airline insurance market news

AUGUST 2008

The airline insurance market continues to be virtually flat from a lead hull and liability premium perspective. July was the third most active month in 2007, and looks set to overtake November as the second most active in the airline insurance market calendar.

PDF users click blue contents title to move to section

Click on Aon logo to access the Aon Aviation & Aerospace website

overview

July has continued the virtually flat lead hull and liability premium growth witnessed last month. Of the recorded renewals, 11 received a reduction in their lead hull and liability premium, three had increases of 5-10%, and the remaining 14 saw their lead premium increase by more than 10%.

This suggests that it is still possible to achieve modest reductions in lead hull and liability premium if the program being placed has an attractive risk profile. The markets continue to take robust negotiating positions however, and reductions are currently the exception rather than the norm.

The gap between lead and following markets continues to close, with secondary markets negotiating program participation according to risk perception rather than lead market price.

Data recorded so far for July suggests that the month represents 46% of the total amount of lead hull and liability premium to renew so far this year. Given that four more renewals are expected, it is highly possible that the month could come close to representing half of the total lead premium collected in the first seven months.

Meanwhile, July looks set to overtake November as the second most active month in the airline insurance market, assuming that there are no major additions to the renewal list in November this year. In 2007, the total amount of lead hull and liability premium renewed in November was US$191m, 4% below the amount of premium renewed in July 2008 with further renewals expected.

Despite the industry's difficulties as a result of the high fuel prices and consumer uncertainty, orders for new aircraft appear to still be buoyant. Nearly 600 new aircraft were ordered during the Farnborough International air show, which compares with just over 200 ordered at the same event two years ago, although the orders were dominated by activity in specific regions.

It would seem that the general feeling in the industry at the moment is that while times are very difficult, the situation is likely to improve in the longer term and airline organizations need to be ready to make the most of their position when the outlook improves.

Coupled with this is the industry's drive to improve its fuel economy from both an environmental and financial perspective. One of the conclusions seems to be that the best ways to improve fuel economy is through the introduction of newer aircraft.

BA, Iberia in talks

Another way to improve efficiency is through bringing operations together. British Airways and Iberia have confirmed that they are holding talks about a possible merger. The negotiations, which could take several months, are supported unanimously by the boards of both

(continues over)

Quarter 1	Renewals	Fleet Value Movement (% Change)	Passenger Movement (% Change)	Expiring Premium (US$m)	Renewal Premium (US$m)	Premium Movement (% Change)
2007 Total	213	+9	+8	1,702.01	1,510.22	-11
Q1 2008	8	+9	+34	24.45	25.80	+6
April	20	+22	+18	92.67	108.14	+17
May	14	+13	+19	46.29	50.02	+8
June	14	+23	+6	42.32	42.28	0
July	28	+3	+8	195.39	197.38	+1
2008-to-date	**84**	**+11**	**+13**	**401.13**	**423.61**	**+6**

Source: Aon Market Data
Numbers on a like-for-like basis

market overview (continued)

companies which have previously been given approval to co-operate widely by the European Union.

Bringing the two organizations together would create an operation with an average fleet value of around US$27.5billion carrying around 90 million passengers before synergies. British Airways renews its airline insurance program in April, while Iberia renews in December.

Aon's estimates suggest that a merger would create the world's sixth largest insurance placement by average fleet value (British Airways is currently eight largest and Iberia the 23rd largest). In terms of passengers carried, the combined operation would be the eighth largest in the world (British Airways is currently 13th largest and Iberia is 26th largest).

US War Risk Coverage Extended

The US Department of Transportation (DOT) has extended war risk insurance for the rest of 2008. There has been a continuing question about whether the US government would drop the coverage because it is suggested by some, including the DOT, to give an unfair advantage to US airlines when competing internationally.

The coverage was introduced after 9/11 when a number of commercial insurance markets cancelled third-party liability war-risk insurance or priced it at prohibitive levels as a result of the perceived increase in threat. According to Air Transport Intelligence, the DOT currently insures 75 air carriers with coverage ranging from US$80million to US$4billion per carrier.

A DOT statement says that the extension is intended to avoid burdening US carriers with higher insurance costs on top of increasing fuel prices. It reiterates the DOT's long-term goal of permitting a gradual re-entry of commercial insurance companies into the war risk market.

Aon services

Counter Terrorism Risk Management

Critical infrastructure hubs such as airports and airlines represent a primary target for terrorists. Equally, the nature of terrorist incidents means that even if a client's facilities are not the primary target, there may still be casualties, property damage, business interruption, relocation costs, long-term damage to reputation and loss of public confidence.

Society is also becoming more litigious. There is an emerging opinion that terrorism is a foreseeable event, and in order to address liability exposure, companies need to have adequate procedures in place to mitigate the risk and fulfill their duty of care.

As part of a sound counter-terrorism risk management plan, clients are advised to:

- Understand risk
- Make employees, customers and the public aware of the risk
- Have physical counter measures in place
- Have adequate response plans and procedures and keep them up to date

Managing the risk

Getting the right advice is difficult. How can organizations ensure that risk assessments are accurate and that mitigation and response procedures are adequate? Has a company bypassed thorough risk assessment in favor of managing the risk through insurance alone?

This could lead to not only a failure in duty of care, but also an inappropriate or unnecessary spend. A company may be over or under insuring assets, or insuring some unnecessarily while leaving others exposed.

Aon has developed a unique approach to terrorism risk management, combining expert counter terrorism consulting with the most appropriate risk transfer solutions.

Counter terrorism consulting

Aon's Crisis Management team conducts thorough terrorism risk assessments, identifying threats in each location, looking at vulnerability to that threat, then modeling the most likely risk scenarios.

Once the most likely perils have been identified, their impact on a business is modeled and any weaknesses in a client's protocols and procedures highlighted. They then help clients make informed decisions about the most appropriate risk management strategy.

Key benefits

Aon's approach to terrorism risk management enables organizations to:

- Understand the risk to employees and operations in each location
- Ensure risk mitigation and crisis response procedures are appropriate and adequate
- Understand where there are weaknesses, and what needs to be done to meet duty of care obligations
- Improve operational resilience to low probability but high impact events
- Enhance the decision making process in the event of a terrorist incident
- Pick the most appropriate level of cover by country or site, ensuring insurance premium spend is fully justifiable.

Consulting services and insurance placement are both available on a stand-alone basis. If you would like further information about Aon's global counter terrorism risk management products and services, please contact aviation@aon.com

Terrorism risk management is more complex than ever. Extremist groups are international and may target any global organisation anywhere in the world. They aim for sensational destruction and loss of life, and give no warnings. Groups are cross-fertilising and becoming more sophisticated.

forecasts for 2008

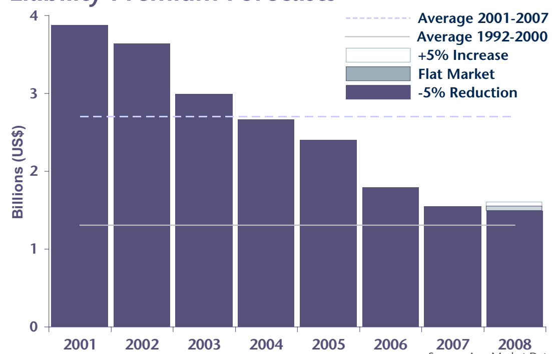
With the majority of July's figures now available, it becomes more possible to forecast market direction for the rest of the year, although naturally these are very preliminary.

It seems likely that the recent flat market conditions will continue until year end, unless a major incident changes market sentiment significantly.

As a result, we forecast a total lead hull and liability figure of around US$1.54bn for the airline insurance market if the market remains flat, which could rise to around US$1.6bn if there is a 5% increase or fall to US$1.49bn if there is a 5% decrease.

There is still scope for the market to decline further if it is to return to pre-9/11 levels, but it should be pointed out that prior to 2001 the airline insurance market had been losing money for some time. As a result, capacity was tight and prices already rising prior to 9/11, and risk exposures are significantly higher than they were seven years ago. A return to this position may not be in the best interests of anyone associated with the markets or the industry that it serves.

2008 Lead Airline Hull and Liability Premium Forecasts



Source: Aon Market Data

Given that the airline insurance market broadly made a loss in 2007 as a result of the total number of hull and liability claims outweighing the total lead hull and liability premium, the 2008 renewal season will have an added significance for airline insurance capacity going forward.

losses

The loss figure excluding attritional losses is US$496m so far in 2008, compared to US$916m 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$798m, compared to US$1,203m in 2007.

Recent Losses

There has been a single loss valued at more than US$10m since the last edition of this newsletter.

On June 28, an ABX Air Boeing 767-200 was damaged by fire while on the ground at San Francisco International Airport. The 22 year old aircraft, registration N799AX has been declared a partial loss. The two person crew escaped without injury.

The limited loss activity in July means that despite the cumulative loss totals being 63% higher than 2007 in January, the current total is 34% lower compared to 2007. That said, it is still 9% higher than the 1996-2007 average loss rate.

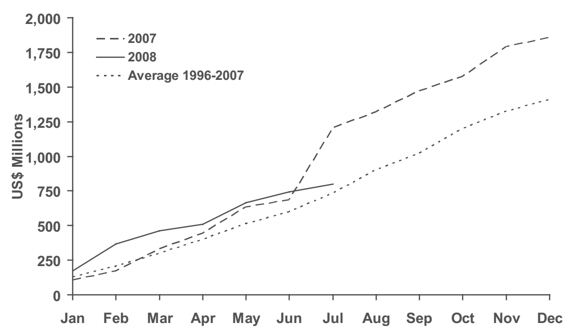
Long-tail Claims

The key point to remember is that while we focus on hull losses that are above the specific thresholds detailed on the back page, the liability claim on smaller losses can also have a significant impact that often takes time to come through after an incident.

As a result, while a loss may initially seem too small to impact market sentiment, the position may change as the liabilities come through. For legal reasons we cannot comment on the cost of liability claims on individual incidents.

Cumulative Loss Graph 2008

(Including attritional losses)



Source: Aon ACRaSh Database
Excludes September 11th Losses

Equally, it must be remembered that a single loss can have a significant impact on these figures.

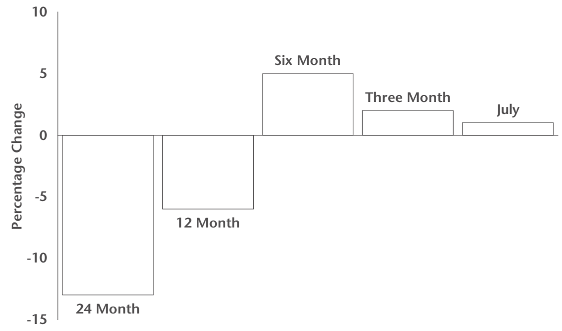
Separately, on July 25, a Qantas Airways Boeing 747-400 en route from Hong Kong to Melbourne made an emergency landing in Manila. On landing, the aircraft was discovered to have a large hole in its fuselage following what initial reports suggest to have been an exploding oxygen tank. Despite the incident occurring while the aircraft was in flight, causing depressurization and the pilots to descend rapidly by 6,100m, the aircraft was landed safely and all 346 passengers and 19 crew disembarked with no reported injuries.

This appears to be another example of a major aviation catastrophe being averted which could potentially have involved a significant loss of life and a major claim on the aviation insurance market.

airline renewals

Airline	Renewal Date
AirAsia	01-Aug
Gemini Air Cargo	01-Aug
Miami Air International	01-Aug
Monarch Airlines	01-Aug
BRA Transportes Aereos	14-Aug
Thomas Cook Airlines	14-Aug
Biman Bangladesh	15-Aug
Skymark Airlines	19-Aug
Berkut Air	23-Aug
Pegasus	24-Aug
XL Leisure Group	29-Aug

Average Percentage Premium Movement



Source: Aon Market Data

After the high level of activity in July, August is expected to be somewhat calmer. That said, although last year the month delivered a comparable amount of lead hull and liability premium to March, June and September, changes to the renewal list should mean that August is more active than last year.

Three programs have come off the August renewal list, one of which has extended, one added to a group program and one whose fleet value has fallen below the level for inclusion in this newsletter.

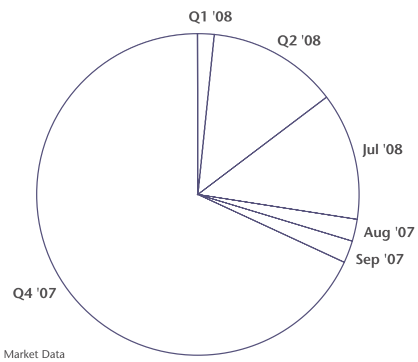
These have been replaced by two new programs, one of which has extended from April and one of which was formerly part of a group program. European tour operator Thomas Cook Airlines, the month's largest renewal, was added to the list of August renewals last year.

These renewals are the three largest to occur in August, and as a result will have increased the month's relative importance in terms of lead hull and liability premium.

As a result, despite being a traditionally quiet month in terms of industry activity as a whole, the airline insurance markets could offer further evidence of market direction for the next few months.

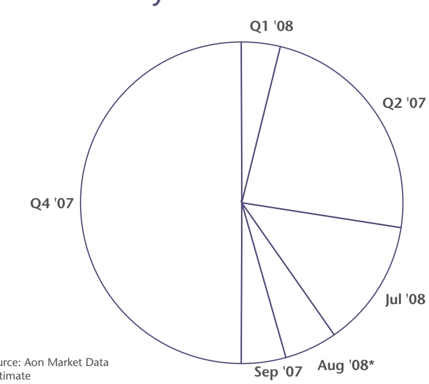
It seems likely that the tough negotiating stance taken by many airline underwriters will continue as the November/December renewal season begins to come into view, with following market positions continuing to be an issue.

Airline Monthly Premium Profile



Source: Aon Market Data

Airline Monthly Renewal Profile



Source: Aon Market Data
*Estimate

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

For information and analysis, please contact:
Kelly Fuller: kelly.fuller@aon.co.uk
Paul Mitchell: paul.mitchell@aon.co.uk

Aon UK is authorised and regulated by the Financial Service Authority for insurance mediation services only.

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.

We must point out that due to the nature of this type of bulletin, Aon UK cannot be held responsible for any loss or damages caused through the use of any information contained herein. While we try to comment on issues we know to be fact, we are fully aware that in gathering the information contained from various sources there is always the possibility of inaccuracy. We can therefore only claim that the information in this newsletter is correct to the best of our knowledge at the time of publication.