



## Fitch Affirms Rothesay Life's 'A+' IFS Rating; Outlook Stable

Fitch Ratings-London-21 June 2019: 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.

At the same time, Fitch has affirmed the company's restricted Tier 1 subordinated notes' at 'BBB-' and published Rothesay Life Plc's Tier 2 subordinated notes (ISIN XS1312953596) at 'BBB+'.

### 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.

Fitch's assessment of Rothesay's business profile reflects its established record in the UK bulk annuity market and the successful annuity back-book acquisition of GBP12 billion of annuities from Prudential Plc in 2018. The UK bulk annuity market features strong fundamental demand, a small number of competitors and high barriers to entry. Fitch expects demand for de-risking products from pension schemes to rise in the medium term.

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-2018. This is reinforced by Rothesay's Solvency II solvency capital requirement (SCR) coverage ratio of 181% (end-2017: 169%). Rothesay's financial leverage ratio (FLR) strengthened to 20% at end-2018 (end-2017: 27%), mainly reflecting the growth of the equity base as a result of GBP350 million restricted Tier 1 notes and GBP380 million share capital issuance in 2018.

Fitch views Rothesay's financial performance as very strong, with operating profit before tax of GBP355 million (2017: GBP382 million). Net income return on equity (ROE) reduced to 3.9% in 2018 (16% in 2017) mainly as a result of the credit default provision increase following the credit spreads widening, but remained high at 20% per year on average in 2014-2018. Fitch expects the group to maintain operating profitability around the current levels as earnings are generated reasonably predictably on the 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 longevity swaps to hedge longevity risk and the overall duration gap between its assets and liabilities is small, less than a year at end-2018. 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.

Rothesay's fixed-charge coverage based on Fitch-calculated pre-tax operating earnings is broadly commensurate with the ratings despite it weakening to 6.5x in 2018 (2017: 11x). The decline reflects growth in interest expenses and a marginal reduction in operating profit before tax.

The Tier 2 subordinated notes XS1312953596 are rated two notches below Rothesay Life Plc's' IDR.

The notes rank junior to unsecured unsubordinated obligations. This level of subordination is reflected in Fitch's 'below average' baseline recovery assumption for the issue, which results in the notes being notched down one from the IDR.

In addition, the instrument includes a mandatory interest deferral feature, which will be triggered if Rothesay Life Plc does not meet solvency capital requirement or minimum capital requirement. Fitch regards this feature as leading to 'moderate' non-performance risk for the notes and consequently one further notch down from the IDR.

The notes receive 100% equity credit in Fitch's Prism FBM, but are treated as 100% debt in Fitch's financial debt leverage calculation.

#### RATING SENSITIVITIES

A decline in Fitch's view of Rothesay's business profile, for example driven by a downturn 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 an increase in financial leverage 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 fixed charge coverage to below 3x (6.5x in 2018).

An upgrade is unlikely in the medium term given the group's limited product and geographical diversification.

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Applicable Criteria

Insurance Rating Criteria (pub. 11 Jan 2019)

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