FitchRatings

Fitch Affirms Pension Insurance Corp's 'A+' IFS Rating; Outlook Stable

Fitch Ratings-London-21 May 2019: Fitch Ratings has affirmed Pension Insurance Corporation PLC's (PIC) Insurer Financial Strength (IFS) Rating at 'A+' (Strong) and Long-Term Issuer Default Rating (IDR) at 'A'. The Outlooks are Stable. Fitch has also affirmed PIC's subordinated notes' 'BBB+' rating.

KEY RATING DRIVERS
The ratings reflect PIC's strong position in the UK bulk annuity market, which is offset by the firm's lack of diversification as a specialist UK annuity writer. The company's strong profitability, very strong capitalisation, low investment risk and very strong asset-liability management also support the ratings.

Fitch ranks PIC's business profile as moderate compared with other UK life insurance companies, reflecting PIC's favourable competitive positioning and business risk profile, moderate operating scale and limited business diversification. Given this ranking, Fitch scores PIC's business profile at 'a' under its rating criteria.

Fitch's assessment of PIC's business profile reflects its established record in the UK bulk annuity market and strong demand for de-risking products from UK pension schemes. PIC almost doubled new business premiums in 2018 compared to 2017 results, achieving a record GBP7.1 billion. This equated to around 30% of overall market buy-in and buy-out volumes in 2018. The UK bulk annuity market features strong fundamental demand, a small number of competitors and high barriers to entry. Fitch expects demand for de-risking products from pension schemes to rise in the medium term.

Offsetting these strengths is the company's concentrated exposure to a single, albeit very important, segment of the UK life insurance sector. As an annuity specialist, PIC has no business line diversification, which leaves it exposed to any downturn in the bulk annuity market. However, the business model is not reliant on writing particular volumes in any given year.

Fitch expects PIC's profitability to remain strong, driven by selective writing of profitable new business and strong returns on investments. PIC's net income return on equity remained at 16% over 2018, which compares favourably with rated peers. Unlike some of its peers, PIC's profit recognition is spread over the life of the contract, resulting in in-force margins being significantly higher than new business margin and driving long-term profitability.

Fitch views PIC's capital position as very strong, giving the company resilience to withstand market fluctuations and supporting the ratings. The company's regulatory Solvency II (S2) coverage ratio improved to 167% at end-2018 (end-2017: 160%), and its score on Fitch's Prism Factor-Based Capital Model (Prism FBM) remained 'Extremely Strong' at end-2018.

PIC's financial leverage ratio (FLR) increased to 27% at end-2018 (end-2017: 21%), following the September 2018 subordinated Tier 2 notes issuance of GBP350 million. This remains commensurate with the rating despite deteriorating towards the upper limit of the 'A' category. We expect the FLR to gradually strengthen over the next two years as a result of PIC's strong profitability and capital generation.

Fitch views PIC's investment and asset risk as low, as driven by a Fitch-calculated risky assets-to-equity ratio of 51% (end-2018). The majority of the company's investment portfolio is held in debt securities, which are on average of high credit quality.

In our view, PIC has a sophisticated approach to asset-liability management, commensurate with that required for the business that the company writes. The company makes extensive use of interest rate swaps, which further reduces its exposure to movements in interest rates. PIC also uses extensive longevity reinsurance to protect its earnings and capital from unexpected longevity improvements over time.

PIC's fixed-charge coverage (FCC) remained at the 2017 level as earnings growth in 2018 offset extra interest costs of the new debt issuance. We expect the company's run-rate FCC to remain commensurate with the ratings.

RATING SENSITIVITIES

A decline in Fitch's view of PIC's business profile, for example driven by a sustained downturn in the market for pensions de-risking products, could lead to a downgrade.

The ratings could also be downgraded in the event of a significant weakening of the group's capitalisation, as evidenced for example by a decrease in the group's S2 SCR coverage to below 130%. An increase in financial leverage to above 30% could also lead to a downgrade.

PIC's ratings could be upgraded following an increase in product and geographical diversification. However, we view this as unlikely given PIC's focus on the UK bulk annuity segment.

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Applicable Criteria
Insurance Rating Criteria (pub. 11 Jan 2019)

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