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Research Update:

St. James's Place U.K. PLC Ratings Affirmed At 'A-' After Insurance Criteria Change; Outlook Stable

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Research Update:

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Overview

- Following a review of U.K.-based St. James's Place U.K. PLC (SJPUK) under our revised insurance criteria, we are affirming our 'A-' ratings.
- The ratings reflect our view of SJPUK's satisfactory business risk profile and strong financial risk profile.
- We no longer link the ratings on SJPUK to Lloyds Banking Group due to the bank's minority shareholding.
- The stable outlook reflects our view that the company has sufficient competitive advantages in the wealth management market to maintain growing sales and earnings despite significant regulatory change.

Rating Action

On May 30, 2013, Standard & Poor's Ratings Services affirmed its 'A-' counterparty credit and insurer financial strength ratings on U.K.-based insurer St. James's Place U.K. PLC (SJPUK). The outlook is stable.

Rationale

The ratings on SJPUK, a wholly owned subsidiary of U.K.-based wealth management group, St. James's Place PLC (SJP), reflect our view of SJPUK's satisfactory business risk profile and strong financial risk profile. The satisfactory business risk profile is based on our view of low industry and country risk in the U.K. and the company's adequate competitive position as one of the U.K.'s largest advice-based wealth managers. SJPUK's strong financial risk profile is based on our view that the company has strong capital and earnings, a low risk position, and adequate financial flexibility. We consider enterprise risk management (ERM) and management and governance to be neutral for the ratings. Overall, we combine these factors to derive a stand-alone credit profile of 'a-' for SJPUK. We no longer link the ratings on SJPUK to Lloyds Banking Group (LBG) due to the bank's minority shareholding of 21% of SJP's shares.

SJP's sales are almost exclusively in the U.K. As such, we consider that the company has low industry and country risk. Our view is supported by our positive opinion of the U.K.'s institutional framework and the U.K. life sector's strong track record of minimizing asset-liability mismatches. We consider the sector to be highly competitive; nevertheless, we believe that it

maintains moderate levels of profitability.

We assess SJP's competitive position as adequate. The company occupies a robust position in a concentrated segment of the U.K. life market, selling unit-linked products with no guarantees principally to high-net-worth customers. A key strength is the company's distribution network of tied agents. The number of these agents, as well as their productivity, has continued to grow despite new regulations in the U.K. requiring advisors to pass additional professional qualifications. We note also that SJP has earned consistently good margins through its distribution network.

Our overall view of SJP's competition position is constrained, however, by the narrowness of its business model. As a result, the company is more susceptible to industry, regulatory, and reputational risks than peers. Earnings are almost exclusively driven by fee income. Sixty per cent of the company's funds under management (FUM) are composed of equities; as a result, capital market movements could diminish fee income from the unhedged annual management charges. Demonstrating that SJP can add value to its clients by selecting funds which outperform the market will be key to the company keeping lapse rates low and maintaining its competitive position. We believe the company has achieved this over recent years, having experienced very stable retention rates on existing funds of around 95%.

We consider that SJP has strong capital and earnings. Our extremely strong assessment of capital adequacy, based on our risk-adjusted capital model, is tempered by the small size of capital, lower quality of capital, and exposure to operational risks that our risk-based capital model does not adequately capture. We consider the quality of total adjusted capital (TAC) to be low because it is heavily reliant on the present value of future profits, one of the softer forms of capital for which we give credit in our model.

We believe that SJP's capital position will be sustained by its ability to generate cash from its growing FUM, which are subject to only limited capital requirements given the lack of insurance risk. As at Dec. 31, 2012, SJP had FUM of £34.8 billion. The nature of SJP's product structure is that new business is cash neutral over the first six years. After this time, assets held on behalf of policyholders are cash generative. SJP's strong growth over recent years means that around 30% of the FUM do not generate cash profits, but are likely to do so over the next six years. We expect the combination of the maturing back book and the company's limited capital needs to comfortably offset the material dividend growth that it has signalled to the market.

We consider SJP's risk position as low risk. The company manages its balance sheet extremely conservatively and we believe that it is likely to continue to do so. The majority of the company's shareholder assets are invested either in U.K. government bonds or diversified among a range of 'AAA' money market funds. The cash balances of £182.5 million as at Dec. 31, 2012 are nearly all held in a number of U.K. banks that we consider to be highly systemically important. Within the company's back book there are no investment guarantees limiting SJP's exposure to interest rate risks. In addition, the company has

heavily reinsured the demographic risks in its small back book of protection liabilities.

We consider that SJP has adequate financial flexibility. This view is based on the company's low capital needs, as well as its largely debt-free balance sheet. At present, the company's track record is unproven in the debt markets and we would expect financing, if needed, to be in the form of bank loans.

We consider enterprise risk management (ERM) and management and governance to be neutral for the ratings. Our assessment of ERM for SJP is adequate with strong risk controls. We consider the importance of ERM to be low given the company's stable risk profile and conservative risk appetite.

We consider management and governance to be satisfactory. SJP's management team has specific financial and operational targets based on a range of metrics. We consider the company's consistent strategy--where it focuses on growing its unit-linked FUM and minimizing insurance risk--as a strength. We view the management team as proactive, as demonstrated by how it positioned its network of tied agents in the lead up to the Retail Distribution Review. The management team's ability to execute its strategy is demonstrated by its track record of profitable growth through the cycle.

We consider liquidity to be exceptional. The company's shareholder assets are invested in highly liquid assets, while the company's insurance liabilities are almost entirely made up of unit-linked business, with limited liquidity risk.

Outlook

The stable outlook reflects our view that SJP has sufficient competitive advantages within the wealth management sector to maintain growing sales and earnings despite significant regulatory change.

We are unlikely to raise the ratings on SJPUK over the next two years given the narrowness of its distribution model and susceptibility to industry or regulatory change.

We may lower the ratings if:

- We believe that SJP is unable to maintain its competitive position as a result of regulatory change or increased competition in its core market segment;
- Retention rates as a percentage of average FUM were to fall below 90% or if net flows were to turn negative, which could indicate a weakening in the business model; or
- The company's capital structure weakens due to greater leverage of the balance sheet.

Ratings Score Snapshot

Financial Strength Rating	A-/Stable/--
Anchor	a-
Business Risk Profile	Satisfactory
IICRA	Low Risk
Competitive Position	Adequate
Financial Risk Profile	Strong
Capital & Earnings	Strong
Risk Position	Low Risk
Financial Flexibility	Adequate
Modifiers	0
ERM and Management	0
Enterprise Risk Management	Adequate With Strong Risk Controls
Management & Governance	Satisfactory
Holistic Analysis	0
Liquidity	Exceptional
Support	0
Group Support	0
Government Support	0

IICRA--Insurance Industry And Country Risk Assessment.

Related Criteria And Research

Related criteria

- Insurers: Rating Methodology, May 7, 2013
- Group Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

Related research

- List Of Issuers With Ratings Under Criteria Observation Due To S&P's New Insurers Rating Methodology, May 7, 2013
- Standard & Poor's Assigns Insurance Industry And Country Risk Assessments, May 7, 2013

Ratings List

Ratings Affirmed

St. James's Place U.K. PLC
Counterparty Credit Rating
Local Currency
Financial Strength Rating
Local Currency

A-/Stable/--

A-/Stable/--

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