

Lloyd's of London

Full Rating Report

Ratings

Lloyd's of London

Insurer Financial Strength Rating AA-

The Society of Lloyd's

Long-Term IDR A+
Subordinated Debt A-

Lloyd's Insurance Company (China) Ltd

Insurer Financial Strength Rating AA-

Lloyd's Insurance Company S.A.

Insurer Financial Strength Rating AA-

Outlooks

Insurer Financial Strength Ratings Negative
Long-Term IDR Negative

Financial Data

Lloyd's of London

| (GBPm) | 2018 | 2017 |
|---------------------------------|---------|---------|
| Total assets | 118,008 | 108,396 |
| Total equity and reserves | 27,428 | 26,767 |
| Gross written premiums | 35,527 | 33,591 |
| Profit before tax | -1,001 | -2,001 |
| Combined ratio (%) | 104.5 | 114 |
| Net income return on equity (%) | -4 | -7 |

Source: Fitch Ratings, Lloyd's of London

Key Rating Drivers

Operating Performance Challenging: Lloyd's of London faces considerable challenges in its financial performance, with large attritional losses and a stubbornly high expense ratio. In 2018 the net combined ratio, excluding major claims, was 92.9% (2017: 95.5%). This means that even a relatively low level of major claims pushes the combined ratio above 100%. In 2018 catastrophe losses added 11.6pp to the combined ratio (2017: 18.5pp).

Rates Improving: Lloyd's embarked on a profitability review in 2018, with a focus on the worst performing classes of business across the market, and on the worst 10% of each syndicate's portfolio. As a result of this review, and the significant natural catastrophe losses of the past two years, Lloyd's reported overall risk-adjusted price rises in 2018 of 3% (2017: 2% fall) but this still leaves risk-adjusted rates well below historical highs. From 2010 to 2017, real risk-adjusted rates at Lloyd's declined by 20%.

Modernisation Gathers Pace: Lloyd's has also announced proposals for further modernisation of the market including new electronic exchanges, improved access for alternative capital providers and easier access for new insurers. Fitch believes these plans will benefit the market but that they may prove difficult to implement in full given the resistance to change typically seen from market participants.

Significant Exposure to Catastrophes: Fitch believes that the exposure of Lloyd's to worldwide catastrophes is high, although Lloyd's has managed this down in recent years. 2018 was the fourth most expensive year for catastrophe losses on record and as a result Lloyd's reported a combined ratio of 104.5% (2017: 114%). This was an improvement on 2017, which represented the worst year for catastrophe losses on record for the industry, but still represented a significant underwriting loss.

Resilient Capital Structure: On a central fund basis the Lloyd's central solvency coverage ratio was very strong at 249% (end-2017: 215%). This is comfortably in excess of the risk appetite of 200%, showing a good level of resilience to catastrophe losses. However, in the longer term, this resilience relies on the willingness and ability of members to recapitalise, following significant losses.

Very Strong Business Profile: Lloyd's of London's business profile is very strong and supports its rating. It is one of a small group of global (re)insurance providers capable of attracting high-quality and specialised business. It operates as a global insurance and reinsurance market comprising more than 100 syndicates, writing business from more than 200 countries and territories, and reported gross written premiums of GBP35.5 billion in 2018.

Rating Sensitivities

Underwriting Deterioration, Outsized Catastrophe Losses: The ratings are likely to be downgraded if the net combined ratio, excluding major claims, remains above 91% (2018: 92.9%). Underperformance or a proportionately larger net catastrophe loss compared with peers or market share could also lead to a downgrade.

Improved Underwriting, Reduced Catastrophe Exposure: A return to a Stable Outlook is likely if the net combined ratio of Lloyd's, excluding major claims, improves to below 91% and if it maintains its risk-adjusted capital exposure to catastrophe losses at a level that is commensurate with peers'.

Related Research

[London Market Insurance Dashboard - 2018 Results \(July 2019\)](#)
[London Market Insurance Dashboard - 2019 Outlook \(January 2019\)](#)
[Fitch Ratings 2019 Outlook: UK Non-Life Insurance \(November 2018\)](#)

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Lloyd's of London

ESG Relevance: 

Insurance Ratings Navigator European Non-Life



| Other Factors & Criteria Elements | | | | |
|---|------------------|----------------|-------------|-------------------|
| Provisional Insurer Financial Strength | | | | AA- |
| Non-Insurance Attributes | Positive | Neutral | Negative | +0 |
| Corporate Governance & Management | Effective | Some Weakness | Ineffective | +0 |
| Ownership | Positive | Neutral | Negative | +0 |
| Transfer & Convertibility / Country Ceiling | Yes | No | AAA | +0 |
| Insurer Financial Strength (IFS) | | | | Final: AA- |
| IFS Recovery Assumption | Good | | | -1 |
| Issuer Default Rating (IDR) | | | | Final: A+ |

| Bar Chart Legend: | |
|---|--------------------|
| Vertical Bars - Range of Rating Factor | |
| Bar Colors = Relative Importance | |
|  | Higher Influence |
|  | Moderate Influence |
|  | Lower Influence |
| Bar Arrow - Rating Factor Outlook | |
|  | Positive |
|  | Negative |
|  | Evolving |
|  | Stable |

Related Criteria

Insurance Rating Criteria (January 2019)

Business Profile

Very Strong Business Profile Supportive of Rating

Fitch believes that Lloyd's has a most favourable business profile driven by its strong franchise, large operating scale and significant diversification within P&C (re)insurance.

Strong Global Franchise

The business profile of Lloyd's, which Fitch considers to be very strong, supports the rating. Lloyd's is one of a small group of global (re)insurance providers capable of attracting high-quality and specialised business. Fitch takes a positive view of the presence of a detailed and defined business strategy executed by the executive team of the Corporation of Lloyd's (see *Appendix B: Glossary*).

Competitive Positioning

Lloyd's is a global insurance and reinsurance market comprising more than 100 syndicates managed by 56 managing agents at end-2018. It writes business from more than 200 countries and territories, and reported 2018 gross written premiums (GWP) of GBP35.5 billion (2017: GBP33.6 billion). Lloyd's is looking to acquire more licences to boost expansion into high-growth markets.

However, Lloyd's faces competition including from established and emerging global reinsurance hubs, such as Bermuda, Switzerland, Singapore and New York; large global reinsurance companies; smaller primary companies located within key markets; and alternative risk-transfer products including catastrophe bonds and other insurance-linked securities (ILS).

These persistent challenges are affecting the London market as a whole. London remains the largest global centre for commercial and specialty risk, but it is not keeping pace with emerging-markets growth, and its market share declined from 2013-2015, as reported in the London Market Group's 'London Matters 2017' report. Lloyd's continues to target these high-growth areas, with significant expansion in the Lloyd's China platform. In other high-growth markets significant challenges remain due to increasing protectionism, M&A activity, and economic slow down.

Underwriting Syndicates

Syndicates are the vehicles used to underwrite insurance. They are not legal entities, and are unique to the Lloyd's insurance market. Syndicates can be made up of a number of members or – as is becoming more common – just one corporate member.

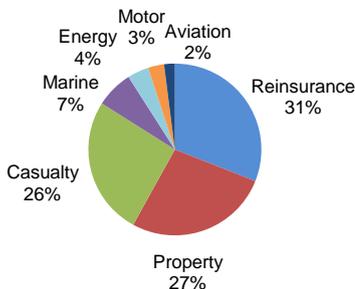
Syndicates are run by managing agents, which are authorised, regulated legal entities. Managing agents' responsibilities are wide-ranging; they create and implement the syndicate's business plan, employ the underwriters that write the business, and process claims. Managing agents are required to report financial results quarterly for their syndicates to Lloyd's and to submit business plans annually, or more regularly if they change.

Product distribution at Lloyd's is carried out primarily through brokers and coverholders, with some business placed directly with service companies (see *Appendix B: Glossary*) owned by managing agents. A large proportion of the business is conducted in the underwriting room, where face-to-face negotiations between brokers and underwriters take place. Most business is placed into the market by brokers.

Significant P&C Diversification

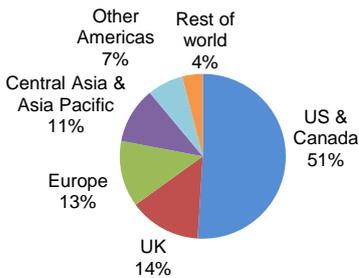
Business written by syndicates focuses on seven main classes. The main class of business at Lloyd's – reinsurance – covers both short- and long-tail lines, offering a variety of placement types including facultative, proportional treaties and non-proportional excess-of-loss placements.

Lloyd's of London – Premium Distribution by Business 2018



Source: Fitch Ratings, Lloyd's

Lloyd's of London – Premium Distribution by Geography 2018



Source: Fitch Ratings, Lloyd's

The US represents the main geographical region for the second major class, property, which includes commercial and private property. The other major class, casualty, includes professional indemnity, medical malpractice, accident and health, directors' and officers' liability, financial institutions, general liability and employers' liability. Business is mostly spread across the US, the UK and the rest of Europe.

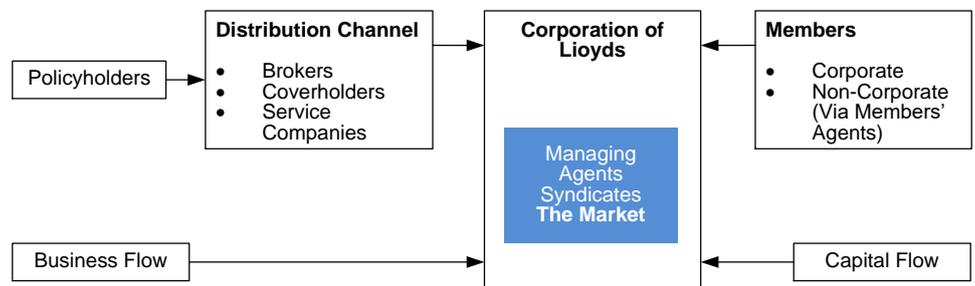
The remaining classes are niche. The International Group of P&I Clubs' programme constitutes a major part of the marine liability class. The motor book is UK-focused, and includes niche non-standard risks such as high-value vehicles, vintage or collectors' vehicles, high-risk drivers and affinity groups. The energy portfolio includes a variety of onshore and offshore property and liability classes, ranging from construction to exploration and production, refinery and distribution.

A significant part of the portfolio is offshore energy, and a large proportion of this is located in the Gulf of Mexico. Lloyd's is an industry leader in the global aviation market, and has a balanced portfolio across all sectors of this class – including airline, aerospace, general aviation and space.

Ownership Neutral

Market Structure a Marginal Positive

Structure Diagram



Source: Fitch Ratings, Lloyd's

The market structure of Lloyd's is marginally positive for its ratings compared with traditional corporate insurers or reinsurers. This view takes into account the 'chain of security,' which provides a mixture of several and mutual claims-paying capital.

Capitalisation and Leverage

| (GBPm) | 2014 | 2015 | 2016 | 2017 | 2018 | Fitch's expectation |
|----------------------------|------|------|------|------|------|---|
| Financial leverage (%) | 5 | 4 | 4 | 3 | 3 | We do not expect a significant change in leverage over the next two years, with the earliest maturity date of current subordinated notes being 2024. Assuming major losses fall within the bounds anticipated by Lloyd's for the rest of 2019, we expect capital also to remain stable. |
| NWP/equity (x) | 0.9 | 0.9 | 0.8 | 0.9 | 0.9 | |
| Net leverage (x) | 2.7 | 2.6 | 2.6 | 2.8 | 2.9 | |
| Gross leverage (x) | 3.4 | 3.3 | 3.4 | 3.9 | 4.2 | |
| TFC ratio ^a (x) | 0.1 | 0.1 | 0.1 | 0 | 0 | |

^a Total financing and commitments ratio, excluding utilised letters of credit
 Source: Fitch Ratings, Lloyd's of London

Strong Member and Central Capital

Capitalisation remains strong both on a regulatory basis and with reference to Fitch's Prism FBM capital model. Lloyd's also maintains low financial leverage and has reduced the reliance on letters of credit which has helped to improve the regulatory solvency ratios.

Regulatory Capital Ratios Remain Stable

Lloyd's reports its Solvency II coverage on both a central and market-wide basis. The market-wide Solvency Capital Ratio (MWSCR) reflects the aggregation of all eligible market-wide assets, and Lloyd's reported a stable ratio of 148% at end-2018, (end-2017: 144%) comfortably above the risk appetite of 125%. On a central basis, reflecting the vulnerability of the central fund, the Lloyd's central SCR (CSCR) remained strong at 249% (end-2017: 215%), which was also comfortably in excess of the risk appetite of 200%.

In 2018, and particularly in 2017, some syndicates at Lloyd's experienced capital depletion. All members are required to recapitalise, should the available capital fall below its required level (i.e. their Lloyd's Economic Capital Assessment (ECA) net of their solvency result). All members were able to fully recapitalise during the "coming into line" process. However, this resilience relies on the willingness and ability of members to recapitalise, following significant losses.

High Catastrophe Risk Affects Capitalisation

Fitch's view of Lloyd's risk-adjusted capital has been negatively affected by the high level of catastrophe risk appetite. Fitch believes that Lloyd's has a higher catastrophe risk appetite than its peers, as evidenced by the significant catastrophe losses experienced in both 2017 and 2018. However, both leverage and the TFC ratio remained low at end-2018 and so Fitch expects overall capitalisation and leverage to remain adequate for the ratings, assuming a normal level of large losses for the rest of 2019.

Low Financial Leverage and TFC Ratio

The Fitch-calculated financial leverage ratio for Lloyd's was 3% at end-2018 (end-2017: 3%). Lloyd's issued GBP300 million of debt in February 2017, which matures in February 2047. The notes bear interest of 4.875% per annum. The TFC ratio was 0x at end-2018 (end-2017: 0x), which is extremely low and supportive of the ratings.

Risk-Based Approach to Setting Member and Central Capital

The Lloyd's ECA at the member level is set at 135% of the syndicates' Solvency Capital Requirement (SCR) on an ultimate time horizon. This percentage has not changed since 2006. Lloyd's reviews each syndicate's SCR in detail, and requires additional capital loading if it considers that the syndicate's business plan exposes the central fund to additional risk.

Process to Keep Capital Level Constant

All members are required to recapitalise, should the ECA that is available to any individual member fall below its required level due to a change in the underlying risk profile or an erosion of funds due to losses. This process ensures that no member poses a significant threat to the central capital of Lloyd's at any given time.

In cases where Lloyd's deems business underwritten within the market as too risky, it can request from the sponsoring parent (or the member) a full financial guarantee. In these cases, should losses exceed the ECA held, the additional capital required to make good the losses is taken directly from the capital provider, while the central fund remains untouched.

Mutual Assets Supported by Central Fund Contributions

The mutual layer or third link in the chain of security at Lloyd's includes contributions collected through an annual levy from members. The levy is 0.35% of premium (1.4% for new members on new syndicates for the first three years), with the value of central fund net assets at GBP2.2 billion at end-2018 (end-2017: GBP2 billion). Lloyd's reviews the level of future capital contributions required from the market in line with changing conditions.

Debt Service Capabilities and Financial Flexibility

| (GBPm) | 2014 | 2015 | 2016 | 2017 | 2018 | Fitch's expectation |
|---------------------------------|------|------|------|------|------|---|
| Interest coverage – market (x) | 56 | 47 | 23 | -42 | -14 | Fitch expects a slight reduction in fixed-charge costs, given the redemption of the perpetual debt issue and the issuance of lower coupon debt. Fitch expects Lloyd's to be comfortably able to service its debt obligations, which remain low. |
| Interest coverage – society (x) | 3 | 3 | 10 | 4 | 6 | |
| Interest paid | 49 | 54 | 54 | 55 | 39 | |

Source: Fitch Ratings, Lloyd's of London

Strong Debt-Servicing Capability and Financial Flexibility

Lloyd's maintain strong financial flexibility, with various different options available to raise capital when required. Fitch believes that Lloyd's maintains a strong ability to cover its debt servicing requirements in the medium term.

Financial Flexibility

Lloyd's has a variety of mechanisms available to raise capital, including member calls, central fund contributions, the requirement of additional capital on top of the ICA, charging a premium levy, and raising additional subordinated debt.

The Society has two tranches of sterling-denominated dated subordinated debt consisting of a GBP500 million Solvency II Tier 2 subordinated bond, callable in 2024, and a GBP300 million Solvency II Tier 2 subordinated bond, callable in 2047.

Ability to Service Debt Will Remain Strong

Fixed-charge coverage excluding unrealised gains and losses was negative in 2018 at -14x (2017: -42x), driven by the significant catastrophe losses and poor investment performance. However, on a five-year average basis, coverage is very strong at 14x. On a Society basis, fixed-charge coverage increased to 6x in 2018 from 4x in 2017, driven by a reduction in finance costs from GBP55 million in 2017 to GBP39 million in 2018.

Flexibility of Repayment Options

In a going-concern scenario, Lloyd's has several options available for the repayment of principal and interest, as it has complete discretion on the use of the central fund. If necessary, Lloyd's could increase members' contributions, impose a premium levy (as it has in the past), or use the callable layer. All of these mechanisms could be used to pay the interest on the debt.

Financial Performance and Earnings

| (Currency) | 2014 | 2015 | 2016 | 2017 | 2018 | Fitch's expectation |
|-------------------------|-------|-------|-------|--------|--------|--|
| Net income | 3,016 | 2,122 | 2,107 | -2,001 | -1,001 | Fitch expects profitability to remain under pressure at Lloyd's. (Re)insurance pricing conditions are improving only moderately, and we expect investment returns to remain low. |
| Change in GWP (%) | -1 | 6 | 12 | 12 | 6 | |
| Operating ratio (%) | 84.1 | 86.5 | 93.2 | 108.1 | 100.7 | |
| Combined ratio (%) | 88.5 | 90 | 97.9 | 114 | 104.5 | |
| Net loss ratio (%) | 49.2 | 49.9 | 57.3 | 74.5 | 65.3 | |
| Admin expense ratio (%) | 11.1 | 11.4 | 10.9 | 9.4 | 9.0 | |
| Commission ratio (%) | 28.1 | 28.8 | 29.7 | 30 | 30.2 | |
| ROE (%) | 14 | 9 | 8 | -7 | -4 | |

Source: Fitch Ratings, Lloyd's of London

Market Performance Remains Pressured

Profitability is under pressure at Lloyd's, both on an underwriting basis and also when including the investment return. The Lloyd's market has suffered in recent years from rising attritional loss ratios and a stubbornly high expense ratio. On top of that in 2018 positive prior year reserve development remained low and investment returns were muted.

Combined Ratio Remains High

Fitch believes that the underwriting profitability of Lloyd's remains under pressure, even if catastrophe losses are reduced in 2019. This reflects the underlying pressure on both risk-adjusted premium rates and expense ratios. In 2018, Lloyd's reported an attritional loss ratio of 57.6% (2017: 58.9%) and an overall expense ratio of 39.2% (2017: 39.5%), meaning the accident-year combined ratio excluding major claims improved marginally to 96.8% in 2018 (2017: 98.4%) reflecting a small improvement in risk adjusted pricing since 4Q17. However, the pressured pricing environment, continued claims inflation and the cost of doing business at Lloyd's continue to contribute to the high combined ratio.

The results at Lloyd's continue to benefit from positive prior-year reserve development, although prior-year reserve releases in recent years (2018: 3.9%; 2017: 2.9%) have been lower than historical levels. Fitch is monitoring the sustainability of reserve releases – given strong competition, falling premium rates, and signs of declining reserve surpluses, particularly on casualty lines.

Market Wide Profitability Review

Lloyd's embarked on a profitability review in 2018 with a focus on the worst-performing classes of business across the market and the worst 10% of each individual syndicate's portfolio. As a result of this review, and the significant natural catastrophe losses of the past two years, Lloyd's reported overall risk-adjusted price rises in 2018 of 3% (2017: 2% fall) but this still leaves its risk-adjusted rates well below historical highs. Prior to 2018, real risk-adjusted rates had declined at Lloyd's by more than 20% since 2010.

Significant Catastrophe Losses

Lloyd's has now reported two consecutive years of underwriting losses following the significant catastrophe events, reporting a net loss of GBP1 billion in 2018 (2017: GBP2 billion loss). The losses were mainly driven by the significant catastrophe losses experienced by the industry in the last two years. However, Lloyd's reported a worse combined ratio than most of its peers, at 104.5% (2017: 114%), indicating a higher exposure to catastrophe losses. Lloyd's reported net claims from the catastrophe events of GBP2.9 billion in 2018 (2017: GBP4.5 billion), compared to its long-term average of GBP1.9 billion.

Moderate Rate Rises Following Catastrophe Losses

Following the catastrophe events of the last two years, premium rates have risen on short-tail loss-affected lines, albeit moderately, reversing the trend of falling rates over the past few years. Prior to 4Q17, real risk-adjusted rates had declined at Lloyd's by more than 20% since 2010. Lloyd's has now benefitted from seven successive quarters of positive rate movements. However, risk-adjusted rates remain well below historical highs. Most of that rate improvement comes from short-tail loss-affected lines; in the wider market, outside of catastrophe-exposed lines, pricing was largely flat.

Volatile Investment Environment

Overall, net investment income fell to GBP0.5 billion in 2018 (2017: GBP1.8 billion). The result was hit by the volatility of financial markets in the fourth quarter of 2018 which was fuelled by geopolitical risks, fears of a global slow down and generally worsening financial conditions. Monetary policy continued to be tightened in the US and the UK with interest rates rising which should lead to an improvement in the investment returns in the future.

PMD Demonstrates Tangible Results

Lloyd's Performance management directorate's (PMD) oversight of market participants has played a key role in improving the overall technical performance of the Lloyd's market, in Fitch's view. Since the PMD was established in 2003, processes including business plan reviews and syndicate benchmarking have helped PMD and syndicates improve key aspects of underwriting, including pricing, reserving, claims management, risk-adjusted capital setting and catastrophe-modelling techniques.

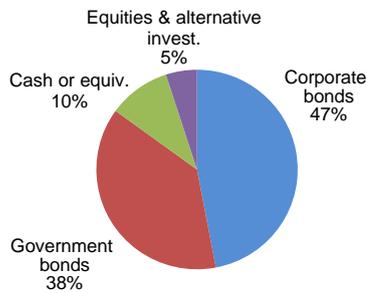
Investment and Liquidity

| (GBPm) | 2014 | 2015 | 2016 | 2017 | 2018 | Fitch's expectation |
|-----------------------------------|--------|--------|--------|--------|--------|---|
| Invested assets | 54,863 | 56,903 | 67,666 | 67,920 | 71,275 | Fitch expects the investment profile and strategy will remain stable in the near term. The greatest challenge is the persistence of low investment yields, which puts pressure on earnings. |
| Investment return (%) | 2.0 | 0.7 | 2.2 | 2.7 | 0.7 | |
| Liquid assets/tech reserves (%) | 184 | 185 | 183 | 173 | 168 | |
| Risky assets/equity (%) | 40 | 37 | 43 | 51 | 48 | |
| NIG bonds to equity (%) | 4 | 3 | 3 | 8 | 9 | |
| Unaffiliated shares to equity (%) | 36 | 34 | 40 | 43 | 39 | |

Source: Fitch Ratings, Lloyd's of London

Syndicate PTF Investments

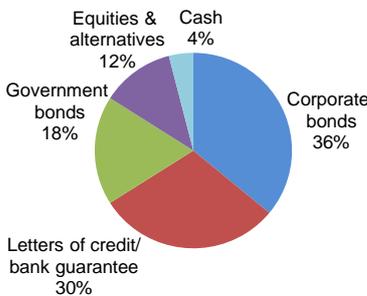
End-2018



Source: Fitch Ratings, Lloyd's

Members' FAL Investments

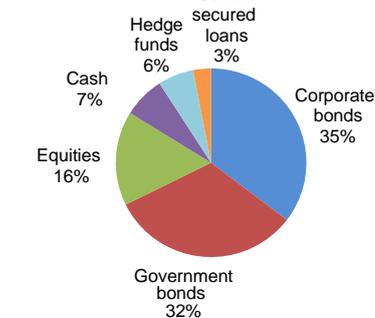
End-2018



Source: Fitch Ratings, Lloyd's

Central Fund Investments

End-2018



Source: Fitch Ratings, Lloyd's

Conservative Investment Policy

The investment portfolio remains stable and low-risk with premium trust funds being made up of high quality, short duration assets. The quality of the funds at Lloyd's (FAL) has also improved as the proportion represented by letters of credit fell to 30% (2017: 38%). Lloyd's takes moderately more risk with central fund assets but the overall portfolio allocation remains conservative.

PTFs: High-Quality and Liquid First Source of Policyholder Repayment

Premium trust funds (PTFs) are the first resource for paying policyholder claims from a syndicate. Investments are held in liquid, short-duration, high-quality assets, with 94% of assets invested in bonds or cash.

FAL: Second Repayment Layer Support Point

Funds at Lloyd's represent the second layer of capital provided by members to support their underwriting. The amount of deposited funds is determined by the Corporation, which reviews each syndicate's Individual Capital Assessment (ICA) and applies an uplift based on the syndicate's business plans. The capital is held in trust as readily realisable assets. Letters of credit (LOCs) remain a significant proportion of assets within FAL (30% at end-2018) but the proportion has decreased in recent years. Fitch considers the pool of banks providing LOCs to Lloyd's as well diversified with strong ratings.

Central Fund: Mutual Layer Available at Discretion of Council of Lloyd's

Central fund assets are the third level of security at Lloyd's, and are available at the discretion of the Council of Lloyd's to meet any valid claim that cannot be met by the resources of any member. Total central fund assets were GBP3 billion at end-2018; 75% was invested in core assets such as investment-grade bonds and cash. The remaining 25% was invested in growth assets that include equities, high-yield bonds, senior secured loans and hedge funds.

Strong Liquidity Position Supported by High-Quality, Liquid Assets

Lloyd's maintains a strong liquidity position, which is supported by a significant level of high-quality liquid assets held by the PTF, FAL and the central fund.

Reserve Adequacy

| (GBPm) | 2014 | 2015 | 2016 | 2017 | 2018 | Fitch's expectation |
|---|------|------|------|------|------|--|
| Loss reserves/current-year incurred losses | 3.0 | 2.9 | 2.6 | 2.0 | 2.4 | Fitch anticipates that aggregate prior underwriting years will continue to develop favourably. But the absolute amount of reserve releases will decrease as favourable reserve development on older years of account become exhausted. |
| Loss reserves/policyholder surplus | 1.3 | 1.2 | 1.3 | 1.4 | 1.5 | |
| Current-year paid losses/incurred losses | 1.0 | 0.9 | 0.9 | 0.8 | 0.9 | |
| Change in loss reserves/earned premium | 4 | -2 | 9 | -3 | -4 | |
| Loss reserve development/equity (%) | -8 | -7 | -5 | -3 | -4 | |
| Loss reserve development/PY loss reserves (%) | -6 | -6 | -4 | -2 | -3 | |

Source: Fitch Ratings, Lloyd's of London

Favourable Reserve Development

Lloyd's continues to report favourable reserve development, though at a lower level than in the past. Lloyd's has not seen significant adverse development in respect of the 2017 hurricane season whereas some other (re)insurers have had to significantly strengthen reserves, particularly in relation to hurricane Irma.

Reserve Releases Decreasing

Fitch believes that Lloyd's will benefit less in future years from favourable reserve development than they have in the recent past. Overall in 2018, there was a 3.9pp improvement in the calendar-year combined ratio (2017: 2.9pp; 2016: 5.1pp) from reserve releases. Fitch is monitoring the sustainability of reserve releases across all lines of business, particularly for more recent years.

High Importance of Reserving Profile

Reserving is an important credit factor for Lloyd's, given its reserve leverage to both capital and to incurred losses (2018: 1.5x and 2.4x, respectively). Fitch monitors reserve and related exposure growth by checking the ratio of paid to incurred losses and the change in loss reserves relative to earned premium growth. Loss reserves have grown in line with underwriting exposures in most years. In 2018, Lloyd's overall reserve development remained positive; this is also the case based on a five-year average. However, Fitch believes that reserve releases from older years are likely to soon become exhausted and future reserve releases are likely to be lower.

Reinsurance, Risk Management and Catastrophe Risk

| (%) | 2014 | 2015 | 2016 | 2017 | 2018 Fitch's expectation |
|--------------------------------|------|------|------|------|--------------------------|
| NWP/GWP | 79 | 79 | 77 | 74 | 72 |
| Reinsurance recoverable/equity | 55 | 52 | 59 | 85 | 99 |

Fitch expects Lloyd's to maintain its well-established exposure management function and good-quality reinsurance counterparties. However, Fitch also expects that catastrophe risk is likely to remain high relative to peers.

Source: Fitch Ratings, Lloyd's of London

Adequate Risk Management and Reinsurance

Fitch considers Lloyd's to have high exposure to catastrophe risk, particularly in relation to US risks. However, the strong oversight provided by Lloyd's helps to mitigate these risks to some extent. The PMD department provides strong oversight for the market and helps to ensure catastrophe risk is commensurate with risk-adjusted capitalisation. The credit quality of reinsurance counterparties also remains strong.

High Catastrophe Risk

Fitch believes Lloyd's has a high exposure to natural catastrophe risk, as evidenced by the significant losses incurred in 2018 and 2017. Lloyd's is looking to strengthen oversight of syndicates with material catastrophe risk, and Fitch monitors the development of the risk-adjusted catastrophe-exposure levels compared to its stated risk appetite and to its peers.

Risk Oversight on Society and Market Level

The unique structure at Lloyd's assists in overseeing and managing risks at the Corporation level in addition to establishing guidelines, control functions and monitoring at the market level. Lloyd's has two key governance forums, the Executive Risk Committee (ERC) and the Board Risk Committee (BRC).

The ERC is responsible for overseeing the identification and control of risks to Lloyd's, covering risks arising from Corporation activities and those from the activities of the market. The ERC is chaired by the chief risk officer and its members consist of the Lloyd's executive team.

The BRC is a sub-committee of the Board of Directors and is responsible for ensuring all risks to Lloyd's are managed in accordance with approved policies and risk appetites set by the Board. The activities of the ERC are reported to the BRC for second-line review and oversight. The ERC is chaired by an independent non-executive; it consists of non-executive members drawn from the Board and the Lloyd's Council.

Well-Established Exposure Management

The exposure management function at Lloyd's is part of the PMD and has grown significantly in recent years. It is responsible for the modelling and monitoring of market and Corporation exposure to catastrophe risks. Catastrophe risk is modelled at the member and Society level, with analysis supplemented by a set of deterministic scenarios, which relate to specific catastrophe-event scenarios. Syndicates are required to consider additional scenarios, should the Lloyd's realistic disaster scenarios be inappropriate for their specific business profile.

Credit Quality of Reinsurance Recoverables

Reinsurance recoverables on Lloyd's' balance sheet are of good credit quality, with 98% in the 'A' range or above at end-2018. Reinsurance recoverables as a percentage of equity was low at end-2018, and supportive of the rating.

Appendix A: Industry Profile and Operating Environment

Regulatory Oversight

Fitch considers regulatory oversight in the UK as very strong. The UK insurance market is highly regulated, with well-developed regulatory practices and supervision processes. As member of the European Union, the UK adopted the risk-adjusted solvency framework (Solvency II), which came into force on 1 January 2016. The UK insurance regulator is focused on ensuring that insurance organisations are viable and their conduct of business is appropriate. Fitch considers the regulator's enforcement as effective.

Technical Sophistication of Insurance Market; Diversity & Breadth

The UK insurance market is the largest in Europe (EUR284 billion of premiums in 2017). Fitch believes the market is technically highly sophisticated. This is underpinned by the use of strong and generally accepted actuarial practices for underwriting analysis, calculating claims reserves and products pricing. In addition, the adoption of Solvency II improved the level of sophistication of enterprise risk management in the market, especially for smaller players.

The UK insurance market is also well diversified. The life and saving business represented 69% of premiums, followed by property and casualty (28%), and health (3%) in 2017. As the market is highly mature, premium growth is low, although growth in the UK was higher than across Europe as a whole.

Competitive Profile

Fitch believes the UK insurance market is very competitive in all insurance segments. The market is relatively fragmented with 337 long-term savings providers (159 UK authorised, 178 headquartered in another European country) and 872 general insurers (281 UK authorised, 591 authorised in another European country).

Typically, life insurance companies have been repositioning their business, favouring the distribution of retirement solutions, often in the form of capital-light and unit-linked savings products. There is also structural growth in demand for pension de-risking solutions. In non-life, the high level of competition, spurred by the extensive use of price aggregators, creates pressure on prices which is currently being experienced by most lines of business. Health and protection business represents an area of strategic growth for all insurers.

Financial Markets Development

The UK financial market is sophisticated and has considerable breadth and depth both in its insurance and non-insurance segments. The UK stock and bond markets are among the largest globally, providing sufficient liquidity in most traded products. Companies' and financial institutions' access to capital markets is strong.

Country Risk

The UK's Long-Term IDR is currently 'AA' with a Negative Outlook. The UK's ratings balance a high-income, diversified and advanced economy against comparatively high public indebtedness. Sterling's reserve currency status, deep capital markets and strong governance indicators further support the ratings. The Negative Outlook reflects the continued downside risks of a disruptive exit from the European Union (EU), which would have negative consequences for UK trade, investment and economic prospects in the short-to-medium term.

Appendix B: Peer Analysis

Lloyd's has no directly comparable peers, due to its unique structure and mix of business underwritten. Below is an illustration of Lloyd's with the global group of reinsurance companies that have some similarities in scale and geographical scope.

Lloyd's compares favourably with other multinational reinsurers on average underwriting performance across a number of years. However, it has high volatility in the combined ratio, indicating the increased exposure to catastrophe risk.

Peer Analysis

| (USDm) ^a | IFS Rating ^d | Gross premiums written ^b | | Combined ratio (%) | Combined ratio volatility (pp) ^e | Shareholders' equity | |
|--------------------------|-------------------------|-------------------------------------|---------------|--------------------------------|---|----------------------|---------------|
| | | 2018 | 2017 | Five-year average ^c | Five-year average | 2018 | 2017 |
| Berkshire Hathaway | AA+/Stable | 57,418 | 60,597 | 94.0 | 16.3 | 348,703 | 348,296 |
| Munich Re | AA/Stable | 57,827 | 55,961 | 98.3 | 8.5 | 30,357 | 33,834 |
| Lloyd's of London | AA-/Negative | 47,260 | 43,708 | 96.7 | 13.1 | 34,851 | 36,143 |
| Swiss Re | AA-/Stable | 36,406 | 34,775 | 95.7 | 10.7 | 28,727 | 34,294 |
| Hannover Re | AA-/Stable | 22,601 | 20,270 | 96.0 | 2.1 | 10,931 | 11,143 |
| SCOR S.E. | AA-/Stable | 17,983 | 16,850 | 94.6 | 5.0 | 6,676 | 7,469 |
| PartnerRe Ltd | A+/Stable | 6,300 | 5,588 | 93.9 | 7.2 | 6,517 | 6,745 |

Combined ratio: Net losses and loss-adjustment expenses divided by net premiums earned plus underwriting expenses divided by net premiums earned

Shareholders' equity is organisation-wide equity and therefore depends on the company's reporting practices; it may include equity that supports operations other than property/casualty reinsurance operations

Financial statement figures for some European reinsurers have been translated into US dollars using year-end or 12-month average rates of exchange, as appropriate. This has led to some exchange-rate distortion between financial years

^a Foreign-exchange rates used for GWP = Full year average rate

^b GWP includes primary and reinsurance business

^c 2014-2018, non-life reinsurance business

^d Denotes operating company insurer financial strength Rating

^e Standard deviation

Source: Fitch Ratings, Company annual reports, financial supplements, and SEC filings

Appendix C: Glossary

Central Fund

The fund financed by (among other things) contributions from Lloyd's members, and administered by the Council primarily as a fund for the protection of policyholders.

Corporation of Lloyd's

This comprises the executive of the Council of Lloyd's, the Lloyd's Franchise Board and their respective committees. The Corporation does not underwrite insurance or reinsurance itself, but provides the licences and other facilities that enable business to be underwritten worldwide by managing agents acting on behalf of members.

Coverholder

A company or partnership authorised by a managing agent to enter into a contract or contracts of insurance to be underwritten by the members of a syndicate managed by it, in accordance with the terms of a binding authority.

Members' Agent

An underwriting agent that has permission from Lloyd's to be appointed by a member to provide services and perform duties of the same kind and nature as those set out in the standard members' agent agreement. These services and duties include advising the member on which syndicates he should participate in, the level of participation in such syndicates, and liaising with the member's managing agents.

Appendix D: Other Ratings Considerations

Below is a summary of additional ratings considerations that are part of Fitch’s ratings criteria.

Group IFS Rating Approach

The Lloyd’s insurance entities listed on page 1 are rated on a group approach, with all entities considered “Core”.

Notching

The regulatory environment of the UK is assessed by Fitch as being Effective, and classified as following a Group Solvency approach.

The unique corporate structure of Lloyd’s, as a market place rather than a corporation, makes reference to operating and holding companies inappropriate. A description of how the respective ratings of Lloyd’s entities were reached is provided below.

Notching Summary

IFS Ratings

Due to the existence of policyholder priority, a baseline recovery assumption of ‘Good’ applies to the IFS rating, and Fitch used standard notching from the implied IDR. The insurance policies issued by Lloyd’s are supported by a chain of security that includes Lloyd’s premium trust funds, members’ funds at Lloyd’s and the central fund. The central fund and central assets of the Society of Lloyd’s, a legal entity distinct from the members of Lloyd’s, provide partial mutuality to the Lloyd’s market. It is this mutuality that enables Fitch to assign an IFS rating to Lloyd’s rather than to individual syndicates.

IDR Ratings

The Society’s IDR is linked to the IFS rating assigned to Lloyd’s. The Society has no legal liability for the insurance liabilities of members other than where it has issued an undertaking. Undertakings are liabilities of the Society, and constitute unsecured obligations ranking pari passu with other senior unsecured liabilities. Fitch has therefore aligned the Society’s IDR with the implied IDR of Lloyd’s. Standard notching was applied between the implied insurance operating company and holding company IDRs for a group solvency regulatory environment.

Debt

Not applicable.

Hybrids

For subordinated debt ratings of The Society of Lloyd’s, a baseline recovery assumption of Below Average and a non-performance risk assessment of Moderate were used. Notching of minus 2 was applied relative to the IDR, which was based on minus 1 for recovery and minus 1 for non-performance risk.

Source: Fitch Ratings

Hybrids – Equity/Debt Treatment

Hybrids Treatment

| Hybrid | Amount | CAR Fitch % | CAR Reg. Override % | FLR Debt % |
|----------|--------|-------------|---------------------|------------|
| Sub debt | 300 | 0 | 100 | 100 |
| Sub debt | 500 | 0 | 100 | 100 |
| Sub debt | 5 | 0 | 100 | 100 |

CAR – Capitalization ratio; FLR – Financial leverage ratio. N.A. – Not Applicable
 For CAR, % shows portion of hybrid value included as available capital, both before (Fitch %) and the regulatory override.
 For FLR, % shows portion of hybrid value included as debt in numerator of leverage ratio
 Source: Fitch Ratings

Corporate Governance and Management

Corporate governance and management are adequate and neutral to the rating.

Transfer and Convertibility Risk (Country Ceiling)

None.

Criteria Variations

None.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

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