



THE AIRLINE HULL AND LIABILITY MARKET

Airline insurers continued to seek and obtain rate and premium increases during 2009. Over the year the lead London hull and liability premium increased by 20% to total US\$1.93 billion.

The year was one of two distinct halves. The first half of the year saw a premium increase of 11% and a total premium of less than US\$240 million. Following a number of major losses during this period however claims (excluding attritional losses) totalled in excess of US\$1.6 billion. In the second half of the year, as a result of these losses, the market started to show signs of further hardening with insurers indicating that despite the overcapacity, they would require rate increases significantly higher in the second half of the year than seen in the first six months.

This change in attitude manifested itself during the third quarter, when premium volumes increased by 18%, which although higher than the first half of the year was not as

large an increase as had been expected. The second half of the year saw a return to recent average claims levels and resulted in the momentum to increase rates yet further start to level off.

During the fourth quarter the level of increase was developed further to 20%, however this figure was influenced by the fact that some of the programmes renewing had suffered significant losses in their expiring periods of insurance and received differentiated premium changes as a result. In addition the level of vertical market differentials started to stabilise.

Despite these increases in premium, insurers have incurred a third loss making year in a row, although the level of loss was not as significant as insurers feared after the first six months of the year. Although some insurers will make recoveries from their reinsurance programmes, these will vary for each insurer dependent on how their programmes are structured.

HULL AND LIABILITY

2009 NET % PREMIUM AND EXPOSURE MOVEMENTS

2009	NO. OF RENEWALS	AFV % CHANGE	PAX % CHANGE	2008 NET PREMIUM US\$M	2009 NET PREMIUM US\$M	US\$M PREMIUM CHANGE	PREMIUM % CHANGE
JANUARY	4	31.8%	14.1%	6.1	7.4	1.3	21.3%
FEBRUARY	4	37.4%	10.8%	4.2	4.5	0.3	7.5%
MARCH	4	12.1%	3.4%	17.0	20.6	3.6	21.2%
Q1 SUMMARY	12	22.5%	5.4%	27.3	32.5	5.2	19.2%
APRIL	19	0.1%	-6.1%	97.2	104.6	7.4	7.7%
MAY	16	9.4%	2.5%	56.8	61.7	4.9	8.6%
JUNE	12	-8.1%	-16.2%	31.7	37.6	5.9	18.7%
Q2 SUMMARY	47	1.3%	-4.7%	185.6	203.9	18.3	9.8%
JULY	35	2.2%	-12.5%	197.3	226.9	29.7	15.0%
AUGUST	7	8.7%	8.3%	17.3	23.6	6.3	36.4%
SEPTEMBER	8	15.0%	-1.2%	20.0	25.0	5.0	25.0%
Q3 SUMMARY	50	3.0%	-10.3%	234.5	275.5	41.0	17.5%
OCTOBER	19	18.7%	4.1%	101.6	135.6	34.0	33.5%
NOVEMBER	22	-0.3%	-7.1%	270.5	307.6	37.0	13.7%
DECEMBER	64	0.3%	1.6%	768.1	923.8	155.8	19.9%
Q4 SUMMARY	105	0.6%	0.2%	1,140.2	1,367.0	226.8	20.3%
2009	214	1.0%	-1.4%	1,587.6	1,878.9	291.3	18.3%
ADJUSTED 2009				1,612.3	1,930.9	318.6	19.8%

THE AIRLINE HULL AND LIABILITY MARKET (Continued)

In terms of the number of losses 2009 was an average year. Fatalities were also lower than the average for the past 10 years, but despite these figures, the actual incurred loss figure was the highest on record (excluding September 11, 2001 losses). This clear illustration of the catastrophe nature of airline insurance highlights the disconnect between the frequency of losses and their severity for insurers.

The nature of the annual renewal cycle means the fourth quarter sets the trend for the first nine months of the following year. We believe this will again be the case in 2010 unless we see further significant losses or reductions in capacity resulting in higher rate increases than recently seen in the last three months of 2009.

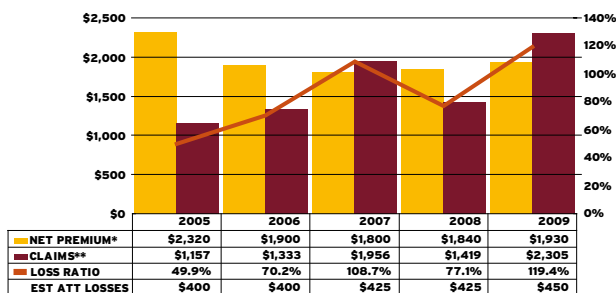
Surprisingly, considering the worldwide economic environment, airline exposures have not seen the level reductions that were expected. Fleet values saw a small increase of 1% and projected passenger numbers have only fallen by 1%. These projections are based on the 2009 versus 2008 exposures declared at inception in both years and are estimates. The 2008 figures were advised when the effects of the economic downturn were at their worst and are in the main yet to be adjusted.

In addition with traffic levels falling throughout 2009, it is likely that when policies that incepted during 2008 are adjusted the level of premium generated for the 2008 underwriting year will be lower than the figure of US\$1,685 million that was anticipated at this time last year.

The reduction in passenger numbers will have the greater impact on premium levels as the majority of premium is generated from liability risks.

WORLD WIDE AIRLINE HULL AND LIABILITY PREMIUM AND CLAIMS ON A CALENDAR YEAR BASIS

2004 - 2009 (NET LEADERS TERMS US\$M)



* Premium for airlines with an AFV in Excess \$100 million and is based on Net London Lead Terms; it is subject to change as more information becomes available
 ** Claims on expired years include the estimated figure for attritional losses

CAPACITY

The level of capacity available through 2009 was still comfortably in excess of that required. It is however the deployment of this capacity rather than the level of capacity available that is important. This can vary on a risk by risk basis with insurers adjusting their involvement dependent on a number of factors including limits purchased, previous loss history, country of domicile, class of operation, and most importantly, price. If insurers perceive a programmes price to be insufficient then the level of capacity can quickly become restricted.

HULL WAR

Despite not seeing any significant losses since 2001, the market has remained stable, with rates showing very little change. We believe that rates have fallen by less than 1%. It is expected that gross premium levels will remain at around US\$125 million. With this income being well below the level of a new wide-bodied aircraft, insurers believe that premium levels cannot be allowed to fall further. With the hull war market normally only incurring total losses it will always be extremely loss reactive. Any significant Hull War or terrorist related loss will result in an immediate increase in premium.

EXCESS THIRD PARTY WAR AND TERRORISM LIABILITY (EXCESS AVN52)

Premium levels for this class of business are believed to have seen reductions in the region of 10% versus 2008 levels. The gross premium for 2009 is estimated to be in the region of US\$200 million. A significant factor in this reduction is the fact that this class of business has not seen any losses since it evolved. Premiums have reduced from a figure of US\$750 million in 2001. In the time since its inception this class is believed to have generated nearly US\$4 billion in premium for insurers.

Recent events involving the attempt to cause an explosion on board a Delta Air Lines/Northwest Airlines flight from Amsterdam to Detroit will have reminded insurers of their potential exposure and clients for the need to purchase this coverage. If this attempt had been successful and the aircraft destroyed the coverage for both the Hull War and Excess Third Party Liability would have been assumed by the U.S. Government through the FAA scheme, with passenger liability being assumed by commercial insurers.

HULL DEDUCTIBLE

This sector of the market remains extremely competitive, with the Talbot syndicate entering this class during 2009, in addition to the existing five insurers (Ace, Aspen, Chartis (formerly AIG), Kiln and XL). It remains a very loss sensitive sector, with a programmes historic loss record having a significant impact on the treatment received from insurers.

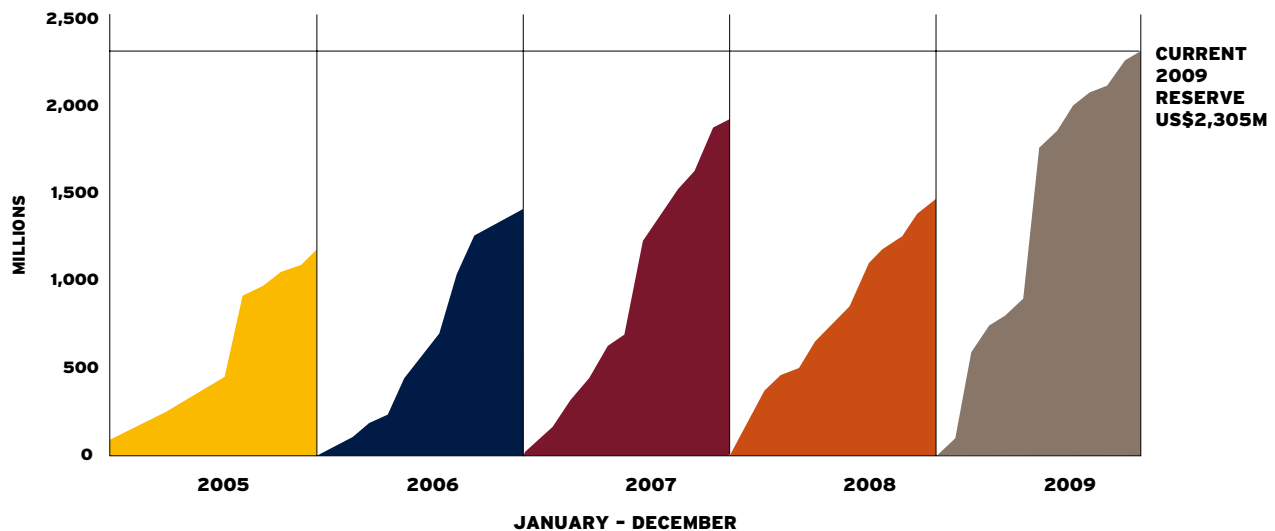
Dependent on the size of programme, with smaller risks being more attractive to insurers, those risks with a good loss record were able to obtain modest reductions. The larger programmes were more likely to have received an 'as before' rate or a small reduction in premium. Programmes with significant losses were less attractive to insurers and subject to increases in premium.

LOSSES

In terms of the monetary cost, losses for 2009 stand at their highest on record (excluding September 11, 2001 losses). Losses for 2009 (including an estimated US\$450 million in respect of attritional losses) total US\$2,305 million.

In terms of losses, 2009 was also a year of two halves with reserves in the first six months totalling US\$1,852 million with 491 fatalities. The second half of 2009 saw losses total just US\$453 million with 192 fatalities. The largest event in terms of loss of life was the disappearance of an Air France A330-200 in the Atlantic Ocean off the coast of Brazil, which resulted in the deaths of 228 passengers and crew.

CUMULATIVE MONTHLY INCURRED RESERVE DEVELOPMENT (USD)



Although the value of losses was very high during 2009, the actual number of total losses of aircraft in airline operation was no worse than an average year, with 17 total losses.

There were 19 aircraft losses with a reserve in excess of US\$10 million, as can be seen from the following table this figure is the average for the decade since 2000. The number of fatalities during 2009 despite very large liability reserves was also low, at 683 compared to an average of 796. Despite this, the total incurred figure of US\$2,305 is the highest on record, if the losses resulting from the atrocities of September 11, 2001 are excluded. This illustrates the unpredictable nature of catastrophe losses and the lack of correlation between the financial severity of losses to insurers which is dependent on a number of factors.

YEAR	NO. OF LOSSES EXCESS \$10M	TOTAL RESERVES US\$M	FATALITIES
2009	19	2,305	683
2008	23	1,419	569
2007	21	1,956	760
2006	18	1,333	877
2005	18	1,157	1,048
2004	9	994	535
2003	19	924	561
2002	21	1,313	1,119
2001 (Excl. 9/11)	14	1,796	869
2000	26	1,804	942
AVERAGE	19	1,500	796

REINSURANCE MARKET

Following the Colgan Air and Air France losses reinsurance programme pricing started to firm, with those layers that had been affected seeing a greater level of increase. In addition the attachment points of some major risk-exposed primary excess of loss layers have seen a limited amount of increase. Those layers of reinsurance that have not been affected by losses have largely remained unchanged.

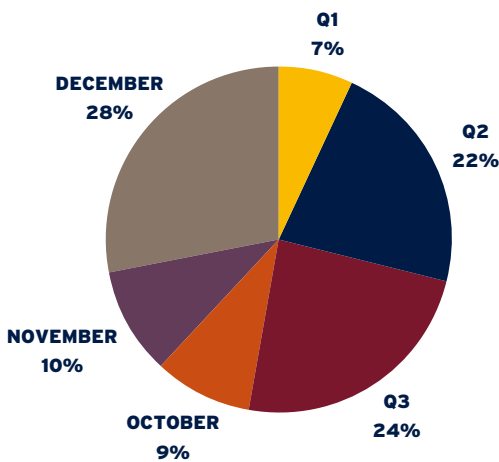
There was also a greater reluctance from traditional markets to support proportional treaty programmes due to disappointing results and insurers believing that rating levels were insufficient on underlying business.

2010 HULL AND LIABILITY

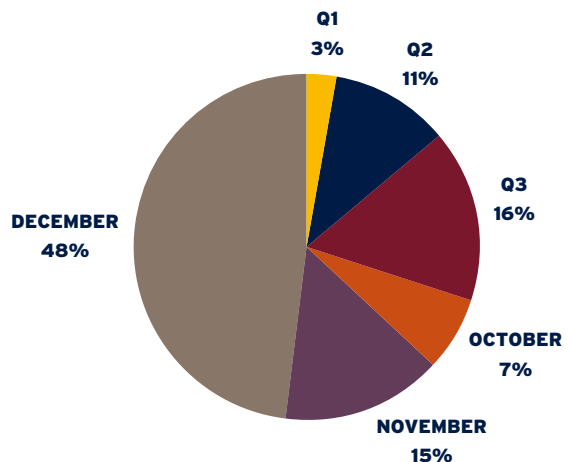
We expect that during the first half of 2010 premiums will see increases no higher than the levels seen during the fourth quarter of 2009 and significant differences in treatment depending on risk profile. The market will remain loss sensitive and it is likely that if we see a major catastrophe loss early in the year, the pressure to further raise rates will increase. However should the market see a low level of loss activity during this time, the pressure will mount on insurers to lower their expectations.

2010 RENEWAL AND NET PREMIUM DISTRIBUTION

RENEWAL DISTRIBUTION % SHARE



PREMIUM DISTRIBUTION % SHARE



For Programmes with an AFV in excess of US\$100 million

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