

Reinsurers
United Kingdom
Full Rating Report

Lloyd's of London

Ratings

Lloyd's of London Insurer Financial Strength Rating	A+
The Society of Lloyd's Long-Term IDR	A
Lloyd's Insurance Company (China) Ltd Insurer Financial Strength Rating	A+
Sovereign Risk	
Foreign-Currency Long-Term IDR	AAA
Local-Currency Long-Term IDR	AAA

Outlooks

Lloyd's of London Insurer Financial Strength Rating	Stable
The Society of Lloyd's Long-Term IDR	Stable
Lloyd's Insurance Company (China) Ltd Insurer Financial Strength Rating	Stable
Sovereign Foreign-Currency Long-Term IDR	Stable
Sovereign Local-Currency Long-Term IDR	Stable

Financial Data

Lloyd's of London	31 Dec 09	31 Dec 08
Total assets (GBPm)	55,179	53,597
Total liabilities (GBPm)	37,016	39,415
Gross written premiums (GBPm)	21,973	17,985
Pre-tax income (GBPm)	3,868	1,899
Combined ratio (%)	86.1	91.3

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Related Research

Applicable Criteria

- [Insurance Rating Methodology \(August 2010\)](#)
- [Non-Life Insurance Rating Methodology \(March 2010\)](#)

Other Research

- [U.S. Property/Casualty Reinsurance Credit Trends \(October 2010\)](#)
- [UK Non-Life Insurance: Profitable Underwriting Remains Key to Strong Earnings \(October 2010\)](#)
- [2010-11 Global Reinsurance Review & Outlook \(September 2010\)](#)

Rating Rationale

- The rating of Lloyd's of London (Lloyd's) was affirmed on 20 July 2010, reflecting the strong operating performance it achieved during 2009, with reported results ahead of Fitch Ratings' expectations. The agency notes that the 2009 performance was aided by a series of beneficial factors that are unlikely to be repeated in 2010. These included a benign US windstorm season, recovery in investment results, favourable foreign exchange movements and improved pricing conditions. Fitch also believes that the results reflect the effect of market oversight by the renamed Performance Management Directorate (PMD), which reviews and controls syndicate performance through a number of measures and requirements.
- Market participants at Lloyd's collectively underwrote GBP22.0bn of gross written premiums (GWP) in 2009, a yoy increase of 22% (8% on a currency-adjusted basis), and reported profit before tax (PBT) of GBP3.9bn, a yoy increase of 103.7%. The improvement in the 2009 underwriting result was reflected in an accident-year combined ratio of 91.7% (2008: 100.5%), with major losses adding just 2.1% to the combined ratio (2008: 12.7%).
- The H110 results were reflective of a more challenging operating environment than that experienced in 2009, mainly due to an uptick in natural catastrophe losses and softer pricing conditions. GWP were largely unchanged at GBP13.5bn (+0.2% yoy), while PBT decreased to GBP628m (H109: GBP1.3bn). Major losses added 17.1% to the combined ratio (H109: +3.2%), which deteriorated to 98.7% (H109: 91.6%). Fitch remains confident that Lloyd's will remain profitable in 2010.

Key Rating Drivers

- The Stable Outlook reflects Fitch's expectation that Lloyd's will report good, albeit weaker, profits for 2010 and continue to strengthen its financial profile, despite the agency's expectation of more challenging underwriting and investment conditions.
- A marked decline in the level of reported profitability, erosion of capital, including Central Fund assets, and poor performance relative to peers would likely lead to downward rating pressure.
- Positive rating pressure would come from 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 soft pricing conditions.

Key Rating Issues

Resilience of Earnings to a Series of Large Loss Events and/or the Underwriting Cycle

Fitch considers the resilience of earnings through currently challenging market conditions, characterised by an uptick in large losses and a raised level of attritional claims, to be the primary rating driver at Lloyd's. Its substantial exposure to catastrophe risk is demonstrated by its higher-than-industry-average losses in years of high catastrophe activity. The agency will continue to assess the volatility of earnings at Lloyd's in relation to a range of European and Bermudian reinsurers considered by the agency to represent the closest peer group.

PMD's Work on Cycle Management Yet to be Fully Tested

Fitch views the PMD's oversight of market participants, under the leadership of Tom Bolt, as being a key mechanism in improving the stability of earnings at Lloyd's in the medium term. The agency will continue to monitor the influence of the PMD's efforts, paying particular attention to cycle management as well as improved long-term profitability and performance of the market, which represent the stated emphasis of the PMD. Fitch views positively the initiatives that the PMD has introduced aimed at improving the ability of Lloyd's to assess a number of quantitative factors against agreed business plans, as well as the benchmarking tools that Lloyd's shares with managing agents to help them assess their performance against their individual syndicate business plans.

Good Financial Flexibility of the Central Fund and of Individual Market Participants

The variety of sources of funding for the Central Fund provides The Society of Lloyd's (the Society) with significant financial flexibility. The Society has powers to raise funds both internally through the use of contributions, levies and syndicate loans and externally through the capital markets. This flexibility has been illustrated in the past by the market's agreement to an increase in the Central Fund contributions from 0.5% of GWP to 1% for 2006, followed by a reduction to 0.5% in 2008. The GBP500m of hybrid debt raised through the capital markets in 2007 also illustrates this flexibility. At member level, a degree of financial flexibility has been demonstrated by the ability of a number of players to raise additional capital since the start of 2009 via rights issues or letters of credit (LOCs), albeit at prices reflective of difficult market conditions at that time.

Strong Capitalisation, Benefiting From Mutuality at the Central Fund Level

Fitch considers capitalisation to be supportive of the current rating and expects it to remain so over the near term. 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 2009 and, despite an uptick in large loss activity during H110, is expected to exhibit a degree of stability as it has done during other recent periods of turbulence.

Peer Analysis

Due to its unique structure and mix of business underwritten, Lloyd's has no directly comparable peers. However, some meaningful comparison can be made with the large global reinsurance players, as Table 1 shows. Among these companies, Lloyd's ranked first by non-life reinsurance premium income in 2009, and performed well against its peers on underwriting profitability, achieving the lowest combined ratio in both 2009 and 2008 at 86.1% and 91.3% respectively.

Table 1: Selected Non-Life Reinsurance Peers

(USDm)	Net premiums written		Combined ratio (%)		Shareholders' equity	
	2009	2008	2009	2008	2009	2008
Lloyd's	27,008	26,201	86.1	91.3	28,930	20,747
Munich Re	20,577	21,200	95.7	99.7	31,931	29,493
Swiss Re	12,069	13,594	90.6	98.4	25,344	19,046
Berkshire Hathaway	9,321	7,960	93.5	92.5	131,102	109,267
Hannover Re	7,418	6,554	97.3	95.7	5,320	3,954

Note: Currency translations have been made using the YE exchange rate for shareholders' equity and an average exchange rate for net premiums written. Combined ratio - Net losses and loss adjustment expenses divided by net premium earned plus underwriting expenses divided by net premiums earned.

Shareholders' equity is organization-wide. Depending on the company's reporting practice, may include equity that supports operations other than the property/casualty reinsurance operations.

Source: Company annual reports, financial supplements and SEC filings.

Market Profile

Lloyd's is a global insurance market comprising 85 syndicates (excluding reinsurance to close (RITC) syndicates as at November 2010). It writes business from over 200 countries and territories and in 2009 reported GWP of GBP21,973m (2008: GBP17,985m).

Most policyholders access the market through Lloyd's brokers. The market is overseen by the Council of Lloyd's and the Franchise Board, while the corporation, managing agents and members' agents are regulated by the Financial Services Authority (FSA).

Capital is provided to the market by members. They can be either private individuals (so-called "Names") or corporate capital providers. At end-2009, 40% of capital came from UK corporate sources, with 46% coming from worldwide corporate sources (including the US and Bermuda), and the remainder provided by around 2,000 individual members (either with unlimited liability or conversion capital). The proportion of corporate capital grew steadily from the 1990s onwards, but has remained relatively flat since 2005.

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 numerous members, or, as is becoming more common, just one corporate member.

Syndicates are managed by managing agents. These 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. The managing agents are required to report financial results for the syndicates they manage to Lloyd's on a quarterly basis as well as to submit business plans on an annual basis. From 2005, managing agents have also been required to calculate the capital needed by the syndicate to fulfil its business plan and report this to Lloyd's.

Ownership Structure

Lloyd's is a marketplace rather than a corporation or company, and thus does not have owners or shareholders like traditional insurance companies. Capital is provided to Lloyd's by corporate and individual members, as described in the section above.

Performance Management Directorate (PMD)

Lloyd's has significantly improved the market's risk controls following the establishment of the PMD (previously known as the Franchise Performance Directorate) in January 2003. The aim of the PMD is to improve the market's long-term profitability and performance, with stated emphasis on cycle management in the context of the Three-Year Strategic Plan.

PMD has brought in initiatives aimed at improving business information tools, to enable better-quality data for Lloyd's to assess pricing and rate monitoring processes, reserving and underwriting performance against agreed business plans. In addition, it has a number of benchmarking tools that are shared with the managing agents, to help them assess their performance against their individual syndicate business plans. During 2009, the Performance Management Data Return was launched, which is expected to improve the level and quality of individual risk data collected from managing agents so that Lloyd's can better monitor the performance of syndicates.

The new entrants' process is managed by the Relationship Management team at Lloyd's, in conjunction with a multidisciplinary team including senior management from the PMD. All new entrant applications must be approved by the Franchise Board. Since the beginning of 2009, 14 new syndicates and three new managing agents have been admitted by Lloyd's to commence operations in the market. Of the 14 new syndicates, eight were launched by well-established managing agents, three established by "turnkey" managing agents and three integrated Lloyd's Vehicles (new managing agent and syndicate). Of the 14, two were life syndicates and one was a special-purpose syndicate (SPS). All of these syndicates were established by existing managing agents.

The uptick in new entrants partly reflects the continuing attractiveness of the business opportunities available through the Lloyd's Market, as well as a desire for diversification by non-insurance capital providers. Fitch views positively the additional oversight over new members provided by Lloyd's, which exists for 12-24 months, with frequent reviews, visits and analysis. Additional uplift to capital held, on top of the 35% loading applied to all syndicates' internal capital assessment (ICA) results, is required for three years for all new entrants.

Chain of Security at Lloyd's

Insurance policies issued by Lloyd's are backed by what is often referred to as its "Chain of Security", which has three main "links": syndicate-level assets; members' funds at Lloyd's; and the central assets held as part of the Central Fund at Lloyd's.

Table 2: Claims-Paying Resources at Lloyd's, 31 December 2009

	(GBPm)	Level at which funds are held	Liability
Premium Trust Funds	37,400	Syndicate	Several
Funds at Lloyd's	13,159	Member	Several
Central Fund	983	Society	Joint
Corporation assets	143	Society	Joint
Subordinated debt/securities	958	Society	Joint

Source: Lloyd's

The Lloyd's market is characterised by partial mutuality. The mutuality only exists at the central assets level. Prior to this link, members' liabilities are several, including within an individual syndicate. Table 2 illustrates the claims-paying resources present in the Lloyd's market at end-December 2009.

Key Events

In May 2010, Lloyd's China was granted a licence by the China Insurance Regulatory Commission (CIRC) to write direct insurance in addition to the existing reinsurance licence. This has involved converting Lloyd's Reinsurance Company (China) Ltd into a direct insurance company, Lloyd's Insurance Company (China) Ltd, with the development of associated required infrastructure. Lloyd's has started on making its new direct licence operational, a process that should be completed during 2011.

In February 2010, Lloyd's published its Strategic Plan 2010-2012 which summarises the major activities to deliver Lloyd's strategic vision and the key priorities for the market and the Corporation for the next three years. Lloyd's strategy 2010-2012 is

not a major change in direction, focusing on the major challenges that Lloyd's faces and considering what these mean for the market and the Corporation.

Lloyd's continues to make progress towards its implementation of Solvency II. Lloyd's is committing significant resource to ensure that all syndicates will be Solvency II compliant for 2013. The approval of the LIM (Lloyd's Internal Model) remains key for Lloyd's with its building phase having started early in 2010.

In June 2009, the English High Court gave the necessary approval for Phase 2 of the Equitas deal to go ahead. Under Phase 2 of the deal, Equitas has purchased a further USD1.3bn of reinsurance cover from Berkshire Hathaway for a premium of GBP40m, with Lloyd's paying a further GBP18m. Phase 2 also involved an insurance business transfer of all of the Names' liabilities in respect of 1992 and prior non-life business written at Lloyd's which had been reinsured by Equitas. These liabilities were transferred from Names to an authorised insurance company, Equitas Insurance Limited, under a Part VII transfer and this relieved the members and former members concerned of the transferred liabilities under English law and the law of every other state within the EEA.

In April 2009, Lloyd's repurchased the local-currency equivalent of GBP102m of its outstanding subordinated debt, taking advantage of the favourable pricing conditions in the market and its strong capital position. This transaction, while marginally positive in Fitch's opinion for the quality of capital at Lloyd's, had no material impact on the Insurer Financial Strength rating.

Lloyd's gained its approval as the first admitted reinsurer in Brazil in 2008. A Lloyd's representative office in Rio de Janeiro was opened in 2009. In 2008 new representative offices were opened in Ireland and in Poland (to support a new establishment licence). Additionally, Lloyd's obtained new establishment licences in Austria (2008) and Portugal (2009).

In April 2007, Lloyd's established a subsidiary in Shanghai, China (Lloyd's Insurance Company (China) Ltd) where six syndicates have underwriting divisions and a further 11 syndicates participate from London. Lloyd's has seen significant growth in its Asia platform based in Singapore, which had expanded to 17 syndicates by end-2010. Additionally, in Japan, Lloyd's is able to access direct business through a Corporation-owned coverholder called Lloyd's Japan Inc. (LJI) which by 2010 was supported by 14 syndicates and moved to new offices in Tokyo.

Products

The portfolios of syndicates at Lloyd's benefit from significant diversification across both products and geographies. The strong premium growth achieved in 2009 was due to a combination of currency fluctuations and improved pricing (see Table 3).

Table 3: Lloyd's Split of GWP By Non-Life Line of Business

	2009	%ch. yoy	2008	%ch. yoy
Reinsurance	7,989	26.8	6,298	15.5
Property	4,954	24.8	3,971	4.3
Casualty	4,320	14.8	3,762	11.8
Marine	1,606	20.4	1,334	8.8
Energy	1,371	19.2	1,150	12.9
Motor	1,118	19.1	939	-4.5
Aviation	551	14.6	481	3.7
Total	21,909	22.2	17,935	9.9

Source: Lloyd's

The reinsurance sector covers both short and long tail, with a variety of placement types including facultative, proportional treaties and non-proportional treaties such as excess-of-loss placements. The largest classes of business within reinsurance are property facultative, catastrophe excess of loss, and property non-proportional risk excess. The sector also includes class-specific reinsurance such as energy and aviation.

The property sector covers both commercial and private property, with the US responsible for the largest geographical share of the segment.

The casualty sector covers professional indemnity, medical malpractice, accident and health, directors' and officers' liability, financial institutions, general liability and employers' liability. A large proportion of casualty business is within the US, UK and European markets.

The marine sector's most significant classes of business are hull, cargo, marine liability and specie. The International Group of P&I Clubs' programme constitutes a major part of the marine liability class of business.

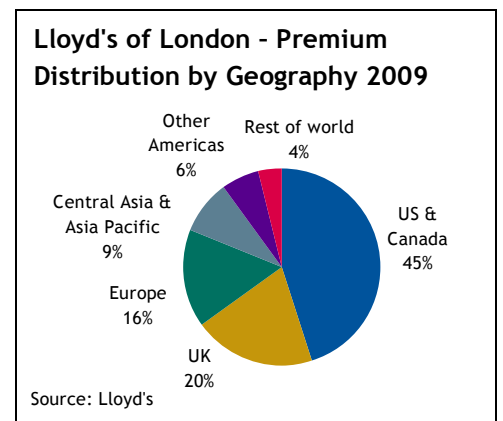
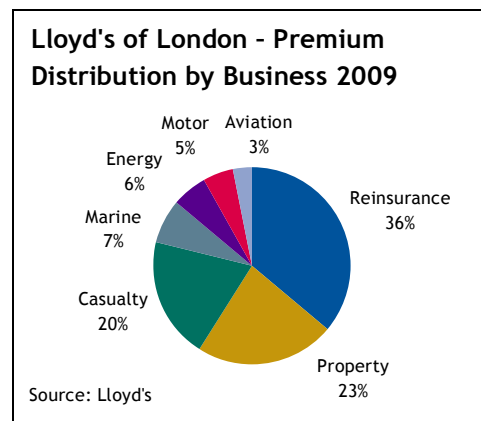
The mix of motor business written within Lloyd's has changed recently, moving away from private car insurance due to strong competitive pressure from the traditional insurance market and consumer-facing organisations such as supermarkets and aggregator websites. Less than half the current motor premium income at Lloyd's comes from private car insurance, and the shift has been towards company fleet business and non-standard risks such as high-value vehicles, vintage or collectors' vehicles, high-risk drivers and affinity groups.

The risks underwritten as part of the energy portfolio include 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 (GOM).

Lloyd's is an industry leader within the global aviation market and has a balanced portfolio across all sectors of this class, including airline, aerospace, general aviation and space business.

Target Markets

Lloyd's provides insurance and reinsurance cover to a wide variety of segments across the globe, and Fitch considers it a well-diversified provider. The geographical reach of Lloyd's has not changed materially since 2006 (see the *Lloyd's of London - Premium Distribution by Geography 2009* chart). Lloyd's is seeking to improve its market access in Europe, Asia and Latin America: recent initiatives include new full time country managers in Benelux, Ireland, the Nordic region, Poland, the UK and a new representative office in Russia in 2011; the opening of a Lloyd's reinsurance company in China and the acquisition of a direct licence for Lloyd's during 2010; obtaining a licence as an admitted reinsurer and opening a representative office in Brazil and undertaking a market development visit to Mexico in 2010.



Distribution Channels

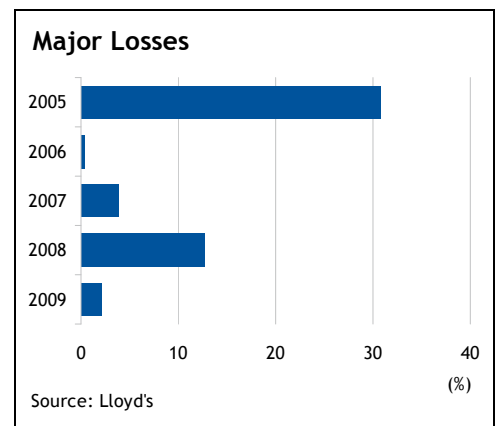
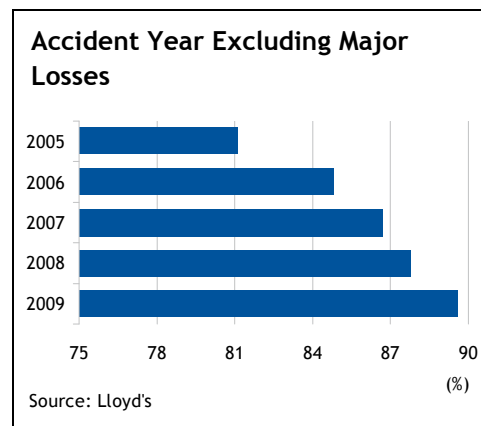
The distribution of products at Lloyd's is primarily carried out through brokers and coverholders, with some business placed directly with service companies owned by

managing agents. A large proportion of the business is conducted in the underwriting room at Lloyd's, where face-to-face negotiations between brokers and underwriters take place. Most business continues to be placed into the market by the 181 Registered Brokers¹².

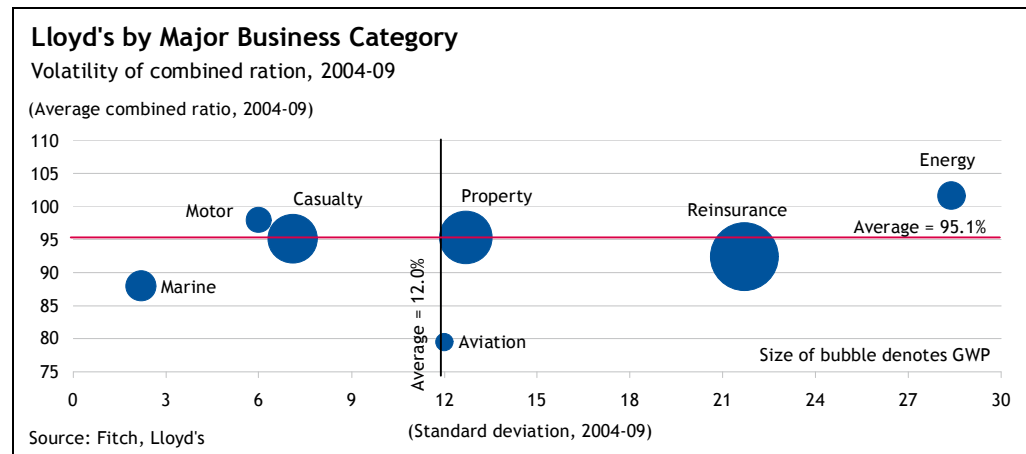
Financial Analysis

Profitability

The resilience of earnings through currently challenging market conditions, characterised by an uptick in large losses in H110 and a raised level of attritional claims, is considered by Fitch to be a key rating driver. Fitch expects Lloyd's to remain profitable and to continue to strengthen its financial profile in 2010, despite the marked rise in large loss events seen in H110, the uncertain level of investment returns and generally weaker pricing conditions than those experienced in 2009.



Fitch will continue to assess the volatility of Lloyds' 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 Lloyds' results and will continue to monitor the influence of its efforts on earnings. The inherent volatility present within Lloyd's business is illustrated in the chart below, which indicates that the largest class, reinsurance, has proved to be the second most volatile category over the last five-year period. Investment returns have exhibited a greater degree of stability, helped by conservative asset allocation.



The agency believes that the strong results reported by Lloyd's at end-2009, where many performance metrics exceeded Fitch's expectations, represent a high-water

¹ As at 01 January 2010

mark, at least in the near term. Growth of 22% in GWP (+8% at a constant rate of exchange) to GBP22.0bn was helped by rate hardening on catastrophe-exposed business. A benign US Atlantic hurricane season and an improved investment result led to a sharp rise in PBT to GBP3.9bn (+103.7%), with the former being reflected in an improved underwriting result of GBP2.3bn (2008: GBP1.2bn). Investment income totalled GBP1.8bn (2008: GBP1.0bn). The favourable underwriting conditions improved the accident-year combined ratio to 91.7% (2008: 100.5%), with a continued prior-year reserve surplus resulting in a calendar-year ratio of 86.1% (2008: 91.3%). Major losses added just 2.1% to the combined ratio (2008: +12.7%).

Table 64: Lloyd's Combined Ratio (%)^a: By Line of Business

Calendar year	2009	2008	2007	2006	2005
Reinsurance	78.4	83.8	81.7	80.8	135.1
Casualty	90.8	95.1	92.7	89.0	93.9
Property	92.4	96.7	86.3	81.9	118.5
Marine	88.7	84.6	87.4	88.6	91.4
Motor	108.4	99.6	98.4	96.4	91.2
Energy	84.1	123.8	73.4	98.8	146.9
Aviation	97.1	86.8	84.5	65.1	70.6

^a Includes impact of movement in prior-year reserves
Source: Lloyd's

Reinsurance

Amongst the main insurance classes at Lloyd's, representing 36% of its 2009 GWP, Fitch believes that the performance of the reinsurance class will have the greatest influence on near-term results. In addition to reinsurance representing the largest insurance class at Lloyd's, the agency expects the 2010 results for the dominant property treaty sub-class to be significantly weaker than those achieved in 2009, reflecting the rise in major loss events. Fitch also anticipates profitability for other sub-classes, including casualty, to remain under pressure through a combination of soft pricing and an increased frequency of attritional claims.

GWP increased by 27% (12% at a constant rate of exchange) to GBP8.0bn at end-2009. A strong calendar-year underwriting result of GBP1.2bn (2008: GBP734m) was driven by the main property treaty sub-class, which benefited from the benign US Atlantic hurricane season. Reduced claims frequency through higher deductibles, absence of large risk losses and lower exposure to catastrophe events in Europe, Asia and Australia also aided performance. Prior-year reserve releases improved the combined ratio of 78.4% (2008: 83.8%) by 5.8% (2008: 12.1%).

Property

Fitch expects a combination of pricing pressure and a rise in loss activity to lead to a yoy deterioration in the 2010 underwriting result for the second-largest class at Lloyd's (23% of 2009 GWP). The agency notes that while there has been steady growth in GWP over the last five years, with 2009 seeing a marked increase by 25% to GBP5.0bn (+10% at a constant rate of exchange), market competition has maintained downward pressure on pricing. The uptick in large loss activity seen during H110 is also expected to affect lines written through this division.

Casualty

The remaining major class at Lloyd's (20% of 2009 GWP) has achieved positive underwriting results in recent years, helped by a consistent surplus being released from prior-year reserves. The outlook for the casualty class looks challenging, with the generally longer-tail lines potentially exposed to the effects of reduced investment returns and rising claims costs, should there be an uptick in claims arising from sub-classes exposed to the financial crisis, including directors' and officers' liability and professional indemnity. Positively, an improved underwriting result of GBP316m for 2009 (2008: GBP148m) was helped by neither attritional nor large losses materialising to the market's late 2008 forecast, whilst sub-prime and financial crisis claims remain significantly below the potential amounts envisaged.

Marine

Pricing conditions are expected to remain flat during 2010 as overcapacity persists in the wake of the global recession. Fitch expects underwriting results to remain at a similar level to those achieved in 2009, which saw a profit of GBP147m (2008: GBP160m).

Energy

Fitch expects a marginal deterioration in the 2010 underwriting result, reflecting an increased level of loss activity witnessed so far this year. The volatility of the energy class is partly reflective of the exposure of underlying risks to US windstorm in particular. The improvement in the 2009 underwriting result to GBP157m (2008: loss of GBP194m) was largely due to the absence of major GOM windstorm losses. Prior-year reserve releases improved the combined ratio of 84.1% (2008: 123.8%) by 6.2% (2008: 8.2%).

Motor

Fitch believes that the 2009 underwriting loss of GBP83m (2008: profit of GBP3m) and prior-year reserve deterioration, which added 3.9% (2008: 1.3% improvement) to the combined ratio of 108.4% (2008: 99.6%), were reflective of the challenging conditions currently facing most writers of this class. Underwriters have been affected by a combination of softening premium rates and rising claims costs in recent years. During 2010, Fitch has observed a marked increase in premium rates, and the agency expects improved pricing to begin to be reflected in results during 2011.

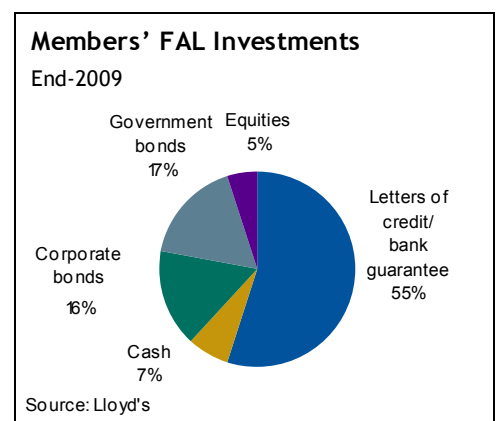
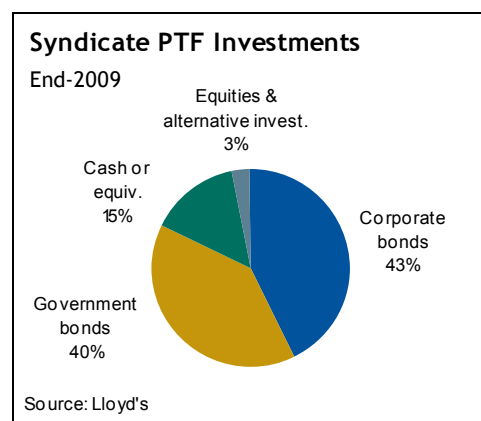
Aviation

The smallest class at Lloyd's experienced reduced underwriting profit of GBP10m in 2009 (2008: GBP48m) and a combined ratio of 97.1% (2008: 86.8%), with prior-year reserve releases improving this by 16.6% (2008: 23.7%). The underwriting result was affected by a high frequency of large airline losses, which continued with weak pricing. Pricing is expected to improve during 2010, although whether the increases will be sufficient to return the class to profitability remains unclear.

Investments and Liquidity

Lloyd's operates a conservative investment policy and has investment criteria for all of the links in the Chain of Security. Fitch considers the overall asset allocation for Lloyd's to be fairly conservative when looking at the aggregate of PTFs, FAL and the Central Fund, although the agency notes that substantial variation exists at the PTF and FAL levels for individual syndicates.

PTFs are the first resource for paying policyholder claims from a syndicate. Investments follow the guidelines set by the FSA and are generally invested in liquid, short-duration, high-quality assets. Around 83% of assets are invested in bonds. Of the 43% of investments held in corporate bonds, 92% are rated A or above.



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. LOCs continue to represent a significant proportion of assets within FAL - 55% at end-2009. Fitch notes that the largest providers of LOC facilities have remained constant through the credit crisis.

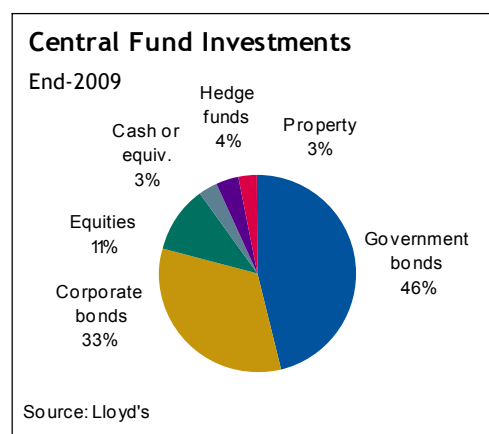
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Central Fund assets at Lloyd's are the third level of security and are available at the discretion of the Council of Lloyd's to meet any valid claim that cannot be met by the resources of any member. The Central Fund value at end-2009 was GBP2bn, with 80% of the portfolio invested in bonds.

Lloyd's maintains a strong liquidity position that is supported by a significant level of high-quality liquid assets held at both the FAL and Central Fund asset levels.

Fitch considers Lloyd's financial flexibility to be very good, with a variety of mechanisms being available to raise capital. These include member calls, Central Fund contributions, which are currently set at 0.5% of GWP but which can be raised if necessary, increased loading for required capital on top of the ICA, the charging of a premium levy (which was done following the 2001 WTC losses to boost Central Fund assets and the raising of subordinated debt in the capital markets (as done in 2004 and 2007).



Reinsurance Protection and Credit Quality

Each syndicate is required to make its own reinsurance arrangements. Across the market, the "external" reinsurance utilisation rate is around 22% (2008: 21%), down from a high of 25% in 2003. Reinsurance within the market between syndicates is excluded from this ratio.

Reinsurance Recoverables

Lloyd's has continued to proactively manage its reinsurance recoverables, which at end-2009 had decreased to GBP9.1bn (-13.3%), 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 96% of counterparties being rated 'A' or above.

Reserve Adequacy and Development

The reserving position of Lloyd's has improved significantly since both 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. 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.

In 2009 reserve releases were again reported across all major classes of business with the exception of the motor account, where the deterioration added 4% to the combined ratio. Just over 3% of the total starting reserve was released, which is slightly down on the 4% released in both 2007 and 2008. The incurred but not reported (IBNR) reserve as a percentage of the total claims reserve remained stable at around 45%, indicating robustness in the valuation of claims reserves.

The accident-year performance in 2009 highlights that pricing across some business lines (Casualty, Marine, Motor and Aviation) remains soft, with technical results close to or at loss-making levels, despite the relatively benign loss conditions experienced in 2009, in the property and reinsurance segments. Positively, claims estimates for the 2008 US hurricanes have been stable, and development on the longer-tail business written in the soft market conditions of 1997-2001 continues to be within expectations.

Capitalisation

Fitch considers Lloyd's to have a strong level of capitalisation, with strength being derived from assets held as part of member capital and central capital. Capital and reserves improved to GBP18.2bn at end-2009, and the agency expects a further modest strengthening at end-2010, despite a more challenging year.

Central resources increased to GBP2.8bn (including the callable layer) at end-2009 (+7.8%), with the main driver being a 15.4% increase in net Central Fund assets to GBP983m. A slight decrease in the subordinated debt tier was as a result of Lloyd's buying back GBP102m during 2009, taking advantage of favourable market conditions. Despite the current strength of the Central Fund, Lloyd's has no plans to suspend the 0.5% contribution from members.

Lloyd's follows a risk-based approach to setting the capital at member level and central capital. At member level, the capital is set at 135% (this percentage has not changed since 2006) of the syndicates' ICA result – 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 2010, Lloyd's has maintained its 35% uplift and continues to review its methodology to reflect changing market, macroeconomic and legislative conditions.

In addition, the ICA review process will in future use as a benchmark a stochastic approach for modelling of underwriting and reserving risks. The benchmark replaces the risk-based capital (RBC) system and will be compared with syndicates' own ICA models. Capital requirements are expected to continue to increase, due to softening market conditions and flattening yield curves. Fitch views the capital requirements imposed by Lloyd's on the market participants as appropriate for the current rating level, and will monitor any substantial changes in these requirements over time. Central capital is also modelled using a stochastic approach.

The FSA regularly reviews a sample of syndicates' ICAs in parallel with Lloyd's, and has in the past identified only a small number of cases where it would have applied a higher loading than that recommended by Lloyd's.

Financial Leverage and Balance Sheet Quality

Fitch believes that Lloyd's has a good quality of capital, with very low levels of intangible assets and deferred acquisition costs.

Both leverage and the total financing commitment (TFC) ratio remained at modest levels at end-2009. Financial leverage, as calculated by Fitch, decreased to 5%

(2008: 6%) following the repurchase of GBP102m of subordinated debt during the year. Fitch does not expect a material change in leverage in the near term. The TFC ratio stood at 18% at end-2009 (2008: 25%).

Debt-Servicing Capabilities

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 is the obligation of the Society. 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 the syndicate contributions, syndicate loans and investment income. Furthermore, 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.

Summary Rating Data

(GBPm)	2005	2006	2007	2008	2009
Key financials					
Total revenue	13,268	14,930	15,263	15,174	18,987
Operating result	110	3,871	4,106	2,155	4,089
Net income	-103	3,662	3,846	1,899	3,868
Combined ratio (%)	111.8	82.8	83.9	91.2	85.9
Return on revenue (%)	0.5	25.3	26.6	13.7	21.2
Total assets	43,404	42,503	44,007	53,597	55,179
Total adjusted equity	10,491	12,836	13,449	14,182	18,163
Coverage of the estimated minimum margin (x)	5.6	6.1	6.3	6.2	6.6
Business statistics					
Total gross written premiums	14,982	16,414	16,366	17,985	21,973
Annual change (%)	2.5	9.6	-0.3	9.9	22.2
Total net written premiums	11,770	13,201	13,256	14,217	17,218
Annual change (%)	0.3	12.2	0.4	7.2	21.1
Operating statistics					
Total revenue	13,268	14,930	15,263	15,174	18,987
Operating result	71	3,757	4,060	2,083	4,018
Net income	-103	3,662	3,846	1,899	3,868
Return on revenue (ex. gains) (%)	0.5	25.3	26.6	13.7	21.2
Return on assets (incl. gains) (%)	-0.2	8.5	8.9	3.9	7.0
Return on adj. equity (incl. gains) (%)	-0.9	31.4	29.3	13.4	21.3
Non-life					
Incurring loss ratio (%)	80.7	49.0	50.0	61.4	51.6
Commission ratio (%)	24.7	25.1	26.3	27.0	26.4
Expense ratio (%)	7.4	6.9	8.4	8.9	7.6
Reins. comm., profit participation, other ratio (%)	-1.0	1.7	-0.9	-6.0	0.4
Combined ratio (%)	111.8	82.8	83.9	91.2	85.9
Portfolio performance					
Net investment income	1,498	1,729	2,007	957	1,769
Running yield (%)	4.5	4.9	5.6	2.4	3.9
Running yield on technical reserves (%)	2.7	3.6	4.7	1.8	4.1
Total yield (incl. unrealised gains) (%)	4.5	4.9	5.6	2.4	3.9
Portfolio composition (%)					
Real estate	0.0	0.0	0.0	0.0	0.0
Shares	8.5	11.1	11.5	10.2	10.9
Bonds	57.9	54.6	56.3	56.7	58.1
Cash and bank deposits	33.6	34.2	32.2	33.0	30.8
Bank deposits	10.6	11.7	11.9	11.8	11.2
Current bank accounts and cash	23.0	22.6	20.3	21.2	19.6
Financial statistics					
Total assets	43,404	42,503	44,007	53,597	55,179
Total adjusted equity	10,491	12,836	13,449	14,182	18,163
Change in adj. equity (%)	-10.0	22.4	4.8	5.5	28.1
Coverage of the estimated minimum margin (x)	5.6	6.1	6.3	6.2	6.6
Non-life technical reserves/non-life NPW (%)	237.0	195.4	198.5	237.2	182.6
Non-life claims reserves/non-life NPW (%)	197.7	160.0	162.4	196.4	148.8
Technical reserves/adj. equity (%)	265.9	200.9	195.6	237.8	173.1
Invested assets/(adj. equity + technical reserves) (%)	91.2	90.9	93.0	92.6	93.3
Liquid assets/technical reserves (%)	125.5	136.0	140.6	131.5	147.0
Investment leverage (%)	28.2	30.3	31.6	31.9	27.8
Debt/capital (%)	4.6	3.7	7.0	7.1	5.0
Non-life reinsurance utilisation ratio (%)	21.4	19.6	19.0	21.0	21.6

Source: Lloyd's, Fitch

Balance Sheet

(GBPm)	2005	2006	2007	2008	2009
Assets					

Investments					
Real estate					
Shares	2,962	3,891	4,255	4,529	5,052
Bonds	20,279	19,174	20,811	25,176	26,898
Cash and bank deposits	11,764	12,019	11,911	14,644	14,271
Bank deposits	3,719	4,093	4,414	5,216	5,189
Current bank accounts and cash	8,045	7,926	7,497	9,428	9,082
Deposits with cedents	14.0	17	9	10	10
Other invested assets	7.0	7	4	18	33
Total investments (non-linked)	35,026	35,108	36,990	44,377	46,264
Insurance receivables	3,853	3,520	3,428	4,663	4,560
Reinsurance receivables	3,629	3,190	2,918	3,763	3,577
Other receivables	685	382	318	419	437
Tangible assets	17	22	26	30	36
Goodwill	-	-	-	-	-
Accruals	184	261	299	334	293
Other assets	10	20	28	8	12
Total assets	43,404	42,503	44,007	53,597	55,179
Liabilities					
Technical reserves					
Unearned premium reserve	6,829	7,024	7,282	9,043	9,433
Reinsurers' share	-696	-771	-841	-1,167	-1,447
Less deferred acquisition costs	-1,503	-1,582	-1,656	-2,064	-2,180
Outstanding claims reserve	37,719	30,377	28,971	38,420	34,111
Reinsurers' share	-14,450	-9,259	-7,449	-10,504	-8,484
Other technical provisions					
Reinsurers' share					
Total (net) technical reserves (non-linked)	27,899	25,789	26,307	33,728	31,433
Reinsurance deposits	142	69	42	161	115
Insurance payables	884	831	697	770	865
Reinsurance payables	2,228	1,643	1,534	2,517	2,526
Short-term debt					
Long-term debt					
Subordinated debt - liability	501	497	1,012	1,082	958
Other creditors	1,113	715	774	883	774
Accruals	146	123	192	274	345
Total liabilities	32,913	29,667	30,558	39,415	37,016
Capital and Reserves					
Members' FAL	10,206	11,282	9,858	10,630	13,159
Members' balances	-408	597	2,652	2,562	3,878
Central fund balance	693	957	939	990	1,126
Total capital and reserves	10,491	12,836	13,449	14,182	18,163

Source: Lloyd's, Fitch

Profit and Loss Account

(GBPm)	2005	2006	2007	2008	2009
Technical account					
Gross written premiums	14,982	16,414	16,366	17,985	21,973
Premiums ceded	-3,212	-3,213	-3,110	-3,768	-4,755
Net written premiums	11,770	13,201	13,256	14,217	17,218
Change in unearned premium reserve	-15	513	159	421	493
Net premiums earned	11,785	12,688	13,097	13,796	16,725
Gross claims paid	10,181	11,718	8,741	9,736	11,544
Reinsurance recoveries	-3,418	-5,120	-2,515	-2,158	-2,469
Net claims paid	6,763	6,598	6,226	7,578	9,075
Change in claims case reserves	2,742	-379	321	886	-451
Net claims incurred	9,505	6,219	6,547	8,464	8,624
Acquisition costs	2,913	3,191	3,449	3,720	4,408
Administrative expenses	872	910	1,117	1,267	1,304
Other underwriting income/(expenses)	117	-226	115	853	-69
Total underwriting expenses (incl. FX)	3,668	4,327	4,451	4,134	5,781
Technical interest	705	957	1,223	543	1,344
Underwriting result	-683	3,099	3,322	1,741	3,664
Non-technical account					
Investment income	1,498	1,729	2,007	957	1,769
Less technical interest	-705	-957	-1,223	-543	-1,344
Net investment income	793	772	784	414	425
Interest paid	39	46	46	74	71
Operating result	110	3,871	4,106	2,155	4,089
Other income/(expenses)	-174	-95	-214	-184	-150
Pre-tax income	-103	3,662	3,846	1,899	3,868
Reported net income	-103	3,662	3,846	1,899	3,868

Source: Lloyd's, Fitch

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