

## **FITCH REVISES LLOYD'S OF LONDON'S OUTLOOK TO NEGATIVE; AFFIRMS AT IFS 'AA-'**

Fitch Ratings-London-27 June 2017: Fitch Ratings has revised Lloyd's of London's (Lloyd's) and Lloyd's Insurance Company (China) Ltd's Outlook to Negative from Stable while affirming the Insurer Financial Strength (IFS) Ratings at 'AA-'. Fitch has also revised the Outlook for the Society of Lloyds to Negative from Stable while affirming the Long-Term Issuer Default Rating at 'A+'. The subordinated bonds have been affirmed at 'A-'

### **KEY RATING DRIVERS**

The Outlook has been revised to Negative because of deterioration in underwriting performance, coupled with increasing exposure to catastrophe risk in the context of continuing pressure on both risk-adjusted premium rates and expense ratios at Lloyd's. The Fitch-calculated combined ratio of 98% was a significant deterioration from recent performance, driven by a return to more normalised levels of catastrophe activity in the market as well as increasing expenses and falling risk-adjusted premium rates.

Lloyd's exposure to worldwide natural and man-made catastrophes is higher than peers'. This is reflected in Lloyd's combined ratio being more sensitive to catastrophic events. Fitch believes that exposure to catastrophe risk has increased in recent years despite declining margins on this line of business. However, Fitch believes that Lloyd's exposure management, through the group's modelling capabilities and the reinsurance in place, allows the market to mitigate tail risks to some extent.

The 'very strong' business profile of Lloyd's of London's supports its rating. It is one of a select band 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. It writes business from over 200 countries and territories, and in 2016 reported gross written premiums of GBP29.9 billion.

Fitch expects capitalisation to support the rating, assuming future losses fall within the limits expected by Lloyd's. The three-layered capital structure at Lloyd's - syndicates' premium trust funds, members' funds at Lloyd's and the central fund - remained strong in 2016, despite the impact of weaker sterling relative to the dollar and increasing catastrophe exposure. Debt is very limited in the capital structure with a financial leverage ratio of 3% at end-2016.

In 2016, Lloyd's results benefitted from foreign exchange gains as a result of the depreciation of sterling and investment returns also improved, driven by a downward shift in bond yields. Overall, Lloyd's net investment income rose to GBP1.3 billion in 2016 (2015: GBP0.4 billion) and foreign exchange gains contributed GBP0.6 billion (2015: GBP0.1 billion loss) to profits which helped to offset a weaker underwriting result in the same period. Fitch views these market movements as being one-off in nature.

Fitch believes that Lloyd's maintains a disciplined approach to underwriting, reinforced by the strong oversight of the Performance Management Directorate (PMD). Underwriting conditions across almost all major (re)insurance classes are deteriorating, and Fitch anticipates that Lloyd's will continue to scale back exposures in the worst affected lines to reflect the weak pricing environment.

### **RATING SENSITIVITIES**

A downgrade may occur if the net combined ratio remains above 97% for a prolonged period. An extended period of underperformance or a proportionally larger net catastrophe loss versus peers or market share could also lead to a downgrade.

The Outlook may be revised to Stable if Fitch anticipates an improvement in Lloyd's underwriting performance to a level commensurate with peers' or if it reduces its capital exposure to catastrophe losses.

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Applicable Criteria  
Insurance Rating Methodology (pub. 26 Apr 2017)  
<https://www.fitchratings.com/site/re/897260>

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