

Operating Company Covered

By This Report

Financial Strength Rating

Local Currency

A+/Stable/—

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Lloyd's

Major Rating Factors

Strengths:

- Strong competitive position.
- Strong operating performance.
- Strong capitalization.
- Strong financial flexibility.

Weaknesses:

- Relatively high utilization of reinsurance and letters of credit for capital support.
- Inherent operating performance volatility.

Rationale

The insurer financial strength rating on the Lloyd's insurance market (Lloyd's or the Market) reflects Lloyd's strong competitive position, strong operating performance, strong capitalization, and strong financial flexibility. These positive factors are partly offset, however, by Lloyd's relatively high utilization of reinsurance and letters of credit for capital support and the inherent potential for operating performance volatility.

Lloyd's competitive position is strong, supported by the positive attributes associated with its unique brand, attraction as the world's largest subscription market, London's continued position as a major international insurance and reinsurance market, policyholder loyalty, and improving systems and processes. The attractiveness of Lloyd's as an operating platform is demonstrated by the continual flow of new entrants to the Market in recent years. This has contributed to Lloyd's operating with a record level of capacity in 2010. This is not all positive in our view, since operating margins are under downward pressure in many of Lloyd's

business lines. This, in turn, will demand increased oversight from the Performance Management Directorate.

Lloyd's prospective operating performance is expected to remain strong overall, but it continues to face challenges that we believe will result in lower profitability in 2010 and 2011, compared with the past four years (see Outlook section). The Market posted a record pre-tax profit of £3.9 billion in 2009 (£1.9 billion in 2008) and impressive operating statistics, including a combined ratio of 86.1% and a return on revenue (ROR) of 20%, but two factors should not be overlooked. Catastrophe losses during 2009 were one-fifth of the average level incurred by Lloyd's since 2001, and reserve releases from prior accident years contributed 40% of total reported underwriting profits in 2009. We do not consider either of these to be sustainable.

Lloyd's capitalization is strong, supported by what we consider to be very strong capital adequacy, strong quality of capital, Lloyd's much diminished exposure to legacy issues, and the efficacy of the capital-setting processes. However, Lloyd's high utilization of reinsurance capacity and of letters of credit (LOCs) to support its capital needs is a relative credit weakness. According to the technical specifications for Quantitative Impact Study 5 (QIS5), at least 50% of the regulatory capital requirement under Solvency II should be met by Tier 1 capital. LOCs are only eligible as Tier 2 capital, and represented £7.3 billion, or 55% of Members' Funds at Lloyd's (FAL) in 2009. It should be noted that FAL are set by Lloyd's at a level that are 35% higher than the current regulatory capital requirements. Nearly 90% of these LOC facilities are provided by 10 banks, so the Market is incurring some concentration risk.

Lloyd's financial flexibility is strong. The diversity of Lloyd's capital providers represents a unique strength for the Market. In addition to the strong flow of high-quality new applicants, financial flexibility is also reinforced by Equitas' \$7 billion reinsurance deal with National Indemnity Co. (NICO; AA+/Stable/—) and the declining trend of annual undertakings given to insolvent members. Solvency deficits amounted to just £59 million in 2009, down from £482 million in 2005.

Outlook

Our outlook on Lloyd's is stable. Negative pricing trends have accelerated for some lines of business during 2010. When coupled with low investment yields, this will suppress the Market's near-term earnings prospects. Lloyd's is expected to bear a large share of the Chilean earthquake losses, and has released a Market loss estimate of \$1.4 billion. This figure is higher and was released later than many peers, so we think it is less likely to develop negatively. Lloyd's has also estimated its exposure to the Deepwater Horizon loss at between \$300 million and \$600 million. Taken together, these events are expected to add around 7% to Lloyd's 2010 combined ratio.

We take this to suggest that a full-year combined ratio of 95% is achievable, assuming some limited additional catastrophe activity, and that reserve releases continue at the same pace as in 2009. Although we expected the impact of prior-year releases on the Market's overall performance to diminish, this does not seem to be the case, looking at the 2010 interim results for the listed Lloyd's vehicles.

Lloyd's central assets of £2.8 billion at year-end 2009 are over £1 billion in excess of its minimum economic target. Despite this, we do not expect Lloyd's to reduce the amount of the Central Fund or contributions to it in the short term. Nor do we expect Lloyd's to adjust the 35% uplift that is applied to each member's Individual Capital Assessment (ICA). Lloyd's has submitted a preapplication for

internal model approval to the U.K.'s Financial Services Authority (FSA), but this is not assured and the Solvency II standard formula would significantly raise capital requirements for the Market. We therefore believe that Lloyd's will adopt a conservative stance in the interim.

The likelihood of medium-term positive rating action is low. Impediments include the uncertainty regarding the overall impact of Solvency II on Lloyd's and the difficult operating environment in the lines of business that Lloyd's operates in. Ultimately, positive rating action would be conditional on the impact of Solvency II being neutral relative to peers, Lloyd's main capital providers remaining committed to the Market as they invest in separate operating platforms, and Lloyd's upholding strong operating performance. The likelihood of negative rating action is similarly low but would be driven either by operating performance returning to levels seen prior to 2002, reflecting poor management of a softening underwriting cycle, or by the occurrence of a major catastrophe loss.

Corporate Profile: Significant Participant In Worldwide Markets

The London-based Lloyd's insurance market is a major participant in specialty commercial insurance and reinsurance markets worldwide. Lloyd's wrote gross premiums in 2009 of £22 billion across a diverse range of classes (see table 1), predominantly via broker distribution. This represented growth of 22% over 2008, or 8.5% on a constant exchange rate basis. Lloyd's ranked as the fifth largest reinsurer in 2009, according to our global survey.

As at Sept. 1, 2010, there were 85 syndicates (including four special-purpose syndicates) trading at Lloyd's, managed by 53 managing agencies. These figures include those managing agents and syndicates that are only authorized to underwrite reinsurance to close (RITC) contracts.

Lloyd's has very wide geographic coverage, with specific trading rights to write insurance business in 80 countries and the ability to write reinsurance in over 200 countries and territories. Nevertheless, a significant majority of income (65% in 2009) continues to be sourced from North America and the U.K.

Competitive Position: Unique Brand, Subscription Market, Mutuality, And Licensing Provide Key Advantages

Table 1

	—2009—		—2008—		—2007—		—2006—		—2005—	
	(Mil. £)	(%)	(Mil. £)	(%)	(Mil. £)	(%)	(Mil. £)	(%)	(Mil. £)	(%)
Reinsurance	7,989	36.4	6,299	35.0	5,455	33.3	5,560	33.8	5,243	35.0
Casualty	4,320	22.5	3,762	20.9	3,364	20.6	3,572	21.8	3,402	22.7
Property	4,954	19.7	3,971	22.1	3,809	23.3	3,638	22.2	3,199	21.3
Marine	1,606	7.3	1,334	7.4	1,226	7.5	1,153	7.0	1,017	6.8
Energy	1,371	6.2	1,150	6.4	1,019	6.2	1,125	6.9	804	5.4
Motor	1,118	5.1	939	5.2	983	6.0	923	5.6	895	6.0
Aviation	551	2.5	481	2.7	464	2.8	393	2.4	375	2.5
Life	60	0.3	49	0.3	46	0.3	50	0.3	47	0.3
Total	21,973	100.0	17,985	100.0	16,366	100.0	16,414	100.0	14,982	100.0

Lloyd's competitive position is very strong, supported by its unique brand, attraction as the world's largest subscription market, London's continued position as a major international

insurance/reinsurance market, and policyholder loyalty. This position has been further enhanced in recent years by a combination of Lloyd's improved financial strength, the successful completion of Equitas' deal with NICO, and improving London Market business processes which aim to make Lloyd's more competitive. The attractiveness of Lloyd's as an operating platform is demonstrated by the continual flow of new entrants to the Market in recent years, either directly or through the acquisition of an existing operation. This has contributed to Lloyd's operating with a record level of capacity in 2010. This is not all positive in our view, since operating margins are under downward pressure in many of Lloyd's business lines. In turn, this will demand increased oversight from the Performance Management Directorate.

Lloyd's draws significant competitive strength from its unique brand. Built over centuries, the brand is recognized globally and is often viewed as a key positive attribute among insurance buyers. Although the brand may not regain the position it had before the Market's near-demise during the mid-1990s, Lloyd's underwriters are still recognized as possessing a number of positive traits. These include a strong track record of timely settlement, particularly following major loss events, and their willingness and ability to offer innovative underwriting solutions to their clients.

Lloyd's is the world's largest subscription insurance market. Lloyd's has endorsed the European Federation of Insurance Intermediaries' (BIPAR) principles, which seems to have resulted in fewer changes to the subscription market than was initially feared. Although Lloyd's managing agents operate as independent businesses, the size and diversity of underwriting capacity within the Market allows it to compete with the largest global (re)insurance groups. This diversity provides Lloyd's with a valuable competitive advantage in that it enables buyers and brokers to diversify risk placement in a single marketplace.

Lloyd's retains a critical mass of relevant underwriting, claims and broking expertise, and support services, remaining the cornerstone of diverse specialist underwriting niches, such as marine, energy, aviation, and certain nonmarine classes. This will, in our view, preserve London's status as a leading marketplace.

However, the proliferation of new regional hubs and the trend toward local placements presents Lloyd's with several challenges. More than 80% of participants at Lloyd's now have access to alternative platforms, and several of the large traditional capacity providers are investing heavily in their non-Lloyd's operations, thereby reducing their reliance on Lloyd's. In our view, this is due to several factors; Lloyd's does not have the same licensing advantages outside the U.S. surplus lines market; Lloyd's has an array of capital providers' whose interests are not always aligned; and local requirements often mean additional operational and regulatory complexity for Lloyd's.

The Market's resilience is evident, however, from the way it withstood Bermuda's emergence as a major competitor. It continues to extend its global reach, notably through the establishment of Lloyd's offices in Singapore, Japan, China, and most recently in Brazil, where it is the second largest reinsurer. It is also party to formative plans to recreate a New York Insurance Exchange, which, over a long period of time, could challenge Lloyd's position as the second-largest writer of U.S. surplus lines business, if successfully launched.

The features of business typically underwritten at Lloyd's include: complexity; large monetary exposure levels; and a high-severity, low-frequency profile of risk. It has accentuated this risk in recent years, capitalizing on well-priced U.S. catastrophe business. The resultant underwriting portfolio, although diverse, is weighted toward a highly credit-sensitive clientele. A significant majority of Lloyd's

income is sourced from the U.S. and the U.K., which are particularly credit-sensitive markets compared with those in Continental Europe.

Lloyd's underweight position in Europe is, in our view, a competitive disadvantage relative to some peers, and one which we believe is difficult to redress. We acknowledge that operating margins have more recently tended to be lower in Europe, but there is some diversification benefit to be gained, and Solvency II may provide growth opportunities in the future.

Lloyd's predominantly sources its business through brokers—the most credit-sensitive distribution channel—and remains highly dependent on the top three large international broking groups (45% in 2009). Nearly one-third of Lloyd's business is also underwritten on a delegated authority basis, which is a higher-risk underwriting model, particularly so when pricing and terms and conditions are under pressure.

Owing to the credit-sensitive nature of its key stakeholders, confidence in Lloyd's among these constituencies is extremely important, hence the value placed by Standard & Poor's on the deal concluded between Equitas and NICO in 2006. Phase II of the NICO transaction was completed effective June 30, 2009. As a result, Equitas and relevant policyholders now benefit from the full \$7 billion of reinsurance cover provided under this arrangement (in addition to Equitas' reserves).

The U.K. High Court approved the insurance business transfer of the members' liabilities in respect of 1992 and prior non-life business written at Lloyd's to Equitas Insurance Ltd., a newly formed insurance company within the Equitas Group, authorized by the FSA. This transfer relieves the members and former members concerned from those liabilities under English law and the law of every other state within the European Economic Area. Standard & Poor's believes the Equitas/NICO deal renders as highly remote the potential for reserve inadequacy at Equitas to undermine confidence in Lloyd's at some point in the future.

The London Market's business administrative processes have historically been a drag on Lloyd's competitive position. In being less efficient than those of global market peers, they reduced London's relative attractiveness to policyholders in terms of service quality and cost. Since 2006, Lloyd's has embarked on a fairly ambitious business process reform agenda, focused on introducing common data standards, improving the process and speed of premium and claims payments, and hopefully, removing the residual frictional costs associated with trading at Lloyd's.

Management And Corporate Strategy: Strategic Review Complete, Business As Usual

Management

As expected within a marketplace, the quality and sophistication of management varies. The Corporation has established a strong track record in relation to its prime goal of protecting, but in reality improving, the Lloyd's franchise, both in a financial and competitive sense. The success of this can be measured in the continual flow of high-quality new applicants to the Market. The more-recent success of the Corporation is evidence of the effectiveness of increasingly robust performance, risk-monitoring processes, tools, and benchmarks against which managing agents are assessed.

Part of the credit for the enhanced effectiveness of the Corporation in positively influencing Market behavior must, in our view, be attributed to the renamed Performance Management Directorate (PMD), which established an impressive track record under Rolf Tolle. His successor, Tom Bolt, has

long experienced the cyclical behavior of the industry from both inside and outside the Lloyd's Market, and has shown no less vigor in enforcing market underwriting discipline. We have noted few changes, but more emphasis on and monitoring against, syndicates' business plans.

The Corporation has an array of tools, enhanced by the implementation of the Performance Management Data Return (PMDR) in 2009, to identify underperforming businesses at an early stage. It possesses the requisite authority to impose sanctions where warranted. These may include capital loadings, business plan restrictions, and requesting changes to the management team. Lloyd's has recently demonstrated its ability and willingness to impose such restrictions.

The FSA has ultimate responsibility for the regulation of the Market. Although the FSA's working relationship with the Franchise Board means that the Corporation effectively performs many of the regulator's duties, the FSA inspects and is actively engaged with individual managing agents and has imposed additional measures, beyond those suggested by Lloyd's, where problems have been identified.

Despite its improved effectiveness, the Corporation's remit remains somewhat limited. It can take necessary action to protect the Central Fund, Lloyd's reputation, brand, and ratings—hence, for example, the introduction from 2007 of underwriting, claims, and risk management principles and minimum standards. Nevertheless, while considering the above, the Corporation is constrained from promoting or undertaking activity that could be considered anticompetitive. In addition, it is understood that the Corporation is not expected to be a micromanager of managing agents. Therefore, the oversight it provides is designed to be robust without being overbearing.

That said, the requirements under Solvency II are demanding, more so given Lloyd's application for internal model approval, and require major improvements to risk management across the Market. Lloyd's has been forceful in preparing the Market for Solvency II, engaging its participants by creating a series of working groups, workstreams and dry runs, through regular dialogue and the publishing of advice, gap analyses, and benchmarking the level of preparedness of individual managing agencies.

Some managing agents are progressing better than others in their implementation of Solvency II. Lloyd's has mandated that each syndicate must have a full Solvency II standard internal model so as not to prejudice the Corporation's application.

Strategy

Following a period of market consultation, Lloyd's announced the results of its new three-year strategic plan in February 2010. In the main, it confirmed the tenets of the existing strategy, the pillar of which is for Lloyd's to be the market of choice, although it attached more weight to regulatory matters. The Corporation's stated priorities are; to preserve and enhance the competitiveness of Lloyd's in terms of accessing and transacting efficiently with(in) the market, ensuring Lloyd's is not disadvantaged by changing regulation especially Solvency II, and to continue to promote and enforce strong risk and performance management within the market. Lloyd's acknowledged its reliance on the U.S. and certain brokers for business, and increased weighting to more-volatile lines of business, but considers them to be part of its success and has no plans to shift focus.

Additional short-term priorities inevitably include process reform. The move to electronic claims files and accounting submissions have impressively cut processing times, but progress with electronic messaging (The Exchange) has been slow. Other initiatives are underway, including claims transformation aimed at improving claims handling and standardizing the administration of coverholders.

Lloyd's considered various optimal systems solutions as part of its strategic review, such as a central clearing function. Ultimately, it determined that the current program of improvements was adequate. Lloyd's is not minded to turn itself into an electronic trading platform, which might in the future be to the advantage of competing marketplaces.

Enterprise Risk Management: Continuous Enhancement Remains A Key Priority For Lloyd's

Standard & Poor's considers the quality of Lloyd's enterprise risk management (ERM) to be adequate with strong risk controls, which is supportive of the rating. Standard & Poor's believes that it is unlikely that Lloyd's will experience losses outside its risk tolerances. The factors supporting the overall assessment are adequate risk management culture and strategic risk management, and strong risk controls overall.

For our ERM assessment, we have considered the Central Fund as a provider of protection to the Market and have assessed the risk controls and strategic risk management with this in mind. This ERM assessment does not reflect the ERM capabilities of the participants in the Lloyd's Market.

ERM is of high importance. The Market operates in numerous complex business lines, many of which have the potential to demonstrate extreme volatility. Individual syndicates have historically performed with significantly varying degrees of success. Centrally, Lloyd's continues to make considerable progress on ERM and further enhancements are planned. In Standard & Poor's view, the frequency and effectiveness of the interaction between the risk management team and the other directorates continues to improve. Nevertheless, ERM capabilities among managing agents continue to vary throughout the market.

Risk management culture is adequate and improving, reflecting the greater focus on and continued development of risk management at Lloyd's centrally. The Corporation seeks to perform its duties in a facilitative manner, although it has the option to adopt a more-prescriptive approach as and when necessary. There are proposed developments of the governance structure and the risk appetite framework which should improve the oversight, quantification, and monitoring of the Corporation's risk taking. The Corporation, through the Lloyd's oversight teams, performs continuous, centrally coordinated, and holistic reviews of its managing agents across all areas of risk using the syndicate risk matrix.

Underwriting risk controls are assessed as strong. Although the risk controls employed by the underlying managing agents are varied, the oversight and ability to manage and review the business plans and capital held at the syndicate levels enables the Corporation to manage how the risk flows up from the syndicates to the Central Fund. The implementation of the PMDR has allowed more granular and timely analysis and monitoring of the underwriting risk assumed by the Central Fund throughout the year.

Catastrophe risk controls are assessed as adequate. The Corporation seeks to ensure there are appropriate levels of catastrophe risk aggregation control both within each managing agent and at the Market level, primarily using the RDS framework. This process has recently been supplemented by the reporting and aggregation of syndicate annual exceedance probability curves that will allow Lloyd's to measure this risk at various return periods. The assumptions used to aggregate the curves have been developed to use as much information as possible on the dependencies between syndicates, and to be

prudent where such information is missing. However, the assumptions needed to aggregate the curves from different models may reduce some of the accuracy of this method.

Reserve risk controls are assessed as strong. The comparison of reserve strength across the market produces an effective tool to highlight weaknesses that can be followed up through Lloyd's visits to the syndicates.

Standard & Poor's have not undertaken a review of Lloyd's risk models and, therefore, risk models are assessed as adequate. The Corporation performs continuous, centrally coordinated, and holistic reviews of its managing agents across all areas of risk using the ICA submissions and RDS as key inputs. The center has operated a Market-level stochastic model for a decade. Having been progressively enhanced, and now built on syndicate ICA inputs, it forms a key part of the capital adequacy dialogue with the U.K. FSA. Risk models used by the Corporation and the Market are being improved in line with Solvency II demands.

We have assessed strategic risk management as adequate. The Corporation's prime goal remains the protection of the Lloyd's franchise, a key element of which relates to financial security. In doing so, the Corporation can direct activity to protect the Central Fund, hence the introduction of underwriting, claims, and risk management minimum standards, the setting of relevant guidelines and generation of controls over the risks it itself manages (e.g., Central Fund investment policy).

We have assessed how the Corporation considers the risk against the reward of the Central Fund and how it optimizes the risk assumed by the Central Fund in relation to the levies it charges for this protection as adequate. We have not seen significant evidence of dynamic adjustment of the levies or the Economic Capital Assessment amounts to optimize the risk versus return or strategic planning for managing the Central Fund to an optimal size.

The Corporation is constrained by law from promoting activity that optimizes Market profitability at the expense of competition. Therefore the Corporation cannot directly intervene to ensure the Market is able to optimize its return on risk-adjusted capital, and we have not considered the strategic risk management of the underlying syndicates in this assessment.

Emerging risk management is considered strong. Lloyd's is at the leading edge of a number of initiatives (e.g., Lighthill Risk Network and Climatewise) that are focused on the identification, and management, of emerging risks. Increasingly, Lloyd's is looking to draw on the research of leading academics and scientists in assessing the risk implications of emerging issues. A comprehensive database of emerging risks is maintained. This stores information in respect of approximately 370 individual risks and is used to produce a report that is regularly reviewed by Lloyd's risk committee. In addition, there is increasing interaction between the emerging risks team and other parts of the Corporation.

Standard & Poor's believes that the proposed developments, especially in the risk appetite framework, will have positive implications for our assessment. The development of the risk appetite framework and the resulting communication of quantitative tolerances should allow a more aligned and transparent risk strategy that may facilitate a broader use of risk in strategic decision-making. Therefore, these changes could result in an improvement in assessment of the Corporation's ERM capabilities in the foreseeable future.

Accounting: Various Accounting Conventions Considered

Standard & Poor's analysis of Lloyd's relies on data provided under a number of accounting conventions, including fully audited three-year funds and U.K. generally accepted accounting principles

(GAAP) accounting for syndicates, and unaudited pro forma financial statements for the Market. The latter, while externally reviewed, are unaudited and are generated to present Lloyd's aggregated results on a basis that is broadly comparable with results for general insurance companies.

Total adjusted capital within Standard & Poor's risk-based capital model has been derived in the capital model after applying adjustments for: 1) loss and unearned premium reserve discounting; 2) a 100% write-down of deferred acquisition costs; and 3) full hybrid equity credit given to the subordinated loan notes and perpetual subordinated capital securities issued by The Society of Lloyd's in 2004 and 2007, respectively.

Operating Performance: Strong, But Headline Numbers Obscure Weakening Prospects

Table 2

Lloyd's/Operating Performance								
(Mii. £)	2009	2008	2007	2006	2005	2004*	2003	2002
Total gross premiums written	21,973	17,985	16,366	16,414	14,982	14,614	16,422	16,203
Annual change (%)	22.2	9.9	(0.3)	9.6	2.5	(11.0)	1.4	0.6
Total net premiums written	17,218	14,217	13,256	13,201	11,770	11,734	12,250	11,160
Annual change (%)	21.1	7.2	0.4	12.2	0.3	(4.2)	9.8	0.8
Total revenue [¶]	18,069	14,339	14,320	13,645	12,490	12,329	12,156	11,313
Annual change (%)	26.0	0.1	4.9	9.2	1.3	1.4	7.5	7.5
Profit before tax	3,868	1,899	3,846	3,662	(103)	1,367	1,892	834
Annual change (%)	103.7	(50.6)	5.0	(3,655.3)	(107.5)	(27.7)	126.9	(126.8)
Return on revenue ^{^*} (%)	20.3	12.1	23.2	22.7	(5.5)	7.5	12.6	7.0
Net loss ratio (%)	51.6	61.4	50.0	49.0	80.7	64.8	57.2	62.3
Net expense ratio (%)	34.6	29.9	34.0	34.1	31.1	31.8	33.5	36.3
Net combined ratio (%)	86.1	91.3	84.0	83.1	111.8	96.6	90.7	98.6
Accident-year combined ratio (%)	80.6	100.5	90.5	85.2	111.9	93.5	85.7	89.0

*Restated. [¶]Net premiums earned plus allocated investment income. [^]Balance on the technical account for general business/total revenue.

We expect Lloyd's prospective operating performance to remain strong overall, but it continues to face challenges that we believe will result in lower profitability in 2010 and 2011 compared to the last four years (see Outlook section).

The Market posted a record pre-tax profit of £3.9 billion in 2009 (£1.9 billion in 2008) and impressive operating statistics; a combined ratio of 86.1% (91.3% in 2008), 20% ROR (16.3% in 2008) excluding investment gains, and a 3.9% total investment return. This represents a very strong level of performance in a challenging operating environment in absolute terms and relative to peers, but two factors should not be overlooked. Catastrophe losses during 2009 were one-fifth of the average level incurred since 2001 (10 percentage points of the combined ratio), and reserve releases from prior accident years contributed 40% of total reported underwriting profits in 2009. We consider neither of these factors to be sustainable.

Analysis of Lloyd's underwriting performance reveals that property reinsurance accounted for £825 million or 60% of the 2009 accident-year result because of a benign year for catastrophes. Casualty insurance produced a small accident-year profit in 2009 following two years of losses, and continued to experience strong positive gains on prior years, accounting for 31% of total reserve releases in 2009.

Reserve releases, which lowered the overall combined ratio by 5.6 percentage points in 2009, came from all major segments except motor in 2009, which generated losses in each of the last four accident years. Energy business has produced a net £60 million underwriting loss in total since 2005.

The accident-year combined ratio (excluding large losses), which gives a reasonable indication of attritional claims for Lloyd's, has remained flat over the period 2007-2009, at just above 90% (see table 3 below), which is encouraging. Normalizing the combined ratio for an average catastrophe year, and excluding any profit emergence from prior underwriting years and foreign-exchange effects, however, produces a combined ratio of 101% in 2009. Implicit within our analysis is an expectation that the impact of prior-year reserve releases on the Market's overall performance will diminish. Although we expected the impact of prior-year releases on the Market's overall performance to diminish, this does not seem to be the case, looking at the 2010 interim results for the listed Lloyd's vehicles.

Table 3

<i>Lloyd's/Breakdown Of Combined Ratio</i>		
<i>(%)</i>	<i>2008</i>	<i>2009</i>
Accident year combined ratio	90.5	87.3
+ Impact of non-monetary items	(2.7)	2.3
+ Impact of major losses	12.7	2.1
- Prior year movements	9.2	5.6
= Reported calendar year combined ratio	91.3	86.1

Negative reinsurance pricing trends have accelerated during 2010. Coupled with low forecast investment returns, this will suppress the Market's earnings. Lloyd's total investment return of £1.8 billion in 2009 recovered strongly in line with credit spreads, but persistently low interest rates meant that the net investment yield weakened to 2.8% (3.7% in 2008). The efficacy of Lloyd's cycle management is expected to be an increasingly key driver of its earnings in the longer term. Our improved view of management control within the Market underpins a belief that performance will not be allowed to return to the levels recorded before 2002. Nevertheless, earnings volatility will remain a feature given the nature of the specialty business lines that continue to represent Lloyd's core business.

Lloyd's is expected to bear a large share of the Chilean earthquake losses, and has released a Market loss estimate of \$1.4 billion. This figure is higher and was released later than some peers, so we think it is less likely to develop negatively.

Lloyd's has also estimated its exposure to the Deepwater Horizon explosion and oil spill in the Gulf of Mexico at between \$300 million and \$600 million. Taken together, these events are expected to add around 7% to Lloyd's 2010 combined ratio. This suggests to us a full-year combined ratio of 95% is achievable, assuming some limited additional catastrophe activity and that reserve releases continue at the same pace as in 2009.

Chart 1

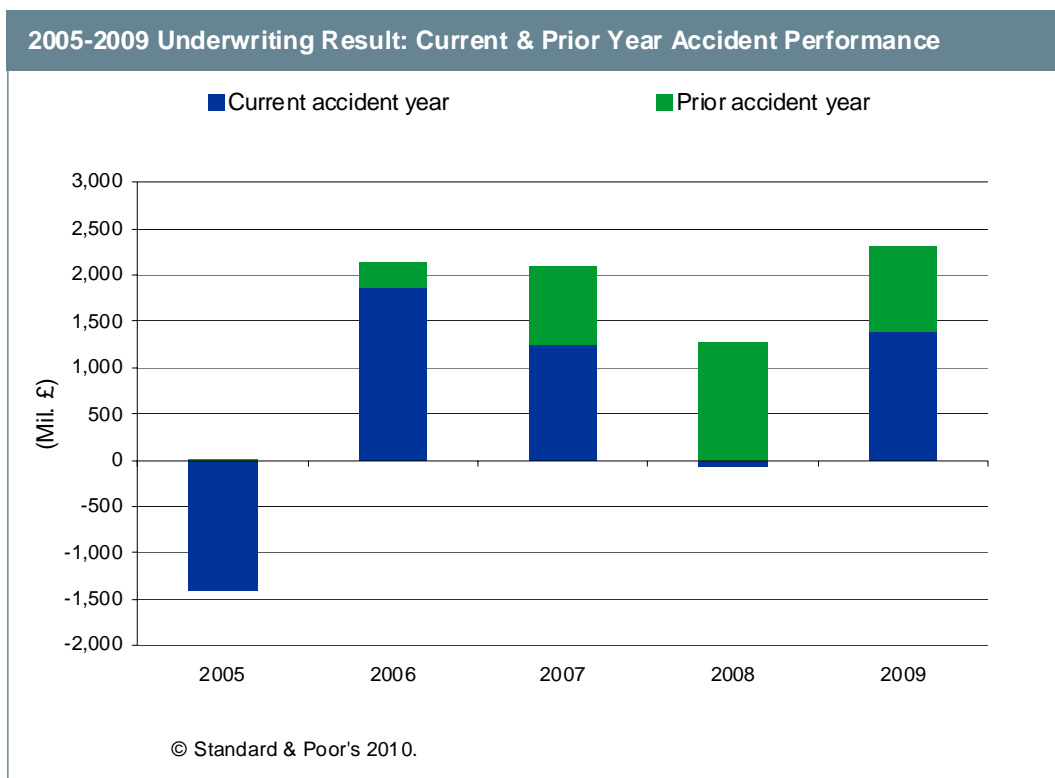


Chart 2

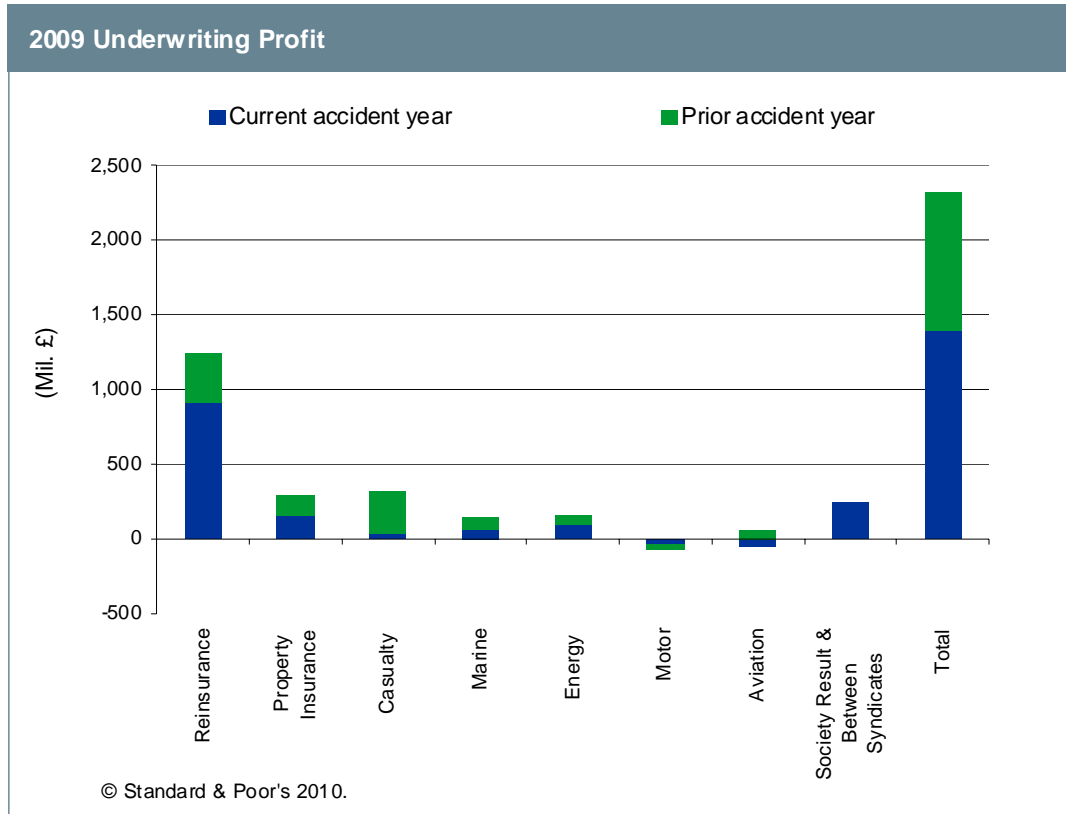


Chart 3

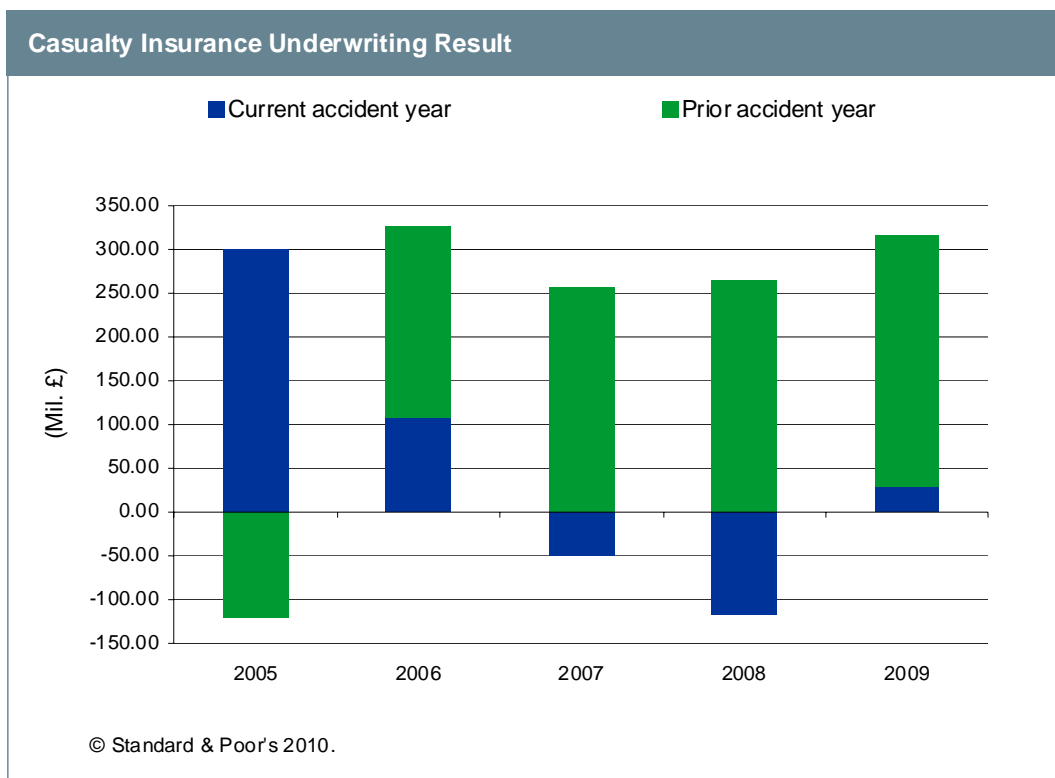
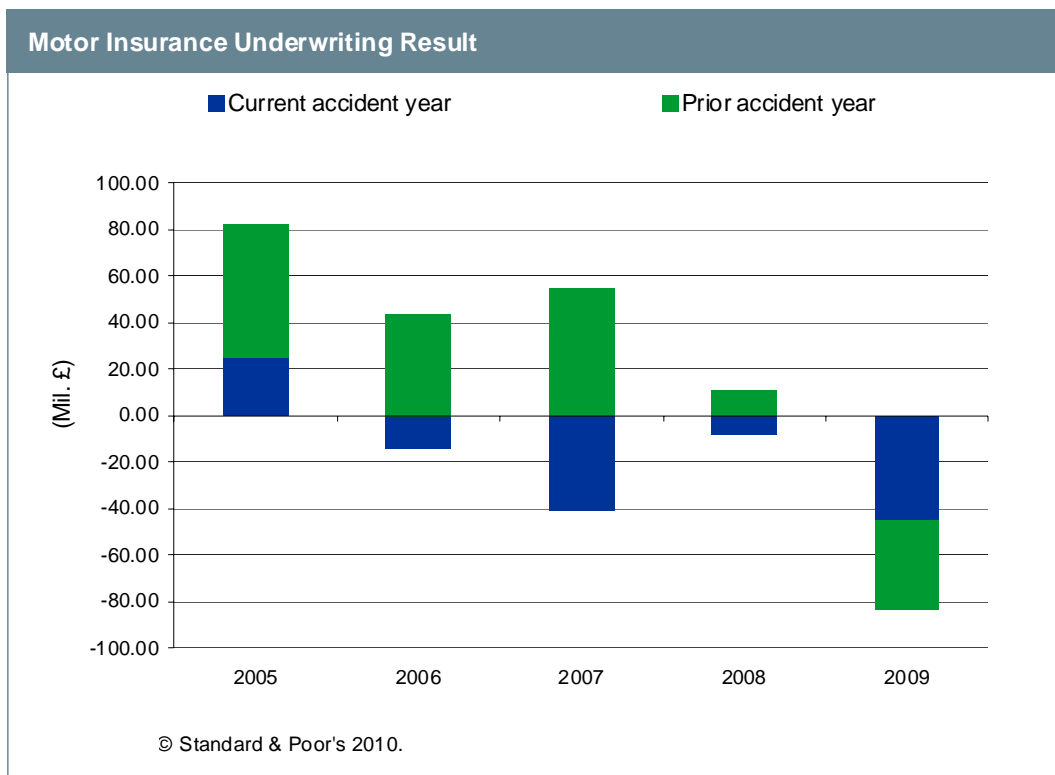


Chart 4



Investments: Conservative Investment Stance Pays Off

Table 4

Lloyd's/Investment Split								
(%)	2009	2008	2007	2006	2005	2004*	2003	2002
Bonds and other fixed-interest securities†]	58	57	56	55	58	54	78	78
Equities and other variable-interest securities	11	10	12	11	8	10	7	5
Cash and bank deposits	20	21	20	23	23	30	12	12
Loans and private placements	11	12	12	12	11	6	3	3
Other investments	0	0	0	0	0	0	0	1
Total investments	100	100	100	100	100	100	100	100

*Restated. †]Pre-2004 includes members' funds at Lloyd's.

Lloyd's investments are very strong. The Market has historically pursued a conservative investment strategy, and this has partially insulated it from the extreme volatility seen in global financial markets. Invested assets can be separated into three groupings; those backing the members fund's at Lloyd's (FAL), premium trust funds (PTF), and central assets (including the Central Fund).

PTFs account for £31 billion of the total £46 billion of investments, and are invested primarily in high-quality bonds and cash. Including LOCs, one-third of syndicate investments were invested in government and related securities. This includes only limited exposure to European government debt because only 9% of syndicate investments are euro-denominated. Bond credit quality weakened during 2009 as the Market looked to maintain yields, but the average portfolio rating was still 'AA', with £1.1 billion of securities rated 'BBB' or below. The portfolio duration is about two years, shorter than the three-year liability profile. Only 3% of assets are held in hedge funds or equities.

The Central Fund's investment policy has always been somewhat more aggressive. Given the intended long-term nature of the Central Fund, this approach is understandable. On Dec. 31, 2009, 14% of investments were held in equities and hedge funds. The remainder was held in high-quality bonds and cash. Almost half of the bond portfolio consisted of sovereign or government-guaranteed debt, with half of this amount held in gilts or debt guaranteed by the U.K. government. Lloyd's currency matches its subordinated debt securities, hence the higher proportion of British pound sterling and euro assets than those held by the syndicates.

Liquidity: Strong, Supported By Highly Liquid Invested Assets

Lloyd's liquidity is strong, supported by a substantial £13 billion cash position, high-quality bond portfolio, and substantial credit facilities in place to support capital and short-term liquidity requirements. Operating cash flow was negative £698 million in 2009 (positive £3.3 billion in 2008), partly as claims related to the 2008 hurricanes were paid out, and as new funds were invested. We expect positive operating cash flow to resume in 2010. Liquidity needs are significantly influenced by U.S. situs trust fund requirements, including Lloyd's 100% collateral requirements as an accredited reinsurer in the U.S.

Capitalization: Strong Adequacy And Quality

Lloyd's capitalization is strong, supported by what we consider to be very strong capital adequacy, strong quality of capital, Lloyd's much diminished exposure to legacy issues, and the efficacy of the capital-setting processes. Strong profits continue to emerge on prior-year loss reserves in aggregate,

however, we expect this trend to progressively diminish. The syndicates' high reliance on LOCs to support their FAL and collateral requirements, and on reinsurance capacity to support their underwriting is a detraction.

Capital adequacy

Capital adequacy is considered to be very strong. Analysis of our capital model indicates extremely strong capital adequacy at year-end 2009, although certain structural aspects of the Market are not easily captured. Lloyd's central assets for solvency purposes—£2.8 billion at year-end 2009—have doubled since 2005. Part of this reflects the issuance of subordinated debt in 2007, of which £958 million was outstanding at year-end 2009.

Lloyd's is required to hold central assets in excess of any solvency deficits at individual syndicates. This shortfall amounted to just £59 million in 2009, down from £482 million in 2005. Lloyd's minimum surplus target is £1.7 billion. In spite of the current excess, both in relation to Lloyd's solvency test and relative to The Society of Lloyd's 2010 ICA, we do not expect Lloyd's to reduce the amount of the Central Fund or contributions to it in the short term. Nor do we expect Lloyd's to adjust the 35% uplift that is applied to each member's ICA. Lloyd's has submitted a preapplication for internal model approval, however, this is not assured and the Solvency II standard formula would significantly raise capital requirements for the Market. We therefore believe that Lloyd's will adopt a conservative stance in the interim. Lloyd's also has the option to redeem one of its hybrids in 2014. Fixed charge coverage at The Society of Lloyd's of 2.1x in 2009 (1.7x in 2008) was marginal relative to the assigned debt ratings.

Quality of capital

Quality of capital is strong. Our analysis is based on the consolidation of the syndicates' annual accounts, the members' FAL and the Society of Lloyd's. There is therefore no consideration of intangible assets or leverage that may reside at the capital providers', where capital quality may be weaker.

Member's FAL is provided for either by depositing assets with Lloyd's, or through the provision of LOCs. According to the technical specifications for QIS5, at least 50% of the regulatory capital requirement under Solvency II should be met by Tier 1 capital. LOCs are only eligible as Tier 2 capital, and represented £7.3 billion, or 55% of Members' FAL in 2009. We do not believe that Lloyd's or its members will want to risk operating at the margin of this requirement, however it should be noted that FAL are set by Lloyd's at a level that are 35% higher than the current regulatory capital requirements. Nearly 90% of these LOC facilities are provided by 10 banks, so the Market is incurring some concentration risk.

Loss reserves

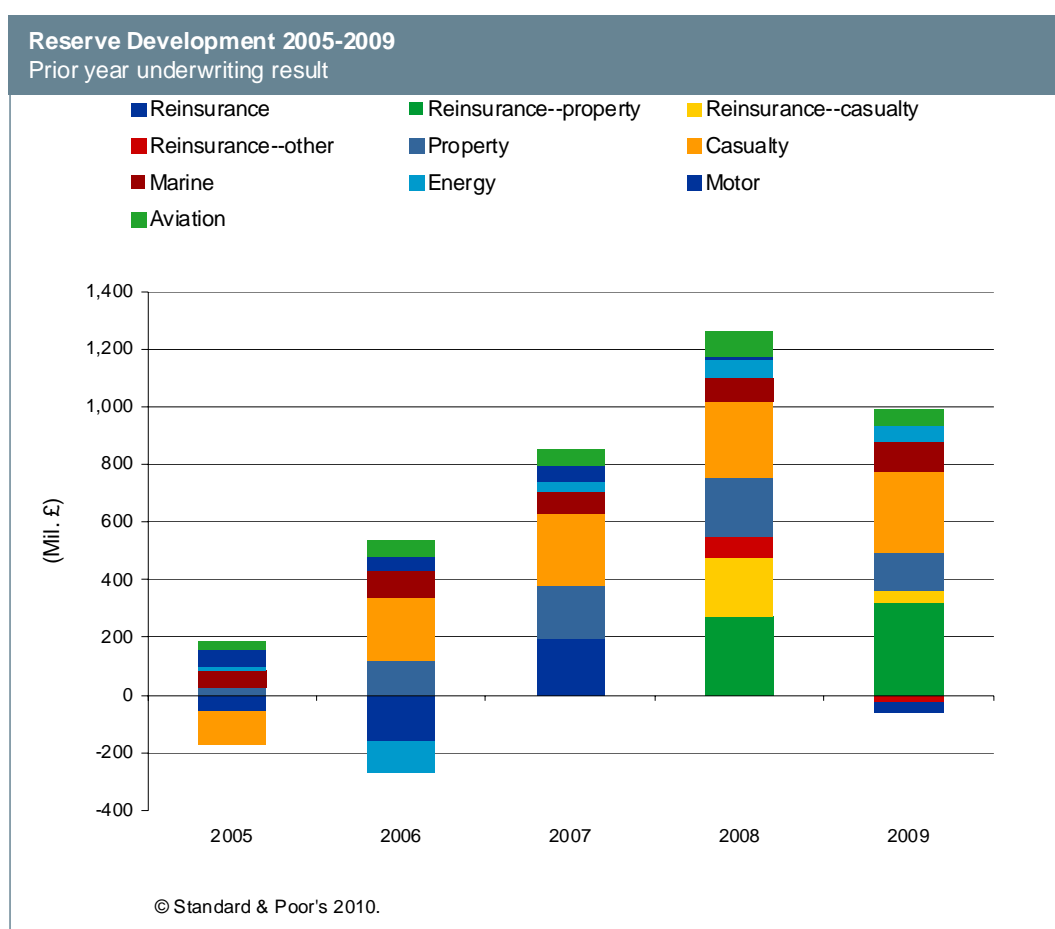
Table 5

Lloyd's/Reserving Track Record*

(%)	2009	2008	2007	2006	2005	2004†	2003	2002
Calendar-year net combined ratio	86.1	91.3	84.0	83.1	111.8	96.0	90.4	94.9
Accident-year combined ratio	80.6	100.5	90.5	85.2	111.9	93.5	85.7	89.0
Prior-year reserve movement combined ratio points	(5.6)	(9.2)	(6.5)	(2.1)	(0.1)	2.5	4.7	5.9
Run-off years' reserve movements (mil. £)	97	39	(48)	(3)	(325)	(350)	(329)	N.A.
Continuing Market reserve movements (mil. £)	837	1,226	904	273	339	48	(343)	N.A.

*Data on pro forma annual accounting basis. †Restated. N.A.—Not available.

Chart 5



Strong profits continued to emerge on most prior underwriting years and classes of business during 2009. The total amount released was £934 million, down from £1.3 billion in 2008. In aggregate, Lloyd's has released £3.3 billion since 2005, and equivalent to 3%-4% of opening loss provisions in the last three years. Despite this, IBNR levels have been maintained at 40%-45% of total loss reserves. Standard & Poor's expects these releases to diminish but to persist for the continuing Market in 2010, particularly in respect of the 2002-2006 years of account. There were some areas of deterioration, such

as U.K. motor and nontrade credit insurance, which performed poorly during the financial crisis, but Lloyd's main classes continued to see positive run-off. This included casualty insurance and casualty reinsurance, which have developed positively in the last two years. Motor only accounts for about 5% of total reserves.

The reported position of run-off years of account continues to improve. At financial year-end 2009, there were 13 syndicates with 22 open underwriting years (i.e., not closed after three years, as is normal), amounting to gross reserves of £1.8 billion. This compares to equivalent figures of 48 syndicates, 102 open underwriting years, and £7.0 billion in gross reserves in 2005. 2009 also saw a further net release of reserves held in respect of run-off liabilities of £97 million (£39 million in 2008).

Reinsurance

Table 6

Lloyd's/Reinsurance Usage									
<i>(Mil. £)</i>	2009	2008	2007	2006	2005	2004*	2003	2002	
Total gross premiums written	21,973	17,985	16,366	16,414	14,982	14,614	16,422	16,203	
Total reinsurance ceded	4,755	3,768	3,110	3,213	3,212	2,880	4,172	5,043	
Total net premiums written	17,218	14,217	13,256	13,201	11,770	11,734	12,250	11,160	
Reinsurance ceded (as % of gross premiums written)	21.6	21.0	19.0	19.6	21.4	19.7	25.4	31.1	
Reinsurers' share of claims outstanding¶]	8,484	10,504	7,449	9,259	14,450	9,678	9,959	12,108	
Capital and reserves	18,163	14,182	13,449	12,836	10,491	11,663	10,145	7,509	
Reinsurers' share of claims outstanding (as % of capital and reserves)¶]	46.7	74.1	55.4	72.1	137.7	83.0	98.2	161.2	

*Restated. ¶]Excludes intersyndicate reinsurance.

The proportion of reinsurance Lloyd's cedes as a percentage of gross premiums written now appears to have stabilized at around 20%, but remains high relative to that of peers. As a result, the Market's competitive position and future earnings remain relatively dependent on the continuing supply of adequate reinsurance capacity. Despite this, we believe the Corporation and managing agents' activity has ensured that the Market's reinsurance protection is broadly adequate and closely monitored.

Following 2008's catastrophe losses, Lloyd's saw a 38% increase to its reinsurance asset on Dec. 31, 2008. This fell back to £13.5 billion, or 71% of reported capital (including hybrids) in 2009. Although in our opinion the overall quality of the reinsurance asset was and remains strong, the potentially sharp increase in recoverables leaves the Market exposed to reinsurer dispute and default following major loss events in the future.

Financial Flexibility: Diversity Of Capital Providers Positively Differentiates

Table 7

Lloyd's/Capital Requirements And Sources	
<i>Capital requirements</i>	<i>Capital sources</i>
Member/syndicate level	
Underwriting losses	Premium trust funds
Increases in capacity	Members' funds
Changes to ICA/ECA requirements	Cash calls
Liquidity requirements	Outward reinsurance

Table 7

Lloyd's/Capital Requirements And Sources (cont. 'd)

<i>Capital requirements</i>	<i>Capital sources</i>
	Short-term bank facilities
	Parental guarantees
<i>Market level</i>	
Member solvency shortfalls	Central Fund and Corporation assets
Corporation liabilities	Central Fund subordinated loans
	Callable layer
	Centrally raised hybrid equity
	Membership levies

ICA—Individual capital assessment. ECA—Economic capital assessment.

Lloyd's financial flexibility is strong, being principally derived from capital providers' continued support. The diversity of Lloyd's capital providers represents a unique strength for the Market. Our view of Lloyd's financial flexibility is also reinforced by the completion of Phase II of Equitas' \$7 billion reinsurance deal with NICO, the declining trend of annual undertakings given to insolvent Names, and the positive momentum that continues to surround the Market, which makes Lloyd's an attractive platform for an increasingly diverse range of capital providers.

Sources

Capital is supplied on the basis of an annual venture, with continuing support from providers needing affirmation each year. As a result, capital providers' continued support, in terms of both willingness and ability, directly or indirectly underpins most of Lloyd's capital sources. The longevity of any Lloyd's investment will ultimately depend on factors such as: the attractiveness of underwriting conditions; the Lloyd's platform enabling operations to outperform those outside of the Market; the effectiveness of the Corporation in minimizing the cost of mutuality, particularly by reducing any strain on the Central Fund; and regulatory costs (in terms of compliance and the amount of capital held).

In part because some Lloyd's managing agents are not in a position to operate meaningfully outside the Market, but largely due to the competitive advantages conveyed by the market outlined earlier, we expect most current capital providers to remain committed to Lloyd's in the short-to-medium term. Nevertheless, there is a divergent trend between new entrants at Lloyd's, many of which are international groups that are seeking to extend the number of platforms they operate and exploit Lloyd's global licenses, and the large, more-established Lloyd's capital providers which are expanding in global (re)insurance markets independent of their Lloyd's operations.

Continued diversity within Lloyd's capital base will remain important. Standard & Poor's believes that mutualization would be weakened were underwriting capacity supplied by too few capital providers or if any one provider were to represent too great a proportion of the Market. Concentration of capacity among a few industry investors would mean less incentive to support the Market in the event of a call for extra funds because this could be construed as supporting a competitor.

Needs

Capital needs declined following Equitas' conclusion of its reinsurance transaction with NICO. Previously, Standard & Poor's had felt that capital providers could be required to support a shortfall scenario at Equitas. In addition, reflecting reducing negative reserve movements in aggregate, annual undertakings given to insolvent members continue to fall. Capital requirements under Solvency II represent an area of uncertainty, however.

Ratings Detail (As Of 09-Sep-2010)***Operating Company Covered By This Report**

Lloyd's

Financial Strength Rating

Local Currency

A+/Stable/—

Domicile

United Kingdom

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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