Research Update:

Lloyd's And Core Subs Affirmed At 'A+', Subordinated Debt Lowered To 'BBB+' Under Revised Hybrid Criteria

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Overview

- Lloyd's strengths include its unique brand and reputation and its diverse product range and geographic spread.
- Its recent volatile underwriting performance and significant exposure to natural catastrophe events somewhat offset these strengths, however.
- We are affirming our 'A+' ratings on Lloyd's, its core subsidiaries, and the Society of Lloyd's. At the same time, we are lowering the ratings on Lloyd's two subordinated Tier 2 notes by one notch to 'BBB+' under our revised hybrid criteria.
- The outlook is stable because we expect management to continue to focus on Lloyd's underwriting performance and to hold capital at levels at least in excess of our 'AA' level.

Rating Action

On July 18, 2019, S&P Global Ratings affirmed its 'A+' long-term rating on Lloyd's, its core subsidiaries, and the Society of Lloyd's (see the ratings list below for further details). The outlook is stable.

At the same time, we lowered the ratings on the Society of Lloyd's subordinated Tier 2 notes to 'BBB+' from 'A-'. The downgrade of the notes follows a review under our revised criteria ("Hybrid Capital: Methodology And Assumptions," published July 1, 2019).

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 three 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.

Rationale

Our rating on the Lloyd's market reflects its unique position in the insurance sector and the strength of its competitive position, particularly in the reinsurance and specialty markets. The market's recent unprofitable underlying performance partially offsets these factors, however.

Following implementation of new criteria, the rating on Lloyd's Tier 2 subordinated notes is now three notches below the long-term issuer credit rating (ICR) on the Society of Lloyd's:

- One notch to reflect the notes' subordination to the company's senior obligations;
- Two notches to reflect the payment risk created by the mandatory and optional coupon cancellation features.

We previously only applied one notch to reflect payment risk due to coupon cancellation. We now believe that the payment risk on these notes is greater than for other similar hybrids, rated in the 'A' range. While Lloyd's cover of its regulatory capital requirement (The Solvency Capital Requirement or SCR) has improved in recent years (149% at year-end 2018 for its Market Wide SCR), it is materially closer to the point of mandatory deferral (below 100% SCR) than closely rated peers. We also note that Lloyd's significant exposure to natural catastrophe risk provides the potential for volatility in the level of its solvency cover, although this is partially offset by the ability of the market to request that its members recapitalize following significant losses. Widening the notching between the ICR on Lloyd's and the rating on Lloyd's hybrid also allows for a smoother transitioning of the rating on the instrument if the market's solvency cover were to near mandatory deferral.

We will continue to monitor Lloyd's SCR coverage and capital plans to assess whether the subordinated debt ratings adequately incorporate the payment risk associated with Lloyd's hybrid instruments. An unexpected deterioration or strengthening in the group's regulatory solvency position not accompanied by a change in ICR could lead us to raise or lower the rating on the notes by widening or narrowing the notching between them and the ICR.

Ratings Score Snapshot

Business Risk Profile	Very Strong
Competitive position	Very strong

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 List

Downgraded

	To	From
The Society of Lloyd's		
Subordinated	BBB+	A-
Junior Subordinated	BBB+	A-
Ratings Affirmed		
The Society of Lloyd's		
Issuer Credit Rating		
Local Currency	A+/Stable/--	

Lloyd's	
Underwriters at Lloyds of London, Kentucky	
Underwriters at Lloyds of London, Illinois	
Lloyd's Insurance Co. S.A.	
Lloyd's Insurance Co. (China) Ltd.	
Financial Strength Rating	
Local Currency	A+/Stable/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.