AIRLINE INSURANCE MARKET OVERVIEW

2014: A DEFINING POINT FOR THE MARKET, OR JUST BUSINESS AS USUAL?

The 2014 airline insurance renewal season is now upon us and there is clearly a desire from insurers to change market renewal conditions. But will this really be a year of significant change when, in reality, the market drivers remain largely the same?

There have undoubtedly been some significant losses, but their circumstances have likely not been as a result of a deterioration in operational safety of either the airline or wider industry. Capacity remains abundant with a large percentage of it not being impacted by these losses.

The airline industry and therefore exposures continue to grow as the global economy continues to recover. The majority of buyers will therefore come to market with a positive story, growth in exposures, good 5 year loss experience and as a result no budget for a significant premium increase.

The vast majority of programmes will represent no worse a risk than they did 12 months ago and while understanding and recognising that the losses of the few are paid for by the many it therefore depends on how much the many can and realistically will be asked to pay.

The market as a whole reached an unprofitable level in 2013 and looks set to deliver a worse result in 2014. This will however not be the case for each market but a long term sustainable position for the market is clearly a key requirement for all stakeholders. Buyers do not want to return to a boom and bust market scenario that was common 10 years ago.

HULL & LIABILITY PREMIUM AND CLAIMS (CALENDAR YEAR)
2010 - 2014 NET LEAD TERMS US$ MILLION

Predictability, sustainability and a technical underwriting mantra have been a feature of the insurance purchase in recent years and as Capacity levels have not been depleted with no withdrawals following the recent major losses the conditions even if there is desire for significant change may not exist.

The nature of the recent losses has made them high profile, not just for the market but for the world at large but should this profile be influential in driving market reaction and behaviour?
A MARKET DIVIDED

Whilst we look at the market as a whole it is clear that there are distinct differences between certain segments of the market, Willis 50 programmes are experiencing clear economies of scale, operators of wide bodied equipment and their requirement for larger limits are distinct from the narrow bodied lower limit buying airlines through their demand for capacity. It is perhaps the capacity arena that sees the greatest differentiation with those insurers that have been impacted by the recent losses having a different view, based on their experience, from those that have not paid these significant claims. This also excludes the different reinsurance arrangements and therefore recoveries each market will be able to make from their reinsurers.

Whilst there has been a call for 50pct increases from some markets that would achieve a premium position of US$1.963 billion based on the premium to renew in the final quarter. If the market was to target a breakeven position against projected losses they would only need to achieve a 27% increase in premium. This would be a considerable gain for those markets unencumbered by the losses on Malaysia Airlines. If things remained as they have been from the first nine months then there would still be a difference of approximately US$350 million for the markets who have not been impacted by Malaysia airlines.

When considering the various scenarios above the next few weeks will see a differentiated picture develop. While there is undoubtedly a general consensus on the need for greater pricing resilience we anticipate each underwriter demonstrating varied opinions of risks presented based on their criteria, characteristics and experience. We shouldn’t really expect anything different should we?

WILLIS AEROSPACE U.S. EXPANDS WITH ADDITION OF WORKERS’ COMPENSATION PRACTICE LEADER

Earlier this month Willis Aerospace Americas announced the development of our team with the addition of Jason Klevens who has joined to become our Workers’ Compensation Practice Leader.

Jason comes to Willis with 12 years experience in Aerospace Workers’ Compensation having most recently held the position of Workers’ Compensation Division Manager at AIG Aerospace. While at AIG, Jason also held the position of Global Product Line Manager for Airports and prior to that, Jason worked in the Major Accounts Division with a focus on commercial general aviation underwriting.

Jason’s experience, his knowledge of the market, as well as his relationships will further round out our product offering bringing us closer to our clients and prospects through industry specialization. Jason will be based in Atlanta, but will be a national resource to the U.S. Aerospace team. While his primary focus will be on Workers’ Compensation, Jason will also get involved in other areas as well given his past experience, capabilities, and relationships.

WILLIS TRANSPORTATION OUTLOOK

Willis has recently published the first in a series of global Industry focused reports – to help inform and educate senior business leaders and raise Willis’s profile with C-suite executives.

Willis’s Transportation Outlook – published this week – explores the critical dynamics in the transportation sector and proposes disruptive new strategies to help business leaders tackle threats and seize opportunities.

The first edition of this annual publication includes views and opinions from a host of leading thinkers, including representatives from business, academia and multilateral organisations, on a diverse range of topics, all of which are pivotal to how Willis sees the transportation sector evolving, including:

— How to choose the best development priorities to ensure transport remains a key driver of economic growth, and continues to propel productivity, innovation, price-cuts, long term competition and employment.
— The transformational effect of the ‘industrial internet’ and new technologies on road and rail networks and what this means, including enhanced data analytics, real time safety information and driverless cars.
— Why the aviation industry is turning to environmental initiatives to help cut costs as well as emissions, and how the transportation sector as a whole is adapting to a changing climate and more extreme weather.
— The challenge facing shipping operators as a result of plummeting freight rates combined with age-old problems, such as marine piracy, which is forcing them to rethink the status-quo.
— Exclusive case studies on: Rio’s rapid transit system; Dubai’s international airport; traffic management systems in Milan, Hong Kong, Mumbai and Singapore; and China’s East African rail project.

To download a copy of the report click here (http://info.willis.com/site/transportation/SitePages/Home.aspx)
The next few weeks and months could mark the next chapter of development for the airline insurance market but there is the potential based on some past experience for the market to suffer little disturbance once the immediate aftermath of an event has occurred.

There can be no doubt that fleet and passenger exposures will continue to grow and industry safety looks set to improve as further new aircraft are delivered into the global fleet. Despite the tragic losses, suffered by Malaysia Airlines, 2014 is set to be one of the safest years ever for the airline industry. It is therefore a question of how much of this growth will be charged for.

The final quarter of the year has always been a pivotal time for the airline insurance market and is so important as it represents approximately 52% of the renewals but more importantly nearly 71% of the premium. It is a period when the vast majority of the largest programmes come to market, these are generally the group programmes but also include the US Majors and numerous large Low Cost Carriers (LCC’s). The range of programmes in terms of exposures, limits and experience will aggregate to form a renewal “trend” which is there to be outperformed or justified against.

It remains to be seen how the market forces will be brought to bear and how much the participants on a programme have been influenced by their experience on other programmes. Whatever happens, it looks set to be the most interesting renewal season for some time.

We will provide regular updates to clients and other market stakeholders via this Airline Insight publication, Renewal Season Bulletins and Video Updates.

The airline insurance market loss position has deteriorated significantly from that experienced in recent year, or has it? The loss figures as a result of two major unusual losses affecting Malaysia Airlines have masked what is, from a standard operations standpoint an excellent year in terms of loss experience. Hull losses to the end of August stood at US$239 million and liabilities at US$725 million. When we add our pro-rata of the annual attritional total the loss total for 2014 stands at US$1,265 million. In the absence of a catastrophe between now and the end of the year the projected loss position is currently US$1,700 million.

It is worthy of note that there have been just 8 losses in excess of US$10 million during 2014 compared to 20 in 2013 and 12 in 2012.

**HULL & LIABILITY LOSSES**

On July 27, a United Continental Holding Boeing 747, registration N194UA, sustained significant damage to its nose when it was struck by a United B777, registration N788UA, wingtip during repositioning at their maintenance hangar at Chicago, Illinois. The hull reserve for this loss is US$4 million.

On July 24, a Swiftair/Air Algerie MD83, registration EC-LTV, crashed while en route between Ouagadougou, Burkina Faso and Algiers, Algeria and was later found to have crashed in a remote desert area southeast of Gossi, Mali. The hull reserve for this loss is US$4 million.

On July 23, a TransAsia ATR72, registration B-22810, crashed after an emergency landing in Penghu, Taiwan during a typhoon. 48 people are reported dead while 10 were injured. The hull reserve for this loss is US$13.2 million.

On July 20, a United Airways, ATR-72, registration S2-AFN, suffered damage after a nose gear collapse after landing at Coxs Bazar Airport, Bangladesh. The hull reserve for this loss is US$3.2 million.

On July 7, an Air Asia A320, registration 9M-AQA, suffered damage when the aircraft veered off the runway upon landing at Brunei International Airport. The hull reserve for this loss has yet to be established.

On July 6, a Saudia A320, registration HZ-AS41, sustained damage after a hard landing at Abha Regional Airport, Abha, Saudi Arabia. The hull reserve for this loss is US$1.3 million.

Atrium recently announced the appointment of James Weigall as Head of Aviation. James will lead the Aviation Team and be responsible for the Aviation War and Hull and Liability accounts.

He will be ably assisted by Alex Cullen, David Langran and Jimmy Curtis who have been servicing the account recently.

James will be reporting to Toby Drysdale. In view of James’ extensive experience it is Atrium’s intention to look to write other aspects of the Aviation account under his leadership.
On June 20, an Omni Air International B767, registration N768NA, sustained damage as a result of a tail strike during arrival at Kabul Airport, Afghanistan. The hull reserve for this loss is US$8 million.

On June 4, an Air India B777, registration VT-ALIT, suffered damage when a catering vehicle ran into the rear fuselage of the aircraft at Liberty International Airport, Newark, USA. The hull reserve for this loss is US$3 million.

On May 30, a Total Linhas Aereas ATR72, registration PR-TKB, sustained damage after it collided with a tapir while taking off from Coari Airport, Amazon, Brazil. The hull reserve for this loss has yet to be established.

On May 20, a Finnair A330, registration OH-LTS, was damaged after the aircraft made a hard landing at JFK International Airport, New York, United States. The hull reserve for this loss is US$2.1 million.

On May 10, an IRS Airlines Fokker 100, registration 5N-SIK, was damaged beyond repair after it carried out an emergency landing in open desert in Kwasi Posa,(near) Dosso, Niger after experiencing a systems failure. The hull reserve for this loss is US$65.1 million.

On May 8, an Ariana Afghan Airlines B737, registration YA-P1B, was damaged beyond repair after the aircraft overran on landing at Kabul Airport, Afghanistan. The hull reserve for this loss is US$5.3 million.

On April 29, an Air Contractors B737, registration EI-STD, sustained damage after it suffered a left main undercarriage failure on landing at East Midlands Airport, United Kingdom. The hull reserve for this loss is US$6.3 million.

On April 25, a Pegasus Airlines A320, registration TC-DCA, suffered a tail strike during take off from Sabiha Gokcen Airport, Istanbul, Turkey. The hull reserve for this loss is US$1.3 million.

On April 14, a Golden Myanmar A320, registration XY-AGT, was damaged after it was involved in a ground collision with an A319 operated by Myanmar Airways International, registration XY-AGR. The hull reserve for this loss is US$10.3 million.

On April 11, a Kenya Airways E190, registration 5Y-FFC, suffered damage on landing at Dar Es Salaam International, Tanzania after it veered off the runway in heavy rain damaging the right engine. The hull reserve for this loss is US$3.3 million.

On April 1, a European Air Transport (DHL) A300, registration D-AEAH, sustained damage after the aircraft tipped back onto its tail during cargo unloading at Abu Dhabi International Airport, United Arab Emirates. The hull reserve for this loss is US$3 million.

On March 28, an Avianca Brasil F100, registration PR-OAF, suffered damage on landing at Brasilia, Brazil when it landed with the nose undercarriage retracted. The hull reserve for this loss has yet to be established.

On March 18, an Lufthansa A340, registration D-AIHR, was damaged after suffering a hard landing at Narita International Airport, Tokyo, Japan. The hull reserve for this loss is US$2.5 million.

On March 18, a Fiji Airways A330, registration DQ-FJV, was damaged after suffering a hard landing at Kingsford Smith International Airport, Sydney, Australia. The hull reserve for this loss is US$6 million.

On March 13, a US Airways A320, registration N113UW, was damaged beyond repair after a nose gear collapse at Philadelphia Airport, USA before take off. The hull reserve for this loss is US$18 million.

On March 9, an ATR-42 operated by Calm Air, registration C-FIVY, was damaged beyond repair after it suffered a left main undercarriage collapse whilst vacating the runway after landing at Churchill Airport, Manitoba, Canada. The hull reserve for this loss is US$5.2 million.

On March 8, a Malaysia Airlines B777, registration 9M-MRO went missing on route to Beijing from Kuala Lumpur. There is currently a search operation taking place. The hull reserve for this loss is US$50 million. (Hull Reserve of $100m is split 50/50 between Hull & Liabs & Hull War)

On March 6, a United Airlines A319, registration N839UA, sustained damage to its engine when it ingested an air conditioning hose during taxi at Chicago O’Hare Airport, Illinois, USA. The hull reserve for this loss is US$1.8 million.

On February 27, a Qantas B747, registration VH-OEI was damaged after the aircraft’s wing came into contact with the wing of another Qantas aircraft, an A380, registration VH-OQI when being towed out of the hanger at Los Angeles Airport, USA. The hull reserve for this loss has yet to be established.

On February 27, a Qantas A380, registration VH-OQI was damaged after the aircraft’s wing came into contact with the wing of another Qantas aircraft, a B747, registration VH-OEI when being towed out of the hanger at Los Angeles Airport, USA. The hull reserve for this loss has yet to be established.

On February 20, a Virgin Australia ATR72, registration VH-FVR, sustained damage after bird strike on route to Sydney. The hull reserve for this loss is US$2.8 million.

On February 17, a Jet2 B737, registration G-GDFC, sustained damage after a hard landing at Madeira Airport, Funchal, Portugal. The hull reserve for this loss is US$2.8 million.
On February 16, a Nepal Airlines DHC-6, registration 9N-ABB, was destroyed when it crashed on high ground in Masine Lek, near Khidim, Nepal on route to Jumla. The aircraft experienced bad weather and the pilot tried to divert the aircraft to Siddharthanagar before losing contact with the ATC. All fifteen passengers and three crew were killed. The hull reserve for this loss is under US$1 million.

On February 13, a Jetstar Asia A320, registration 9V-JSN, suffered engine damage after the aircraft flew through an ash cloud from Mount Kelud whilst on route to Jakarta. The aircraft later safely landed at Jakarta. The hull reserve for this loss is US$10.3 million.

On February 12, an Aer Arann ATR-42, registration EI-BYO, was damaged beyond repair by storm winds while parked at Shannon Airport, Ireland. The hull reserve for this loss is US$3 million.

On February 10, a Centurion Air Cargo B747, registration N901AR, suffered damage after it was struck by a push back tug at Antonio C Jobim International Airport, Rio de Janeiro, Brazil. The hull reserve for this loss is US$2.7 million.

On February 2, an East Air A320, registration EY-623, was damaged beyond repair when the aircraft overran the end of the runway into deep snow during landing at Kulyab Airport, Tajikistan. The hull reserve for this loss is US$2.7 million.

On February 1, a Lionair B737, registration PK-LFH, sustained damage after it suffered a hard landing at Juanda Airport, Surabaya, Indonesia. The hull reserve for this loss is US$8 million.

On January 29, an Air Greenland Dash 8, registration OY-GRI, was damaged beyond repair after it suffered a runway excursion on landing at Ilulissat Airport, Greenland. It is reported that three passengers suffered minor injuries. The hull reserve for this loss is US$8 million.

On January 28, a Darwin Airline Saab 2000, registration HB-IZG, sustained damage after it landed at Charles de Gaulle Airport, Paris, France and both wheels separated from the nose undercarriage which shortly after collapsed. The aircraft came to a stop on the runway resting on its forward fuselage. The hull reserve for this loss is US$2.4 million.

On January 26, a Pacific Air Express B737, registration ZK-TLC, was damaged beyond repair after the aircraft landed at Honiara Airport, Solomon Islands and its right main gear collapsed. The hull reserve for this loss is US$12 million.

On January 5, an Air India A320, registration VT-ESH, sustained substantial damage to its left wing in a landing accident at Jaipur International Airport, India. The hull reserve for this loss is US$11.3 million.

On January 5, an Orient Thai Airlines B767 on operations for Saudia, registration HS-BKE suffered damage at Medina – Prince Mohammad bin Abdulaziz, Saudi Arabia. The aircraft reported a technical issue on approach and landed with the undercarriage retracted. 29 passengers are reported to have suffered minor injuries. The hull reserve for this loss is US$6 million.

HULL WAR LOSSES

Between July 13 & July 22, various Libyan African holdings, Buraq & Nouvelair aircraft were damaged during fighting at Tripoli Airport, Libya. The hull war reserve for these losses are estimated at US$407 million.

On July 17, a Malaysia Airlines B777, registration 9M-MRD, crashed after being shot down whilst flying over Ukraine. All 280 passengers and 15 crew members on board were killed. The hull war reserve is US$97 million.

On June 8, various Shaheen and Pakistan International aircraft were damaged by fighting at Karachi Airport, Pakistan. The hull war reserve is estimated at US$20 million.

On March 8, a Malaysia Airlines B777, registration 9M-MRO went missing on route to Beijing from Kuala Lumpur. The hull war reserve for this loss is US$50 million. (50% Hull & Liabs, 50% Hull War)

On January 31, an Iraqi Airways, Boeing B777, registration YI-AQZ and Airbus A320, registration YI-ARB, reported shrapnel damage, Baghdad, Iraq. The hull war reserve is US$2.5 million.
The Willis 50 represents the largest passenger airline programmes in the market. These 50 programmes contributed 76% of the fleet and 82% of the passenger exposure in 2013 and this looks set to grow in 2014.

239 Programmes with an AFV in excess of US$100 million
Willis sourced data

As evidence of the economies of scale in insurance purchasing they represented 59% of the overall airline premium, a discount of between 17 – 23% against the exposure contributed. This takes no account of the limits they buy or the individual risk profile of the operations but provides a clear indicator of a market desire to participate on the large programmes and secure a share of their premiums.

239 Programmes with an AFV in excess of US$100 million
Willis sourced data

This performance of this group is differentiated from the remainder of the market as the results of 2013 outlined below demonstrate.

HULL & LIABILITY 2013 PERCENTAGE CHANGES AS AT October 31, 2013

<table>
<thead>
<tr>
<th></th>
<th>AFV % CHANGE</th>
<th>PAX % CHANGE</th>
<th>2012 NET PREMIUM USD MILLION</th>
<th>2013 NET PREMIUM USD MILLION</th>
<th>USD M PREMIUM CHANGE</th>
<th>% PREMIUM CHANGE</th>
</tr>
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<tbody>
<tr>
<td>Willis 50</td>
<td>11%</td>
<td>6%</td>
<td>278.68</td>
<td>245.41</td>
<td>-33.27</td>
<td>-12.25%</td>
</tr>
<tr>
<td>All Programmes Excess of $100 million AFV</td>
<td>8%</td>
<td>8%</td>
<td>602.67</td>
<td>542.04</td>
<td>-60.63</td>
<td>-10.06%</td>
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HULL WAR MARKET

The Hull War Market is traditionally a very reactionary market that sees significant volatility in response to losses.

At the start of the year significant rate reductions were being achieved but premium levels were largely maintained due to exposure growth with the annual net lead premium projected to be to be under US$75 million. This low premium level has been a function of a combination of low losses in the past, and significant overcapacity in the class.

The Hull War market has now however suffered it’s most turbulent period since the SriLankan and WTC incidents in 2001 with a series of losses which are having a major impact on the Hull War market:

- Linhas Aereas Mocambique
- MH370, possible malicious act
- Shaheen Air and Pakistan International Airlines damage caused by Terrorists attacking Karachi Airport
- MH17 – believed to have been shot down in Eastern Ukraine
- Various losses at Tripoli Airport, Libya

The annual Hull War premium for 2014 has been exhausted many times over by these losses and the market is in the process of addressing pricing levels as a consequence. Insurers have currently delivered a measured response with no wholesale issue of notice of cancellation to review terms and the majority of the prominent insurers in the class are taking waiting until renewal to review pricing and coverage.

There will undoubtedly be corrective measures implemented to increase premium volumes. It is likely that there will be some rate revisions for all buyers, but insurers also remain committed to underwriting risks on their merits, and accounts with low exposure risk, or those who have not presented a loss to the market can be expected to fare considerably better. The uncertainty factor continues to be the issue of capacity. There is approximately 175% capacity in this sector of the market and there will be a number of markets not impacted by these losses, who will be keen to capitalise on their good fortune and increase market share. This added level of competition, as in the hull and liability market, could well lead to a blunting in rate increases and a fractionalisation of the market.

Claims figures are estimated and subject to change, includes LAM in 2013.
2014 figures include M370 (50%), MH17 (100%), Tripoli, Karachi Airport and Iraq incidents
*To date (projected premium US$65 million)
Willis sourced data
This is the Willis Airline Insurance Insight, which is our vehicle to keep our clients and others informed of developments in the airline insurance market. We welcome any comments or suggestions you may have to improve this publication. All data and analysis within this newsletter includes all known information at the time of production and is based on the net lead terms of airline insurance programmes renewing with fleet values in excess of US$100 million. The analysis does not take into account any coverage changes and is not weighted in relation to the size of the programme's exposure or volume of premium paid. Loss information includes western built equipment and our attritional loss threshold is below US$1 million. These figures are based on a like for like basis and exclude those risks that incepted in 2011 and are no longer in operation and those risks that have commenced operations in 2012 as these will distort the percentage change figure.

This newsletter offers a general overview of its subject matter. It does not necessarily address every aspect of its subject or every product available in the market. It is not intended to be, and should not be, used to replace specific advice relating to individual situations and we do not offer, and this should not be seen as, legal, accounting or tax advice. If you intend to take any action or make any decision on the basis of the content of this publication you should first seek specific advice from an appropriate professional. Some of the information in this publication may be compiled from third party sources we consider to be reliable, however we do not guarantee and are not responsible for the accuracy of such. The views expressed are not necessarily those of the Willis Group. Copyright Willis Limited 2014. All rights reserved.

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