

Research Update:

# Somerset Reinsurance Ltd. Upgraded To 'BBB+' On Improved Market Position And Strong Capitalization; Outlook Stable

July 20, 2021

## Overview

- Somerset Reinsurance Ltd. has demonstrated a sustainable business model while executing its growth strategy of adding new flagship partnerships via life and annuity reinsurance transactions.
- As a result of its improving market and strong capital positions, we raised our financial strength and issuer credit ratings on Somerset to 'BBB+' from 'BBB'.
- The stable outlook reflects our view that Somerset will undertake new transactions consistent with its business plan, produce stable earnings, and demonstrate strong risk controls around its alternative investment strategy.

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## Rating Action

On June 20, 2021, S&P Global Ratings raised its financial strength and issuer credit ratings on Somerset Reinsurance Ltd. to 'BBB+' from 'BBB'. The outlook is stable.

## Rationale

The upgrade is based on Somerset's successful growth strategy, as demonstrated by its track record of closing on new transactions with high-profile primary insurers, and conservatism incorporated into our long-term expectations for capital and earnings. As a relatively new player in the highly competitive life reinsurance market, management has a strong value proposition, providing clients with both flow and block risk transfer solutions and strong liability and investment management capabilities.

Somerset closed on three new deals in 2020 totaling \$2.4 billion in reserves, including a \$1.2 billion quota share treaty with a well established mutual company on a legacy annuity block. Somerset has closed on nine deals since Dec. 31, 2018, including flow transactions with larger,

well known and highly rated primary carriers with total reserves of about \$4 billion as of year-end 2020. We think that Somerset's partnership with Hannover Re has helped it gain traction in the life reinsurance market via joint marketing efforts and leveraging Hannover Re's balance sheet.

While operating performance has lagged larger peers, new deals have significantly grown Somerset's asset base, moving its asset allocation more in line with the company's long-term strategy as of year-end 2020. While earnings have been volatile, alternative investment returns bounced back in 2020 to 6.6% from 2.6% in 2019, producing net income of \$92.9 million and adjusted EBIT of \$2.4 million in 2020 (excluding the impact of unrealized gains on an embedded derivative on reinsurance funds withheld). Given the strong increase in assets, we expect earnings to stabilize over the next 24 months as the company looks to further diversify its investment strategies in its alternatives portfolio.

As of year-end 2020, Somerset's capital was significantly redundant at the 'AAA' level, and we anticipate further capital injection later in 2021 to support new business growth. Additionally, we incorporate a risk-adjusted capital credit for its holding in its multistrategy fund based on a look through of its risk characteristics. In our analysis of capital and earnings, we place additional conservatism on the potential for capital and earnings volatility based on Somerset's relatively small total adjusted capital base of about \$583 million as of year-end 2020.

Long term, we expect the company to manage capital levels more in line with an 'A' level redundancy. We have taken a conservative approach in our view of capitalization because the company is in an accelerated growth period, although management is targeting to hold a material buffer of 20% above the required capital at the 'A' confidence level long term.

Our upgrade has not resulted in a change in our business or financial risk profile assessments at this time. We are selecting the higher anchor due to our improved view of the strength of its business risk profile and capital track record.

## **Outlook**

The stable outlook indicates our expectation that over the next 12-24 months Somerset will continue its growth strategy and remain competitive among larger life reinsurance peers. We expect earnings to stabilize and the company to produce positive operating earnings that support business growth while maintaining at least 'A' level capital adequacy.

## **Downside scenario**

We could lower our ratings in the next 12-24 months if:

- Operating performance becomes materially worse than expected and we expect it to remain volatile for a sustained period,
- Competition challenges Somerset's ability to close on new transactions, or
- Somerset's capitalization declines below the 'A' confidence level.

## **Upside scenario**

While unlikely, we could raise our ratings in the next 12-24 months if Somerset can sustainably improve its competitive position via:

- Consistently strong operating performance relative to higher rated peers,

- Material earnings diversity via increased mortality exposure,
- Execution of its business plans and growth strategy, and
- Maintenance of capital redundancy at least at the 'A' level.

## **Ratings Score Snapshot**

Financial strength/Issuer Credit ratings: BBB+/Stable/--

Anchor: bbb+

Business risk: Satisfactory

- IICRA: Low
- Competitive position: Satisfactory

Financial risk: Satisfactory

- Capital and earnings: Satisfactory
- Risk exposure: Moderately low
- Funding structure: Neutral

Modifiers: 0

- Governance: Neutral
- Liquidity: Exceptional
- Comparable ratings analysis: 0

Support: 0

- Group support: 0
- Government support: 0

## **Related Criteria**

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

## **Ratings List**

Upgraded

	To	From
<b>Somerset Reinsurance Ltd.</b>		
Issuer Credit Rating		
Local Currency	BBB+/Stable/--	BBB/Stable/--
Financial Strength Rating		
Local Currency	BBB+/Stable/--	BBB/Stable/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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