry. Its total gross earned premiums in 2019 was NIS 11.3 billion. About 45% of its gross earned premiums were generated by its life insurance activity, while its health and PC Insurance operations generated 28% and 25%, respectively. Over the past five years Phoenix Insurance's average premium growth was materially faster than local peers, about 8% per year compared with about 2% in the industry as a whole.

However, the challenging economic environment due to the coronavirus pandemic is expected to decelerate premium growth for Phoenix Insurance and its local peers in 2020. In addition, the regulatory changes to unit-linked life insurance policies, which cancel the built-in insurance component in the policies, are expected to make them a less attractive product and lead to an increase in pension and provident funds deposit at their expense. We believe that, in accordance with industry trends in recent years, most of the Phoenix group's marketing efforts in the long-term savings segment will go towards pension funds, provident funds and financial savings, and towards achieving significant AUM (assets under management) growth which is crucial for the segment's profitability in the medium- to long term, especially as Phoenix's pension AUM are low compared with local peers, that is to say, fixed management fees will have to balance out volatility in variable management fee revenue and the expected decrease in unit-linked life insurance policies mentioned above.

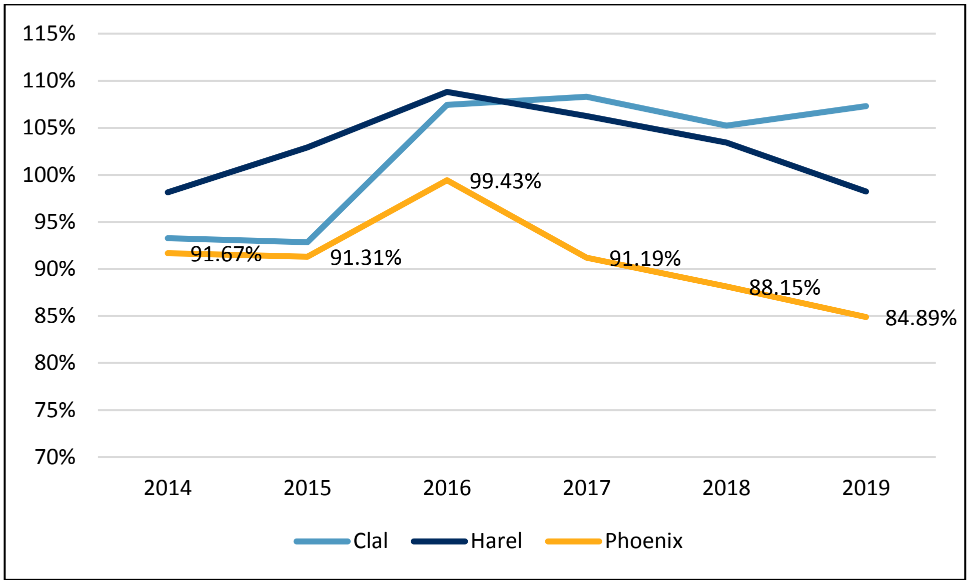
We believe Phoenix Insurance benefits from sound distribution capabilities in direct channels, especially in PC Insurance and particularly in vehicle insurance through the Phoenix Smart brand successfully developed in recent years. We also estimate that Phoenix Agencies Ltd., fully controlled by Phoenix Holdings, provides additional distribution benefits to Phoenix Insurance. The Company's ability to maintain direct distribution activity alongside investment in service and digital tools it provides to insurance agents working with Phoenix, may support its business activity and operating performance in changing market condition and increasing competition. In addition, we believe the group's cost saving actions through the pandemic, decreasing manpower by the end of 2020, will drive a decrease in expenses of about NIS 150 million per year, accelerate streamlining processes and increase use of technological and digital operating tools.

Chart 1: Return on Equity - Phoenix Insurance and Local Peers



Phoenix's good operating performance were reflected in high return on equity compared with the industry in the past five years, about 10% per year compared with an average of about 8% for local peers (see Chart 1). We believe Phoenix's high profitability compared with local peers is predominantly supported by high profitability in PC insurance, as measured by a net combined ratio (the ratio between total insurance claims and expenses to premiums - the lower this ratio, the higher underwriting profitability is) of 92% on average over the past five years, low compared with its local peers (see Chart 2). Phoenix's good underwriting profitability compared with the industry is positively affected by its technological capabilities, advanced use of its databases, and their use in underwriting procedures, together with its focus on car and property lines. In addition, the liability segment, which is characterized by high underwriting losses, constitutes a smaller share of Phoenix's PC insurance compared with local peers. Phoenix Insurance's high profitability is also positively affected by its investment income.

Chart 2: PC Insurance Net Combined Ratio



Financial Risk

The coronavirus pandemic outbreak led to sharp drops in global capital markets in March 2020, which led to significant investment losses for Phoenix Insurance and its local peers in the first quarter. On March 31, 2020, Phoenix Insurance's pre-tax investment losses totaled about NIS 945 million. However, markets recovered since, and as of June 30, 2020, the Company had a NIS 65 million investment income. Despite the recovery, our capital and earnings forecast considers that capital markets are expected to remain volatile at least in the next 12 months. We believe Phoenix Insurance is weathering the challenging business environment from a relatively strong position. As of December 31, 2019, the Company's capital buffer over capital requirements as measured by our capital model allows it to absorb the volatility we expect to see in capital markets.

In our base case scenario we assume a ~5%-8% decrease in Phoenix Insurance's premiums in 2020, rebounding to ~2%-3% growth per year in 2021-2022. Our assessment is based on the expected GDP contraction in 2020, higher unemployment and weakened economic environment, alongside regulatory changes in the structure of unit-linked life insurance policies. We expect the life insurance and long term savings segment to post the strongest decline, due to its sensitivity to labor market shifts and to the unemployment rate. Also, in addition to the effects of the coronavirus pandemic on travel insurance, health insurance premiums are likely to decrease in 2020 due to the termination of the Company's engagement with Meuhedet Health Fund on its long term care insurance plan. We also expect a decrease in average AUM in 2020, and consequently a decrease in management fee collection. Low or no collection of variable management fees due to capital market volatility is also expected to adversely affect total management fee revenue. We expect Phoenix Insurance's strong underwriting profitability in the PC lines to remain stable, with a net combined ratio of about 91% on average in 2020-2022. Also, excluding health LAT (liability adequacy test) reserves release, we expect health insurance underwriting profitability to hover around 100% in the outlook horizon.

Phoenix group's capital assessment, according to S&P Global Ratings' risk based capital model, reflects its strong total profitability in recent years, which is positively affected mainly by Phoenix Insurance's high profitability and is reflected both in Phoenix Insurance's capitalization and in the group's consolidated capitalization. At the same time, changes in the group's organizational structure, including placement of "AD-120" under Phoenix Insurance and placing Phoenix Agencies under Phoenix Holdings, strengthened Phoenix Insurance's capital. We therefore expect the current capitalization and adequate capital reserves to support the Company's current rating in the next two years.

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 decline in the solvency ratio mainly reflects the effects of the decline in the risk-free yield curve on solvency requirements in life and long-term care insurance. We believe the approval of the amendments to the Solvency 2 circular, mainly those related to spreading the capital requirements for long term life insurance reserves over 16 years, is expected to positively impact Phoenix Insurance's solvency ratio. According to the published circular, changes are expected to be reflected in the 2019 solvency report which is due to be published by the end of 2020. We expect the Company's solvency ratio after the suggested amendment to be materially above 100% considering transitional requirements. In addition, without a clear dividend policy, future capitalization level is uncertain.

Our view of Phoenix insurance investment portfolio assets quality is largely driven by its about 46% exposure to Israeli government bonds rated 'AA-'. We also consider the leverage based on Phoenix group's consolidated debt to remain below 45% in 2020-2022 (excluding the value in force component, which we do not count as part of on-balance capital). We also expect the average interest coverage ratio to be materially higher than 4x in the same period.

Other Key Credit Considerations

Phoenix Holdings

Our rating on Phoenix Holdings (ilAA-/Stable) reflects our view of its capability to serve its ongoing cash requirements. Our assessment is supported by Phoenix Holdings' actions to increase diversification of the group's activity, such as expanding Phoenix Agency's operations by acquiring insurance agencies. Our assessment takes into account dividend streams from non-regulated entities, in particular subsidiaries Phoenix Agencies and Excellence, and Phoenix Holdings' ongoing cash requirements, including management expenses and principal and interest payments on issued bonds. This assessment reflects a sources to uses ratio of at least 1.2x on an annual basis in the next 18-24 months. Our assessment is also supported by the fact that Phoenix Holdings has sufficient liquid asset compared with its cash requirements (at least 1.5x on an annual basis in the next 18-24 months).

Phoenix Insurance Liquidity

We assess Phoenix Insurance's liquidity as 'adequate'. The Company has large cash and liquid investment reserves compared with its on-balance obligation.

Environmental, Social, And Governance

Phoenix group's corporate governance is in line with local insurance industry norms. We believe the group's management has been implementing its strategic plans successfully in recent years. We also believe the Company has a clear view of the risk inherent in its business operation, as reflected in its risk management and capital management policies and the tools it's developing.

As an insurance company operating in the life and health insurance lines, its exposure to environmental and social factors may lead to an increase in its obligation, for instance as a result of higher life expectancy and an increase in chronic morbidity due to lifestyle changes. In PC insurance, we estimate the Company's exposure to climate damages as limited, due to the fact that it only operates in Israel. However, in recent years we have seen climate changes causing harsher weather conditions in Israel in the winter, mainly floods. The Company is fully covered against this kind of catastrophic risks through re-insurance.

Related Criteria And Research

- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Principles Of Credit Ratings, February 16, 2011
- Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Insurers Rating Methodology, July 1, 2019
- Group Rating Methodology, July 1, 2019
- S&P Global Ratings Definitions, August 7, 2020

Ratings List

Additional details

Phoenix Insurance Ltd.

Issuer rating(s)	
Long term	ilAA+/Stable

Issuer Credit Rating history	
Long term	
April 21, 2020	ilAA+/Stable
October 07, 2018	ilAA+/Positive
February 19, 2017	ilAA+/Stable
November 13, 2015	ilAA+/Negative
May 19 ,2014	ilAA+/Stable
November 18, 2012	ilAA+/Negative
July 17, 2012	ilAA+/Watch Neg
October 11, 2011	ilAA+/Stable
August 25, 2010	ilAA/Stable
August 17, 2009	ilAA-/Negative
May 19 ,2009	ilAA-/Watch Neg
February 08, 2009	ilAA/Watch Neg
May 24 ,2004	ilAA

The Phoenix Holdings Ltd.

Issuer rating(s)	
Long term	ilAA-/Stable

Issue rating(s)	
<u>Senior Unsecured Debt</u>	
Series 3,4,5	ilAA-

Issuer Credit Rating history	
Long term	
October 06, 2019	ilAA-/Stable
October 07, 2018	ilA+/Positive
February 19, 2017	ilA+/Stable
November 13, 2015	ilA+/Negative
May 19 ,2014	ilA+/Stable
November 18, 2012	ilA+/Negative
July 17, 2012	ilA+/Watch Neg
January 12, 2012	ilA+/Stable
August 25, 2010	ilA/Stable
May 19 ,2009	ilA/Negative
November 16, 2008	ilAA/Watch Neg
May 14 ,2007	ilAA/Stable

Additional details - continued

Phoenix Capital Raising (2009) Ltd.

Issue rating(s)

<u>Subordinate hybrid debt</u>	
Series D, E, F, G, H, I, J	ilAA-

Additional details

Time of the event	21/10/2020 14:26
Time when the event was learned of	21/10/2020 14:26
Rating requested by	Issuer

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