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Ratings

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Lloyd's

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Lloyd's

Credit Highlights

Operating Company Covered By This Report
Financial Strength Rating
Local Currency
A+/Stable/--

Overview

Strengths	Risks
Unique brand and reputation and a center for underwriting specialist risks.	Underwriting performance of late has been at the lower end of its peer group.
Revenue comes from diverse geographic locations across several different property/casualty (P/C) product lines.	Lloyd's is still more heavily exposed to catastrophe risk than the majority of its reinsurance peers according to our metrics.
The capital position is very strong and likely to improve over the next two to three years.	Management is undertaking a large modernization program at Lloyd's with significant execution risks.

U.K. domiciled Lloyd's has a unique brand and place in the insurance industry. Lloyd's enjoys worldwide recognition and is considered a leading center for the writing of specialist insurance risks. We expect the market will continue to attract business and loyalty from brokers thanks to depth of its underwriting expertise and the face-to-face culture of the market.

The market will continue to manage capital to at least very strong levels. Lloyd's capital position per our risk based model is now comfortably above our 'AA' benchmark and we expect that management will at least maintain capital at this level. Despite heavy losses in 2017 and 2018, management has been able to restore capital to the market quickly and take measures to control previously high levels of catastrophe risk.

Lloyd's still faces significant underlying problems with its business model that could impact its competitive position. Despite recent efforts by Lloyd's to improve underwriting performance, we still have concerns about the market's underlying business model. The cost of doing business at Lloyd's is higher than in many other (re)insurance centers and Lloyd's has an expense ratio near the top of its peer group. In 2019 Lloyd's announced a series of measures to deal with this issue and other initiatives aimed at ensuring the competitiveness of the market. While we view the aims of the program positively, there will be significant execution risk attached.

Outlook

The stable outlook signifies that we expect management to continue to focus on Lloyd's underwriting performance and to address its overall cost structure, which has hindered the market over the years. We also expect that the market will continue to hold capital at levels at least in excess of our 'AA' level.

Downside scenario

We could lower our ratings by one notch if Lloyd's cannot maintain capital above our 'AA' requirement through 2019-2021, or if its competitive strength significantly weakens. This could be triggered by a further deterioration in underlying performance, compared with similarly rated reinsurers and insurers.

Upside scenario

We see limited upside to the rating over the next two years. We would have to see both a significant improvement in operating performance and a successful implementation of the new management team's strategy to modernize the market before we took a positive rating action.

Key Assumptions

- Global GDP growth to slow.
- Average 10-year U.S. Treasury yield of about 3.4% in 2019 and 3.6% in 2020
- Stable outlook on the global reinsurance sector and on the majority of the reinsurers we rate.

Key Metrics

	2020F	2019F	2019H1	2018	2017	2016	2015
GPW (Mil. £)	~34,000	~33,000	19,869	35,527	33,591	29,862	26,690
Combined ratio (non-life; %)	95-98	97-100	98.8	104.5	114	97.9	90
Net investment yield (%)	~1.8	~1.8	1.7*	1.4	2.1	1.7	1.3
Net income (mil. £)	~1,500	~1,000	2,325	(1,001)	(2,001)	2,107	2,122
Financial leverage	<5	<5	2.4	2.8	2.9	3.1	3.5
Fixed-charge coverage	>30	>30	90.5*	(12.1)	(41.6)	35.2	46.5

F--Forecast. H1--first half. *Estimate. GPW--Gross premium written.

Business Risk Profile

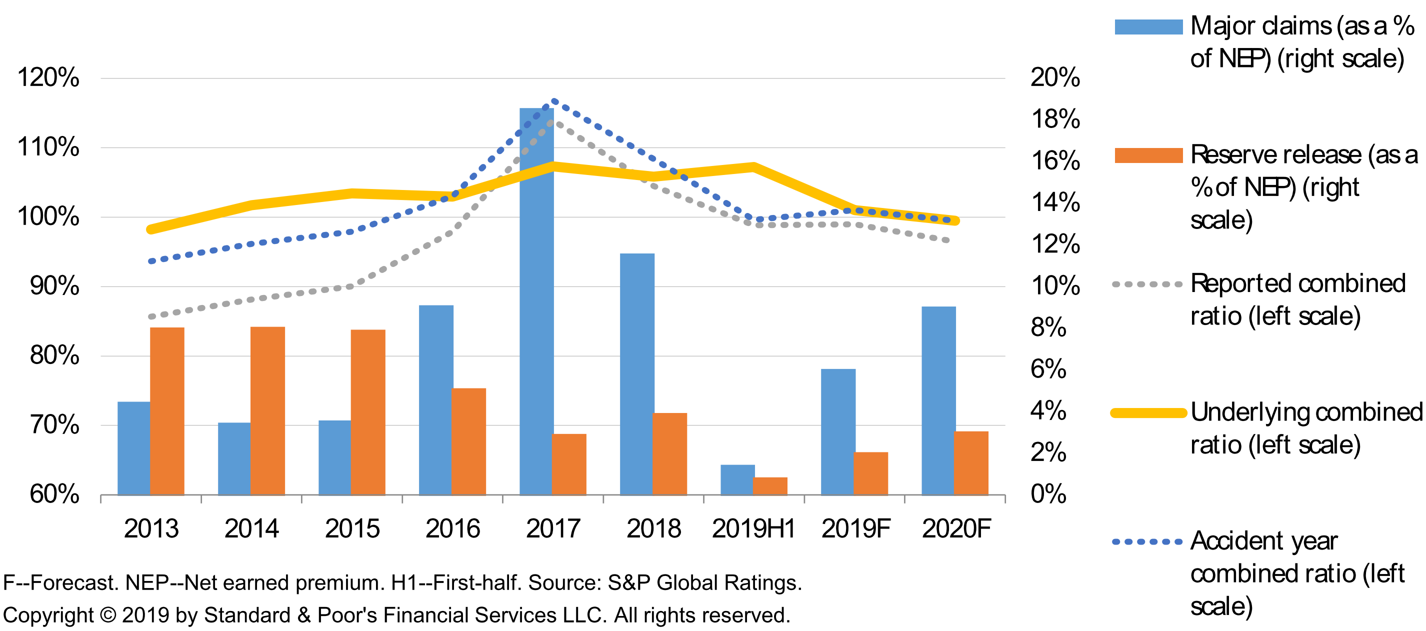
In our opinion, Lloyd's benefits from its unique brand, the attraction of being the world's largest subscription market, and its large geographic footprint from which it distributes its wide product offering. The expense of doing business at Lloyd's and its recent poor performance slightly offset these strengths.

We view Lloyd's brand and reputation as a key differentiator for the rating. The availability of one-stop shopping for various niche and standard products, the expertise of Lloyd's underwriters, and the strong face-to-face culture have led to policyholder and broker loyalty that we view as a competitive strength.

Lloyd's enjoys a leading position in the global reinsurance market, consistently ranking among the top five global reinsurers, and it has been the leading excess and surplus writer in the U.S. since 2011. Lloyd's is also the leading reinsurer for global marine business. However, a significant majority of Lloyd's income (65%) comes from the U.S., Canada, and the U.K., which are particularly credit-sensitive markets compared with those in continental Europe.

Chart 1

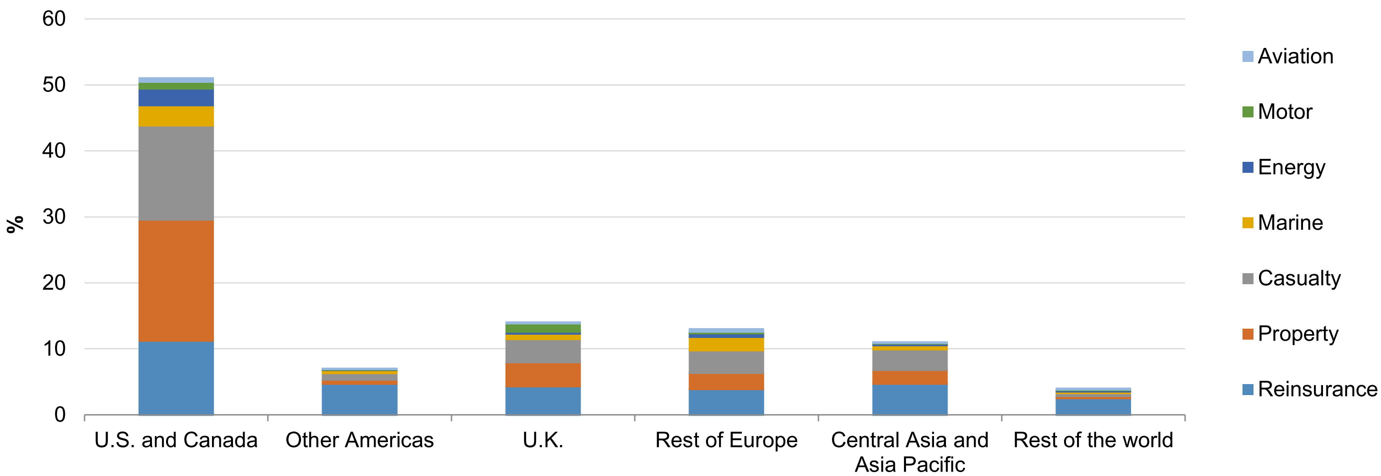
Lloyd's Underlying Underwriting Performance Has Been Unprofitable For Some Time



F--Forecast. NEP--Net earned premium. H1--First-half. Source: S&P Global Ratings.

Chart 2

Lloyd's Risks Still Predominantly U.S. Based With A Heavy Bias Toward Reinsurance And P/C Lines



P/C--Property/casualty. Source: S&P Global Ratings.

The cost of doing business at Lloyd's somewhat constrains our assessment of the market's competitive position. Lloyd's expense ratio is significantly higher than that of peers (39.2% in 2018, compared with a simple sector average closer to 35%). This is driven in part by high acquisition costs (the top six global brokers provide 50% of Lloyd's business) but also by Lloyd's dependence on coverholders who produce nearly 30% of its premium. Lloyd's management is working to change its operating model to address this issue by introducing initiatives, such as electronic placement and simplifying claims handling. We believe these programs have been more successful than previous attempts to modernize the market.

The increasing amount of alternative capital in the wider reinsurance market also poses a threat to Lloyd's profitability via increased competition and pressure on pricing. Despite the significant losses faced by the reinsurance industry in 2017 and 2018, rate increases were hard to find in the January 2019 renewal season. Although the April and June renewals were more positive, we expect pricing to remain competitive in 2020 due to the increasing appetite for reinsurance risk among nontraditional capital providers, such as pension funds.

Lloyd's still has a significant amount of work to do to ensure the market can maintain--and improve--its competitiveness against other major reinsurance hubs such as Bermuda, Zurich, and Singapore. The new management team has recognized the need for the market to change in order keep its pre-eminent position and held a major consultation with market stakeholders over 2018-2019 around the future of the market. Following the consultation, Lloyd's launched its "Future at Lloyd's" blueprint which lays out six initiatives management hopes will make Lloyd's "the most advanced marketplace in the world". We believe that the program is essential in order for Lloyd's to at least maintain its competitive position, but we recognize the significant execution risk involved and the strain it may place on the management team. Our expectation is that management will be able to work on the modernization program while maintaining the work it has performed recently in improving the market's underwriting performance.

At mid-year 2019, Lloyd's gross written premium had increased by 2%, but excluding exchange rate movements had actually fallen by 2.6%, which was a smaller contraction than we expected. We had expected a 5% fall in premium excluding foreign exchange movements, driven by corrective actions of the performance management division (PMD) at the end of 2018 when many syndicates reduced or stopped certain unprofitable lines of business. The decrease in volumes was, however, slightly offset by improvement in rates (Lloyd's estimates a 3.9% improvement on average risk-adjusted rates). Our expectation is that excluding foreign exchange movements, the market will contract by around 2% in 2019.

Financial Risk Profile

Lloyd's has a very strong capital position in our view based on its excess of capital at the 'AA' benchmark in our risk-based model. We expect that Lloyd's capital position will improve over the next two years so that its capital is in excess of our 'AAA' benchmark.

In regulatory terms, Lloyd's holds comfortable capital surpluses in both its market wide regulatory solvency ratio of 172% and a central solvency ratio of 266%. Lloyd's regulatory solvency position has been improved by an increase in eligible capital as the market has reduced its reliance on letters of credit as a form of capital. We note that not all the capital held by Lloyd's is fungible (only the central fund and corporation assets are available to pay all claims). However, offsetting this concern is the corporation's strong history of managing syndicate level capital and its ability to ask the market to recapitalize (demonstrated in 2017, when approximately £3 billion of capital was injected into the market following Hurricanes Harvey, Irma, and Maria).

We expect Lloyd's operating performance to improve in 2019-2020 so that by 2020 it will record combined ratios more in line with peers at around 96% (absent any significant catastrophes). In the past two years, Lloyd's has recorded significant losses (£1 billion in 2018 and £2 billion in 2017) mainly due to large catastrophe losses in both years (in 2017, hurricanes Harvey, Irma, and Maria; in 2018, Typhoon Jebi, Hurricane Florence, and the Californian wildfires). These catastrophes led to Lloyd's combined ratio being over 100% (signifying underwriting losses) for the past two years (2018: 104.5%, 2017: 114%), whereas, in the previous five years Lloyd's average combined ratio was about 90%. However, on an underlying basis (excluding prior year reserve releases and assuming a blanket catastrophe load of 9%), Lloyd's has not recorded a combined ratio of less than 100% since 2013, reflecting the tough market conditions described earlier.

As of June 30, 2019, the market recorded a significant increase in earnings on 2018 with a profit before tax of £2.3 billion (first-half 2018: £0.6 billion). The improvement was largely driven by an improved investment result of £2.3 billion compared with just £0.2 billion on June 30, 2018. On the underwriting side there was some improvement with the expense ratio falling by 1.2% to 38.1% and the attritional loss ratio (claims not classified as major claims) on policies written in 2019 fell by almost 3%. In our opinion this reflects the work done by the PMD in 2018 to remove some of the worst performing business from the market along with a slight improvement in rates. Traditionally Lloyd's faces most of its major claims burden in the second half of the year, due to the hurricane season, so the 2019 result will depend much on the experience in the next three months. So far, major claims have been light in 2019, with only Hurricane Dorian likely to have a material effect. Assuming an average hurricane experience for the remainder of 2019, we expect Lloyd's will record a combined ratio of 98%. In 2020, again assuming a standard catastrophe experience of around 9% we would expect improvements in Lloyd's attritional loss ratio to lead to a combined ratio of close to 96%.

Lloyd's currently holds minimal levels of leverage with subordinated debt in issuance of £794 million, making up under 3% of the market's capital. We do not expect Lloyd's capital structure to change significantly over the next two to three years.

Other Key Credit Considerations

Governance

We have a positive view of the market's governance, reflecting the significant expertise and experience of Lloyd's managing agents and the market's overall governance. We note, however, that Lloyd's itself has seen significant turnover in its senior executives in recent years. The majority of the top executive team have been replaced in the last 24 months including the CEO, the CFO, and the COO. However, we believe that the new team under the guidance of Lloyd's Chairman Bruce Carnegie-Brown have quickly made a positive impact and demonstrated its willingness to address Lloyd's key challenges.

We view positively Lloyd's robust strategic planning process, which its performance management and finance directorates have established and improved in recent years. The initiatives implemented include a stringent business planning process and benchmarking exercises, and have fueled significant improvements in performance standards and measurement. We have not identified any governance deficiencies in our assessment.

Liquidity

Lloyd's premium income flow provides readily available liquidity. The market also has a highly liquid asset portfolio that contains more than £60 billion in marketable securities. The vast majority of the Lloyd's chain of security could be liquidated in 90 days. We also credit the market's ability to call on members for capital injections throughout the year and withhold profits in order to ensure claims are paid as a positive factor for its liquidity assessment.

Accounting considerations

Although the Lloyd's market itself is not a legal entity, the corporation provides an audited pro-forma set of financial statements that aggregate the financial results of Lloyd's members, allowing comparison with other insurance companies. These accounts are prepared where practicable under U.K. generally accepted accounting principles. We view the market's financial communication and disclosure as sound and transparent

Ratings Score Snapshot

Ratings Score Snapshot	
Business Risk Profile	**Very strong**
Competitive position	Very strong

Ratings Score Snapshot (cont.)	
IICRA	Intermediate risk
Financial Risk Profile	**Satisfactory**
Capital and earnings	Very strong
Risk exposure	High
Funding structure	Neutral
Anchor*	a+
Modifiers	
Governance	Neutral
Liquidity	Adequate
Comparable ratings analysis	0
Financial Strength Rating	**A+**

*This is influenced by our view of Lloyd's competitive strength compared to 'A' rated peers.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of October 10, 2019)*	
Operating Company Covered By This Report	
Lloyd's	
Financial Strength Rating	
Local Currency	A+/Stable/--
Domicile	United Kingdom

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.