KBRA Affirms AA- IFSR for Lloyd's of London with a Stable Outlook

DUBLIN (1 July 2022) – KBRA Europe (KBRA) affirms the AA- insurance financial strength rating (IFSR) of Lloyd's of London (Lloyd's), the world's leading insurance and reinsurance marketplace. The Outlook for the rating is Stable.

Key Credit Considerations

The rating reflects Lloyd's strong risk-adjusted capitalisation, favourable capital trends, multi-faceted capital structure, conservative underwriting leverage, sound technical reserves, strong liquidity profile, diversified earnings sources, broad distribution channels and comprehensive risk management programme. At end-2021, Lloyd's market wide Solvency II ratio was 177%. Lloyd's capital has grown at a compound annual growth rate of 5.2% over the last five years and is up 7.7% at end-2021 over prior year. Lloyd's capital structure incorporates multiple successive layers of claims paying resources. KBRA believes that the increase in the callable layer from 3% to 5% plus a £650 million layer of reinsurance to protect the Central Fund, in conjunction with reduced risk and improved performance, materially enhances Lloyd's financial position. In combination, these changes resulted in a central Solvency II ratio of 388% at end-2021. KBRA believes that this represents an extremely strong backstop over and above capital resources at the market level. Compared to peers, Lloyd's maintains conservative premium and reserve leverage metrics. At end-2021, net carried reserves exceeded market and central actuarial best estimates. Lloyd's invests its assets conservatively and holds approximately 85% of its investments in cash and liquid, high credit quality fixed income securities. As one of the largest insurance underwriters in the world, Lloyd's writes business across all major sectors and covers over 60 lines of insurance and reinsurance in more than 200 countries and territories. Approximately 55% of 2021 gross premiums emanated from the U.S. and Canada while around 36% of gross premiums consisted of reinsurance. KBRA believes that Lloyd's credit profile is enhanced by its expansive coverholder distribution network that provides it broad access to risks across the globe. Lloyd's has a robust, dynamic risk management framework and processes characterized by well-articulated risks and conservative risk tolerances which are regularly monitored and subject to various stress tests and scenario analysis.

Balancing these strengths are recent unfavourable underwriting performance, an elevated expense ratio, heavy reliance on reinsurance and exposure to event risk. While Lloyd's has reported a cumulative result before tax from 2017-2021 of £0.9 billion, it has been driven by net investment income of £9.1 billion, offset by cumulative underwriting losses of £6.0 billion. While some of the underwriting loss is attributable to major and catastrophe events in 2017, 2018 and 2020, attritional losses during 2017 – 2019 were elevated as well. Lloyd's reported attritional loss ratio improvement in 2020 and again in 2021 due to continued focus on performance since 2018. KBRA expects Lloyd's to report attritional loss ratios generally in line with 2020 and 2021 over the medium term. While Lloyd's expense ratio showed continued improvement in 2021, it remains elevated compared to peers. As implementation of the Future at Lloyd's programme begins, KBRA expects more meaningful expense reductions will materialise. Since each syndicate structures and purchases its own reinsurance programme, Lloyd's is more heavily dependent on reinsurance than peers which utilise reinsurance more strategically although this weakness is partially offset by central management's detailed monitoring of counterparty credit risk across the market. Due to its wide product and geographic footprints, Lloyd's incurs claims for most catastrophic events around the world. While exposure to catastrophes is partially mitigated by appropriate risk tolerances and high-credit quality reinsurance, KBRA expects Lloyd's to continue to provide material cover for large loss-generating events going forward.

Rating Sensitivities

Successful implementation of Lloyd's new principles-based oversight of the market, consistent net attritional underwriting profitability over the medium term, and successful execution of the Future at Lloyd's programme could result in a positive rating action.

Unfavourable, or inconsistent, underlying underwriting performance over the medium term, meaningful reduction in capital or a drop in Solvency II ratios below Lloyd's minimum targets could result in a negative rating action.

ESG Considerations

In May 2022, Lloyd's published its second ESG Report, reflecting its progress to date and its continuing commitment to address ESG factors that are important to various stakeholders. As Lloyd's makes progress in fulfilling its commitments to its ESG targets, the insurance financial strength rating may be influenced over the medium to longer term.

A full report will soon be available on www.kbra.com.

To access ratings and relevant documents, click [here]().

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- Long Time No See: What Inflation Might Mean for Insurers
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Information on the meaning of each rating category can be located here.

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