

aerospace insurance market news

QUARTER TWO 2008



So far, 2008 has followed the trends set in 2007, with an average reporting currency reduction in lead premium of -6%, the same level as reported for last year. Capacity continues to be high and there have been no significant aerospace losses so far.

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overview

Average lead premium reductions of -6% on 2008/09 aerospace insurance programs continue the direction set in on 2007/08 renewals. Looking in more depth at the data, the three major sectors of the industry, airport, manufacturer and service provider, also show their respective trends continuing.

The figures are slightly impacted by one renewal in February that had a significant increase in lead premium price. This was the result of a loss on the maintenance, repair and overhaul operation's 2007/08 policy that has meant premiums have more than doubled.

Factoring this renewal out of the figures and the average reduction in reporting currency would actually be around -8%. This aside, there is only one other renewal which has the potential to skew the data at this stage, a European airport authority that has seen its lead premium halved as a result of some constituent operations setting up their own programs.

So far this year, only 10 of the 61 renewals that we have recorded have seen lead premium increases. Only half of these have had premium increases of more than +5%, all of which have been the result of losses.

The continued reductions in the aerospace insurance market are being driven by the high level of insurance capacity that is available for renewals with a good loss history. This is being accentuated by the relatively low level

of airline losses over the last five years which has meant that there have been fewer major claims against aerospace policies.

Safety Improvements Continue

The Federal Aviation Administration (FAA) has said that its latest safety audit revealed a 99% airline compliance with its Airworthiness Directives. It also plans to improve its inspection programs and wants aircraft black box data recorders to be upgraded.

According to the FAA, this has been the safest period in aviation history and the black box enhancements will provide more information about the causes of accidents and help ensure that similar incidents are avoided in the future. The new rules will come into force on all newly built aircraft and helicopters from 2010.

Further work by organizations such as the FAA in specific countries and the International Air Transport Association globally is likely to encourage of the recent good loss environment in the aviation industry to continue. That said, aviation remains an industry with a high potential for major losses and the price of insurance must reflect this.

With lead premium prices in the aerospace sector falling for five consecutive quarters, there is a danger that it will become a less attractive place for insurers to do business and capacity may contract as a result.

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	Renewals	Expiring Premium (US\$m)	Renewal Premium (US\$m)	US\$ Premium Movement (% Change)	RC* Premium Movement (% Change)
Quarter 3 2007	70	383.07	338.36	-12	-10
Quarter 4 2007	52	169.24	159.75	-6	-8
January	30	46.86	41.98	-10	-7
February	8	11.88	13.97	+18	+15
March	16	24.59	22.51	-8	-9
April	7	8.95	8.59	-4	-16
2008-to-date	61	92.28	87.04	-6	-6

Source: Aon Market Data
*RC: Reporting Currency
Numbers on a like-for-like basis

sector analysis

	Renewals	Expiring Premium (US\$m)	Renewal Premium (US\$m)	US\$ Premium Movement (% Change)	RC* Premium Movement (% Change)
Airport	25	56.82	51.68	-9	-6
Manufacturer	23	25.02	25.78	+3	-2
Service Provider	13	10.44	9.59	-8	-10
2008-to-date	61	92.28	87.04	-6	-6

Airport (including ATC)

Around a third of the total expected amount of airport, air traffic control (ATC) and civil aviation authority (CAA) premium has renewed at this point in the year, meaning that at this stage, barring major incident, we have a fairly good indication of market direction for the sector in 2008.

Over 85% of the 25 renewals that have occurred so far this year in the airport sector have been Europe-based however, so while there has been a relatively significant amount of activity, trends may differ in other regions.

The -6% reduction in average lead premium continues the pattern reported for the whole of 2007. That said, the sector witnessed significant reductions in average lead

premium in the third and final quarters of last year, both quarters over -10%, so it may be that the sector is becoming less soft following a nadir late in 2007.

Looking at the airports specifically, the reductions have been consistently in the low to mid single digit range, reflecting the sub-sector's close relationship with the airline insurance markets.

From an ATC and CAA perspective, there has only been limited activity. This has also shown low single digit reductions, although the average has not been quite as high because the market is relatively limited.

Manufacturer (including MRO)

Manufacturers continue to receive the least favorable treatment from the aerospace insurance markets, with only a -2% reduction in average lead premium so far in 2008.

This is the result of the relatively high level of perceived risk in the manufacturing sector, as well as the complex nature of claims in the market that can create a long time lag between an incident occurring and a claim being made against a manufacturing organisation.

While the reductions are relatively modest, this is the fourth consecutive quarter where the sector has seen a fall in average lead premium, and the component side has tended to receive slightly better results so far this year

Under 20% of the expected total number of renewals in the manufacturing sector have taken place so far this year. This translates into around 4% of the total lead premium amount expected for 2008 if the current trends continue.

As a result, there is a significant potential for the trends to change as the year progresses.

Of the renewals that have taken place, nearly 70% are based in Europe, and just over 20% based in North America.

The maintenance, repair and overhaul (MRO) sub-sector, included with the manufacturers because of the similar risk profiles, has been more volatile during 2008 so far. This is mainly due to a significant increase in February that was driven by a single renewal that suffered a major loss in 2007. The impact of this should be balanced out as the year progresses and more programs renew.

MRO operations represent just under 20% of the renewals included in the manufacturing sector during the first quarter, although this amount will decline to under 15% as the year progresses.

Service Provider

Service providers continue to receive a high level of average reductions from the aerospace insurance markets, reflecting the generally positive perception of the sector from a risk point of view.

The service provider sector became softer in the first quarter of 2008, having looked as though it had reached its lowest point in the second and third quarters of last year. While it has not returned to mid-teen reductions reached during the middle of 2007, the -10% reductions in the first quarter of 2008 would seem to confound predictions that the sector could not become more soft.

That said, under 20% of the expected total amount of lead premium has renewed in 2008 so far, creating the potential for significant changes in average lead premium movements as the year progresses. This is the fifth consecutive quarter that has seen a reduction in average lead premium.

At this point in the year, Europe dominates the service provider renewals, with over 60% of the total number of renewals. Of the 13 programs that have been placed, 12 are classified as refuellers.

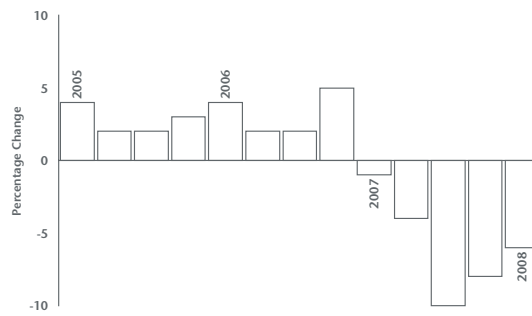
outlook

This is now the fifth consecutive quarter of average lead premium reductions in the aerospace insurance markets.

While this is generally a good thing from the point of view of an insurance buyer, it does mean that the global insurance providers will increasingly be examining their books of aerospace business in comparison with other industries and may begin to reduce their capacity if they come to the conclusion that there is more profitable business elsewhere.

It seems likely that this is still some months ahead, however, and we expect there to continue to be strong competition for aerospace business during the next few months.

Average Quarterly Percentage Premium Movement
(original reporting currency percentage change)



Source: Aon Market Data

the impact of the subprime mortgage crisis on insurers

This article looks at how the subprime mortgage crisis has impacted professional indemnity insurers so far.

As economists, bankers, politicians and businesses wrestle with the possible implications of the subprime mortgage crisis and scramble to minimize their risk, it appears that there is no escape from the turmoil.

There has been speculation about the insurance market's vulnerability to subprime-related issues and potential liability claims on directors' and officers' (D&O) and professional indemnity (PI) books.

Policies sold to banks where most claims are expected may well be mitigated by 5% ceiling limits and exclusion riders, so it is estimated only a quarter of claims relating to write down losses are likely to be valid. Nevertheless, lawsuits involving investment banks, money managers and rating agencies are likely to be inevitable.

In the US there has been a rise in the number of class action lawsuits filed against companies with significant credit losses.

On February 24, 2008, HSH Nordbank sued UBS to recover millions of US dollars of losses it incurred on a portfolio of credit derivatives sold to it by the Swiss bank, and in January State Street announced a US\$618million charge for subprime related litigation. Earlier this year Bear Stearns, itself suffering significant subprime issues, suggested that liability insurers could lose US\$8-9billion on claims related to such lawsuits, although Clear Capital estimates the loss might be half that, creating a total industry claims ratio of 40-50%.

In the London market Brit, Beazley and Novae have all been suggested by industry analysts to be particularly vulnerable to claims as D&O, financial institutions E&O and PI represent around 30%-40% of their books. However, Lloyd's insurers' exposure to US liability lines is generally quite limited and Bear Stearns estimates that Lloyd's potential exposure is around US\$649m.

Brit recently tried to allay analysts concerns by announcing profits which exceeded expectations, no subprime exposure in assets and unusually identified reserves of

£62.5m net of reinsurance to deal with subprime claims. Aviva recently reported that it has £1.9bn subprime related assets which relates to 0.6% of all assets, and Royal Sun Alliance identified its exposure to such assets as £100m. No write downs have been announced by insurers in the UK so far, however.

There has been a greater spotlight in the US, with AIG reporting a US\$11bn write down of its subprime mortgage derivatives in the fourth quarter, for example.

The worst hit, however, appear to have been the specialist bond insurers that guarantee asset securities and mortgage insurers. These insurers are not involved in providing property and casualty insurances and their financial woes are not expected to impact the mainstream insurance markets except for organizations involved in providing reinsurance for these specialist risks.

Elsewhere, Swiss Re announced a CHF1.2bn loss on two credit default swaps and XL Capital took a fourth quarter charge of US\$1.5bn to US\$1.7bn related to credit market conditions. Both Fitch and Bests have subsequently downgraded XL Capital.

Munich Re has announced subprime losses of €20m for the fourth quarter 2007 and now only 0.2% of its total investments are exposed to the crisis. Axa is not expected to have any significant losses and ACE and Chubb are said to have exposures of US\$741m each, 4.6% and 5.25% respectively. Allianz announced subprime write-downs of €575m in the third quarter 2007 in its banking arms.

While there is too much uncertainty to draw many conclusions at this stage, it is generally believed that the global core insurance industry is not significantly exposed to the subprime crisis either through balance sheet investments or exposure to subprime liability claims.

As a word of caution, however, the repackaging of original mortgages that were sold on might mean that claims are yet to emerge. In the meantime the PI market remains soft and we expect little to change this year.

To discuss further details or to arrange a meeting, please contact aviation@aon.com

quarter two aerospace renewals

Manufacturers	Renewal Date
BAE Systems	01 Apr
Crane Company	01 Apr
Denel PTY Limited	01 Apr
Indra Sistemas	01 Apr
Kawasaki Heavy Industries	01 Apr
Liebherr	01 Apr
MBDA SAS	01 Apr
Mitsubishi Heavy Industries	01 Apr
Textron Inc.	01 Apr
Alstom Power Ltd	01 May
Dyncorp	01 May
ITP	01 May
Raytheon Company	01 May
Volvo Aero Corporation	31 May
3M Company	01 Jun
AAR Corporation	01 Jun
Allegheny Technologies Incorporated	01 Jun
GenCorp	01 Jun
HAECO	01 Jun
Lockheed Martin Corporation	01 Jun
Mooney Aircraft Corporation	01 Jun
Sequa Corporation	01 Jun
TAECO	01 Apr
TAESL (Texas Aero Engine Services LLC)	01 Jun
Teledyne Continental	01 Jun
Teledyne Technology	01 Jun
Woodward Governor	01 Jun
L-3 Communications	27 Jun

Airport	Renewal Date
Aeroports de Paris	01 Apr
Bahrain CAA (Govt of Bahrain)	01 Apr
HungaroControl/Hungarian Government	01 Apr
Peel Airports (Holdings)	01 Apr
The Airports Company South Africa	01 Apr
Tunisian Airports (OACA)	01 Apr
CAAC	05 Apr
SEA Aeroporti di Milano (Milan Airport)	21 Apr
Avinor	01 May
CAA of Qatar	01 May
Hong Kong Airport Authority	01 May
Israel Airport Authority	01 May
City of Chicago	15 May
Ente Nazionale Per L'Aviazione Civile	16 May
Dutch Air Traffic Control	01 Jun
NAV E Portugal	01 Jun
NV Luchthaven Schiphol	01 Jun
Southern Cross Airports Corp	01 Jun
Greater Toronto Airport Authority	15 Jun
Airservices Australia	30 Jun

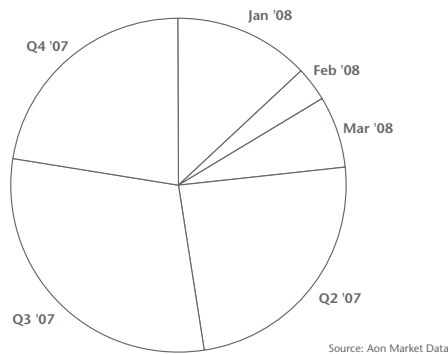
Service Provider	Renewal Date
Abu Dhabi National Oil Co.	01 Apr
Canadian Air Transport Security (CATSA)	01 Apr
CEPSA	01 Apr
Engen Petroleum	01 Apr
Neste Oil OYJ	01 Apr
Petronas	01 Apr
John Menzies	01 May
Kuwait Petroleum	01 May
ChevronTexaco Group	01 Jun
Exxon Joint Venture	01 Jun
Prospect Airport Services	01 Jun

The aerospace insurance market continues its pattern of peaks in activity during the first month of each quarter. In terms of renewals, the second quarter is expected to be the second least active in the year. From a premium point of view, however, it is the second most active as a result of the renewal of some of the world's largest aerospace insurance programs.

The second quarter is dominated by the manufacturing sector, which represents just under half of the total number of renewals, a similar proportion to the full year. The other two sectors are also similar to the full year in terms of the proportion of programs renewing.

We currently only have data for around 10% of the expected number of programs renewing in the second quarter, and as a result do not expect the current -1.7% average lead premium reductions to continue as more data becomes available. It seems likely that unless there is a catastrophic loss or string of losses with potential for claims in on aerospace insurance programs, the average lead premium will continue to fall in the low to mid-single digit range while capacity remains at its current levels.

Aerospace Monthly Renewal Profile



This is the Aon Aviation Aerospace Insurance Market Newsletter, which is our attempt to keep our clients and others informed of developments in the aerospace insurance market.

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