Research Update:

Lloyd's of London Outlook To Stable On Portfolio Remediation And Improved Capitalization; 'A+' Ratings Affirmed

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Overview

- The steps Lloyd's of London has taken to remediate its portfolio should ensure that its underwriting performance improves in 2019-2021. Management has also taken action to bring Lloyd's catastrophe exposure back within its risk appetite.
- After reporting over £3 billion of losses in the past two years, Lloyd's has also strengthened its capital adequacy and we now expect its capital to be significantly higher than our 'AA' confidence level over the next three years.
- We are therefore affirming our 'A+' rating on Lloyd's.
- The stable outlook signifies that we expect management's focus on underwriting discipline to improve operating performance in 2019-2021.

Rating Action

On June 14, 2019, S&P Global Ratings revised to stable from negative the outlook on its ratings on Lloyd's, the Society of Lloyd's, and its core subsidiaries. At the same time, we affirmed our issuer credit and financial strength ratings on these entities at 'A+'.

Rationale

We revised the outlook because, under its new leadership team, the London-based Lloyd's insurance market has taken the necessary steps to improve its overall underwriting performance. In its annual "coming into line" process (where Lloyd's reviews and approves syndicates' business plans) in late 2018, Lloyd's performance management division took very public action to remediate some of the worst-performing business in the market.

Management's focus on the worst-performing 10% of business at Lloyd's (known as "decile 10"), demonstrates that it has started to deal with Lloyd's worsening underlying performance. We expect this process may take some time--the extent of the remediation may not become clear until year-end 2020--but we anticipate that Lloyd's will continue to manage its business tightly to ensure that underwriting performance improves.

Lloyd's recorded a loss of £2.0 billion in 2017, but has since steadily rebuilt its capital position. It now holds a considerable excess above the 'AA' confidence level in our risk-based capital model. This improvement has been achieved--despite another £1 billion loss in 2018--through the recapitalization of syndicates, a reduction in the use of letters of credit as part of the market's capital, and improved control over the market's catastrophe risk appetite. Under the Solvency II regulations, the use of letters of credit is restricted; we therefore also restrict its use in our capital model.

The actions management took in late 2018 to remediate some of the worst-performing business in the market should enable it to maintain capital levels. Indeed, Lloyd's capital adequacy is likely to strengthen further in 2019 as the market's net premium written shrinks and Lloyd's continues to exercise stronger control over exposure to catastrophe risk.

Under our base-case scenario, we assume that the market will see a rise in premium rates in 2019, particularly in loss-affected lines. This should help to improve Lloyd's underlying earnings in 2019-2020. We forecast that the market will record combined (loss and expense) ratios of 95%-99% in 2019-2021, including a catastrophe load of about nine percentage points, assuming a normal catastrophe year.

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 currently. 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.

Ratings Score Snapshot

	To	From
Financial strength rating	A+/Stable	A+/Negative
Anchor	a+	a+

	To	From
Business risk profile	Very strong	Very strong
IICRA	Intermediate risk	Intermediate risk
Competitive position	Very strong	Very strong
Financial risk profile	Moderately strong	Moderately strong
Capital & earnings	Very strong	Very strong
Risk position	High risk	High risk
Financial flexibility	Strong	Strong
Modifiers	0	0
ERM and management	0	0
Enterprise risk management	Adequate with strong risk controls	Adequate with strong risk controls
Management and governance	Satisfactory	Satisfactory
Holistic analysis	0	0
Liquidity	Strong	Strong
Support	0	0
Group support	0	0
Government support	0	0

Note that support does not consider our ratings above sovereign criteria. IICRA--Insurance industry and country risk assessment. ERM--Enterprise risk management.

Related Criteria

- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- 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
- General Criteria: Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Criteria | Financial Institutions | General: Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- Criteria | Financial Institutions | Banks: Assumptions: Clarification Of The Equity Content Categories Used For Bank And Insurance Hybrid Instruments With Restricted Ability To Defer Payments, Feb. 9, 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; Outlook Action		
	To	**From**
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	A+/Stable/--	A+/Negative/--
The Society of Lloyd's		
Issuer Credit Rating	A+/Stable/--	A+/Negative/--
Ratings Affirmed		
The Society of Lloyd's		
Subordinated	A-	
Junior Subordinated	A-	

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.