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# Plane Talking

JLT AEROSPACE OCTOBER 2011

## Executive Summary

### IN TURBULENT TIMES

The airline renewal results to date in 2011 continue the predicted trend of rate softening, however the effect on premium is being largely offset by growing exposures.

With the combined airline hull and liability premium remaining at a similar level to 2010 perhaps the key question should be whether this represents the market's premium floor - have we reached the bottom of the cycle?

With an absence of any failed placements or a withdrawal of capacity (indeed it appears quite the contrary), perhaps this might suggest that we are yet to reach the bottom. Maybe the apparent premium equilibrium is more the result of skilful underwriting balanced alongside responsible competitive behaviour?

It is however undeniable that from a simple technical pricing perspective, the current premium volumes are unable to provide a stable foundation and fall short of being able to satisfy requirements of the various stakeholders over the longer term.

As evidenced by Mr Sethsson's "Lead Lines" this month, other sectors of aviation are being similarly squeezed, choking off the flexibility offered by cross-subsidy between aviation business classes.

Reinsurers have historically enjoyed a more stable pricing environment and with the backdrop of the benign loss experience over recent years, they are facing a growing pressure to "cut some slack" but at the same time wrestling with the need to maintain their businesses. Should some fail to recognise the pressing needs of their clients (the insurers); they are likely to face a fundamental shift in buyers' attitudes that will ultimately be to their detriment.

Outside of the usual round of broking and underwriting staff, the perfect storm continues to develop, awaiting an external influence or sharp deterioration in loss experience to cause this to break.

It seems that the period ahead will become increasingly difficult.

Are you interested in featuring in Lead Lines, or do you know someone who is, if so please contact us at: [publications@jltgroup.com](mailto:publications@jltgroup.com)

“

Underwriters will need skills and luck to deliver the required return on capital.

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# Lead Lines



**Roger Sethsson**

Senior Underwriter, Aviation

- Inter Hannover

## Biography

Roger Sethsson is a Senior Underwriter at Inter Hannover with responsibility for the Aerospace book.

Roger has over 25 years aviation experience (from Skandia, Skandia International and since 1997 Inter Hannover).

## The current Aerospace premium is below trended loss expectations

Despite the positive flight safety trend, the near future for products underwriters may not be bright. With an overall shrinking premium base, increased policy limits, increased aircraft values and liability settlements, the reality is an all time high volatility in the aerospace market.

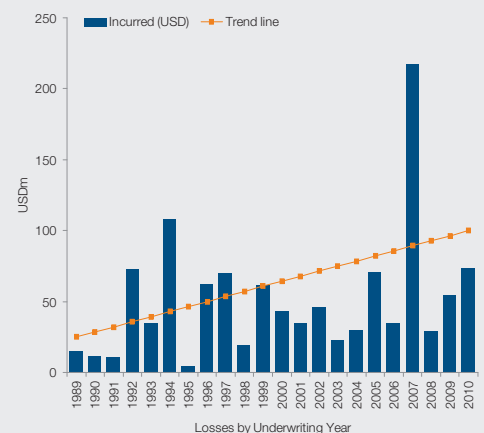
## Simple mathematics based on underwriting year experience

Although the most recent years look good at first glance it may be an illusion. The aerospace market is in its fifth year with premium reductions and current world market gross premium is now below USD1 billion (Inter Hannover seen businesses).

After deductions of brokerage, internal expenses and insurers required return on capital, USD650 million is left for losses and claims expenses.

## Original Equipment Manufacturers

After deduction of the trended manufacturers hull losses of USD100 million, USD550 million is left for liability losses.



## Manufacturers Hull Losses

Aircraft values have continued to increase and short tailed hull losses have unfortunately followed the same trend.



After deduction of the trended liability losses of USD450 million then USD100 million is left for losses from the balance of the aerospace book i.e. sub-contractors, suppliers, MRO's, Refuellers, Airports and ATC and Service Providers (excludes major ground handlers as figures unknown to Inter Hannover).

A rough estimate of the trended losses is USD300 million. The result is USD200 million is missing. The uncertainty in the financial market and the low interest rate will make it challenging to reach a profitable level.

#### **The soft market fatigue**

In contrast to airline losses, few products losses make headlines. Old losses are old news.

Aircraft accident investigations and final liability sharing agreements take years.

Potentially high valued products liability losses are initially low reserved. A low reserve makes it difficult for the underwriter to argue for a premium increase.

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Like ageing aircraft facing the risk of metal fatigue, underwriters may find some unpleasant surprises as the underwriting years mature.

Many clients have in recent years taken substantial self insured retentions. This has led to lower premiums.

The voice of the actuaries appears to have fallen silent with the softening in the market. These facts may lead the underwriter, actuary and management into a false sense of security.

But like the finance industry, historical good results are saying little about the future. Therefore, underwriters will need skills and luck to deliver the required return on capital.

# Introducing New Section!

## JLT Market Meters

### Introduction...

The new JLT market meters that can be seen on the following page, are designed to provide the insurance buyer with a more realistic guide to what is happening in the market.

Based on a **composite** rather than just the **leader's** rate change it reflects the effect of both the change in rate and the change in differentials between markets (i.e. the "vertical marketing" process). In the current climate with differentials typically narrowing this can have a significant impact on what the final result will be.

We have excluded any abnormal renewals from consideration (where rates have been recalibrated due to the influence of claims, major changes in exposure or other anomalies) to give a more realistic and accurate reading of the market trend.

### The Rate Meter...

This meter provides an indication of what core rate change a good quality, clean renewal with no growth can expect. Currently a 4% reduction in JLT's opinion. This may appear a low figure to some but remember the big rate changes have tended to come as a result of acquisition, grouping or extraordinary growth and this is the composite figure not solely the leader's.

### The Growth Meter...

This meter reflects the amount of growth that a buyer may get "gifted" by insurers on a good quality renewal. For example, an Airline with 20% growth may only pay for 60% of the growth amount in increased premium. Therefore the premium would be only 12% higher than the previous year. Combine this with the 4% rate reduction and the premium would increase by 7.50% (or an overall rate reduction of 10.40%).

### The Market Climate Meter...

This meter gives an indication of where we see the negotiating environment of the market. For some time "neutral" would have been our view, with capacity stable, losses average and underwriting results poor but not bad enough to bring about significant change. Now we are predicting a slight movement to a "hard" market as capacity becomes more selective (rather than withdrawing) and negotiations are tougher. Differentials in the vertical market are narrowing and in extreme cases some following markets may be higher than the lead.

### The Claims Meter...

Balanced against the market climate meter, as shown on the following page, losses are lower than average this year which has probably postponed the arrival of a harder market environment than otherwise might have been expected. Unfortunately, loss figures can change overnight.

**Notwithstanding all the above, remember no two renewals are exactly alike.**

# Market Meters

## THE COMPOSITE MOVEMENT IN AVIATION RATES

The Rate Meter



This meter shows the typical combined composite hull and liability rate change at renewal for a good quality airline with no losses and no growth. As indicated above the typical rate reduction is -4%.

The Growth Meter



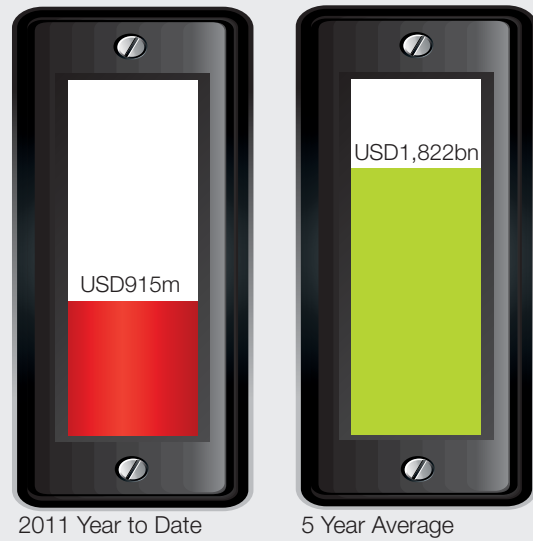
This meter shows the typical amount of growth not charged for at renewal. Are your exposures increasing? You may get just under half for free.

The Market Climate Meter



This meter shows the current market climate position. As indicated above we are moving slightly towards a hard market as signified by greater selectivity and a narrowing of vertical market discounts.

The Claims Meter



These meters indicate the year to date and 5 year average claims figures (including attritional estimates). As indicated the year to date claims are currently 48% below the 5 year average. With six weeks to go it would be unwise to make assumptions.

# Renewal Analysis

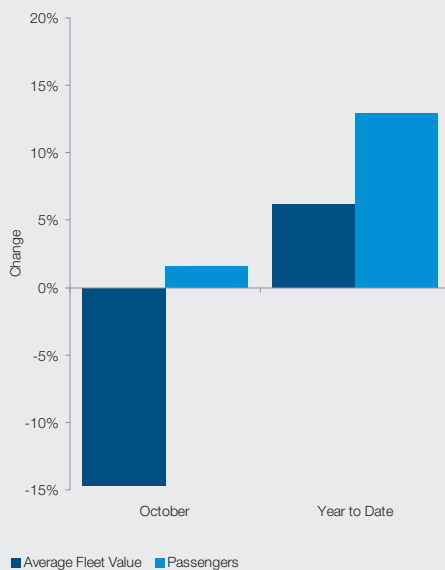
## EXPOSURES

October produces more airline renewals than in recent months, and although it appears there is quite a reduction in AFV this is mainly due to two of the largest airlines having amendments to their fleet schedules. Passenger numbers however remain positive for the next 12 months.

### Year on Year Exposure % change.

October / Year to date - based on the latest Information at 28 October 2011

Source: JLT Database



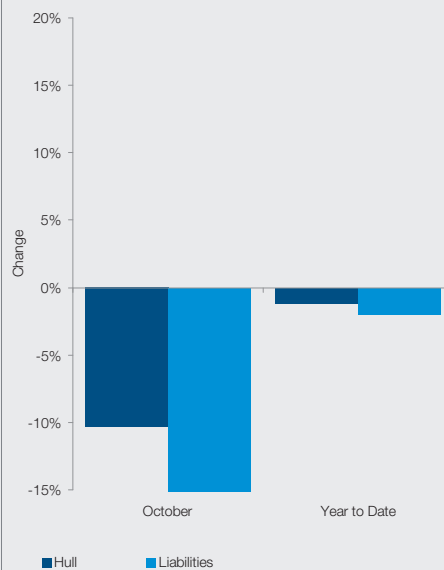
## PREMIUMS\*

The reduction in premium shown for the month appears greater than the annual average and can be attributed in the most part to the reduction in hull exposures. The year to date figure however does indicate the continuing flat nature of the airline insurance market.

### Year on Year Premium % change.

October / Year to date - based on the latest Information at 28 October 2011

Source: JLT Database



Year to Date (Like for Like)	Hull USDm	Liability USDm	Total USDm
2010	285	430	715
2011	282	421	703
% Change	-1%	-2%	-2%

\* Net of brokerage and at lead terms

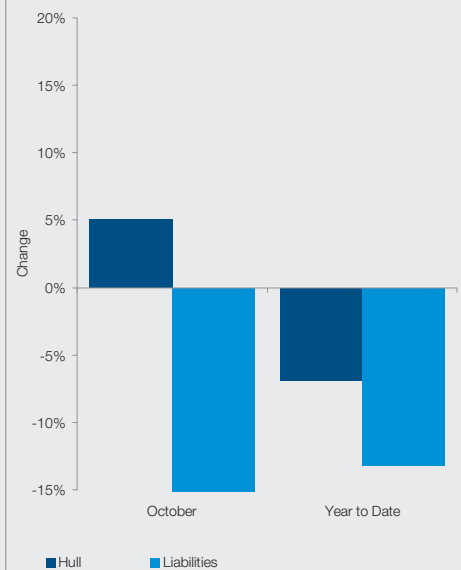
## RATES

The hull and liability rating is as usual an imprecise science and has probably produced the minimum underwriters need to achieve in retaining their commercial return on the current level of airline exposures plus airlines loss experience.

### Year on Year Rate % change.

October / Year to date - based on the latest Information at 28 October 2011

Source: JLT Database





## COMMENT

The fourth quarter provides the aviation market with the greatest number of airline renewals by far, with October raising the tempo of the marketplace with its contribution of around 14 operators.

Due to moving its inception date forward from December, Skywest Airlines, the regional operator in the US now becomes the largest renewal in October with a fleet valued at USD9.8 billion and passenger numbers expected to exceed 54.8 million.

Air India (previously known as NACIL) is the second largest renewal with a similar fleet size valued at USD9.3 billion. The airline predicts that it will fly around 11% more passengers next year at over 18 million.

China Airlines, the largest carrier in Taiwan and placed in conjunction with Mandarin Airlines represents the next largest by fleet value, followed by the newly created placement Avianca / Taca Holdings which replaces most of the Synergy Group and is now made up of 11 Latin American airlines.

Some October renewals have moved to November and December and it is expected that the Libyan Airlines consortium will probably come back to the market sometime in November.

## FORTHCOMING AIRLINE RENEWALS

November represents the second busiest month of the year after December, both in airline numbers and premiums generated.

Around 40 renewals come to the market in November and of these 15 airlines have fleets valued in excess of USD1 billion.

The largest renewal by far is Emirates, with a fleet valued in size at USD21.6 billion. The airline has almost doubled its fleet size in the past five years and its growth is expected to continue as it acquires large numbers of wide bodied aircraft including over 70 Airbus A380.

A number of other significant Middle East/Gulf operators also renew as do the two prominent small-package/cargo carriers UPS and DHL.

Below we list the ten largest renewals in November based on AFV.

Airline	Renewal Date	Expiring AFV USDm
Emirates	16th Nov	21,600
UPS	16th Nov	13,863
Singapore Airlines	1st Nov	13,209
Qatar Airways	16th Nov	11,830
TUI	1st Nov	7,665
DHL	1st Nov	7,652
Saudi Arabian Airlines	16th Nov	6,630
Ethad	16th Nov	5,865
Thomas Cook Group	14th Nov	3,589
South African Airways	1st Nov	3,236

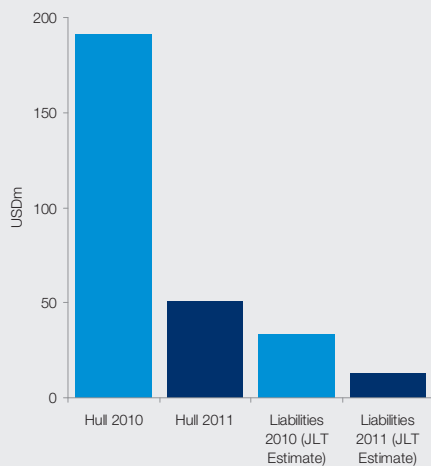
Source: JLT Database.

# Loss Analysis

## SEPTEMBER - AIRLINE LOSS SUMMARY

- Hull losses:  
USD 48.55m
- Liability loss estimate of:  
USD 16.25m
- Number of airline fatalities:  
92

All Known Airline Losses Net of deductible

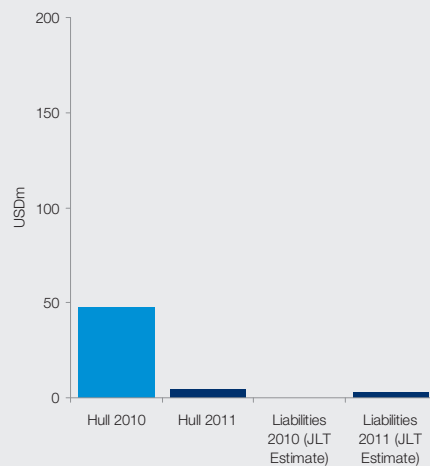


\* The JLT liability estimates are provided merely as a guide.

## OCTOBER - AIRLINE LOSS SUMMARY

- Hull losses:  
(TBA\*)
- Liability loss estimate of:  
(TBA\*)
- Number of airline fatalities:  
28

All Known Airline Losses Net of deductible



## COMMENT\*

The loss reserves for October's accidents do not include those insured in the London market as, at the time of publication, repair teams are still assessing the work needed. Of the others, we assume they are insured in the local markets, if at all.

## OCTOBER AIRLINE LOSSES SUMMARY

- 02 October 2011

Sudan Airways,  
Fokker F50 (ST-ASD), Sudan

The aircraft was on approach to Malakal when the port undercarriage would not lower. After a period of troubleshooting, the crew decided to return to Khartoum where a landing was made with the port undercarriage retracted. Damage looks limited to fuselage skin, propeller and wingtip. No injuries were reported amongst the 45 people on board.

- 10 October 2011

Sky Airlines,  
Boeing 737-400 (TC-SKF), Turkey

On landing at Antalya, the aircraft burst a right hand main gear tyre followed by the collapse of the right main gear. The aircraft slid to a stop on left main gear, nose gear and right engine pod. No injuries occurred.

- 12 October 2011

Allegiance Air operating for National Regionale Transport,  
Embraer Emb-120RT (ZS-PYO), Gabon

The aircraft overran the runway on landing at Port Gentil causing the wings and engines to separate from the aircraft. The aircraft was operating a domestic charter with 27 passengers and 3 crew. No fatalities were reported.

- 13 October 2011

Airlines of PNG,  
Bombardier DHC8-102 (P2-MCJ), Papua New Guinea

The aircraft was descending en-route to Madang on a scheduled flight from Lae when it crashed into a forest. Some reports suggest there may have been a fire on board and that the crew tried to make an emergency landing. 28 of the 29 passengers and one of the four crew members are reported to have died in the accident.

- 14 October 2011

Yamal,  
Tupolev Tu-134A3 (RA-65143), Russia

During climb out from Salekhard on a scheduled passenger flight, the crew received warning of an engine fire. A return to the airport was completed safely but severe fire damage was caused to the engine and surrounding fuselage. No injuries were reported.

- 18 October 2011

Iran Air,  
Boeing 727-200 (EP-IRR), Iran

The aircraft, on approach to Tehran Imam Khomeini Airport, couldn't lower the nose undercarriage. Following unsuccessful troubleshooting, the aircraft diverted to Tehran's Mehrabad Airport where a landing was made with nose gear retracted. The aircraft was evacuated, no injuries were reported.

# Market News

## NEWS IN BRIEF

### Swiss Re bolsters US aviation portfolio

Swiss Re Corporate Solutions has established a New York based underwriting team dedicated to developing its General Aviation (GA) portfolio across the US.

As part of its growth strategy in the United States, the company has also expanded its relationship with Seattle-based London Aviation Underwriters (LAU) to service the market for smaller GA risks. It has filed new product forms with each state, meaning the company will now be able to offer hull, liability and commercial general liability across the US on an admitted basis.

### White Mountains rebrand

All of White Mountains' reinsurance operations have been rebranded under its well-regarded Sirius Group brand.

Its operating reinsurance entities have all been consolidated into Sirius International, which has a regulatory capital of USD2.2 billion.

White Mountains Reinsurance Company of America will be renamed as Sirius America and will be wholly owned by Sirius International.

### Change of name for Chartis

Chartis Insurance UK Limited announced that it will be changing its name to Chartis Europe Limited with effect from 1 December 2011.

### New aviation and aerospace team for HFW

International law firm Holman Fenwick Willan (HFW) announced the hire of an eight partner team which will join with effect from 17 October 2011.

The eight partners, which formerly made up the highly-rated aviation team at Barlow Lyde & Gilbert (BLG), will work across five office locations; London, Hong Kong, Singapore, São Paulo and Dubai.

The partners are: Sue Barham (London), Peter Coles (Hong Kong), Richard Gimblett (London and Dubai), Mert Hifzi (Singapore), Nicholas Hughes (London), Giles Kavanagh (London), Keith Richardson (Singapore) and Jeremy Shebson (London and São Paulo). In addition to the partners, 16 associates also join with them.

HFW also announced that they have taken over BLG's office lease in São Paulo, giving HFW its first foothold in the South American market.

### Ince & Co expand

International commercial law firm Ince & Co is expanding its insurance and reinsurance practice with the recruitment of two new partners, making a total of four new insurance and reinsurance partners to have joined since May 2011. The new partners Simon Cooper and Kiran Soar join Ince & Co from Barlow Lyde & Gilbert (BLG).

Additionally, the firm announced that it will be opening its new London market desk in the Lloyd's Building on 1 November 2011.

### Boeing 787 makes maiden passenger flight

The first ever passenger flight of the Boeing 787 aircraft took place on 26 October 2011. The aircraft powered by twin Rolls-Royce Trent 1000 engines was operated by launch customer All Nippon Airways (ANA).

The specially chartered flight departed from Tokyo Narita International Airport, with more than 240 passengers on board just after midday and landed just over four hours later in Hong Kong.

The aircraft will return to Japan before commencing scheduled services on 1 November 2011.

### Thai floods shut down Bangkok airport

Advancing floodwaters spilled over airport barriers causing the closure of Thailand's second biggest airport, Don Muang, on October 25.

It is reported that as much as 90% of the facility is now covered with at least some water and damages to the airport and to abandoned cargo will be worse than initially predicted. The two main carriers based at Don Muang, Thai Orient Airlines and Nok Air, both announced they were suspending their operations and diverting flights to Suvarnabhumi Airport because of the flood threat.

At the time of going to print Bangkok's Suvarnabhumi Airport, the country's main international gateway, had yet to be affected by flooding and flights there were operating normally.



### SIGNIFICANT RATING ACTIONS

#### AM BEST

##### **Sirius Group**

Ratings agency AM Best has upgraded to "A" (Excellent) from "A-" (Excellent) the financial strength rating of Sirius America Insurance Co. The agency also upgraded to "bbb" from "bbb-" the issuer credit rating of group parent Sirius International. The outlook for both ratings is stable.

##### **Middle East Insurance Company**

Ratings agency AM Best has affirmed the financial strength rating of "B++" (Good) and the issuer credit rating of "bbb" of Middle East Insurance Company (MEICO) (Jordan). The outlook for both ratings remains stable.

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#### FITCH RATINGS

##### **Assicurazioni Generali**

Ratings agency Fitch has affirmed the financial strength rating of "AA-" for Italian insurance company Assicurazioni Generali and its subsidiaries. The ratings outlook for the group has been cut from stable to negative following the recent downgrade by Fitch of the Italian sovereign rating.

##### **Brit Insurance**

Ratings agency Fitch has affirmed Brit Insurance Ltd's insurer financial strength rating at "A" with a stable Outlook.

#### STANDARD & POORS

##### **Liberty Mutual Group**

Ratings agency Standard & Poor's (S&P) has revised the outlook on Liberty Mutual Group's "A-" insurer financial strength ratings to positive from stable.

##### **Mapfre Group**

Ratings agency Standard & Poor's (S&P) has downgraded to "AA-" from "AA" the insurer financial strength and long-term counterparty credit rating of Spanish insurer Mapfre and its core subsidiaries.

This action follows S&P's recent rating downgrade on the Kingdom of Spain to "AA-" with a negative outlook.

##### **Swiss Re**

Ratings agency Standard & Poor's (S&P) has upgraded to "AA-" from "A+" the insurer financial strength rating of Swiss Re. The outlook for the rating remains stable.

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#### MOODY'S

##### **Allianz Italy**

Ratings agency Moody's has cut its outlook for Allianz Italy to negative following its downgrade of Italy's sovereign debt. The agency preserved its insurance financial strength rating at "AA3".

This action follows Moody's recent cut of Italy's credit rating by three notches to "A2" with a negative outlook from "AA2".

### ARRIVALS AND DEPARTURES

- Groupama announced the replacement of CEO, Jean Azéma, following the group's rating downgrade by Standard & Poor's last month. His replacement is Thierry Martel, who has been promoted from managing director of the firm's insurance and banking divisions.

- Mark Wood has assumed the role of Chairman of Chaucer Syndicates Limited, following the resignation of Bob Deutsch.

- Paul Letherbarrow is to move from his current position as active underwriter at Kiln to head the aviation practice at QBE.

- Scott Radford has started at Willis after leaving Marsh.

- Thomas Thompson is joining Colemont from Cooper Gay.

- Nick Vine has left Marsh to join Boston Marks.



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