

Research Update:

Legal & General Assurance Society Ratings Lowered To 'AA-' On Elevated Industry And Economic Risks; Outlook Stable

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Overview

- Elevated industry and economic risks in the U.K. life sector continue to weigh on credit quality for insurers operating in this market.
- We are lowering our ratings on Legal & General Assurance Society Ltd. to 'AA-' from 'AA' owing to its concentration in the U.K.
- The stable outlook takes into account these risks and recognizes the strength of Legal & General's business and financial profile to respond to these pressures.

Rating Action

On Feb. 9, 2010, Standard & Poor's Ratings Services lowered its long-term counterparty credit and insurer financial strength ratings on U.K.-based life insurer Legal & General Assurance Society Ltd. (LGAS) to 'AA-' from 'AA'. At the same time, we lowered our long-term counterparty credit ratings on the group holding company, Legal & General Group PLC (L&G), to 'A' from 'A+', and our long-term counterparty credit and insurer financial strength ratings on L&G's U.S.-based life insurance subsidiaries, Banner Life Insurance Co. and William Penn Life Insurance Co. of NY to 'A+' from 'AA-'. In addition, the 'A-1' short-term counterparty credit ratings on L&G were affirmed. The outlook on all ratings is stable. (See Ratings List below for all rating actions.)

Rationale

The downgrade of L&G and its operating subsidiaries reflects our view that industry and economic risks in the U.K. life sector remain elevated. In our opinion, these risks are weighing on credit quality for all insurers operating in this market. We consider that L&G's concentration in the U.K. life market exposes it to these risks and to changes in the competitive landscape. Relative to other insurers with ratings in the 'AA' category, this U.K. concentration is increasingly viewed as a weakness in its rating profile.

The ratings on LGAS continue to reflect its very strong competitive position in the U.K., very strong consolidated capital adequacy, and robust underlying operating performance. These strengths are partly offset, however, by the challenging operating environment for U.K. life insurers, its limited geographic diversification, and its weaker financial profile than historically.

In our opinion, L&G retains one of the most favorable business profiles in the U.K. life sector. L&G's very strong position in the U.K. financial services market is based on its diverse distribution, high-quality retail

product range, expertise in index-tracking fund management, and strong brand. L&G continues to be successful in securing strategic alliances and leveraging group synergies across its risk, savings, and asset management operations to support its market position. The difficult operating environment, however, continues to constrain new sales.

L&G's robust underlying operating performance is supported by its very strong business profile. Earnings are well diversified by type, with relatively stable and resilient underlying earnings contributions from its market-leading risk and asset management operations. Earnings from savings products are a relative weakness owing to the adverse impact of fiscal changes and the economic and financial market climate, but management action on business mix, pricing, and costs is improving earnings prospects. We view favorably actions to de-risk shareholder assets and reduce new business strain to enhance earnings quality and cashflow.

L&G's robust underlying earnings, a recovery in equity markets, and de-risking have resulted in an improvement in capital adequacy during 2009, supporting our very strong assessment. L&G's risk profile has evolved over recent years as equity risk has been managed down and replaced by risks associated with its growing volumes of annuity business. Despite the increase in financial leverage to 30% on a pro forma basis at June 30, 2009, we continue to view capital quality as supportive of the rating reflecting the high quality of the group's balance sheet. We consider that actions over recent years to improve capital efficiency indicate that management is likely to operate with a somewhat weaker financial profile than historically, although remaining very strong.

Outlook

The stable outlook takes into account our assumption that industry and economic risks in the U.K. life sector will remain elevated over the rating horizon. We believe L&G is well positioned relative to peers to respond to these pressures, increase market share, and deliver new business margins ahead of peers. We anticipate L&G maintaining very strong capital adequacy, financial leverage below 30%, and fixed charge cover above 5x.

We will continue to monitor the potential impact of the developing Solvency II standards. Adoption by the EC of the latest CEIOPS (Committee of European Insurance and Occupational Pensions Supervisors) advice--which is not our assumption--would have significant implications for annuity writers in the U.K., including L&G. A material adverse outcome from Solvency II that could not be mitigated by management could lead to negative rating actions. We see no upside potential for the rating over the near term.

Related Research

- Interactive Ratings Methodology, April 22, 2009
- Group Methodology, April 22, 2009
- Holding Company Analysis, June 11, 2009
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Downgraded

	To	From
Legal & General Assurance Society Ltd.		
Counterparty credit rating	AA-/Stable/--	AA/Negative/--
Insurer financial strength rating	AA-/Stable	AA/Negative

Legal & General Group PLC

Counterparty credit rating	A/Stable/A-1	A+/Negative/A-1
Junior subordinated debt	BBB+	A-

Banner Life Insurance Co./ William Penn Life Insurance Co. of NY

Counterparty credit rating	A+/Stable/--	AA-/Negative/--
Insurer financial strength rating	A+/Stable	AA-/Negative

Ratings Affirmed

Legal & General Finance PLC

Commercial paper A-1*

*Guaranteed by Legal & General Group PLC.

N.B.--This does not include all ratings affected.

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