Lloyd's of London

Full Rating Report

Ratings

Lloyd's of London

Insurer Financial Strength Rating	AA-

The Society of Lloyd's

Long-Term IDR	A+
Subordinated Debt	A-

Lloyd's Insurance Company (China) Ltd

Insurer Financial Strength Rating	AA-

Lloyd's Insurance Company S.A.

Insurer Financial Strength Rating	AA-

Outlooks

Insurer Financial Strength Ratings	Negative
Long-Term IDR	Negative

Financial Data

Lloyd's of London

	2017	2016
Total assets (GBPm)	108,396	101,602
Total equity and reserves (GBPm)	26,767	27,714
Gross written premiums (GBPm)	33,591	29,862
Profit before tax (GBPm)	-2,001	2,107
Combined ratio (%)	114	98
Net income return on equity (%)	-7	8

Related Research

2018 Outlook: London Market Insurance (November 2017)

London Market Insurance Dashboard – 2018 Outlook (January 2018)

London Market Insurance Dashboard - 2017 Results (April 2018)

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Key Rating Drivers

Deteriorating Underwriting Performance: The Negative Outlook on Lloyd's of London is driven by worsening underwriting performance over the past three years. In 2017, the accident year combined ratio, excluding major claims, weakened to 98.4% (2016: 93.9%) on continuing pressure on risk-adjusted premium rates and expense ratios. Fitch Ratings believes that this deterioration in underlying performance has reduced Lloyd's ability to outperform its peers, even in more benign catastrophe years.

Significant Exposure to Catastrophes: Fitch believes that the exposure of Lloyd's to worldwide catastrophes is high, although Lloyd's has been managing this down. Its combined ratio deteriorated to 114% (2016: 97.9%), driven mainly by the high level of exposure to catastrophe losses in 2017, which was one of the costliest years on record following a series of events, including three major hurricanes – Harvey, Irma and Maria – and earthquakes in Mexico and wildfires in California.

Limited Rate Rises: Premium rates on short-tail loss-affected lines rose following the catastrophe events of 2017. However, Lloyd's reported risk-adjusted price rises at January renewals of just 3% overall, which still leaves its risk-adjusted rates well below historical highs; prior to 2017, real risk-adjusted rates had declined at Lloyd's by 20% since 2010. Fitch believes that Lloyd's maintains a disciplined approach to underwriting, reinforced by the strong oversight of its Performance Management Directorate (PMD).

Resilient Capital Structure: A number of syndicates at Lloyd's experienced significant capital depletion as a result of the catastrophe events in 2017, although all were able to fully recapitalise during the "coming into line" process in December 2017 and the central fund remained unaffected, which showed a good level of resilience to catastrophe losses. However, this resilience relies on the willingness and ability of members to recapitalise, following significant losses. Financial leverage remained low at 3% at end-2017 (end-2016: 4%).

Reducing Reserve Releases: Lloyd's experienced a reduction in positive prior-year reserve development compared to previous years. In 2017, prior-year reserve movements contributed a 2.9pp improvement to the combined ratio (2016: 5.1pp; 2015: 7.9pp). Fitch expects reserve releases to remain low as reserve releases from older, better-performing years become exhausted.

Very Strong Business Profile: Lloyd's of London's business profile is very strong and supports its rating. It is one of a small group of global (re)insurance providers capable of attracting high-quality and specialised business. It operates as a global insurance and reinsurance market comprising more than 100 syndicates, writing business from more than 200 countries and territories, and reported gross written premiums of GBP33.6 billion in 2017.

Rating Sensitivities

Underwriting Deterioration, Outsized Catastrophe Losses: The ratings are likely to be downgraded if the net combined ratio, excluding major claims, remains above 91% (2017: 95.5%). Underperformance or a proportionally larger net catastrophe loss compared with peers or market share could also lead to a downgrade.

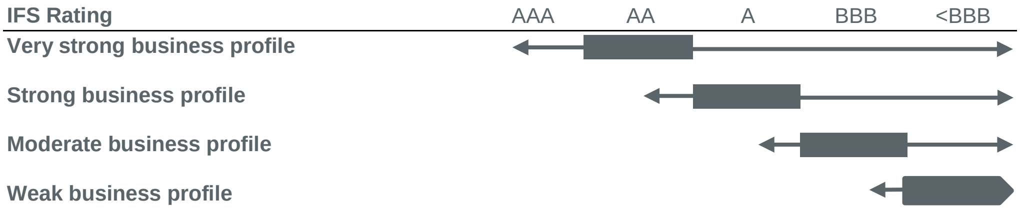
Improved Underwriting, Reduced Catastrophe Exposure: A return to a Stable Outlook is likely if the net combined ratio of Lloyd's, excluding major claims, improves to below 91% and if it maintains its risk-adjusted capital exposure to catastrophe losses at a level that is commensurate with peers'.

Business Profile

Very Strong Business Profile Supportive of Rating

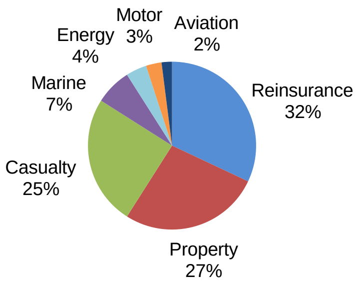
- Strong global franchise
- EU subsidiary set up
- Broad diversification by class of business
- Focus on ease of doing business
- Underwriting syndicates a unique market feature

Ratings Range Based on Business Profile



Source: Fitch

Lloyd's of London – Premium Distribution by Business 2017



Source: Lloyd's

Strong Global Franchise

The business profile of Lloyd's, which Fitch considers to be very strong, supports the rating. Lloyd's is one of a small group of global (re)insurance providers capable of attracting high-quality and specialised business. Fitch takes a positive view of the presence of a detailed and defined business strategy executed by the executive team of the Corporation of Lloyd's (see *Appendix B: Glossary*).

Lloyd's is a global insurance and reinsurance market comprised of more than 100 syndicates managed by 56 managing agents as at 31 December 2017. It writes business from more than 200 countries and territories, and reported 2017 gross written premiums (GWP) of GBP33,591 million (2016: GBP29,862 million). Lloyd's is looking to acquire more licences to boost expansion into high-growth markets.

However, Lloyd's faces competition including from established and emerging global reinsurance hubs, such as Bermuda, Switzerland, Singapore and New York; large global reinsurance companies; smaller primary companies located within key markets; and alternative risk-transfer products including catastrophe bonds and other insurance-linked securities (ILS).

These persistent challenges are affecting the London market as a whole. London remains the largest global centre for commercial and specialty risk, but it is not keeping pace with emerging-market growth, and its market share declined from 2013-2015, as reported in the London Market Group's 'London Matters 2017' report. Lloyd's continues to target these high-growth areas, with significant expansion in the Lloyd's China platform. In other high-growth markets significant challenges remain due to increasing protectionism, M&A activity, and economic slowdown.

EU Subsidiary Set Up

Fitch has assigned Lloyd's Insurance Company S.A. (Lloyd's Europe), the Brussels-based subsidiary of the group that will handle all EU business following the UK's departure from the EU, an IFS Rating of 'AA-' with a Negative Outlook. The rating is the same level as Lloyd's because Fitch views the subsidiary as being 'core' to the group.

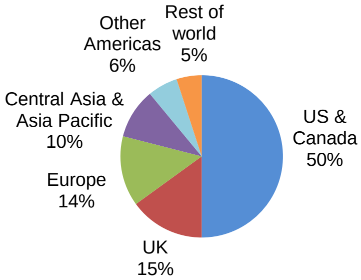
Lloyd's Europe has been set up solely to obtain a license to write business in the EU with a 100% quota-share reinsurance agreement ceding all risk back to the syndicates. This subsidiary is therefore strategically core to the group as it is fully supportive of the group's

Related Criteria

Insurance Rating Criteria (November 2017) objectives and strategy. It will maintain common branding and will write a material portion of the group's premiums (that we estimate at more than EUR2 billion of premiums in 2019).

Broad Diversification by Class of Business

Lloyd's of London – Premium Distribution by Geography 2017



Source: Lloyd's

Business written by syndicates focuses on seven main classes. The main class of business at Lloyd's – reinsurance – covers both short- and long-tail lines, offering a variety of placement types including facultative, proportional treaties and non-proportional excess-of-loss placements.

The US represents the main geographical region for the second major class, property, which includes commercial and private property. The remaining main class, casualty, includes professional indemnity, medical malpractice, accident and health, directors' and officers' liability, financial institutions, general liability and employers' liability. Business is mainly spread across the US, the UK and the rest of Europe.

The remaining classes are niche. The International Group of P&I Clubs' programme constitutes a major part of the marine liability class. The motor book is UK-focused, and includes niche non-standard risks such as high-value vehicles, vintage or collectors' vehicles, high-risk drivers and affinity groups. The energy portfolio includes a variety of onshore and offshore property and liability classes, ranging from construction to exploration and production, refinery and distribution. A significant part of the portfolio is offshore energy, and a large proportion of this is located in the Gulf of Mexico. Lloyd's is an industry leader in the global aviation market, and has a balanced portfolio across all sectors of this class – including airline, aerospace, general aviation and space.

Focus on Ease of Doing Business

Lloyd's is focused on improving the ease of doing business, with rates under pressure and expenses continually on the rise. The London Market Target Operating Model aims to deliver and encourage the adoption of improved services for the market to make it easier, faster and more cost effective to do business with the London market. Similarly, Lloyd's is working on its corporate operating model to deliver cost savings and improve the ease and efficiency of doing business

Underwriting Syndicates a Unique Market Feature

Syndicates are the vehicles used to underwrite insurance. They are not legal entities, and are unique to the Lloyd's insurance market. Syndicates can be made up of a number of members or – as is becoming more common – just one corporate member.

Syndicates are run by managing agents, which are authorised, regulated legal entities. Managing agents' responsibilities are wide ranging; they create and implement the syndicate's business plan, employ the underwriters that write the business, and process claims. Managing agents are required to report financial results quarterly for their syndicates to Lloyd's and to submit business plans annually, or more regularly if they change.

Product distribution at Lloyd's is carried out primarily through brokers and coverholders, with some business placed directly with service companies (see *Appendix B: Glossary*) owned by managing agents. A large proportion of the business is conducted in the underwriting room, where face-to-face negotiations between brokers and underwriters take place. Most business is placed into the market by brokers.

Corporate Governance and Risk Management

External Oversight

Fitch considers corporate governance to be strong at Lloyd's due to the insurer's clear governance structure. The agency takes a favourable view of the existence of the Council of Lloyd's, the governing body of the Society of Lloyd's; the Council has ultimate responsibility for the management of the market as a whole.

The Society of Lloyd's and Lloyd's' managing agents have been dual-regulated since 1 April 2013. Prudential regulation is conducted by the Prudential Regulation Authority (PRA) while business conduct regulation is the responsibility of the Financial Conduct Authority (FCA). Member agents and brokers of Lloyd's are FCA-regulated firms.

The Council acts through the Franchise Board for many of its functions. Its members are appointed by the Council, and are drawn from both within and outside the Lloyd's market.

Clear Governance Structure

Strong and Well-Structured Risk-Management Framework

Fitch takes a positive view of the approach taken by Lloyd's to managing risk and corporate governance. The agency believes that the market structure of Lloyd's leads to greater emphasis on the successful management of these areas to maintain the confidence of market participants. The market is overseen by the Council of Lloyd's and the Franchise Board; while the Corporation, managing agents and members' agents (see *Appendix B: Glossary*) are regulated by the FCA.

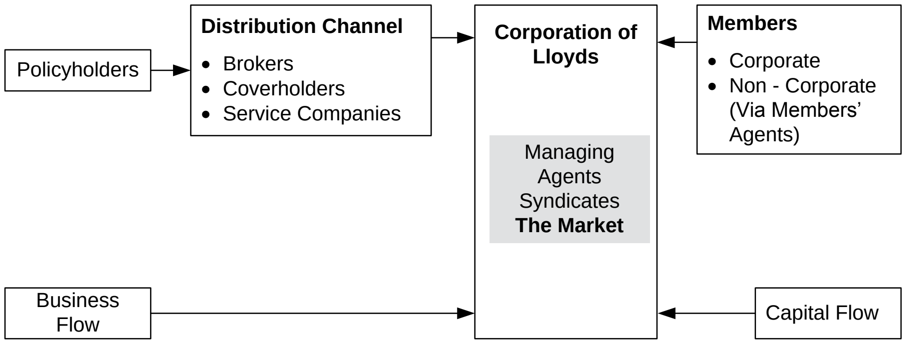
Unique Risk Profile Leads to Separation of Risks

Lloyd's has developed its risk-management framework around two distinct types of risk: Corporation-level risks (financial, operational, regulatory and legal) and market (business)-level risks. Corporation risks are managed through a traditional governance structure, while market risks are managed by managing agents and the central team at Lloyd's.

Ownership Neutral

Market Structure a Marginal Positive

Structure Diagram



Source: Lloyd's Fitch

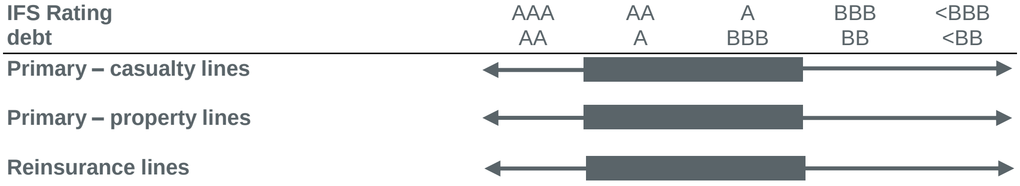
The market structure of Lloyd's is marginally positive for its ratings compared with traditional corporate insurers or reinsurers. This view takes into account the 'chain of security,' which provides a mixture of several and mutual claims-paying capital.

Sovereign and Country-Related Constraints

Fitch rates the sovereign obligations of the United Kingdom at ‘AA’ with a Negative Outlook, and the Country Ceiling is ‘AAA’. The Country Ceiling expresses the maximum limit for foreign-currency ratings of most but not all issuers in a given country. With these high levels, the ratings of UK insurance organisations and other corporate issuers are not likely to be constrained by sovereign or macroeconomic risks, and there are no constraints biting in the specific case of Lloyd’s of London.

Industry Profile and Operating Environment

Ratings Range Based on Industry Profile/Operating Environment



Source: Fitch

Pricing to Improve but Underwriting Results to Remain Pressured

Fitch’s sector outlook on the London market remains negative in 2018, reflecting our expectation that underwriting results will continue to be pressured by the high cost of doing business, due to high acquisition and administration costs. The trend of rising expense ratios since 2012 was halted last year, with expense ratios remaining high but broadly flat year-on-year, for most London market insurers.

The majority of London market insurers reported underwriting losses in 2017, driven by their exposure to the major catastrophe events. Beazley and Hiscox were exceptions to this, with combined ratios just below 100%, due to a greater proportion of non-catastrophe-exposed specialty lines of business that offset catastrophe losses.

Following the catastrophe events of 2017, premium rates have risen on short-tail loss-affected lines. Hiscox reported that its catastrophe reinsurance pricing rose on average 9% and Beazley said that its property insurance and reinsurance pricing increased by 6% at the January renewal season. In the wider market, outside of catastrophe-exposed lines, pricing was largely flat. Lloyd’s reported risk-adjusted price rises at January renewals of 3%, which still leaves risk-adjusted rates well below historical highs.

The trend of rising expense ratios appears to have halted in 2017, with expense ratios remaining broadly flat YOY for most London market insurers. Expense ratios had increased since 2012 due to rising acquisition expenses and higher administration costs. Modernisation and cost-effectiveness are key priorities for London market insurers. Lloyd’s recently said that it will require syndicates to place at least 30% of risks electronically by the end of 2018. Managing agents who meet these requirements will get a rebate on their annual subscription and those which fail to meet the target will be subject to additional fees and capital loading.

Capitalisation in the London market remains strong, despite the significant catastrophe losses. Lancashire experienced erosion in shareholders’ equity of 8.3%, driven by the significant catastrophe losses incurred. A number of syndicates at Lloyd’s also experienced some capital depletion. However, all were able to fully recapitalise during the ‘coming into line’ process in December 2017 and hence Lloyd’s reported stable solvency coverage ratios at 31 December 2017 compared to the prior year.

Low Barriers to Entry

The reinsurance industry has low barriers to entry, as indicated by the wave of start-up reinsurers (primarily in Bermuda) entering the market after significant catastrophe events.

The barriers to entry to Lloyd’s are high, as the PMD keeps tight control on the number of new syndicates and managing agents entering the market. One reason is to protect the mutual capital layers from unscrupulous underwriting.

Peer Analysis

Lloyd's has no directly comparable peers, due to its unique structure and mix of business underwritten. Below is an illustration of Lloyd's with the global group of reinsurance companies that have some similarities in scale and geographical scope.

Lloyd's compares favourably with other multinational reinsurers on average underwriting performance across a number of years. However, it has high volatility in the combined ratio, indicating the increased exposure to catastrophe risk.

Peer Analysis

		Gross premiums written[b]		Combined ratio (%)	Combined ratio volatility (pp)[e]	Shareholders' equity	
(USDm)[a]	IFS Rating[d]	2017	2016	Five-year average[c]	Five-year average	2017	2016
Berkshire Hathaway	AA+/Stable	60,597	45,881	90.1	18.0	348,296	282,070
Munich Re	AA/Stable	55,961	53,886	96.8	9.8	33,834	33,446
Lloyd's of London	**AA-/Negative**	**43,708**	**40,147**	**91.6**	**15.1**	**36,143**	**34,177**
Swiss Re	AA-/Stable	34,775	35,622	91.6	11.8	34,294	35,716
Hannover Re	AA-/Stable	20,270	18,039	95.8	2.4	11,143	10,250
SCOR S.E.	AA-/Stable	16,850	15,251	93.4	5.3	7,469	7,045
PartnerRe Ltd	A+/Stable	5,588	5,357	90.0	6.2	6,745	6,688

Combined ratio: Net losses and loss-adjustment expenses divided by net premiums earned plus underwriting expenses divided by net premiums earned
Shareholders' equity is organisation-wide equity and therefore depends on the company's reporting practices; it may include equity that supports operations other than property/casualty reinsurance operations
Financial statement figures for some European reinsurers have been translated into US dollars using year-end or 12-month average rates of exchange, as appropriate. This has led to some exchange-rate distortion between financial years
[a] Foreign-exchange rates used for GWP = Full-year average rate
[b] GWP includes primary and reinsurance business
[c] 2013-2017, non-life reinsurance business
[d] Denotes operating company insurer financial strength Rating
[e] Standard deviation
Source: Company annual reports, financial supplements, and SEC filings

Capitalisation and Leverage

(GBPm)	2013	2014	2015	2016	2017	Fitch's expectation
Financial leverage (%)	4	5	4	4	3	Fitch does not foresee a significant change in leverage in the near term, with the earliest maturity date of current subordinated notes being 2024. Assuming major losses fall within the bounds anticipated by Lloyd's for the rest of 2018, we expect capital also to remain stable.
NWP/equity (x)	1.0	0.9	0.9	0.8	0.9	
Net leverage (x)	2.9	2.7	2.6	2.6	2.8	
Gross leverage (x)	3.7	3.4	3.3	3.4	3.9	
TFC ratio[a] (x)	0.1	0.1	0.1	0.1	0	

[a] Total financing and commitments ratio, excluding utilised letters of credit
Source: Lloyd's annual reports, Fitch

Strong Member and Central Capital

- Capitalisation resilient to losses
- Regulatory capital ratios remain stable
- High catastrophe risk affects capitalisation
- Low financial leverage and TFC ratio
- Risk-based approach to setting member and central capital
- Process to keep capital level constant
- Mutual assets supported by central fund contributions

Capitalisation Resilient to Losses

Following the significant catastrophe losses in 2017, a number of syndicates at Lloyd's experienced significant capital depletion. All members are required to recapitalise, should the available capital fall below its required level (i.e. their Lloyd's Economic Capital Assessment (ECA) net of their solvency result). All members were able to fully recapitalise during the "coming into line" process in December 2017. However, this resilience relies on the willingness and ability of members to recapitalise, following significant losses.

Regulatory Capital Ratios Remain Stable

Lloyd's reports its Solvency II coverage on both a central and market-wide basis. The market-wide Solvency Capital Ratio (MWSCR) reflects the aggregation of all eligible market-wide assets, and Lloyd's reported a stable ratio of 144% at end-2017, (end-2016: 144%) comfortably above the risk appetite of 125%. On a central basis, reflecting the vulnerability of the central fund, the Lloyd's central SCR (CSCR) remained stable at 215% (end-2016: 215%), which was also comfortably in excess of the risk appetite of 200%.

High Catastrophe Risk Affects Capitalisation

Fitch's view of Lloyd's risk-adjusted capital has been negatively affected by the high level of catastrophe risk appetite. Fitch believes that Lloyd's has a higher catastrophe risk appetite than peers, as evidenced by the significant catastrophe losses in 2017. However, both leverage and the TFC ratio remained low at end-2017 and hence Fitch expects overall capitalisation and leverage to remain adequate for the ratings, assuming a normal level of large losses for the rest of 2018.

Low Financial Leverage and TFC Ratio

The Fitch-calculated financial leverage ratio for Lloyd's was 3% at end-2017 (end-2016: 4%). During the year, Lloyd's issued GBP300 million of debt in February 2017, which matures in February 2047. The notes bear interest of 4.875% per annum. Lloyd's also redeemed, in whole in June 2017, GBP392 million of perpetual subordinated capital securities, which had a coupon of 7.421%. The net impact of this was a small reduction in the financial leverage ratio. Its TFC ratio was 0x at end-2017 (end-2016: 0.1x), which is extremely low and supportive of the ratings.

Risk-Based Approach to Setting Member and Central Capital

The Lloyd's ECA at the member level is set at 135% of the syndicates' individual capital assessment (ICA) result. This percentage has not changed since 2006. Lloyd's reviews each syndicate's ICA in detail, and requires additional capital loading if it considers that the syndicate's business plan exposes the central fund to additional risk.

Process to Keep Capital Level Constant

All members are required to recapitalise, should the ECA that is available to any individual member fall below its required level due to a change in the underlying risk profile or an erosion of funds due to losses. This process ensures that no member poses a significant threat to the central capital of Lloyd's at any given time.

In cases where Lloyd's deems business underwritten within the market as too risky, it can request from the sponsoring parent (or the member) a full financial guarantee. In these cases, should losses exceed the ECA held, the additional capital required to make good the losses is taken directly from the capital provider, while the central fund remains untouched.

Mutual Assets Supported by Central Fund Contributions

The mutual layer or third link in the chain of security at Lloyd's includes contributions that are collected through an annual levy from members. The levy is 0.35% of premium (1.4% for new members on new syndicates for the first three years), with the value of central fund net assets at GBP2.04 billion at end-2017 (end-2016: GBP1.95 billion). Lloyd's reviews the level of future capital contributions required from the market in line with changing conditions.

Debt-Servicing Capability and Financial Flexibility

(GBPm)	2013	2014	2015	2016	2017	Fitch's expectation
Interest coverage – market (x)	64	56	47	23	-42	Fitch expects a slight reduction in fixed-charge costs, given the redemption of the perpetual debt issue and the issuance of lower coupon debt. Fitch expects Lloyd's to be comfortably able to service its debt obligations, which remain low.
Interest coverage – society (x)	2	3	3	10	4	
Interest paid	56	49	54	54	55	

Source: Lloyd's annual reports, Fitch

Strong Debt-Servicing Capability and Financial Flexibility

- Debt issuance and redemption
- Financial flexibility
- Ability to service debt will remain strong
- Flexibility of repayment options

Debt Issuance and Redemption

Lloyd's issued GBP300 million of fixed- to floating-rate callable subordinated notes in February 2017. The notes pay a fixed annual coupon of 4.875% in arrears until the first call date of 7 February 2027. In June 2017, Lloyd's redeemed GBP392 million of perpetual subordinated capital securities, which had a coupon of 7.421%. As a result of the overall reduction in issued debt and the lower coupon of the new issuance, Fitch expects overall debt-servicing costs to fall further in 2018.

Financial Flexibility

Lloyd's has a variety of mechanisms available to raise capital, including member calls, central fund contributions, the requirement of additional capital on top of the ICA, charging a premium levy, and raising additional subordinated debt.

The Society has two tranches of sterling-denominated dated subordinated debt. The remaining debt consists of a GBP500 million Solvency II Tier 2 subordinated bond, callable in 2024, and a GBP300 million Solvency II Tier 2 subordinated bond, callable in 2047.

Ability to Service Debt Will Remain Strong

Fixed-charge coverage excluding unrealised gains and losses was negative in 2017 at -42x, driven by the significant catastrophe losses (2016: 47x). However, on a five-year average basis, coverage is still well in excess of Fitch's 'AAA' median of 18x. Fitch expects this ratio to improve in 2018 – in the absence of any further significant catastrophe losses – given Lloyd's' strong capability to generate earnings. On a Society basis, fixed-charge coverage fell to 4x in 2017 from 10x in 2016, driven by a big reduction in investment returns.

Flexibility of Repayment Options

In a going-concern scenario, Lloyd's has several options available for the repayment of principal and interest, as it has complete discretion on the use of the central fund. If necessary, Lloyd's could increase members' contributions, impose a premium levy (as it has in the past), or use the callable layer. All of these mechanisms could be used to pay the interest on the debt.

Financial Performance and Earnings

(GBPm)	2013	2014	2015	2016	2017	Fitch's expectation
Net income	3,205	3,016	2,122	2,107	-2,001	Fitch believes underwriting profitability remains under pressure at Lloyd's. Attritional losses are rising and the expense ratio remains above 40%, limiting underwriting profitability even if 2018 is an average year for natural catastrophes. Reinsurance pricing conditions are improving only moderately, and we expect investment returns to remain low.
Change in GWP (%)	1	-1	6	12	12	
Operating ratio (%)	81	84	87	93	108	
Combined ratio (%)	87	88	90	98	114	
Net loss ratio (%)	49	49	50	57	75	
Admin expense ratio (%)	11	11	11	11	9	
Commission ratio (%)	28	28	29	30	30	
ROE (%)	16	14	9	8	-7	

Source: Lloyd's annual reports, Fitch calculations

Market Performance Remains Strong

- Attritional loss ratio increasing
- Significant catastrophe losses
- Moderate rate rises following catastrophe losses
- Strong investment returns
- PMD demonstrates tangible results

Attritional Loss Ratio Increasing

Fitch believes that the underwriting profitability of Lloyd's remains under pressure, even if there is a more-average level of catastrophe losses in 2018. This reflects the underlying trend of pressure on both risk-adjusted premium rates and expense ratios. In 2017, Lloyd's reported an attritional loss ratio of 58.9% (2016: 53.3%) and an overall expense ratio of 39.5% (2016: 40.6%), meaning the accident-year combined ratio excluding major claims deteriorated to 98.4% in 2017 (2016: 93.9%). This shows that even with an average level of major claims activity, Lloyd's would have been likely to report an underwriting loss.

The results of Lloyd's continue to benefit from positive prior-year reserve development, although prior-year reserve releases in 2017 fell to 2.9% (2016: 5.1%). Fitch is monitoring the sustainability of reserve releases – given strong competition, falling premium rates, and signs of declining reserve surpluses, particularly on casualty lines.

Significant Catastrophe Losses

Lloyd's swung to a loss in 2017 for the first time since 2011, the last year of significant catastrophe losses, reporting a net loss of GBP2 billion (2016: GBP2.1 billion profit). The loss was mainly driven by the significant catastrophe losses experienced by the industry in 2017. However, Lloyd's reported a worse combined ratio than most of its peers, at 114% (2016: 98%), indicating a higher exposure to catastrophe losses than peers. Lloyd's reported net claims from the catastrophe events of GBP4.5 billion in 2017 (2016: GBP2.1 billion), compared to its 15-year average of GBP1.6 billion.

Moderate Rate Rises Following Catastrophe Losses

Following the catastrophe events of 2017, premium rates have risen on short-tail loss-affected lines, albeit moderately, reversing the trend of falling rates over the past few years. Prior to 2017, real risk-adjusted rates had declined at Lloyd's by 20% since 2010. Lloyd's reported overall risk-adjusted price rises at January 2018 renewals of 3%, which still leaves risk-adjusted rates well below historical highs. Most of that rate improvement comes from short-tail loss-affected lines; in the wider market, outside of catastrophe-exposed lines, pricing was largely flat.

Strong Investment Returns

Overall, net investment income at Lloyd’s rose to GBP1.8 billion in 2017, which was an improvement on prior year (2016: GBP1.3 billion) and also above the five-year average. The improvement was mainly driven by the strong performance of the fixed-income portfolio, with a large allocation to investment-grade corporate bonds, as well as a small but significant allocation to equity and risk assets, which also performed well.

PMD Demonstrates Tangible Results

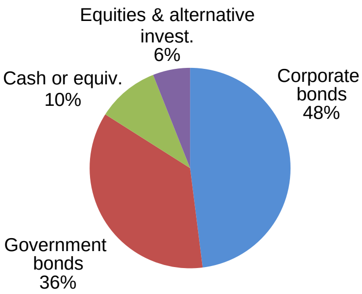
PMD’s oversight of market participants has played a key role in improving the overall technical performance of the Lloyd’s market, in Fitch’s view. Since the PMD was established in 2003, processes including business plan reviews and syndicate benchmarking have helped PMD and syndicates improve key aspects of underwriting, including pricing, reserving, claims management, risk-adjusted capital setting and catastrophe-modelling techniques.

Investments and Asset Risk

(GBPm)	2013	2014	2015	2016	2017	Fitch's expectation
Invested assets	51,498	54,863	56,903	67,666	67,920	Fitch expects the investment profile and strategy will remain stable in the near term. The greatest challenge is the persistence of low investment yields, which puts pressure on earnings.
Investment return (%)	1.6	2.0	0.7	2.2	2.7	
Liquid assets/tech reserves (%)	177	184	185	183	172	
Risky assets/equity (%)	43	40	37	43	51	
NIG bonds to equity (%)	6	4	3	3	8	
Unaffiliated shares to equity (%)	37	36	34	40	43	

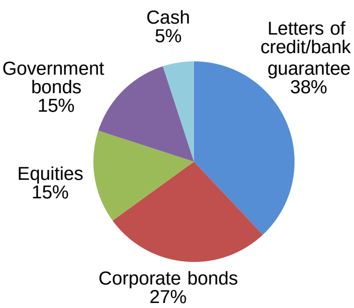
Source: Lloyd's annual reports, Fitch

Syndicate PTF Investments
End-2017



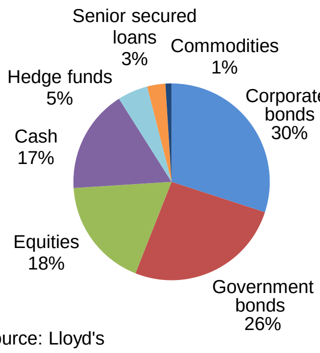
Source: Lloyd's

Members' FAL Investments
End-2017



Source: Lloyd's

Central Fund Investments
End-2017



Source: Lloyd's

Conservative Investment Policy

- PTFs: High-quality and liquid first source of policyholder repayment
- FAL: Second repayment layer support point
- Central fund: Mutual layer available at the discretion of Council of Lloyd's
- Strong liquidity position supported by high-quality, liquid assets

PTFs: High-Quality and Liquid First Source of Policyholder Repayment

Premium trust funds (PTFs) are the first resource for paying policyholder claims from a syndicate. Investments are held in liquid, short-duration, high-quality assets, with 94% of assets invested in bonds or cash.

FAL: Second Repayment Layer Support Point

Funds at Lloyd's (FAL) represent the second layer of capital provided by members to support their underwriting. The amount of deposited funds is determined by the Corporation, which reviews each syndicate's ICA and applies an uplift based upon the syndicate's business plans. The capital is held in trust as readily realisable assets. Letters of credit (LOCs) represent a significant proportion of assets within FAL (38% at end-2017). Fitch considers the pool of banks providing LOCs to Lloyd's as well-diversified and with strong ratings.

Central Fund: Mutual Layer Available at Discretion of Council of Lloyd's

Central assets are the third level of security at Lloyd's, and are available at the discretion of the Council of Lloyd's to meet any valid claim that cannot be met by the resources of any member. Total central assets were GBP2.2 billion at end-2017; 73% was invested in core assets such as investment-grade bonds and cash. The remaining 27% was invested in growth assets that include equities, high-yield bonds, senior secured loans, hedge funds and commodities.

Strong Liquidity Position Supported by High-Quality, Liquid Assets

Lloyd's maintains a strong liquidity position, which is supported by a significant level of high-quality liquid assets held by the PTF, FAL and central fund.

Reserve Adequacy

	2013	2014	2015	2016	2017	Fitch's expectation
Loss reserves/current-year incurred losses	3.0	3.0	2.9	2.6	2.0	Fitch anticipates that aggregate prior underwriting years will continue to develop favourably but that the absolute amount of reserve releases will reduce as favourable reserve development on older years of account become exhausted and more recent years run off more in line with best estimate.
Loss reserves/policyholder surplus	1.4	1.3	1.2	1.3	1.4	
Current-year paid losses/incurred losses	1.1	1.0	0.9	0.9	0.8	
Change in loss reserves/earned premium	-9	4	-2	9	-3	
Loss reserve development/equity (%)	-8	-8	-7	-5	-3	
Loss reserve development/PY loss reserves (%)	-6	-6	-6	-4	-2	

Source: Lloyd's annual reports, Fitch

Continued Favourable Development

- Reserve releases reducing
- High importance of reserving profile

Reserve Releases Reducing

Fitch believes that Lloyd's will benefit less in future years from favourable reserve development than they have in the recent past. Overall in 2017, there was a 2.9pp improvement in the calendar-year combined ratio (2016: 5.1pp; 2015: 7.9pp) from reserve releases. Lloyd's reported favourable claims experience from prior years on reinsurance, property, casualty and energy lines of business in 2017, with unfavourable development across marine, motor and aviation lines. Fitch is monitoring the sustainability of reserve releases across all lines of business, particularly for more recent years.

High Importance of Reserving Profile

Reserving is an important credit factor for Lloyd's, given its reserve leverage to both capital and to incurred losses (2017: 1.4x and 2x, respectively). Fitch monitors reserve and related exposure growth by checking the ratio of paid to incurred losses and the change in loss reserves relative to earned premium growth. Loss reserves have grown in line with underwriting exposures in most years. In 2017, Lloyd's overall reserve development remained positive; this is also the case based on a five-year average. However, Fitch believes that reserve releases from older years are likely to soon become exhausted and future reserve releases are likely to be lower.

Reinsurance, Risk Mitigation and Catastrophe Risk

(%)	2013	2014	2015	2016	2017	Fitch's expectation
NWP/GWP	79	79	79	77	74	Fitch expects Lloyd's to maintain its well-established exposure management function and good-quality reinsurance counterparties. However, Fitch also expects that catastrophe risk is likely to remain high relative to peers.
Reinsurance recoverable/equity	62	55	52	59	85	

Source: Lloyd's annual reports, Fitch

Reinsurance, Risk Mitigation and Catastrophe Risk

Adequate Risk Management and Reinsurance

- High catastrophe risk
- Risk oversight on Society and market level
- Well-established exposure management
- Credit quality of reinsurance recoverables

High Catastrophe Risk

Fitch believes Lloyd's has a high exposure to natural catastrophe risk, as evidenced by the significant losses incurred following the series of loss events in the second half of 2017. Lloyd's is looking to strengthen oversight of syndicates with material catastrophe risk, and Fitch monitors the development of the risk-adjusted catastrophe-exposure levels compared to its stated risk appetite and to its peers.

Risk Oversight on Society and Market Level

The unique structure at Lloyd's assists in overseeing and managing risks at the Corporation level in addition to establishing guidelines, control functions and monitoring at the market level. Lloyd's has two key governance forums, the Executive Risk Committee (ERC) and the Board Risk Committee (BRC).

The ERC is responsible for overseeing the identification and control of risks to Lloyd's, covering risks arising from Corporation activities and those from the activities of the market. The ERC is chaired by the chief risk officer and its members consist of the Lloyd's executive team.

The BRC is a sub-committee of the Board of Directors and is responsible for ensuring all risks to Lloyd's are managed in accordance with approved policies and risk appetites set by the Board. The activities of the ERC are reported to the BRC for second-line review and oversight. The ERC is chaired by an independent non-executive; it consists of non-executive members drawn from the Board and Lloyd's Council.

Well-Established Exposure Management

The exposure management function at Lloyd's is part of the PMD and has grown significantly in recent years. It is responsible for the modelling and monitoring of market and Corporation exposure to catastrophe risks. Catastrophe risk is modelled at the member and Society level, with analysis supplemented by a set of deterministic scenarios, which relate to specific catastrophe-event scenarios. Syndicates are required to consider additional scenarios, should the Lloyd's realistic disaster scenarios be inappropriate for their specific business profile.

Credit Quality of Reinsurance Recoverables

Reinsurance recoverables on Lloyd's' balance sheet are of good credit quality, with 89% in the 'A' range or above at end-2017. Reinsurance recoverables as a percentage of equity was low at end-2017, and supportive of the rating.

Appendix A: Other Ratings Considerations

Below is a summary of additional ratings considerations of a "technical" nature that are part of Fitch's ratings criteria.

Group IFS Rating Approach

The Lloyd's insurance entities listed on page 1 are rated on a group approach, with all entities considered "Core".

Notching

The unique corporate structure of Lloyd's, as a market place rather than a corporation, makes reference to operating and holding companies inappropriate. A description of how the respective ratings of Lloyd's entities were reached is provided below. Fitch considers the regulatory environment in the United Kingdom to be "Strong".

Notching Summary

Society of Lloyd's

- The Society's IDR is linked to the IFS rating assigned to Lloyd's. The Society has no legal liability for the insurance liabilities of members other than where it has issued an undertaking. Undertakings are liabilities of the Society, and constitute unsecured obligations ranking pari passu with other senior unsecured liabilities. Fitch has therefore aligned the Society's IDR with the implied IDR of Lloyd's.

IFS Ratings

- Due to the existence of policyholder priority, a baseline recovery assumption of 'Good' applies to the IFS rating, and Fitch used standard notching from the implied IDR.
- The insurance policies issued by Lloyd's are supported by a chain of security that includes Lloyd's premium trust funds, members' funds at Lloyd's and the central fund. The central fund and central assets of the Society of Lloyd's, a legal entity distinct from the members of Lloyd's, provide partial mutuality to the Lloyd's market. It is this mutuality that enables Fitch to assign an IFS rating to Lloyd's rather than to individual syndicates.

Debt

- Not applicable.

Hybrids

- Subordinated debt ratings of The Society of Lloyd's (issuer) are based on a standard baseline recovery assumption of Below Average, and are designated by Fitch as having a moderate risk of non-performance. Standard notching was used.

Hybrids – Equity/Debt Treatment

Hybrids Treatment

Hybrid	Amount (GBPm)	FBM Fitch (%)	FBM Reg override (%)	FLR debt (%)
Sub debt	300	0	100	100
Sub debt	500	0	100	100
Sub debt	5	0	100	100

FBM: Prism factor-based capital model
FLR: Financial Leverage Ratio
Source: Fitch

Exceptions to Criteria/Ratings Limitations

None.

Appendix B: Glossary

Central Fund

The fund financed by (among other things) contributions from Lloyd's members, and administered by the Council primarily as a fund for the protection of policyholders.

Corporation of Lloyd's

This comprises the executive of the Council of Lloyd's, the Lloyd's Franchise Board and their respective committees. The Corporation does not underwrite insurance or reinsurance itself, but provides the licences and other facilities that enable business to be underwritten worldwide by managing agents acting on behalf of members.

Coverholder

A company or partnership authorised by a managing agent to enter into a contract or contracts of insurance to be underwritten by the members of a syndicate managed by it, in accordance with the terms of a binding authority.

Members' Agent

An underwriting agent that has permission from Lloyd's to be appointed by a member to provide services and perform duties of the same kind and nature as those set out in the standard members' agent agreement. These services and duties include advising the member on which syndicates he should participate in, the level of participation in such syndicates, and liaising with the member's managing agents.

The ratings above were solicited and assigned or maintained at the request of the rated entity/Issuer or a related third party. Any exceptions follow below.

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