



Airline Insurance market news

05/10

Average premium increases have slowed during May so far, but the airline insurance market looks set to comfortably break the US\$2 billion mark this year. Loss statistics at this point are also very positive.

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Aerospace Insurance Market Outlook 2010 now available



Aon Aviation & Aerospace website

May renewals so far show that the airline insurance market has continued the trend for single digit increases in lead hull and liability premium.

This suggests that the 20% average premium increase in 2009 was enough to attract capacity into the airline sector. If claims are around average in 2010, it will be the first time that underwriters have had a return on their investment in four years.

Line of safety?

If it continues in its current direction, the airline insurance market will comfortably clear US\$2 billion in lead hull and liability premium. Many suggest that this is the level needed to ensure ongoing capacity.

The argument is that by reaching US\$2 billion, there is enough premium to cover for the hull and liability claims in an average year. Adding a 9% increase to the lead hull and liability premium for 2009 would deliver a total of US\$2.09 billion in 2010.

It should be pointed out that there is a discussion about the relevance of the US\$2 billion figure. Excluding the claims that resulted from the events of 9/11, annual hull and liability claims estimates have only breached the US\$2 billion mark three times in the last 14 years. The average claim figure is US\$1.5 billion.

Aiming at US\$2 billion potentially inflates the level that the airline insurance market needs to be at to ensure that underwriters cover their fixed costs and enjoy the level of return they need to justify their investment in the airline insurance markets.

Green shoots

At this point in the year, the relatively limited level of activity in the airline insurance market can mean that the average lead hull and liability premium change is impacted by major fluctuations at a single renewal.

This does not appear to be the case at this point. Around 23% of renewals that have renewed so far in 2010 have seen their premium decrease, while 74% have seen their premium increase.

By comparison, the full year figures for 2009 saw only 17% of renewals enjoy reductions on their insurance policies while 83% had increases.

While many of the reductions in 2010 have been the result of falling exposure, similar exposure falls in 2009 did not tend to lead to premium reductions.

This does not mean that the hard market conditions in the airline insurance markets are over, but it does suggest that the position is becoming more comfortable for airlines that present a good risk from an underwriter's perspective.

Meanwhile, the International Air Transport Association (IATA) says that demand for air travel continued to grow in March, with passenger demand up by 10.3% and cargo demand up by 28.1% compared to March 2009. This is one of the key indicators of the health of the aviation sector.

It should be pointed out that these increases reflect the

(continues overleaf)

	Renewals	Fleet Value Movement (% Change)	Passenger Movement (% Change)	Expiring Premium (US\$m)	Renewal Premium (US\$m)	Premium Movement (% Change)
Q2 2009	49	+1	-4	191.59	214.81	+12
Q3 2009	52	+2	-11	246.98	297.03	+20
Q4 2009	104	+3	0	1,138.39	1,366.28	+20
Q1 2010	10	+11	-10	34.06	38.83	+14
April 2010	16	+7	+9	97.34	105.89	+9
May 2010	5	+11	+14	25.58	26.97	+5
2010 to date	31	+8	+8	156.99	171.69	+9



Overview (continued)

very low market conditions in 2009, but the data does suggest that the position is improving.

IATA points out that the numbers are likely to be less positive in April as a result of the disruption caused by the volcanic eruption in Iceland.

Carriers in the Middle East continue to show the strongest growth, with IATA stating that the region's passenger numbers are up by 25.9% during March.

African traffic growth was up by 13.6%, with Asia Pacific demand rising by 12.6%. The picture was less positive for North American and European carriers where traffic grew by 7.8% and 6% respectively, although in both cases this was an improvement on the figures for February.

Latin America reported the weakest passenger growth, 4.6%, although growth is likely to have been curbed by the earthquake in Chile, IATA says

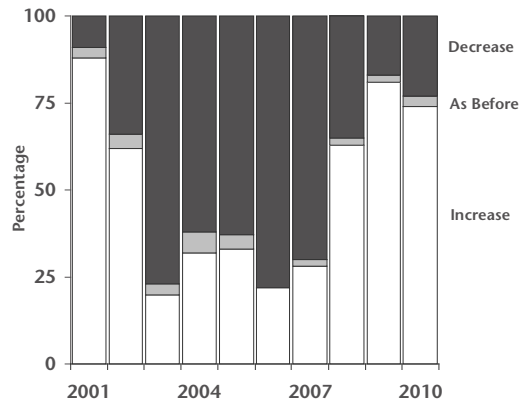
Mergers Continue

Meanwhile, away from the insurance markets, United Airlines and Continental Airlines are to merge. The airlines will operate under the United Airlines brand but with Continental's livery and logo.

Bringing the airlines together will create the fifth largest airline in the world by average fleet value, and the third largest by number of aircraft.

The airlines both renew their insurance in December. There are no details about how their insurance

Increase and decrease proportion
(Percentage of lead hull and liability premium changes)



Source: Aon market data

requirements will change at this stage. The deal is expected to close during the final quarter of 2010.

The move follows the formal merger agreement announced in April by European flag carriers British Airways and Iberia. This is also expected to be completed by the end of the year.

The industry is currently rife with merger rumours. While, to be fair, this has been fairly constant over the last five years, it does appear that the current conditions are conducive to airlines coming together and further activity is likely as 2010 progresses.



LOSSES

The current loss figure, excluding minor losses, is US\$264 million so far this year, compared to US\$597 million recorded at the same point in 2009. Adding an estimate for minor losses, the overall loss total is US\$447 million at present, compared to US\$780 million in 2009.

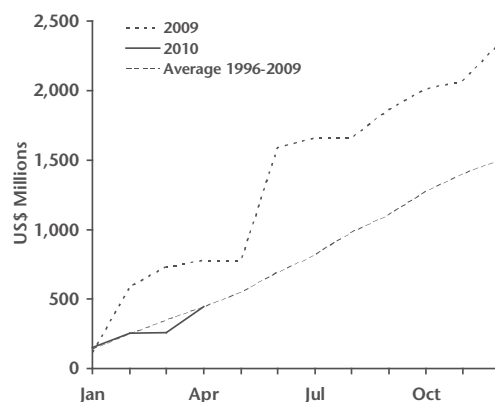
There has been a single major loss since the last edition for this newsletter.

On May 12, an Airbus 330 operated by Afriqiyah Airways, crashed while landing at Tripoli Airport, Libya, following a flight from Johannesburg, South Africa. Details are limited at this stage, but it appears that there were 104 fatalities among the 105 people on board. The aircraft was built in 2009 and has been valued at US\$124 million. There is a potential for high liability claims as a result of the loss.

The loss means that as we approach the mid-point of the year, total claims for the airline industry are only 2% above the long term average of US\$439 million between 1996 and 2009.

That said, as shown last year, it only takes a single loss for the position to change significantly and the airline industry will always present the potential for catastrophic incidents.

Cumulative loss 2010
(Including minor loss estimate)



Source: Aon loss data
Averages exclude September 11th losses

A single loss has pushed total claims for 2010 just above the long term average.

INDUSTRY REELS FROM VOLCANIC CLOUD

The recent eruption of the Eyjafjöll volcano in Iceland has turned attention on business interruption practices at organisations around the world.

Just as the aviation industry appeared to be getting back on its feet, the eruption of the Eyjafjöll volcano in Iceland has wreaked further havoc. An estimated 100,000 flights were cancelled towards the end of April when the majority of governments in Europe closed their airspace, costing the industry between €1.5 billion and €2.5 billion.

The volcano is located in the north of Europe, but the disruption that followed the closure of most of the region's airspace was pretty much global, with passengers, crews and aircraft stranded in the wrong place. For many of the airlines, it will have been weeks before their schedules returned to normal.

Further, albeit limited, cancellations occurred at the beginning of May, and there is a chance that the disruptions could continue sporadically for some time. There are also those that point out that an eruption of Eyjafjöll tends to be a prelude to an eruption of Katla, a far bigger neighboring volcano.

The current issues could have a number of ramifications for the aviation industry. From the perspective of the insurance markets the position is relatively clear. Successful claims against standard airline liability insurance policies due to delays as a result of the volcanic eruption in Iceland are unlikely.

The main reason for this is that this is a natural event and there has not been any actual damage to aircraft or property at this stage.

Under the European regulations, EC261/2004, the obligations on airlines should be limited or excluded in cases where an event has been caused by extraordinary circumstances that could not have been avoided even if all reasonable measures had been taken.

Business, interrupted

The picture is similar from a business interruption point of view, suggests Stephen Cross, CEO of Aon Global Risk Consulting (AGRC). "Typically, business interruption (BI) policies will most likely not be responding to the disruption to airspace caused by the volcanic ash," he says. "BI policies usually only kick in when there is physical damage. If ash falls to Earth and lands on a business' premises and causes damage, blocking air pipes that could lead to an explosion for example, then that could trigger a resulting BI policy.

"It is important to note, however, that insurance policies vary," Cross points out. "A firm should always ensure they study their own policy language in determining whether they are able to claim on their insurance cover."

Cross suggests that ensuring that BI policies are as responsive as possible is a key part of AGRC's work in the sector. "Aon has been working for some time now with insurers and industry bodies in the London insurance market on bringing BI cover into the 21st century, developing this product to make it more relevant to today's world and today's risks," he explains. "The current crisis underlines the importance of this



Stephen Cross, CEO,
Aon Global
Risk Consulting

ongoing work."

Supply chain management

Cross points out that while it is difficult to foresee every possible event, it is the companies that have an effective plan for disruption that are likely to get back on their feet most quickly.

"Supply chain management becomes a critical area of business in situations such as Europe has been experiencing," he observes. "While you can't plan for every eventuality, especially such rare occurrences as a volcanic eruption, the fundamental principles of sound supply chain management still apply: you should always be aware of what business continuity measures your suppliers of critical inputs have in place and be thinking about alternative suppliers.

"Unfortunately, as economies contract or competition increases, lean manufacturing becomes the name of the game, either through Just-in-Time inventory management or through moving to single suppliers in order to generate economies of scale. Such an approach might be highly efficient when things are running smoothly, but in the event of a major disruption event such as this, it can lead to significant delays in key materials and inputs being delivered, or in a worst case scenario to a systemic failure in your supply chain."

Cross points out that this is as true for the aviation as any sector, with airlines reliant on fuel suppliers, as well as food and refreshments providers in order to ensure that they can look after their passengers.

The silver lining

While the last few weeks have proved difficult for many and the position looks like it may continue to be challenging for some time, there are positives that can be taken. "As is often the case in such events as this, there is a silver lining for some firms or sectors," concludes Cross. "There is an upside for firms that invested in rigorous business continuity planning. They will have examined alternative ways of providing their product or service and will come out the other side of a lengthy disruption in a better position than those who haven't."





AEROSPACE INSURANCE COSTS CONTINUE STEADY DESCENT

The price of insurance for the aerospace industry looks set to continue to decline in 2010, the fourth year in a row, finds Aon's Aerospace Insurance Markets Outlook 2010 report. After 2009's turbulence, this represents an oasis of relative calm for airports, aerospace manufacturers and support companies.

2009 saw the continuation of decreasing of steady rates for insurance in the aerospace sector:

- **Airports: 2% decrease in average cost of premium**

Reduced exposure to risks, including falling passenger numbers have played a significant role in the recent premium reductions. Airports in the Middle East are the only ones to have bucked the trend with passenger numbers expected to grow by 11% during the 2009/10 policy period.

- **Manufacturers: holding steady, no change in average cost of premium**

Just over half of aerospace manufacturers are forecasting turnover reductions during the 2009/10 policy period. Maintenance, repair and overhaul (MRO) operations have a more positive view, with turnover expected to grow by 9% on average.

- **Service Providers: 6% reduction in average cost of premium**

The service provider sector, which is comprised of refuellers, ground-handlers, and airport service providers, saw a fall of 6% for the third consecutive year in the average cost of the premium they paid.

Nearly 60% of refuellers forecast a reduction in the amount of fuel they are expecting to supply during the 2009/10 policy period.

- **Age of global fleet: second oldest global fleet since 1989**

The average age of the global fleet held steady at around 13.5 years old during 2009, the second oldest that the global fleet has been since 1989. This reflects falling order books for airframe manufacturers but also explains the positive turnover forecasts coming from the MRO sub-sector.

The insurance renewals so far in 2010 indicate that we will see similar trends as 2009, although there is a slight chance that prices could start to rise minimally as the year progresses, the report suggests.

Insurance prices are declining as a result of three factors. Primarily, capacity continues to be strong in the aerospace insurance market. The global economic conditions have also had a significant impact on the aviation industry as a whole, and exposures have declined as aerospace organisations have responded to the new realities.

Finally, the sector has also been very proactive in its approach to insurance and risk management, as well as introducing a number of new technologies and approaches that have reduced the level of inherent risk.

To read the full report, please go to www.aon.com/aviationinsight. The Airline Insurance Market Outlook 2010 report is also available from this site.

The Aon Aviation Insurance Market Outlook 2010 document is now available.

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All figures detailed in this newsletter include all known information at time of production on the lead London terms of airlines renewing with fleet values in excess of US\$150 million. They do not take into account any coverage changes and are not weighted in any way with regard to the size of the airline's fleet or the volume of premium paid.

Average fleet values are the average value of a fleet during the entire length of the insurance programme rather than a single specific date.

Loss information covers western built equipment only and the data only includes losses with a total incurred value of over US\$1 million. We only write about losses over US\$10 million.

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