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Ratings

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Research Update:

Ratings On Lloyd's Affirmed, Enterprise Risk Management Score Lowered; Outlook Stable

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Table Of Contents

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Overview

- Lloyd's returned strong profits again in 2016, however, it was more dependent on investment income than previously.
- Foreign exchange movements and capital exposure impaired capitalization on our capital model but we expect it to remain extremely strong overall.
- Challenges in maintaining exposure within the corporation's risk appetite led us to lower our enterprise risk management score, however, our view of strong risk controls at Lloyd's is unaffected.
- We are affirming our 'A+' ratings on Lloyd's and The Society of Lloyd's.
- The outlook is stable.

Rating Action

On June 14, 2017, S&P Global Ratings affirmed its 'A+' insurer financial strength rating on Lloyd's and its 'A+' long-term counterparty credit rating on The Society of Lloyd's. The outlook is stable.

At the same time, we affirmed our 'A-' issue ratings on the subordinated notes issued by The Society of Lloyd's.

Rationale

In 2016, Lloyd's technical performance moved more in line with other major insurers. While Lloyd's had enjoyed the low catastrophe years of 2012-2015, returning combined (loss and expense) ratios of 87%-91%, more significant major losses in 2016 such as Hurricane Matthew and the Fort McMurray fires saw the combined ratio move to 97.9%.

Major losses accounted for 9% of the combined ratio in 2016, close to our long-term average expectation of 10%. A lower release of reserves from previous years of account has also had a significant impact, although we continue to regard Lloyd's as enjoying a significant reserve surplus. While strong investment performance later in the year lifted the market's 2016 net income to £2.1 billion, we do not see this as necessarily repeatable. Looking forward, we expect combined ratios of about 97% in 2017-2019, assuming normal catastrophe experience and annual net incomes of about £1.6 billion.

Lloyd's capitalization on our model deteriorated over 2016. The weakening of the pound sterling (Lloyd's reporting currency) against most major currencies, the U.S. dollar in particular, inflated premium growth to 12% in pound sterling terms and also contributed to the increase in investment assets to £55 million from £45 million. Along with an increase in catastrophe exposure, this increased the charges we apply within our capital model. We expect, however, that capital will soon recover to above our 'AAA' threshold and remain there, given our earnings expectations.

We view positively Lloyd's risk controls and its strategic and emerging risk management in this highly complex marketplace. We believe that enterprise risk management (ERM) is of high importance to Lloyd's operations. We are revising down our assessment of risk management culture (a subfactor of ERM) to neutral following recent growth in Lloyd's catastrophe risk exposure. This has highlighted, in our opinion, some limitations in the execution and adequacy of the corporation's risk appetite framework. Consequently, we now view ERM as adequate with strong risk controls rather than strong, as previously.

Outlook

The outlook on Lloyd's is stable. We expect that the market will produce a combined ratio of about 97% in 2017-2018, assuming normalized catastrophe losses. Such performance would imply annual profits of about £1.6 billion. We anticipate that premiums written in the market will increase more slowly than previously as the corporation's management looks to scale back exposures during a period of weak rates.

Upside scenario

We are unlikely to raise our ratings in the next 12-24 months given Lloyd's risk profile.

Downside scenario

We are also unlikely to lower our ratings in the next two years. This is due to Lloyd's competitive and capital strengths. A catastrophe loss significantly outside Lloyd's expectations or tolerance levels could, however, prompt a negative rating action, as could a deterioration in ongoing operating profitability.

Ratings Score Snapshot

Financial Strength Rating	A+/Stable
Anchor	a+
Business Risk Profile	Very Strong
IICRA*	Intermediate Risk
Competitive Position	Very Strong
Financial Risk Profile	Moderately Strong

Capital & Earnings	Very Strong
Risk Position	High Risk
Financial Flexibility	Strong
Modifiers	0
ERM and Management	0
Enterprise Risk Management	Adequate with Strong Risk Controls from Strong
Management & Governance	Satisfactory
Holistic Analysis	0
Liquidity	Strong
Support	0
Group Support	0
Government Support	0

*Insurance Industry And Country Risk Assessment.

Related Criteria

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 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
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Ratings List

Ratings Affirmed

Lloyd's	
Underwriters at Lloyds of London, Kentucky	
Underwriters at Lloyds of London, Illinois	
Lloyd's Insurance Co. (China) Ltd.	
Financial Strength Rating	A+/Stable/--
The Society of Lloyd's	
Counterparty Credit Rating	A+/Stable/--
Subordinated	A-
Junior Subordinated	A-

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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.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the 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.