

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

Fitch Ratings-London-07 June 2018: 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.

Fitch has also assigned Lloyd's Insurance Company S.A. (Lloyd's Brussels), a subsidiary of the group which will handle all EU business post Brexit, an IFS Rating of 'AA-' with a Negative Outlook. The rating is at the same level as Lloyd's as the subsidiary is viewed by Fitch as 'core' to the group.

KEY RATING DRIVERS

The Negative Outlook reflects our view that Lloyd's underwriting profits are under pressure from worsening attritional losses, lower risk-adjusted premium rates and high expense ratios. The ratings reflect Lloyd's very strong business profile in insurance and reinsurance classes, low financial leverage and strong reserve adequacy. These positives are somewhat offset by the underlying pressure on underwriting performance, together with Fitch's belief that Lloyd's exposure to catastrophe risk remains high relative to that of its peers.

In 2017, Lloyd's reported an attritional loss ratio of 58.9% (2016: 53.3%) and an expense ratio of 39.5% (2016: 40.6%). This shows that even with an average level of catastrophe losses, Lloyd's would have reported an underwriting loss. Lloyd's is trying to reduce expenses through its "Target Operating Model" initiative and recently announced that it will require syndicates to place at least 30% of risks electronically by end-2018.

Lloyd's exposure to worldwide natural and man-made catastrophes is higher than peers', although Lloyd's has been actively managing this down over the past 12 months. The overall combined ratio of 114% in 2017 was a significant deterioration on prior year (2016: 97.9%), mainly driven by Lloyd's high level of exposure to catastrophe losses. 2017 was one of the costliest years on record for catastrophe losses following a series of events, including three major hurricanes - Harvey, Irma and Maria - and earthquakes in Mexico and wildfires in California.

A number of syndicates at Lloyd's experienced significant capital depletion as a result of the catastrophe events in 2017. However, all were able to fully recapitalise as required 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 also remained low at 3% at end-2017 (end-2016: 4%).

Following the significant catastrophe events of 2017 Lloyd's reported risk-adjusted price rises at January renewals of around 3%, which still leaves risk-adjusted rates well below historical highs, with risk-adjusted rates having declined by almost 20% since 2010. Fitch believes that Lloyd's maintains a disciplined approach to underwriting, reinforced by the strong oversight of Lloyd's Performance Management Directorate (PMD).

Lloyd's experienced a reduction in positive prior year reserve development compared with 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 prior, better performing years become exhausted.

The business profile of Lloyd's remains very strong and supports the group's 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 GBP33.6 billion in 2017.

Lloyd's Brussels 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 objectives and strategy. It will maintain common branding and will write a material portion of the group's premiums (estimated at EUR2 billion of premiums in 2019).

RATING SENSITIVITIES

The ratings are likely to be downgraded if the net combined ratio, excluding major claims, remains above 91% (2017: 95.5%). Under-performance or a proportionally larger net catastrophe loss than peers or market could also lead to a downgrade.

A return to a Stable Outlook is likely if Lloyd's net combined ratio, excluding major claims, improves to below 91% and risk-adjusted capital exposure to catastrophe losses is maintained at a level that is commensurate with peers.

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Applicable Criteria
Insurance Rating Criteria (pub. 30 Nov 2017)
<https://www.fitchratings.com/site/re/905036>

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