

Plane Talking

JLT AEROSPACE

MARCH 2011

Executive Summary

The seatbelt sign is now illuminated

Market capacity appears to be holding firm overall, however it should be noted that individual markets continue to realign their portfolios and this is likely to create some imbalance over the short term, with specific segments of the market seemingly abundant with capacity leading to heightened competition whilst other segments may appear to be much more challenging to complete orders. Due to individual views, portfolio experiences and differing corporate drivers, it is inappropriate to offer any meaningful segmental analysis at this point in time.

It is highly likely that the recent string of catastrophic events will impact the reinsurance market, particularly in respect of catastrophe capacity, with the prospect that capacity to support lines such as aviation may become scarcer (and more expensive). However to date there is no evidence of this. Indeed the recent April 1st aviation reinsurance programme renewals might suggest the opposite, with competition between reinsurers as fierce as ever.

Another possible issue may come from the implementation of the new Solvency II capital rules, which will generally increase capital requirements, particularly for risks that possess catastrophic loss components such as aviation. On the other hand these speciality lines actually bring greater diversification to a portfolio with the effect of lowering required corporate capital.

How these influences ultimately play out is anyone's guess, but the cost of capacity is set to increase over time bringing further pressure to increase aviation premium levels.

Another significant influence on capacity is actual loss experience and whilst it is undeniable that the market has endured a difficult few years, individual results have been varied as well as the ability to cross fund aviation classes. Perhaps the greatest spectre for disturbing market stability in the short term rests with a frequency of large or very large losses. Such an experience will force market pricing to change quickly or capacity to be curtailed leading to the same end result.

Exposures continue to show modest growth, particularly in the shape of passenger numbers although of course there have been only a few renewals to date during 2011. Nevertheless this trend is set to continue as well as the inexorable underlying growth in aircraft values together with the cost of repairing the most modern equipment.

Overall premium levels appear to be holding although each renewal demonstrates its own unique factors leading to a broad range of renewal outcomes, whilst rates often appear still a "means to an end" rather than the key determinant in premium setting, as driven by many of the rating models.

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Editor's note

“ Please note that over the coming months we will be refreshing the format and content of Plane Talking. We hope that you can take a moment to complete our online reader survey to help us improve on our future editions. ”



Lead Lines

“ Towards the end of 2009 and throughout 2010 we have seen an increasing trend appearing within the Airline sector of the market. This trend has been titled as ‘reverse verticals’ others have called it ‘gouging’.

Where did it all start? And where will the market go?

During the seventies, eighties and arguably the nineties Airline underwriters developed in the feast or famine culture with more years of famine than feast. As it became clear that no one was making money, consolidation became the name of the game. As we moved into the new millennium and after seeing the effects of 9/11 the capacity became more security conscious and aware of the downside in the event of the unthinkable catastrophic loss.

More recently we have seen four consecutive years where claims have exceeded global premium. At the same time there has been in excess of 200% of capacity, and significantly underwriters have become more risk selective concentrating their focus on either sub sectors of the business, e.g. low cost carriers, second or third tier carriers and/or geographical classification. They believe that by carving the airline sector into smaller parts that rates in these same parts were at a sustainable level. In addition, the use of rating or capital allocation models have now become commonplace thus forcing the underwriter to look at the business in a far more sophisticated corporate manner. So important are these models that some underwriters have been accused of relying totally on these tools rather than utilizing an element of risk assessment and personal opinion. Business plans have therefore been developed on the basis of risk selection. This has effectively allowed whole sectors of the market to view certain types of business in a more critical manner, e.g. if it does not fit the plan, don't write it. This will have the result of reducing available capacity on these risks. Additionally, we are now seeing maximum hull values well in excess of USD300m and coupled with liability limits in excess of USD2,250m means that again in this ‘major airline’ segment available capacity will be well below 200%.

As these market dynamics evolved the role of the lead underwriter has also changed. The leader when rating the business must be extremely conscious of what the actual working capacity is on any given area of the business. Therefore, when the inevitable pressure gets applied by the broker and the leading underwriter is asked to become more competitive because the broker is under threat from a rival, the underwriter should be aware at what price level a risk becomes unplaceable. We have seen a huge number of people moving from one broker to another in recent times. Each move escalates the level of competition within this area of the market. Each broker is fighting harder to either win or defend an account. This intensity has required the broker to apply yet more pressure on the underwriters and unfortunately, it would appear that, not all are up for the fight.

Regrettably, in recent history, there are far too many examples of where the leader has essentially got it wrong and whole sections of the following market have achieved higher prices. There are also those underwriters who now adopt a policy of waiting until a risk is nearing completion and knowing the broker is up against the clock will deliberately ‘gouge’ a higher set of terms without necessarily knowing or caring whether or not these terms are justifiable. The boast of being at higher than lead price is effectively the plan!!

The question therefore needs to be asked, what is the modern role of the lead underwriter? Does the market now evolve into an ‘every man for himself’ environment where individual shares are all negotiated independently? The implications of this are potentially damaging for the market and the insured. Who will take on the responsibilities of servicing the business from a technical standpoint, who will be ultimately responsible for the claims handling and will the current differences in price then develop into differences in cover and potentially gaps in cover? In the co-insurance marketplace all underwriters are bound together and therefore cannot adopt a totally selfish perspective to the business.

An additional feature that is also taking on a different form is the application of the leaders fee.



Andrew Trundle, Senior Vice President - Head of Underwriting - Aerospace, Chartis Insurance UK Limited

Biography

Insurance Industry Experience: 33 years

Aviation Experience: 33 years

Andrew Trundle is the Head of Underwriting at Chartis Insurance UK Limited and was promoted to Senior Vice President in 2011.

Andrew rejoined AIG Aviation London in mid 2004 and was promoted to Vice President, Airline Underwriting in June 2006, after initially joining AIG Aviation London in 1996 until 2000. Andrew later formed the Aviation department of the Catlin Syndicate in Lloyds.

Andrew started his career working for Phoenix Assurance Aviation division in 1978, who later merged with the Royal Sun Alliance which became part of the British Aviation Insurance Group, now Global Aerospace Underwriting Managers.

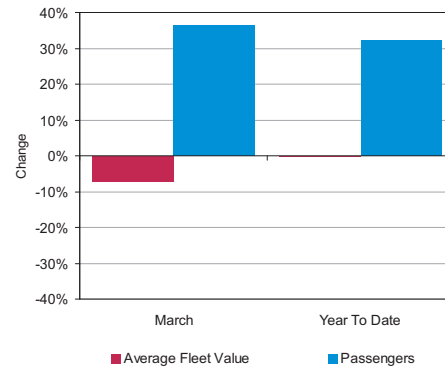
Renewal Analysis

Exposures

Due to the dearth in airline renewals in March, there is no discernable direction airlines are taking. This month's figures are distorted by one airline.

Year on Year % Exposure Change

March / Year to date. Based on latest Information at 29 March 2011



Source: JLT Database

Lead Lines

(Continued from previous page)

Whilst leaders fees are nothing new, the amount now being charged is increasing to arguably unjustifiably high figures in some cases. The reasoning for them is that the leader will undertake more technical, processing and claims work on behalf of the following market. Whilst this is true, when the quantum becomes too high and therefore unreasonable, the argument for them changes. There is a danger that poor underwriting in the first place by the leader in not getting the price right is being offset by ever increasing fees which are there to compensate the leader against others getting higher than his core price, i.e. the price that goes to market. It is misguided logic and who are we kidding?

A senior airline broker said quite recently "if you have too many people above lead terms then you have the wrong leader". Sometimes the desire not to lose a lead account has exceeded the desire to achieve sustainable rating levels.

If the leaders in this market continue to under perform in their negotiating position and then demand excessive leaders fees to offset against poor underwriting then these same lead underwriters cannot expect the following market to simply fall in behind. Reversed verticals will become more dramatic and 'gouging' will become more widespread. The lead underwriter on any given risk must take on the responsibility of ensuring that a fair competitive price has been negotiated based upon a clear understanding of what the actual capacity is for that type of risk and exposure.

There is also the issue of what the original client thinks of this scenario. Is it really very professional to see their selected leading underwriter so out of touch with the rest of the market, does this generate mutual respect from all sides?

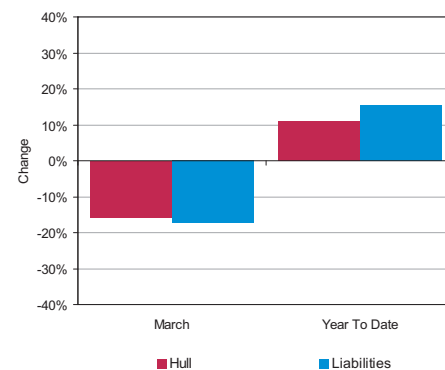
For a strong but competitive market to exist all parties must understand and recognise that our principles and practices must have some benefit for all.

Premiums*

Again it is too early to determine market trends with too few renewals.

Year on Year % Premium Change

March / Year to date. Based on latest Information at 29 March 2011



Source: JLT Database

Year to Date (Like for Like)	Hull USDm	Liability USDm	Total USDm
2010	10.7	14.5	25.2
2011	11.8	16.7	28.5
% Change	11%	15%	13%

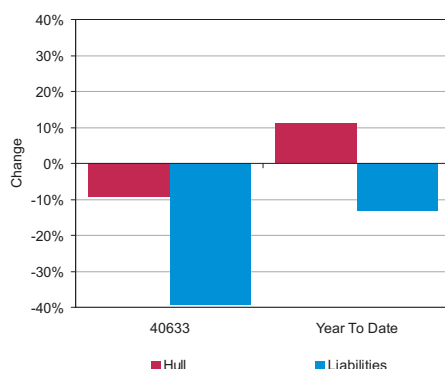
* Net of brokerage and at lead terms

Rates

The significant impact of one airlines proposed growth in passengers is clearly evident. Trends are indecisive at present.

Year on Year % Rate Change

March / Year to date. Based on latest Information at 29 March 2011



Source: JLT Database



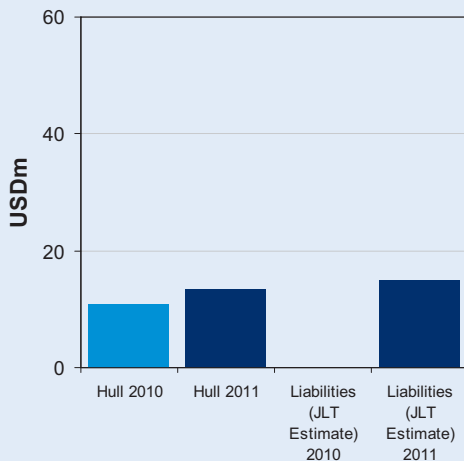
Airline Loss Summary

February

- Hull and spares losses of USD13.41m
- 27 airline fatalities
- Liability loss estimate of USD14.85m

February Losses

All Known Airline Losses Net of deductible

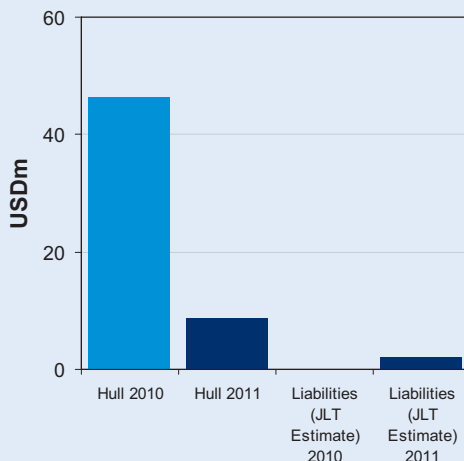


March

- Hull losses USD8.75m
- 23 airline fatalities
- Liability loss estimate of USD2.00m

March Losses

All Known Airline Losses Net of deductible



Loss Analysis

Known Losses in March

1st	Vietnam Airlines	Airbus A320-214 (VN-A305)	Vietnam
<p>Whilst being towed in darkness from the main apron to the hangar area at Hanoi, the aircraft struck a lighting pole causing substantial damage to the tailplane.</p>			
4th	Flugfag Air Iceland	Bombardier DHC8-106 (TF-JMB)	Greenland
<p>On landing at Nuuk in a strong and gusty crosswind, the aircraft veered off the runway striking a rocky embankment and causing substantial damage to the nose, propeller, engine and undercarriage. No injuries occurred. As a result of the damage, the aircraft was declared a CTL.</p>			
5th	Voronezh Aircraft JSC	Antonov An-148 (61708)	Russia
<p>The aircraft was on a manufacturer's test or training flight near Voronezh and crewed by pilots from the prospective customer when it disappeared from radar. The aircraft is suspected to have broken up in mid-air though exact details of the event have yet to be released. 6 crew lost their lives. This is the first known accident to the AN-148 aircraft.</p>			
10th	Ameriflight	Fairchild Metro III (N671AV)	USA
<p>At the culmination of a cargo flight into Boeing Field, Seattle, the aircraft veered off the runway causing all undercarriage legs to collapse.</p>			
17th	Air Libya Tibesti	2 Yakovlev Yak-40s and a Boeing 737-200	Libya
<p>Two Yak-40s were destroyed and a Boeing 737 damaged reportedly by an air raid on Benghazi. Reports of this damage appeared in mid March though later information suggests the damage was caused in February when the current round of violence in Libya started.</p>			
18th	TAM - Transporte Aereo Militar	Xian MA-60 (FAB-96)	Bolivia
<p>Landing at Rurrenabaque on a scheduled passenger flight, the aircraft reportedly landed on its belly with the undercarriage retracted. Initial reports suggested an undercarriage failure but this is now in doubt. The extent of damage is so far unknown.</p>			
21st	Trans Air Cargo	Antonov An-12 (TN-AGK)	Congo
<p>On approach to Pointe Noire airport on a domestic cargo flight, the aircraft was seen to roll almost inverted before crashing into a residential area killing 19 on the ground as well as the four aircrew. Reports suggest the aircraft was on a list of aircraft no longer airworthy released by ICAO in 2006.</p>			

Insurance Market News

- Lloyd's of London has made a pre-tax profit of £2.2bn for 2010, down 43% on the £3.9bn it made in 2009.

Following a heavy year of natural catastrophes, the market's combined ratio - the measure of premiums against claims - increased to a still-profitable 93.3% in 2010 from 86.1% in 2009. Any measure below 100 percent indicates an underwriting profit, and a lower number indicates higher profitability.

While investment returns fell 29% to £1.3bn (2009: £1.8bn), the result was bolstered by £1bn of reserve releases (2009: 934m)

Lloyd's also reported a record level of central assets at £2.4bn in 2010, up 14% on 2009's £2.1bn.

This is a solid result in a year that saw a slightly higher than average number of natural catastrophes.

2011 looks set to be another difficult year due to the unrest in the Middle East, floods in Australia, another earthquake in New Zealand and the recent earthquake and tsunami in Japan.

- The HM Treasury are investigating possible sanctions against some Libyan companies following the adoption of the UN Security Council Resolution of 26th February.

It is still not clear what effect the order and associated regulations will have on existing insurance policies at this time.

- The Japanese nuclear crisis worsened last week. Japan raised the accident level at the damaged Fukushima nuclear plant from four to five on a seven-point international danger scale for atomic accidents.

What effect will this nuclear threat have on aviation - are aircraft covered for the nuclear risk?

No, as per the Nuclear Risks Exclusion Clause (referenced as AVN38B), which is included in Aviation Insurance Policies.

This clause essentially states that the insurance policy would not cover loss of, or destruction of, or damage to, any property of the insured or others, or any legal liability of,

whatsoever nature arising from radioactive, toxic, explosive, or other hazardous properties arising from the damage to the Japan nuclear power facilities.

Can I purchase any protection?

Yes, there have recently been a number of innovative Business Interruption products unveiled in the aviation sector.

These products would pay out for the business interruption cost in precisely these circumstances.

They will also pay out (subject to policy conditions) in the event of ashclouds and severe weather flight disruptions.

JLT Specialty Limited is holding an audio briefing on this crisis at 12.30 BST on 6th April 2011 for details on how to register or for further information on this topic please contact us.

- Standard & Poor's (S&P) downgraded the financial-strength rating of American International Group's (AIG) property/casualty subsidiary Chartis to A from A+ and revised its outlook on AIG and its operating companies to stable from negative.
- Standard & Poor's (S&P) has marked nine Japanese insurers with negative outlooks, but affirmed their present credit ratings for now. The nine firms are: Mitsui Sumitomo Insurance; Aioi Nissay Dowa Insurance; Mitsui Sumitomo Kirameki Life Insurance; Mitsui Sumitomo MetLife Insurance; Sompo Japan Insurance; Nipponkoa Insurance; Sompo Japan Himawari Life Insurance; Kyoei Fire & Marine Insurance and Secom General Insurance Co.

The outlooks of six more Japanese insurance firms were kept level at stable. The six firms are: Tokio Marine & Nichido Fire Insurance Co. Ltd, Tokio Marine & Nichido Life Insurance Co. Ltd, Nisshin Fire & Marine Insurance Co. Ltd, ACE Insurance, Allianz Fire and Marine Insurance Japan Ltd and Toa Reinsurance Co.

Arrivals and Departures

- XL Insurance has appointed Robert Schenone, formally of Sciemus, as Vice President and Senior Class Underwriter to its space underwriting unit. Robert will be based in New York and report to Chris Kunstadter, Head of Space Underwriting.
- QBE the Americas has announced the creation of a US based general aviation insurance underwriting operation. Its new team consists of William McGloin, Roger Ridings, Michael Clark and Russell Walker.
- Argo Group International Holdings Limited announced that Bruno Ritchie has joined the company to lead Argo Assurances, their new Paris-based underwriting platform for large specialty risks. Argo Assurances will initially focus on insurance solutions for space and aviation clients worldwide.
- Brit Insurance announced the expansion of its War & Terrorism team with the appointment of Charles Barrett as Terrorism Underwriter. In his new role, Charles will be responsible for underwriting a diverse range of political violence and aviation war related risks.
- Clyde & Co recently announced the establishment of a new Aviation Finance Practice in Asia. The new practice will be led by Paul Jebely, who joins the firm from Ashurst in Hong Kong where he was a senior associate and Head of Aviation for Asia, Middle East and Africa.
- International law firm Holman Fenwick Willan (HFW) has announced the hire of eight aerospace and aviation partners, formally of Barlow Lyde & Gilbert (BLG). The new partners are: Sue Barham, Peter Coles, Richard Gimblett, Mert Hifzi, Nicholas Hughes, Giles Kavanagh, Keith Richardson and Jeremy Shebson.

PlaneTalking

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