



RATING ACTION COMMENTARY

Fitch Affirms Lloyd's at IFS 'AA-'; off Watch Negative; Outlook Stable

Fri 18 Sep, 2020 - 07:06 ET

Fitch Ratings - London - 18 Sep 2020: Fitch Ratings has affirmed Lloyd's of London's (Lloyd's), Lloyd's Insurance Company (China) Ltd's and Lloyd's Insurance Company S.A.'s Insurer Financial Strength (IFS) Ratings at 'AA-' (Very Strong) and removed them from Rating Watch Negative (RWN). The Outlook is Stable.

KEY RATING DRIVERS

The removal of RWN primarily reflects Lloyd's completed capital collection from members in June 2020 to fully compensate for the company's estimated GBP3 billion of COVID-19 losses net of reinsurance, as well as improvements in underlying underwriting performance, before major losses in 1H20. The affirmation of the 'AA-' IFS ratings primarily reflects the company's very strong business profile and capitalisation and leverage. These strengths are partially offset by Fitch's assessment that Lloyd's financial performance and earnings are more consistent with the agency's 'a' rating category.

Lloyd's saw an increase in its reported combined ratio to 110% in 1H20 from 102% in 2019, with 20pp attributable to major losses. Major losses, which were heavily influenced by COVID-19, totalled GBP2.4 billion and were driven mainly by contingency, property and casualty classes. As of end-1H20 Lloyd's expected net

ultimate losses from the pandemic of GBP3 billion at end-2020, up slightly from mid-year levels.

Lloyd's underlying combined ratio before major losses improved to 90% in 1H20 from 95% in 2019, reflecting positive results from the company's performance management division initiated in 2018. This improvement in underlying underwriting performance will help Lloyd's absorb possible upward revisions in its 2020 COVID-19 losses, given still material market-wide uncertainties related to possible business interruption, liability and other classes of claims.

Given the year-to-year variability in major losses at Lloyd's, Fitch believes evaluating underwriting results over longer periods can provide a useful perspective. For the period of 2015-2019, Lloyd's combined ratio averaged 102%, which is within Fitch's 'A'-category guidelines. During that period, Lloyd's underlying combined ratio before major losses averaged 92%, with major losses contributing an average of 10pp. Assuming no material additional major losses in 2H20 beyond Lloyd's current estimates, the five-year average combined ratio from 2016-2020 would be expected to increase modestly to about 104%.

Following a profitability review in 2018 and significant natural catastrophe losses of the past two years, Lloyd's reported an increase in overall risk-adjusted premiums in 1H20 of 8.7% (2019: 5.4%, 2018: 3%). We expect pandemic-related losses still to be absorbed by the market and ongoing performance management actions to support favourable pricing conditions in 2021.

Fitch ranks Lloyd's business profile as 'favourable' compared with that of global insurance and reinsurance companies, driven by a strong franchise, large operating scale and significant diversification within P&C (re)insurance. Lloyd's is part of a small group of global (re)insurance providers capable of attracting high-quality and specialised business.

On a central fund basis Lloyd's central solvency coverage ratio was very strong at 250% at end-1H20 (end-2019: 238%), a level that is comfortably in excess of its risk appetite of 200%. The improvement was mainly driven by Lloyd's completed a capital collection from members in June 2020 in respect of COVID-19 net losses. However, in the longer term, such resilience relies on the willingness and ability of members to recapitalise, following significant losses.

Fitch views Lloyd's exposure to worldwide catastrophes as high, although the company has managed this down in recent years. Lloyd's has an ESG Relevance Score of '4' for

Exposure to Environmental Impacts due to underwriting/reserving exposed to natural catastrophe risks, with its property business representing 45% of 2019 gross premiums written. This has a negative impact on the credit profile and is relevant to the ratings in conjunction with other factors.

RATING SENSITIVITIES

The ratings remain sensitive to a material change in Fitch's rating assumptions with respect to the pandemic. Factors that could, individually or collectively, lead to negative rating action/downgrade: -The five-year average combined ratio, excluding 2020 COVID-19 related losses, rising above 104%. -The underlying annual combined ratio, before major losses, weakening to above 92% on a sustained basis. -Inability to recapitalize after a large loss event. Factors that could, individually or collectively, lead to positive rating action/upgrade: -An upgrade would result from a significant improvement in Lloyd's general competitive position. However, we view this as unlikely in the medium term.

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

Exposure to Environmental Impacts: ESG Relevance Score of '4'.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). 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	Ins Fin Str	AA- Rating Outlook Stable	Affirmed	AA- Rating Watch Negative
Lloyd's Insurance Company (China) Limited	Ins Fin Str	AA- Rating Outlook Stable	Affirmed	AA- Rating Watch Negative
Lloyd's of London	Ins Fin Str	AA- Rating Outlook Stable	Affirmed	AA- Rating Watch Negative
The Society of Lloyd's	LT IDR	A+ Rating Outlook Stable	Affirmed	A+ Rating Watch Negative

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FITCH RATINGS ANALYSTS

Ekaterina Ishchenko

Director

Primary Rating Analyst

+44 20 3530 1532

Fitch Ratings Ltd

30 North Colonnade, Canary Wharf London E14 5GN

Federico Faccio

Senior Director

Secondary Rating Analyst

+44 20 3530 1394

Willem Loots, FIA

Senior Director

Committee Chairperson

+44 20 3530 1808

MEDIA CONTACTS**Athos Larkou**

London

+44 20 3530 1549

athos.larkou@thefitchgroup.com

Additional information is available on www.fitchratings.com**APPLICABLE CRITERIA**[Insurance Rating Criteria \(pub. 25 Aug 2020\) \(including rating assumption sensitivity\)](#)**APPLICABLE MODELS**

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

Prism Factor-Based Capital Model, v1.7.1 ([1](#))**ADDITIONAL DISCLOSURES**[Dodd-Frank Rating Information Disclosure Form](#)[Solicitation Status](#)[Endorsement Policy](#)**ENDORSEMENT STATUS**

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