

**Rating Action: Moody's assigns A3 Insurance Financial Strength Rating to
Rothesay Life**

12 Jul 2018

Baa2 issuer rating assigned to Rothesay Holdco

London, 12 July 2018 -- Moody's Investors Service has assigned an A3 insurance financial strength rating and a Baa1 issuer rating to Rothesay Life Plc (Rothesay Life), the main operating company of the Rothesay Group (Rothesay, the Group). Moody's has also assigned a Baa2 issuer rating to Rothesay's ultimate holding company, Rothesay Holdco UK Limited (Rothesay Holdco). The rating outlook is stable.

RATINGS RATIONALE

-- Rothesay Life IFSR

Moody's said that the A3 IFSR reflects Rothesay's good market position in the growing UK bulk annuity market and proven ability to acquire sizeable annuity portfolios, together with its good asset quality, profitability and financial flexibility. These strengths are mitigated somewhat by the Group's limited business and geographic diversification with a focus on the lumpy UK annuity business, very high asset leverage and a relatively moderate Solvency II ratio.

Despite its recent history, Rothesay has become one of the established UK insurers in the growing and relatively concentrated bulk annuity market. Moody's expects Rothesay's market position to remain good in this line of business which benefits from relatively high barriers to entry, especially in the largest scheme segment where Rothesay is one of the few active participants. Rothesay has also become a leading acquirer of life insurers' legacy books of business, demonstrated by its most recent acquisition of the GBP6 billion and GBP12 billion annuity portfolios from Aegon N.V. and Prudential Public Limited Company in 2016 and 2018 respectively.

Rothesay's credit profile also benefits from its lack of intangible assets and relatively conservative investment portfolio which is invested roughly half in gilts, government and supranational bonds with the balance in secured bilateral transactions. Furthermore, the Group's return on capital (ROC) performance has been strong averaging around 18% over the last five years with a level of around 11.5% in 2017. Going forward, Moody's expects the Group's ROC to reduce, reflecting an increased capital base, but overall profitability to remain at a good level.

Other credit strengths include the Group's very good ALM capability, with a close matching of assets and liabilities and active hedging of interest rate and inflation risk, and good financial flexibility. Notwithstanding the meaningful increase of the Group's adjusted financial leverage, driven by the GBP500 million bank loan to partly fund the Prudential portfolio acquisition, Moody's expects the adjusted financial leverage to reduce going forward and for earnings coverage to be at a good level. Although the Group is not listed which somewhat constrains financial flexibility, Moody's expects Rothesay to continue to benefit from the support of its three main shareholders - Blackstone, GIC and Massachusetts Mutual Life Insurance Company (MassMutual) - which recently injected GBP380 million of capital to partly fund the Prudential transaction.

In terms of credit challenges, the business and geographic diversification of Rothesay, which remains a relatively small player within the context of the overall UK life market, is constrained by its focus on UK annuities, which dominate the Group's liabilities. As a result of its focus on larger pension schemes and back book acquisitions, Rothesay's new business volume will remain lumpy and less predictable than more diversified peers, and it has significant exposure to longevity risk although its cedes around 80% of this to reinsurers. Such reliance on reinsurance is a potential long-term risk, but at least in the short to medium term, Moody's sees a continued appetite amongst reinsurers to take on longevity exposure.

Following the Prudential transaction, Rothesay's invested asset leverage is currently very elevated at around 20x shareholders' equity, meaning that relatively small exposures in relation to the overall investment portfolio become much larger when related to the Group's capital. Notwithstanding the good match they provide for the Group's illiquid annuity liabilities, Rothesay also has a meaningful proportion of its asset portfolio in more

complex and illiquid investments, some of which are not externally rated, and the Group is generally very reliant on obtaining matching adjustment approval for its investments.

From a capitalisation perspective, notwithstanding a relatively high economic solvency ratio, the Group's Solvency II ratio of around 150% following the Prudential transaction is relatively moderate compared to UK life peers as is Rothesay Life's target range of 130-150%.

-- Rothesay Life issuer rating

The Baa1 issuer rating assigned to Rothesay Life is consistent with Moody's standard notching practice for senior debt issued by insurance operating companies.

-- Rothesay Holdco

The Baa2 issuer rating assigned to Rothesay Holdco is consistent with Moody's practice of applying narrower notching for certain insurance groups domiciled in locations with enhanced regulatory supervision at a group-wide level. Rothesay Holdco, which is the ultimate holding company of the Rothesay Group, is domiciled in the UK and subject to group supervision under the Solvency II regime at a group-wide level.

WHAT COULD CHANGE THE RATING UP/DOWN

The stable rating outlook reflects our expectation that Rothesay will maintain good profitability, asset quality and financial flexibility as well as its good market position in the UK bulk annuity market.

In terms of rating drivers for Rothesay going forward, Moody's said that positive rating pressure could arise from: 1) Successful deployment of assets received and profit generation in relation to the acquisition of the GBP12 billion annuity portfolio from Prudential Public Limited Company and/or; 2) Return on capital (Moody's definition) consistently above 6% and/or; 3) Reduction in adjusted financial leverage with earnings coverage consistently above 6x.

Conversely, negative rating pressure could arise from: 1) Return on capital (Moody's definition) consistently below 4% and/or; 2) Meaningful increase in adjusted financial leverage with earnings coverage consistently below 4x and/or; 3) Group Solvency II ratio consistently below 130%.

The following ratings were assigned:

Rothesay Life Plc:

- Insurance Financial Strength Rating of A3

- Issuer rating of Baa1

The outlook is stable

Rothesay Holdco UK Limited:

- Issuer rating of Baa2

The outlook is stable

Based in the UK, Rothesay reported gross premiums written of GBP1,447 million and net income of GBP261 million at YE17.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Life Insurers published in May 2018. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

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