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Ratings

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Scottish Equitable PLC

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Scottish Equitable PLC

SACP* Assessments				SACP*		Support		Ratings
Anchor	bbb+	+ Modifiers	0	= bbb+		+ 3		= Financial Strength Rating
Business Risk		ERM and Management	0	Liquidity	0	Group Support	3	A+/Negative/--
Satisfactory								
Financial Risk		Holistic Analysis	0	Sovereign Risk	0	Gov't Support	0	
Moderately Strong								

*Stand-alone credit profile.
See Ratings Detail for a complete list of rated entities and ratings covered by this report.

Strengths

- Longstanding history in the U.K. market and well-established relationships with intermediaries.
- Strong capital and earnings, supported by a capital-light strategy and debt-free balance sheet.
- Strategically important to the Netherlands-based Aegon group, and therefore our rating on SEPLC benefits from three notches of uplift for group support.

Weaknesses

- Execution risk remains in the build-up of its fee-based business.
- Weaker and volatile operating performance compared to peers.

Rationale

The ratings predominantly reflect our view that SEPLC has a good business position in the U.K.'s life insurance and workplace pensions sectors and a solid financial profile, supported by strong capital and earnings.

We believe that SEPLC is strategically important to the Aegon group, therefore our ratings on SEPLC benefit from three notches of uplift from the 'bbb+' stand-alone credit profile (SACP), leading to 'A+' issuer credit and insurer financial strength ratings.

SEPLC's strategic focus is to develop its platform/capital light business and move toward a fee-based business model. In our view, these developments, if successfully implemented, would support SEPLC's competitive position and enable the company to generate better earnings in the longer term. These factors are also likely to support SEPLC's importance to the Aegon group.

Outlook: Negative

The negative outlook on SEPLC is based on the outlook on the core entities of the Aegon group. The outlook also continues to reflect some uncertainties related to SEPLC's ability to successfully execute its strategy and deliver results that support its strategic importance to Aegon group.

Downside scenario

If we were to downgrade the Aegon group, we would also likely downgrade SEPLC. Although it is not our base-case scenario, we could lower the ratings if we revise our view of SEPLC's group status to moderately strategic.

This could occur if:

- New business margins are consistently negative;
- The U.K. operations fail to integrate all the newly acquired businesses successfully; or
- Although unlikely, capital adequacy declines to levels significantly below the 'A' level of confidence, according to our capital model.

Upside scenario

Our revision of the outlook on SEPLC to stable primarily depends on a similar action on the Aegon group, together with successful execution of SEPLC's strategy.

Base-Case Scenario

Table 1

United Kingdom Selected Indicators

	2018	2019	2020	2021
ECONOMIC INDICATORS (%)				
Real GDP growth	1.3	1.3	1.5	1.2
Unemployment rate	4.1	4.3	4.5	4.6
MONETARY INDICATORS (%)				
CPI growth	2.4	1.9	1.7	2.6

- We expect the 10-year government yield to be 1.47% in 2018, 1.89% and 2.19% in 2019, and 2.90% in 2020.
- Brexit disruptions are a potential concern for companies operating out of the U.K.

Key Metrics

	Year-end Dec. 31					
	2019F	**2018F**	**2017A**	**2016A**	**2015A**	**2014A**
Net income (mil. £)	30-50	30-50	34.4	(2.0)	(589.4)	175.5
ROE (%)	2-4	2-4	2.2	(0.1)	(29.7)	6.7
GPW (mil. £)	N/A	N/A	8,399	7,997	5,996	3,917
NPW (mil. £)	N/A	N/A	7,881	(1,867)	5,652	3,573
Total invested assets (mil. £)	N/A	N/A	57,296	54,528	58,512	59,830
Net investment income (mil. £)	N/A	N/A	1,311	1,342	1,642	1,652
Net investment yield (%)	N/A	N/A	2.3	2.5	2.8	2.8
Shareholder equity (mil. £)	N/A	N/A	1,366	1,721	1,682	2,288
S&P Global Ratings capital adequacy	Extremely strong	Extremely strong	Extremely strong	Extremely strong	Extremely strong	Extremely strong

A--Actual. F--Forecast. N/A--Not applicable.

Business Risk Profile: Satisfactory

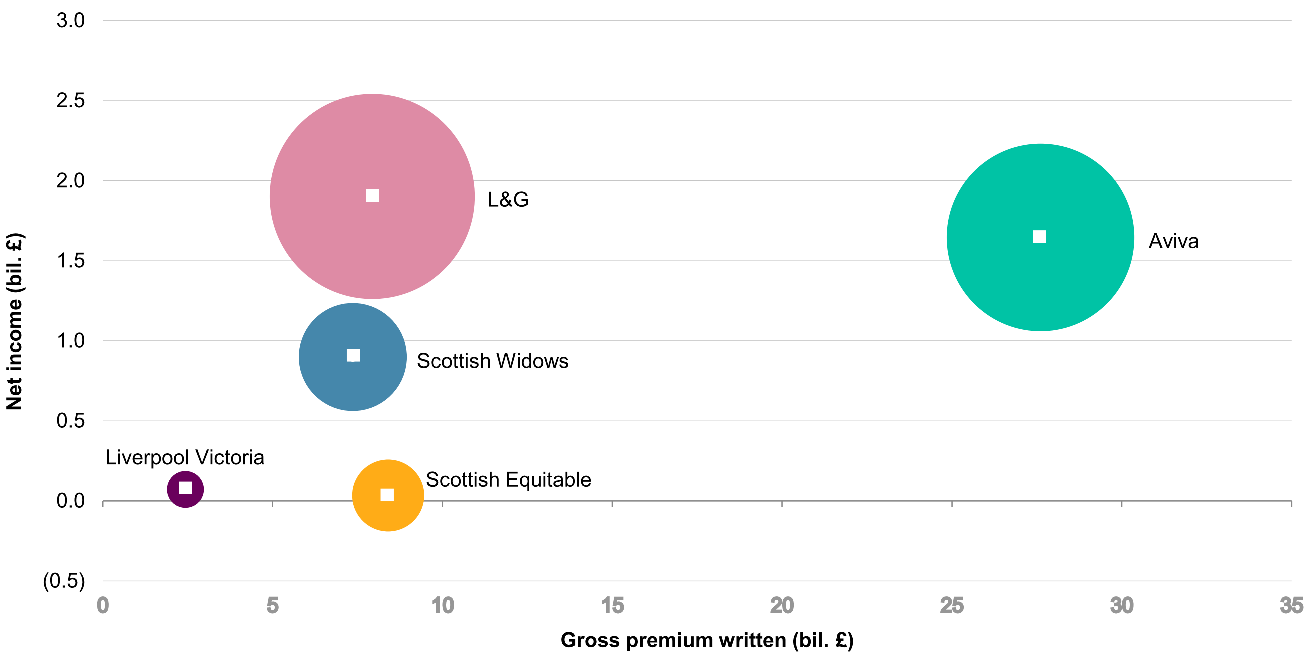
SEPLC's business is focused on the provision of highly competitive corporate and individual pensions, and protection and savings products in the U.K. Mitigating this is SEPLC's well-established positions with a long history and is well-known among the intermediary community.

SEPLC's strategic focus on developing and marketing its platform offering has made it a leading platform provider in the U.K. However, the company still faces several execution challenges in transforming its business model through the integration of newly acquired businesses and divestments. This contributed to the delay in delivering some cost savings and missing our earnings expectations for 2018 (based on unaudited 2018 results).

SEPLC's margins on its new business have been historically negative, mostly due to a lack of scale at its platform business. However, because of recent acquisitions and the ongoing transfer of unit-linked business to its platform business, SEPLC achieved a positive margin in 2017. The company is therefore now in a good position to improve its earnings. Nonetheless, we still consider that SEPLC lags behind higher-rated peers, particularly after the sale of its annuity business. The changing business profile distorts this comparison.

Chart 1

Scottish Equitable PLC Peer Comparison By Gross Premium Written, Net Income, And Assets Under Management In 2017



Bubble size represents assets under management. For reference, Scottish Equitable assets under management = £57.3 bil.
Point at centre of bubble represents exact gross premium written and net income.
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We also consider that uncertainties remain around the development of persistency rates as SEPLC completes the transfer of assets onto its platform and as the auto-enrolled-schemes market develops.

Financial Risk Profile: Moderately Strong

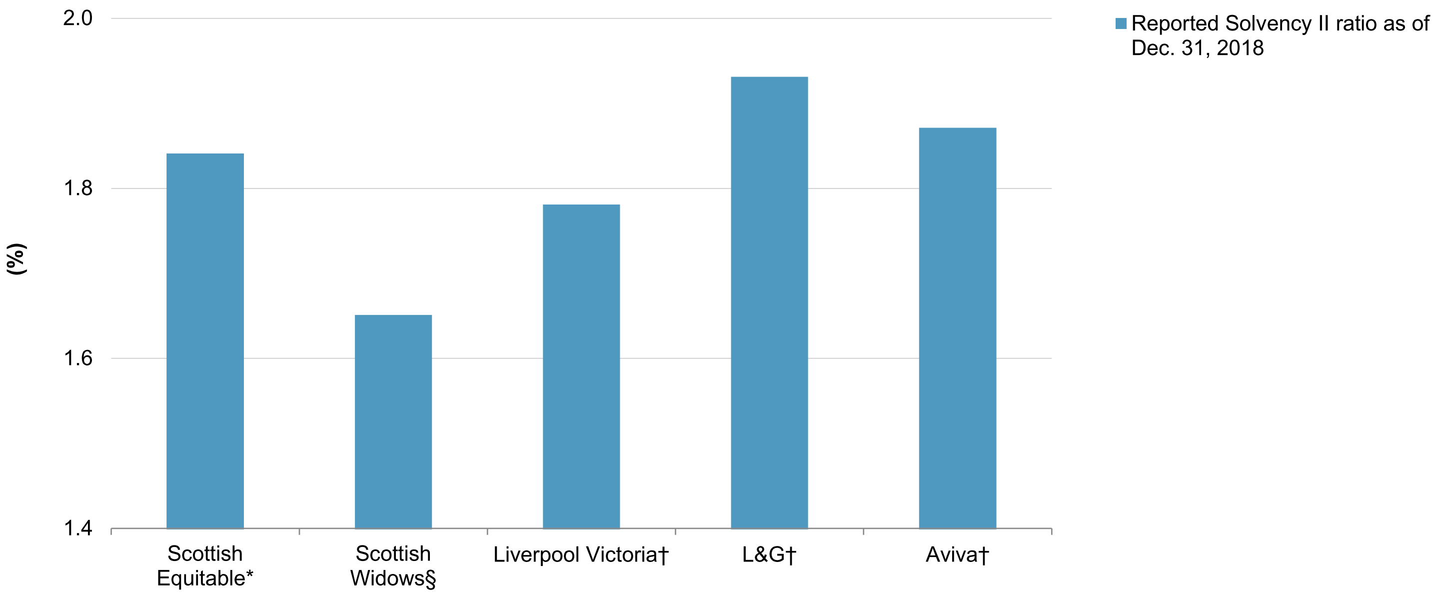
Benefits from capital-light balance sheet

We anticipate that SEPLC will maintain its strong capital and earnings following the sale of its annuity business. The latter has reduced its asset and liability capital requirements significantly. Our view of the company's risk-based capital takes into account the reliance on weaker capital components (the value in force implied on Solvency II basis) and the uncertainty around the level of capital returned to its parent.

That said, we recognize the company is committed to maintaining robust coverage under the Solvency II capital regime. We do not expect aggressive levels of capital returned to SEPLC's parent.

Chart 2

Scottish Equitable Peer Comparison



*Estimated solvency level reported in Aegon 2018 results refers to Aegon UK, which includes Scottish Equitable, rather than Scottish Equitable's standalone solvency ratio. §Estimated pre-final dividend solvency II ratio. †As of June 30, 2018.

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Earnings have been affected by the ongoing costs of platform-related expenses and asset de-risking in 2018; however, we anticipate they will improve progressively over the rating horizon as the platform expands and margins improve.

Over 2019-2020, we expect SEPLC's net income to be £30 million-£50 million annually.

At the wider Aegon U.K. group level, we expect earnings to improve over the medium term as the group increases the scale of its platform business by: (i) transferring its old unit-linked business onto the platform, as well as integrating the recently acquired Cofunds business; and (ii) attracting new U.K. pensions and savings business.

SEPLC's material pension scheme exposure also weighs on its risk position as it could contribute to volatility. However, our view of its risk position is supported by material reductions in risk in the with-profits fund, reducing the company's exposure to interest rate and market risk. Furthermore, the annuity sale has de-risked SEPLC's balance sheet.

Following the sale of its annuity book, SEPLC's potential need for additional capital has reduced significantly. We expect the Aegon group to provide capital to SEPLC if needed. SEPLC's funding needs are largely dependent on the Aegon group, bearing in mind it is strategically important to the group.

Other Assessments

We view SEPLC as integrated into the Aegon group with regard to enterprise risk management (ERM). We assess the group, and therefore SEPLC, as having strong ERM, reflecting our positive view of the risk-management culture, risk controls, and strategic risk management.

We continue to view ERM of low importance to SEPLC, reflecting its capital-light, simple business model. This is supported by the sale of the majority of its U.K. annuity book.

We view the risk model as neutral. The risk framework predominantly relies on the locally approved risk-based regulatory model, which is under a strong governance framework. The choice of the group's economic framework depends on the decision-making circumstance and suitability.

SEPLC's strategy is primarily focused on building its fee-based business. While we believe that the abovementioned acquisitions will contribute positively to the company's scale, we recognize the execution risk. That said, we think that SEPLC's strong risk controls mitigate this risk to some extent.

Recent signs that the platform is gaining traction give us some confidence in the platform strategy's chances of success. Furthermore, we consider that the team's success in cutting costs has materially improved SEPLC's earnings prospects.

We regard SEPLC's liquidity as exceptional, owing to the strength of available liquidity sources. We have no concerns regarding refinancing risk and we consider the group capable of managing unexpectedly large claims or an increase in life-insurance-policy lapses.

Support

We view SEPLC as strategically important to the Aegon group. This reflects SEPLC's focus on fee-based products, and its capital light risk profile particularly following the sale of the annuity book aligns it well with Aegon group's long-term strategy. Furthermore, SEPLC provides diversification by geography and product type.

Scottish Equitable PLC	
Rating Score Snapshot	
Financial Strength Rating	A+/Negative
SACP	bbb+
Anchor	bbb+
Business Risk Profile	Satisfactory
IICRA*	Low Risk
Competitive Position	Adequate
Financial Risk Profile	Moderately Strong
Capital & Earnings	Strong
Risk Position	Moderate Risk
Financial Flexibility	Adequate

Scottish Equitable PLC (cont.)	
Modifiers	0
ERM and Management	0
Enterprise Risk Management	Strong
Management & Governance	Satisfactory
Holistic Analysis	0
Liquidity	Exceptional
Support	+3
Group Support	+3
Government Support	0

*Insurance Industry And Country Risk Assessment. NB: Support does not consider Ratings Above Sovereign criteria.

Related Criteria

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of March 7, 2019)	
Operating Company Covered By This Report	
Scottish Equitable PLC	
Financial Strength Rating	
Local Currency	A+/Negative/--
Issuer Credit Rating	
Local Currency	A+/Negative/--
Domicile	United Kingdom

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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