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A.M. Best Affirms Ratings of Lloyd’s, Lloyd’s Insurance Company (China) Limited and Society of Lloyd’s

LONDON, 26 July 2012—A.M. Best Europe – Rating Services Limited has affirmed the financial strength rating (FSR) of A (Excellent) and issuer credit ratings (ICR) of “a+” of Lloyd’s (United Kingdom) and Lloyd’s Insurance Company (China) Limited (LICCL) (China). At the same time, A.M. Best has affirmed the ICR of “a” of the Society of Lloyd’s (the Society) (United Kingdom) and the debt ratings of “a-” on the subordinated loan notes issued by the Society in two tranches in November 2004 (6.875% subordinated notes of GBP 300 million maturing 17 November 2025 and 5.625% subordinated notes of EUR 253 million maturing 17 November 2024), and the 7.421% GBP 392 million junior perpetual subordinated loan notes issued in June 2007. The outlook for all the above ratings is stable.

Lloyd’s capitalisation is expected to remain strong into 2013, underpinned by a stable central capital base. Central assets for solvency purposes rose over 2% in 2011 to GBP 3,095 million and are likely to remain close to this level throughout 2012. The exposure of central resources to insolvent members continues to diminish as run-off liabilities decline. In addition, Lloyd’s robust risk-based approach to setting member level capital, as well as its close monitoring of syndicates’ performance and catastrophe exposure, should reduce the risk of material drawdowns on the central fund. Moreover, A.M. Best believes that Lloyd’s internal capital model, which is intended to be used to determine its solvency capital ratio under Solvency II, enhances Lloyd’s understanding of the likelihood and potential magnitude of claims being made upon central assets from future member

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insolvencies.

In 2011, the Lloyd’s market recorded a pre-tax loss of GBP 516 million, in contrast to the profit of GBP 2,195 million reported in 2010. Although this appears to be a weak performance overall, it represents a good result given the number and magnitude of the year’s catastrophe events, which continued the catalogue of natural disasters started in 2010 and included further flooding and Cyclone Yasi in Australia, earthquakes in New Zealand and Japan, tornadoes in the United States and floods in Thailand. While the results were supported by a significant release from prior year reserves, the on-going low interest rate environment meant that the overall investment return of 1.9% was insufficient to offset the underwriting losses completely.

Assuming a more normal year for natural catastrophes after the severely catastrophe-affected years of 2010 and 2011, Lloyd’s is expected to produce a good profit in 2012, supported by prior year reserve releases and investment income. An improvement in the combined ratio to approximately 95% from 106% in 2011 is anticipated so as to give an outcome more in keeping with Lloyd’s recent history of good results.

Lloyd’s benefits from an excellent position in the global insurance and reinsurance markets. The collective size of the market and its unique capital structure enable syndicates to compete effectively with large international insurance groups under the well recognised Lloyd’s brand. Good financial flexibility is enhanced by the diversity of capital providers, which include corporate and non-corporate investors. Although a number of traditional Lloyd’s businesses have established other underwriting platforms in locations such as Bermuda, the United States and Switzerland, their commitment to the market remains strong. In addition, Lloyd’s continues to attract international businesses, drawn by its capital efficient structure and global licences.

Although the Solvency II regulatory regime poses a threat to Lloyd’s unique capital efficiencies, pending approval of the Lloyd’s internal capital model (LIM), a smooth transition to the new regime seems likely. Preparations for Solvency II are well advanced at both the Corporation of Lloyd’s and managing agents, and, in
spite of a very tight timetable, development of the LIM was completed on schedule in readiness for submission to the Financial Services Authority’s approval process at the end of July 2012. Lloyd’s continues to work towards completion of all development work this year, even though implementation of Solvency II has been deferred to 2014.

The ratings of LICCL reflect explicit support from Lloyd’s in the form of quota share retrocession contracts that transfer all reinsurance risk underwritten to syndicates that elect to write business through LICCL. In addition, the ratings take into account the operating model that LICCL uses to write direct insurance business employing mechanisms that comply with local regulatory requirements but that transfer the greater part of the risk to Lloyd’s.

Continued strong operating performance and capitalisation could lead to positive rating actions, while an unexpectedly weak performance or significant erosion of capital would put downward pressure on the ratings.

A.M. Best has also withdrawn the FSR of A (Excellent) and ICRs of “a+” of Underwriters at Lloyd’s London (IL) (Illinois) and Underwriters at Lloyd’s London (KY) (Kentucky) as these offices do not issue insurance policies. Underwriters taking advantage of the U.S. licences for the Lloyd’s market in these states, as well as in the United States Virgin Islands, issue policies on behalf of Lloyd’s. These policies are supported by the financial strength of the Lloyd's market.

The methodology used in determining these ratings is Best’s Credit Rating Methodology, which provides a comprehensive explanation of A.M. Best’s rating process and contains the different rating criteria employed in the rating process. Key criteria utilised include: “Risk Management and the Rating Process for Insurance Companies”; “Rating Members of Insurance Groups”; “Catastrophe Analysis in A.M. Best Ratings”; “Insurance Holding Company and Debt Ratings”; “Understanding BCAR for Property/Casualty Insurers”; and “Understanding Universal BCAR”. Best’s Credit Rating Methodology can be found at

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In accordance with Regulation (EC) No. 1060/2009, the following is a link to required disclosures: [A.M. Best Europe - Rating Services Limited Supplementary Disclosure](http://www.ambest.com/ratings/methodology).

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