MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns A2 IFSRs to The Phoenix Insurance Company Ltd.; outlook stable

23 May 2023

London, May 23, 2023 -- Moody's Investors Service (Moody's) has today assigned A2 insurance financial strength ratings (IFSRs) to The Phoenix Insurance Company Ltd. (Phoenix Insurance), the principal insurance operating subsidiary of The Phoenix Holdings Ltd. (Phoenix), a diversified financial services group based in Israel. The outlook is stable.

RATINGS RATIONALE

Phoenix Insurance's A2 IFSRs reflect its very strong market position in Israel and good business diversification across life, health and property and casualty (P&C) insurance, along with strong capital adequacy, good reserve adequacy and strong profitability supported by an established back book and strong new business generation capabilities. These strengths are partially offset by limited geographic diversification of its insurance book, relatively high exposure to equity and alternative invested assets that have the potential to drive volatility in profits, interest rate risk and significant longevity risk related to its closed book of life and long-term care business, and high financial leverage relative to international peers.

Phoenix Insurance's market presence and overall financial profile is enhanced by the significant ancillary businesses that are part of the broader Phoenix group, including asset management, pension and provident funds, insurance agencies and credit. These businesses have lower financial markets risk exposure than the insurance operations and contribute to improved diversification of earnings and cashflows across the group and provide an important source of backup liquidity and funding for the insurance operations.

The insurer's capital adequacy is strong and benefits from natural capital release as its back books run off. At 30 June 2022, Phoenix Insurance reported Solvency II capital cover of 202% with transitional provisions (137% without transitionals), the highest amongst the large diversified insurance groups in Israel. Transitional measures remain in place through 2032 and are reduced gradually over time with a natural offset from the back book runoff. Phoenix's diversified business moderates the group's sensitivity to various market and insurance stress scenarios, whilst surplus capital and liquidity in the group's ancillary businesses are available to provide support to the insurance operations as needed. The group benefits from excess of loss and proportional reinsurance that provides added protection of its capital.

The group benefits from strong profitability with return on capital (Moody's calculation, based on net income) averaging 8.3% over the past five years, and the group's profitability strengthened by its diverse business profile. Over the past four years, the group's key earnings drivers - insurance, additional business, and investments - have contributed approximately equally to profitability, albeit that income from investments is more volatile from year-to-year, in part because the group reflects all mark-to-market movement on investments through earnings. Based on comprehensive income, which adjusts for some of the mark-to-market movements, and is the way Phoenix measures its profits, return on equity averaged 15% over the past five years. Phoenix Insurance has a strong track record of underwriting profitability in the P&C segment, reporting an average combined ratio of 92% over the three years to 2022, despite significant inflationary pressure on motor insurance.

Phoenix has elevated exposure to high risk assets, primarily driven by its exposure to public and private equity holdings. At year-end 2022, its ratio of high risk assets to consolidated shareholders' equity was approximately 112% including only the nostro assets (shareholder own balance sheet assets). This risk is offset by significant holdings of high quality liquid fixed income securities and Phoenix's long duration liabilities, which enable it to hold its equities for longer periods and absorb fluctuations in market valuations. In addition, Phoenix holds excess capital relative to peers that enables it to manage slightly higher asset risk exposure.

While the group's leverage is higher than for similarly rated international peers, it compares well to other large Israeli insurers and Phoenix has demonstrated a strong track-record of good access to capital which supports it financial flexibility. On a Solvency II basis, leverage for Phoenix Insurance is more comparable to international peers, given that this reflects the insurer's significant in force business that is not reflected on a current IFRS basis.

The insurer is exposed to material equity market, longevity, and interest rate risk through its back book of traditional guaranteed savings, long-term care and permanent health insurance products, which have not been sold for a number of years, and are running off slowly. Based on its published sensitivities, the most severe exposure is to equity market risk through its non-yield dependent guaranteed products, where a 10% decrease in equity values would result in a 4.6% decrease in shareholders' equity. Its exposure to longevity risk in the long-term care (LTC) business is also meaningful, with a 10% decline in the mortality rate resulting in a 4.4% negative impact to shareholders' equity. However, these risks are manageable for the group and it is taking a number of steps to reduce its sensitivity to this, including through reinsurance.

The assigned ratings also incorporate Phoenix Insurance's environmental, social and governance (ESG) considerations, as per Moody's Investors Service's General Principles for Assessing Environmental, Social and Governance Risks Methodology. Moody's assessment of Phoenix's exposure to governance risks is neutral to low, reflected in a Governance Issuer Profile Score (IPS) of G-2, supported by good risk management and an appropriate financial strategy with an independent and experienced Board. The group is publicly listed, although with a controlling stake owned by private investors which could give rise to risks around governance and oversight, although to date, the group's controlling shareholders have had a positive impact on overall governance and transparency.

The stable outlook is a reflection of Moody's view that Phoenix Insurance's credit profile will remain stable over the next 12-18 months.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Given the insurer's concentrated exposure to Israel and the proximity of its IFSRs to the sovereign rating, there is currently limited upward pressure on the rating. However, the following factors could, over time, lead to upward pressure on Phoenix Insurance's ratings (i) greater business or geographic diversification that results in diminished exposure to the Israeli economy and financial markets, (ii) significantly lower exposure to high risk assets relative to capital; (iii) improved capital adequacy with, for example, the Solvency II ratio (excluding transitionals) exceeding 170% on a consistent basis through the cycle, (iv) improved stability of profitability, with group return on capital remaining above 8% and the sharpe ratio in excess of 350%, and (v) improved financial flexibility, with financial leverage falling below 30% and earnings coverage remaining above 10x.

Conversely, the following factors could lead to downward pressure on the ratings (i) weakening of the group's strong franchise and market position, (ii) deterioration in capitalisation, with the Solvency II ratio (excluding transitionals) remaining consistently below 130%, (iii) lower or more volatile profitability, with return on capital falling below 6% and sharpe ratio below 150%, (iv) significant increase in high risk assets held in the nostro account, and/or (v) significantly reduced access to reinsurance capacity or weakened quality of reinsurance partners.

PRINCIPAL METHODOLOGIES

The methodologies used in these ratings were Life Insurers Methodology published in January 2023 and available at https://ratings.moodys.com/rmc-documents/397713, and Property and Casualty Insurers Methodology published in January 2023 and available at https://ratings.moodys.com/rmc-documents/397707. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the issuer/deal page for the respective issuer on https://ratings.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website https://ratings.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the EU and is endorsed by Moody's Deutschland GmbH, An der Welle 5, Frankfurt am Main 60322, Germany, in accordance with Art.4 paragraph 3 of the Regulation (EC) No 1060/2009 on Credit Rating Agencies. Further information on the EU endorsement status and on the Moody's office that issued the credit rating is available on https://ratings.moodys.com.

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