

Lloyd's of London

Full Rating Report

Ratings

Lloyd's of London

Insurer Financial Strength Rating A+

The Society of Lloyd's

Long-Term IDR A
Subordinated debt BBB+

Lloyd's Insurance Company (China) Ltd

Insurer Financial Strength Rating A+

Outlooks

Insurer Financial Strength Ratings Stable
Long-Term IDR Stable

Financial Data

Lloyd's of London

	2010	2009
Total assets (GBPm)	70,610	67,290
Total liabilities (GBPm)	52,419	49,127
Gross written premiums (GBPm)	22,592	21,973
Pre-tax profit (GBPm)	2,195	3,868
Combined ratio (%)	93.3	86.1
Return on capital (%)	12.1	23.9

Amendment

This report, which was originally published on 25 August 2011, is being amended to change Figure 6, Figure 15 and to remove the term "IFRS" in Figures 16, 17 & 18."

Key Rating Drivers

Resilience of Earnings: Fitch Ratings considers the resilience of Lloyd's of London's (Lloyd's) earnings in currently challenging market conditions, characterised by significant natural catastrophe losses in Q111 and soft pricing conditions across some classes, to be the primary rating driver. The agency will continue to assess the volatility of earnings at Lloyd's in relation to a range of European and Bermudian reinsurers that the agency considers to represent the closest peer group.

PMD's Market Oversight: Fitch views the Performance Management Directorate's (PMD) oversight of market participants as a key mechanism in improving earnings stability in the medium term. The agency will continue to monitor the influence of the PMD's efforts, paying particular attention to cycle management, improved long-term profitability and the performance of the market, which are the PMD's stated areas of emphasis.

Financial Flexibility: The variety of funding sources for the Central Fund gives The Society of Lloyd's (the Society) significant financial flexibility. The Society has the ability to raise funds both internally – through contributions, levies and syndicate loans – and externally through the capital markets.

Capitalisation Remains Strong: Fitch anticipates that capitalisation will continue to support the current rating, assuming further losses fall within boundaries anticipated by the market. The three-layered capital structure at Lloyd's (consisting of syndicates' Premium Trust Funds (PTFs), members' Funds at Lloyd's (FAL) and the Central Fund) remained strong in 2010, despite an uptick in large loss activity during H110.

What Could Trigger a Rating Action

Weakened Capitalisation: A marked erosion of capital, including Central Fund assets, or a poor level of reported profitability relative to peers over a period of time could lead to a downgrade of the ratings.

Reduced Earnings Volatility: Key drivers for an upgrade would be a reduced level of earnings volatility versus peers in the wake of a large catastrophe event, or evidence of earnings resilience during a prolonged period of increased attritional losses and lower premium pricing conditions.

Related Research

[UK Non-Life Insurance – Profitability: Capital is Both the Problem and the Solution \(June 2011\)](#)

[Hurricane Season 2011: A desk Reference for Insurance Investors \(May 2011\)](#)

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Corporate Governance

- Fitch considers corporate governance to be strong at Lloyd's due to the insurer's clearly defined governance structure. The agency views favourably the presence of the Council of Lloyd's, the governing body of the Society of Lloyd's; the council has ultimate responsibility for the management of the market as a whole.
- The appointment of nominated members is confirmed by the governor of the Bank of England and the Council is regulated by the UK Financial Services Authority.
- For many of its functions, the Council acts through the Franchise Board, whose members are appointed by the Council and are drawn from both within and outside the Lloyd's market.

Company Profile

Unique Ownership Structure Viewed as Marginal Positive

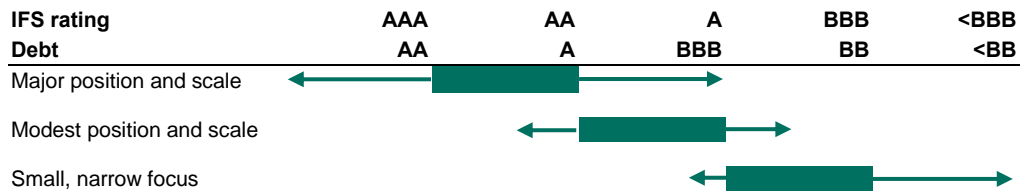
Fitch considers the unique corporate structure of Lloyd's, being a marketplace rather than a corporation, as marginally positive for its ratings compared to traditional corporate reinsurers. This view considers two primary factors: (i) the "Chain of Security," which provides a mixture of several and mutual claims-paying capital, and (ii) the subscription basis of underwriting used within Lloyd's, allowing large complex risks to be underwritten by a group of syndicates.

Strong Market Position and Management Strategy Supportive of Rating

- Globally renowned (re)insurance market
- Product diversification stronger by class than by geography
- Broker-led distribution model
- Underwriting syndicates a unique market feature
- Clearly defined and consistent strategy viewed positively.

Figure 1

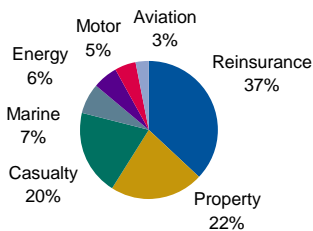
Ratings Range Based on Market Position and Size/Scale



Source: Fitch

Figure 2

Lloyd's of London – Premium Distribution by Business 2010



Source: Lloyd's

Globally renowned (re)insurance market

The strong market position of Lloyd's supports its current rating, which falls within the major position and scale category. Lloyd's is one of a select band of global players capable of attracting high quality and specialised business. Fitch views positively the presence of a detailed and clearly defined business strategy executed by the Corporation's (see *Appendix C: Glossary*) executive team.

Lloyd's is a global insurance and reinsurance market comprising 89 syndicates. It writes business from over 200 countries and territories, and in 2010 reported gross written premiums (GWP) of GBP22,592m (2009: GBP21,973m).

Lloyd's faces competition from a number of sources. These include: established and emerging global reinsurance hubs including Bermuda, Switzerland, Singapore and New York; large global reinsurance players; and smaller primary players located within key markets.

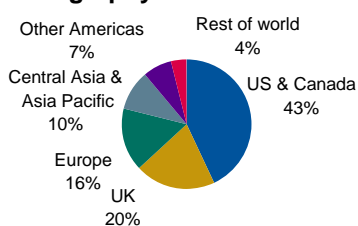
Product diversification stronger by class than by geography

Business written by syndicates focuses on seven main classes (see Figure 2). Lloyd's has a relative level of geographical concentration to the US and Canada (see Figure 3), specifically to the hurricane-exposed US energy fields in the Gulf of Mexico, which Fitch considers has been a key factor in the historical volatility of results at Lloyd's.

Lloyd's main class, reinsurance, covers both short and long tail business offering a variety of placement types including facultative, proportional treaties and non-proportional treaties such as excess-of-loss placements. The US represents the main geographic region for the second major class, property, which includes both commercial and private property. The remaining main class, casualty, covers professional indemnity, medical malpractice, accident and health, directors' and officers' liability, financial institutions, general liability and employers' liability. Business focus is spread across the US, UK and European markets in the most part.

Figure 3

Lloyd's of London – Premium Distribution by Geography 2010



Source: Lloyd's

The remaining classes have niche focus. 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 business, 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.

Broker-led distribution model

Product distribution at Lloyd's is primarily carried out through brokers and coverholders (see *Appendix C: Glossary*), with some business placed directly with service companies (see *Appendix C: 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 continues to be placed into the market by the 178 registered brokers.

Underwriting syndicates a unique market feature

Syndicates are the vehicles used for underwriting policies. They are not legal entities, and are a feature 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 managed 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 for the syndicates that they manage to Lloyd's on a quarterly basis, and to submit business plans on an annual basis or on an ad-hoc basis if business plans change.

Clearly defined and consistent strategy viewed positively

The current strategy document of Lloyd's covers 2011-2013. While many of the key elements, including market oversight, remain consistent with those set out in the previous strategic document, the notable change is the increased emphasis on regulatory issues, including Lloyd's preparations for Solvency II, new framework of regulation in the UK and uncertainty arising from international regulatory reform.

Risk Management

Strong and well structured risk management framework

Fitch views positively the approach taken by Lloyd's to managing risk and corporate governance. The agency believes that the market structure of Lloyd's leads to greater emphasis on the successful management of these areas to maintain the confidence of market participants. The market is overseen by the Council of Lloyd's and the Franchise Board, while the corporation, managing agents and members' agents (see *Appendix C: Glossary*) are regulated by the Financial Services Authority (FSA).

Unique risk profile leads to separation of risks

Lloyd's has developed its risk management framework around two distinct types of risk: Corporation level risks (financial, operational, regulatory and legal) and market (business) level risks. Corporation risks are managed along a traditional governance structure, while market risks are managed by managing agents and the central team at Lloyd's.

Revised risk governance aligned with incoming Solvency II regime

The revised structure has improved the clarity of roles and responsibilities relating to market oversight, as well as identifying areas where further formalisation is required.

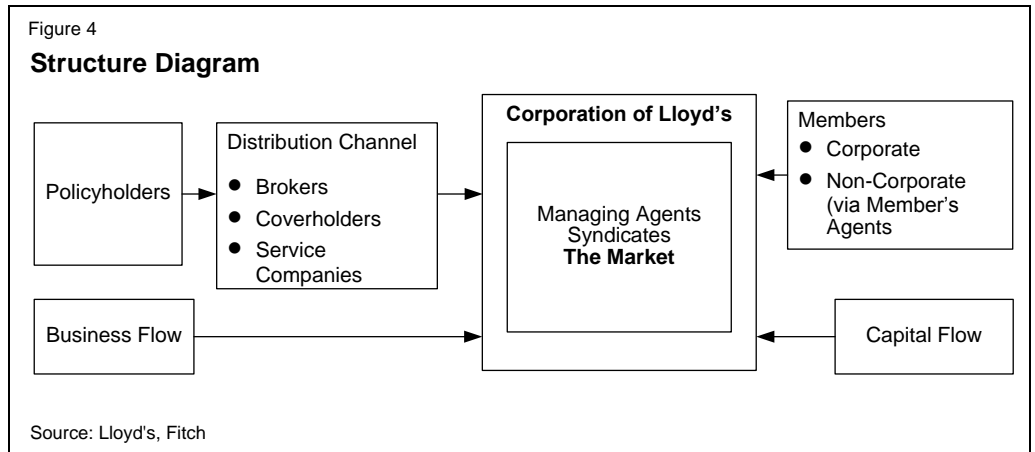
Related Criteria

[Insurance Rating Methodology \(March 2011\)](#)

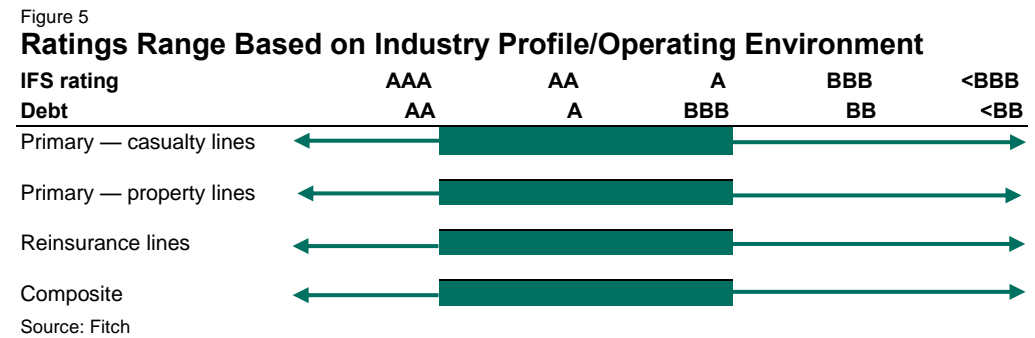
[Non-Life Insurance Rating Methodology \(March 2011\)](#)

[Life Insurance Rating Methodology \(March 2011\)](#)

Organisational Structure



Industry Profile and Operating Environment



Reinsurance Industry Supports Wide Range of Ratings

The provision by reinsurers of risk-transfer services for the primary insurance industry generally requires companies operating in this sector to hold higher quality credit ratings. The achievable range of ratings reflects:

Generally low barriers to entry

The reinsurance industry generally has low barriers to entry, as seen by the wave of start-up reinsurers (primarily in Bermuda) entering the market following significant catastrophe events.

Fitch notes that the barriers to entry to Lloyd's itself are quite high, with the PMD keeping a tight control on the number of new syndicates and managing agents entering the Market. One reason for this is to protect the mutual capital layers from unscrupulous underwriting.

Cyclical pricing

Reinsurers are generally more susceptible to cyclical pricing trends, which fundamentally result from changes in supply and demand for different business lines.

Sovereign and Macroeconomic Risks
United Kingdom

Foreign Currency
Long-Term IDR AAA
Short-Term IDR F1+

Local Currency
Long-Term IDR AAA
Country Ceiling AAA

Outlooks
Stable

Strength
Delivery of government deficit reduction would help underpin the UK's AAA rating.

Weakness
Possibility of negative growth and inflationary surprises.

Peer Analysis

Favourable performance compared with peers

Due to its unique structure and mix of business underwritten, Lloyd's has no directly comparable peers. However, meaningful comparison can still be made with large global reinsurance players.

Solid underwriting performance

Among these companies, Lloyd's ranked second by net earned premium in 2010, and performed well against its peers on underwriting profitability, achieving the lowest combined ratio in 2010 at 93.3% (see figure 6).

Figure 6

Peer Comparisons (2010)

	IFS Rating	Combined ratio (%)				ROE (%)	Net earned premiums (EURm)
		2010	2009	Q111	Q110		
Munich Re	AA-	100.5	95.3	159.4	109.2	11.1	43,075
Lloyd's	A+	93.3	86.1	NR	NR	12.1	19,914
Swiss Re	Not rated	93.9	95.3	163.7	109.4	8.2	14,476
Hannover Re	A+	98.2	96.6	123.8	99.3	23.2	10,047
Partner Re	AA-	95.0	81.8	193.7	116.9	11.8	3,518

Source: Fitch and company financial statements

Note: Premiums converted to Euro at 2010 average exchange rates

Figure 7
Capitalisation and Leverage

(GBPm)	2006	2007	2008	2009	2010	Fitch's expectation
Adjusted debt leverage (%)	4	9	9	6	6	Leverage will remain largely unchanged or reduce slightly in the near-term. Assuming that major losses fall within the bounds anticipated by the market for the remainder of 2011, Fitch does not foresee a significant change in the level of capitalisation in the near term.
Estimated statutory solvency surplus	1,801	2,297	2,475	2,756	2,923	

Source: Fitch

Capital Strength Derived from Member and Central Capital

- Growth of Members' Funds improves risk-adjusted capitalisation
- Financial leverage remains at a modest level
- Modest Total Financing Commitments (TFC) ratio
- Risk-based approach to setting capital at member level and central capital

Fitch considers the capitalisation of Lloyd's to be supportive of its current rating, with strength being derived from assets held as part of member capital and central capital. Capital and reserves were largely unchanged at GBP18.2bn at end-2010, while both leverage and the total financing commitments ratio remained at modest levels at end-2010. Assuming a normalised level of large losses for the rest of 2011, Fitch anticipates that capitalisation will remain broadly similar to that reported at end-2010.

Growth of Members' Funds improves risk-adjusted capitalisation

Considered on Fitch's risk-adjusted basis, the capitalisation of Lloyd's improved marginally in 2008 to 2010, as growth in Members' Funds has outstripped growth in net written premiums (NWP), which represents a key element of the risk-based capital charges.

Financial leverage remains at a modest level

Financial leverage, as calculated by Fitch, remained unchanged at 6% at end-2010 (end-2009: 6%). Fitch notes that, in 2009, Lloyd's repurchased the equivalent of £102m of outstanding debt. During 2010, a further GBP21m was repurchased.

Modest Total Financing Commitments (TFC) ratio

Lloyds' TFC ratio remained at a modest level at end-2010, improving to 12% (end-2009: 18%). The primary driver was a reduction in the value of contingent liabilities captured under the ratio.

Risk-based approach to setting capital at member level and central capital

At member level, capital is set at 135% of the syndicate's Individual Capital Assessment (ICA) result. This percentage has not changed since 2006. Lloyd's reviews each syndicate's ICA in detail, and requires loadings if it deems the syndicate's calculations deficient. Lloyd's believes that the 35% uplift allows for sufficient capital to maintain financial strength and credit ratings at their current levels. In 2011, Lloyd's has maintained its 35% uplift, and continues to review its methodology to reflect changing market, macroeconomic and legislative conditions.

Figure 8

Debt-Servicing Capability and Financial Flexibility

(GBPm)	2006	2007	2008	2009	2010	Fitch's expectation
Interest coverage – Market (x)	80.6	84.6	27.3	55.5	33.3	Interest coverage will remain strong in the medium term, although the level of absolute coverage for 2011 is expected to be lower, reflecting the agency's expectations for a lower level of reported profitability. Fitch does not foresee a significant increase in interest expense in the near-term.
Interest coverage – Society (x)	2.5	3.1	1.4	2.1	4.9	
Interest paid	46.0	46.0	72.1	71.0	68.0	

Source: Fitch

Strong Debt-Servicing Capability and Good Financial Flexibility

- Ability to service debt expected to remain strong
- Flexibility of repayment options
- No immediate maturities

Fitch anticipates that the ability of Lloyd's to service its debt obligations will remain strong in the foreseeable future. The agency notes that Lloyd's has a variety of mechanisms available to raise capital, including member calls, Central Fund contributions, increased loading for required capital on top of ICA, charging premium levy and raising subordinated debt.

Ability to service debt expected to remain strong

Lloyd's continues to exhibit a strong debt-servicing capability, despite a reduction in the level of interest coverage since 2008. Fitch anticipates that this coverage will decrease for 2011, due to lower reported net income.

Flexibility of repayment options

In a going-concern scenario, the Society has several options available for the repayment of principal and interest, as it has complete discretion over the use of the Central Fund. The Central Fund receives a regular supply of funds from syndicate contributions, syndicate loans and investment income. Moreover, if necessary, the Society could increase members' contributions, impose a premium levy (as it has in the past) or use the callable layer. These can all be used on an ongoing basis to pay the interest on the debt.

No immediate maturities

Lloyd's has no immediate debt falling due, with the outstanding issues having call dates in 2014 and 2015. The subordinated debt issued in 2004 and 2007 are obligations of the Society.

Figure 9

Financial Performance and Earnings – Combined Ratio by Major Class

(GBPm)	2006	2007	2008	2009	2010	Fitch's expectation
Reinsurance	80.8	81.7	83.8	78.4	90.3	Lloyd's will report a weaker underwriting result at end-2011, reflecting the unprecedented level of catastrophe losses sustained by the industry during Q111.
Property	81.9	86.3	96.7	92.4	92.4	
Casualty	89.0	92.7	95.1	90.8	96.6	
Marine	88.6	87.4	84.6	88.7	90.9	
Energy	98.8	73.4	123.8	84.1	83.3	
Motor	96.4	98.4	99.6	108.4	151.5	
Aviation	65.1	84.5	86.8	97.1	74.9	

Source: Lloyd's

Catastrophe Losses Key Near-Term Earnings Driver

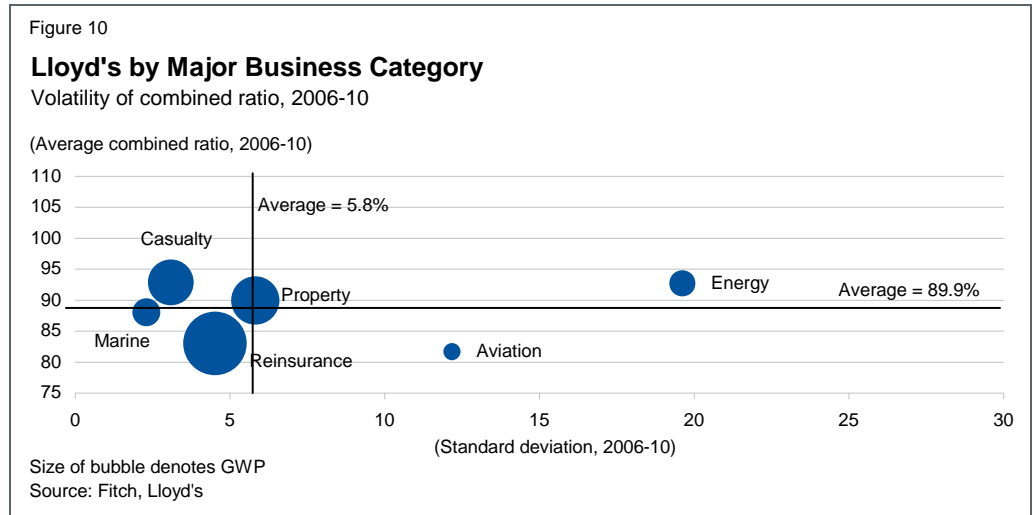
- Continued assessment of PMD's ability to regulate earnings volatility
- Reinsurance: largest class will take significant share of catastrophe losses
- Property: competition maintains pricing pressure
- Casualty: Longer-tail lines exposed to low-yielding investment horizon
- Marine: Industry recovery suggests slow improvement
- Energy: Recent trend of low losses keeps rates under pressure
- Motor: Controlling claims costs viewed as a priority
- Aviation: High frequency of losses fails to dampen capacity

Fitch believes that Lloyd's will report weaker results in 2011 than in 2010, when it exceeded the agency's expectations. This view is driven by the agency's expectations of reduced technical profitability and a lower level of investment income. The market reported modest premium growth in 2010 together with a reduced level of profitability. GWP totalled GBP22.6bn (+3%, also on a currency-adjusted basis) while an increase in H110 loss activity resulted in a deteriorated combined ratio for FY10 of 93.3% (2009: 86.1%), with major losses adding 12.7% (2009: 2.1%).

Considering the high level of catastrophe activity in Q111 the agency anticipates that if catastrophe losses for the remainder of 2011 rise above those of a "normal" year, the pre-tax profit of Lloyd's will be largely reliant on investment income and prior-year reserve releases.

Continued assessment of PMD's ability to regulate earnings volatility

Fitch will continue to assess the volatility of Lloyd's earnings in relation to a range of large European and Bermudian reinsurers considered by the agency to represent the closest peer group to the Lloyd's market. Fitch views the PMD's oversight of market participants as a key mechanism in improving the stability of Lloyd's results and will continue to monitor the influence of its efforts on earnings. The inherent volatility present within Lloyd's business is illustrated by the degree of result variation experienced by individual classes (see figure 10). Investment returns have exhibited a greater degree of stability, helped by conservative asset allocation.



Reinsurance: largest class will take significant share of catastrophe losses

Fitch anticipates that the dominant property sub-treaty class will incur a significant proportion of the losses arising from the catastrophe events witnessed so far during 2011. The agency notes that this was the case in 2010, when catastrophe losses in H110 left underwriting profitability almost entirely dependent on prior-year reserve surplus.

Property: competition maintains pricing pressure

Abundant capacity has caused pricing and terms and conditions to remain under pressure. Fitch also expects catastrophe losses to influence results for 2011. As with the reinsurance class, the 2010 property underwriting result was largely supported by prior year surplus for profitability.

Casualty: Longer-tail lines exposed to low-yielding investment horizon

Capacity continues to remain in this class despite the challenging outlook, although all of 2010 underwriting profitability came from prior-year surpluses. While some uncertainty remains regarding a possible increase in claims arising from the financial crisis, Fitch will continue to closely assess the overall adequacy of reserves for this class.

Marine: Industry recovery suggests slow improvement

While continuing strong capacity is likely to hamper any significant rate increases Fitch anticipates that the 2011 underwriting result will be similar to that achieved in 2010.

Energy: Recent trend of low losses keeps rates under pressure

The positive technical results reported by this class in 2009 and 2010 were due to the large hurricanes in these seasons avoiding the major US energy fields. Strong capacity continues to keep terms and conditions under pressure, placing greater emphasis on underwriting control of what is a highly technical class.

Motor: Controlling claims costs viewed as a priority

Fitch anticipates that the pace of premium rate increases, compared with those achieved in 2010, will slow during 2011. It remains uncertain as to whether the marked increase in pricing achieved over the last 18 months will be sufficient to restore technical profitability in this class and the agency believes that successful claim cost control is a key factor in this context.

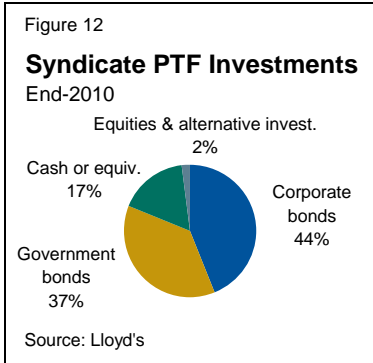
Aviation: High frequency of losses fails to dampen capacity

Lloyd's smallest class achieved an improved technical result in 2010 despite a relatively high number of large losses. With the market continuing to supply adequate capacity, the rating environment for 2011 continues to look challenging.

Figure 11
Investments and Asset Risk

(GBPm)	2006	2007	2008	2009	2010	Fitch's expectation
Invested assets	35,108	36,990	44,377	46,264	48,494	Investment profile and strategy will remain fairly constant in the near term. Currently, the greatest challenge is the persistence of a low yielding investment environment, which would continue to place pressure on earnings.
Investment return (%)	4.7	5.6	2.4	3.9	2.7	
Liquid assets/tech reserves (%)	136.0	140.6	131.5	147	143.3	

Source: Fitch



Conservative investment policy for all links in the Chain of Security

- PTFs: First source of policyholder repayment is high quality and liquid
- FAL: Second repayment layer Support Point
- Central Fund: Mutual layer available at discretion of Council of Lloyd's
- Strong Liquidity position supported by high quality, liquid assets

Fitch considers the overall asset allocation for Lloyd's to be fairly conservative when looking at the aggregate of Premium Trust Funds (PTFs), Funds at Lloyd's (FAL) and the Central Fund. However, the agency notes that substantial variation exists at the PTF and FAL levels for individual syndicates.

PTFs: First source of policyholder repayment is high quality and liquid

PTFs are the first resource for paying policyholder claims from a syndicate. Investments are generally invested in liquid, short-duration, high-quality assets. Around 81% of assets are invested in bonds. Of the 44% of investments held in corporate bonds, 92% are rated 'A' or above.

FAL: Second repayment layer Support Point

FAL represent the second layer of capital provided by members to support their underwriting. The amount of deposited funds is determined by the Corporation, reviewing each syndicate's ICA and applying an uplift based upon the syndicate's business proposal. The capital is held in trust as readily realisable assets. Letters of Credit (LOCs) continue to represent a significant proportion of assets within FAL (49% at end-2010). Fitch notes that the largest providers of LOC facilities have remained constant through the credit crisis.

Central Assets: Mutual layer available at discretion of Council of Lloyd's

Central Assets at Lloyd's are the third level of security, 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. The Central Assets value at end-2010 was GBP2.4bn, with 80% of the portfolio invested in bonds.

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 at both the FAL and Central Fund asset levels.

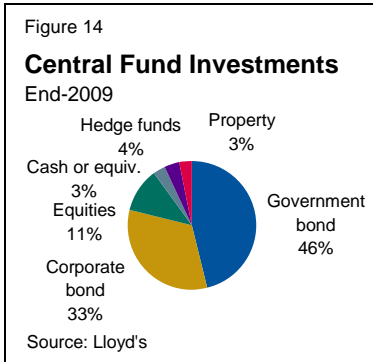
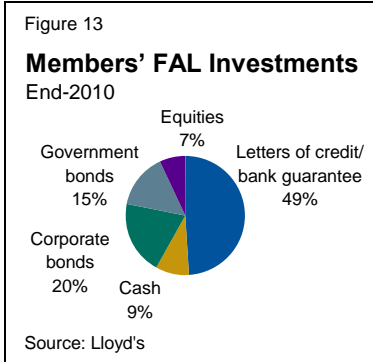


Figure 15

Reserve Adequacy – Prior Year Reserve Movement

% Movement in Combined Ratio	2006	2007	2008	2009	2010	Fitch's expectation
Reinsurance	3.8	-4.6	-12.1	-5.8	-9.5	Continued caution regarding the level of surplus that will be generated by prior underwriting years. Of the seven classes, the future development of the casualty and motor reserves will receive the greatest scrutiny.
Property	-4.3	-6.0	-6.5	-3.4	-6.7	
Casualty	-7.3	-9.1	-8.8	-8.3	-4.5	
Marine	-10.4	-7.6	-7.8	-7.4	-7.5	
Energy	15.1	-3.9	-8.2	-6.2	-18.3	
Motor	-5.3	-6.4	-1.3	3.9	36.7	
Aviation	-22.3	-18.3	-23.7	-16.6	-24.5	

Note: Negative figures indicate a surplus development from prior years, whereas positive figures indicate a deficit.
Source: Fitch

Prior Year Surplus Continues to be Generated by Majority of Classes

- Motor development worsens
- Casualty strengthening suggests further challenges
- Reserving position has greatly improved following Equitas

This trend was driven by favourable claims experiences across most of Lloyds' main classes, which resulted in a 5.9% improvement in the calendar-year combined ratio (2009: 5.6%). Less favourable developments occurred within the motor and casualty classes, where the level of surplus was much reduced from 2009, following the strengthening of more recent underwriting years.

Motor development worsens

Reserve releases were again reported across all major classes of business, with the exception of the motor account, where the deterioration added 36.7% to the combined ratio (2009: 3.9%). Fitch views the level of prior-year deterioration in this class as surprising, and will continue to monitor future developments.

Casualty strengthening suggests further challenges

The challenging outlook for this major class was reflected by the strengthening seen in the more recent underwriting years, which sharply reduced the overall release. While the ultimate level of claims arising from the financial crisis remains unclear, the agency views strengthening efforts positively, although it remains cautious about future development.

Reserving position has greatly improved following Equitas

The reserving position of Lloyd's has improved significantly since the 1992-and-prior liabilities were reinsured into Equitas in 1996 and then subsequently further reinsured with the Berkshire Hathaway Phase 1 and Phase 2 deals in 2007 and 2009 respectively. With the transfer of long-tailed liabilities into Equitas, the reserving position of Lloyd's is now much less volatile, as the proportion of long-tailed liabilities has significantly diminished.

Reinsurance, Risk Mitigation and Catastrophe Risk

Reduced Reinsurance Recoverable; Credit Quality of Reinsurers is Good

- Falling external reinsurance utilisation rate

Lloyd's has continued to manage its reinsurance recoverables, which at end-2010 stood at GBP9.2bn (+1.1%), significantly down from a peak of GBP17.4bn at the end of 2001 following the 11 September 2001 terrorist attack in the US. Fitch regards the reinsurance recoverables as generally high quality, with 93% of counterparties rated 'A' or above.

Falling external reinsurance utilisation rate

Each syndicate is required to make its own reinsurance arrangements. Across the market, the "external" reinsurance utilisation rate is around 22% (2009: 22%), down from a high of 25% in 2003. Reinsurance within the market between syndicates is excluded from this ratio.

Appendix A: Financial Statements

Figure 16
Lloyd's of London: Summary Rating Data

(GBPm)	2006	2007	2008	2009	2010
Key financials					
Total revenue	14,930	15,263	15,174	18,987	18,914
Operating result	3,757	4,060	2,083	4,018	2,333
Net income	3,662	3,846	1,899	3,868	2,195
Combined ratio (%)	82.8	83.9	91.2	85.9	93.1
Return on revenue (%)	25.3	26.6	13.7	21.2	12.3
Total assets	42,503	44,007	53,597	55,179	58,002
Total adjusted equity	12,836	13,449	14,182	18,163	18,191
Coverage of the estimated minimum margin (x)	6.1	6.3	6.2	6.6	6.4
Business statistics					
Total gross written premiums	16,414	16,366	17,985	21,973	22,592
Annual change (%)	9.6	-0.3	9.9	22.2	2.8
Total net written premiums	13,201	13,256	14,217	17,218	17,656
Annual change (%)	12.2	0.4	7.2	21.1	2.5
Operating statistics					
Total revenue	14,930	15,263	15,174	18,987	18,914
Operating result	3,757	4,060	2,083	4,018	2,333
Net income	3,662	3,846	1,899	3,868	2,195
Return on revenue (ex. gains) (%)	25.3	26.6	13.7	21.2	12.3
Return on assets (incl. gains) (%)	8.5	8.9	3.9	7.0	3.8
Return on adj. equity (incl. gains) (%)	31.4	29.3	13.4	21.3	12.1
Non-life					
Incurred loss ratio (%)	49.0	50.0	61.4	51.6	58.6
Commission ratio (%)	25.1	26.3	27.0	26.4	27.4
Expense ratio (%)	6.9	8.4	8.9	7.6	8.4
Reins. comm., profit participation, other ratio (%)	1.7	-0.9	-6.0	0.4	-1.3
Combined ratio (%)	82.8	83.9	91.2	85.9	93.1
Portfolio performance					
Net investment income	1,729	2,007	957	1,769	1,258
Running yield (%)	4.9	5.6	2.4	3.9	2.7
Running yield on technical reserves (%)	3.6	4.7	1.8	4.1	2.7
Total yield (incl. unrealised gains) (%)	4.9	5.6	2.4	3.9	2.7
Portfolio composition (%)					
Real estate	0.0	0.0	0.0	0.0	0.0
Shares	11.1	11.5	10.2	10.9	12.0
Bonds	54.6	56.3	56.7	58.1	59.6
Cash and bank deposits	34.2	32.2	33.0	30.8	28.3
Other assets	0.1	0.0	0.1	0.2	0.1
Financial statistics					
Total assets	42,503	44,007	53,597	55,179	58,002
Total adjusted equity	12,836	13,449	14,182	18,163	18,191
Change in adj. equity (%)	22.4	4.8	5.5	28.1	0.2
Coverage of the estimated minimum margin (x)	6.1	6.3	6.2	6.6	6.4
Non-life technical reserves/non-life NPW (%)	195.4	198.5	237.2	182.6	191.5
Non-life claims reserves/non-life NPW (%)	160.0	162.4	196.4	148.8	155.9
Technical reserves/adj. equity (%)	200.9	195.6	237.8	173.1	185.9
Invested assets/(adj. equity + technical reserves) (%)	90.9	93.0	92.6	93.3	93.2
Liquid assets/technical reserves (%)	136.0	140.6	131.5	147.0	143.3
Investment leverage (%)	30.3	31.6	31.9	27.8	32.1
Debt/capital (%)	3.7	7.0	7.1	5.0	4.9
Non-life reinsurance utilisation ratio (%)	19.6	19.0	21.0	21.6	21.8

Source: Fitch-adjusted company audited financial statements

Figure 17

Lloyd's of London: Profit & Loss Account

(GBPm)	2006	2007	2008	2009	2010
Technical account					
Gross written premiums	16,414	16,366	17,985	21,973	22,592
Premiums ceded	-3,213	-3,110	-3,768	-4,755	-4,936
Net written premiums	13,201	13,256	14,217	17,218	17,656
Change in unearned premium reserve	513	159	421	493	545
Net premiums earned	12,688	13,097	13,796	16,725	17,111
Gross claims paid	11,718	8,741	9,736	11,544	11,565
Reinsurance recoveries	-5,120	-2,515	-2,158	-2,469	-2,751
Net claims paid	6,598	6,226	7,578	9,075	8,814
Change in claims case reserves	-379	321	886	-451	1,215
Net claims incurred	6,219	6,547	8,464	8,624	10,029
Acquisition costs	3,191	3,449	3,720	4,408	4,692
Administrative expenses	910	1,117	1,267	1,304	1,475
Other underwriting income/(expenses)	-226	115	853	-69	228
Total underwriting expenses (incl. FX)	4,327	4,451	4,134	5,781	5,939
Technical interest	957	1,223	543	1,344	865
Underwriting result	3,099	3,322	1,741	3,664	2,008
Non-technical account					
Investment income	1,729	2,007	957	1,769	1,258
Less technical interest	-957	-1,223	-543	-1,344	-865
Net investment income	772	784	414	425	393
Interest paid	46	46	74	71	68
Operating result	3,871	4,106	2,155	4,089	2,333
Other income/(expenses)	-95	-214	-184	-150	-138
Pre-tax profit	3,662	3,846	1,899	3,868	2,195
Reported net income	3,662	3,846	1,899	3,868	2,195

Source: Fitch-adjusted company audited financial statements

Figure 18
Lloyd's of London: Balance Sheet

(GBPm)	2006	2007	2008	2009	2010
Assets					
Investments					
Real estate					
Shares	3,891	4,255	4,532	5,052	5,840
Bonds	19,174	20,811	25,176	26,898	28,886
Cash and bank deposits	12,019	11,911	14,644	14,271	13,736
Bank deposits	4,093	4,414	5,216	5,189	5,086
Current bank accounts and cash	7,926	7,497	9,428	9,082	8,650
Deposits with cedents	17	9	10	10	11
Other invested assets	7	4	18	33	21
Total investments (non-linked)	35,108	36,990	44,380	46,264	48,494
Insurance receivables	3,520	3,428	4,663	4,560	4,825
Reinsurance receivables	3,190	2,918	3,763	3,577	3,572
Other receivables	382	318	419	437	691
Tangible assets	22	26	30	36	44
Goodwill	-	-	-	-	-
Accruals	261	299	334	293	343
Other assets	20	28	8	12	33
Total assets	42,503	44,007	53,597	55,179	58,002
Liabilities					
Technical reserves					
Unearned premium reserve	7,024	7,282	9,043	9,433	10,125
Reinsurers' share	-771	-841	-1,167	-1,447	-1,458
Less deferred acquisition costs	-1,582	-1,656	-2,064	-2,180	-2,371
Outstanding claims reserve	30,377	28,971	38,420	34,111	36,303
Reinsurers' share	-9,259	-7,449	-10,504	-8,484	-8,779
Other technical provisions					
Reinsurers' share					
Total (net) technical reserves (non-linked)	25,789	26,307	33,728	31,433	33,820
Reinsurance deposits	69	42	161	115	89
Insurance payables	831	697	770	865	722
Reinsurance payables	1,643	1,534	2,517	2,526	2,820
Short-term debt					
Long-term debt					
Subordinated debt - liability	497	1,012	1,082	958	930
Other creditors	715	774	883	774	1,046
Accruals	123	192	274	345	384
Total liabilities	29,667	30,558	39,415	37,016	39,811
Capital and reserves					
Members' FAL	11,282	9,858	10,630	13,159	13,832
Members' balances	597	2,652	2,562	3,878	2,912
Central fund balance	957	939	990	1,126	1,447
Total capital & reserves	12,836	13,449	14,182	18,163	18,191

Source: Fitch-adjusted company audited financial statements

Appendix B: Other Ratings Considerations

Below is a summary of additional ratings considerations of a “technical” nature 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 being considered core.

Notching

Lloyd’s unique corporate structure, being a market place rather than a corporation, makes reference to operating and holding companies inappropriate in this circumstance. A description of how the respective ratings of Lloyd’s’ entities were reached is provided below. The regulatory environment in the United Kingdom is considered to be strong.

Notching Summary

Society of Lloyd’s

- The Society’s IDR rating is linked to the IFS rating assigned to Lloyd’s of London. The Society has no legal liability for the insurance liabilities of members other than where it has issued an undertaking. The undertakings are liabilities of the Society and constitute unsecured obligations of the Society ranking pari passu with its other senior unsecured liabilities. Thus, Fitch has aligned the IDR of the Society with the implied IDR of Lloyd’s of London.

IFS Ratings

- Due to the existence of policyholder priority, a baseline recovery assumption of Good applies to the IFS Rating, and standard notching from the implied IDR was used.
- The insurance policies issued by Lloyd’s of London 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, and provide partial mutuality to the Lloyd’s market. It is this mutuality that enables Fitch to assign an IFS rating to Lloyd’s of London.

Debt

- Not applicable.

Hybrids

- Notching of junior subordinated debt was based on a standard baseline recovery assumption, given default, of Poor for the Society being the issuer, and standard notching was used.

Hybrids – Equity/Debt Treatment

Figure 19
Hybrids Treatment

Hybrid	Amount	CAR		FLR Debt (%)
		Fitch (%)	Reg override (%)	
Sub debt	GBP300m	0	100	100
Sub debt	EUR253m	0	100	100
Sub perpetual	GBP419m	0	100	100

Source: Fitch

Exceptions to Criteria/Ratings Limitations

None.

Appendix C: Glossary

Corporation of Lloyd's

The executive of the Council of Lloyd's, 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 on a worldwide basis 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 which 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's agreement. These services and duties include advising the member on which syndicates he should participate, the level of participation on such syndicates and liaising with the member's managing agents

Service Company

A 'service company coverholder (referred to in the Code simply as a "service company")' is an approved coverholder which Lloyd's has agreed can be classified as a "service company" by reason of it being a wholly owned subsidiary of either a managing agent or of a managing agent's holding company and which is normally only authorised to enter into contracts of insurance for members of its associated syndicate and/or associated insurance companies

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