FitchRatings

Fitch Rates Rothesay's Proposed Restricted Tier 1 Notes 'BBB-(EXP)'

Fitch Ratings-London-05 September 2018: Fitch Ratings has assigned Rothesay Life Plc's (Issuer Default Rating (IDR) A/Stable) proposed Restricted Tier 1 subordinated notes a 'BBB-(EXP)' expected rating.

The proposed notes are rated four notches below Rothesay's IDR, comprising two notches for expected recovery and two notches for moderate non-performance risk, in line with Fitch's notching criteria. Proceeds will be used for general corporate purposes and to partially repay bank debt raised in March 2018, which funded a GBP12 billion purchase of annuities from Prudential plc (A/Stable).

KEY RATING DRIVERS
The proposed notes will not have a fixed maturity or redemption date, but will be callable after 10 years and each fifth anniversary thereafter. If the issue is not called at the first call date, the coupon will reset from fixed to floating at the rate of the then-current five-year Gilt rate plus the initial margin, and the coupon will reset in the same manner every five years thereafter if not called. The proposed notes will not have interest step-up features.

The proposed notes will rank in priority to ordinary shares in the event of winding-up, but behind senior creditors, which are defined as including Solvency II Tier 2 and Tier 3 subordinated debt. The level of subordination results in our baseline recovery assumption of 'poor'. We therefore notch down twice from the IDR for recovery.

The proposed notes will include a mandatory interest cancellation feature, which will be triggered if any minimum capital requirement applicable to the issuer is not met or if the regulator has notified the issuer that payments under the notes have to be cancelled.

The issuer will also have full discretion to cancel interest payments at any time at its option. Fitch notches down by two notches from the IDR to reflect this fully flexible interest cancellation feature, which we regard as 'moderate' non-performance risk. This represents one extra notch compared with our treatment of standard Solvency II Tier 2 instruments to reflect the higher non-performance risk arising from the fully flexible interest cancellation.

The proposed notes will be automatically written down if a trigger event occurs, which is defined as the amount of own funds eligible to cover the solvency capital requirement (SCR) being equal or less than 75% of the SCR; or the amount of own funds eligible to cover the minimum capital requirement (MCR) being equal or less than the MCR; or a breach of the SCR has occurred and compliance was not re-established within three months from the occurrence of the breach. The write-down feature does not affect our rating notching over and above that described above.

We expect the proposed notes to qualify as Restricted Tier 1 capital under Solvency II. The proposed notes will be treated as 100% equity in Fitch's Prism Factor-Based Model and our financial debt leverage calculation, given that they are non-cumulative perpetual instruments with no step-ups on call dates. However, the proposed notes will be treated as 100% debt in our total financing and commitments ratio, in common with any other debt instrument.

Fitch sees the proposed issue as positive for Rothesay's financial-debt leverage and capital adequacy, as they will replace existing bank debt. Fixed-charge coverage is negatively affected, as the proposed notes are expected to pay a higher coupon than the bank debt they will replace.

RATING SENSITIVITIES
The rating of the proposed notes is subject to the same sensitivities that may affect Rothesay's Long-Term IDR. See 'Fitch Rates Rothesay Life IFS 'A+'; Outlook Stable', dated 12 July 2018 at www.fitchratings.com for details.

Contact:
Primary Analyst
Fedor Smolyakov
Director
+44 20 3530 1306
Fitch Ratings Limited
30 North Colonnade
London E14 5GN

Secondary Analyst
Willem Loots
Senior Director
+44 20 3530 1808

Committee Chairperson
Federico Faccio
Senior Director
+44 20 3530 1394

Date of Relevant Rating Committee: 9 August 2018

Media Relations: Athos Larkou, London, Tel: +44 20 3530 1549, Email: athos.larkou@fitchratings.com

Additional information is available on www.fitchratings.com
Applicable Criteria
Insurance Rating Criteria (pub. 30 Nov 2017) (https://www.fitchratings.com/site/re/905036)

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