

Media Release:

Cathay Life Insurance And Cathay Financial Holding Ratings Affirmed On Revised Capital Model Criteria; Outlook Stable

February 6, 2024

Overview

- On Nov. 15, 2023, we published our revised criteria for analyzing insurers' risk-based capital (see "Insurer Risk-Based Capital Adequacy--Methodology And Assumptions").
- The implementation of the revised criteria has minimum impact on the credit profile of **Cathay Life Insurance Co. Ltd.** and **Cathay Financial Holding Co. Ltd.** (Cathay FHC), the holding company of the Cathay group.
- We believe Cathay Life can maintain satisfactory financial strength over the next two years and we expect the insurer's credit profile to continue to drive the overall credit profile of the parent group, given the insurer's flagship role.
- We affirmed the 'twAA+' long-term issuer credit rating and financial strength rating on Cathay Life. At the same time, we affirmed the 'twAA' long-term and 'twA-1+' short-term issuer credit ratings on Cathay FHC.
- The rating outlook is stable to reflect our expectation that Cathay Life will continue to drive the group credit profile and maintain a stable stand-alone credit profile over the next two years.

Rating Action

Taiwan Ratings Corp. today affirmed its 'twAA+' long-term issuer credit rating and financial strength rating on Cathay Life, as well as the 'twAA' long-term issue credit rating on the insurer's subordinated corporate bond. At the same time, we affirmed the 'twAA' long-term and 'twA-1+' short-term issuer credit ratings on Cathay FHC. The outlook on the long-term ratings is stable.

Impact Of Revised Capital Model Criteria

- Our revised criteria has no material impact on our assessment of Cathay Life's overall creditworthiness. Our analysis indicates the insurer will maintain satisfactory capital and earnings over the next one to two years.
- We've captured the benefits of risk diversification more explicitly in our analysis, which supports the insurer's capital adequacy. We have revised our calculation of total adjusted capital to reduce complexity and align with changes to our measure of an insurer's risk-based capital requirements, including removing haircuts to value-in-force.

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Credit Highlights

Overview

Key strengths

Leading market position and solid franchise in Taiwan's life insurance industry.

Very strong control over its distribution channels.

Well-established scale advantage.

Key risks

Higher investment leverage than its regional peers.

Average capital and earnings by domestic standards.

Outlook

The stable rating outlook on Cathay Life and Cathay FHC reflects our view that Cathay Life will continue to drive the group credit profile, while other major subsidiaries will maintain stable credit profiles over the next one to two years. We believe the life insurer will remain the group's flagship entity and continue to dominate the group credit profile over the next few years.

In addition, we assess Cathay Life will maintain satisfactory capital and earnings under its proactive asset liability management and a likely reduction in capital consumption along with slower growth in invested assets. We also believe Cathay FHC group will maintain prudent capital management including a supportive dividend policy for Cathay Life over the next few years.

Downward scenario

We could lower the long-term ratings on Cathay FHC and Cathay Life if we lower our assessment of the group credit profile due to a weakening in Cathay Life's credit profile. This may happen if:

- Cathay Life's capital deficiency weakens significantly due to: (1) unexpected financial market volatility with sizable and unrecoverable losses on the insurer's investment portfolio; (2) overly aggressive business growth; or (3) significantly slower growth of value of in-force (VIF) 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 (forex) risks that could negatively affect the insurer's capitalization.

Upward scenario

We could raise the long-term ratings if we raise our assessment of the group credit profile. This could occur if there is sustainable improvement in Cathay Life's capital such that we raise our assessment of the insurer's capital and earnings to strong from satisfactory at present. This would also have to be accompanied by the insurer's superior earnings resilience compared with its peers, along with stable credit profiles for the group's other core entities.

Rationale

The ratings on Cathay Life continue to reflect the insurer's leading market position by most measures, solid franchise in Taiwan's life insurance industry, solid competitive advantage over distribution channels, and well-established scale advantage. Counterbalancing these strengths are the company's average capital and earnings by local comparison and higher investment leverage and forex risk exposure than that of its regional peers.

Our revised criteria has no material impact on our assessment of Cathay Life's capital and earnings. In our view, Cathay Life's capitalization will remain average by local comparison over the next two to three years, despite a slight improvement in recent quarters. The insurer's risk-adjusted capitalization improved slightly at the end of 2022 on the back of good VIF accumulation, a reduced equity investment holding, and lower capital requirements from slower asset growth. Furthermore, Cathay Life's capital adequacy remains good as of June 2023, supported by a rebound in investment valuations, despite reduced earnings.

We believe Cathay Life's capitalization will continue to face pressures from market volatility, high hedging cost, and reduced opportunities for capital gains on investments over the next two years. We see these factors slowing the insurer's capitalization growth but underpinning its still-average capitalization over the same period. We believe Cathay Life will pursue business growth in line with the domestic industry average under the insurer's value-oriented product strategy. At the same time, we believe the Cathay FHC group's proactive capital management policy, including appropriate capital plans to meet Cathay Life's capital needs, will help support the insurer's capitalization.

We assume the insurer's VIF will increase by about 2% per year in 2023-2025, reflecting the ongoing risk discount rate of 9.5% on its in-force business, but hampered by high forex hedging costs. Our assumed growth rate for the insurer's VIF also considers pressure from slower business growth and potential unfavorable assumption changes that could occur if the investment market and the insurer's actual underwriting experience weaken.

Cathay Life's investment risks are neutral to its financial risk profile. We assess the insurer has satisfactory investment diversification and comprehensive forex risk controls and hedging mechanisms compared with other domestic life insurers. These factors help Cathay Life to manage the potential forex risk associated with its sizable overseas investments. By contrast, we assess the insurer's ratio of investment leverage in high-risk assets to total adjusted capital to be higher than its regional peers, albeit similar to most of its domestic peers. The insurer's investment leverage could remain high over the next two years and expose it to balance sheet volatility.

Forex risk exposures will remain manageable over the next two years, in our view. We base this on our assessment of Cathay Life's proactive hedging strategy and satisfactory track record for its hedging mechanism, including the effectiveness of the use of proxy hedging and the availability of a forex volatility reserve. We believe Cathay Life can manage its forex risk exposure without causing material risks that could weaken its fundamental capital strength.

Our assessment of the Cathay FHC group credit profile largely reflects our assessment of the stand-alone credit profile of Cathay Life. As the group's flagship unit, Cathay Life has on average accounted for about 68% of the group's net worth and over 60% of its profits over the past five years. This is supported by Cathay Life's leading market position, extensive retail customer base, and solid franchise in Taiwan's life insurance industry.

The group credit profile also reflects the group's more balanced business diversification than that of other domestic financial groups, as well as satisfactory investment diversification with strong underlying liquidity. The constraints on the group's credit profile from Cathay Life's modest capitalization as well as the insurer's investment risk somewhat offset these strengths.

The long-term issuer rating on Cathay FHC is one notch below our ratings on the group's core entities on a global rating scale, to reflect the holding company's structural subordination to these entities. However, this compares with generally a two-to-three notch gap between an insurance

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group holding company and its core units. The single notch difference reflects Cathay FHC's direct control over multiple material operating units such that non-insurance operations have contributed on average around 40% of the group's overall profits for the last three years. We also acknowledge the limited regulatory restrictions to cash flows between group members and insurance operating units and holding companies in Taiwan.

Related Criteria & Research

Related Criteria

- Criteria | Insurance | General: Insurer Risk-Based Capital Adequacy--Methodology And Assumptions, Nov 15 2023
- General Criteria: National And Regional Scale Credit Ratings Methodology, Jun 08 2023
- General Criteria: Hybrid Capital: Methodology And Assumptions, Mar 02 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct 10 2021
- General Criteria: Group Rating Methodology, Jul 01 2019
- Criteria | Insurance | General: Insurers Rating Methodology, Jul 01 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, Apr 07 2017
- General Criteria: Principles Of Credit Ratings, Feb 16 2011

Related Research

- Taiwan Ratings' Ratings Definitions – Nov. 11, 2021

(Unless otherwise stated, these articles are published on www.taiwanratings.com)

Ratings Score Snapshot

Cathay Life Insurance Co. Ltd.

Financial strength rating	twAA+
Anchor	a-
Business risk	Strong
Competitive position	Very strong
IICRA	Moderately high
Financial risk	Satisfactory
Capital and earnings	Satisfactory
Risk exposure	Moderately low
Funding structure	Neutral
Modifiers	
Governance	Neutral
Liquidity	Adequate
Comparable Ratings Analysis	0
Support	0
Group support	0

IICRA--Insurance Industry And Country Risk Assessment. SACP--Stand-alone credit profile.

Ratings List

Ratings Affirmed

Cathay Life Insurance Co. Ltd.

Issuer Credit Rating	twAA+/Stable
Financial Strength Rating	twAA+/Stable
Series 112-1 Unsecured Subordinated Corporate Bond	twAA

Cathay Financial Holding Co. Ltd.

Issuer Credit Rating	twAA/Stable/twA-1+
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