MOODY'S
INVESTORS SERVICE

# Rating Action: Moody's changes outlook to stable on selected UK life insurers; Aviva placed on review for upgrade

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**Stable outlook for Legal & General, Prudential UK, and Royal London. Aviva and its UK subsidiaries on review for upgrade**

London, 19 June 2017 -- Moody's Investors Service has today taken rating actions on four UK life insurance groups and their associated ratings.

Moody's affirmed the ratings and changed the outlooks to stable from negative for:

- Legal & General Group Plc

- Prudential Assurance Company Ltd

- Royal London Mutual Insurance Society Ltd.

Moody's has also placed on review for upgrade the ratings of Aviva Plc and its main UK operating companies.

The actions reflect Moody's expectation that the impact of Brexit on the UK life insurance sector will be moderate and operational risks are manageable over the next 12 to 18 months. This expectation is the main driver also behind Moody's revision of its outlook to stable from negative on the UK life sector https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1075364 . For Aviva, the rating action also reflects continued improvements in the Group's financial profile, and notably its profitability and capitalisation.

Please refer to the end of this press release for a detailed list of affected insurance ratings.

RATINGS RATIONALE

The change in outlook for selected UK life insurers is driven by our expectation that the impact of Brexit on UK life insurers' capital and earnings will be moderate over the next 12 to 18 months. This is given the UK's resilient macroeconomic environment since the referendum vote and the recovery of financial markets following an initial downturn. This expectation reflects Moody's base case scenario that the UK and the EU will eventually come to an agreement that broadly mimics most — but not all— of current trading and regulatory arrangements.

UK life insurers' solvency and earnings have proved resilient since the referendum vote. The recovery in financial markets to date - the FTSE 100 has risen by around 20% from 24 June 2016 and UK 10 year government bond yields have almost doubled from the low point of around 0.5 in August 2016 - and insurers' diversified investment portfolios have protected the sector's Solvency II ratios which, for most insurers, increased in 2H16.

The sector's profitability has also held up well, notwithstanding increasing competition and persistent regulatory headwinds, with the majority of UK insurers increasing their operating profit in 2016. This resilient performance reflects certain strengths of the UK life insurance business model which has given insurers significant asset gathering and fee revenue generation capability, together with growing sales of non-fee products such as protection, bulk annuities, and equity release. Also, while low interest rates weigh on the investment returns of UK life insurers, they are less vulnerable than most of their European counterparts because of the nature of their liabilities, in particular the high proportion of unit-linked policies with no guarantees and the smaller and declining book of variable-bonus with-profits business.

However, we recognise that there remains material uncertainty over the impact of Brexit over the medium to long-term. There are clear downside risks to our base case which could have negative implications for economic growth and financial markets, resulting in possible repercussions for the UK life sector, given its high asset leverage and material exposure to UK financial markets.

--- ISSUER SPECIFIC ACTIONS

RATINGS AFFIRMED - OUTLOOK CHANGED TO STABLE FROM NEGATIVE

--Legal & General Group Plc

Moody's has revised the outlook to stable from negative on Legal & General Group Plc (L&G) and associated ratings reflecting Moody's expectation that the impact of Brexit on L&G will be moderate over the next 12 to 18 months, and that L&G maintains its strong competitive position, profitability and financial flexibility.

In 2016 L&G reported a good set of results, including strong growth in 2H16. Net cash generation increased by 12% to GBP1,411 million and IFRS operating profit was up by 11% to GBP1,628 million, reflecting growth in the asset management and especially retirement businesses. The group's improved profitability also helped increase its earnings coverage to a relatively high 9.3x (YE15: 9.2x).

Furthermore, L&G's capitalisation remained robust in 2016. The group's shareholder Solvency II ratio improved during 2H16 to 171% (1H16: 163%) and reduced only slightly compared to YE15 (176%), and its economic capital solvency ratio was stable at a relatively high 230%.

Moody's has also affirmed the A2 insurance financial strength rating (IFSR) with a stable outlook on Legal & General Insurance Limited (LGI), L&G's non-life insurer. The rating reflects LGI's continued good profitability and capitalisation and continues to benefit from some implicit support from L&G. However, the rating is not aligned with the Aa3 IFSR of L&G's main operating entity, Legal & General Assurance Society Ltd., in light of LGI's relatively small size and the non-life nature of its business.

WHAT COULD MOVE THE RATINGS DOWN/UP

Positive rating pressure for L&G could arise from: 1) A substantial improvement in the geographic diversification of revenues and profit and/or 2) Adjusted financial leverage and total leverage consistently below 25% and 30% respectively and earnings coverage above 10x and/or 3) Material improvement in solvency

Negative rating pressure could arise from: 1) Material deterioration in solvency and/or 2) adjusted financial leverage consistently above 30% and earnings coverage below 6x 3) a material deterioration of bottom line earnings and underlying profits

--Prudential UK

Moody's has revised the outlook to stable from negative on Prudential Assurance Company Ltd (PAC), Prudential Public Limited Company's (Prudential plc) main UK life operating company, reflecting Moody's expectation that the impact of Brexit on PAC will be moderate over the next 12 to 18 months, and that PAC will maintain its market leading position and outperformance in UK with-profits savings business, along with strong capitalisation and stable core profitability.

In 2016 Prudential UK (Pru UK) reported good growth in its retail APE sales and new business profit (NBP), which both increased by 33% to GBP1,160 million and GBP268 million respectively, although overall NBP fell by 16% as a result of Pru UK's withdrawal from bulk annuities. Following the 60% increase in 2015, IFRS operating profit reduced by 32% to GBP799 million in 2016, negatively affected by a GBP175 million (gross of any reinsurance recovery) provision related to a regulatory review concerning non-advised annuity sales, and by reduced profits from annuity new business following its withdrawal from the bulk annuity market. Moody's views Pru UK's core in-force profit, which reduced by 7% in 2016 to GBP601 million, as resilient and will enable Pru UK to continue to up-stream meaningful and stable dividends to Prudential plc.

Capitalisation improved during 2016, with the shareholder Solvency II ratio increasing to 163% (1H16: 138%, YE15: 146%), and the with-profit ratio increasing to 179% (1H16: 176%, YE15: 175%). The regulatory Solvency II ratio of PAC, which maintains one of the financially strongest life funds in the UK with a GBP9 billion inherited estate, was lower at 139% but excludes around GBP3.9 billion of with-profits surplus because of restrictions on ring-fenced funds which apply to all insurers.

Following its Part VII transfer into PAC in October 2016 and its subsequent deauthorisation by the UK regulator, Moody's has withdrawn its IFSR on Prudential Retirement Income Ltd.

WHAT COULD MOVE THE RATINGS DOWN/UP

Positive rating pressure could arise from: 1) Meaningfully increased product diversification without compromising profitability and/or 2) Meaningfully increased profitability on both an operating profit and new business profit basis and/or 3) Substantially reduced levels of equities and diminished volatility in capitalisation.

Negative rating pressure could arise from: 1) Depressed levels of sales with a consequent impact on profitability and/or 2) capitalisation falls materially.

--Royal London Mutual Insurance Society Ltd.

Moody's has revised the outlook to stable from negative on Royal London Mutual Insurance Society Ltd. (RL) reflecting Moody's expectation that the impact of Brexit on RL will be moderate over the next 12 to 18 months, and that RL maintains a strong capitalisation. Profitability and financial flexibility remain commensurate to its financial strength rating.

In 2016 RL reported a good set of results characterised by good growth. New business (PVNBP basis) of Life & Pension operations increased by 28% to GBP8.7 billion (YE2015: GBP6.8 billion), particularly reflecting double-digit growth in its group and individual pension proposition. RLAM, the asset management business, also reported growing net inflows of GBP2.3 billion and funds under managements rising by c.18% to GBP100 billion (YE2015: GBP85 billion). IFRS result before tax and transfers to unallocated divisible surplus grew materially to GBP325 million (2015: GBP143 million), primarily reflecting a positive investment performance which more than offset a GBP165 million one-off charge resulting from a change in the rate curve used to discount technical provisions.

Furthermore, capitalisation remained robust in 2016. As at 31 December 2016 RL's open fund, which includes the capital requirements on new business, reported a relatively high 206% Solvency II coverage ratio (1 January 2016: 239%), with an year-on-year decrease primarily reflecting a lower 10 year swap rate.

The Solvency II ratio of RL's closed funds was also relatively high at 249% when including c.GBP2.6 billion of with-profits surplus (1 January 2016: GBP1.7 billion). However this surplus is ring-fenced within the closed funds and not fully fungible under Solvency II rules applying to all insurers. As a result the regulatory Solvency II coverage ratio ("regulatory view") was 153% (1 January 2016: 169%).

WHAT COULD MOVE THE RATINGS DOWN/UP

Positive rating pressure for RL could arise from a material increase in market share within the UK life and pensions market with no deterioration in its profitability and capital adequacy fundamentals.

Negative rating pressure could arise from 1) a substantial deterioration in the group's economic capitalisation due to market disruption events or active M&A, or 2) a Sharpe ratio consistently below 100% and/or new business margin on Life & Pension business consistently below 1%, or 3) an adjusted financial leverage in excess of 30%

RATINGS PLACED ON REVIEW FOR UPGRADE

--Aviva Plc

The review for upgrade on Aviva Plc and its subsidiaries reflects continued improvements in Aviva group's financial profile, notably in its profitability and capitalisation. According to Moody's, these improvements result from the substantial de-risking and business re-focusing that Aviva undertook in recent years. Moody's review will focus on the sustainability of this enhanced operating performance and improved capital position. The review for upgrade also reflects Moody's expectation that the impact of Brexit on Aviva will be moderate over the next 12 to 18 months.

Commenting on 2016 profitability, Moody's mentions that, despite the lower reported net results of GBP859 million (GBP1,097 million in 2015), the group's operating profits increased significantly by 12% (GBP3,010 million versus GBP2,688 million in 2015). Aviva's 2016 reported net results were negatively impacted by a revaluation of reserves triggered by the change in the regulatory rate (known as Ogden rate) used to discount motor insurance annuity reserves in the UK, that Moody's considers a one-off item and which impacted the entire motor insurance sector in the UK. Aviva's operating profits benefitted from increased synergies following the acquisition of Friends Life in 2015 and from lower restructuring costs, which Moody's expects to continue in 2017.

In addition, Moody's believes that, whilst maintaining its leading position in the UK insurance market, Aviva's aggregate risk profile has improved following the group's restructuring over the last five years, notably through a series of disposals and de-risking of its assets and liabilities. Moody's adds that Aviva's geographic and business diversification (with 62% of the group's premiums related to life insurance and 38% related to P&C insurance), as well as the group's focus on retail business, will help the company to report a low volatility in its operating profits.

Going forward Aviva's profitability could further benefit from synergies from bolt-on acquisitions, such as the acquisition of RBC General Insurance Company in Canada in 2016, from continued growth in asset management and from a successful implementation of its composite digital offering to its customers.

Commenting on Aviva's capitalisation, Moody's says that Aviva reported a solvency ratio, based on its internal model and excluding the with-profit business, of 189% in 2016, up from 181% in 2015. The regulatory Solvency II ratio (including with-profit business, with a surplus for this business capped at zero) was 172% in 2016. Moody's says that the increase in solvency ratio was driven by model changes but also by good capital generation (earnings generated by the group represented GBP1.7 billion in 2016 when including holding costs and interest expenses, equivalent to 13 percentage points of the solvency ratio) and by low sensitivity to financial risks. Moody's expects Aviva's economic capital to prove resilient and show low levels of volatility thanks to the group's low risk profile.

In 2017, Aviva's solvency ratio will further improve with the sale of the majority of its Spanish operations. Nonetheless, this improvement combined with expected organic growth will be partly offset by Aviva's intention to redeploy capital. On 25 May 2017, Aviva announced a GBP300 million share buy-back and is also considering debt repayment and bolt-on acquisitions.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Moody's review will focus on the sustainability of the improvements that Aviva reported in profitability and capitalisation.

Aviva Plc's ratings could be upgraded if 1) the group reported consistently good profitability, as evidenced by a return on capital of 7% or above (on a normalized basis, notably excluding amortisation of intangibles) and Moody's concluded that such level of profitability would be sustainable and 2) the group maintained a strong level of capital.

SUMMARY PROFILES OF AFFECTED GROUPS

Aviva Plc, headquartered in London, United Kingdom, had consolidated total assets of GBP440.4 billion and total equity of GBP19,551 million at year-end 2016 under IFRS.

Legal & General Group Plc, headquartered in London, United Kingdom, had consolidated total assets of GBP468 billion and total equity of GBP7,283 million at year-end 2016 under IFRS.

Prudential Assurance Company Ltd, headquartered in London, United Kingdom, had total assets of GBP186 billion and shareholders' funds of GBP13,623 million at year-end 2016 under UK GAAP.

Royal London Mutual Insurance Society Ltd., headquartered in London, United Kingdom, had consolidated total assets of GBP91 billion and unallocated divisible surplus of GBP3,292 million at year-end 2016 under IFRS.

LIST OF AFFECTED RATINGS

Issuer: Aviva Plc

..Placed on Review for Upgrade:

....Senior Unsecured Regular Bond/Debenture, currently A3

....Senior Unsecured Medium-Term Note Program, currently (P)A3

....Subordinate Regular Bond/Debenture, currently Baa1(hyb)

....Subordinate Medium-Term Note Program, currently (P)Baa1

....Junior Subordinated Regular Bond/Debenture, currently Baa1(hyb)

....Tier III debt Regular Bond/Debenture, currently Baa1(hyb)

....Tier III Debt Medium-Term Note Program, currently (P)Baa1

....Preferred Stock, currently Baa2(hyb)

....Commercial Paper, currently P-2

..Affirmation:

....Backed Commercial Paper, affirmed P-1

..Outlook Action:

....Outlook changed to Ratings under Review from Stable

Issuer: Aviva International Insurance Limited

..Placed on Review for Upgrade:

....Insurance Financial Strength Rating, currently A1

..Outlook Action:

....Outlook changed to Ratings under Review from Stable

Issuer: Aviva Insurance Limited

..Placed on Review for Upgrade:

....Insurance Financial Strength Rating, currently A1

..Outlook Action:

....Outlook changed to Ratings under Review from Stable

Issuer: Aviva Life & Pensions UK Limited

..Placed on Review for Upgrade:

....Insurance Financial Strength Rating, currently A1

..Outlook Action:

....Outlook changed to Ratings under Review from Stable

Issuer: Friends Life Limited

..Placed on Review for Upgrade:

....Insurance Financial Strength Rating, currently A1

..Outlook Action:

....Outlook changed to Ratings under Review from Stable

Issuer: Friends Life Holdings plc

..Placed on Review for Upgrade:

....Backed Junior Subordinated Regular Bond/Debenture, currently Baa1(hyb)

....Backed Senior Subordinated Regular Bond/Debenture, currently A3(hyb)

..Outlook Action:

....Outlook changed to Ratings under Review from Stable

Issuer: Prudential Assurance Company Ltd

..Affirmation:

....Insurance Financial Strength Rating, affirmed Aa3

..Outlook Action:

....Outlook changed to Stable from Negative

Issuer: Scottish Amicable Insurance Fund

..Affirmation:

....Insurance Financial Strength Rating, affirmed Aa3

..Outlook Action:

....Outlook changed to Stable from Negative

Issuer: Prudential Retirement Income Ltd

..Withdrawal:

....Insurance Financial Strength Rating, withdrawn, previously at Aa3

..Outlook Action:

....Outlook changed to Rating Withdrawn from Negative

Issuer: Scottish Amicable Finance Plc

..Affirmations:

....Backed Subordinate Regular Bond/Debenture, affirmed A2(hyb)

..Outlook Action:

....Outlook changed to Stable from Negative

Issuer: Royal London Mutual Insurance Society Ltd.

..Affirmation:

....Insurance Financial Strength Rating, affirmed A2

..Outlook Action:

....Outlook changed to Stable from Negative

Issuer: Scottish Life Fund

..Affirmation:

....Insurance Financial Strength Rating, affirmed A2

..Outlook Action:

....Outlook changed to Stable from Negative

Issuer: RL Finance Bonds No. 2 plc

..Affirmation:

....Backed Subordinate Regular Bond/Debenture, affirmed Baa1(hyb)

..Outlook Action:

....Outlook changed to Stable from Negative

Issuer: RL Finance Bonds No. 3 plc

..Affirmation:

....Backed Subordinate Regular Bond/Debenture, affirmed Baa1(hyb)

..Outlook Action:

....Outlook changed to Stable from Negative

Issuer: Legal & General Group Plc

..Affirmations:

....Long-term Issuer Rating, affirmed A3

....Senior Unsecured Medium-Term Note Program, affirmed (P)A3

....Subordinate Regular Bond/Debenture, affirmed Baa1(hyb)

....Subordinate Medium-Term Note Program, affirmed (P)Baa1

....Junior Subordinated Regular Bond/Debenture, affirmed Baa1(hyb)

..Outlook Action:

....Outlook changed to Stable from Negative

Issuer: Legal & General Assurance Society Ltd.

..Affirmation:

....Insurance Financial Strength Rating, affirmed Aa3

..Outlook Action:

....Outlook changed to Stable from Negative

Issuer: Legal & General Insurance Limited

..Affirmation:

....Insurance Financial Strength Rating, affirmed A2

..Outlook Actions:

....Outlook remains Stable

Issuer: Legal & General Finance plc

..Affirmations:

....Long-term Issuer Rating, affirmed A3

....Backed Senior Unsecured Regular Bond/Debenture, affirmed A3

....Backed Senior Unsecured Medium-Term Note Program, affirmed (P)A3

....Backed Commercial Paper, affirmed P-2

..Outlook Action:

....Outlook changed to Stable from Negative

PRINCIPAL METHODOLOGIES

The methodologies used in rating Aviva Plc were Global Life Insurers published in April 2016, and Global Property and Casualty Insurers published in May 2017. The principal methodology used in rating Aviva Insurance Limited, Aviva International Insurance Limited and Legal & General Insurance Limited was Global Property and Casualty Insurers published in May 2017. The principal methodology used in rating Aviva Life & Pensions UK Limited, Friends Life Limited, Friends Life Holdings plc, Prudential Assurance Company Ltd, Scottish Amicable Insurance Fund, Scottish Amicable Finance Plc, Royal London Mutual Insurance Society Ltd., RL Finance Bonds No. 2 plc, RL Finance Bonds No. 3 plc, Scottish Life Fund, Legal & General Group Plc, Legal & General Assurance Society Ltd. and Legal & General Finance plc was Global Life Insurers published in April 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

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The person who approved Aviva Plc, Aviva Insurance Limited, Aviva International Insurance Limited, Aviva Life & Pensions UK Limited, Friends Life Limited, Friends Life Holdings plc, Prudential Assurance Company Ltd, Scottish Amicable Insurance Fund, Prudential Retirement Income Ltd, Scottish Amicable Finance Plc, Royal London Mutual Insurance Society Ltd., RL Finance Bonds No. 2 plc, RL Finance Bonds No. 3 plc and Scottish Life Fund credit ratings is Antonello Aquino, Associate Managing Director, Financial Institutions Group, JOURNALISTS: 44 20 7772 5456, SUBSCRIBERS: 44 20 7772 5454. The person who approved Legal & General Group Plc, Legal & General Assurance Society Ltd., Legal & General Insurance Limited and Legal & General Finance plc credit ratings is Simon Harris, MD-Gbl Ins and Mgd Invests, Financial Institutions Group, JOURNALISTS: 44 20 7772 5456, SUBSCRIBERS: 44 20 7772 5454.

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