

FITCH AFFIRMS LLOYD'S OF LONDON AT IFS 'A+', OUTLOOK STABLE

Fitch Ratings-London-04 August 2008: Fitch Ratings has today affirmed Lloyd's of London's (Lloyd's) Insurer Financial Strength (IFS) rating at 'A+'. At the same time, the agency has affirmed the Society of Lloyd's Long-term Issuer Default rating (IDR) at 'A', as well as the Lloyd's Reinsurance Company (China) Ltd IFS at 'A+'. All ratings have Stable Outlooks. Additionally, the agency has affirmed Lloyd's subordinated debt issues, as listed below, at 'A-' (A minus).

The ratings reflect Lloyd's strong 2007 results, with record profitability, strong investment income and a low combined ratio, enhanced by net releases from prior year reserves. All these factors have led to an increase in net assets and stronger capital at the Central Fund level. Although these strong results were expected in the light of a benign catastrophe environment in 2007 Fitch notes they were ahead of the strong results delivered by a number of Lloyd's peers. Given the historical track record of volatile performance in the Lloyd's market, Fitch will look for evidence of the impact of Franchise Performance Directive (FPD) initiatives on Lloyd's ability to weather increasingly soft conditions in a number of market segments and significant future catastrophic losses should they arise.

Following significant losses in 2005 relating to Hurricanes Katrina, Rita and Wilma (KRW), Lloyd's operating performance in 2006 and 2007 was very strong. On an annual accounting basis, the market reported a record aggregate profit of GBP3.85bn in 2007 (2006: GBP3.66bn). Its return on adjusted equity reached an impressive 29% at end-2007, and combined ratio was 83.9% (according to Fitch's calculations), up slightly from a five-year low of 82.8% in 2006. Performance in 2007 was improved by net prior-year releases of GBP856m (2006: GBP270m) from across all business lines. Relative to 2006, the net releases in 2007 were enhanced by the absence of the deterioration of KRW claims, which in 2006 caused GBP415m deterioration in reserves. Lloyd's 2007 results also benefited from record investment yields, with totals yield, reaching 5.6% in a favourable investment environment (based on Fitch's calculation), and total investment income hitting a record GBP2,007m in 2007 (2006: 1,661m).

"From a rating perspective, we view positively the many initiatives undertaken by FPD, such as the issuance of underwriting guidelines, review of syndicates' business plans, development of various benchmarking tools and oversight of the new entrants process", says Lyuba Tarnopolsky, Director in Fitch's Insurance Group. "While progress has been made, the effectiveness of FPD's initiatives and oversight has not yet been fully tested. It is still too early to accurately assess its impact through the soft market". FPD, set up by Lloyd's in 2003, continued its efforts in 2007 to improve the market's long-term profitability and performance, with cycle management being a key priority in the three-year strategic plan. FPD was set up in the more profitable part of underwriting cycle, and the results of its work have benefited from the recent benign catastrophe environment.

Fitch expects Lloyd's to achieve good profitability in 2008, although lower than the high levels of 2006 and 2007, and to continue performing well against its peers. In the absence of severe natural catastrophes, its net income is likely to be well below GBP3,000m and combined ratio is expected to rise to the low- to mid-90s, driven by lower net reserve releases compared to 2007. In the event of significant natural catastrophes, Fitch expects Lloyd's results to show a narrowing differential with the industry's in the years of weak pricing and high catastrophe activity, reflecting the impact of FPD's measures and reducing results' volatility.

Lloyd's has a strong global franchise and operates in over 200 countries. Its broad set of international licenses support Lloyd's standing as a specialist insurance market and a leading market for marine, aviation and energy insurance. In 2007, Lloyd's ranked fourth by premium income, and second by net income among the world's six largest reinsurance companies.

Subordinated debt and their ratings

-GBP300m 6.875% per annum subordinated debt with a final maturity in November 2025, callable from November 2015, affirmed at 'A-' (A minus)
-EUR300m 5.625% per annum subordinated debt with a final maturity in November 2024, callable from November 2014, affirmed at 'A-' (A minus)
-GBP500m 7.421% per annum perpetual subordinated debt, redeemable in 2017, affirmed at 'A-' (A minus).

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