

## Marsh/IATA/AEA sponsored liability WMD write-back clauses now finalised by AICG



A process started by the Aviation Insurance Clauses Group (AICG) in October 2005 with the Consultation Period on AVN48C, AVN52X and AVN52Y, has now been completed by the release of the following new war clauses:

**The underwriter sponsored clauses:**

**AVN48C** - WAR, HI-JACKING AND OTHER PERILS EXCLUSION CLAUSE (AVIATION)

**AVN52H** – EXTENDED COVERAGE ENDORSEMENT (AVIATION LIABILITIES) – applicable to coverage provided to aircraft operators, (formerly designated AVN52X)

**AVN52J** – EXTENDED COVERAGE ENDORSEMENT (AVIATION LIABILITIES) – applicable to coverage provided to service providers, (formerly designated AVN52Y)

The above clauses were originally produced at the request of the Lloyd's and London Company Aviation Underwriter Associations and are intended to **exclude all** cover for the hostile use of so called weapons of mass destruction (WMD), namely nuclear, radioactive contamination (RADCON), bio/chemical (BIO/CHEM) and electromagnetic pulse (EMP) devices or materials.

**The Marsh/IATA/AEA sponsored clauses:**

**AVN48D** - WAR, HI-JACKING AND OTHER PERILS EXCLUSION CLAUSE (AVIATION)

**AVN52K** – EXTENDED COVERAGE ENDORSEMENT (AVIATION LIABILITIES) – applicable to coverage provided to aircraft operators.

**AVN52L** – EXTENDED COVERAGE ENDORSEMENT (AVIATION LIABILITIES) – applicable to coverage provided to service providers.

These clauses were requested and outlined by Marsh, IATA and AEA in their November 2005 co-ordinated responses to the AICG Consultation on AVN48C mentioned above. The clauses are intended to provide **limited WMD** cover for RADCON, BIO/CHEM and EMP devices or materials. There is no cover for nuclear or atomic detonations.

Marsh produced the first drafts of these clauses which were reviewed by other brokers on the LMBC Aviation Technical Committee before submission to AICG in January 2006. The LMBC Aviation

Technical Committee has continued to monitor the progress of the clauses.

A copy of each of the above clauses is included in *Appendix 1*.

*Appendix 2* includes comparisons of WMD coverage provided by the current and new AVN52 clauses.

### **What Marsh, IATA and AEA set out to achieve with these clauses**

1. In order to have any chance of market support we had to limit underwriter's potential exposure to WMD loss accumulation as much as possible, especially in an airport attack scenario.
2. We had to demonstrate to the EC, who were closely following the AICG process, that the industry and Marsh were fully engaged and using their best efforts to obtain a market solution.
3. We had to achieve a level of cover that would reasonably comply with EU Regulation 785/2004.
4. For corporate governance purposes we had to achieve a reasonable level of cover for all sectors of industry.

### **What AVN48D, AVN52K and AVN52L are intended to cover**

AVN52K and AVN52L are more complicated than the other AVN52 write-back clauses, and to assist all users, the AICG have produced detailed Guidance Notes that are included in *Appendix 1*.

The following explanation of what we intended these Clauses to cover is provided, purely for guidance purposes only:

The clauses are designed to provide limited cover for the hostile use of RADCON, BIO/CHEM and EMP in addition to the other perils normally written back by AVN52 clauses.

Any cover provided for WMD perils is within the Policy limits applying to the main AVN52 write-backs (paragraphs a and c to g of AVN48D), and not in addition to those limits. All WMD cover and WMD sub-limits are fully negotiable.

Any or all of these WMD perils can be covered. For example, if an Underwriter feels unable to provide RADCON cover then he can just cover BIO/CHEM and EMP, or if he feels unable to cover RADCON and EMP then he can just cover BIO/CHEM.

The limited cover is split into two sections to provide the opportunity of maximum limits for 'Single aircraft cover', where loss accumulation potential to underwriters is low, and reduced limits for 'Regulatory/corporate governance compliance cover' (Regulatory cover), where the accumulation potential to underwriters is higher because of the airport exposure.

The Clauses allow for one or both of the *Single aircraft cover* or *Regulatory cover* to be included.

Any variations of cover and limits are possible although we hope that the limitations built into these Clauses will allow the underwriters to provide the maximum cover for their clients under both sections, as follows:

#### **Single aircraft cover (Paragraphs 1.2 (i) and (ii) of AVN52K and AVN52L)**

Any aircraft on which the hostile use of a WMD device originates whether on the ground or in the air or any

aircraft that suffers a crash fire explosion or collision or a recorded emergency as a result of a WMD peril originating external to the aircraft while in flight can be covered up to the maximum policy limits under this section.

However, there is no cover for EMP originating external to the aircraft under this section because no one is certain how many aircraft can be brought down by one of these devices. In view of this uncertainty, cover for EMP originating external to an aircraft is only included in the *Regulatory cover* section.

There is also no cover under this section for any aircraft that, knowingly or otherwise, flies through a WMD contamination cloud and lands normally, even though contamination may have entered the aircraft. Multi aircraft contamination in these circumstances is a possibility according to experts advising underwriters so cover for this type of loss is covered under the *Regulatory cover* section only to minimise any accumulation.

#### **Regulatory cover (Paragraph 1.3 of AVN52K and AVN52L)**

This section provides the opportunity to cover all WMD losses but only for restricted limits as negotiated. If *Single aircraft cover* is operative then that cover is excluded from this section, although claims arising from one event can be covered under both sections.

For example, under AVN52K, if the use of a WMD device originating on board an aircraft on the ground (as covered by *Single aircraft cover*) also affected the carrier's passengers on another of their aircraft on the ground or in the terminal, then this section would provide cover up to the restricted limits negotiated for

liability to those passengers. Any liability arising from contamination to other carrier's aircraft or passengers would be covered by the third party aggregate limit available under *Single aircraft cover* or *Regulatory cover*, whichever is the highest.

### Timing

Based on Marsh's on-going discussions with leading underwriters, we do not expect any of these clauses to be used prior to 1 October 2006 renewals at the earliest. Indeed, some underwriters have indicated to us that they may delay introduction of these clauses until the beginning of 2007.

In any event, leading underwriter's have made it clear that they have no intention of rushing any of these clauses into use until they have had time to fully discuss with their reinsurance underwriters and, most importantly, their clients.

We will advise further as the reinsurance market position develops.

### Marsh working with like-minded underwriters for the benefit of the industry in general

AVN52K and AVN52L write-back clauses are largely based on the WMD coverage innovations that Marsh developed last year for our clients in response to the hull war market excluding WMD cover last year.

In order for the industry in general to benefit from our efforts, Marsh worked with a number of underwriters including Angus Roberts of St Paul, Mark Adams of Kiln and Bruce Carman of Atrium to produce LSW555D. Introduced in April 2006, LSW555D provides limited WMD cover and is the new market standard.

Not content with our efforts to improve hull war WMD cover, we were also the first broker to obtain agreement on two of our flag carrier policies to LSW555D replacing LSW555C mid-term at no extra cost. This very quickly led to all air carrier policies being changed mid-term across the market.

As with our efforts on hull war WMD cover, Marsh has been working with a number of underwriters on the liability WMD issue since early 2005. These underwriters agree in principle to providing limited WMD primary liability cover for clients. We are working on building further support to this position so that AVN52K and AVN52L become the new standard for liabilities. This will be very challenging to achieve but we will continue our work with IATA and AEA to try to allay some of the market's unstandable concerns on WMD exposure.

### Excess third party war liability market

The position of this market on the WMD issue will largely depend on the take up of AVN52K and AVN52L by the primary liability market.

If AVN52K and AVN52L are accepted by the majority of the primary market then we do not anticipate any major issue with the excess market providing excess WMD third party cover for air carriers and aircraft operators.

The position on service providers may require discussion in order for underwriters to be satisfied that they do not face any increased loss accumulation potential from WMD perils than from other war and terrorism perils if a number of service providers are implicated in the same WMD loss.

We will advise further as the Excess AVN52 market's position develops.

### Regulatory approval

#### EU Regulation 785/2004 minimum insurance requirements

The AEA, IATA and Marsh have met with the EC on many occasions since the first draft of AVN48C was released in June 2003 in order to lobby for government involvement in the provision of WMD cover.

Since the above regulation came into force in April 2005, the EC have stated at our joint meetings and even at industry conferences, that AVN48C breaches the requirements of 785/2004. They have stated that any intervention by governments would at best be short term and if there was no insurance market solution available then there would have to be an industry solution.

Furthermore, the EC made it clear that they expected AEA, IATA and Marsh to make every effort to obtain a market solution especially in view of the formation of the AICG that the EC had agreed with the London Aviation Underwriting Associations in March 2005.

At our latest meeting with the EC in June 2006, AEA, IATA and Marsh were able to demonstrate their full participation in the AICG process from start to finish - Carol Gates of IATA represented the industry on the AICG War Clauses Group and Ken Coombes of Marsh represented the LMBC - so no criticism of the industry's efforts to obtain WMD cover could be levelled. We made it clear to the EC that the AICG process worked as intended but, as they were aware, AVN52K and AVN52L were not binding on underwriters.

We therefore pressed the EC to provide a formal position on

785/2004 compliance at the earliest opportunity as clarity was urgently needed. We also pressed them to accept 100,000 SDR as the minimum passenger limit for WMD under the regulation on the basis that for an airport WMD attack, most airlines would have no fault and only be exposed for the Strict Liability limit.

The EC are considering our input and we will advise further when we have their formal response.

At this time, in order for a commercial air carrier to fully comply with EU Regulation 785/2004, AVN52K Regulatory cover section would need to provide cover for all WMD perils with the following sub-limits:

#### Passenger liability

US\$375,000 per passenger

#### Baggage

US\$1,500 per passenger

#### Cargo

US\$25 per kilogram

#### Third Party

Up to US\$150m aggregate (plus Excess Third Party War Liability cover as needed to reach total third party limit required based on MTOM of aircraft operated).

We have included in *Appendix 3* an example of AVN52K completed on the above basis which represents the optimum position for aircraft operators, and an example of AVN52L completed at US\$50m aggregate limit for all WMD perils.

#### Other regulatory approval

At this time, the minimum insurance regulations for flights to and from Australia, Canada, Switzerland and the United States of America only allow underwriters to exclude, at the most (a) and (b) of AVN48B.

Therefore, underwriters will have to obtain approval from these countries regulatory bodies to amend the regulations to (a) and (b) of AVN48C or AVN48D. If they decide to use AVN48C and AVN48D before approval is obtained then they will have to rely on the reimbursement provisions of the AVN57 series of clauses that incorporate the above minimum insurance regulations into air carrier insurance policies. Up to now underwriters have been reluctant to do this and we will advise if this position changes.

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