S&P Global
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
Lloyd's has a unique brand and reputation and is a center for underwriting specialist risks.	Underwriting performance has been unprofitable for the past three years.
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.
Management has taken swift action to maintain very strong levels of capital in the market following significant losses in recent years.	Management is undertaking a large modernization program, 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. S&P Global Ratings expects the market will continue to attract business and loyalty from brokers thanks to the depth of its underwriting expertise and the market's face-to-face culture.

The market will continue to manage capital to at least very strong levels. Lloyd's capital position per our risk based model is now above our 'AAA' benchmark and we expect that it will remain at these levels through to 2022. Despite both the investments and underwriting losses Lloyd's will likely experience in 2020 due to COVID-19, we expect management will ensure that the market maintains sufficient capital adequacy. We base our view on recent recapitalizations following large losses and the measures the corporation has taken to reduce previously high levels of catastrophe risk.

Lloyd's still faces significant underlying problems with its business model that could affect its competitive position. Despite recent efforts by Lloyd's to improve underwriting performance, we still believe the market's underlying business model has risk. The cost of doing business at Lloyd's is higher than that in many other (re)insurance centers and Lloyd's has an expense ratio near the top of its peer group. In 2019, the corporation 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 program's aims 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 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 exceeding our 'AAA' level.

Downside scenario

We could lower our ratings by one notch if Lloyd's cannot maintain capital above our 'AA' requirement through 2020-2022, or if its competitive strength significantly weakens. This could follow 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 take a positive rating action.

Key Assumptions

- COVID-19 will lead to a global recession in 2020. We forecast GDP will fall in 2020 by 5.2% in the U.S. and by 6.5% in the U.K.
- We expect central bank monetary policy responses will cement interest rates at a lower level for a longer period, putting pressure on insurers investment yields. We expect US ten year yields will fall to 1.3% in 2019 slightly increasing to 1.8% in 2022.
- Despite recent rate improvements in most lines, we still believe business conditions in the reinsurance sector remain weak following the significant levels of alternative capital entering the market over the past decade.
- COVID-19 will test reinsurers both through investment losses (from equity market falls and credit spread widening) and their underwriting portfolios (with those writing pandemic covers and event cancellation policies most affected).

Table 1

Lloyd's--Key Metrics

	2021f	2020F	2019	2018	2017	2016	2015
GPW (mil. £)	~36,500	~35,000	35,905	35,527	33,591	29,862	26,690
Combined ratio (non-life; %)	~98.0	105.0	102.1	104.5	114.0	97.9	90.0
Net Investment Yield (%)	~1.5	~1.5	3.5	1.4	2.1	1.7	1.3
Net income (mil. £)	~1,000	~(2,500)	2,532	(1,001)	(2,001)	2,107	2,122
Financial leverage (%)	~4.0	~4.0	3.1	2.8	2.9	3.1	3.5
Fixed-charge coverage (%)	~25.0	<0	27.5	(12.1)	(41.6)	35.2	46.5

f--S&P Global Ratings' forecast. GPW--Gross premium written.

Business Risk Profile

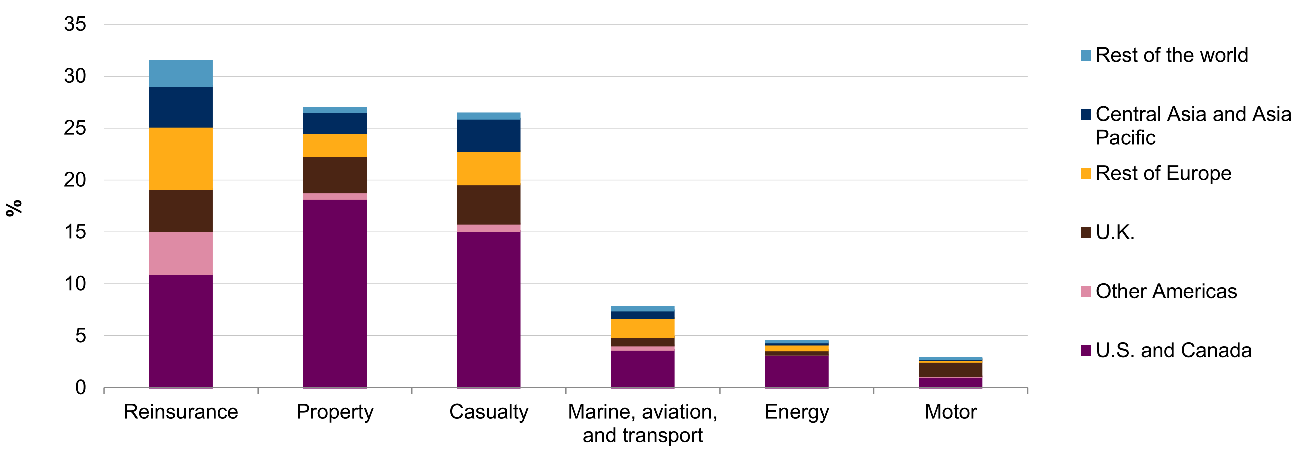
In our opinion, Lloyd's benefits from its unique brand, the attraction of being the world's largest subscription market, and its large geographic footprint from which it distributes its wide product offering. The expense of doing business at Lloyd's and its recent poor performance slightly offset these 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 the Lloyd's market 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. The Lloyd's market is also the leading reinsurer for global marine business. However, a significant majority of its revenue (66%) 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 Premium Base Remains Denominated By U.S. Dollars And Short-Tail Risks
The coporation's premium by line of business and geography



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 (38.7% in 2019, compared with that of peers like Allianz 27.5%, RSA 29.7%, Swiss Re 31.7%). This is driven in part by high acquisition costs (the top five global brokers provide 50% of Lloyd's business) but also by Lloyd's dependence on coverholders who produce nearly 30% of its premium. The corporation'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 succeeded more than previous attempts to modernize the market.

The increasing amount of alternative capital in the wider reinsurance market also poses a risk to Lloyd's profitability via increased competition and pressure on pricing. The market suffered from significant rate declines in 2012-2017 as nontraditional capital providers (such as pension funds) increased their appetite for reinsurance and in particular catastrophe risk. However, the industry losses in 2017 and 2018 (because of significant catastrophes in those years) means rates have improved recently. The Lloyd's market has reported nine quarters of rate improvements and we expect that this momentum is likely to carry on through 2020.

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 to keep its preeminent position and held major consultations with market stakeholders in 2018-2019 concerning the future of the market. Following the consultation, the corporation 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 for Lloyd's to maintain and improve its competitive position, but recognize the significant execution risk involved and the strain it might place on the management team. Our expectation is that due to the COVID-19 pandemic, the pace of change in some areas will slow. However, the pandemic has accelerated the market's use of electronic placement and proved the business can be placed without a physical market. We expect that management will work on the modernization program while maintaining the work it has performed recently in improving the market's underwriting performance.

In 2019, Lloyd's gross written premium increased by 1.1%, but excluding exchange rate movements had actually shrunk by 2.4%, 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 at year-end 2018 when many syndicates reduced or stopped some unprofitable lines of business. The decrease in volumes was, however, largely offset by improvement in rates (Lloyd's estimates a 5.4% improvement on average risk-adjusted rates). Our expectation is that the market will contract in 2020 between 1% and 5%, as a result of the COVID-19 pandemic,. Premium levels are likely to suffer in the COVID-19 pandemic due to reduced premium in the aviation and marine lines of business, where activity has fallen significantly.

Financial Risk Profile

Lloyd's has a very strong capital position, in our view, based on its excess of capital at the 'AAA' benchmark in our risk-based model. We expect that Lloyd's will maintain this level of capital through the end of 2022.

In regulatory terms, Lloyd's holds comfortable capital surpluses in both its market wide regulatory solvency ratio of 156% and a central solvency ratio of 238%. Following investment losses from COVID-19, Lloyd's -forecast the central solvency ratio fell to 205%, however, we would expect Lloyd's efforts to recapitalize the market will bring the ratio back to levels close to 220% by June 30, 2020.

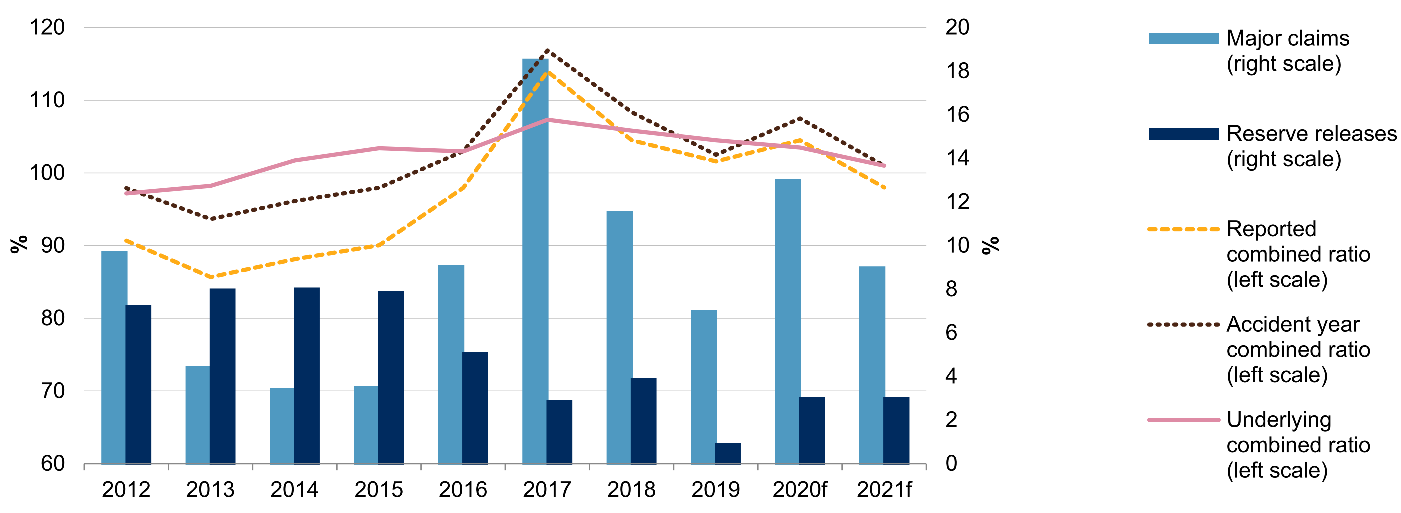
Not all the capital held by Lloyd's is fungible (only the central fund and corporation assets are available to pay all claims). However, offsetting this risk is the corporation's strong history of managing syndicate level capital appropriately (the last central fund loss was from the 2007 year of account) 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 underlying operating performance (excluding catastrophe events and reserve releases) to continue improving in 2020-2021. We base our expectation on the past two years of improving rates across the market and some efficiency gains from the modernization program. On a headline basis, however, the Lloyd's market is likely to record another year of significant underwriting losses due to claims from the COVID-19 pandemic. Lloyd's are likely to suffer significant claims from contingency polices (event cancellation) business interruption policies that cover pandemics and credit (guarantee) business. The quantum of these claims is very difficult to forecast because the claims' amount and size will depend on how long the pandemic and lockdown policies last. Our base-case scenario is that Lloyd's will record a combined ratio of 105% in 2020 but could fall anywhere in the 100%-115% range due to COVID-19 uncertainties and potential losses from hurricane season. We expect that the corporation will also record minimal investment gains in 2020 due to equity price falls and widening credit spreads. At the end of first quarter, the investment loss was £1.0 billion-£1.1 billion but markets have rebounded somewhat since. We therefore expect Lloyd's will make a loss in the region of £2.5 billion in 2020. We expect that the market will return to profit in 2021 (assuming an average year of catastrophe losses) with a combined ratio of 98% and overall profit of £750 million-£1 billion.

Lloyd's holds minimal levels of leverage with subordinated debt of £794 million, making up under 3% of the market's capital. In January 2020, Lloyd's issued £300 million of senior notes to fund its modernization project, these notes are not included in our total adjusted capital. We do not expect Lloyd's capital structure to change significantly over the next two-to-three years.

Chart 2

Slow Turnaround In Lloyd's Operating Performance



f--Forecast. Source: S&P Global Ratings.

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. However, the corporation has seen significant turnover in its senior executives in recent years. The majority of the top executive team have been replaced in the past three years, including the CEO, CFO, and COO. In 2020, the market's performance management director left and has yet to be replaced. However, we believe that the new team, under the guidance of Chairman Bruce Carnegie-Brown, has quickly made a positive impact and demonstrated its willingness to address Lloyd's key challenges.

We view positively the corporation's robust strategic planning process, which its performance management and finance directorates have established and improved in recent years. 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 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 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 combine the financial results of the market'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

Table 2

Lloyd's--Credit Metrics History		
	--Fiscal year end Dec. 31--	
	2019	**2018**
LC to US$ (average rate)	0.8	0.8
LC to US$ (year-end)	0.8	0.8
(Mil. LC, unless otherwise stated.)		
S&P Global Ratings capital adequacy	Very strong	Very strong
Total invested assets	73,098.0	71,203.0
Total shareholder equity	29,844.0	27,428.0
Gross premium written	35,905.0	35,527.0
Net premium written	25,659.0	25,681.0
Net premium earned	25,821.0	25,178.0
Reinsurance utilization (%)	28.5	27.7
EBIT	2,591.0	(962.0)
Net income (attributable to all shareholders)	2,532.0	(1,001.0)

Table 2

Lloyd's--Credit Metrics History (cont.)		
Return on revenue (%)	5.7	(1.8)
Return on assets (excluding investment gains/losses) (%)	1.7	(0.5)
Return on shareholders' equity (%)	8.8	(3.7)
Property/casualty: Net combined ratio (%)	102.1	104.5
Property/casualty: Net expense ratio (%)	38.7	39.2
Property/casualty: Return on revenue (%)	7.1	(0.6)
EBITDA fixed-charge coverage (x)	27.5	(12.1)
EBIT fixed-charge coverage (x)	27.4	(12.3)
EBIT fixed-charge coverage including realized and unrealized gains (losses) (x)	43.9	(24.7)
Financial obligations/adjusted EBITDA (x)	0.6	(1.7)
Financial leverage including pension deficit as debt (%)	3.1	2.8
Net investment yield (%)	3.6	1.4
Net investment yield including investment gains (losses) (%)	4.9	0.7

LC--Local currency.

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 June 10, 2020)*	
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.