Lloyd’s of London

Full Rating Report

Ratings

- Lloyd’s of London: A+
- The Society of Lloyd’s: A BBB+
- Lloyd’s Insurance Company (China): A+

Outlooks

- Insurer Financial Strength Ratings: Positive
- Long-Term IDR: Positive

Financial Data

Lloyd’s of London

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets (GBPm)</td>
<td>78,091</td>
<td>76,548</td>
</tr>
<tr>
<td>Total liabilities (GBPm)</td>
<td>59,791</td>
<td>59,332</td>
</tr>
<tr>
<td>Gross written premiums (GBPm)</td>
<td>25,500</td>
<td>23,477</td>
</tr>
<tr>
<td>Pre-tax profit (GBPm)</td>
<td>2,771</td>
<td>(516)</td>
</tr>
<tr>
<td>Combined ratio (%)</td>
<td>91.1</td>
<td>106.8</td>
</tr>
<tr>
<td>Return on capital (%)</td>
<td>14.8</td>
<td>(2.8)</td>
</tr>
</tbody>
</table>

Key Rating Drivers

Underwriting Performance Key: Fitch Ratings regards continued underwriting discipline by Lloyd’s of London as important. We expect Lloyds’ future cross-cycle underwriting profitability to be more favourable than historically, due in part to the work undertaken by the Performance Management Directorate (PMD). The agency has increased confidence that prior underwriting years will develop favourably on aggregate across the rating horizon. Fitch forecasts a sub-95% calendar-year combined ratio for 2013, subject to normal catastrophe experience.

PMD’s Market Oversight Positive: Fitch considers the increased oversight of market participants provided by the PMD to have played a key role in the reduction in cross-cycle earnings volatility since it was established in 2003. Processes including business plan reviews and syndicate benchmarking have helped PMD and syndicates improve key aspects of underwriting, including pricing, reserving, claims management, risk-adjusted capital setting and catastrophe modelling techniques.

Favourable Performance Versus Peers: Lloyds’ has achieved marginally reduced cross-cycle earnings volatility in the context of the wider industry, both in absolute terms and when compared with peers.

Extensive Financial Flexibility: The variety of funding sources for the Central Fund (see Appendix B: Glossary) gives The Society of Lloyd’s (the Society) significant financial flexibility. The Society has the ability to raise funds both internally – through contributions, levies and syndicate loans – and externally through the capital markets.

Capitalisation Remains Strong: Fitch expects capitalisation to continue to support the current rating, assuming future losses fall within boundaries anticipated by the market. The three-layered capital structure at Lloyd’s – syndicates’ Premium Trust Funds, members’ Funds at Lloyd’s and the Central Fund – remained strong in 2012, helped by reduced large loss activity during the year.

Management of Major Losses: Lloyd’s ability to absorb major loss events has been proved on several occasions in recent years. The agency’s view of improved 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 (2010-2011), all of which remain within the boundaries of originally reported estimates.

Rating Sensitivities

Continued Lower Earnings Volatility: Key drivers for an upgrade would be the maintenance of Fitch risk-adjusted capitalisation close to, or at, the current level, combined with a continuation in the recent trend of lower cross-cycle earnings volatility, including the cross-cycle combined ratio remaining below 95%.

Weakened Capitalisation: 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.

Related Research

- Hurricane Season 2013: A Desk Reference for Insurance Investors (May 2013)
- Bermuda Market Update (January 2013)
- Hurricane Sandy Update (January 2013)
- 2013 Outlook: Global Reinsurance - Earnings Pressure to Return in 2013; Pricing to Stagnate (September 2012)

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Market Position and Size/Scale

Strong Market Position and Management Strategy Supportive of Rating

- Globally renowned (re)insurance market
- Co-insured broker portfolio deals
- Vision 2025 strategy likely to place additional responsibility on PMD
- Product diversification stronger by class than by geography
- Broker-led distribution model
- Underwriting syndicates a unique market feature

<table>
<thead>
<tr>
<th>IFS Rating</th>
<th>AAA</th>
<th>AA</th>
<th>A</th>
<th>BBB</th>
<th>BB</th>
<th>&lt;BB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Figure 1
Ratings Range Based on Market Position and Size/Scale

Globally Renowned (Re)Insurance Market

Lloyd’s strong market position, which falls within the major position and scale category, supports its rating. Lloyd’s is one of a select band of global (re)insurance providers capable of attracting high-quality and specialised business. Fitch views positively the presence of a detailed and clearly defined business strategy executed by the Corporation’s (see Appendix B: Glossary) executive team.

Lloyd’s is a global insurance and reinsurance market comprising 87 syndicates. It writes business from over 200 countries and territories, and in 2012 reported gross written premiums (GWP) of GBP25,500m (2011: GBP23,477m).

Lloyd’s faces competition from a number of sources. These include: established and emerging global reinsurance hubs including Bermuda, Switzerland, Singapore and New York; large global reinsurance companies; and smaller primary companies located within key markets.

Co-Insured Broker Portfolio Deals

The debate concerning these arrangements continues and it is too soon to determine how their presence will influence the future development of the market. While the automatic provision of capacity that follows Lloyd’s insurers could be interpreted as an endorsement of the high standard of underwriting present within Lloyd’s, it could erode the diversity of underwriting input into each underwritten risk, and put smaller capacity providers under greater pressure to secure a place on an underwriting slip.
Vision 2025 Strategy Likely to Place Additional Responsibility on PMD

The publication of the Vision 2025 document in May 2012 provided an insight into the strategic priorities for Lloyd’s over the next 10 to 15 years. Key among these is growth led by further expansion into emerging markets. Although it primarily remains the responsibility of businesses operating at Lloyd’s to determine how and where the growth is achieved, Lloyd’s, through the PMD, is likely to face increasing challenges in ensuring that expansion into emerging markets is undertaken in a controlled and disciplined way.

Product Diversification Stronger by Class Than by Geography

Business written by syndicates focuses on seven main classes (see Figure 2). Lloyd’s has a relatively high level of geographical concentration on the US and Canada (see Figure 3), specifically to the hurricane-exposed US energy fields in the Gulf of Mexico, which Fitch considers to have been a key factor in the historical volatility of results at Lloyd’s.

The main class of business at Lloyd’s, reinsurance, covers both short- and long-tail business, offering a variety of placement types including facultative, proportional treaties and non-proportional treaties such as excess-of-loss placements. The US represents the main geographical region for the second major class, property, which includes both commercial and private property. The remaining main class, casualty, includes professional indemnity, medical malpractice, accident and health, directors’ and officers’ liability, financial institutions, general liability and employers’ liability. Business is mainly spread across US, UK and Europe.

The remaining classes have niche focus. The International Group of P&I Clubs’ programme constitutes a major part of the marine liability class. The motor book is UK focused, and includes niche non-standard risks such as high-value vehicles, vintage or collectors’ vehicles, high-risk drivers and affinity groups. The energy portfolio includes 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. Lloyd’s is an industry leader in the global aviation market, and has a balanced portfolio across all sectors of this class, including airline, aerospace, general aviation and space.

Broker-Led Distribution Model

Product distribution at Lloyd’s is primarily carried out through brokers and coverholders (see Appendix B: Glossary), with some business placed directly with service companies (see Appendix B: Glossary) owned by managing agents. A large proportion of the business is conducted in the underwriting room, where face-to-face negotiations between brokers and underwriters take place. Most business continues to be placed into the Market by the 178 registered brokers.

Underwriting Syndicates a Unique Market Feature

Syndicates are the vehicles used for underwriting policies. They are not legal entities, and are unique to the Lloyd’s insurance market. Syndicates can be made up of a number of members or, as is becoming more common, just one corporate member.

Syndicates are managed by managing agents, which 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. Managing agents are required to report financial results for the syndicates that they manage to Lloyd’s quarterly, and to submit business plans annually or ad hoc if they change.
Corporate Governance and Risk Management

Fitch considers corporate governance to be strong at Lloyd's due to the insurer's clearly defined governance structure. The agency views favourably the existence of the Council of Lloyd's, the governing body of the Society of Lloyd's; the Council has ultimate responsibility for the management of the Market as a whole.

External Oversight

From 1 April 2013, the Society of Lloyd's and Lloyd's managing agents became dual-regulated. Prudential regulation is conducted by the Prudential Regulation Authority (PRA) while business conduct regulation is the responsibility of the Financial Conduct Authority (FCA). Lloyd's members' agents and Lloyd's brokers are FCA-regulated firms.

The Council acts through the Franchise Board for many of its functions. Its members are appointed by the Council and are drawn from both within and outside the Lloyd's Market.

Clearly Defined Governance Structure

Strong and Well-Structured Risk Management Framework

Fitch views positively the approach taken by Lloyd's to managing risk and corporate governance. The agency believes that the Market structure of Lloyd's leads to greater emphasis on the successful management of these areas to maintain the confidence of Market participants. The Market is overseen by the Council of Lloyd's and the Franchise Board, while the Corporation, managing agents and members' agents (see Appendix B: Glossary) are regulated by the Financial Services Authority.

Unique Risk Profile Leads to Separation of Risks

Lloyd's has developed its risk management framework around two distinct types of risk: Corporation-level risks (financial, operational, regulatory and legal) and Market (business)-level risks. Corporation risks are managed through a traditional governance structure, while Market risks are managed by managing agents and the central team at Lloyd's.

Revised Risk Governance Aligned with Incoming Solvency II Regime

The revised structure has improved the clarity of roles and responsibilities relating to Market oversight, and identified areas where further formalisation is required.

Ownership Neutral

Market Structure a Marginal Positive

Fitch considers the structure of Lloyd's, as a market place rather than a company, as marginally positive for its ratings compared with traditional corporate reinsurers. This view takes into account two primary factors: the “Chain of Security,” which provides a mixture of several and mutual claims-paying capital; and the subscription basis of underwriting used within Lloyd's, which allows large complex risks to be underwritten by a group of syndicates.

Figure 4
Structure Diagram

Source: Lloyd's Fitch
Industry Profile and Operating Environment

Figure 5
Ratings Range Based on Industry Profile/Operating Environment

<table>
<thead>
<tr>
<th>IFS Rating Debt</th>
<th>AAA</th>
<th>AA</th>
<th>A</th>
<th>BBB</th>
<th>BB</th>
<th>&lt;BB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary – casualty lines</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary – property lines</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reinsurance lines</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Fitch

Sovereign and Country-Related Constraints

Fitch rates the sovereign obligations of the United Kingdom at ‘AA+’ with a Stable Outlook, and the Country Ceiling is ‘AAA’. The Country Ceiling expresses the maximum limit for foreign-currency ratings of most but not all issuers in a given country. Given these very high levels, the ratings of UK insurance organisations and other corporate issuers are not likely to be constrained by sovereign or macroeconomic risks, and in the specific case of Lloyd’s of London there are no constraints.

Ratings in Reinsurance Industry Generally Strong

The provision by reinsurers of risk-transfer services for the primary insurance industry generally requires companies operating in this sector to hold higher-quality credit ratings, typically not lower than ‘A−’. The achievable range of ratings (see Figure 5) reflects this.

Generally Low Barriers to Entry

The reinsurance industry generally has low barriers to entry, as indicated by the wave of start-up reinsurers (primarily in Bermuda) entering the market after significant catastrophe events. The barriers to entry to Lloyd’s itself are quite high, as the PMD keeps tight control on the number of new syndicates and managing agents entering the Market. One reason for this is to protect the mutual capital layers from unscrupulous underwriting.

Cyclical Pricing

Reinsurers are generally more susceptible to cyclical pricing trends, which ultimately result from changes in supply and demand for different business lines.

Underwriting Margins for Primary Classes Still Under Pressure

Underwriting margins for many of the primary insurance classes written in the London Market have been under pressure for some time, and Fitch believes that the major obstacle to an upturn in pricing is the strong capitalisation of the sector, with significant underwriting capacity and sustained competition. The agency continues to believe that the inability at present of the London Market to generate sufficient returns on capital will be the key driver of improved pricing in the next 12-24 months.
Peer Analysis

Due to its unique structure and mix of business underwritten, Lloyd’s has no directly comparable peers. Figure 6 provides an illustration of Lloyd’s alongside the global group of reinsurance companies that have some similarities in scale and geographical scope.

Reduction in Earnings Volatility Versus Peers

Lloyd’s compares favourably with other multinational reinsurers regarding average underwriting performance across a number of years. Operating leverage – net written premiums (NWP)/equity – is higher than for most peers, although this metric remains within acceptable boundaries for the rating.

<table>
<thead>
<tr>
<th></th>
<th>Net premiums writtenb</th>
<th>Combined ratio (%)</th>
<th>NPWd / Equity</th>
<th>Shareholders’ equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACE Limited (IFS Rating AA/ Stable)*</td>
<td>1,025</td>
<td>979</td>
<td>74.1</td>
<td>0.58</td>
</tr>
<tr>
<td>Berkshire Hathaway (IFS Rating AA+/ Stable)*</td>
<td>9,668</td>
<td>9,867</td>
<td>94.7</td>
<td>0.19</td>
</tr>
<tr>
<td>Everest Reinsurance Company (IFS Rating AA+/ Stable)</td>
<td>3,229</td>
<td>3,288</td>
<td>97.5</td>
<td>0.61</td>
</tr>
<tr>
<td>Hannover Re (IFS Rating AA+/ Stable)</td>
<td>8,918</td>
<td>8,709</td>
<td>98.4</td>
<td>1.01</td>
</tr>
<tr>
<td>Lloyd’s of London (IFS Rating AA+/ Positive)</td>
<td>11,175</td>
<td>11,172</td>
<td>94.8</td>
<td>1.02</td>
</tr>
<tr>
<td>Munich Reinsurance Company (IFS Rating AA+/ Stable)</td>
<td>21,112</td>
<td>22,200</td>
<td>100.4</td>
<td>0.59</td>
</tr>
<tr>
<td>Partner Reinsurance Company Ltd (IFS Rating AA-/ Stable)</td>
<td>3,768</td>
<td>3,688</td>
<td>96.8</td>
<td>0.76</td>
</tr>
<tr>
<td>SCOR S.E. (IFS Rating A+/ Stable)*</td>
<td>5,412</td>
<td>5,027</td>
<td>99.7</td>
<td>0.86</td>
</tr>
<tr>
<td>Swiss Re (IFS Rating A+/ Stable)</td>
<td>12,407</td>
<td>11,641</td>
<td>93.6</td>
<td>0.36</td>
</tr>
</tbody>
</table>

Combined ratio: Net losses and loss-adjustment expenses divided by net premiums earned plus underwriting expenses divided by net premiums earned. Shareholders’ equity is organisation-wide equity and therefore depends on the company’s reporting practices; it may include equity that supports operations other than property/casualty reinsurance operations.

Financial statement figures for some European reinsurers have been translated into US dollars using year-end or 12-month average rates of exchange, as appropriate. This has led to some exchange-rate distortion between financial years.

* Foreign exchange rates used for NPW = average rate. For 2012; EUR1 = USD1.2872, GBP1 = USD1.5890. For 2011; EUR1 = USD1.3998, GBP1 = USD1.6084. Foreign exchange rates used for shareholders’ equity = year-end rate. For 2012; EUR1 = USD1.3105, GBP1 = USD1.6125. For 2011; EUR1 = USD1.3478, GBP1 = USD1.5689.
  
  **NWP** for non-life reinsurance operations.

  * Notes operating company Insurer Financial Strength Rating.

  Source: Company annual reports, financial supplements, and SEC filings.
Capital Strength Derived from Member and Central Capital

- Growth of Members’ Funds improving risk-adjusted capitalisation
- Financial leverage still modest
- Modest total financing commitments (TFC) ratio
- Risk-based approach to setting capital at member level and central capital

Fitch considers the capitalisation of Lloyd’s to be supportive of its current rating, with strength derived from assets held as part of member capital and central capital. Capital and reserves increased to GBP19.3bn at end-2012 (2011: GBP18.2bn), while both leverage and the TFC ratio remained modest at end-2012. Assuming a normal level of large losses for the rest of 2013, Fitch expects capitalisation to remain stable.

Growth of Members’ Funds Improving Risk-Adjusted Capitalisation

The Fitch-assessed risk-adjusted capitalisation of Lloyd’s improved marginally in 2008-2012, as growth in Members’ Funds outstripped growth in NWP, a key element of the risk-based capital charges.

Financial Leverage Still Modest

Financial leverage calculated by Fitch remained stable at 5% at end-2012 (end-2011: 5%). Lloyd’s repurchased GBP180m of principal during 2013. It repurchased GBP27.4m of principal at a modest profit in 2011.

Modest TFC Ratio

Lloyd’s’ TFC ratio remained modest at end-2012, improving to 10% (end-2011: 11%). The primary driver was an increase in the value of adjusted capital captured under the ratio.

Risk-Based Approach to Setting Capital at Member Level and Central Capital

Capital at member level is set at 135% of the syndicates’ Individual Capital Assessment result. This percentage has not changed since 2006. Lloyd’s reviews each syndicate’s Individual Capital Assessment in detail, and requires additional capital if it considers the syndicate’s calculations deficient. Lloyd’s believes that the 35% uplift allows for sufficient capital to keep financial strength and credit ratings at current levels. In 2013 Lloyd’s has maintained its 35% uplift, and has confirmed that it will apply the same uplift in 2014. Lloyd’s continues to review its methodology to reflect changing market, macroeconomic and legislative conditions.

Figure 7
Capitalisation and Leverage
(GBPm)

<table>
<thead>
<tr>
<th>Year</th>
<th>Adjusted debt leverage (%)</th>
<th>Estimated statutory solvency surplus</th>
<th>NPW/equity (x)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>9</td>
<td>2,490</td>
<td>1.00</td>
</tr>
<tr>
<td>2009</td>
<td>6</td>
<td>2,756</td>
<td>0.95</td>
</tr>
<tr>
<td>2010</td>
<td>6</td>
<td>2,905</td>
<td>0.97</td>
</tr>
<tr>
<td>2011</td>
<td>5</td>
<td>2,976</td>
<td>1.01</td>
</tr>
<tr>
<td>2012</td>
<td>5</td>
<td>3,121</td>
<td>1.01</td>
</tr>
</tbody>
</table>

Leverage will remain largely unchanged or reduce slightly in the short term. Assuming major losses fall within the bounds anticipated by the Market for the rest of 2013, Fitch does not foresee a significant change in the level of capital in the near term.

Source: Fitch
Insurance

Lloyd’s of London

August 2013

Strong Debt-Servicing Capability and Good Financial Flexibility

- Cross-cycle ability to service debt likely to remain strong
- Flexibility of repayment options
- No immediate maturities

Fitch expects the ability of Lloyd’s to service its debt obligations to remain strong in the foreseeable future. Lloyd’s has a variety of mechanisms available to raise capital, including member calls, Central Fund contributions, the requirement of additional capital on top of the Individual Capital Assessment, charging a premium levy and raising subordinated debt.

Cross-Cycle Ability to Service Debt Likely to Remain Strong

Lloyd’s continues to have strong debt-servicing ability, despite a reduction in the level of interest coverage since 2008. Fitch expects coverage to reduce slightly for 2013, reflecting a slight reduction in earnings.

Flexibility of Repayment Options

In a going-concern scenario, the Society has several options available for the repayment of principal and interest, as it has complete discretion regarding the use of the Central Fund. The Central Fund receives a regular supply of funds from syndicate contributions, syndicate loans and investment income. Moreover, 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.

No Immediate Maturities

Lloyd’s has no immediate debt falling due; the outstanding issues have call dates in 2014 and 2015. The subordinated debt issues of 2004 and 2007 are obligations of the Society.

Figure 8
Debt-Servicing Capability and Financial Flexibility

(GBPm)

<table>
<thead>
<tr>
<th>Interest coverage – market (x)</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>Fitch’s expectation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest coverage – society (x)</td>
<td>1.4</td>
<td>2.1</td>
<td>4.9</td>
<td>1.4</td>
<td>2.0</td>
<td></td>
</tr>
<tr>
<td>Interest paid</td>
<td>74.4</td>
<td>69.3</td>
<td>66.1</td>
<td>64.4</td>
<td>62.2</td>
<td></td>
</tr>
</tbody>
</table>

Interest coverage will remain strong in the medium term, and Fitch expects the level of absolute coverage for 2013 to reduce slightly, reflecting a slight reduction in reported profitability. Fitch does not foresee a significant increase in interest expense in the near term.

Source: Fitch
Market Performance Benefits from PMD Oversight

- Improved results in 2012 due to lower catastrophe burden
- Adequate if softer pricing across main sub-classes

PMD’s oversight of market participants has played a key role in improving the overall technical performance of the Lloyd’s market, in Fitch’s view. Since the PMD was established in 2003, processes including business plan reviews and syndicate benchmarking have helped PMD and syndicates improve key aspects of underwriting, including pricing, reserving, claims management, risk-adjusted capital setting and catastrophe modelling techniques. Figure 10 highlights the relative stability of return on capital in recent years, and the higher level of solvency maintained within the market.

Improved Results in 2012 Due to Lower Catastrophe Burden

End-2012 results improved to GBP2.8bn (2011: loss of GBP516m), ahead of Fitch’s expectations. The improvement follows a markedly lower catastrophe burden compared with 2011. Losses from Hurricane Sandy and the sinking of the Costa Concordia resulted in GBP1.8bn catastrophe net claims (2011: GBP4.8bn), adding 9.7 percentage points (pp) to the combined ratio (2011: 26pp). Although US windstorms are Lloyd’s largest catastrophe exposure, Hurricane Sandy’s path did not cross the south-eastern regions in which the Market’s exposure is most concentrated.

There were no material catastrophe events in H113. The US windstorm season, which runs from June to November, could adversely influence earnings for the rest of 2013.

Adequate if Softer Pricing Across Main Sub-Classes

Fitch maintains the view that the global supply of underwriting capacity will continue to outstrip demand during 2013, softening pricing for sub-classes not directly affected by major loss events during 2012, such as Hurricane Sandy. Nevertheless, Fitch considers that pricing remains adequate.
Figure 11
Investments and Asset Risk

<table>
<thead>
<tr>
<th>(GBPm)</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>Fitch’s expectation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Invested assets</td>
<td>44,377</td>
<td>46,264</td>
<td>48,494</td>
<td>51,424</td>
<td>51,773</td>
<td>Investment profile and strategy will remain fairly constant in the near term. The greatest challenge is the persistence of a low-yielding investment environment, which will continue to put pressure on earnings.</td>
</tr>
<tr>
<td>Investment return (%)</td>
<td>2.4</td>
<td>3.9</td>
<td>2.7</td>
<td>1.9</td>
<td>2.5</td>
<td></td>
</tr>
<tr>
<td>Liquid assets/tech reserves (%)</td>
<td>131.5</td>
<td>147</td>
<td>143.3</td>
<td>137.8</td>
<td>142.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: Fitch

Conservative Investment Policy for All Links in the Chain of Security

- PTFs: high-quality and liquid first source of policyholder repayment
- FALs: Second repayment layer support point
- Central Fund: mutual layer available at discretion of Council of Lloyd’s
- Strong liquidity position supported by high-quality, liquid assets

Fitch considers the overall asset allocation for Lloyd’s, the aggregate of Premium Trust Funds (PTFs), Funds at Lloyd’s (FAL) and the Central Fund, to be fairly conservative. However, substantial variation exists at the PTF and FAL levels for individual syndicates.

PTFs: High-Quality and Liquid First Source of Policyholder Repayment

PTFs are the first resource for paying policyholder claims from a syndicate. Investments are generally invested in liquid, short-duration, high-quality assets. Around 82% of assets are invested in bonds. Of the 43% of investments in corporate bonds, 88% are rated ‘A’ or above.

FALs: Second Repayment Layer Support Point

FALs represent the second layer of capital provided by members to support their underwriting. The amount of deposited funds is determined by the Corporation, which reviews each syndicate’s ICA and applies an uplift based upon the syndicate’s business proposal. The capital is held in trust as readily realisable assets. Letters of credit (LOCs) continue to represent a significant proportion of assets within FAL (50% at end-2012). The largest providers of LOC facilities have remained constant through the credit crisis.

Central Assets: Mutual Layer Available at Discretion of Council of Lloyd’s

Central assets are the third level of security at Lloyd’s, 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 assets value was GBP2.4bn at end-2012, 84% invested in bonds.

Strong Liquidity Position Supported by High-Quality, Liquid Assets

Lloyd’s maintains a strong liquidity position, which is supported by a significant level of high-quality liquid assets held at both the FAL and Central Fund asset levels.
Increased Confidence of Continued Favourable Development

- Prior-year surplus generated by all classes
- Greater confidence in level of casualty surplus
- Motor development stabilising
- Reserving position greatly improved following Equitas

Prior-Year Surplus Generated by All Classes

This trend was driven by favourable claims experiences across all the main classes of business at Lloyd’s, which resulted in a 7.2pp improvement in the calendar-year combined ratio (2011: 6.5%). Fitch will closely monitor developments across the casualty and motor classes, with the agency believing that it is here that the greatest near-term uncertainty resides.

Greater Confidence in Level of Casualty Surplus

Fitch remains cautious about the development of this major class, but the level of surplus achieved in 2012, equivalent to 4.8pp in the combined ratio (2011: 1.8pp), exceeded the agency’s expectations. This trend, combined with evidence suggesting a significant reserve margin still held across the market, gives greater confidence that further surpluses will be generated across the rating horizon.

Motor Development Stabilising

After significant strengthening in 2010, equivalent to 36.7pp in the combined ratio, this class achieved a modest 0.9pp surplus in 2012. Fitch remains cautious about how this class will perform over the coming years, with adequate control of claims costs the key factor for determining profitability.

Reserving Position Greatly Improved Following Equitas

The reserving position of Lloyd’s has improved significantly since 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, respectively. The transfer of pre-1993 liabilities into Equitas in 1996 has reduced the volatility of the reserving position of Lloyd’s, as the proportion of long-tailed liabilities has significantly diminished.

Reinsurance, Risk Mitigation and Catastrophe Risk

Increased Reinsurance Recoverables; Good Credit Quality of Reinsurers

- Falling external reinsurance utilisation rate

The level of net reinsurance recoverables was stable at GBP10.9bn at end-2012 (2011: GBP11bn), significantly down from a peak of GBP14.5bn at end-2001 after the 11 September 2001 attacks in the US. Fitch regards the reinsurance recoverables as generally high quality, with 96% of counterparties rated ‘A’ or above.
Stable External Reinsurance Utilisation Rate

Each syndicate is required to make its own reinsurance arrangements. Across the market, the “external” reinsurance utilisation rate is 17% (2011: 17%). Reinsurance within the market between syndicates is excluded from this ratio.
Appendix A: Other Ratings Considerations

Below is a summary of additional ratings considerations of a “technical” nature that are part of Fitch’s ratings criteria.

Group IFS Rating Approach

The Lloyd’s insurance entities listed on page 1 are rated on a group approach, with all entities considered “Core”.

Notching

The unique corporate structure of Lloyd’s, as a market place rather than a corporation, makes reference to operating and holding companies inappropriate. A description of how the respective ratings of Lloyd’s entities were reached is provided below. Fitch considers the regulatory environment in the United Kingdom strong.

Notching Summary

Society of Lloyd’s

- The Society’s IDR is linked to the IFS Rating assigned to Lloyd’s of London. The Society has no legal liability for the insurance liabilities of members other than where it has issued an undertaking. Undertakings are liabilities of the Society and constitute unsecured obligations of it ranking pari passu with its other senior unsecured liabilities. Fitch has therefore aligned the Society’s IDR with the implied IDR of Lloyd’s of London.

IFS Ratings

- Due to the existence of policyholder priority, a baseline recovery assumption of “Good” applies to the IFS Rating, and Fitch used standard notching from the implied IDR.
- The insurance policies issued by Lloyd’s of London are supported by a chain of security that includes Lloyd’s premium trust funds, members’ funds at Lloyd’s and the Central Fund. The Central Fund and central assets of the Society of Lloyd’s, a legal entity distinct from the members of Lloyd’s, provide partial mutuality to the Lloyd’s market. It is this mutuality that enables Fitch to assign an IFS Rating to Lloyd’s of London.

Debt

- Not applicable.

Hybrids

- Junior subordinated debt ratings of The Society of Lloyd’s (issuer) are based on a standard baseline recovery assumption of “Below Average”, and are designated by Fitch as having Material loss-absorption features. Standard notching was used.

Hybrids – Equity/Debt Treatment

<table>
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<th>Hybrid</th>
<th>Amount</th>
<th>CAR Fitch (%)</th>
<th>Reg override (%)</th>
<th>CAR Debt (%)</th>
<th>FLR Debt (%)</th>
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<td>100</td>
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</tr>
</tbody>
</table>

Source: Fitch

Exceptions to Criteria/Ratings Limitations

None.
Appendix B: Glossary

Central Fund
The fund financed by (among other things) contributions from Lloyd’s members and administered by the Council primarily as a fund for the protection of policyholders. It includes both the “Old” Central Fund and the New Central Fund.

Corporation of Lloyd’s
The executive of the Council of Lloyd’s, Lloyd’s Franchise Board and their respective committees. The Corporation does not underwrite insurance or reinsurance itself but provides the licences and other facilities that enable business to be underwritten worldwide by managing agents acting on behalf of members.

Coverholder
A company or partnership authorised by a managing agent to enter into a contract or contracts of insurance to be underwritten by the members of a syndicate managed by it, in accordance with the terms of a binding authority.

Members’ Agent
An underwriting agent that has permission from Lloyd’s to be appointed by a member to provide services and perform duties of the same kind and nature as those set out in the standard members’ agent agreement. These services and duties include advising the member on which syndicates he should participate in, the level of participation in such syndicates and liaising with the member’s managing agents.

Service Company
A service company coverholder (referred to in the Code simply as a "service company") is an approved coverholder that Lloyd’s has agreed can be classified as a service company because it is a wholly owned subsidiary either of a managing agent or of a managing agent’s holding company, and which is normally only authorised to enter into contracts of insurance for members of its associated syndicate and/or associated insurance companies.
The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

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