

Media Release:

# Outlook On Most Cathay Group Units Revised To Negative On Rising Market Volatility; Ratings Affirmed

April 29, 2020

## Overview

- A widespread economic recession amid the COVID-19 outbreak have exacerbated financial market volatility and increase downside risk for our assessment of Cathay Life's satisfactory capital and earnings.
- We are revising the rating outlook on Cathay Life to negative from stable and affirmed the issuer credit rating and financial strength rating on the insurer.
- We view Cathay Life to be the flagship company of the Cathay FHC group, and any changes in the insurer's credit profile will affect the overall group credit profile. Therefore, we are revising the outlook on our ratings on Cathay Century, Cathay Securities, and Cathay FHC. At the same time, we have affirmed our various ratings on the companies.
- We have also affirmed our ratings on Cathay United Bank with a stable outlook, given our view of implicit systematic support from the Taiwan government to the bank. At the same time, we affirmed the issue credit ratings on the bank's various debts.
- The negative outlook reflects the challenges to Cathay Life's capital resilience over the next one to two years, given the insurer's already thin capital buffer to meet our satisfactory capital assessment.

## Rating Action

Taiwan Ratings Corp. today revised its rating outlook on **Cathay Life Insurance Co. Ltd.**, **Cathay Financial Holding Co. Ltd.** (Cathay FHC), **Cathay Century Insurance Co. Ltd.**, and **Cathay Securities Corp.** to negative from stable. At the same time, we affirmed our various ratings on the companies (see ratings list). At the same time, we affirmed our ratings on **Cathay United Bank Co. Ltd.** (CUB) with a stable outlook and affirmed the issue credit ratings on the bank's debt instruments.

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## Rationale

In our view, growing capital market volatility as a result of the COVID-19 pandemic will heighten capital risk for Cathay Life over the next few quarters. We expect several factors to weigh on the insurer's capitalization. These include potential marked-to-market losses on investments, slower capital accumulation, and increasing reinvestment risks under the lower-for-longer-interest rate environment.

We also believe that Cathay Life's high investment leverage exposes the insurer to heightened balance sheet volatility as financial market uncertainties grow. This is in spite of the company's de-risking action in 2019 to lower its equity stock allocation to about 10.8% in 2019, from 14.2% in 2018. Market volatility in the first quarter of 2020 has already reduced Cathay Life's capital buffer.

We expect the current lower-for-longer interest rate environment to constrain Cathay Life's ability to accumulate capital or to improve its earnings over the next one to two years. Under our base case assumptions, we expect the company's value of in-force to grow only modestly, while the insurer's return on average assets is likely to lower to 0.3%-0.4%, from 0.5%-0.6% in 2017-2019. That said, we believe Cathay Life has proactive asset and liability risk management which helps to provide effective risk oversight and guides the company to respond in a timely manner to investment market changes.

We also acknowledged Cathay Life's efforts to reduce its liability costs. The insurer has also show it is able to manage the foreign exchange-related cost ratio on its sizeable overseas investments to ease earning pressure amid rising market uncertainty.

We anticipate Cathay Life will sustain its very strong competitive advantages as the largest player in Taiwan's life insurance market for the next one to two years. The insurer has a well-established distribution force to help secure satisfactory business prospects. At the same time, we expect Cathay Life to maintain its capitalization at about the domestic industry average through proactive risk management.

We view Cathay Life as the flagship company of the Cathay FHC group. Therefore, the increased capital risk will also affect the overall group credit profile and ultimately on our ratings on other core and highly strategic group members.

We affirmed the ratings on CUB because the bank benefits from a degree of implicit support from the Taiwan government due to its moderate systemic importance in Taiwan's banking sector. Currently the bank rating receives one notch of group support considering its core group status. If the group credit profile weakened by one notch, we believe the one-notch government support will kick in and help to maintain the bank's credit profile.

## Outlook

### **Cathay Life Insurance Co. Ltd., Cathay Financial Holding Co. Ltd., Cathay Century Insurance Co. Ltd., and Cathay Securities Corp.**

The outlook reflects the potential that the recent surge in global financial market volatility could negatively affect Cathay Life's capital resilience through asset depreciation and slower capital accumulation.

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The outlook on the Cathay FHC group members, mirrors the trend of the stand-alone credit profile for Cathay Life. We expect Cathay life to remain the group's flagship entity and we believe the insurer will dominate the group credit profile over the next few years. We also expect the group to maintain a prudent capital management policy including a supportive dividend policy for Cathay Life.

### Downward scenario

We could lower the ratings on Cathay FHC, Cathay Life, Cathay Century, and Cathay Securities if:

- Cathay Life's capital deficiency weakens due to: (1) unexpected financial market volatility with sizable and unrecoverable losses on the insurer's investment portfolio; (2) overly aggressive business growth, either organically or via merger and acquisitions, or (3) significantly slower growth of value in-force than in our current forecast; or
- The effectiveness of Cathay Life's hedging mechanism materially weakens or its hedging policies become more aggressive, resulting in higher foreign exchange risks that could negatively affect the insurer's capitalization.

### Upward scenario

We may revise the outlook on Cathay FHC, Cathay Life, Cathay Century, and Cathay Securities to stable if there is persistent restoration in Cathay Life's capital buffer to sustain our assessment of the insurer's satisfactory capital and earnings. This would also have to be accompanied by Cathay Life's stable investment allocation, very strong competitive position compared with its peers', and stable credit profiles for the other core entities of the Cathay FHC group.

## Cathay United Bank Co. Ltd.

The stable outlook reflects the likelihood that CUB's strong capitalization, satisfactory risk controls, and implicit government support will continue to sustain the bank's credit profile over the coming two years. We expect CUB to maintain its moderate systemic importance in Taiwan's banking sector with stable market share. We continue to assess CUB as a core member of Cathay FHC group because of the bank's material representation and contribution in the group.

### Downward scenario

We would lower the long-term issuer credit rating on CUB if the bank's capital and earnings weakens to adequate, or the group credit profile deteriorates significantly.

### Upward scenario

We view the likelihood of an upgrade to be remote over the next two years.

## Rating Score Snapshot

### For Cathay Life Insurance Co. Ltd.

<b>Business Risk Profile</b>	<b>Strong</b>
Competitive position	Very strong
IICRA	Moderately high
<b>Financial Risk Profile</b>	<b>Satisfactory</b>
Capital and earnings	Satisfactory
Risk exposure	Moderately low
Funding structure	Neutral
<b>Modifiers</b>	
Governance	Neutral
Liquidity	Adequate
<b>Financial Strength Rating</b>	<b>twAA+</b>
IICRA--Insurance Industry And Country Risk Assessment.	

## Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions - November 09, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions - November 09, 2011
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions - July 17, 2013
- Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology - December 09, 2014
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology - July 20, 2017
- Criteria | Insurance | General: Insurers Rating Methodology - July 01, 2019
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model - June 07, 2010
- General Criteria: Group Rating Methodology - July 01, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions - July 01, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises - December 19, 2014
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- TRC Financial Services Issue Credit Rating Criteria - July 31, 2019
- Understanding Taiwan Ratings' Rating Definitions - June 26, 2018

(Unless otherwise stated, the above articles can be found at [www.taiwanratings.com](http://www.taiwanratings.com))

## Ratings List

### Ratings Affirmed; Outlook Action

	To	From
<b>Cathay Life Insurance Co. Ltd.</b>		
Issuer Credit Rating	twAA+/Negative/--	twAA+/Stable/--
Insurer Financial Strength Rating	twAA+/Negative/--	twAA+/Stable/--
<b>Cathay Financial Holding Co. Ltd.</b>		
Issuer Credit Rating	twAA/Negative/twA-1+	twAA/Stable/twA-1+
<b>Cathay Century Insurance Co. Ltd.</b>		
Issuer Credit Rating	twAA+/Negative/--	twAA+/Stable/--
Insurer Financial Strength Rating	twAA+/Negative/--	twAA+/Stable/--
<b>Cathay Securities Corp.</b>		
Issuer Credit Rating	twAA-/Negative/twA-1+	twAA-/Stable/twA-1+
<b>Cathay United Bank Co. Ltd.</b>		
Issuer Credit Rating	twAA+/Stable/twA-1+	
Senior Debenture Issue Credit Rating	twAA+	
Unsecured Subordinated Debenture Issue Credit Rating	twAA	
Unsecured Subordinated Debenture Issue Credit Rating	twAA-	
Unsecured Subordinated Debenture Issue Credit Rating	twA	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.taiwanratings.com](http://www.taiwanratings.com) for further information. Complete ratings information is available to subscribers of Rating Research Service at [rrs.taiwanratings.com.tw](http://rrs.taiwanratings.com.tw). All ratings affected by this rating action can be found on Taiwan Ratings' public website at [www.taiwanratings.com](http://www.taiwanratings.com).

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