Research Update:

U K Insurance Ltd. Affirmed At 'A'; Restricted Tier 1 Notes Raised To 'BB+' Under Revised Hybrid Criteria

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Overview

- Direct Line Insurance Group PLC (DLG) has a leading position in U.K. personal lines, supported by robust operating performance.
- The group is less diversified than some of its 'A' rated peers in terms of both geography and product line.
- We are affirming our 'A' rating on the group's main operating subsidiary U K Insurance Ltd.
- At the same time we are upgrading the group's restricted tier one notes by one notch to 'BB+' under our revised hybrid criteria.
- The outlook is stable because we believe DLG will continue to maintain capital adequacy at least comfortably at the 'A' level over the next 24 months, under our risk-based capital model.

Rating Action

On July 18, 2019, S&P Global Ratings affirmed its 'A' long-term insurer financial strength and issuer credit ratings on U K Insurance Ltd. (UKI), the core operating subsidiary of U.K.-domiciled Direct Line Insurance Group PLC (DLG). We also affirmed the 'BBB+' issuer credit rating on the group's holding company DLG. The outlook is stable.

At the same time, we raised the rating on DLG's restricted tier 1 (RT1) notes to 'BB+' from 'BB' and affirmed the rating on its tier 2 subordinated notes at 'BBB+'.

Outlook

The stable outlook reflects our view that DLG will continue to maintain capital adequacy at least comfortably at the 'A' level over the next 24 months, under our risk-based capital model. We also expect that DLG will maintain stable earnings during this period, a conservative investment profile, and a strong competitive position in the U.K. non-life market.

Downside scenario

Although we consider a downgrade unlikely in the next two years, we could lower the rating if:

- The group's capital adequacy were to fall below the 'A' category and the group was unable or not committed to rebuilding capital to meet our 'A' level requirement; or
- The group's underwriting profitability and market share significantly deteriorated with combined ratios consistently above 100%.

Upside scenario

We consider an upgrade unlikely in the next two to three years. However, we would consider raising the rating if DLG's management committed to maintaining its capital consistently at the 'AAA' confidence level.

Rationale

The rating action on DLG's RT1 notes follows our review of the notes under our revised criteria ("General Criteria: Hybrid Capital: Methodology And Assumptions," published July 1, 2019, on RatingsDirect).

The rating on DLG reflects the group's leading position in the U.K. personal lines insurance market and its very strong capital adequacy under our risk-based capital model. The rating also reflects the consistent underwriting profits DLG's management has delivered since the group listed on the London Stock Exchange in 2012. The group remains relatively undiversified outside of the U.K. personal lines market.

Following the new criteria implementation, the rating on the RT1 notes is now three notches below the long-term issuer credit rating (ICR) on DLG:

- One notch to reflect the notes' subordination to the company's senior obligations;
- One notch to reflect the risk of a potential temporary write-down of principal; and
- One notch to reflect the payment risk created by the mandatory and optional coupon cancellation features.

The rating on these notes was previously one notch lower, because we believed that the payment risk was higher than for the group's other hybrid instruments. We now believe that the payment risk on these notes is not materially greater than for the group's tier 2 hybrids, which would also be required to defer coupons upon a breach of DLG's solvency capital requirement (SCR). We believe that one notch is sufficient to reflect the payment risk on these notes as well as on the group's other hybrids, in part because the SCR coverage level has been strong and is expected to remain so with limited sensitivity or volatility. The SCR stood at 170% on Dec. 31, 2018.

We will monitor DLG's SCR coverage and capital plans to assess whether the ICR adequately incorporates the payment risk associated with DLG's hybrid instruments. An unexpected deterioration in the group's regulatory solvency position not accompanied by our raising the ICR, or increased sensitivity to stress, could lead us to lower the rating on the notes by widening the notching between them and the ICR, in order to ensure that the rating on the hybrid instruments follows a measured transition to default.

Ratings Score Snapshot

Business Risk Profile	**Strong**
Competitive position	Strong
IICRA	Intermediate risk
Financial Risk Profile	**Very Strong**
Capital and earnings	Very Strong
Risk exposure	Moderately low
Funding structure	Neutral
Anchor*	a
Modifiers	
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0
Financial Strength Rating	**A**

*This is influenced by DLG's concentration in one country (the U.K.) compared with its more geographically diverse 'A+' rated peers.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria | Insurance | Property/Casualty: Assessing Property/Casualty Insurers' Loss Reserves, Nov. 26, 2013
- 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 List

Upgraded

	To	From
Direct Line Insurance Group PLC		
Subordinated	BB+	BB

Ratings Affirmed	
Direct Line Insurance Group PLC	
Issuer Credit Rating	
Local Currency	BBB+/Stable/--
Junior Subordinated*	BBB+
U K Insurance Ltd.	
Issuer Credit Rating	
Local Currency	A/Stable/--
Financial Strength Rating	
Local Currency	A/Stable/--

*Guaranteed by U K Insurance Ltd.

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