



Fitch Rates Rothesay Life IFS 'A+'; Outlook Stable

Fitch Ratings-London-12 July 2018: Fitch Ratings has assigned Rothesay Life Plc an 'A+' (Strong) Insurer Financial Strength (IFS) Rating and an 'A' Long-Term Issuer Default Rating (IDR). Fitch has also assigned Rothesay Holdco UK Limited (Rothesay), the group's ultimate holding company, an IDR of 'A'. The Outlooks on the Long-Term IDRs and IFS Ratings are Stable.

KEY RATING DRIVERS

The ratings reflect Rothesay's capitalisation, 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, which we assess as only strong, and high financial leverage.

Fitch's assessment of capitalisation is based primarily on the group's "Extremely Strong" score in Fitch's Prism factor-based capital model (Prism FBM) at end-2017. This view is reinforced by Rothesay's Solvency II solvency capital requirement (SCR) coverage ratio of 169% (including transitional measures). For UK annuity writers, Fitch considers the SCR ratio including the impact of transitional measures. This is because the transitional measures offset the significant Solvency II risk margin on annuity business, which in our view is an uneconomic feature of the regime.

Fitch views Rothesay's financial performance as very strong, with net income return on equity (ROE) of 16% in 2017, and 24% per annum on average in 2014-2017. Fitch expects the group to maintain 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 asset-liability management, 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 half a year at end-2017.

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 also has extensive controls around collateralisation, reducing credit risk from the swaps it holds to manage insurance and market risks.

Fitch's assessment of Rothesay's business profile as strong reflects the established track record of the group in the UK bulk annuity market, particularly on larger deals as illustrated by its purchase of GBP12 billion of annuities from Prudential Plc in March 2018, which increased Rothesay's assets under management to GBP37 billion from GBP24 billion. The UK bulk annuity market benefits from 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. The group's limited product and geographical diversification is an offsetting factor.

Rothesay's financial leverage is high for the rating, at 27% at end-2017 (end-2016: 28%). On a pro-forma basis this has increased to 35% following the funding of the Prudential Plc deal with GBP380 million of new equity and GBP500 million of new bank debt. This is a negative factor for the ratings but we expect leverage to fall below 30% over the medium term as capital requirements for the acquired business are optimised and debt is repaid.

RATING SENSITIVITIES

The ratings could be downgraded if Rothesay fails to reduce financial leverage to below 30% in the medium term.

A 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 reduction in net income ROE below 12% for a sustained period could also lead to a downgrade.

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. 30 Nov 2017)
(<https://www.fitchratings.com/site/re/905036>)

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