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Harel Insurance Company Ltd.

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Harel Insurance Company Ltd.

Insurer Financial Strength Rating (IFS)	Aa1.il	Rating outlook: Stable
Hybrid Tier-3 capital	Aa2.il (hyb)	Rating outlook: Stable
Hybrid Tier-2 capital and Tier-2 capital instrument	Aa3.il (hyb)	Rating outlook: Stable

Midroog leaves unchanged the Aa1.il Insurer Financial Strength (IFS) rating of Harel Insurance Company Ltd ("Harel Insurance" and/or "the Company") and leaves unchanged the Aa2.il (hyb) ratings for the subordinated liability notes (hybrid Tier-3 capital) and - Aa3.il (hyb) rating for the subordinated liability notes (hybrid Tier-2 capital and Tier-2 capital instruments), that were raised through the subsidiary Harel Finance and Issues Ltd. The rating outlook is stable.

The subordinated debt ratings factor in the legal-contractual subordination **of these debts with respect to the IFS rating, the ranking of seniority among the actual subordinated debts and the effect of the loss absorption mechanisms inherent in them.** Taking into account the Company's IFS level, the present and anticipated economic solvency level, while at the same time maintaining an adequate margin from the effective regulatory economic solvency requirement for the instrument, we estimate that the uncertainty regarding the probability of reaching the "delaying circumstances"[1] is low and is therefore not factored into the lowering of an additional notch for Tier-2 capital instruments.

Bonds in circulation rated by Midroog:

Bond series	Security number	Rating	Rating outlook	Category of recognized capital	Final maturity date
Harel F&I 7	1126077	Aa2.il(hyb)	Stable	Tier-2 capital [2]	May 31, 2026
Harel F&I 9	1134030	Aa3.il(hyb)	Stable	Tier-2 capital [1]	December 31, 2028
Harel F&I 10	1134048	Aa3.il(hyb)	Stable	Tier-2 capital [1]	December 31, 2029
Harel F&I 11	1136316	Aa3.il(hyb)	Stable	Tier-2 capital [1]	December 31, 2030
Harel F&I 12	1138163	Aa3.il(hyb)	Stable	Tier-2 capital [1]	December 31, 2031
Harel F&I 13	1138171	Aa3.il(hyb)	Stable	Tier-2 capital [1]	December 31, 2032
Harel F&I 14	1143122	Aa3.il(hyb)	Stable	Tier-2 capital	December 31, 2033
Harel F&I 15	1143130	Aa3.il(hyb)	Stable	Tier-2 capital	December 31, 2034

[1] Equity required for "delaying circumstances" is defined as 80% of the solvency ratio required in the transitional period, after adjustment for equity risk according to the Solvency Circular (above and below: "Required Solvency Ratio").

Harel F&I 16	1157601	Aa3.il(hyb)	Stable	Tier-2 capital	June 30, 2029
Harel F&I 17	1161454	Aa3.il(hyb)	Stable	Tier-2 capital	December 31, 2030
Harel F&I 18	1182666	Aa3.il(hyb)	Stable	Tier-2 capital	December 31, 2035

[1] Hybrid Tier-2
[2] Hybrid Tier-3

Rationale

The Company's rating reflects a strong business profile which is supported by the fact that the Company is Israel's largest insurer and has held a dominant position over time, as reflected in a 23% overall market segment in terms of gross premiums, with AUM of NIS 121 billion, as at September 30, 2023. The business profile is also supported by relatively good diversification of lines of business, good control of the distribution network and a broad customer base, all of which support future revenue generating potential. The risk profile is commensurate with the rating and is supported by relatively low product risk and an adequate risk management policy, but it suffers from relatively high exposure to large groups (collectives) and policyholders. Nonetheless, we anticipate that the change in the long-term care insurance agreement with Clalit Health Services which entered into force in January 2024 will positively affect the risk profile in light of the elimination of the Company's insurance risk in long-term care insurance, as part of the revised agreement between the Company and Clalit Health Services.[2] In this context we note that in 2022 the percentage exposure to groups in the motor sectors decreased. In view of the foregoing, we expect the percentage exposure to groups to fall in the in the forecast years. The Company's financial profile is negatively affected by an erosion of the asset quality, mainly due to substantial dividend distributions, while the Company's profitability is reasonable in comparison with the benchmark group,[3] although it is low relative to the rating and partly affected by volatility due to its exposure to exogenous factors and limited due to relatively low underwriting profitability in non-life insurance. Nonetheless, the Company's underwriting profitability has improved over the last nine months compared with the corresponding period last year. This profitability supports the growth of the capital buffer which in our opinion will increase at a moderate pace, and be affected by the volume of dividends, if and insofar as they are distributed. The Company's capital adequacy is commensurate with the rating, as reflected in the capital surpluses in relation to the Solvency II Directive, where the Solvency Capital Ratios (SCR) at June 30, 2023, were 167% (taking the transitional period into account) and 126% (without taking the transitional period into account), while the former is higher than the benchmark group, notwithstanding significant dividend distributions in the past two years. The Company's liquidity profile is reasonable for the

[2] For additional information see: Report by Harel Investments dated December 14, 2023, Harel Insurance Company Ltd. and Clalit Health Services agreed upon an outline that includes, among other things, elimination of the Harel's insurance risk threshold and reduction of the insurance benefits.

[3] The Phoenix Insurance Company Ltd., Migdal Insurance Company Ltd., Clal Insurance Company Ltd. and Menora Mivtachim Insurance Ltd.

rating, supported by a long duration of liabilities, where the financial flexibility is commensurate with the rating and supported by a broad margin relative to the regulatory capital adequacy.

In Midroog's baseline scenario for 2023-2024 we expect the challenging business environment to persist, which will continue to overshadow the insurance industry as a whole, and specifically the potential to generate revenues. Furthermore, the tight monetary environment characterized by high inflation and interest environments relative to the past few years, adversely affect economic activity and capital market yields, thus impacting sector-based growth as well as the Company's profits. At the same time, the Swords of Iron War ("the War") led to a series of repercussions and restrictions including a decrease of activity in the economy and decline in economic activity. In contrast, the rising interest environment of the past few years has boosted the solvency ratio and reduced the insurance liabilities in long-tail segments. According to its baseline scenario, Midroog believes that the Company will maintain its business positioning while the volume of gross earned premiums increases by 3%-6% annually. In view of the foregoing, we believe that the ratios of ROC and comprehensive income to total gross earned premiums are expected to range between 2.8%-2.9% and 1.5%-1.6%, respectively, in the forecast range. These profitability rates are low for the rating however they demonstrate an improvement compared with 2022 in light of the optimization processes carried out by the Company, that are expected to be favorably expressed in the forecast years.

Rating outlook

The stable rating outlook reflects our opinion that the Company's financial profile and key data will remain within the range of Midroog's baseline scenario.

At the same time, the war that broke out in Israel on October 7, 2023 led to a series of repercussions and restrictions including, among other things, the partial or full closure of businesses, restrictions on congregating in the workplace and education system, as well as a decrease in the size of the workforce resulting from a broad call-up of the military reserves and a reduction in the number of foreign workers. These measures resulted in a decrease of activity in the Israeli economy and decline of economic activity. Furthermore, as a result of the war, prices in Israel's financial markets slumped and the shekel exchange rate depreciated. Midroog believes that this period is characterized by a high degree of uncertainty regarding the development of the war and its economic ramifications. Consequently, Midroog might revise the rating's baseline scenario in line with developments. For further information on this subject, please refer to the special report "Repercussions of the Swords of Iron War on the credit repayment capacity of bond issuers rated by Midroog" (October 2023).[4]

[4] The report "Repercussions of the Swords of Iron War on the Credit Repayment Capacity of Issuers Rated by Midroog - Special Report"., appears on Midroog's website.

Factors that may lead to upgrading the rating:

- Improvement of the capital surpluses according to Midroog's capital model
- Ongoing improvement of underwriting performance in the core sectors and/or continuous improvement of overall profitability.

Factors that may lead to downgrading the rating:

- Ongoing erosion of the capital surpluses according to Midroog's capital model
- Ongoing deterioration of underwriting performance in the core sectors and/or significant and ongoing erosion of overall profitability.
- Distribution of dividends that could harm the Company's financial strength.

Harel Insurance Company Ltd. - key data (NIS million)

NIS million	Sept. 30, 2023	Sept. 30, 2022	Sept. 30, 2021	Dec. 31, 2021	Dec. 31, 2020	Dec. 31, 2019
Total assets [1]	**127,183**	**124,393**	**124,305**	**128,644**	**113,964**	**110,512**
Total equity attributable to shareholders of the Company [1]	**3,953**	**4,908**	**4,230**	**6,031**	**5,320**	**5,489**
Total comprehensive income (loss) attributable to the Company's shareholders [1]	**155**	**(469)**	**(253)**	**1,223**	**661**	**825**
Total premiums earned, gross	**12,992**	**12,556**	**16,674**	**14,833**	**14,460**	**14,582**
Of which: life assurance and long-term savings	4,894	5,040	6,504	5,887	6,116	6,255
Of which: health insurance	4,815	4,401	5,928	5,364	4,953	4,922
Of which: non-life insurance	3,283	3,115	4,242	3,582	3,391	3,405
Total earned premiums, on retention	**11,286**	**10,973**	**14,521**	**13,053**	**12,875**	**12,939**
Total investment profit (loss) (including other comprehensive income)	**5,150**	**(7,045)**	**(5,770)**	**12,215**	**3,856**	**8,676**

Solvency ratio [2]	***167%**	****180%**	**169%**	**175%**	**159%**	**170 %**
Solvency ratio without application of the temporary provisions for the transitional period [3]	***126%**	****132%**	**125%**	**116%**	**105%**	**113%**

Midroog's adjusted ratios

Intangible assets and - DAC long-term savings from equity	64%	48%	57%	37%	36%	46%
Return on capital (ROC) [4]	2.1%	(5.7%)	(2.4%)	11.1%	6.3%	8.6%
Comprehensive income to gross premium	1.2%	(3.7%)	(1.5%)	8.2%	4.6%	5.7%

[1] 2019 includes the effect of an amendment to the LAT circular published in March 2020.

[2] Including the effect of material capital transactions that took place in the period between the date of the calculation and date of publication of the Economic Solvency Ratio Report.

[3] Without taking into account the provisions for the transitional period and after adjustment for equity risk.

[4] Comprehensive income factored in annually to the financial liabilities average (excluding derivatives) and equity (own funds) attributed to the shareholders in the period.

** As at June 30, 2023*

*** As at June 30, 2022*

Rating Rationale

A good business profile reflected in the Company's substantial size and diversification of the lines of business, which support the ability to generate revenues

The Company is Israel's largest insurer and has held a dominant position over time, as reflected in a 23% overall market segment in terms of gross premiums, with AUM of NIS 121 billion, as at September 30, 2023. The business profile is supported by relatively good diversification of lines of business, reflected in three significant pillars over time, and particularly in the last 12 months - life assurance[5] (about 39% of total gross premiums and management fees), health insurance (36%) and non-life insurance (26%). At the same time, we examine revenue diversification according to the largest line of business (in terms of premiums and management fees) relative to the sum total of the lines of activity, where this line of activity accounted for approximately 39% and originates in the life and long-term savings sector (42% in the 12 months ended September 30, 2023), reflecting a relatively diverse mix of revenues, in addition to a strong brand and broad and diverse customer base. These support the business profile and potential to generate income over the economic cycle, while addressing changes in the business environment, regulatory changes and macroeconomic effects.

The Company's principal marketing and distribution channels are insurance agents and agencies, while in recent years the Company has operated in parallel to diversify the distribution channels, adapting them to the changing business environment and to the public's tastes. Accordingly, in 2020 the Company launched direct insurance in the motor segment under the brand Harel Switch which is expected to continue to expand. Additionally, after entering the reverse mortgage sector with Harel 60+ Ltd. ("Harel 60+"), the Company launched Mortgage Plus for marketing regular mortgages.

We expect that continuing brand reinforcement will support the expenses structure, the basket of products offered to customers as part of the customer retention process and while addressing the challenges of innovation in the industry in the future. At the same time, we believe that insurers who do not adopt technological innovation and adapt their business model over time will experience significant deterioration of their business positioning.

In Midroog's baseline scenario for 2023-2024 we expect the challenging business environment to persist, which in turn will continue to overshadow the insurance industry as a whole, and specifically the potential to generate revenues. Furthermore, the tight monetary environment characterized by high inflation and interest environments relative to the past few years, adversely affect economic activity and capital market yields, impacting sector-based growth as well as the Company's profits. At the same time, the War led to a series of repercussions and restrictions including a decrease of activity in the economy and reduction of economic activity, as detailed above. In contrast, the rising interest environment boosts the solvency ratio and reduces the

[5] Not including premiums for investment contracts.

insurance liabilities in long-tail segments. According to its baseline scenario, Midroog believes that the Company will maintain its business positioning while the volume of gross earned premiums increases by 3%-6% annually.

On the one hand, the life assurance and long-term savings segment is likely to be influenced by a tight labor market that contributes to continuing growth of the volume of activity in the economy and will positively impact the pace of ongoing deposits in this segment. On the other hand, these effects will be moderated in long-term savings as a direct outcome of the regulations limiting provision for managers' insurance[6] that entered into force on September 1, 2023. Likewise, in the life assurance sector, in which the Company holds a significant market segment and holds a dominant position with its "risk" (term assurance) products, growth is expected to be moderate as competition intensifies and combined with the effects of the War will overshadow the potential for growth and volume of premiums.

The potential for growth in the health segment will be supported by a relatively high penetration rate,[7] in addition to further competition in this sector and the structure of the standard policy that will create an element of price pressure in this segment. We expect the Company to enjoy further growth while retaining significant market segments that will be expressed in the exploitation of economies of scale, with particular focus on the more profitable personal lines products, while we believe that the existing long-term care portfolio (policies sold in the past) will continue to be eroded in the forecast range.

We believe that the volume of premiums in the non-life insurance segment will grow at rates of between 3% and 9% annually, in the forecast range. The higher CPI, effects of the supply chain in the motor property sector and sharp increase in the number of car thefts, supported the increase in the price of premiums (and claims) in the forecast period. Additionally, the continuing growth of activity and the labor market are expected to positively impact growth rates in the property and liabilities segment, and as a consequence the volume of premiums in these sectors.

The risk profile is commensurate with the rating and is supported by relatively low product risk; however it is negatively impacted by high exposure to large customers

The Company is characterized by relatively low product risk, which supports underwriting ability and reduces the insurance risk, given a higher degree of certainty regarding the volume of claims. We estimate product risk in non-life insurance and health insurance in the short term as good for the rating, where 67% of the premiums in the 12 months ended September 30, 2023, are for short-tail insurance contracts.[8] In our opinion, these are characterized by a lesser degree of

[6] The regulations stipulate that for new applicants, deposits in managers insurance will be permitted provided that their salary is higher than twice the average wage in the economy.
[7] Premiums earned to GDP
[8] Motor property (CASCO), other property and short-term health.

insurance risk than "long-tail" contracts,[9] which entail greater uncertainty and are less flexible due to their exposure to changes in the business environment. The Company hedges the insurance risks in some sectors of the non-life segment through highly rated reinsurers with relatively low exposure in the retention for catastrophe events, that was 2.6% of the eligible equity (own funds) at December 31, 2022. The share of "high-risk" reserves, according to our definition in life and long-term health insurance, is commensurate with the rating and was 29.8% at December 31, 2022 (29.0% on average between 2019 and 2021). This ratio reflects relatively low exposure to yield guaranteed and/or life expectancy mechanisms net of Hetz bonds, which expose the insurers to significant exogenous changes, including changes in the interest-rate curve and capital market volatility, in addition to the demographic risks. The risk profile is affected by a certain exposure to collectives (groups) and large policyholders that could aggravate the insurance risks, credit risks and sector-specific risks over the economic cycle and limits risk-adjusted pricing, in view of economies of scale for the customers. This exposure accounted for 27% of total gross earned premiums in 2022 and is also affected by significant exposure to collectives in premiums in the health segment which is unfavorable with respect to the rating. Nonetheless, we anticipate that the change in the long-term care insurance agreement with Clalit Health Services which entered into force in January 2024 will positively affect the risk profile in light of the elimination of the Company's insurance risk in long-term care insurance, as part of the outline for the revised agreement between the Company and Clalit Health Services. In this context we note that in 2022 the percentage exposure to groups in the motor sectors decreased. In view of the foregoing, we expect the percentage exposure to groups to fall in the in the forecast years. We believe that the Company's risk management policy and levels of control are commensurate with the risk profile and supported by regulatory requirements, while, in our opinion, full implementation of the Solvency II Directive and particularly Pillar II (ORSA) further improves risk management processes within both the Company and the industry as a whole, can support improvement of the risk profile over time and the measurement of economic capital, despite volatility of the economic capital under the Solvency II regime. Midroog also anticipates that in coming years the Company will continue to place considerable emphasis on the measurement of operating risks, which constitute a key, developing focus of risk and regarding information security, business continuity and cyber security.[10] The Company's capital surplus under Solvency II supports its risk profile, business flexibility and ability to build adequate risk management processes without regulatory pressures. Furthermore, the risk management function in Harel Insurance is also supported by computer and software services provided by Harel Hamishmar Computers Ltd., which is responsible for providing the various divisions within Harel Group with a range of automation services.

[9] Compulsory motor and liabilities.

[10] See a related Midroog report on this subject: Reputation damage resulting from cyber attacks that could exact a heavy business price from companies.

Material erosion of the capital buffer, alongside an increase in the volume of intangible assets and deferred acquisition costs threaten the quality of the Company's assets, which is unfavorable with respect to the rating

In our opinion, the investments in the Company's Nostro (proprietary) portfolio indicate a high-risk appetite relative to the rating, as reflected in the ratio of "high-risk assets"[11] to equity of 203.3% at September 30, 2023. The deterioration in the past few years (December 31, 2021: 121%) is attributable to a material erosion of the equity resulting from significant dividend distributions, a comprehensive loss in 2022 and the Company's growing exposure to Risk-Weighted Assets (RWA) over time, mainly due to burgeoning competition that has incentivized insurers to improve their returns in the members and Nostro portfolios. At September 30, 2023, the investment mix in the Nostro (proprietary) portfolio comprises the following: government bonds - 31%, collateral-backed loans – 20%, investment funds – 11% and tradable corporate bonds in Israel with a rating of Aa3 and above – 8%. Any other investments are well diversified and less significant. In our opinion, no material change is expected in the portfolio mix, as the Company continues to focus on investing in non-marketable assets and RWA, given the current interest environment which poses a challenge to maintaining potential returns and fluctuating value.

At September 30, 2023, the percentage of intangible assets and DAC in life assurance, which typically have a "softer" value than the equity, was 64%. This ratio is unfavorable for both the rating and the benchmark group and has deteriorated significantly in recent years (by an average of 40% between 2019 and 2021). The higher ratio is attributable to an increase of the intangible assets and DAC alongside material erosion of the capital buffer, as noted above.

The Company's capital adequacy is commensurate with the rating, as reflected in the economic solvency ratio

At September 30, 2023, the capital to balance sheet ratio (excluding assets for yield-dependent contracts) was 8.4%. This is commensurate with the rating although it was negatively affected in the past two years by a reduction of the equity, as noted above (11.7% on average between 2019 and 2022). In our opinion, in the short to medium term the ratio will remain stable and/or improve, due the continuing strengthening of the Company's capital buffer. The Company's capital adequacy is also reflected in the capital surpluses with respect to the Solvency II Directive, where the Solvency Capital Ratios (SCR) at June 30, 2023, were 167% (taking the transitional period into account) and 126% (without taking the transitional period into account), while the former reflects a relatively high rate for the benchmark group, notwithstanding significant dividend distributions, as noted above.

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[11] High-risk assets generally include all the financial investments assets other than cash, government bonds and corporate bonds with an investment rating, where the latter are weighted by a partial financing rate which reflects possible impairment risk over the credit cycle as a result of credit risks, market risks or liquidity risks.

Notably, on February 28, 2021, the Company's Board of Directors approved a dividend distribution policy in which the Company will distribute a dividend of at least 35% of its comprehensive income in the annual consolidated financial statements, and this as long as the Company is in compliance with the minimum targets for solvency based on Solvency II. Additionally, on May 29, 2023, the Company's Board of Directors approved a revision of the capital management plan for minimum targets to ensure that the minimum economic solvency ratio taking the transitional provisions into account does not fall below 135% after the dividend distribution, and a minimum solvency ratio without taking the transitional provisions into account of no less than 110% after the dividend distribution.

We believe that the Company will continue to build up the capital buffer and maintain the Solvency II ratio that is commensurate with the rating, notwithstanding our assumption that dividend distributions will continue in the forecast range, in line with the Company's aforementioned dividend distribution policy.

Profitability indicators are low for the rating, volatile due to exposure to exogenous factors and limited due to low underwriting profit in non-life insurance

The Company's profitability is low with respect to the rating, which is negatively affected by low underwriting profit in non-life insurance, as reflected in a Net Combined Ratio or Combined Ratio in the Retention in non-life insurance of 105% on average between 2019 and 2022, compared with an average of 97% for the industry as a whole in the same period. The foregoing are reflected in the Company's ratios of ROC and comprehensive income to total gross earned premiums between 2019 and 2022, which averaged 5.9% and 4.2%, respectively.[12] In Midroog's baseline scenario for 2023-2024, we expect the Company's profit potential to improve compared with 2022, in which there was a comprehensive loss due to negative yields in the capital market. Additionally, we expect the Company's profit potential to improve compared with 2022 in light of the optimization processes carried out by the Company, that are expected to be favorably expressed in the forecast years. Nonetheless, we expect that the business environment which is affected by the repercussions of the War and by the challenging macroeconomic environment, will continue to threaten the insurance industry and specifically the potential to generate profits and the ability to build up the capital buffer from ongoing profits. Additionally, the insurance industry will remain under the influence of volatile yields in the capital markets and exposed to excessive regulation, which encourages competition and generates additional costs.

In the life assurance and long-term savings sector we expect that risk (term assurance) products will continue to dominate this market segment. Concurrently, we anticipate that profits will continue to fluctuate in view of the exposure to exogenous factors. Additionally, due to real negative yields recorded in the profit-sharing life assurance policies marketed until 2004, the Company has not recorded variable management fees since the beginning of 2022, in addition to

[12] Taking into account a retrospective correction of the effect of the LAT circular on the results for 2019.

the loss of management fees that were not collected due to the real negative yield, until a positive, cumulative yield of NIS 343 million (correct to September 30, 2023) is attained. This contrasts with variable management fees of NIS 416 million that were collected in 2021. Due to the considerable volatility in the markets we believe that there is uncertainty regarding the ability to collect variable management fees in the short term.

Regulatory changes, including the structure of the standard policy, will continue to affect the health segment and the business focus of most companies in the sector. These are expected to intensify price competition, exerting pressure on profits in this sector. The Company's dominance in this market segment is a moderating factor in this respect.

In the non-life segment, we expect competition to remain strong from both the traditional companies and the direct insurance companies, alongside the continuing development and growing use of digital tools that intensify competition in this sector. We expect that the rising tariffs in the motor sector over the past two years will support the growth of premiums in these sectors, and have a positive impact on profitability. We believe that profitability could also improve as a result of greater operating efficiency with better control of the operating expenses structure, in part through the growing use of technology in addition to the streamlining of claims and use of arrangement repair garages. Notably, we believe that the Company is well positioned in the face of competition in the motor sector, with a broad product line including Harel Switch, that is expected to continue to support greater control over the expense structure to the extent that these policies account for a growing share of products. Nonetheless, in our opinion, profit potential in this sector will remain relatively low.

In view of the foregoing, the Company's profitability rates are expected to demonstrate improvement relative to 2022, but will remain low for the rating, so that the ratios of ROC and comprehensive income to total gross earned premiums are expected to range between 2.8%-2.9% and 1.5%-1.6%, respectively, in the forecast range.

The liquidity profile is reasonable for the rating and supported by a long duration of liabilities; financial flexibility is commensurate with the rating and supported by a broad margin relative to the regulatory capital adequacy

The Company's liquidity profile is reasonable for the rating, as reflected in a current ratio of x 1.6 between the weighted liquid assets inventory and the insurance and financial liabilities due for repayment in the short term. In view of the Company's diverse mix of business, some of the liabilities are expected to mature in the long term (life assurance and long-term savings) and others in the short term (non-life insurance). At the same time, we do not expect any significant change in the leverage ratio in the forecast years and we therefore believe that the Company will continue to remain close to the limit of regulatory recognition in Tier-2 capital instruments (40% of SCR). The Company's financial flexibility is commensurate with the rating, supported by Solvency II ratios that are higher than the regulatory requirement, and is positively influenced by

an absence of significant pressure to distribute dividends in the short term from the parent company Harel Insurance Investments and Financial Services Ltd (“Harel Investments” or the “Parent Company”), which has a rating of Aa2.il, outlook stable. In our opinion, Harel Investments is dependent on the dividend distributions from the Company to service its debts. This is a formal and predictable policy which relies on additional sources (Harel Pension and Provident Ltd.), however we note that the Company still serves as the principal anchor for the parent company’s consolidated activity and it has business ties with the other group companies. Nonetheless, we believe that the Company has good access to sources of finance, in order to improve the solvency ratio (raising additional Tier-1 capital), as well as other tools at its disposal (agreements with reinsurers, change in the investment mix, etc.) for addressing deterioration of the solvency ratio, should this be necessary.

Additional rationale

Relatively long duration of liabilities supports the liquidity profile

The Company has a relatively long duration of liabilities which provides strong support for its liquidity profile and rating. In our opinion, insurers characterized by a long duration of liabilities and that have no PUT options for policyholders to call in money, are less exposed to liquidity risk and are better able to respond over time, supporting their resilience and rating. Moreover, the volatility that may result from marking to market of assets (MTM) does not always reflect the economic value of insurers with a long duration of liabilities, given their ability to hold the relevant assets to maturity. We therefore believe that the economic capital of those companies may be less exposed to short-term market volatility.

ESG considerations

Environmental considerations: Israel’s insurance companies, and particularly insurers operating in the non-life sector, are exposed to risks that could materialize in view of climate change. Climate change has the potential to affect the frequency and severity of natural perils (earthquakes, fires, floods, etc.), that could cause significant losses and affect the actuarial models. In our opinion, the impact of climate events, if and when they materialize, is difficult to estimate thus increasing the uncertainty attributable to this risk. While insurers are only able to reprice policies periodically, the increasing global frequency of catastrophe losses relating to climate change and the accumulation of these risks, make underwriting and risk management ever more complex. In contrast, such exposures are moderated mainly by the use of reinsurance for spreading risks. However, the insurance companies have indirect exposure by means of the financial strength of the reinsurers that insure the local insurance companies and any harm to them could create an additional risk for the insurance companies in the industry. We believe that these risks are adequately expressed in the rating matrix, and specifically in the “product risk - non-life and short-term health insurance” parameter as well as in the solvency ratio which reflects various scenarios with respect to the the Company’s capital requirement.

Social considerations: Israel's insurance companies, and particularly the insurers operating in the life assurance and long-term savings and health sectors, are exposed to significant demographic and social changes, including: longevity and an increase in the morbidity rate. Accordingly, increased longevity due to a decrease in mortality rates after the age of retirement affects the period of future annuity payments (mainly with the development of accrual in policies with a guaranteed annuity option), which are expected to lead to an increase in the reserves required to cover these payments. Furthermore, an increase in the mortality rates for insureds with life assurance that includes compensation in the event of death ("risk"), including in the event of catastrophe, might cause an immediate loss and affect the value of the portfolio. Rising morbidity, including long-term care, work disability and insurance for medications, also has a material impact on the scope of the insurance companies' profits. We believe that these risks are adequately expressed in the rating matrix, and specifically in the "product risk - long-term life assurance and long-term savings, long-term care and long-term health insurance" parameter as well as in the solvency ratio which reflects various scenarios with respect to the Company's capital requirement.

Corporate governance considerations: In our opinion, corporate governance risks carry a material effect for the insurance industry. These risks form a key credit consideration, where weak corporate governance could lead to a worsening of the insurer's credit repayment capacity, whereas strong corporate governance might positively impact its credit repayment capacity. Corporate governance risks are mitigated by the regulatory framework in which the insurers operate, a framework that outlines the internal control functions as well as tight controls imposed by the regulator. Midroog examined the effect of corporate governance on the Company and does not assume any significant exposure in this respect.

Structural considerations

Characteristics of subordinated instruments

Based on Midroog's methodology, the anchor for rating the subordinated debts (hybrid Tier-3, hybrid Tier-2, and Tier-2 capital instruments) is the Insurance Financial Strength (IFS) rating, from which we adjust the rating to the credit risk of the subordinated debt instrument according to its contractual characteristics. We lower one notch and two notches from the insurer's IFS for rating hybrid Tier-3 capital, and hybrid Tier-2 / Tier-2 capital, respectively. Lowering the notches factors in the legal-contractual subordination of these debts in relation to IFS, the ranking of seniority among the actual subordinate debts and the effect of the loss-absorption mechanisms they incorporate (in the contractual trigger for "delaying circumstances" or at the discretion of the Commissioner of Insurance).

For Tier-2 capital instruments, we estimate that the uncertainty regarding the probability of reaching the "delaying circumstances" is substantially lower than the Company's current and expected solvency ratio and it was therefore not factored into the lowering of an additional notch. The Solvency Circular defines "delaying circumstances" as a solvency ratio which is 80% of the solvency ratio required in the transitional period, after adjustment for equity risk. At June 30, 2023, the Company's solvency ratio in the transitional period was 167%, as mentioned above.

Rating matrix

			As at September 30, 2023		Midroog outlook [1]	
Category	**Parameter**	**Sub-parameter**	**Measurement [1]**	**Score**	**Measurement**	**Score**
Business profile	**Business positioning**		22.8%	Aaa.il	22.8%	Aaa.il
	Distribution channels		-	Aa.il	-	Aa.il
	Revenue diversification		39%	Aa.il	~39%	Aa.il
Risk profile	**Product risk - short-term non-life and health insurance**		66.8%	Aaa.il	~67%	Aaa.il
	Product risk - life assurance and long-term savings, long-term care and health		29.8%	Aa.il	<30%	Aa.il
	Percentage exposure to groups and large enterprises (group from total premiums)		26.6%	A.il	<20%	Aa.il
	Risk management policy		-	Aa.il	-	Aa.il
Financial profile	**Asset quality**	Assets at risk / equity	203%	Baa.il	~203%	Baa.il
		DAC life + intangible / equity	64.1%	A.il	~64%	A.il
	Capital adequacy	% capital surplus over regulatory requirements [1]	167.1%	Aa.il	~167%	Aa.il
		Equity / total assets in balance sheet (excluding yield dependent)	8.4%	Aa.il	~8%	Aa.il
	Profitability	Return on capital (ROC)	2.1%	A.il	2.8%-2.9%	A.il*
		Comprehensive income to gross premium	1.2%	Baa.il	1.5%-1.6%	A.il*

	Liquidity	Liquidity ratio (excluding yield dependent)	x 1.6	Aa.il	x1.6	Aa.il
	Financial flexibility		-	Aa.il	-	Aa.il
Estimated derived financial strength						**Aa2.il**
Estimated actual financial strength						**Aa1.il**

** The forecast range and results for previous years were taken into account in calculating the score*

[1] The indicators presented in the table are after Midroog's adjustments and are not necessarily the same as those presented by the Company. Midroog's outlook includes its assessments of the issuer based on Midroog's baseline scenario, rather than the issuer's assessments.

About the Company

Harel Insurance is a private company fully controlled by Harel Investments. Harel Investments is a public company whose shares have been traded on the Tel Aviv Stock Exchange since 1982. The principal shareholders in Harel Investments are Yair Hamburger, Gideon Hamburger and Nurit Manor ("the Controlling Shareholders"), holding approximately 47 of the voting rights and the issued share capital of Harel Investments. The Controlling Shareholders hold the Company principally through G.Y.N. Financial Consulting & Management 2017 Limited Partnership ("G.Y.N. Partnership") which they fully own and control and which they hold, as limited partners, through private companies which are fully controlled by each of the Controlling Shareholders, and they also hold the general partner in G.Y.N. Partnership. The Company's CEO is Mr. Nir Cohen and Chairman of the Board is Mr. Guy Rotkopf.[13]

Harel Insurance operates primarily in the insurance industry, including: life assurance and long-term savings, health insurance and non-life insurance. The insurance activity is performed by the Company itself. In the long-term savings segment, activity is performed by the Company and also through the following subsidiaries that are provident fund and pension fund management companies: Tzva Hakeva Savings Fund - Provident Funds Management Company Ltd., under full control, ("Tzva Hakeva") and LeAtid Pension Funds Management Company Ltd. (in which the Company holds a 79% stake), which manages an old pension fund ("LeAtid"). Additionally, credit activity takes place through: (1) the subsidiary Harel 60+, which provides ordinary mortgage loans, reverse mortgages in the form of a loan provided to customers aged 60 or more, against a first lien on their home; (2) within the context of development property finance activity, including the Company's sale guarantee activity; (3) within the framework of providing financial guarantees and operating services for mortgage portfolios. At September 30, 2023, the credit sector does not constitute an operating segment in the Company's financial statements.

[13] Until February 1, 2024, Mr. Michel Siboni served as CEO of Harel Investments and Chairman of the Board of Harel Insurance. Since that date, Mr. Nir Cohen has served as CEO of Harel Investments in addition to serving as CEO of Harel Insurance and Mr. Guy Rotkopf serves as Chairman of the Board of Directors of Harel Insurance. Mr. Siboni continues to serve as a director in Harel Insurance and was also appointed as a director in Harel Investments commencing February 5, 2024.

Rating history

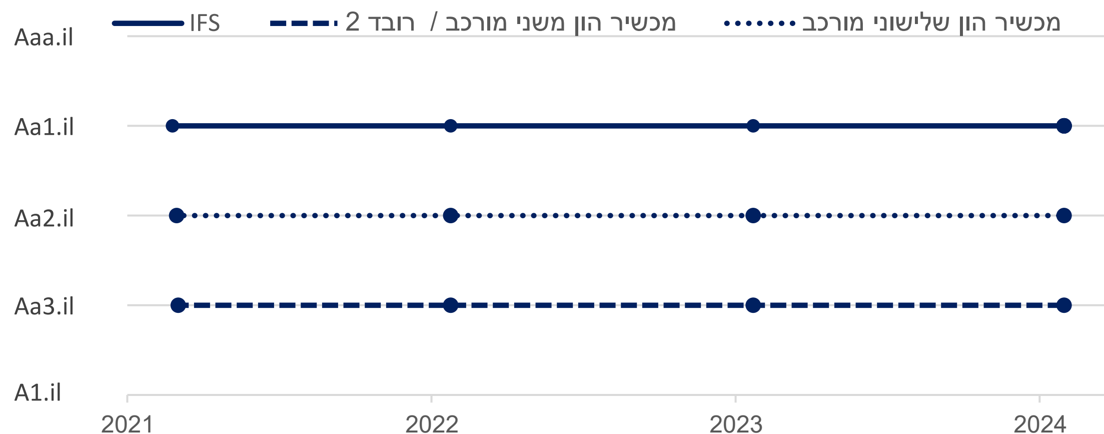

Diagram text [key]:

Solid line: IFS

Dashed line: Hybrid Tier-2 capital instrument / Tier-2 capital

Small dotted line: Hybrid Tier-3 capital instrument

Related reports

Harel Insurance Company Ltd. – related reports

Harel Insurance Investments and Financial Services Ltd. – related reports

Rating for Life assurance, Health and Non-life Companies - Methodology Report, May 2022

Special Report: "Repercussions of the Swords of Iron War on the Credit Repayment Capacity of Issuers Rated by Midroog", October 2023

Guidelines for assessing environmental, social and corporate governance risks as part of a credit rating – Methodology Report, February 2022

Table of affiliations and holdings

Midroog Rating Scales and Definitions

The reports are published (in Hebrew) on Midroog's website www.midroog.co.il

General Information

Date of rating report:	February 8, 2024
Date of previous rating update:	January 30, 2023
Publication date of initial rating:	February 24, 2021
Name of rating initiator:	Harel Insurance Company Ltd.
Rating paid for by:	Harel Insurance Company Ltd.

Information from the Issuer

Midroog's rating relies, among other things, on information received from authorized parties at the issuer.

Local Long-term Rating Scale

Aaa.il	**Issuers or issues rated Aaa.il demonstrate, in Midroog's judgment, have the highest creditworthiness relative to other local issuers.**
Aa.il	**Issuers or issues rated Aa.il demonstrate, in Midroog's judgment, very high creditworthiness relative to other local issuers.**
A.il	**Issuers or issues rated A.il demonstrate, in Midroog's judgment, high creditworthiness relative to other local issuers.**
Baa.il	**Issuers or issues rated Baa.il demonstrate, in Midroog's judgment, moderate creditworthiness relative to other local issuers and may possess certain speculative characteristics.**
Ba.il	**Issuers or issues rated Ba.il demonstrate, in Midroog's judgment, weak creditworthiness relative to other local issuers and may possess speculative characteristics.**
B.il	**Issuers or issues rated B.il demonstrate, in Midroog's judgment, very weak creditworthiness relative to other local issuers and possess speculative characteristics.**
Caa.il	**Issuers or issues rated Caa.il demonstrate, in Midroog's judgment, excessively weak creditworthiness relative to other local issuers and possess very significant speculative characteristics.**
Ca.il	**Issuers or issues rated Ca.il demonstrate, in Midroog's judgment, extremely weak creditworthiness and are very near insolvency, with some prospect of recovery of principal or interest.**
C.il	**Issuers or issues rated C.il demonstrate, in Midroog's judgment, the weakest creditworthiness and are usually insolvent, with little prospect of recovery of principal or interest.**

Note: Midroog appends numeric modifiers 1, 2, and 3 for each rating category from Aa.il to Caa.il. The modifier "1" indicates that the debenture ranks in the higher end of its rating category, which is denoted by letters. The modifier "2" indicates a mid-range ranking category and the modifier "3" indicates a ranking in the lower end of that category, which is denoted by letters.