Willis INSIGHT

THE NEWSLETTER FOR THE AIRLINE INSURANCE INDUSTRY | JULY 2011

AIRLINE INSURANCE MARKET OVERVIEW

After months of low loss levels there were three significant losses within the week spanning the end of July and beginning of August. The unfortunate losses of an Asiana B747-400 freighter, Caribbean Airlines B737-800 and the constructive total loss of an Egyptair B777 following a cockpit fire will generate losses totalling in the region of US$250 million.

A change in the market conditions remains very unlikely though. 2011 remains a comparatively good year in terms of losses and with these losses being hulls and therefore known amounts makes it easier for underwriters to deal with. With the current neutral market situation there appears to be a repeated clamour to understand the ramifications whenever a loss occurs. It must be remembered that losses are the function of the market. It is there to service the needs of an increasingly exceptionally safe industry and therefore needs a shift in overall trading conditions to significantly change.

July was one of the busiest periods of the year in the airline insurance market. The renewals again witnessed the trend for low single digit premium increases against higher levels of exposure increase. The level of rate relief as a result of this exposure development remains a potential issue for the market. Airlines gather their renewal information approximately three months prior to renewal for the 12 months following renewal. This 15 month period has the potential for some significant changes in the exposure levels of individual programmes. The continued uncertainty around the global economy creates an element of scepticism around the realisation of these projected passenger exposures and therefore generated premium volume.

One positive from the growth experience of recent years is that increased exposures do not directly translate into claims. Insurers would argue the negative is that the market has been unable to translate it into premium either!

The most influential market factor remains the level of capacity which, does not look like diminishing in the short term. There is no market that has experienced the 'market result' due to the different portfolio of risks they write. Having an aviation portfolio is something that has remained attractive to insurers and provided diversity to their overall portfolio.

The consolidation of the airline industry in Russia has boosted the exposures of the Aeroflot programme which included STC, Orenburg and Vladavia during the expiring policy. This led to significant exposure increases when comparing to the previous year. Other major renewals included American Airlines, which demonstrated a significant reduction in average fleet value, with passenger numbers increasing slightly, and received a small reduction in premium. Ethiopian Airlines declared exposures that were up almost 30% on average fleet value, and passenger numbers which were up 12% when comparing to last year (including ASKY for 2010). This increase in exposures contributed to the overall July increase which was 8% for AFV and 13% for passengers declared.

There were some changes in the renewals taking place during July as Alaska Airlines extended its policy to renew in August, Synergy/TACA Group purchased a 15 month policy in 2010 and therefore renews in October and Siberia Airlines renewed early in May. There were also programmes that are no longer included in the analysis as Mandala ceased operations and LIAT dropped below our US$100 million average fleet value criteria.

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2011 HULL AND LIABILITY NET % PREMIUM AND EXPOSURE MOVEMENTS

	NO. OF RENEWALS	AFV % CHANGE	PAX % CHANGE	2010 NET PREMIUM US$ M	2011 NET PREMIUM US$ M	US$ M PREMIUM CHANGE	PREMIUM % CHANGE
January	6	-59%	-49%	16.08	17.43	1.35	8.4%
February	3	41%	9%	3.98	5.19	1.21	30.4%
March	6	14%	21%	9.65	11.18	1.53	15.8%
Q1 Summary	**15**	**-32%**	**-28%**	**29.71**	**33.80**	**4.09**	**13.7%**
April	18	11%	15%	128.53	123.13	-5.40	-4.2%
May	17	10%	11%	71.74	71.92	0.18	0.3%
June	21	3%	7%	40.62	43.10	2.47	6.1%
Q2 Summary	**56**	**10%**	**13%**	**240.89**	**238.15**	**-2.75**	**-1.1%**
July	33	8%	13%	232.76	226.38	-6.38	-2.7%
2011 Total	**104**	**7%**	**12%**	**503.36**	**498.33**	**-5.04**	**-1.0%**

MARKET NEWS

ALLIANZ GLOBAL CORPORATE & SPECIALITY NEW CEO ANNOUNCEMENT

Carsten Scheffel, current CEO of Allianz Global Corporate & Specialty Americas (AGCS), has been confirmed as the new CEO of AGCS London. He will begin his new role on the October 1, 2011 and will be responsible for AGCS in the United Kingdom, Ireland, Belgium, The Netherlands and South Africa. Mr. Scheffel will be based in London. Mr. Scheffel has worked at Allianz since 1978, and was previously Chief Agent of AGCS in Canada before moving to AGCS's Chicago offices in 2006 where he became CEO in 2009. Current CEO, Andreas Berger, is starting a new role on the Board of Allianz Global Corporate & Speciality AG in Munich.

WILLIAM HARRIGAN JOINING WILLIS AEROSPACE CLAIMS TEAM

Willis Aerospace is delighted to announce that William (Bill) Harrigan will be joining Willis Aerospace in the New Year. Bill will be joining the Aerospace claims team reporting to Philip Clarabut and will have the title of Executive Director/Claims Advocate. Bill will concentrate on supporting our North American business. Bill who is currently with Cooper Gay has worked in the claims environment for in excess of twenty-five years and has a wealth of experience.

USAIG APPOINTS PAUL S. RATTÉ AS DIRECTOR OF AVIATION SAFETY PROGRAMMES

USAIG strengthens its efforts to promote safe flight with the appointment of Paul S. Ratté as its new director of aviation safety programmes.

Ratté, a career U.S. Coast Guard aviator, offers a wealth of advanced experience in aviation operations, safety and human factors, and emergency response management. He is among the service's most decorated aviators, with two Distinguished Flying Crosses and the Air Medal awarded for lifesaving rescues at night.

He will draw on his extensive experience to guide a wide range of USAIG initiatives designed to improve aviation safety through education, incentives and proactive solutions tailored to every type of flight operation, from single aircraft operators to major flight departments.

David L. McKay, USAIG president and COO said, 'We are delighted to welcome Paul as a member of the USAIG team. As we build on and expand our safety programs for aircraft operators of every type and mission, we required a strong leader with an extensive background in aviation operations. Paul offers an outstanding mix of expertise and the drive to share his broad knowledge and dedication to safety.' (RotorNews, 09/08/2011)

UIB ANNOUNCEMENT

David George has resigned his position as head of UIB aviation to join Marsh Aerospace.

KILN LAUNCHES AVIATION TEAM IN SINGAPORE

Kiln, the international specialist insurance and reinsurance underwriting group, has launched a new team to underwrite aviation risks in Singapore.

The team, led by established aviation underwriter Brendan Warner, will focus on underwriting a broad range of aviation risks including Regional Airline; General Aviation; Products & Airport Liability; Hull War; Hull Deductible and Excess Liability business across the Asia-Pacific region, which has experienced a period of rapid growth in recent years. They will operate with a US$80 million line size for Liability and US$12 million for Hull risks.

Brendan, who has 33 years experience in the aviation insurance industry, joins Kiln alongside underwriter Jenny Choi, with whom he has worked for the past five years in the Australian aviation market. They will be supported by Idie Si as underwriting assistant, who recently relocated from Kiln's office in Hong Kong.

The launch follows the recruitment of a number of Property, Treaty, Marine Hull and Marine Liability underwriters to Kiln in Singapore in the past year.
(Kiln, 26/07/2011)

CLYDE & CO AND BARLOW LYDE & GILBERT SIGN HEADS OF AGREEMENT

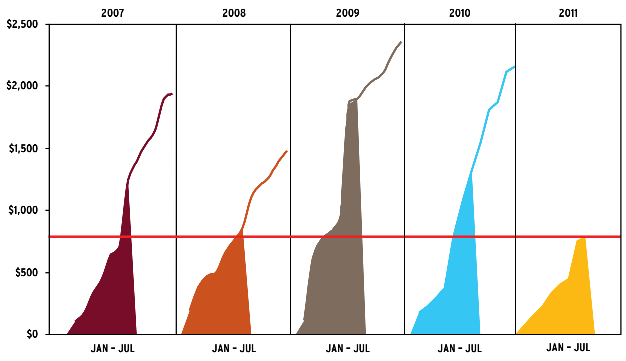
Further to the commitment to merge shown by the partnership votes at Clyde & Co and Barlow Lyde & Gilbert on 28 and 29 July, the two firms have now signed heads of terms and will move forward to sign a formal merger agreement. The intention is to complete the merger of the two firms on November 1, 2011.
(Barlow Lyde & Gilbert LLP, 04/08/2011)

LOSSES OVERVIEW

Despite the run of recent hull losses the 2011 loss experience continues to be comparatively good. The lack of fatalities in the three losses that have occurred continues to highlight the excellent safety performance of the industry and delivering some good fortune for underwriters.

With a hull loss total of US$426 million and liability reserves totalling just US$68 million the attritional total remains a significant portion of the US$794 million overall loss total. This is the lowest loss total at the end of July since 2006.

CUMULATIVE MONTHLY INCURRED RESERVE DEVELOPMENT (US$M)



Current 2011 Reserve US$794 million (incl. pro rata attritionals)

On July 28, an Asiana Airlines B747-400F aircraft, registration HL7604, crashed into the sea close to Jeju Island after departing from Seoul's Incheon Airport. There were reports of a fire in the hold. The two crew members on board were killed. The hull reserve for this loss is US$127 million.

On July 29, an Egyptair B777 aircraft, registration SU-GBP, sustained damage after if suffered a cockpit fire whilst parked on the ground at Cairo Airport, Egypt. The fire burned a hole through the side of the cockpit. Five passengers sustained minor injuries. The aircraft has been declared a Constructive Total Loss. The hull reserve for this loss is US$60 million.

On July 30, a Caribbean Airlines B737-800 aircraft, registration 9Y-PBM, overran the runway at Georgetown Airport, Guyana and the fuselage broke into two pieces. The hull reserve for this loss is US$49 million.

These three losses represent a continuation of the trend for high valued hull losses. This type of loss is a direct drain on the cash reserves of underwriters but at the same time provide certainty of loss levels rather than long tail liability losses.

Other significant losses that have occurred since our last publication are outlined below.

On August 3, a Nolinor Aviation Convair 580 aircraft, registration C-GKFP, sustained damage when the aircraft's nose undercarriage collapsed during landing at Kasba Lake Airport, Canada. The hull reserve for this loss is $1 million.

On July 28, an IndiGo A320 aircraft, registration VT-IEH, was hit by a empty B737 aircraft operated by SpiceJet, registration VT-SPS, as the A320 was parked at New Delhi Airport, India. The B737 was being repositioned by ground maintenance staff when the engineer apparently lost control until it hit the parked A320. The winglet and outer wing of the B737 hit the fuselage of the A320 with force, resulting in substantial damage to the A320 and minor damage to the B737. The hull reserve for this loss is yet to be set.

On July 17, an Aer Arann ATR 72 aircraft, registration EI-SLM, suffered a nose undercarriage collapse on landing at Shannon Airport, Ireland. The undercarriage collapsed on vacating the runway onto the taxiway. The four crew and 21 passengers were uninjured. The hull reserve for this loss is yet to be set.

On July 14, a Delta B767 aircraft, registration N185DN, sustained damage when its left wingtip collided with an Atlantic Southeast CRJ-900 aircraft, registration N132EV, at Boston Airport, USA. The CRJ-900's horizontal stabilizer was sheared off and the B767's wing also took significant damage. The hull reserve for this loss is yet to be set.

On July 14, a Eurolot ATR-72 aircraft, registration SP-LFH, was hit by a small baggage vehicle at Warsaw International Airport resulting in substantial damage to its right wing and propeller. The driver sustained serious injuries. No one on board the aircraft was hurt. The hull reserve for this loss is US$3.25 million.

On July 13, 13 United Continental and 18 Frontier aircraft were damaged on the ground at Denver Airport, USA when a strong hailstorm swept through the area. Inspections showed dents on skin panels of the wings, flaps and spoilers which have needed replacement. The hull reserve for this loss is yet to be set.

On July 8, a Hewa Bora B727 aircraft, registration 9Q-COP, missed the runway on landing at Kisangani Airport, Congo. The aircraft disintegrated on impact and caught fire. 75 people on board have been confirmed dead. We have been advised that there is no hull cover in London, but the liability cover is placed in London and the reserve is in excess of US$5 million.

On July 5, an Aerosur B747 aircraft, registration CP-2603, sustained damage when a tire burst upon landing. The crew also received information that tire debris was found on their departure runway. The aircraft's undercarriage and braking system was damaged in the process. The hull reserve for this loss is $4.5 million.

INDUSTRY NEWS

GLOBAL AIRLINE DEMAND SOFTENED IN JUNE 2011: IATA

Demand for passenger and cargo traffic both saw a 'slight softening' in June 2011 according to IATA, reflecting slower global economic growth and increased fuel costs.

It reported 4.4% growth in global passenger traffic against the same month last year, but a 3% decline in freight traffic for June 2011.

Global passenger capacity grew 5.1%, and the passenger load factor was 79.5%, said IATA. The international market saw a growth of 5.9% in passenger traffic and a 7.2% increase in capacity, as compared with June 2010.

The domestic passenger market showed a 1.9% growth over the previous year, outpacing a capacity increase of 1.5%.

In the cargo market, international freight traffic declined 3% against a capacity increase of 3%. Domestic freight traffic fell 3% while capacity declined 1.9%. Freight volumes have not grown since July – August 2010, it said, as global trade uses other modes to move goods.

IATA's director general and CEO, Tony Tyler said: 'The Middle East carriers have moderated to single digit expansion and tighter economic conditions have slowed China's growth. Meanwhile, Latin America is leading the industry expansion followed by Europe which is growing strongly despite its currency crisis. And North America is underperforming the industry on growth but leading on load factors.

'The average price for the second quarter was $133/barrel which is an increase of $10 over the first quarter. With an expected profit margin of only 0.7%, the ability of airlines to recoup this cost is critical to staying in the black for the year,' added Tyler.

IATA is forecasting an industry profit of $4 billion for 2011 which is a 78% fall from the $18 billion that the airlines made in 2010. On anticipated revenues of $598 billion, this translates to a net industry margin of 0.7%.

Source: Air Transport Intelligence news

FORTHCOMING RENEWALS

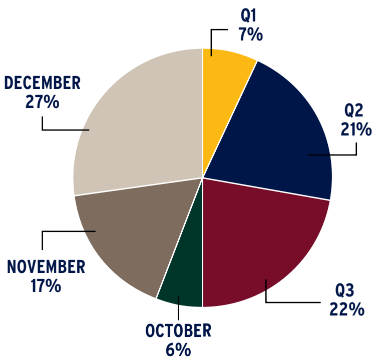
August and September see very little renewal activity. The premium volume generated is usually between US$20 – 25 million for each month. Combined this represents less than 3% of the annual premium volume. The premium exposure figures have however been boosted through the addition of Alaska which extended its policy from July into August, and also Belavia which extended its policy from May to August. There have been some other programmes changing renewal date as Atlasjet of Turkey extended from July to September.

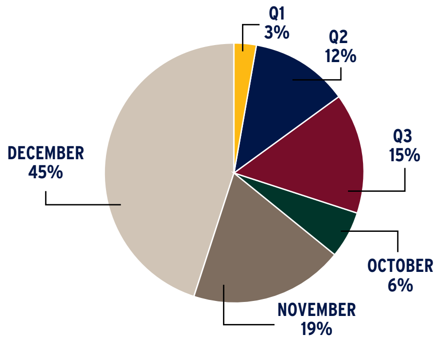
With little change taking place in the market the major interest in these renewals is likely to be if they are looking to make final adjustments to remove any penalty imposed on their premium volume following the market reaction to the Air France loss in 2009.

When the market enters the final quarter 2011 will have been one of the best years ever for airline insurance, exposures will be projected to grow dramatically and excess levels of capacity will continue to exist. Surely a buyers market!

These conditions could see actual premium volumes reduce but by how much and for how long remains to be seen.

RENEWAL DISTRIBUTION % SHARE AND PREMIUM DISTRIBUTION % SHARE





AUGUST RENEWALS

AIRLINE	RENEWAL DATE	EXPIRING AFV US$
Monarch Airlines	01-Aug-11	1,272,710,548
Skymark Airlines	01-Aug-11	862,054,349
Air Nigeria	01-Aug-11	123,600,000
Kalitta	03-Aug-11	268,087,671
Alaska Air Group	05-Aug-11	4,475,500,000
Belavia	06-Aug-11	212,843,836
Bangladesh Biman	15-Aug-11	167,800,000
Pegasus Airlines	24-Aug-11	1,335,165,323

SEPTEMBER RENEWALS

AIRLINE	RENEWAL DATE	EXPIRING AFV US$
TRIP Linhas Aereas	01-Sep-11	624,747,233
InterJet	09-Sep-11	777,800,000
AMC Aviation	11-Sep-11	182,750,500
Kolavia Airlines	11-Sep-11	110,998,630
Atlasjet International Airways	15-Sep-11	565,825,000
Nordwind Airlines	15-Sep-11	182,139,727
Aerorepublica	21-Sep-11	480,658,487
Cargojet	22-Sep-11	121,000,000
FinAvia Group	30-Sep-11	799,926,055
Georgian Airlines	30-Sep-11	135,090,000

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