

RatingsDirect®

Lloyd's

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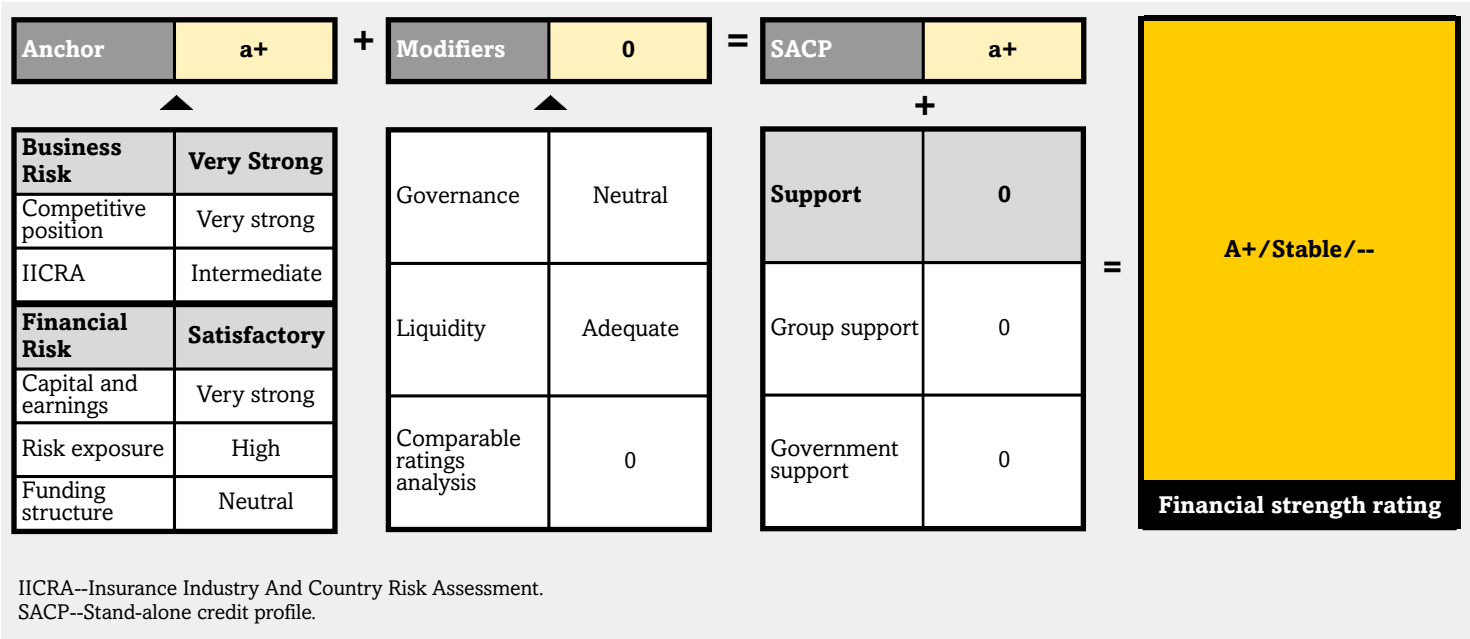
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Lloyd's



Credit Highlights

Overview	
Key strengths	Key risks
Unique brand and reputation and at the center of underwriting specialist risks.	Headline underwriting performance has been unprofitable for the past four years.
Revenue comes from diverse geographic locations across several different property/casualty (P/C) product lines.	Still more heavily exposed to catastrophe risk than most its reinsurance peers, according to our metrics.
Management has taken swift action to maintain very strong levels of capital in the market following significant losses in recent years.	Management is undertaking a large modernization program, with significant execution risks.

U.K.-domiciled Lloyd's has a unique brand and place in the insurance industry. It enjoys worldwide recognition and is considered a leading center for the writing of specialist insurance risks. S&P Global Ratings expects the market will continue to attract business and loyalty from brokers, thanks to the depth of its underwriting expertise and face-to-face culture.

The market will continue to manage capital to at least very strong levels. Lloyd's capital position, as per our risk-based model, is now above our 'AAA' benchmark and we expect that it will remain at these levels through 2021-2022. Despite significant COVID-19 claims during 2020, management has worked quickly to ensure that the market maintains its excellent levels of capital adequacy. We base our view on recent recapitalizations following large losses and the measures the corporation has taken to reduce previously high levels of catastrophe risk.

Lloyd's still faces significant underlying problems with its business model that could affect its competitive position. Despite recent efforts by Lloyd's to improve underwriting performance, we still believe the market's underlying business model has risk. The cost of doing business at the corporation is higher than that in many other (re)insurance centers and Lloyd's has an expense ratio near the top of its peer group. Since taking over in 2018, CEO John Neal has unveiled several ambitious measures to deal with this issue and other initiatives aimed at ensuring the competitiveness

of the market. Although we view the program's aims positively, there will be significant execution risk.

Outlook: Stable

The stable outlook signifies that we expect management to continue to focus on Lloyd's underwriting performance and address its overall cost structure, which has hindered the market over the years. We also expect that the market will continue to hold capital exceeding our 'AAA' level.

Downside scenario

We could lower our ratings by one notch if Lloyd's cannot maintain capital above our 'AA' requirement through 2021-2023, or if its competitive strength significantly weakens. This could follow a further deterioration in underlying performance, compared with similarly rated reinsurers and insurers.

Upside scenario

We see limited upside to the rating over the next two years. We would have to see both a significant improvement in operating performance and a successful implementation of the management team's strategy to modernize the market before we take a positive rating action.

Key Assumptions

- The global economy will recover from the COVID-19 pandemic in 2021 as vaccination roll-out progresses across the globe. We expect G20 economies to bounce back with growth of 6.1%.
- Investment returns will remain muted due to continued low interest rates. We expect 10-year U.S. government bond yields to improve somewhat to 1.7% in 2021.
- Pricing in Lloyd's reinsurance segment will improve, but lag behind rate improvements we have seen in specialty and direct commercial business.

Lloyd's--Key Metrics

	2022f	2021f	2020	2019	2018	2017
GPW (mil. £)	~36,500	~36,000	35,466	35,905	35,527	33,591
S&P Global Ratings capital adequacy	Excellent	Excellent	Excellent	Excellent	Very Strong	Satisfactory
Combined ratio (non-life; %)	~96	~97	110%	102.1	104.5	114
Net investment yield (%)	~2	~2	2.2	3.5	1.4	2.1
Net income (mil. £)	2,700	2,400	(887)	2,532	(1,001)	(2,001)
Financial leverage (%)	~3.5	~3.5	3.6	3.1	2.8	2.9
Fixed-charge coverage (x)*	>30	>30	(23.3)	31.7	(12.1)	(41.6)
Return on shareholders' equity (%)	~8	~7	(2.8)	8.8	(3.7)	(7.4)

f--Forecast. GPW--Gross premium written.

Business Risk Profile: Very Strong

In our opinion, Lloyd's benefits from its unique brand, the attraction of being the world's largest subscription market, and its large geographic footprint from which it distributes its wide product offering. The expense of doing business at Lloyd's and its recent poor performance slightly offset these strengths.

We believe that Lloyd's brand and reputation will continue to be a key differentiator for the rating. The availability of one-stop shopping for various niche and standard products, the expertise of the Lloyd's market underwriters, and the strong face-to-face culture will continue to attract policyholder and broker loyalty that we view as a competitive strength.

We expect Lloyd's will continue to enjoy a leading position in the global reinsurance market, consistently ranking among the top five global reinsurers. We also expect that Lloyd's will remain the leading excess and surplus writer in the U.S. (it has been since 2011). In addition, the Lloyd's market is the leading (re)insurer for global marine and aviation business. Most of its revenue (66%) comes from the U.S., Canada, and the U.K., which are more credit-sensitive markets compared with those in continental Europe.

We believe that the cost of doing business will remain a constraint on our assessment of the market's competitive position. Although the corporation's expense ratio fell in 2020 to 37.2% (2019: 38.7%) it is still higher than that of most of its peers (Allianz at 26.8%, Chubb at 27.6%, and RSA at 31.2%). This is fueled in part by high acquisition costs (the top five global brokers provide 50% of Lloyd's business) but also by Lloyd's dependence on coverholders who produce nearly 30% of its premium. The corporation's management is working to change its operating model to address this by introducing initiatives such as electronic placement and simplifying claims handling. We believe that so far these programs have succeeded more than previous attempts to modernize the market. In our view, the expense ratio could drop below 37% in 2021 but it will be challenging. Some of the reduction in expenditure seen in 2020 was caused by COVID-19 and will likely return to the expense base in 2021.

The increasing amount of alternative capital in the wider reinsurance market also poses a risk to Lloyd's profitability via increased competition and pressure on pricing. The market suffered from significant rate declines in 2012-2017 as nontraditional capital providers (such as pension funds) increased their appetite for reinsurance and in particular catastrophe risk. However, the industry losses in 2017-2018 (because of significant catastrophes in those years) and COVID-19 related losses in 2020 mean rates have improved recently. The Lloyd's market has reported 12 quarters of rate improvement and we expect this momentum will likely continue in 2021.

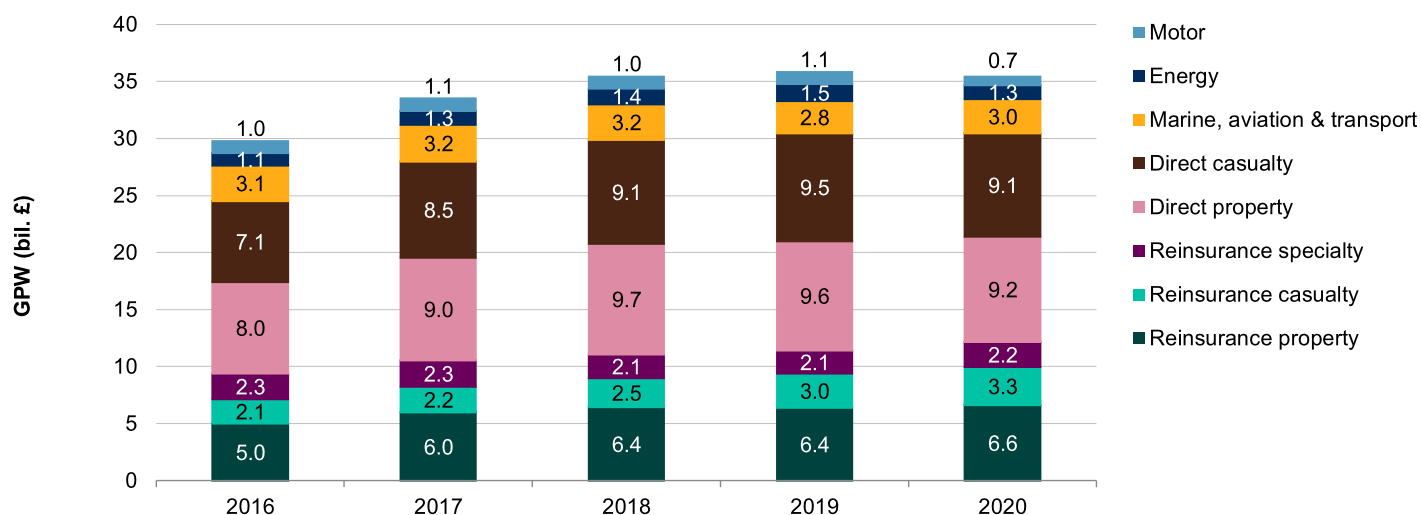
Lloyd's still has a significant amount of work to ensure the market can maintain--and improve--its competitiveness against other major reinsurance hubs such as Bermuda, Zurich, and Singapore. The new management team has recognized the need for the market to change to keep its preeminent position, and held major consultations with stakeholders in 2018-2019 concerning its future. Following the consultation, the corporation launched its "Future at Lloyd's" blueprint, which lays out six initiatives management hopes will make the corporation "the most advanced marketplace in the world". We believe that the program is essential for Lloyd's to maintain and improve its competitive position, but recognize the significant execution risk involved and the strain it might place on the management team.

We expect that, due to the pandemic, the pace of change in some areas will slow. However, the pandemic has also accelerated the market's use of electronic placement and proved business can be placed without a physical market. We expect that management will work on the modernization program while maintaining recent progress in improving underwriting performance.

In our view, Lloyd's premium base will return to growth in 2021 although we expect that this growth will be measured. The trend of improving rates and reduced volumes is likely to continue into 2021, although we do not expect the same drops in volume (12%) we saw in 2020. Lloyd's continues to take a hard line with poorly performing syndicates (where volumes reduced significantly in 2019-2020) but improving rates in many lines mean that it will allow syndicates with strong underwriting performance to take advantage of conditions. We also expect Lloyd's may benefit from new business as insurers are forced to go outside their local markets due to a lack of capacity.

Chart 1

New Management Applies The Brakes--Lloyd's Top Line Has Plateaued Post-2018



GPW--Gross premium written. Source: S&P Global Ratings.

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Financial Risk Profile: Satisfactory

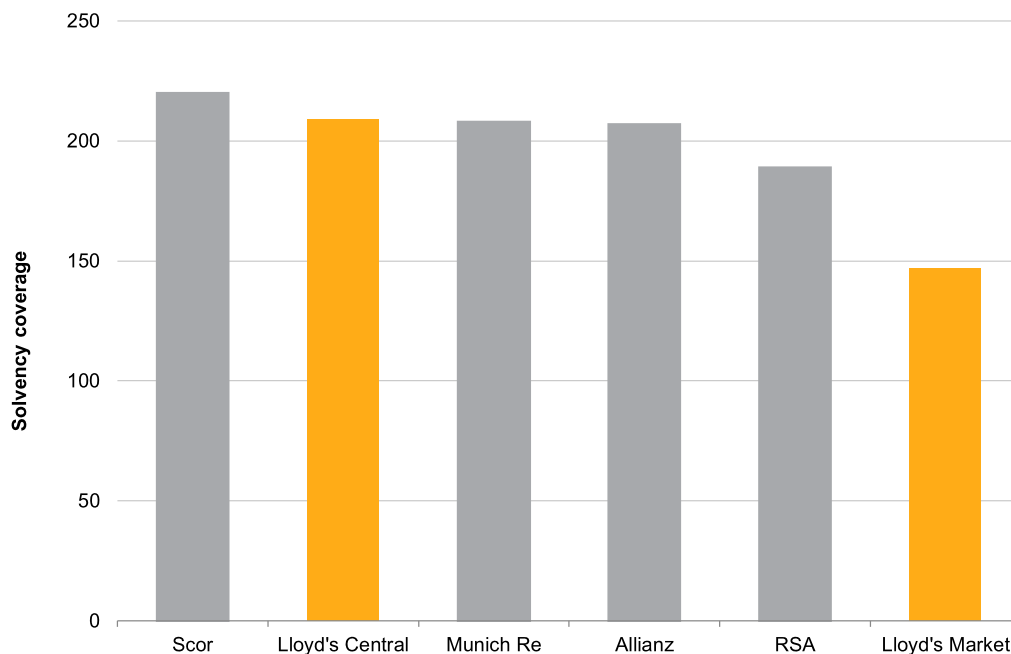
Lloyd's has a very strong capital position, in our view, based on its excess of capital at the 'AAA' benchmark in our risk-based model. We expect that Lloyd's will maintain this level of capital through year-end 2023.

In regulatory terms, Lloyd's holds comfortable capital surpluses in both its market wide regulatory solvency ratio of 147% and central solvency ratio of 209%. We expect that Lloyd's will maintain coverage levels similar to this throughout 2021-2023. In recent years Lloyd's has acted quickly to address large claims events by accelerating capital collection from members. We expect that, should another significant claims event (similar to the 2017 hurricanes or

COVID-19) occur, management will again seek to address any capital shortfalls quickly.

Chart 2

Although Lloyd's Central Solvency Ratio Is In Line With Peers', Its Marketwide Solvency Ratio Is Lower



Source: S&P Global Ratings.

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Not all the capital held by the corporation is fungible--only the central fund and corporation assets are available to pay all claims. However, this risk is offset by the corporation's strong history of managing syndicate level capital appropriately (the most recent central fund loss was from the 2007 year of account) and its ability to ask the market to recapitalize. This capacity to recapitalize was demonstrated in 2017 when the market injected £3 billion following hurricanes Harvey, Irma, and Maria; and in 2020, with a further £3.5 billion following COVID-19 losses.

We expect Lloyd's underlying operating performance (excluding catastrophe events and reserve releases) to continue improving in 2021-2023. We base our expectation on the past three years of improving rates across the market and some efficiency gains from the modernization program. We do not expect COVID-19 to have a significant effect on the market in 2021 due to the large provisions in place at the syndicate level. Much of the market's exposure is now extinguished through policy wording changes, although further claims could arise on event cancellation policies if lockdowns are extended through 2021 and into 2022. Lloyd's 2020 result was hit by £3.4 billion of net COVID-19, claims largely from contingency policies (event cancellation) business interruption policies that cover pandemics, and credit (guarantee) business. Our base-case scenario is that Lloyd's will record combined ratios (loss and expense) of 96%-98% in 2021-2023, assuming an average natural catastrophe load of 10%, as improving rates in the market

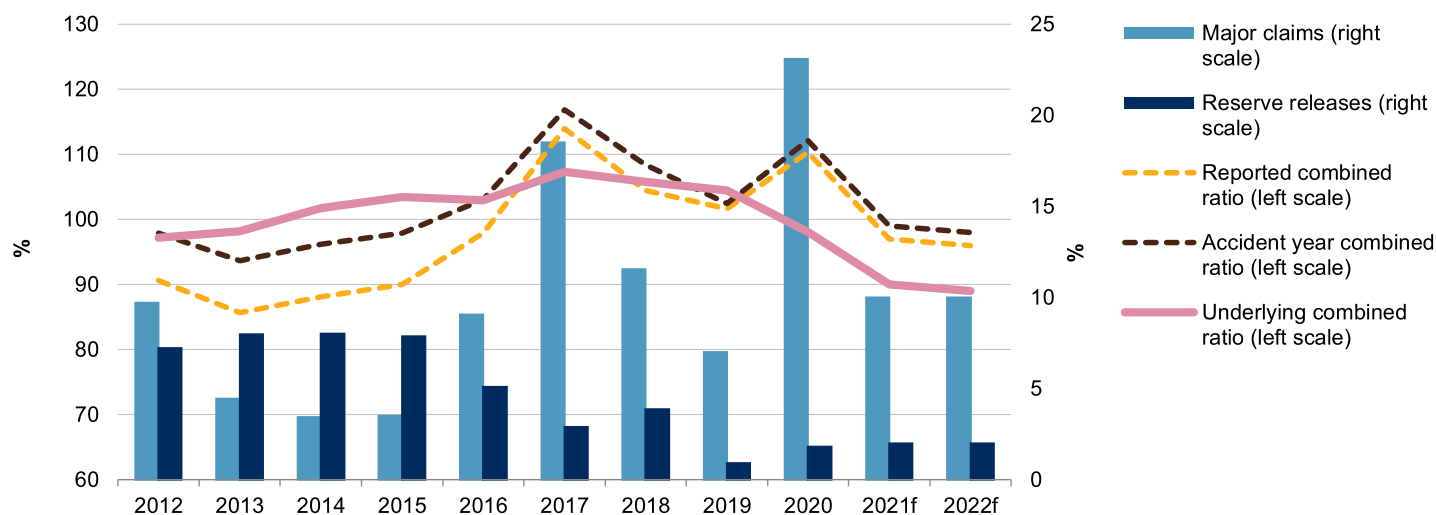
strengthen margins.

Lloyd's has a fairly conservative approach to investments and, as such, we expect future returns on investment to be relatively muted. Our base-case scenario is that Lloyd's will see net investment income of about 2% over the next two years. This reduction in yield reflects both the continuing low-interest-rate environment and Lloyd's further de-risking of the investment portfolio backing its central fund in 2020.

Lloyd's holds minimal levels of leverage, with subordinated debt of £794 million and £300 million of senior notes (which do not qualify as capital in our model), making up just over 3% of the market's capital. We do not expect Lloyd's capital structure to change significantly over the next two-to-three years.

Chart 3

Turnaround In Lloyd's Underlying Performance



f--Forecast. Source: S&P Global Ratings.

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Other Key Credit Considerations

Governance

We have a positive view of the market's governance, reflecting the significant expertise and experience of Lloyd's managing agents and the market's overall governance. However, the corporation itself has seen significant turnover in its senior executives in recent years. The majority of the top executive team has been replaced in the past four years, including the CEO, CFO, and COO. In 2020, the performance management director responsible for many of the programs to improve underwriting at Lloyd's left and a new head of markets was announced in 2021. However, we believe that the new team, under the guidance of chairman Bruce Carnegie-Brown, has quickly made a positive impact and demonstrated its willingness to address Lloyd's key challenges.

We view positively the corporation's robust strategic planning process, which its performance management and finance directorates have established and improved in recent years. Initiatives include a stringent business planning process and benchmarking exercises, and have fueled significant improvements in performance standards and measurement. We have not identified any governance deficiencies in our assessment.

Liquidity

Lloyd's premium income flow provides readily available liquidity. The market also has a highly liquid asset portfolio that contains more than £60 billion in marketable securities. Most of the chain of security could be liquidated in 90 days. We also credit the market's ability to call on members for capital injections throughout the year and withhold profits to ensure claims are paid as a positive factor for its liquidity assessment.

Environmental, social, and governance

In our view, Lloyd's is more exposed to environmental risk than the industry average because it writes significant amounts of property reinsurance and insurance. In particular, it is more exposed to natural catastrophe risk than some other large nonlife insurers like RSA or Mapfre, which can increase capital and earnings volatility. We revised our outlook on Lloyd's to negative from stable after the corporation suffered significant catastrophe claims in 2017, for example. It reported losses of £4.5 billion, representing about 16% of total reported capital. Lloyd's catastrophe exposure is in line with that of most P/C reinsurance or specialty writers. We do not believe the corporation's exposure to social risks materially differs from other P/C and reinsurance players.

Accounting considerations

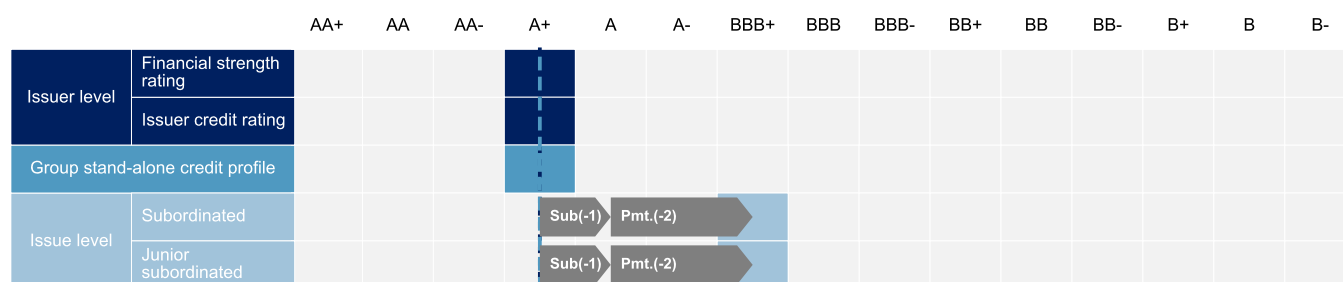
Although the Lloyd's market itself is not a legal entity, the corporation provides an audited pro forma set of financial statements that combine the financial results of the market's members, allowing comparison with other insurance companies. These accounts are prepared where practicable under U.K. generally accepted accounting principles. We view the market's financial communication and disclosure as sound and transparent.

Hybrid and senior debt issue ratings

We rate Lloyd's debt instruments according to their respective features (see chart 4).

Chart 4

Society of Lloyd's: Notching



Key to notching

- - - - - Group stand-alone credit profile
- - - - - Issuer credit rating
- Sub Contractual subordination
- Pmt Payment risk, for example, deferral of coupon, writedown, or conversion

Note: The number-letter labels in the table above are in reference to the notching steps we apply to hybrid capital instruments, as detailed in table 3 of our "Hybrid Capital: Methodology And Assumptions" criteria, published on July 1, 2019.

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Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria | Insurance | Property/Casualty: Assessing Property/Casualty Insurers' Loss Reserves, Nov. 26, 2013
- 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

Appendix

Lloyd's--Credit Metric History		
S&P Global Ratings capital adequacy	Excellent	Excellent
Total invested assets	79,835.0	73,098.0
Total shareholder equity	33,146.0	29,844.0
Gross premium written	35,466.0	35,905.0
Net premium written	25,826.0	25,659.0

Lloyd's--Credit Metric History (cont.)

Net premium earned	25,876.0	25,821.0
Reinsurance utilization (%)	27.2	28.5
EBIT	(828.0)	2,583.0
Net income (attributable to all shareholders)	(887.0)	2,532.0
Return on revenue (%)	(5.1)	5.7
Return on assets (excluding investment gains/losses) (%)	(1.4)	1.7
Return on shareholders' equity (%)	(2.8)	8.8
Property/casualty: Net combined ratio (%)	110.3	102.1
Property/casualty: Net expense ratio (%)	37.2	38.7
Property/casualty: Return on revenue (%)	(3.6)	7.1
EBITDA fixed-charge coverage (x)	(23.3)	31.7
EBIT fixed-charge coverage (x)	(23.9)	31.5
EBIT fixed-charge coverage including realized and unrealized gains/losses (x)	(14.0)	50.6
Financial obligations/adjusted EBITDA (x)	(0.9)	0.6
Financial leverage including pension deficit as debt (%)	3.6	3.1
Net investment yield (%)	2.2	3.6
Net investment yield including investment gains/(losses) (%)	3.0	4.9

Business And Financial Risk Matrix

Business risk profile	Financial risk profile							
	Excellent	Very Strong	Strong	Satisfactory	Fair	Marginal	Weak	Vulnerable
Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
Very Strong	aa	aa/aa-	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	aa-/a+	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bb+	bb/bb-	b+/b
Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bb+/bb	bb-/b+	b/b-
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

Note: Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

Ratings Detail (As Of May 19, 2021)***Holding Company: Society of Lloyd's (The)**

Issuer Credit Rating

Local Currency

A+/Stable/--

Junior Subordinated

BBB+

Subordinated

BBB+

Operating Companies Covered By This Report**Lloyd's**

Financial Strength Rating

Local Currency

A+/Stable/--

Ratings Detail (As Of May 19, 2021)*(cont.)
Lloyd's Insurance Co. (China) Ltd.

Financial Strength Rating

Local Currency

A+/Stable/--

Lloyd's Insurance Co. S.A.

Financial Strength Rating

Local Currency

A+/Stable/--

Domicile

United Kingdom

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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