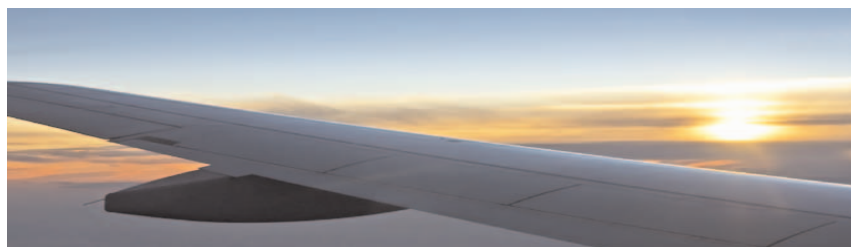


airline insurance market news

MAY 2008



April's +16% increase in average lead hull and liability premium suggests that the market is hardening, but at the same time nearly all of the month's renewals are projecting significant fleet and passenger growth during 2008/09. Once again, the picture is complex.

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overview

The average lead hull and liability premium in the airline insurance market rose by +16% in April 2008, compared to a -17% reduction reported in April 2007.

losses overview

All four months of 2008 have shown an increase in average lead hull and liability premium, suggesting that the market is achieving the hardening that has been touted for the last six months.

the impact of the subprime mortgage crisis on insurers

The increases are being offset by risk exposure growth, however. Average fleet value (AFV) and projected passenger numbers, the main gauges of exposure, have risen by around 20% on average for renewals in 2008, suggesting that on a rating basis the market is flat or even falling in real terms.

airline renewals

Over half of the programs renewing in April have seen their average fleet values grow by more than 10% compared with their 2007/08 policies. Six expect increases in passenger numbers of more than 30%.

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Exposure Grows

Interestingly, AFVs and passenger movements are based on projections for the whole of the insurance policy period. If it transpires that the global economy takes a significant turn for the worse, it may be that these figures will be lower when the full year figures become available.

The International Air Transport Association (IATA) appears to support this suggestion. Its report on passenger numbers for March 2008 shows year-on-year passenger

growth of 5.8%, but it suggests that the figures are skewed by Easter falling early and that the true figure is closer to 4%. January and February numbers also point to slowed growth, IATA says.

This creates the potential for a significant correction in the projected passenger movement figures for the rest of the year and early 2009/10 airline renewals. It may also mean that the lease rates for aircraft may fall over the next few months as airlines are unable or unwilling to buy their expected orders as a result of difficulties in securing finance.

We expect two more renewals to have occurred in April, although neither is expected to be large enough to change the averages significantly.

Harsh Times

Looking at the aviation industry itself, the high cost of aviation fuel is creating significant problems for carriers across the globe.

In the US, oil prices have been cited in the bankruptcy of ATA Airlines, Aloha Airlines and Eos Airlines, as well as smaller operators Skybus Airlines and Champion Air. Frontier Airlines has filed for Chapter 11 bankruptcy protection, but continues to operate.

Elsewhere, Nationwide Airlines in South Africa and Oasis

(continues over)

Quarter 1	Renewals	Fleet Value Movement (% Change)	Passenger Movement (% Change)	Expiring Premium (US\$m)	Renewal Premium (US\$m)	Premium Movement (% Change)
Quarter One '07	12	-10	-14	49.40	37.60	-24
Quarter Two '07	50	+13	+15	222.72	187.21	-16
Quarter Three '07	49	+14	+13	273.69	245.03	-10
Quarter Four '07	102	+8	+7	1,156.19	1,040.39	-10
Quarter One '08	9	+12	+34	25.43	27.32	+7
April 2008	18	+21	+18	88.99	103.61	+16
2008-to-date	27	+20	+19	114.42	130.93	+14

Source: Aon Market Data
All available data

market overview (continued)

Hong Kong Airlines have both suspended operations.

The cost of fuel is also named as one of the primary reasons behind the proposed merger between Delta Air Lines and Northwest Airlines. The coming together of the two airlines would an operation with an AFV of around US\$28bn before synergies.

As suggested previously, bringing two major US airlines together has led to significant speculation that there will be further regional consolidation. US Airways and United Airlines, for example are said to be discussion.

In Europe, meanwhile, discussions between Air France KLM and Alitalia have once again reached an impasse. There is speculation that the change of government in Italy may help clarify the flag carrier's status, and there are said to be a number of other airlines interested in stepping in, including Russia's Aeroflot and Italy's own Air One. December renewal Alitalia, which has an AFV of around US\$5.5bn, has been for sale for over a year.

Meanwhile, Boeing has confirmed a six month delay in both first flight and first deliveries of its new 787 aircraft. Planned production of the aircraft will be 75% lower in 2009 than previously forecast, the manufacturer says. The stretched 787-9 iteration will be delayed by two years, with first deliveries expected in 2012.

The delays are being blamed on difficulties faced when bringing completed sections of the aircraft together as well as more time needed to complete flight tests.

Safety Improvements Continue

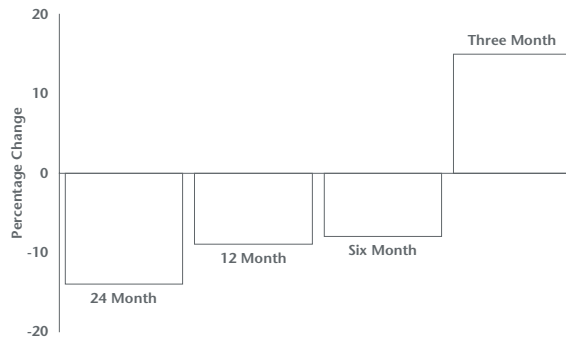
The Federal Aviation Administration (FAA) has said that its latest safety audit revealed 99% airline compliance with its Airworthiness Directives. It also plans to improve its inspection programs and wants aircraft black box data recorders to be upgraded.

According to the FAA, this has been the safest period in aviation history and the black box enhancements will increase the information collected about 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.

Meanwhile, IATA is currently implementing the IATA Safety Audit for Ground Operations (ISAGO), complementing its IATA Operational Safety Audit. The association says that the new program is aimed at reducing accidents and injuries on the ground. IATA intends to conduct regional ISAGO information seminars throughout 2008.

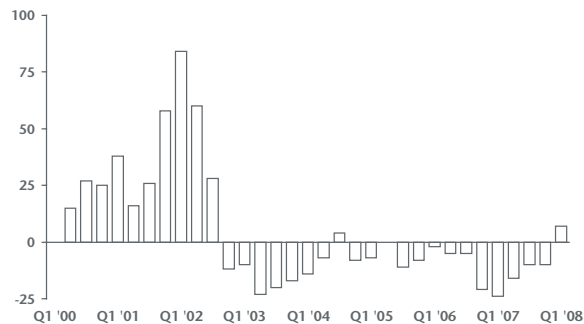
Further work by organizations such as the FAA in specific countries and IATA globally is likely to encourage a continuation of the recent good loss environment in the aviation industry. The key point to remember is that aviation remains an industry with a high potential for catastrophic loss and the price of insurance must reflect this. Prices have fallen for 19 of the last 21 quarters, and no matter how safe the industry becomes, some sort of correction has become almost inevitable if the market is to remain viable in the long term.

Average Percentage Premium Movement



Source: Aon Market Data

Average Quarterly Percentage Premium Change 2000-08



Source: Aon Market Data

losses overview

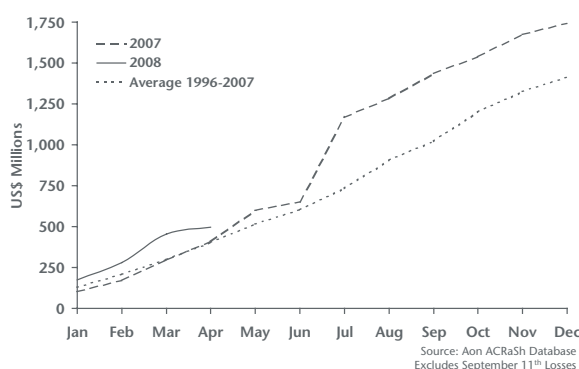
The hull loss figure excluding attritional losses is US\$325m so far in 2008, compared to US\$244m recorded at the same point last year. Taking a pro-rata figure for an annual estimate of attritional losses into account, the overall loss total is US\$497m, compared to US\$408m in 2007.

No incidents that meet our criteria have occurred since the last edition of this newsletter, again highlighting the improved safety rates in the aviation industry over the last few years.

This means that while the cumulative losses for the industry in January 2008 were 70% higher than they were in January 2007, at this point at the beginning of May, they are only 20% higher than a year ago (these figures have changed somewhat since last month as a result of values of some losses being confirmed).

Cumulative Loss Graph 2008

(Including attritional losses)



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 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 that only a quarter of claims relating to write-down losses will be valid. That said, lawsuits involving investment banks, money managers and rating agencies may 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, identifying 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. UK-based insurers have not announced any write-downs so far, however.

Much of the focus has been on the US, with AIG reporting a US\$11bn write-down of its subprime mortgage derivatives at the end of 2007, 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, equating to 4.6% and 5.25% respectively. Allianz's banking arms announced subprime write-downs of €575m in the third quarter 2007.

While there is currently too much uncertainty to draw any definite conclusions, market commentators suggest 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. The PI market, meanwhile remains soft and we expect little to change this year.

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

airline renewals

Airline	Renewal Date
easyJet	01 May
Air Jamaica	01 May
Transaero	01 May
Tarom - Romanian Airlines	01 May
Air Canada Tier III	01 May
JetX	07 May
Sunwing Airlines	10 May
Aerolineas Mesoamericanas (ALMA)	11 May

Airline	Renewal Date
Virgin Atlantic Airways	14 May
Virgin Blue	14 May
Virgin America	14 May
Virgin Nigeria Airways	14 May
Audeli Air	15 May
Ryan International	15 May
airblue	18 May
Vueling Airlines	19 May

While activity in May is somewhat lower than witnessed in April, the month is still expected to provide a good spread of airline types. In 2007, April represented 7% of the total lead hull and liability premium, while May only represented 3%. May was still the fifth most active month in terms of hull and liability premium renewed, higher than the October total, traditional the start of the renewal season.

Compared to last year, six programs have extended, one dropped below the threshold for inclusion in the data that we track in this newsletter, and one other joined a group program. There are two airlines that have joined the list of May renewals, one due to fleet growth and another that has come out of a large group program that renews in November.

The question of exposure growth will make the May numbers pivotal for the direction of the market in 2008/09. A great deal of the increases in lead hull and liability premium that have occurred so far this year appear to have been the result of exposure growth, but if the renewals come in with increases in hull and liability premium without corresponding exposure growth, it would be further evidence that the market has been successful in hardening.

The market remains in a fascinating position as the mid-point of the year approaches. Losses are higher than they were a year ago, but fatalities are once again relatively low. At the same time, the market appears to have at least stabilized if not hardened despite the high capacity creating the potential for competition.

The airline insurance market is unlikely to have continued on the trajectory set in early 2007 and remained viable. As a result, despite all of the factors weighing in favor of continued reductions, the market has had to undergo something of a correction. The question is how long the process will take and how deep the correction will be.

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

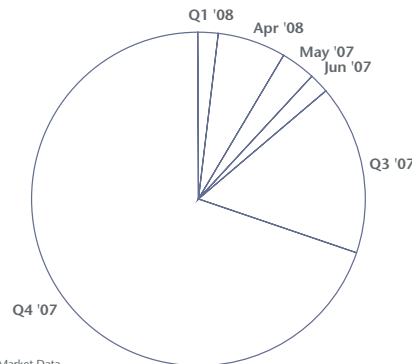
We welcome any comments or suggestions to add to or improve our product.

If you have any comments regarding this newsletter, please contact: Magnus Allan: magnus.allan@aon.co.uk

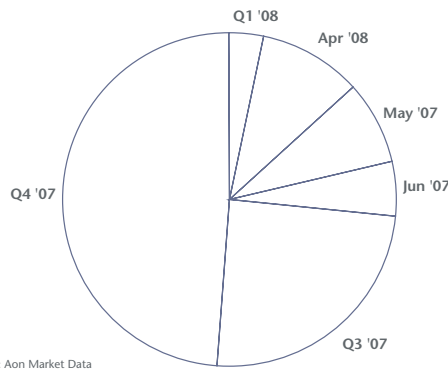
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Airline Monthly Premium Profile



Airline Monthly Renewal Profile



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\$1million. We only write about losses over US\$10m.

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