

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-

Outlooks

Insurer Financial Strength Ratings Negative
Long-Term IDR Negative

Financial Data

Lloyd's of London

	2016	2015
Total assets (GBPm)	101,602	83,629
Total equity and reserves (GBPm)	27,714	24,216
Gross written premiums (GBPm)	29,862	26,690
Profit before tax (GBPm)	2,107	2,122
Combined ratio (%)	98	90
Net income return on equity (%)	8.1	9.1

Related Research

[2017 Outlook: UK Non-Life Insurance \(November 2016\)](#)

[London Market Insurance Dashboard – 2017 Outlook \(January 2017\)](#)

[London Market Insurance Dashboard - 2016 Results \(April 2017\)](#)

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Key Rating Drivers

Deteriorating Underwriting Performance: The Negative Outlook on the Lloyd's entities is due to the deterioration in underwriting performance, coupled with rising exposure to catastrophe risk in the context of continuing pressure on both risk-adjusted premium rates and expense ratios. The Fitch-calculated combined ratio of 98% was a significant deterioration from recent performance, driven by a return to more normalised levels of catastrophe activity in the market as well as rising expenses and falling risk-adjusted premium rates.

Growing Exposure to Catastrophes: Fitch believes that Lloyd's exposure to both natural and man-made worldwide catastrophes is higher than at its peers. This is reflected in the combined ratio being more sensitive to catastrophe events. The higher exposure to catastrophe risk in recent years comes despite the narrowing margins in this line of business. However, we believe that Lloyd's' exposure management allows the market to mitigate tail risks to some extent through its modelling capabilities and the reinsurance in place.

Very Strong Business Profile: Lloyd's of London's very strong business profile 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 over 200 countries and territories, and reported gross written premiums of GBP29.9 billion in 2016.

Strong Capital Position: Fitch expects capitalisation to support the rating, assuming future losses fall within limits expected by Lloyd's. The three-layered capital structure – syndicates' premium trust funds, members' funds at Lloyd's and the central fund – remained strong in 2016, despite the impact of a weaker pound against the US dollar and the rising catastrophe exposure. There is also very limited debt in the capital structure, with a financial leverage ratio of 3%.

Strong Investment Result, FX Gains: Lloyd's' results benefitted from foreign-exchange gains as a result of the depreciation of sterling, while investment returns were boosted by a downward shift in bond yields. Overall, Lloyd's' net investment income rose to GBP1.3 billion (2015: GBP0.4 billion), and foreign-exchange gains contributed GBP0.6 billion (2015: GBP0.1 billion loss) to profit – which helped to offset the reduced underwriting result. Fitch views these market movements as more of a 'one off'.

Disciplined Underwriting: Fitch believes that Lloyd's maintains a disciplined approach to underwriting, reinforced by the strong oversight of Lloyd's' Performance Management Directorate (PMD). Underwriting conditions across almost all major (re)insurance classes are deteriorating, and Fitch expects Lloyd's to continue to scale back exposures in the worst affected lines to reflect the weak rating environment.

Rating Sensitivities

Underwriting Deterioration, Outsized Catastrophe Losses: A downgrade may occur if the net combined ratio remains above 97% for a prolonged period. An extended period of underperformance or a proportionally larger net catastrophe loss versus peers or market share could also lead to a downgrade.

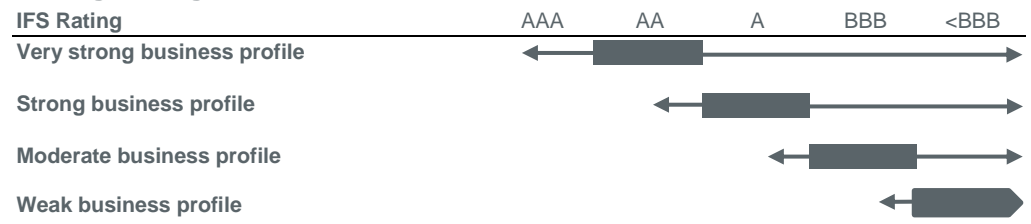
Improved Underwriting, Reduced Catastrophe Exposure: The Outlook may be revised to Stable if Fitch anticipates an improvement in Lloyd's underwriting performance to a level commensurate with its peers, or if it reduces its capital exposure to catastrophe losses.

Business Profile

Very Strong Business Profile Supportive of Rating

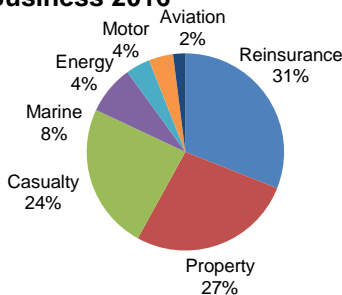
- Strong global franchise
- Broad diversification by class of business
- Focus on ease of doing business
- Underwriting syndicates a unique market feature

Ratings Range Based on Business Profile



Source: Fitch

Lloyd's of London – Premium Distribution by Business 2016



Source: Lloyd's

Strong Global Franchise

Lloyd's' business profile, which Fitch considers to be very strong, supports its 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 Corporation of Lloyd's' (see *Appendix B: Glossary*) executive team.

Lloyd's is a global insurance and reinsurance market that comprised over 100 syndicates as of end-January 2017. It writes business from over 200 countries and territories, and reported gross written premiums (GWP) of GBP29,862 million (2015: GBP26,690 million) in 2016. Lloyd's is continually looking to acquire more licences to boost further expansion into high-growth markets

However, Lloyd's faces competition from a number of sources. These include: established and emerging global reinsurance hubs including 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 longer-term challenges are affecting the London market as a whole. London remains the largest global centre for commercial and specialty risk, while it is not keeping pace with emerging-market growth, with a declining share 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 growth in the Lloyd's China platform. Significant challenges remain, however, in other high-growth markets due to increasing protectionism, M&A activity and economic slowdown.

Broad Diversification by Class of Business

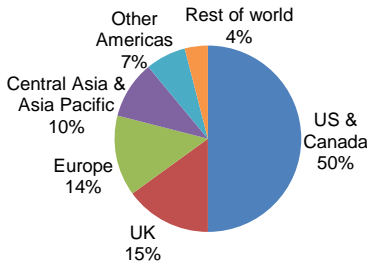
Business written by syndicates focuses on seven main classes. The main class of business at Lloyd's – reinsurance – covers both short- and long-tail lines, offering a variety of placement types including facultative, proportional treaties and non-proportional excess-of-loss placements.

The US represents the main geographical region for the second major class, property, which includes both 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 Europe.

Related Criteria

[Insurance Rating Methodology \(April 2017\)](#)

Lloyd's of London – Premium Distribution by Geography 2016



Source: Lloyd's

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). Lloyd's' members' agents and Lloyd's' brokers 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.

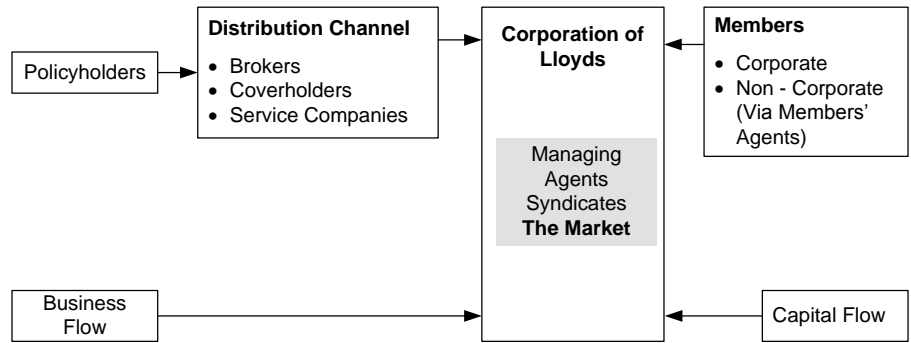
Unique Risk Profile Leads to Separation of Risks

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

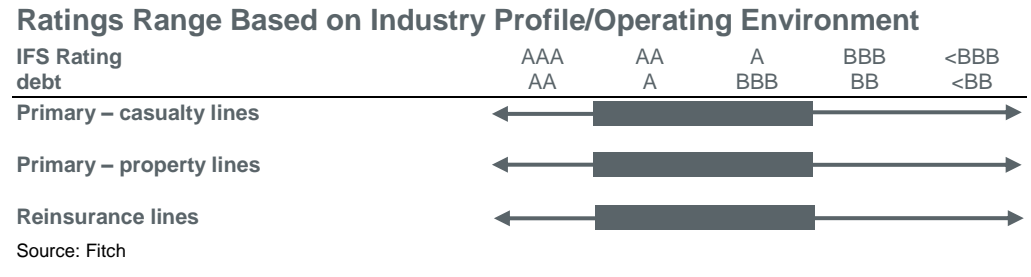
Structure Diagram



Source: Lloyd's Fitch

Lloyd's' market structure 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.

Industry Profile and Operating Environment



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.

Pricing Pressures on London Market Business to Increase

Fitch's negative outlook on the London market insurance sector reflects our belief that a significant proportion of London market (re)insurance business classes will see further heavy pricing pressures in 2017. If pricing does not improve, the London market may be unable to generate positive underwriting results, should catastrophe losses revert to the long-term historical average.

Fitch expects premium rates to fall in 2017. Short-tail catastrophe exposed lines are likely to fall the furthest, but other major non-catastrophe lines such as casualty are also likely to encounter further price falls as more (re)insurers move into these business classes in order to diversify. Rates fell again in January 2017, but there was more evidence of a deceleration in the level of rate reductions. The biggest rate declines were in energy, marine and aviation classes (reductions of 5%, 4% and 4%, respectively).

Fitch expects the London market's combined ratio to deteriorate further in 2017, reflecting our view that attritional loss ratios and expense ratios will continue to increase. We also expect reduced prior-year reserve releases. A large proportion of reserve releases in recent years have come from older years of account. There is some evidence of small deficits in recent years of account, particularly in casualty lines, and we believe further deficits could occur.

Fitch expects capitalisation in the London market to remain strong. The low level of catastrophe events, particularly US windstorms, has prevented the erosion of capital strength. This is reflected not only in the highest-ever absolute amount of capital but also by a declining underwriting leverage ratio (net written premiums to shareholders' equity).

The prospect of Brexit brings uncertainty for the London market sector in particular, given the importance of access to the single market through 'passporting' rights. Fitch believes that Lloyd's is the most exposed within the London market to the downside risk associated with Brexit. The high likelihood of the UK leaving the single market would mean that UK insurers underwriting risks from the European Economic Area (EEA) would need to establish regulated entities within the EEA, which would further increase operating costs. Lloyd's is seeking to address this issue through the creation of a subsidiary in Brussels through which EEA business will be conducted.

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 the highest volatility of combined ratio, indicating the increased exposure to catastrophe risk.

Peer Analysis

(USDm) ^a	IFS Rating ^d	Gross premiums written ^b		Combined ratio (%)	Combined ratio volatility (pp) ^e	Shareholders' equity	
		2016	2015	Five-year average ^c	Five-year average	2016	2015
Berkshire Hathaway	AA+/Stable	45,881	41,294	90.2	1.4	283,001	255,550
Munich Reinsurance Company	AA/Stable	53,886	55,566	92.3	2.0	33,446	33,651
Lloyd's of London	AA-/Stable	40,147	35,883	86.4	4.8	34,177	35,750
Swiss Re	AA-/Stable	35,622	32,249	85.5	4.3	35,716	33,606
Hannover Re	AA-/Stable	18,039	18,828	95.0	0.6	10,250	9,538
SCOR S.E.	AA-/Stable	15,251	14,804	91.5	1.3	7,045	6,915
PartnerRe Company Ltd	A+/Stable	5,357	5,548	87.7	3.1	6,688	6,903

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 2012-2016, 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)	2012	2013	2014	2015	2016	Fitch's expectation
Financial leverage (%)	5	4	5	4	3	Financial leverage will increase slightly as a result of the debt issuance in 2017. Fitch does not foresee a significant change in the level of capital in the near term, assuming major losses fall within the bounds anticipated by Lloyd's for the rest of 2017.
NWP/equity (x)	1.0	1.0	0.9	0.9	0.8	
Net leverage (x)	3.0	2.9	2.7	2.6	2.6	
Gross leverage (x)	4.0	3.7	3.4	3.3	3.4	
TFC ratio ^a (x)	0.1	0.1	0.1	0.1	0.1	

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

Strong Member and Central Capital

- Rising catastrophe risk affects capitalisation
- Solvency II coverage stable
- 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

Rising Catastrophe Risk Affects Capitalisation

Fitch considers the capitalisation of Lloyd's to be in line with the current rating level. However, our view of risk-adjusted capital has been affected by the rising levels of catastrophe exposure in the portfolio. Both leverage and the TFC ratio remained low at end-2016. Fitch expects risk-adjusted capitalisation to remain adequate for the ratings, assuming a normal level of large losses for the rest of 2017.

Solvency II Coverage Stable

Lloyd's reports its Solvency II coverage on both a central and market-wide basis. The market-wide Solvency Capital Ratio (SCR) reflects the aggregation of all eligible market-wide assets, and Lloyd's reported a ratio of 144% at end-2016 (end-2015: 146%) which was comfortably above the risk appetite of 125%. On a central basis, reflecting the vulnerability of the central fund, the solvency ratio remained stable at 215% (end-2015: 218%), which was also comfortably in excess of the risk appetite of 200%.

Low Financial Leverage and TFC Ratio

The Fitch-calculated financial leverage ratio for Lloyd's was 3% at end-2016, with no debt issuance in 2016. Lloyd's issued GBP300 million of debt in early 2017, but overall financial leverage remains low.

Lloyd's' TFC ratio was unchanged at 0.1x (end-2015: 0.1x), which is low and supportive of the ratings.

Risk-Based Approach to Setting Member and Central Capital

The Lloyd's Economic Capital Assessment (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.

Lloyd's believes that the 35% uplift allows for sufficient capital to keep financial strength and credit ratings at current levels.

Process to Keep Capital Level Constant

All members are required to recapitalise, should the ECA 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 Lloyd's' central capital 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 Lloyd's' chain of security 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), with the value of central fund net assets standing at GBP1.95 billion at end-2016 (end-2015: GBP1.66 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)	2012	2013	2014	2015	2016	Fitch's expectation
Interest coverage – market (x)	37	64	56	47	23	Interest coverage to remain strong. Fitch expects a small increase in fixed-charge costs, given the recent debt issue, but expects Lloyd's to be comfortably able to service its debt obligations, which remain low.
Interest coverage – society (x)	4	2	3	3	10	
Interest paid	62	56	49	54	54	

Source: Lloyd's annual reports, Fitch

Strong Debt-Servicing Capability and Financial Flexibility

- GBP300 million debt issued in 2017
- Financial flexibility
- Ability to service debt will remain strong
- Flexibility of repayment options

GBP300 Million Debt Issued in 2017

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. If not called, the coupon will reset to a floating rate equal to 3-month Libor plus 4.479% payable quarterly in arrears, representing a step-up of 100bp. The scheduled maturity date is 7 February 2047. The net proceeds of the issue of the notes are being used to provide the issuer with additional solvency capital to meet regulatory capital requirements and for general corporate purposes.

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 four tranches of sterling-denominated perpetual and dated subordinated debt including the most recent issuance. The remaining debt consists of a GBP500 million Solvency II Tier 2 subordinated bond, callable in 2024, and perpetual Tier 1 subordinated securities of GBP392 million. Another GBP5 million remains outstanding for the dated subordinated debt issued in 2004.

Ability to Service Debt Will Remain Strong

Lloyd's' debt-servicing ability is strong for its rating level. Fixed-charge coverage excluding unrealised gains and losses came down significantly to 23x in 2016 (2015: 47x). However, this is still well in excess of Fitch's 'AAA' median of 18x. The reduction was driven by the reduction in Lloyd's' pre-tax operating earnings which exclude the significant foreign-exchange gains made in 2016. Fitch expects this ratio to remain strong in 2017 in the absence of any significant earnings event, given Lloyd's' strong capability to generate earnings.

On a Society basis, fixed-charge coverage improved from 3x in 2015 to 10x in 2016 driven by a big improvement 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)	2012	2013	2014	2015	2016	Fitch's expectation
Net income	2,771	3,205	3,161	2,122	2,107	Lloyd's to report reduced profits in 2017, assuming losses arising from natural catastrophes are in line with the long-run average. Weak reinsurance pricing conditions remain, and the strong investment result is not likely to be repeated.
Change in GWP (%)	9	1	-1	6	12	
Operating ratio (%)	86	81	84	87	93	
Combined ratio (%)	91	87	88	90	98	
Net loss ratio (%)	54	49	49	50	57	
Admin expense ratio (%)	10	11	10	11	11	
Commission ratio (%)	28	28	28	29	30	
ROE (%)	15	16	15	9	8	

Source: Lloyd's annual reports, Fitch calculations

Market Performance Remains Strong

- Investment return offsets declining underwriting profit
- Pricing pressures continue across main sub-classes
- Strong investment returns and FX gains
- PMD demonstrates tangible results

Investment Return Offsets Declining Underwriting Profit

Pre-tax income remained strong at GBP2.1 billion (2015: GBP2.1 billion), while the sources of profit were very different in 2016 and 2015 despite a similar net result. The 2015 result benefitted from a benign natural catastrophe environment whereas the 2016 result relied on a strong investment and foreign-exchange result. In 2016, major claims amounted to GBP2.1 billion (2015: 0.7 billion), which equates to 9.1pp on the combined ratio (2015: 3.5pp), compared with Lloyd's fifteen-year average of USD1.7 billion.

Lloyd's' results continue to benefit from positive prior-year reserve development, although prior-year reserve releases in 2016 were down to 5.1% (2015: 7.9%). Fitch is monitoring the sustainability of reserve releases – given strong competition, falling premium rates and signs of declining reserve surpluses, particularly on casualty lines.

Pricing Pressures Continue Across Main Sub-Classes

Pricing continued to decline in 2016, with further risk-adjusted rate reductions of 2% forecast for 2017. Risk-adjusted rates have declined at Lloyd's in every year bar two since 2010, with a reduction of around 20% in real rates over that period.

Fitch believes the global supply of underwriting capacity will continue to outstrip demand during 2017 but expects the rate of price-softening to ease, driven mainly by improvements in some treaty classes. Premium renewals were up 4% in January 2017 compared with 2015 despite the reducing rates, which implies that exposures are rising despite adverse market conditions.

Strong Investment Returns and FX Gains

Lloyd's benefitted from foreign-exchange gains as a result of the depreciation of sterling, and investment returns also improved due to a downward shift in bond yields. Overall, Lloyd's net investment income rose to GBP1.3 billion in 2016 (2015: GBP0.4 billion); and foreign-exchange gains contributed GBP0.6 billion (2015: GBP0.1 billion loss) to profit, which helped to offset the reduced underwriting result. Fitch views these market movements as a "one off".

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.

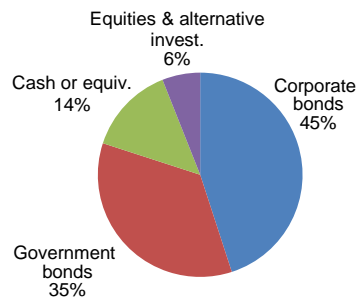
Investments and Asset Risk

(GBPm)	2012	2013	2014	2015	2016	Fitch's expectation
Invested assets	51,773	51,498	54,863	56,903	67,666	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 (%)	2.5	1.6	1.9	0.7	2.2	
Liquid assets/tech reserves (%)	170	177	184	185	181	
Risky assets/equity (%)	38	43	40	37	39	

Source: Lloyd's annual reports, Fitch

Syndicate PTF Investments

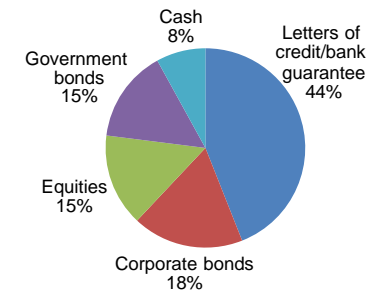
End-2016



Source: Lloyd's

Members' FAL Investments

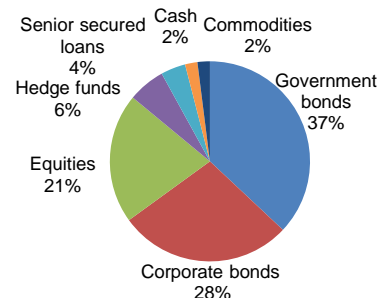
End-2016



Source: Lloyd's

Central Fund Investments

End-2016



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 (44% at end-2016). 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 GBP2.7 billion at end-2016; 62% was invested in core assets such as investment-grade bonds and cash. The remaining 38% was invested in growth assets which 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 – Prior-Year Reserve Movement

	2012	2013	2014	2015	2016	Fitch's expectation
Loss reserves/current-year incurred losses	3.0	3.0	3.0	2.9	2.6	The development of the casualty and motor reserves remains Fitch's key focus among the seven classes. The agency anticipates that aggregate prior underwriting years will develop favourably over the next two years.
Loss reserves/policyholder surplus	1.5	1.4	1.3	1.2	1.3	
Current-year paid losses/incurred losses	1.0	1.1	1.0	0.9	0.9	
Change in loss reserves/earned premium	-7	-9	4	-2	9	
Loss reserve development/equity (%)	-7	-8	-8	-7	-5	
Loss reserve development/PY loss reserves (%)	-4	-6	-6	-6	-4	

Source: Lloyd's annual reports, Fitch

Continued Favourable Development

- Prior-year result generated by all classes except motor
- High importance of reserving profile

Prior-Year Result Generated by All Classes Except Motor

Lloyd's reported a favourable claims experience across all classes of business in 2016, with the exception of motor business, which was affected by the change to the Ogden discount rate for lump-sum payments on UK bodily injury claims. Overall, there was a 5.1pp improvement in the calendar-year combined ratio (2015: 7.9pp) from reserve releases. However, Fitch is monitoring the sustainability of reserve releases particularly for more recent years – and particularly for casualty lines where some mild strengthening of reserves has been seen. The strongest releases were on reinsurance, energy and aviation classes, with prior year releases improving the combined ratio by 10pp, 14pp and 22pp, respectively.

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 (2016: 1.3x and 2.6x, respectively). Fitch monitors reserve and related exposure growth by monitoring 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 2016, Lloyd's overall reserve development remained positive; this is also the case based on a five-year average.

Reinsurance, Risk Mitigation and Catastrophe Risk

(%)	2012	2013	2014	2015	2016	Fitch's expectation
NWP/GWP	76	79	79	79	77	Metrics should remain very strong, reflecting the prudent approach to reinsurance.
Reinsurance recoverable/equity	77	62	55	52	59	

Source: Lloyd's annual reports, Fitch

Reinsurance, Risk Mitigation and Catastrophe Risk

Adequate Risk Management and Reinsurance

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

Increased Catastrophe Risk

Lloyd's catastrophe risk exposure has grown over the last couple of years despite the softening of rates with an overall increase in natural catastrophe exposure in 2017. Lloyd's is looking to strengthen oversight of syndicates with material catastrophe risk. Fitch will be monitoring the development of the catastrophe risk exposure levels to see whether the actions taken reduce exposure over time.

Risk Oversight on Society and Market Level

Lloyd's' unique structure assists in overseeing and managing risks at the Corporation level in addition to establishing guidelines, control functions and monitoring at the market level. Responsibility for the market-level function is held by the syndicate risk committee, which is directly involved in all syndicate oversight, including oversight of the new entrants' process, change-of-control and performance monitoring. The financial risk committee is responsible for all financial risks at market and Corporation levels whereas the Corporation risk committee is solely focused on Society risk issues, including international regulation and conduct risk.

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, as well as being home to a department for emerging risks. Catastrophe risk is modelled at both 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 91% in the 'A' range or above. Reinsurance recoverables as a percentage of equity was low at end-2016, 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
Sub perpetual	392	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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