FitchRatings

RATING ACTION COMMENTARY

# Fitch Affirms Lloyd's at IFS 'AA-'; Outlook Stable

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Fitch Ratings - London - 13 Jun 2023: Fitch Ratings has affirmed Lloyd's of London's (Lloyd's), Lloyd's Insurance Company (China) Limited's and Lloyd's Insurance Company SA's Insurer Financial Strength (IFS) Ratings at 'AA-' (Very Strong). The Outlooks are Stable. A full list of rating actions is below.

The affirmation reflects Lloyd's very strong business profile and capitalisation and leverage. The ratings also reflect strong and improved financial performance and earnings, as well as strong reserve adequacy.

## KEY RATING DRIVERS

**Very Strong Business Profile**: Fitch ranks Lloyd's business profile as 'Favourable' compared with that of global insurance and reinsurance companies. The ranking is driven by the market's strong franchise, large operating scale and significant diversification within property and casualty (P&C) insurance and reinsurance. Lloyd's is one of a small group of global (re)insurance providers capable of attracting high-quality and specialised business.

**Very Strong Capital Position:** Lloyd's central solvency coverage ratio was very strong at 412% at end-2022 (end-2021: 388%), following the implementation of reinsurance cover against large losses. This is comfortably in excess of the company's risk appetite of 200%. The market-wide solvency ratio was also very strong at 181% at end-2022 (end-2021: 177%).

**Unique Recapitalisation Process:** Lloyd's employs a unique to the market annual 'coming into line' process, which ensures a certain capital level is maintained and that all members have sufficient eligible assets to meet their current and future underwriting liabilities. Lloyd's successfully collected funds from members to fully cover large losses including pandemic-related losses. In the longer term, this resilience relies on the willingness and ability of members to recapitalise following significant losses.

**Strong Financial Performance Driven by Underwriting:** Our assessment of Lloyd's financial performance is driven by the level and volatility of the underwriting results. We expect Lloyd's to maintain the improvements in its underlying underwriting performance, but the overall results are likely to remain volatile, given its exposure to catastrophe-exposed lines. Lloyd's underwriting performance was strong in 2022, despite the marketplace booking sizeable large losses related to Hurricane Ian and the war in Ukraine. The combined ratio further improved to 91.9% (2021: 93.5%), helped by further reductions in the attritional loss ratio and the expense ratio.

However, Lloyd's reported an overall net loss of GBP0.8 billion for 2022, driven by valuation losses on its bond portfolio following the rise in interest rates. Given the short duration of the investment portfolio, these losses are expected to reverse in 2023-2024 as the bonds are typically held to maturity. Moreover, improved reinvestment yields are expected to contribute strongly to overall earnings. Lloyd's net result has limited bearing in our overall assessment of the marketplace's earnings profile.

**Favourable Pricing Conditions:** In 2022 Lloyd's reported strong growth in premiums of 19.1%. The strong growth was supported by favourable pricing conditions: in 2022 Lloyd's reported overall risk-adjusted rate rises (a measure of pricing per unit of risk) of 7.7% (2021: 10.9%, 2020: 10.8%, 2019: 5.4%). We expect pricing conditions to remain favourable in 2023 amid inflationary pressures and limited capacity in some business lines. These favourable pricing conditions should support Lloyd's strong underwriting profitability and capital generation.

**Strong Reserve Adequacy:** We view Lloyd's reserve adequacy as strong, supported by stable market-level surplus in the held reserves and continued reserve releases. This is reinforced by an independent review of reserves, which confirmed the market level of surplus estimated by Lloyd's. Our favourable view of reserve adequacy is further supported by robust market oversight of reserving practices, which is increasingly important, given the impact of inflation.

Lloyd's has an ESG Relevance Score of '4' for exposure to environmental impacts due to underwriting/reserving being exposed to natural catastrophe risks, with its property business representing 42% of 2022 gross written premiums.

## RATING SENSITIVITIES

### Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- A significant improvement in Lloyd's general competitive position. However, we view this as unlikely in the medium term.

### Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- A five-year average combined ratio above 104% (reported five-year average to 2022: 100.5%) on a sustained basis or the underlying annual combined ratio, before major losses, weakening to above 92% on a sustained basis.

- Inability to recapitalise after a large loss event as part of the market's 'coming into line' process.

## BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

Lloyd's of London has an ESG Relevance Score of '4' for Exposure to Environmental Impacts due to underwriting/reserving being exposed to natural catastrophe risks, with its property business representing 42% of 2022 gross written premiums , which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

## RATING ACTIONS

| ENTITY / DEBT | RATING | | | PRIOR |
|---|---|---|---|---|
| Lloyd's Insurance Company SA | LT IFS | AA- Rating Outlook Stable | Affirmed | AA- Rating Outlook Stable |
| Lloyd's Insurance Company (China) Limited | LT IFS | AA- Rating Outlook Stable | Affirmed | AA- Rating Outlook Stable |
| Lloyd's of London | LT IFS | AA- Rating Outlook Stable | Affirmed | AA- Rating Outlook Stable |
| The Society of Lloyd's | LT IDR | A+ Rating Outlook Stable | Affirmed | A+ Rating Outlook Stable |
| subordinated | LT | A- | Affirmed | A- |

**VIEW ADDITIONAL RATING DETAILS**

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## APPLICABLE CRITERIA

Insurance Rating Criteria (pub. 15 Jul 2022) (including rating assumption sensitivity)

## APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Prism Factor-Based Capital Model, v1.8.0 (1)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

## ENDORSEMENT STATUS

| | |
|---|---|
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| Lloyd's Insurance Company SA | EU Issued, UK Endorsed |
| Lloyd's of London | UK Issued, EU Endorsed |
| The Society of Lloyd's | UK Issued, EU Endorsed |

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