The Phoenix Insurance Company Ltd.

Monitoring Report | November 2021

This credit rating report is a translation of a report that was written in Hebrew for a debt issued in Israel. The binding version is the Hebrew.

Contacts:

Nil Harel
Senior - Analyst, Lead Rating Analyst
nilh@midroog.co.il

Itay Navarra, Vice President
Head of Financial Institutions
Itay.navarra@midroog.co.il

The Phoenix Insurance Company Ltd.

Insurer financial strength (IFS) rating	Aa1.il	Rating outlook: Stable
Hybrid Tier III capital	Aa2.il (hyb)	Rating outlook: Stable
Hybrid Tier II capital and Tier II capital instrument	Aa3.il (hyb)	Rating outlook: Stable

Midroog affirms the Insurer Financial Strength (IFS) rating of The Phoenix Insurance Company Ltd. (hereinafter: "The Phoenix " or "the Company") and affirms the ratings of Aa2.il(hyb) for subordinated notes (Hybrid Tier III capital) and of Aa3.il(hyb) for subordinated notes (Hybrid Tier II capital and Tier II capital instruments) issued by the subsidiary The Phoenix Capital Issuance (2009) Ltd. Rating outlook – Stable.

These subordinate debt ratings reflect the legal-contractual subordination of this debt relative to the IFS rating, the seniority ranking among subordinated debt instruments, as well as the effect of their loss-absorption provisions. Considering the Company's IFS, its current and expected economic solvency as we estimate it, while maintaining sufficient margin from the effective regulatory economic solvency requirement for the instrument, we believe that the uncertainty associated with the likelihood of reaching "suspensive circumstances"[1] is low, and therefore was not reflected by a further lowering of one notch for Tier II capital instruments.

Outstanding debentures rated by Midroog:

Debenture series	Securities ID	Rating	Rating outlook	Type of regulatory approved capital	Final maturity
D	1133529	Aa2.il(hyb)	Stable	Tier II capital [1]	January 31, 2026
E	1135417	Aa3.il(hyb)	Stable	Tier II capital [2]	October 31, 2029
F	1136696	Aa3.il(hyb)	Stable	Tier II capital [2]	January 31, 2026
H	1139815	Aa3.il(hyb)	Stable	Tier II capital [2]	July 31, 2028
I	1155522	Aa3.il(hyb)	Stable	Tier II capital	August 31, 2029
J	1155530	Aa3.il(hyb)	Stable	Tier II capital	January 31, 2028
K	1159359	Aa3.il(hyb)	Stable	Tier II capital	April 30, 2032

[1] Hybrid Tier III; [2] Hybrid Tier II

Key Rating Considerations

[1] Capital requirement for "suspensive circumstances" are defined as 80% of the solvency ratio required over the phase-out period after adjustment for the equity scenario pursuant to the Solvency circular ("**Required solvency ratio**").

Midroog

The Company rating reflects a strong business profile, with significant size, relatively good diversification of business lines and substantial distribution capacity that support revenue generation across the cycle. The rating also reflects the risk profile, that is appropriate for the rating, and is supported by relatively low product risk and relatively low exposure to large customers. The Company's financial profile includes asset quality that is appropriate for the rating, but is negatively impacted by higher exposure to "risk assets" compared to the absorption cushion. However, Company profitability is outstandingly positive compared to the peer group[2] and is supported by excess underwriting profitability, which are also reflected by implementation of the strategic plan and by streamlining measures applied in 2020. This profitability is supportive of creating the capital cushion, which absorbs losses in a manner appropriate for the rating, but it is expected to be created at a more moderate pace than in recent years, given our assessment of further dividend distribution within the forecast period, if possible. The Company has a liquidity profile supported by long duration of liabilities, but the financial flexibility is not favorable for the rating, due to the relatively high financial leverage (debt to CAP, excluding VIF), but good compared to the peer group.

According to Midroog's capital model, the Company has appropriate risk adjusted capital surplus for the current rating, and the Company is in compliance with the second stress scenario out of five by severity, based on data as of June 30, 2021. The main risks to which the Company is exposed, as perceived in the model, derive from non-life insurance risks and in particular life expectancy risks in policies with guaranteed annuity and from market risks in the nostro portfolio (guaranteed-return life insurance, P&C and equity), with diversification of operations and correlations between operations reducing the required capital. The Company's solvency ratio, in conformity with Solvency II provisions (excluding the phase-out provisions) was 116% as of December 31, 2020 and 192% of required capital for the phase-out period as of said date, including a NIS 200 million dividend distribution in the first quarter of 2021. We should note that through June 2021 there were other equity transactions, including a further NIS 200 million dividend distribution, and a distribution of dividend in kind by The Phoenix Excellence Pension and Provident Funds Ltd. (both in June 2021). The Company believes, after the aforementioned equity transactions, that the solvency ratios would be at 110% (excluding the phase-out provisions and including the effect of equity transactions) and 186% during the phase-out period. Moreover, on August 5, 2021, a Tier I capital instrument was issued, valued at NIS 200 million; this issuance should increase the solvency ratio, according to the Company, by 3% (taking into account the phase-out period). These ratios provide an appropriate margin from the regulatory requirement, and are good by comparison to the peer group of companies with similar operations. We should note that spin-off of the management company should also support the solvency ratio over time, due to

[2] Harel Insurance Company, Migdal Insurance Company, Clal Insurance Company and Menorah Mivtachim Insurance.

the decrease in intangible assets (DAC and goodwill), which would support the reduced capital requirements.

In our baseline scenario for 2021-2022 for the entire insurance sector, we expect the challenging business environment to continue casting shadows over the sector, and in particular over revenue growth potential. We further believe that the sector would continue to be impacted by the low interest rate environment and by inflationary pressures, along with continued volatility in the capital market and exposure to regulatory load, which promotes competition and creates additional costs in some segments, with continued competitive pressures for some of the products. On the other hand, these effects would be offset to some extent by high growth rates over the next two years; According to the Bank of Israel forecast, GDP growth is expected to reach 7.0% and 5.5% in 2021 and 2022, respectively.

Under this scenario, we expect the Company to maintain its business positioning, while increasing earned premiums at an annual rate of 1.5%-3.5% in 2021-2022; the growth engines would be life and non-life insurance, in accordance with the Company's strategic plan focused on growth and profitable products in terms of return on equity. Under this scenario, we expect the Company to maintain good profitability for the sector; this assumption is based on our assessment whereby the Company would continue to operate in conformity with the strategic plan, with obvious results, and should also be supported by improved operating efficiency and re-organization of the Company in 2020. Moreover, in view of the COVID crisis and the global climate crisis, which negatively impact global re-insurers, there may be adjustments made to agreements with those re-insurers, which may result in stricter policy in the market and in higher tariffs. In view of the foregoing, Company margins are expected to be appropriate for the rating and favorable compared to the peer group, with ROC and ROA ratios expected to range between 7.0%-11.0% and between 0.6%-1.0%, respectively, within the forecast range. This forecast still includes an element of uncertainty, due to materialization of a risk event, such as the COVID outbreak in Israel in 2020, the long-term efficacy of vaccinations against this virus, its impact on economic activity in the local market and increased volatility in capital markets.

Rating outlook

The Stable rating outlook reflects our assessment, whereby the Company's financial profile and key data would be maintained within the range of Midroog's baseline scenario. The forecast range still includes an element of uncertainty, due to materialization of a risk event, such as the COVID outbreak in Israel in 2020, the long-term efficacy of vaccinations against this virus, its impact on economic activity in the local market and increased volatility in capital markets.

Factors which may result in a rating upgrade:

- Significant improvement in retained earnings according to Midroog's capital model
- Significant improvement in business scope and diversification
- Significant improvement and stability over time in underwriting earnings cushion

Factors which may result in a rating downgrade:

- Continued erosion of retained earnings according to Midroog's capital model
- Continued deterioration in underwriting results in core segments and/or significant, prolonged erosion in overall earnings
- Dividend distributions which may impact the Company's financial robustness

The Phoenix Insurance Company Ltd. - Key Financial Indicators (NIS millions)

NIS in millions	June 30, 2021	June 30, 2020	December 31, 2020	December 31, 2019	December 31, 2018	December 31, 2017
Total assets on balance sheet	124,498	104,627	115,498	107,177	88,839	81,497
Total equity attributable to equity holders of the Company	5,942	5,139	6,192	5,128	5,336	4,142
Total comprehensive income (loss) attributable to equity holders of the Company	791	18	1,060	412	376	711
Total Earned premiums, gross	5,361	5,248	10,383	11,325	10,104	9,691
Of which: life insurance and long-term savings	2,596	2,393	4,766	5,209	5,082	5,059
Of which: healthcare insurance	1,332	1,449	2,782	3,257	2,231	2,042
Of which: non-life insurance	1,434	1,405	2,835	2,859	2,790	2,590
Total premiums earned in residual	4,714	4,570	9,054	9,923	8,926	8,801
Total investment gain(loss) (including Other Comprehensive Income)	8,476	(4,349)	5,743	9,710	812	5,041

Solvency ratio [1]	N/R	N/R	192%	165%	195%	187%
Solvency ratio excluding implementation of transition provisions for phase-out period [2]	N/R	N/R	116%	105%	134%	105%

Midroog's adjusted ratios

Intangible assets and long-term savings DAC as percentage of shareholder equity	26%	41%	35%	41%	43%	54%
Return on capital (ROC) [3]	15.2%	0.4%	10.8%	4.6%	4.9%	12.1%
Return on assets (ROA) [4]	1.3%	0.0%	1.0%	0.4%	0.4%	0.9%
Adjusted debt to adjusted debt and shareholder equity [5]	43%	46%	41%	44%	38%	38%
Earnings Before Interest and Tax (EBIT) and	x16.3	x1.0	13.9%	5.9%	x6.3	x12.3

revenues from investments under Other Comprehensive Income to interest expenses							

[1] Includes NIS 200 million dividend distribution in the first quarter of 2021, excludes impact of other material capital transactions in the period from the calculation date to the issue date of the solvency ratio report; [2] Does not take into account provisions for the phase-out period and adjustment of equity scenario; [3] Comprehensive income annualized to average financial liabilities (excluding derivatives) and shareholder equity attributable to equity holders during the period; [4] Comprehensive income annualized to average total assets for the period; [5] Adjusted debt including financial liabilities (excluding derivatives) and liabilities in respect of employee benefits, net. Moreover, as from January 1, 2019, adjusted debt includes leases.

Detailed rating considerations

Good business profile, supported by significant size and diversified business lines, supporting its revenue generation capacity

The Company has been one of the top 3 insurers in Israel for a long time, as reflected by a 16% overall market share in terms of gross premiums and by total assets under management[3] amounting to NIS 116 billion, based on the Company's financial statements as of June 30, 2021.

The business profile is also supported by relatively well diversified lines of business, as reflected in three significant segments over the past 12 months – life Insurance[4] (54% of total gross premiums and management fees, on average), non-life insurance (24%) and healthcare insurance (22%). This diversification, along with a strong brand and a large, diversified client base, are supportive of the business profile and revenue generation across the cycle, while addressing changes to the business environment, regulatory changes and macro-economic effects. On June 30, 2021, the Company conducted a spin-off of The Phoenix Excellence Pension and Provident Funds Ltd. after obtaining all regulatory approvals, by distribution of a dividend in kind to the parent company. We believe that this should not materially impact the Company's business positioning, including market shares and line of business diversification, but should be beneficial for the solvency ratio over time, as set forth below.

The Company's major marketing and distribution channels include insurance agents and agencies; concurrently, in recent years, the Company has diversified its distribution channels, adapting them to the changing business environment and to the range of public tastes. Thus, the Company launched an online sales platform in the auto and travel segment under the Smart brand, and expanded the range of products on this platform to direct sales of home, mortgage and pet insurance. We expect that continued expansion of this platform would further support the expense structure, offering a comprehensive product range to clients with client preservation and addressing in future the innovation challenges facing the sector; We

3 In conjunction with spin-off of HaPhoenix Excellence Pension and Provident Funds Ltd. From the Company, pension and provident fund assets are not included in assets under management as of June 30, 2021.

4 Excludes premiums with respect to investment contract.

believe that insurers that would not adopt technological innovation and would not adapt their business model over time, may see their business positioning significantly eroded.

In our baseline scenario for 2021-2022 for the entire insurance sector, we expect the challenging business environment to continue casting shadows over the sector, and in particular over revenue growth potential. We further believe that the sector would continue to be impacted by the low interest rate environment and by inflationary pressures, along with continued volatility in the capital market and exposure to regulatory load, which promotes competition and creates additional costs in some segments, with continued competitive pressures for some of the products. On the other hand, these effects would be offset to some extent by high growth rates over the next two years; According to the Bank of Israel forecast, GDP growth is expected to reach 7.0% and 5.5% in 2021 and 2022, respectively.

Under this scenario, we expect the Company to maintain its business positioning, while increasing earned premiums at an annual rate of 1.5%-3.5% in 2021-2022; the growth engines would be life and non-life insurance, in accordance with the Company's strategic plan focused on growth and profitable products in terms of return on equity.

The life and long-term savings segment, which is impacted by the macro-economic environment and by the labor market, should be supported by high growth rates in the forecast range, as noted, and by further recovery of the labor market, which should contribute to growth in premiums and management fees in the forecast range, in addition to positive development in receipts with respect to investment contracts in savings insurance policies, expected to support higher management fees to be charged by the Company. On the other hand, these effects would be moderated by further increased competition for long term savings products (primarily in risk products), regulatory limitations imposed in recent years, including on the retirement insurance segment, which are expected to continue casting a shadow over potential growth in this segment.

In the healthcare segment, we assume more moderate premiums due to continued competition in this sector and high regulatory involvement, which promotes creation of a uniform insurance policy and avoiding duplicate insurance, expected to cast a shadow over potential growth in this segment. Moreover, total premiums would be negatively impacted, in our opinion, by termination of the contract with DavidShield Global for relocation insurance and PassportCard for overseas travel, but we assume that growing use of the Smart platform, to be supported by development of a custom app for overseas travel ("Airdoctor"), along with nation-wide penetration rates, should allow the Company to further maintain its high market shares in this segment.

In the non-life insurance segment, we expect growth in total premiums, given the Company's business focus, with gross premiums growing at 3.5%-4.0% per year over the forecast range. These growth rates should be supported by our assumption, whereby the tariff erosion in the auto and property segment in recent years should be exhausted, the higher Consumer Price Index and impacts of the supply chain in the automotive industry, which would have some effect on higher premiums (and claims) over the forecast range, and the expected recovery in economic activity and in the labor market, which should have a positive effect on growth rates in the property and liability segments. Conversely, the sector would continue to be impacted by sector competition in auto and personal insurance segments, with limited price flexibility in some of the products in these segments.

We should note that this forecast still includes an element of uncertainty, due to materialization of a risk event, such as the COVID outbreak in Israel in 2020, the long-term efficacy of vaccinations against this virus, its impact on economic activity in the local market and increased volatility in capital markets.

The risk profile is appropriate for the rating and is supported by relatively low product risk

The Company is characterized by relatively low product risk, which supports its underwriting capacity and reduces insurance risk, due to the higher level of certainty. We believe that product risk in non-life insurance and short-term healthcare insurance is appropriate for the rating, with 62% of total gross premiums over the 12 months through June 30, 2021 being with respect to insurance "short tail"[5] contracts. We believe that these carry lower insurance risk compared to "long tail" contracts[6], which are associated with higher uncertainty and lower business flexibility to changes in the business environment.

The Company hedges insurance risk in some segments of non-life insurance through highly-rated re-insurers, with relatively low exposure in residual given a catastrophic event, at 0.5% of adjusted recognized capital[7] as of December 31, 2020.

The rate of "low risk" reserves, as per our definition, in long-term life and healthcare insurance is appropriate for the rating, at 44% as of December 31, 2020 and similar over time. This ratio reflects relatively low exposure to return-guaranteed and/or life expectancy provisions, excluding HETZ debentures, which expose re-insurers to significant external change, including change to the interest curve and capital market volatility, in addition to demographic risk. Over the short and medium term, we expect no material change in the reserve mix. We note as positive the Company's actions with regard to asset and liability management (ALM), concurrently with regulatory changes[8] to calculation of LAT reserves, which should moderate the sensitivity of insurance reserves with respect to long portfolios in life and healthcare insurance policies to fluctuations in the risk-free interest curve. Thus, according to the scenario of Company sensitivity to a 1% decrease in the interest curve, earnings should decrease by NIS 645 million (according to data as of December 31, 2020), rather than NIS 1,146 million prior to these changes, at end of 2019. Midroog expects the Company would continue to manage and reduce the interest exposure, which is a risk factor

[5] Auto and property, other property and short-term healthcare
[6] Mandatory auto and liability
[7] Includes accounting shareholder equity and subordinated notes
[8] Revised provisions of uniform circular – allocation of assets other than at fair value upon testing calculation of appropriateness of reserve (LAT)

for stability of earnings and the capital cushion. Moreover, the risk profile is affected by some exposure to major collectives and policy holders, which exposure may enhance the insurance risk, credit risk and sector risk across the cycle and limit the risk-adjusted pricing, given the clients' economies of scale. This exposure accounted for 18% of total gross earned premiums in 2020, appropriate for the rating, and is impacted, *inter alia*, by the Company being awarded a contract to provide collective nursing insurance services to members of Maccabi Health Services[9]. However, we believe that this collective has a relatively wide diversification of insured persons, which moderates the aforementioned risk.

We believe that the Company's risk management policy and controls are appropriate for the risk profile and are also supported by regulatory requirements. Full implementation of the Solvency II Directive should further improve the Company's risk management processes, as well as the industry's, and should support improvement of the risk profile over time and measurement of economic capital, despite volatility of economic capital under this regime. Midroog also expects that the Company would continue to place more emphasis on management of operating risk in the coming years, which are a key emerging risk concentration, primarily in information security, business continuity and cyber[10].

On November 3, 2019, control over The Phoenix Holdings Ltd. (hereinafter: "the **Parent Company**") was transferred from Delek Group to entities controlled by Centerbridge Partners LP and Gallatin Point Capital LLC – foreign investment funds, and consequently, some Board members were replaced, and a new Chairman was appointed. We believe that with the new ownership structure comes a certain effect on the appetite for dividends at the Company, as reflected also by the strategic plan[11] of The Phoenix Holdings, which is primarily focused on return-focused growth in profitable operating segments, improvements in technology and Group-wide efficiency, maximizing the value of portfolio companies and optimal capital management. Thus, as for capital management, the holding structure was re-organized in recent years, and a dividend distribution policy was formulated as from October 2020 for The Phoenix Insurance and The Phoenix Holdings. However, we believe that the risk profile is affected by the absence of significant pressure to distribute dividends in the short to medium term for debt service at the Parent Company, which is rated Aa3.il / Stable outlook. We

[9] As from January 1, 2019, the Company provides collective nursing insurance services to members of Maccabi Health Services, including operating services for nursing insured persons under Maccabi Magen – Co-operative for Mutual Insurance Against Illness Ltd. The term of this contract is from January 1, 2019 through December 31, 2023, and either party may extend this term by up to 3 years in total. The number of insured members is 1.35 million, and total premiums for the period is estimated at NIS 4.7 billion. The Company bears 20% of total insurance payout and the insured reserve would bear 80% of total insurance payout. The Company has contracted with multiple re-insurers to hedge its risk.

[10] See related report by Midroog on this topic: Reputation risk following cyber attacks which may cause companies to incur a business cost – Special Report, October 2020

[11] On December 1, 2020, the Board of Directors of HaPhoenix Holdings resolved to adopt and publish a multi-annual strategic plan for the Company and for Group subsidiaries, based on collaboration with an international advisory group specialized in strategy and re-organization.

believe that The Phoenix Holdings can rely, over the short to medium term, on the current liquidity cushion, its financial flexibility, dividends from other sources (insurance agencies, Excellence Investments, The Phoenix Excellence Pension and Provident Funds and Gamma) and interest received from issuance of another Tier I capital issuance conducted by the Company. However, following issuance of another Tier I capital instrument, amounting to NIS 1.02 billion, to the Parent Company *in lieu* of Tier I capital notes previously issued (amounting on aggregate to NIS 860 million as of June 30, 2021), these should continue to support liquidity of The Phoenix Holdings, as these instruments are more negotiable. We also note that the Company is still the main focal point of the consolidated operations of the Parent Company and has business connections to other Group companies.

Asset quality is appropriate for the rating, but risk assets at the Company increased by comparison to the absorption cushion

We believe that the Company's nostro investment profile indicates a risk appetite that is reasonable for the rating, as reflected by the ratio of adjusted "assets at risk"[12] to adjusted approved capital at 61% as of June 30, 2021. The deterioration in this ratio over the past years (December 2017: 52%) is primarily due to growing exposure of the Company to "risk assets", primarily given the low interest rate environment, which poses a challenge to preservation of potential returns and valuation volatility, and along with growing competition, which provides an incentive for insurers to improve returns in the member and nostro portfolios, despite the increase in the capital cushion, serving as a potential absorption cushion for such risk.

The investment mix in the nostro portfolio as of June 2021 primarily includes Government debentures (37%), real estate investments (9%), loans secured by collateral (9%) and equity funds (8%). The remaining investments are diversified and are not as material. We expect no material change in the investment mix, with continued focus on non-negotiable assets and investments overseas.

The ratio of intangible assets and deferred acquisition costs in life insurance (which have a "softer" value), to shareholder equity was26% as of June 30, 2021. This ratio is favorable for the rating, and a significant improvement over previous years (December 2017: 54%), primarily due to the capital cushion generated by good profitability, and due to re-structuring of the Company, including spin-off of The Phoenix Agencies in 2019 and spin-off of The Phoenix Excellence Pension and Provident Funds Ltd. On June 30, 2021, with relatively high goodwill on Company accounts and deferred acquisition costs in life insurance, despite a NIS 400 million cash dividend distribution and distribution of dividend in kind by the management Company amounting to NIS 656 million in 2021, which impacted the capital cushion.

[12] High risk assets generally include all financial investment assets other than cash, Government debentures and investment-grade corporate debentures, with the weighting of the latter based on partial reliance reflecting risk of potential impairment over the credit cycle due to credit, market or liquidity risk.

Company profitability is appropriate for the rating, and should remain favorable for the sector, even given implementation of the strategic plan.

The Company profitability is outstanding compared to the peer group, positively affected by excess underwriting profitability, as reflected in the combined ratio in residual for non-life insurance of 88% on average in 2017-2020, compared to 95% on average for the sector in said period.

The Company, like other major companies in the sector, showed volatility in profitability in recent years, due to high exposure to external factors, such as the capital markets, interest curve, revised discounts and actuarial models and regulation. However, the Company's profit potential improved recently due, in our opinion, also to implementation of a multi-annual strategic plan based on return-focused growth, technology innovation for improved efficiency, maximizing the portfolio and strict capital management. These were reflected, *inter alia*, in streamlining measures applied in 2020, including a 12% reduction in headcount in 2020 (compared to the previous year) through a voluntary retirement program for employees, re-organization which included improvements to the Sales Division formation and increased investment in IT and digital, as well as focusing on profitable products in terms of return on equity. We note that the Company estimated the total annual savings due to the aforementioned streamlining measures to be NIS 150 million.

Due to the foregoing, the Company's ROC and ROA ratios in 2017-2020 were, on average, at 8.2% and 0.7%, respectively – which are favorable compared to the peer group.

Under our baseline scenario for 2021-2022, we expect the Company to maintain good profitability for the sector; this assumption is based on our assessment whereby the Company would continue to operate in conformity with the strategic plan, with already evident results, and should also be supported by improved operating efficiency and re-organization of the Company in 2020.

In the life insurance and long-term savings sector, we expect continued profit volatility due to exposure to external factors (demographic and regulatory changes) and volatile returns in the capital market. Moreover, we expect no material effect due to re-structuring by the Company with respect to spin-off of The Phoenix Excellence Pension and Provident Funds Ltd. to the Parent Company.

The healthcare segment should continue to be impacted by regulatory changes and business focus of most companies in the sector, which should continue to increase price competition and bear down on sector profitability, and the existing nursing care portfolio (previously sold) should continue to be impacted by the interest rate curve. Furthermore, we do not expect significant profitability in this segment in 2021, due to external effects on segment results in the first half of 2021, and only gradual resumption of the Company's overseas travel insurance activity, which was also affected by discontinuation of activity with PassportCard and DavidShield on overseas travel and relocation insurance.

In the non-life insurance segment, we expect competition would remain high from both legacy companies and direct insurers, along with further development and increasing use of digital tools, which increase competition in this segment. These factors, as well as the economy re-opening during this year, and with return to nearly business as usual in most sectors (compared to 2020), should increase the incidence of claims in auto and individual insurance, along with higher claim severity in recent years in auto and individual insurance. We believe that profitability in this segment may be preserved primarily by improved operating efficiency, with better control over operating expenses, including through increased use of technology tools. We note, in this regard, that the Company is well-positioned against the competition in the auto segment, with a product offering, including the Smart brand, which should continue to support better control over expenses as the share of such insurance policies out of total originations grows.

Moreover, in view of the COVID crisis and the global climate crisis, which negatively impact global re-insurers, there may be adjustments made to agreements with those re-insurers, which may result in stricter policy in the market and in higher tariffs.

In view of the foregoing, Company margins are expected to be appropriate for the rating and high compared to the peer group, with ROC and ROA ratios expected to range between 7.0%-11.0% and between 0.6%-1.0%, respectively, within the forecast range.

This forecast still includes an element of uncertainty, due to materialization of a risk event, such as the COVID outbreak in Israel in 2020, the long-term efficacy of vaccinations against this virus, its impact on economic activity in the local market and increased volatility in capital markets.

The capital cushion absorbs loss in a manner that is appropriate for the risk profile; potential for improvement of the capital cushion should remain good, but it is expected to be created at a more moderate pace, given our assessment of further dividend distribution within the forecast range

According to Midroog's capital model, the Company has appropriate risk adjusted capital surplus for the current rating, and the Company is in compliance with the second stress scenario out of five by severity, based on data as of June 30, 2021. The main risks to which the Company is exposed, as perceived in the model, derive from non-life insurance risks and in particular life expectancy risks in policies with guaranteed annuity and from market risks in the nostro portfolio (guaranteed-return life insurance, P&C and equity), with diversification of operations and correlations between operations reducing the required capital. Against these risks, the Company has an economic capital cushion with adjusted shareholder equity[13] as of June 20, 2021 amounting to NIS 8.3 billion and adjusted EPIFP[14][15] amounting to NIS 3.5 billion.

13 Includes shareholder equity attributable to equity holders, additional Tier I capital, 50% of Tier II capital and revaluation of non-negotiable financial assets (excluding HETZ debentures), with a reliance rate of 85%. The following are deducted from this amount: deferred acquisition costs in life insurance and long-term savings and other intangible assets, net from deferred taxes.

As a complementary test, not based on risk weighting for insurer leverage, we consider the ratio of equity to adjusted total assets (excluding assets for return-dependent contracts) excluding 10% of assets at risk, which reflect the expected erosion in asset value under more stringent scenarios. As of June 30, 2021, this ratio was 14.5%, favorable for the rating in recent years, due to continued creation of the capital cushion out of current earnings, despite dividend distribution in the first half of 2021. In our baseline scenario, we believe that balance-sheet leverage should remain somewhat stable, even given continued increase in business, with the potential for creation of the capital cushion remaining good, but it should be created at a more moderate pace compared to recent years, due to the dividend distribution policy as from October 2020 and consequently, our assessment of further dividend distribution in the forecast range, subject to Board of Directors targets as set forth below.

The Company's solvency ratio, in conformity with Solvency II provisions (excluding the phase-out provisions) was 116% as of December 31, 2020 and 192% of required capital for the phase-out period as of said date, including a NIS 200 million dividend distribution in the first quarter of 2021. We should note that through June 2021 there were other equity transactions, including a further NIS 200 million dividend distribution, and a distribution of dividend in kind by The Phoenix Excellence Pension and Provident Funds Ltd. (both in June 2021). The Company believes, after the aforementioned equity transactions, that the solvency ratios would be at 110% (excluding the phase-out provisions and including the effect of equity transactions) and 186% during the phase-out period. Moreover, on August 5, 2021, a Tier I capital instrument was issued, valued at NIS 200 million; this issuance should increase the solvency ratio, according to the Company, by 3% (taking into account the phase-out period). These ratios provide an appropriate margin from the regulatory requirement, and are good by comparison to the peer group of companies with similar operations. We should note that spin-off of the management company should also support the solvency ratio over time, due to the decrease in intangible assets (DAC and goodwill), which would support the reduced capital requirements. Midroog expects the Company would continue to improve these ratios and would continue to maintain an appropriate margin over time from the regulatory threshold, despite expected volatility in this ratio.

On October 27, 2020, the Company Board of Directors set minimum targets and target range for the economic solvency ratio based on Solvency II ("**Capital Target**"). The minimum economic solvency ratio including the phase-out provisions, was set at 135%, and the economic solvency ratio excluding the phase-out provisions, was set at 105%, to reach 135% after the phase-out period (in 2032), in conformity with the Company's capital plan. The Board of Directors of The Phoenix Insurance also set a target range for the economic solvency ratio, between 150%-170%, which the Company strives to maintain during and after the

14 Expected Profit in Future Premiums.

15 With a reliance rate of 60%.

phase-out period, considering the deduction during the phase-out period and the gradual decrease thereof. The Company also set the annual dividend distribution policy, at 30%-50% of total distributable earnings pursuant to the consolidated annual financial statements of The Phoenix Insurance and subject to the aforementioned capital targets and restrictions[16] on dividend distribution applicable to insurers. It was further stipulated that the Board of Directors of The Phoenix Insurance may review the dividend distribution policy from time to time, and may resolve at any time, with due note of business considerations and statutory and regulatory provisions applicable to the Company, to make changes to the dividend distribution policy, including the percentage of any dividend distribution.

Appropriate liquidity profile supported by long duration of liabilities; financial flexibility is not favorable for the rating, and is negatively impacted by relatively high financial leverage, but is supported by an appropriate margin from regulatory capital adequacy

The Company's liquidity profile is appropriate for the rating, as reflected by a current ratio of x2.5 for weighted liquid assets to short-term expected insurance and financial liabilities. Given the Company's diverse business mix, some of the liabilities should be repaid over the long term (life insurance and long-term savings) and some – over the short term (non-life insurance); we expect no significant change in the leverage ratio over the forecast period, and we believe the Company would remain close to the regulatory recognition limit for Tier II capital instruments (40% of SCR). We note, however, that in August 2021, the Company issued another Tier I capital instrument[17] (hereinafter: "the **Capital Instrument**"), amounting to NIS 200 million, which is recognized as regulatory capital in conjunction with capital requirements under the economic solvency regime, in order to improve the solvency ratio. Moreover, in this issuance and after obtaining approvals from the relevant organs, including approval from the Capital Market, Insurance and Savings Authority, the Company (through The Phoenix Capital Issuance) issued to The Phoenix Holdings NIS 1.02 billion in the Capital Instrument, *in lieu* of Tier I capital notes previously issued there to (NIS 862 million on aggregate, as of June 30, 2021); this replacement should support the decrease in annual interest expenses for the Company, and should improve liquidity of The Phoenix Holdings.

The Company's financial flexibility shows a relatively high balance sheet leverage ratio (debt[18] to CAP, excluding VIF) at 43% as of June 30, 2021, which is not favorable for the rating but is

[16] According to the letter issued by the Supervisor in October 2017, insurers may only distribute dividends if, after such distribution, its solvency ratio (pursuant to the Solvency Circular) would be at least 100%, calculated excluding transitional provisions and subject to the target solvency ratio specified by the Board of Directors. The letter also stipulates reporting provisions to the Supervisor.

[17] The Company issued, through its subsidiary HaPhoenix Capital Issuance, a capital instrument linked to the Consumer Price Index and bearing annual interest at 2.29%. This instrument is currently trading on continuous institutional trading.

[18] Includes subordinated notes, loan from a related party and capital notes issued to the Parent Company, amounting to NIS 862 million, and excludes additional Tier I capital issuance and replacement of obligatory

good compared to the peer group. We believe that this ratio is not expected to materially change over the short to medium term. Moreover, the Company is compliant with an appropriate margin from the Solvency II ratio (excluding phase-out provisions), which is supportive of the Company's financial and business flexibility.

Other rating considerations

Relatively long duration of liabilities is supportive of the liquidity profile

Company liabilities have a relatively long duration, which strongly supports its liquidity profile and rating. In our opinion, insurers characterized by a long duration of liabilities and no put options for policyholders to call for money, are less exposed to liquidity risk and are better capable of responding to them over a longer period of time, which supports their survivability and rating. Moreover, the volatility that may result from marking to market of assets (MTM) sometimes does not reflect the economic value of insurers with a long duration of liabilities, given their ability to hold the relevant assets to maturity, therefore the economic capital of these insurers may be less exposed to short-term market volatility in our opinion.

Features of subordinated instruments

In conformity with Midroog's methodology, the anchor for rating of subordinated debt (hybrid Tier III, hybrid Tier II and Tier II capital instruments) is the insurer's financial strength (IFS) rating, which we then adjust for the credit risk of the subordinated debt instrument, based on its contractual terms. We reduce the rating by one notch and two notches from the insurer's IFS rating for rating of hybrid Tier III capital and hybrid Tier II capital / Tier II capital, respectively. This notch reduction reflects the legal-contractual subordination of such debt compared to IFS, the seniority ranking among subordinated debt instruments and the impact of the loss absorption provisions included therein (by contractual trigger or at the discretion of the Supervisor of Insurance).

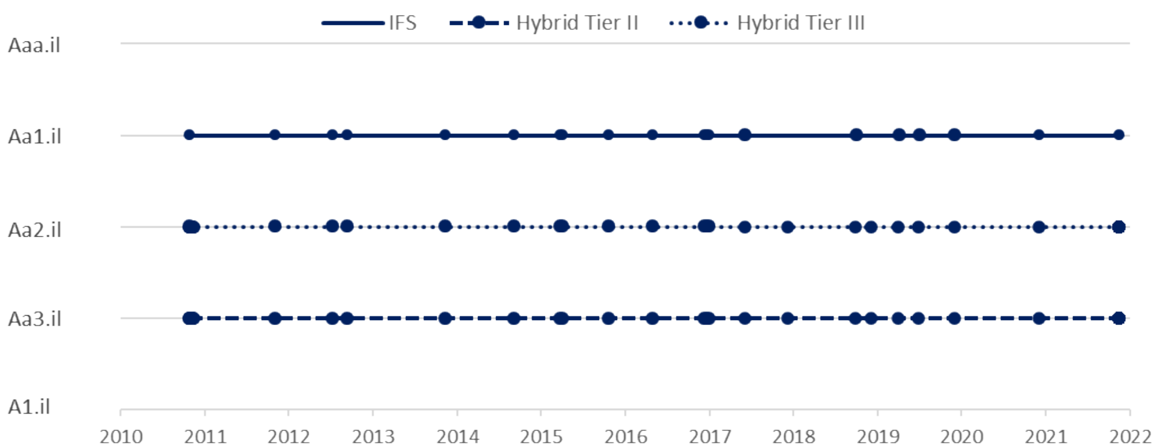
For Tier II capital instruments, we believe that the uncertainty associated with the likelihood of reaching "suspensive circumstances" is low, and therefore was not reflected by a further lowering of one notch. "Suspensive circumstances" are defined in the Solvency Circular as a solvency ratio at 80% of the required solvency ratio in the phase-out period (80% as of December 31, 2020) after adjustment for the equity scenario. The Company's solvency ratio in the phase-out period was 192% as of December 31, 2020.

notes to the Parent Company in August 2021. Including the foregoing, the ratio would be 48% as of June 30, 2021.

Company profile

The controlling shareholder of the Company is The Phoenix Holdings Ltd. ("The Phoenix Holdings" or "the Parent Company"), a public company whose shares are traded on the Tel Aviv Stock Exchange. The controlling shareholder of The Phoenix Holdings is Belenus Lux S.a.r.l, which is owned by entities controlled by Centerbridge Partners LP and Gallatin Point Capital LLC ("the Funds"), who acquired control from Delek Group Ltd. for consideration of NIS 1.57 billion in November 2019. As of the report date, these entities directly own 32.98% of the issued and paid-in share capital of The Phoenix Holdings. The Company CEO is Mr. Eyal Ben-Simon and the Chairman of the Board of Directors is Mr. Binyamin Gabbay.
The Company is engaged in all major insurance sectors, including life insurance and LTS, non-life insurance (including motor insurance (liability and property) and other non-life insurance) and healthcare insurance.

Rating history



Related Reports

The Phoenix Insurance Company Ltd. – related reports
The Phoenix Holdings Ltd. – related reports
Rating of insurers - Methodology Report, December 2017
Life, healthcare and non-life insurers – Special Report, Sector Note, March 2020
Table of affinities and holdings
Midroog's rating scales and definitions
These reports are available on the Midroog website at: www.midroog.co.il

General information

Rating report date:	November 25, 2021
Most recent rating revision date:	December 24, 2020
Initial rating issue date:	October 28, 2010
Rating initiated by:	The Phoenix Insurance Company Ltd.
Rating paid for by:	The Phoenix Insurance Company Ltd.

Information from the issuer

In its ratings, Midroog relies, *inter alia*, on information received from competent organs of the issuer.

Midroog

Long-Term Rating Scale

Aaa.il	Issuers or issues rated Aaa.il are those that, in Midroog judgment, have highest creditworthiness relative to other local issuers.
Aa.il	Issuers or issues rated Aa.il are those that, in Midroog judgment, have very strong creditworthiness relative to other local issuers.
A.il	Issuers or issues rated A.il are those that, in Midroog judgment, have relatively high creditworthiness relative to other local issuers.
Baa.il	Issuers or issues rated Baa.il are those that, in Midroog judgment, have relatively moderate credit risk relative to other local issuers, and could involve certain speculative characteristics.
Ba.il	Issuers or issues rated Ba.il are those that, in Midroog judgment, have relatively weak creditworthiness relative to other local issuers, and involve speculative characteristics.
B.il	Issuers or issues rated B.il are those that, in Midroog judgment, have relatively very weak creditworthiness relative to other local issuers, and involve significant speculative characteristics.
Caa.il	Issuers or issues rated Caa.il are those that, in Midroog judgment, have extremely weak creditworthiness relative to other local issuers, and involve very significant speculative characteristics.
Ca.il	Issuers or issues rated Ca.il are those that, in Midroog judgment, have extremely weak creditworthiness and very near default, with some prospect of recovery of principal and interest.
C.il	Issuers or issues rated C are those that, in Midroog judgment, have the weakest creditworthiness and are usually in a situation of default, with little prospect of recovery of principal and interest.

Note: Midroog appends numeric modifiers 1, 2, and 3 to each rating category from Aa.il to Caa.il. The modifier '1' indicates that the obligation ranks in the higher end of its rating category, which is denoted by letters. The modifier '2' indicates that it ranks in the middle of its rating category and the modifier '3' indicates that the obligation ranks in the lower end of that category, denoted by letters.

Caveat regarding the limitations of a rating and the risks of relying on a rating, and caveats and reservations in respect to the activity of Midroog Ltd. and the information appearing on its website

Ratings and/or publications issued by Midroog are or contain Midroog's subjective opinions about the relative future credit risk of entities, credit obligations, debts and/or debt-like financial instruments, that apply on the date of their publication, and as long as Midroog has not changed the rating or withdrawn it. Midroog's publications may contain assessments based on quantitative models of credit risks, as well as related opinions. Ratings and publications by Midroog do not constitute a statement about the accuracy of the facts at the time of the publication or in general. Midroog makes use of rating scales to issue its opinions, according to definitions detailed in the scale itself. The choice of a symbol to reflect Midroog's opinion with respect to credit risk reflects solely a relative assessment of that risk. Midroog's ratings are issued on a national scale and, as such, are opinions of the relative creditworthiness of issuers and financial obligations within Israel. National scale ratings are not designed to be compared between countries; rather, they address relative credit risk within a given country.

Midroog defines credit risk as the risk that an entity may fail to meet its contractual financial obligations on schedule and the estimated financial loss in the event of default. Midroog's ratings do not address any other risk, such as risks relating to liquidity, market value, change in interest rates, and fluctuation in prices or any other element that influences the capital market.

The ratings and/or publications issued by Midroog do not constitute a recommendation to buy, hold, and/or sell bonds and/or other financial instruments and/or make any other investment and/or forgo any of these actions.

Nor do the ratings and/or publications issued by Midroog constitute investment advice or financial advice, nor do they address the appropriateness of any given investment for any specific investor. Midroog issues ratings on the assumption that anybody making use of the information therein and of the ratings will exercise due caution and make his own assessment (himself and/or through authorized professionals) of the merit of any investment in a financial asset that he is thinking of buying, holding or selling. Every investor should obtain professional advice in respect to his investments, to the applicable law, and/or to any other professional issue.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MIDROOG IN ANY FORM OR MANNER WHATSOEVER.

Midroog's credit ratings and publications are not intended for use by retail investors and it would be reckless and inappropriate for retail investors to use Midroog's credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

All the information contained in Midroog ratings and/or publications, and on which it relied (hereinafter: "the Information") was delivered to Midroog by sources (including the rated entity) that it considers credible. Midroog is not responsible for the accuracy of the Information and presents it as provided by the sources. Midroog exercises reasonable means, to the best of its understanding, so that the Information is of sufficient quality and that it originates from sources Midroog considers to be credible, including information received from independent third parties, if and when appropriate. However, Midroog does not carry out audits and cannot therefore verify or validate the Information.

The provisions of any Midroog publication other than one expressly stated as a methodology do not constitute part of any Midroog methodology. Midroog may change its position regarding the content of such publications at any time.

Subject to applicable law, Midroog, its directors, its officers, its employees and/or anybody on its behalf involved in the rating shall not be held responsible under law, for any damage and/or loss, financial or other, direct, indirect, special, consequential, associated or related, incurred in any way or in connection with the Information or a rating or a rating process, including not issuing a rating, including if they were advised in advance of the possibility of damage or a loss as said above, including but not confined to (a) any loss of profit in present or future, including the loss of other investment opportunities; (b) any loss or damage caused consequential to holding, acquisition and/or selling of a financial instrument, whether it is a subject of a rating issued by Midroog or not; (c) any loss or damage caused consequential to the relevant financial asset, that was caused, *inter alia* and not exclusively, as a result of or in respect to negligence (except for fraud, a malicious action or any other action for which the law does not permit exemption from responsibility) by directors, officers, employees and/or anybody acting on Midroog's behalf, whether by action or omission.

Midroog maintains policies and procedures in respect to the independence of the rating and the rating processes.

A rating issued by Midroog may change as a result of changes in the information on which it was based and/or as a result of new information and/or for any other reason. Updates and/or changes in ratings are presented on Midroog's website at http://www.midroog.co.il.