



RATING ACTION COMMENTARY

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

Fri 12 May, 2023 - 7:04 AM ET

Fitch Ratings - London - 12 May 2023: 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 Limited's (Rothesay), IDR at 'A'. The Outlooks are Stable.

A full list of rating actions is below.

The ratings reflect Fitch's 'very strong' assessment of Rothesay's capitalisation and leverage, financial performance, investment risk and asset-liability management (ALM). In addition, Fitch assesses the group's company profile and debt service capabilities as strong.

KEY RATING DRIVERS

Strong Company Profile: Fitch's assessment of Rothesay's company profile reflects the group's position as one of the leaders of the bulk purchase annuity (BPA) market in the UK, with total assets under management of GBP47.3 billion at end-2022 (end-2021: GBP62.5 billion). The reduction in the assets under management reflects a rise in long-term interest rates that depressed the value of its fixed income portfolio, which offset strong new business volumes in 2022.

Rothesay's new business volumes improved to GBP3.3 billion in 2022 from GBP3 billion in 2021, and we expect its new business to grow over the medium term. This will be supported by the predictable growth trend in the UK bulk annuity market and the group's significant excess capital to write new business.

Very Strong Capitalisation and Leverage: 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-2022, unchanged from end-2021. In addition, Rothesay's Solvency II (S2) capital coverage ratio improved to 255% at end-2022 (end-2021: 226%), which largely benefitted from strong surplus generation from its in-force book and higher interest rates. We expect Rothesay's S2 capital coverage ratio to remain very strong, despite some reduction as business grows.

Rothesay's Fitch-calculated financial leverage ratio (FLR) remained very strong and improved marginally to 18% at end-2022 from 19% at end-2021. We expect Rothesay's GBP500 million tier 2 debt issue in May 2023 to increase its pro-forma FLR to 23%; however, we believe the ratio will remain strong and commensurate with its rating.

Very Strong Financial Performance: We view Rothesay's profitability as very strong, with a reported pre-tax operating profit of GBP1,016 million in 2022 (2021: GBP904 million). This was buoyed mainly by stronger profits generated from its in-force book helped by higher returns on surplus assets as well as improved new business profits.

However, Rothesay's IFRS pre-tax net income fell to GBP170 million (2021: GBP913 million) driven by large economic variances due to wider credit spreads and increased interest rates that resulted in accounting losses on S2 hedges against lower interest rates. However, Fitch expects Rothesay's underlying earnings to remain very strong.

In line with its peers', we expect Rothesay's operating profit recognition to shift to a more back-end loaded profile under the new IFRS17 reporting standard that came into force on 1 January 2023.

Strong Asset Quality: Our assessment of investment risk is driven by the majority of the group's investment portfolio being held in debt securities of a high credit quality, including Rothesay's privately placed investments. Rothesay continues to expand its offshore asset origination capabilities mainly in the US, where around 25% (2021: 18%) of its total assets under management are invested. However, Rothesay continues to hold a concentrated exposure to UK sovereign debt (AA-/Negative), in line with some of its similar-rated peers, although the exposure as a proportion to its total assets under management was reduced at-end 2022.

Strong Fixed-Charge Coverage: Rothesay's fixed-charge coverage (FCC), calculated based on the reported pre-tax operating profit, was strong and remained broadly unchanged at 8x in 2022. Fitch expects Rothesay's FCC to reduce following its recent tier 2 issue but to remain commensurate with its rating, supported by strong operating profitability.

Very Strong ALM: Rothesay has a sophisticated approach to ALM, in line with that required for the business it writes. The group makes extensive use of longevity swaps to hedge longevity risk and the duration of assets and liabilities are closely matched. As a result, the reduction in asset values owing to higher interest rates is broadly matched by a reduction in Rothesay's insurance liabilities.

RATING SENSITIVITIES

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

-- A substantial improvement in Fitch's view of Rothesay's company profile

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

-- A substantial weakening of the group's capitalisation as evident by a sustained fall in the group's Prism FBM to the 'Very Strong' category or a sustained increase in FLR to above 30%

--A sustained weakening in the group's run-rate FCC to below 4x

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit

impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit

www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕		PRIOR ↕
Rothesay Life Plc	LT IDR	A Rating Outlook Stable	A Rating Outlook Stable
	Affirmed		
	LT IFS	A+ Rating Outlook Stable	A+ Rating Outlook Stable
	Affirmed		
subordinated	LT	BBB- Affirmed	BBB-
subordinated	LT	BBB+ Affirmed	BBB+
Rothesay Limited	LT IDR	A Rating Outlook Stable	A Rating Outlook Stable
	Affirmed		

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FITCH RATINGS ANALYSTS

Rishikesh Sivakumar, CFA

Associate Director

Primary Rating Analyst

+44 20 3530 2565

rishikesh.sivakumar@fitchratings.com

Fitch Ratings Ltd

30 North Colonnade, Canary Wharf London E14 5GN

Willem Loots, FIA

Senior Director

Secondary Rating Analyst

+44 20 3530 1808

willem.loots@fitchratings.com

Federico Faccio

Senior Director

Committee Chairperson

+44 20 3530 1394

federico.faccio@fitchratings.com

MEDIA CONTACTS**Athos Larkou**

London

+44 20 3530 1549

athos.larkou@thefitchgroup.com

Additional information is available on www.fitchratings.com**PARTICIPATION STATUS**

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APPLICABLE CRITERIA[Insurance Rating Criteria \(pub. 15 Jul 2022\) \(including rating assumption sensitivity\)](#)**APPLICABLE MODELS**

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

Prism Factor-Based Capital Model, v1.8.0 (1)

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Endorsement Policy

ENDORSEMENT STATUS

Rothesay Life Plc	UK Issued, EU Endorsed
Rothesay Limited	UK Issued, EU Endorsed

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