MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns Baa1(hyb) rating to Royal London's guaranteed dated subordinated notes

Global Credit Research - 03 Nov 2015

London, 03 November 2015 -- Moody's Investors Service has assigned a Baa1(hyb) rating, stable outlook, to the planned guaranteed subordinated notes to be issued by RL Finance Bonds No.3 plc and guaranteed by Royal London Mutual Insurance Society Ltd ("Royal London").

The Baa1(hyb) rating of the bonds is based on the expectation that there will be no material difference between current and final documentation.

RL Finance Bonds No.3 is a direct wholly-owned subsidiary of Royal London. The company is a special purpose vehicle established for the purpose of issuing the new securities. The proceeds of the notes will be on-lent to Royal London on the same interest, repayment and subordinated terms applicable to those of the notes.

RATINGS RATIONALE

The Baa1(hyb) rating is two notches below the A2 Insurance Financial Strength Rating (IFSR) of Royal London, in line with Moody's standard notching practice for subordinated debt guaranteed by an insurance operating company. The rating reflects (i) the subordination of the bonds, (ii) the mandatory coupon deferral mechanism and (iii) the cumulative nature of deferred coupons, in case of deferral.

The notes issue is a dated subordinated notes issue with a bullet maturity of 13 years. The subordinated notes are guaranteed on a subordinated basis by Royal London and rank pari-passu with the existing GBP400 million tier 2 notes and senior to the outstanding GBP246 million upper tier 2 notes, which Royal London announced it intends to call next December.

The new instrument contains a mandatory interest deferral trigger, notably based upon breach of solvency requirements. Upon a mandatory coupon deferral, no profit-share arrangements will be declared or paid. The terms of the notes explicitly state that the mandatory coupon deferral trigger will be based on breach of Royal London's Solvency II capital requirements on implementation of Solvency II. However, any deferred interest payment will constitute arrears of interest and remains payable by Royal London at a future date (cumulative coupon deferral mechanism).

The notes are intended to qualify as Tier 2 capital under Solvency II. The documentation of the notes also allows the company to substitute or vary the terms of the securities under certain circumstances, including the situations where, as a result of change in regulation, the instrument would no longer fully qualify as regulatory capital under Solvency II. Nonetheless, Moody's believes that the terms cannot be changed in a way that is materially adverse to the investor.

The proceeds of the notes will be used by Royal London for general corporate purposes. The notes will not receive equity credit from Moody's given that the maturity is less than 30 years. Nevertheless, the impact on leverage metrics will be modest as the debt issuance is slightly in excess of the outstanding GBP246 million subordinated notes the company intends to call next December. Moody's estimates financial and total leverage will modestly increase to a strong pro-forma 16% and 19% at year-end 2014.

Moody's maintains an A2 IFSR for Royal London and the Scottish Life Fund, a sub-fund of Royal London. The primary driver for the A2 rating is the company's very strong capitalisation and the existing product range which remains relatively low risk. This is counteracted by a relatively small market share in the very competitive UK life market and an elevated exposure to high-risk assets, which has significantly increased following the acquisition of CIS in 2013. Nevertheless, Moody's notes that the investment risk in CIS is partially mitigated by considerable hedging protection and the participating nature of the liabilities, which enable sharing of investment risk with policyholders if equity markets decline.

Moody's views Royal London's capitalisation as very strong and one of the main credit strengths. At H1 2015, IGD coverage remained stable at 134% from year-end levels. Nevertheless, we believe Royal London's IGD number does not recognize the solvency surplus in closed funds, which we view as robust with limited burn-through risk.

The IGD solvency cover in the open funds improved to an excellent 833% at H1 2015 (YE2014: 744%). On a more economic basis, the group's realistic excess of capital on a Solvency I basis slightly increased to an excellent GBP3.4 billion at H1 2015 from year-end levels despite the volatility in investment markets.

WHAT COULD MOVE THE RATINGS UP/DOWN

Positive rating pressure is unlikely in the short term given the stable outlook. However, the rating could be upgraded if there is a material increase in market share within the UK life and pensions market without deteriorating its profitability and capitalization fundamentals.

Conversely, negative rating pressure could occur 1) - A substantial deterioration in the group's economic capitalization due to market disruption events or active M&A, 2)- UK life insurance market share of less than 1%, 3)- Adjusted financial leverage in excess of 30%, or 4)- return on capital consistently below 4% and PVNBP margins persistently below 1%.

RATING LIST

The following rating has been assigned with a stable outlook:

RL Finance Bonds No. 3 plc -- Subordinated Notes at Baa1(hyb) guaranteed by Royal London Mutual Insurance Society Ltd.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Global Life Insurers published in August 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

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