Aon Risk Solutions

Airline Insurance
market news

Q3 2013

Premium and rate reduction levels are accelerating, with low loss levels and more capacity potentially looking at entering the market, this trend looks set to continue to the end of the year.

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GRIP
Aon Global Risk Insight Platform

Overview

- July renewals show the largest average rate reductions this year
- The years only major loss looks to have had little impact on market trends
- Passenger fatality levels are some of the lowest ever recorded
- New generation composite aircraft are in the spotlight

Summary

Our analysis shows that insurers seem unable to halt the momentum of falling rating movements that began at the end of 2009.

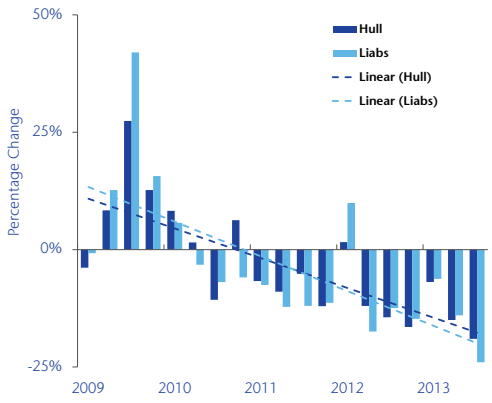
As the graph opposite indicates, while rates were still going up in 2009 the level at which they were increasing slowed. Since this point, other than one or two small blips, the over-riding trend has been for the rating levels to continue to be incrementally lower than previous averages.

This has culminated in the Q3 renewals recorded so far this year having the highest average level of rate reduction for a single quarter this century, which is testament to the feeling that we are in one of the most competitive markets in living memory.

Once again this is in part attributable to loss levels being exceptionally low when compared to long term averages, and as can be seen, in the analysis on page 3, in particular with regards to the number of fatalities. The largest loss of the year, the Asiana Airlines B777 crash at San Francisco Airport 2 July, appears, to have had little or no impact on market conditions at the the time of writing. There is also little to suggest that it will either due to the excess of market capacity available, another factor in

(continues overleaf)

Average quarterly percentage rate change
2009-13



Source: Aon market data

	Renewals	Fleet Value Movement (% change)	Passenger Movement (% change)	Expiring Premium (US$m)	Renewal Premium (US$m)	Premium Movement (% change)
Q3 2012	43	+4	+2	284.60	255.47	-10
Q4 2012	109	+5	+3	1,261.85	1,111.36	-12
2012 total	206	+5	+4	1,808.10	1,610.97	-11
Q1 2013	9	+20	+18	25.05	29.21	+17
Q2 2013	43	+8	+9	212.34	196.74	-7
July	24	+8	+8	205.72	174.23	-15
2013 to date	76	+8	+8	443.10	400.17	-10

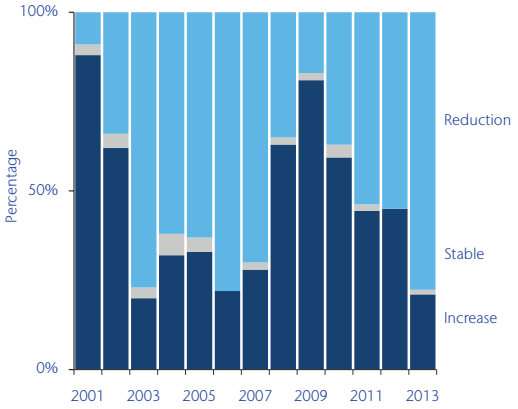
Summary (continued)

the reductions we are seeing, showing no sign of relenting. Rather than being put off by the falling rates and premiums, market capacity seems set to grow even further with rumours of new markets looking to enter the aviation insurance sector.

Swingometer

Almost 80% of the renewals for 2013 to-date have received a reduction in their renewal premium. This is yet another indicator as to the position of today's market conditions with only 2006 being able matching this ratio. Of those renewals with increased premiums, all but three were due to exposure growth and were coupled with rate reductions, thus meaning that their real term premium spend would have reduced had the exposures remained static. The other three renewals with increases were due to deterioration in loss records.

Proportion of airline programme premium movement



Source: Aon market data

Expectations for the remainder of the 2013

All indicators seem to be pointing to the market being at one of its softest periods in recent years.

If current market conditions were to continue as they are, we estimate that the premium income generated by the airlines in our reporting criteria would be circa $1,450m.

With losses as they stand today plus the full year allocation of estimated minor losses, the loss total for 2013 would be around $900m (and this is without provision for the Asiana Airlines liability reserve). This leaves little room for profit for airline insurers after overheads and reinsurance costs are taken into consideration.

While it is difficult to visualise a scenario, short of a run of catastrophic losses that would stabilise or shift the conditions into a hard market phase. It is equally difficult, however, to see how the current levels of rate and premium reductions could be sustained for much longer.

This is a market where supply currently outstrips demand and as a consequence affecting pricing levels. All insurers have target portfolios which vary according to risk appetite. The pressure to shore up income volume in order to pay for losses, infrastructure costs and reinsurance is immense and seems to be increasing pressure for insurers to be less risk selective.

Seven Best Practices for Managing Cyber Risk

Cyber risk has become a leading issue for many organisations as awareness of cloud computing, social media, corporate bring your own device policies, big data, and state-sponsored espionage has grown and recently been amplified by new laws coming into force. In an increasingly punitive legal and regulatory environment, and in the face of more frequent contractual insurance requirements specifying cyber liability, forward-thinking companies are taking proactive steps to explore and transfer cyber risk.

Aon recommends that companies form a network risk management team, which should include finance, human resources, information technology, legal, privacy, sales and security to achieve the right balance between the costs and benefits. The team should:

- Lock down IT security. Underwriters typically measure IT security assessments against such standards as ISO/IEC 27000 series, SSAE 16 (formerly SAS 70, Type II). Companies should require the same assessments of their outsourced service providers and third-party suppliers and distributors.
- Appropriately manage the risk of third-party vendors including appropriate contractual allocation of liability.
- Integrate the insurance claims process with internal breach response. Companies need to understand how and when to involve their carrier if a data breach occurs.
- Regularly update appropriate training, awareness and monitoring.
- Develop data protection and privacy policies and procedures for all employees, partners, customers, suppliers and independent contractors.
- Implement a data breach response plan. Insurers expect that every entity will experience some type of breach. Underwriters increasingly conduct due diligence regarding breach response plans to determine scope of insurability and pricing.
- Limit access to confidential information, including controlling software, hardware and system access.

For more cyber risk management advice and information, please contact your Aon representative.

As technology and legal frameworks evolve, both the insured and the insurer struggle to protect against cybercrime

Losses

Claims up until the beginning of July continue to be well below the long term average for the industry. While the current loss figure, excluding minor losses for the year so far is US$254.79m doesn't compare well against US$ 92.07m recorded at the same point in 2012, it is significantly below the long term average of US$652.99m. Adding an estimate for minor losses, the current loss total is US$654.79m, compared to US$ 492.07m in 2012 and the long term average of US$947.99m.

Passenger and third party fatality levels are the lowest Aon have ever recorded going back to 1995

Passenger and third party fatality levels are exceptionally low, with only 27 recorded for the year so far. This compares to 354 on average for the same point between 1995 and 2012, and is the lowest we have recorded for this period. There are 273 fewer fatalities than there were at the same time in 2012, which is widely considered to be one of the safest on record.

The good news continues as there have only been six incidents meeting the criteria for inclusion in the data so far in 2013. This compares to around 31 on average between 1995 and 2012.

Long way to go

The low number and value of claims and fatalities so far in 2013 is exceptionally positive, even in comparison to 2011 and 2012 when claims were also very low against to the long term average.

The airline industry still represents a considerable risk where a single loss could mean that the claims statistics for 2013 overtake the long term average. Equally, as we have seen in the past, a string of incidents at the mid-point of the year can change the position significantly.

At this point, however, the low number of claims for 2013 so far is very positive and will support the buyer with the insurance negotiation process.

Notable losses

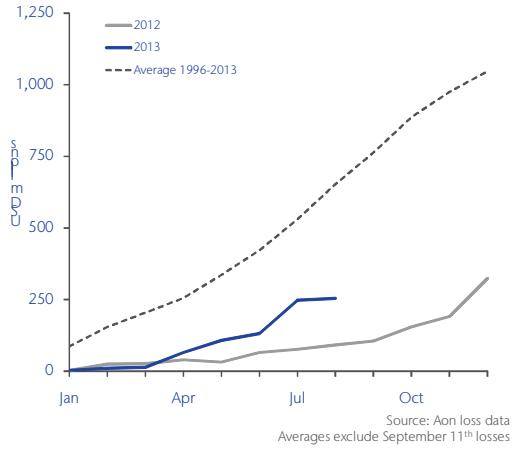
Wizz Air, 8 June

During approach to Rome's Fiumicino International Airport a problem was noted with the A230's (HA-LWM) left hand rear undercarriage in that had failed to extend. The crew executed a go-around, but it was forced to carry out an emergency landing with the aircraft coming to rest with the left hand engine and rear fuselage contacting the runway. Of the 165 passengers on board, only three were said to have suffered minor injuries, no crew injuries were reported.

Asiana Airlines, 6 July

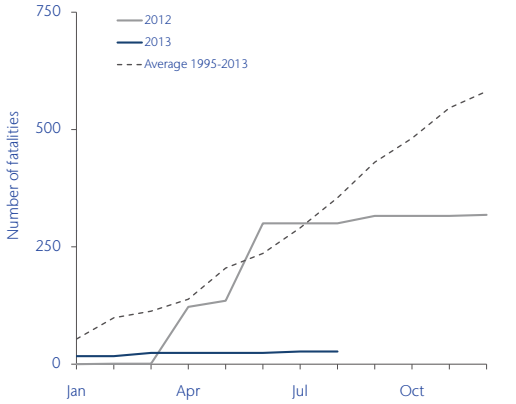
A B777-200ER, registration HL7742, operated by Asiana Airlines descended below the approach path into San Francisco Airport which resulted in the rear fuselage and main undercarriage impacting a seawall short of the runway threshold causing them to tear off. The aircraft then skidded along the runway, coming to rest off the side of the runway with an engine detached, the aircraft subsequently caught fire. Three passengers were fatally injured while up to 180 onboard are said to have been injured, with some of these reported to be critical.

Cumulative claims 2013
(Excluding minor loss estimate)



Source: Aon loss data
Averages exclude September 11th losses

Cumulative fatalities 2013
(Passenger and third party fatalities)



Source: Aon loss data
Averages exclude September 11th losses

The first loss of its kind for the B787 will be under scrutiny by all parties.

Ethiopian Airlines, 12 July

While parked at the apron of Heathrow Airport an Ethiopian Airlines B787-8, ET-AOP, caught fire. It has been reported that the rear part of the fuselage was burned through and the cause of the incident is under investigation.

While the exact cause and reserve are still unknown, the market is waiting with bated breath as to how this loss will develop. It is unprecedented in that it is the first time an incident has occurred with minor hull damage on an aircraft made of composite materials, and the repair method and cost will all be under scrutiny by all parties involved.

Spotlight on Composite Aircraft

Developments in composite structures and the use of non-metallic materials in aircraft has been high in the thought process of many people for a number of years.

The changes and developments required to ensure safe operations has its history in the migration from early wooden aircraft to metallic flying machines of various types. Composite structures and similar materials are not new in aviation and have been used in the development and manufacture of, flight controls, fuselage panels and complete fuselage structures for a number of years. The relatively recent, and well publicised material uses within commercial aircraft such as the Airbus A380, Boeing 787, A350, Diamond and Cirrus aircraft pose some very interesting questions.

Aircraft design and build with aluminium underwent years of development, with some extremely unfortunate events. The technical challenges in consideration of, for example, condensation, noise and vibration transmission, fatigue, rework and modification requirements, in composite aircraft types are regular topics of conversation. Airclaims has experience in composite material structure and uses a range of aviation applications from General Aviation aircraft, to the very biggest commercial airliners and it is clear that safe repairs of composite materials is a perfectly achievable goal. The insurance industry is one of the key movers in ensuring this process develops. We often encounter manufacturers who advise that repairs are limited or not available for the components under question. Within the Airclaims worldwide network we have a large number of surveyors who have experience in gently persuading the operators, owners and manufacturers that development of economical repair solutions is of benefit both in the short and long term for all stakeholders. With the ratio of Materials vs Man-hours changing with the extensive use of composites, there is a new focus on the approaches to repairs.

An aluminium aircraft will begin to corrode during the manufacturing stage and although this is a slow, predictable process, exposure to contaminants accelerates material degradation. The potential of having a composite aircraft that predominantly requires only inspection and possibly very little rework is something that clearly excites maintenance budget planners but equally raises some very difficult planning decisions in terms of long-term workforce skill requirements and facility needs.

There is no doubt that the Original Equipment Manufacturers (OEM) will remain the specialists for their aircraft types in the short and medium term. We see that our constant high level dialogue with OEMs plays a large part in diluting the view that insurance events should be lower on the list of management input than some operators and manufacturers believe.

There is a broad acceptance that the advent of composite structures in aircraft is an exciting, inevitable development, and a brilliant concept provided the new engineering support required to respond to all expected needs is provided in tandem. Aluminium aircraft underwent years of development and we would expect that there will be several bumps along the composite highway before a similar level of acceptance is reached, but it will lead to a very impressive product range in the future. The interest and anticipation generated by composites used in aviation will remain high as there will be many new materials developed which will far exceed our expectations of reliability and use. For that reason we continue to follow the latest industry developments in this respect and all of the Airclaims offices constantly monitor developments with interest in order that we can continue to serve the insurance industry, through knowledge and expertise, for many years ahead.

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John Bayley
Airclaims
Director of Claims, UK

John is experienced in aviation having qualified as Licensed Aircraft Engineer and Private Pilot whilst with Britannia Airways for 10 years. He worked in senior positions and also spent time overseas on secondment to other airlines with wet leased aircraft. He was awarded a scholarship with the International Federation of Airworthiness to study engines and control systems with the French engine manufacturer Snecma, in France where he became fluent in French. Thereafter followed a period of product support in the UK with several of their airline customers, followed by 15 years to date, with Airclaims. He has handled many claims and a number of complex and major incidents and accidents in various geographical regions. He was promoted to Director of Claims, UK for Airclaims in April 2012.

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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 excludes Russian built equipment and the data only includes losses with a total incurred value of over US$1 million. We only write about losses over US$10 million.

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