

FITCH AFFIRMS LLOYD'S OF LONDON AT IFS 'AA-'; OUTLOOK REMAINS NEGATIVE

Fitch Ratings-London-20 October 2017: Fitch Ratings has affirmed Lloyd's of London's (Lloyd's) and Lloyd's Insurance Company (China) Ltd's Insurer Financial Strength (IFS) Ratings at 'AA-' (Very Strong). Fitch has also affirmed the Society of Lloyd's Long-Term Issuer Default Rating (IDR) at 'A+' and subordinated bonds at 'A-'. The Rating Outlooks remain Negative.

KEY RATING DRIVERS

The rating action follows Fitch's initial review of significant catastrophe losses in 3Q17, currently estimated by Lloyd's at GBP3.3 billion from hurricanes Harvey and Irma, with material additional losses expected from hurricane Maria, Mexican earthquakes and California wildfires. While Fitch believes such losses will likely fall within tolerances for the current rating, they will likely place some pressure on Lloyd's capital. The affirmation reflects Fitch's short-term expectation that Lloyd's will be able to restore its capitalisation through the 'coming into line' exercise in December 2017.

Even before the 3Q17 catastrophe losses, the Negative Outlook reflected the underlying trend of pressure on both risk-adjusted premium rates and expense ratios, together with Fitch's belief that Lloyd's exposure to catastrophe risk remains high relative to peers. The 3Q17 catastrophe losses place further pressure on the Negative Outlook.

Fitch expects Lloyd's capitalisation to likely deteriorate to a level that is not in line with the current rating as a result of 3Q17 catastrophe losses. However, Fitch believes that Lloyd's will restore its capitalisation to a level that is commensurate with the rating as part of the next 'coming into line' process that closes before end-2017. Lloyd's is temporarily more exposed to any further major losses in advance of 'coming into line' and any such event could increase uncertainty around the ability of the market to successfully recapitalise.

The Lloyd's economic capital assessment at the member level is set at 135% of the syndicates' solvency capital requirement on an ultimate basis (uSCR). Fitch expects the majority of losses to date to fall within the buffer above syndicates' uSCR, assuming no material deterioration in loss estimates and hence Fitch expects the impact on the central fund to be minimal.

Lloyd's reported a 1H17 combined ratio of 96.9% (1H16: 98%), which was higher than peers', despite a benign first half of the year for natural catastrophe activity. The result was driven by increasing expenses and falling risk-adjusted premium rates as well as declining reserve releases.

Lloyd's exposure to worldwide natural and man-made catastrophes is higher than peers'. This is reflected in Lloyd's combined ratio being more sensitive to catastrophic events. Fitch believes that exposure to catastrophe risk has increased in recent years despite declining margins on this line of business. However, Fitch believes that the recent catastrophe events will lead to an improved pricing environment, particularly on loss affected lines, which should boost profitability in 2018.

RATING SENSITIVITIES

A failure to restore capital by the 1 December 2017 'coming into line' deadline would lead to a downgrade. A downgrade may also occur if the net combined ratio remains above 97% for a prolonged period. The rating is also highly sensitive to additional catastrophic or other losses incurred prior to year-end, or upward development in 3Q17 catastrophe loss estimates.

The Outlook may be revised to Stable if Fitch anticipates an improvement in Lloyd's underwriting performance to a level commensurate with peers' or if it reduces its capital exposure to catastrophe losses.

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Applicable Criteria

Insurance Rating Methodology (pub. 26 Apr 2017)
<https://www.fitchratings.com/site/re/897260>

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