

Rating Action: Moody's upgrades Rothesay's insurance financial strength rating to A2, stable outlook

22 August 2022

London, August 22, 2022 – Moody's Investors Service ("Moody's") has upgraded by one notch to A2 from A3 the insurance financial strength rating ("IFSR"), and to A3 from Baa1 the long-term issuer rating of Rothesay Life Plc (Rothesay Life), the main operating company of Rothesay Limited ("Rothesay" or "Group"). In the same rating action, the long-term issuer rating of Rothesay Limited has also been upgraded by one notch to Baa1 from Baa2. The rating outlook on all entities has been changed to stable from positive.

A list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

The upgrade to A2 of the IFSR on Rothesay Life reflects the group's (1) well established and strong market position in the growing and relatively concentrated UK bulk annuity (BPA) market; (2) strong and sustainable return on capital performance; (3) good asset quality supported by a conservative investment portfolio and lack of intangible assets; and (4) strong asset-liability management (ALM) capabilities together with a demonstrated ability to originate the required assets to back long-duration illiquid liabilities. These strengths are somewhat tempered by the group's limited product and geographic diversity, with its sole focus on UK BPAs, which are inherently exposed to longevity risks and elevate pricing, reserving and financial market risks.

The Rating Agency considers Rothesay to be one of the leading players within the UK BPA market, with demonstrated capabilities to price, originate required assets and transact very large deals. Moody's expects Rothesay to remain active and continue to grow its assets under management, which at 31 December 2021 (YE21) stood at around £63 billion.

However, Rothesay's overall business profile will remain somewhat constrained by its moderate size in the context of the overall UK life insurance market as well as the lack of geographic and product diversity. Furthermore, given the group's focus on lumpy BPAs, Rothesay has a significant exposure to pricing, reserving, operational and longevity risk, although it cedes most of this longevity risk to reinsurers.

Rothesay's overall financial profile is good with profitability, asset quality and ALM as relative strengths. The Group's Return on Capital has averaged around 12% over the last five years (2017-2021) although results have been volatile given the focus on lumpy annuity business together with the fact that assets are often not sourced until after the execution of bulk annuity deals. This is particularly noticeable under current IFRS accounting standards. As Rothesay continues to grow its back-book over the medium term, Moody's expects it will lead to more consistent results and strong capital generation.

Whilst capitalisation has been consistently and significantly above the group's regulatory solvency target range of 130-150%, peaking at 226% as at YE21, Moody's expects the ratio to start to reduce towards the upper end of the group's target as Rothesay deploys surplus capital towards funding new deals and investment in illiquid assets, enhancing its earnings generation capacity. Notwithstanding the overall close matching of the Group's assets and liabilities and use of interest

rate hedging, the group's ratio is relatively sensitive to market movements, including a fall in UK property values, and rising inflation, although the latter would be offset to some extent by the positive impact of rising interest rates.

Rothesay's asset quality benefits from its lack of intangible assets and a relatively conservative investment portfolio. Owing to the long-duration nature of its insurance liabilities, Rothesay's asset leverage is relatively high. Notwithstanding the group's strong asset origination capabilities and 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, where credit risk could more correlated to macroeconomic conditions.

Although the group is not listed, the Rating Agency expects Rothesay's to continue to benefit from the support of its two main shareholders, GIC Funding Limited and Massachusetts Mutual Life Insurance Company. The group's adjusted financial leverage remains relatively low level at 22.3% at YE2021, although total leverage has increased to 32.8% - with the difference reflecting the Restricted Tier 1 issuances, which receive equity credit under Moody's Hybrid Equity Credit methodology, published in September 2018. Moody's expects Rothesay's earnings coverage, which amounted to 8.9x for YE21 to remain good despite higher borrowing costs, as the group's profit base continue to grow.

STABLE OUTLOOK

The stable outlook reflects the Moody's expectation that the insurer will continue to undertake meaningful bulk annuity volumes over the medium term leading to more consistent return on capital and strong capital generation.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Moody's said that the following factors could lead to an upgrade of the Group's ratings: (i) diversification and expansion of the group's position in the UK life insurance market whilst maintaining its good position in the UK BPA sector; (ii) sustaining return on capital (Moody's definition) consistently above 8%; and (iii) maintaining solvency ratio comfortably above 200%.

Conversely, negative rating pressure could arise from: (i) return on capital (Moody's definition) consistently below 6%; (ii) a meaningful and sustained increase in adjusted financial leverage with earnings coverage consistently below 6x; and/or (iii) the group's solvency II ratio consistently below 150%.

LIST OF AFFECTED RATINGS

Rothesay Life Plc:

- Insurance Financial Strength Rating, upgraded to A2 from A3
- Long-term Issuer rating, upgraded to A3 from Baa1

The outlook has been changed to Stable from Positive

Rothesay Limited:

- Long-term Issuer rating, upgraded to Baa1 from Baa2

The outlook has been changed to Stable from Positive

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Life Insurers Methodology published in August 2022 and available at <https://ratings.moodys.com/api/rmc-documents/391815>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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