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Research Update:

Legal & General Reinsurance Assigned 'A+' Ratings On Highly Strategic Status In Legal & General Group; Outlook Stable

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Overview

- In 2014, Legal & General Group (L&G Group) formed a new legal entity, Legal & General Reinsurance Co. Ltd. (L&G Re), to write new outward reinsurance business from its Bermuda domicile.
- We view the entity as highly strategic within L&G Group.
- We are therefore assigning an 'A+' rating to L&G Re, one notch below the ratings on the group's core operating entities.
- The stable outlook reflects that on the L&G Group.

Rating Action

On Dec. 18, 2015, Standard & Poor's Ratings Services assigned its 'A+' long-term insurer financial strength rating to Bermuda-based Legal & General Reinsurance Co. Ltd. (L&G Re), a reinsurance subsidiary of Legal & General Group (core operating subsidiaries rated AA-/Stable). The outlook is stable.

Rationale

We consider L&G Re to be a highly strategic subsidiary of the Legal & General Group (L&G Group), owing to its targeted key role in pursuing the group's expansion in the international longevity risk transfer market. Based on our group rating methodology, we rate L&G Re one notch below our ratings on the group's core operating entities.

Our view of the subsidiary's highly strategic status is based on L&G Re's role within the group. L&G Re is aligned with the international diversification agenda of the L&G Retirement Division, which generates about 30% of the group's profits. L&G Re operates from Bermuda, but has close operational, strategic, and financial integration with the rest of the group. We recognize this operation as a platform for the group to build its third-party international reinsurance business. This affirms our view of this subsidiary as highly strategic to group operations.

The ratings on L&G Re reflect our view that the operations in Bermuda will continue to be an important part of Legal & General's group structure. L&G Re represented less than 5% of the group's capital base as of year-end 2014, but we expect it to grow over time due to retained earnings and growth in third-party reinsurance business. L&G Re has written a 10% quota share treaty

of the inforce and new annuity business of L&G Group since July 1, 2014. We expect this book of business to generate over £50 million in net profits annually for L&G Re. While group-originated business accounts for 100% of L&G Re's business at inception, its business plan envisions substantial growth in international third-party business from The Netherlands, Canada, the U.S., and other countries.

In our view, the internal quota share treaty provides a capital and earnings buffer to support L&G Re's development. It also reduces the risks typically associated with start-up insurers. Our opinion that the internal reinsurance contract is a sustainable and enduring feature of L&G Re's profile supports its group status.

There is some execution risk associated with this initiative, in our view. This new business, to be brought in through L&G Re, will not have the benefit of a track record within the Legal & General group. That said, the pricing for the new business at L&G Re is conducted utilizing similarly robust tools and data, and is subject to the same profitability hurdle rates. Risk management oversight allows the group to closely monitor and control the subsidiary.

The ratings on L&G Group reflect its very strong competitive position in the U.K., as well as its strong financial risk profile. In our opinion, L&G retains one of the most favorable business risk profiles in the U.K. life sector through its expertise across products--including its market-leading risk and asset management operations, its multichannel distribution model, and a respected brand.

Legal & General Group is a leading provider of life and pensions products in the U.K., where it writes 73% of its life and pensions new business (totaling about £10 billion in gross premium written in 2014). International operations are primarily concentrated in the U.S. and The Netherlands. The group is also a U.K. household insurer, writing nearly £400 million of gross premium in 2014. The group's investment management business, Legal & General Investment Management Ltd., is one of the top global index fund managers, holding about £500 billion of funds under management.

Outlook

The stable outlook on L&G Re mirrors that on the core operating subsidiaries of L&G Group and, as long as we continue to view the entity as highly strategic, the rating on L&G Re will move in lock-step with that on the group.

Downside scenario

Although we do not expect it, a weakening in group support could result in us lowering the ratings on L&G Re. This could occur following an unexpected change in the internal quota share reinsurance contract or a divergence between L&G Re's strategy or risk profile and the group's.

Upside scenario

We consider it unlikely that we would raise the ratings over the next two years. An upgrade would likely be dependent on a change in group status to core. This could occur if L&G Re develops a multiyear track record of successful growth in its international reinsurance business and levels of risk-adjusted profitability closely aligned with those of the group.

Related Criteria And Research

- Group Rating Methodology, Nov. 19, 2013
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

New Rating; CreditWatch/Outlook Action

Legal & General Reinsurance Co Ltd

Financial Strength Rating

Local Currency

A+/Stable/--

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