



RATING ACTION COMMENTARY

Fitch Places Lloyd's of London's Ratings on Negative Watch

Thu 02 Apr, 2020 - 8:32 AM ET

Fitch Ratings - London - 02 Apr 2020: Fitch Ratings has placed Lloyd's of London's (Lloyd's), Lloyd's Insurance Company S.A. and Lloyd's Insurance Company (China) Ltd's 'AA-' Insurer Financial Strength (IFS) Ratings on Rating Watch Negative (RWN). The Society of Lloyd's Long-Term Issuer Default Rating (IDR) of 'A+' and subordinated bonds of 'A-' have also been placed on RWN.

RATING ACTIONS

| ENTITY/DEBT | RATING | | |
|--|-------------------|-----|-----------------|
| Lloyd's Insurance Company S.A. | Ins Fin Str | AA- | Rating Watch On |
| Lloyd's Insurance Company (China) Limited | Ins Fin Str | AA- | Rating Watch On |
| Lloyd's of London | Ins Fin Str | AA- | Rating Watch On |

| ENTITY/DEBT | RATING | | |
|---------------------------|--------|----|-----------------|
| The Society of Lloyd's | LT | A+ | Rating Watch On |
| | IDR | | |

[VIEW ADDITIONAL RATING DETAILS](#)

KEY RATING DRIVERS

The RWN reflects the uncertainty and increased risk to Lloyd's earnings and underwriting performance due to claims emanating as a result of the COVID-19 pandemic. Lloyd's ratings have been on Negative Outlook since June 2017, mainly due to its underwriting performance being weak for the rating. Underwriting performance, although improved in 2019, was below our expectations. In addition any outsized COVID-19-related losses could add further pressure to Lloyd's earnings. Lloyd's is potentially exposed to COVID-19-related losses through event cancellation, business interruption, directors & officers' liability and trade credit lines of business.

Lloyd's reported a pre-tax profit of GBP2.5 billion in 2019 (2018: pre-tax loss of GBP1 billion) and a combined ratio of 102.1% (2018: 104.5%); the improvement to the pre-tax result was primarily driven by stronger investment performance. The better headline combined ratio followed the market's 'Decile 10' performance reviews and nine consecutive quarters of rate rises, but the pace of improvement was slower than we originally expected. In particular, Lloyd's attritional loss ratio on more recent underwriting years showed a 1.7% improvement to 57.6% (2018: 59.3%), but the deterioration in older underwriting years was a drag on the result.

In addition, Lloyd's combined ratio, excluding major losses, deteriorated to 95.1% in 2019 from 92.9% in 2018. This was a result of lower reserve releases, below average at 0.9% in 2019 (2018: 3.9%), due to a loss creep on 2018 losses as well as reserve strengthening on US casualty lines.

Lloyd's ratings reflect Fitch's current assessment of the impact of the COVID-19 pandemic, including its economic impact, under a set of ratings assumptions related to interest-rate levels; declines in the market values of stocks, bonds, derivatives and other capital market instruments typically owned or traded by insurance companies. These assumptions were used by Fitch to develop pro-forma financial metrics for Lloyd's that Fitch compared with both ratings guidelines defined in its criteria, and relative to previously established Rating Sensitivities for Lloyd's.

Under these assumptions we continue to view Lloyd's capitalisation as strong. This is further supported by our expectation that Lloyd's will be able to restore its capitalisation through the 'coming into line' exercise in June 2020. At this point, we do not expect underwriting losses to be of a magnitude to cause significant capital depletion. A majority of syndicates at Lloyd's are also owned by large multinational insurance companies, who should be able to provide capital as required.

RATING SENSITIVITIES

The ratings remain sensitive to a material change in Fitch's rating assumptions with respect to the pandemic. Periodic updates to our assumptions are possible given rapid changes in government actions in response to the pandemic, and the pace with which new information is available on the medical aspects of the disease.

The resolution of the RWN will be driven by the availability of more information related to the development of COVID-19-related losses and on Lloyd's underlying underwriting performance. We therefore do not expect to resolve the RWN before 3Q20. In particular, Lloyd's incurring outsized coronavirus-related losses compared with the sector could lead to a downgrade.

Upon resolution of RWN, Lloyd's rating level will be determined by applying the following rating sensitivities:

The ratings are likely to be downgraded if Lloyd's fails to report improving underlying underwriting performance excluding catastrophe losses.

An upgrade would result from a significant improvement in Lloyd's general competitive position. However, we view this as unlikely in the medium term.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

BEST/WORST CASE RATING SCENARIO

Ratings of financial institutions issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings <https://www.fitchratings.com/site/re/10111579>.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

[Insurance Rating Criteria \(pub. 02 Mar 2020\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Prism Factor-Based Capital Model, v1.7.1 (1)

ADDITIONAL DISCLOSURES

[Solicitation Status](#)

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ENDORSEMENT STATUS

| | |
|---|-----------|
| Lloyd's Insurance Company (China) Limited | EU Issued |
| Lloyd's Insurance Company S.A. | EU Issued |
| Lloyd's of London | EU Issued |

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