Fitch Ratings-London-25 June 2013: Fitch Ratings has affirmed Lloyd's of London's (Lloyd's) Insurer Financial Strength (IFS) rating at 'A+'. Fitch has also affirmed the Society of Lloyd's Long-term Issuer Default Rating (IDR) at 'A' and Lloyd's Insurance Company (China) Ltd's IFS rating at 'A+'. Fitch has additionally affirmed Lloyd's subordinated debt issues at 'BBB+', as detailed at the end of this comment. The Outlook has been revised to Positive from Stable.

KEY RATING DRIVERS

The Outlook revision to Positive reflects an observed reduction in Lloyds' earnings volatility, both in absolute terms and when compared with higher rated peers. It also conveys the agency's expectation that, in relative terms, Lloyds' future cross-cycle underwriting performance will be more favourable than that achieved by the market historically. The ratings continue to reflect Lloyd's strong financial profile, including a level of Fitch risk-adjusted capitalisation that is more than supportive of the current rating level, low financial leverage and a significant market position in both insurance and reinsurance classes.

Fitch views the increased oversight of market participants provided by the Performance Management Directorate (PMD) as having played a key role in the reduction in earnings volatility, since the directorate was established in 2003. Processes including business plan reviews and syndicate benchmarking have assisted PMD and syndicates in improving key aspects of underwriting, including pricing, reserving, claims management, risk-adjusted capital setting and catastrophe modelling techniques. The agency considers that the substantial investment made by Lloyd's in preparing for Solvency II has further enhanced risk and exposure management practices across the market.

The agency's view of market oversight is supported by initial market loss estimates posted by Lloyd's in relation to recent major loss events including Hurricane Sandy (2012), flooding in Thailand and earthquakes in Japan, New Zealand and Australia (2010/11), all of which remain within the boundaries of originally reported estimates. Fitch's expectations concerning future underwriting performance are also grounded in the work undertaken by the PMD, which has provided the agency with increased confidence that, on an aggregate basis, prior underwriting years will continue to develop favourably across the rating horizon.

Fitch recognises that Lloyd's continues to face a number of headwinds that continue to test the wider insurance industry, including persistently low yielding investment environment and softening pricing across certain major insurance classes.

Market participants at Lloyd's collectively underwrote GBP25.5bn of gross written premiums (GWP) in 2012, a y-o-y increase of 8.6%, which included a risk adjusted rate change (RARC) of 3%. Profit before tax recovered to GBP2.8bn (2011: loss of GBP516m), ahead of the agency's central forecast. The market achieved a combined ratio of 91.1% (2011: 106.8%), mainly due to a reduced burden from major claims of 9.7pp (2011: 25.5pp). Lloyd's has a global franchise and operates in over 200 countries and territories. It is a leading market for reinsurance and specialist property, casualty, marine, energy and aviation insurance.

RATING SENSITIVITIES

Key drivers for an upgrade would be the maintenance of Lloyds' existing financial profile, including Fitch risk-adjusted capitalisation close to, or at, the current level, combined with a continuation in the recently observed trend of lower earnings volatility, including a five-year average combined ratio remaining below 95%. The agency will make a detailed assessment of
Lloyds’ financial performance once full-year 2013 financial statements become available.

A marked decline in the level of reported profitability, erosion of capital, including central fund assets, and poor performance relative to peers could lead to a downgrade.

The subordinated debt ratings are as follows:

GBP153m 6.875% per annum subordinated debt with final maturity in November 2025, callable from November 2015, affirmed at 'BBB+'

EUR214m 5.625% per annum subordinated debt with final maturity in November 2024, callable from November 2014, affirmed at 'BBB+'

GBP392m 7.421% per annum perpetual subordinated debt, callable in 2017, affirmed at 'BBB+'

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Additional information is available on www.fitchratings.com.


Applicable Criteria and Related Research:
Insurance Rating Methodology — Amended

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