FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Rothesay at IFS 'A+'; Outlook Stable

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Fitch Ratings - London - 07 Jul 2020: Fitch Ratings has affirmed Rothesay Life Plc's Insurer Financial Strength (IFS) Rating at 'A+' (Strong) and Long-Term Issuer Default Rating (IDR) at 'A'. Fitch has also affirmed the group's ultimate holding company, Rothesay Holdco UK Limited's (Rothesay) IDR at 'A'. The Outlooks are Stable.

A full list of rating actions is below.

KEY RATING DRIVERS

The ratings reflect Rothesay's capitalisation and leverage, profitability, investment risk and asset-liability management (ALM), all of which Fitch assesses as very strong. These are somewhat offset by the group's business profile and debt service capabilities, which we assess as strong. The ratings also incorporate Fitch's current assessment of the impact of the coronavirus pandemic on Rothesay's credit fundamentals, which remain strong under our rating-case assumptions.

Fitch ranks Rothesay's business profile as moderate compared with other UK life insurance companies', reflecting Rothesay's favourable competitive positioning and moderate business risk profile, moderate operating scale and limited business diversification. Given this ranking, Fitch scores Rothesay's business profile at 'a' under its rating criteria.

Our assessment of the group's capitalisation is based primarily on an 'Extremely Strong' score in Fitch's Prism factor-based capital model (Prism FBM) at end-2019. This is reinforced by Rothesay's Solvency II solvency capital requirement (SCR) coverage ratio of 183% at end-March 2020 (end-2019: 202%). Rothesay's very strong capital position remains resilient under our COVID-19 rating-case assumptions.

Rothesay's financial leverage ratio (FLR) weakened to 28% at end-2019 (end-2018: 20%), mainly reflecting the insurer's GBP800 million issue of Tier 2 and Tier 3 subordinated debt in 2020. Under our COVID-19 rating-case assumptions, the group's pro-forma FLR increases, due to a decline in equity, but remains below our 30% negative rating sensitivity.

Rothesay's fixed-charge coverage (FCC) was around 6x in 2019. However, allowing for a full annual interest accrual for debt issued in 2019, FCC would fall to 5x. Under our rating-case assumptions the pro-forma FCC falls marginally below the 'a' category range. However, we expect that the run rate of FCC will remain commensurate with ratings owing to Rothesay's strong profit generation.

Fitch views Rothesay's financial performance as very strong, with an operating profit before tax of GBP507 million (2018: GBP355 million). Net income return on equity (ROE), although volatile, improved to 16% in 2019 (3.9% in 2018), mainly reflecting a positive investment result. Fitch expects the group to maintain operating profitability around current levels as earnings are generated reasonably predictably on its growing annuity book.

Fitch views Rothesay as having a sophisticated approach to ALM, commensurate with that required for the business it writes. The group makes extensive use of swaps to hedge longevity risk and the overall duration gap between its assets and liabilities is small, less than a year at end-2019. Rothesay maintains extensive controls around collateralisation, reducing credit risk from the swaps it holds to manage insurance and market risks.

We also view Rothesay's investment and asset risk as low. The majority of the group's investment portfolio is held in debt securities of a high credit quality.

We assess Rothesay's liquidity position as very strong, allowing the group to meet near-term liquidity requirements such as coupons and collateral requirements.

RATING SENSITIVITIES

The ratings remain sensitive to a material change in Fitch's rating-case assumptions with respect to the coronavirus pandemic. Periodic updates to our assumptions are possible given the rapid pace of changes in government actions in response to the pandemic, and the pace with which new information is made available on the medical aspects of the outbreak.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A material adverse change in Fitch's Ratings Assumptions with respect to the coronavirus impact.

--A weaker assessment of Rothesay's business profile, for example driven by a fundamental demand reduction in the market for pensions de-risking products, could lead to a downgrade.

--A substantial weakening of the group's capitalisation as evidenced by a sustained fall in the group's Prism FBM to the low end of the "Very Strong" category or a sustained increase in FLR to above 30% could also lead to a downgrade.

--The ratings could also be downgraded as a result of a sustained weakening in the group's run rate of FCC to below 4x.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--A substantial improvement in Fitch's view of Rothesay's business profile could lead to upgrade. However, we view this as unlikely in the medium term.

--A positive rating action is prefaced by Fitch's ability to reliably forecast the impact of the coronavirus pandemic on the financial profiles of both the UK life insurance industry and Rothesay.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Rothesay Life Plc	LT IDR	A Rating Outlook Stable	Affirmed
	Ins Fin Str	A+ Rating Outlook Stable	Affirmed
• subordinated	LT	BBB-	Affirmed
• subordinated	LT	BBB+	Affirmed

ENTITY/DEBT	RATING		
Rothesay Holdco UK	LT IDR	A Rating Outlook Stable	Affirmed

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Insurance Rating Criteria (pub. 02 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Prism Factor-Based Capital Model, v1.7.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Rothesay Holdco UK Limited	EU Issued
Rothesay Life Plc	EU Issued

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