Lead hull and liability premium growth appeared to slow in December 2010, but the position is distorted as a result of changes at some programmes. Ultimately, the renewal season followed the annual trend.

Overview

- Lead premium in 2010 looks to be just above US$1.9 billion
- Annual claims of US$2.1 billion means a significant shortfall for underwriters even before reinsurance and fixed costs
- Claims in 2010 were over US$2 billion for the third time in four years
- Selective underwriting changed the dynamic of supporting markets at the end of 2010

Summary

Preliminary data suggests that the airline insurance market endured more claims than lead premium once again in 2010, raising the prospect of far more challenging conditions as negotiations begin for 2011/12 airline insurance programmes.

At this stage, there are just under 20 programmes expected to be added to the data, representing an additional US$150 million of lead hull and liability premium. While this may have a slight impact on the final figures for 2010, we believe the data that we have at this stage is correct in terms of direction.

Nasty undercurrents

Getting a full understanding of the airline insurance market demands looking beneath the headlines and examining movements in more detail.

The supporting markets took an exceptionally strategic approach to their involvement in the sector during the final quarter of 2010. While it is impossible to accurately gauge prices in the supporting markets, anecdotal evidence suggests underwriters were showing few qualms about walking away from an insurance programme that did not meet their pricing strategies.

As a result, while lead prices were generally stable at the end of 2010 depending on the risk being presented, supporting markets were tending to be more challenging as they took the opportunity to improve their position relative to the lead.

The key reason for this is that the rising cost of premium in 2010 meant that many of the supporting markets met their budgets for their airline books of business prior to the frenetic activity in December.

This meant that many supporting underwriters could afford to decline involvement on a risk during the renewal season, reducing competition and driving up supporting costs.

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Structured ambiguity...

Meanwhile, it should be noted that lead premium movements in December are distorted as a result of merged placements, improved loss records and unknown leader fees at some of the renewals.

As a result, while the markets appear to have become less hard or even softened during the final month of the year according to preliminary data, the reality is likely to be somewhat more complex, particularly given the supporting markets’ stances.

Ultimately, defining the start or end of a market trend is virtually impossible given the hundreds of factors that can influence the pricing of an insurance programme. From the data available, in 2010 more airlines saw the price of lead hull and liability premium increase than saw it fall.

…but all quite logical

It could seem that the challenges of the last few years for underwriters would make a significant contraction of capacity imminent.

In reality however, there are a number of reasons why capacity continues to be healthy and is likely to stay that way in the near term.

One of the key reasons is that global underwriters are keen to make sure that their portfolios are diversified across as many insurance sectors as possible. Hiscox’s recent debut in the mainline of the airline sector is an example of this.

It is relatively easy for an underwriter to maintain a presence in the airline sector without actively participating on every insurance programme. As a result, playing even a minor role in the sector is a relatively efficient way of meeting diversification strategies.

It is this factor that means that while the market hardens considerably in the immediate aftermath of a loss, it tends to soften relatively quickly in the following months as underwriters that have been holding back from participating are attracted by the higher prices and become more active.

As a result, the airline insurance market will continue to fluctuate in the immediate aftermath of a loss, but the effect is likely to be short lived. Equally, unless there is a dramatic development that alters global underwriting strategy, capacity should continue to be healthy.

Keep underwriters closer

The best way for an airline to avoid being caught out by capacity’s ebbs and flows is to maintain strong relationships with the insurance markets and ensure that underwriters have a full understanding of the risk that it represents.

Where they do not have a full understanding of the risk being placed, or where they feel that the information is not transparent, underwriters will tend to simply offer a lead price that is at best based on the market change.
The final loss figure for 2010, excluding minor losses, is US$1.55 billion, compared to US$1.79 billion recorded for 2009. Adding an estimate for minor losses, the overall loss total is US$2.10 billion, compared to US$2.34 billion in 2009.

Aon estimates suggest that claims for last year breached the US$2 billion level for the third time in four years. This includes an estimate for minor claims such as minor hull damage and slips and falls, but even without this claims have been above the long term average in three of the last five years.

While it is very difficult to claim that this represents the new average level for the sector given that the level of claims in a year can fluctuate significantly, some are suggesting that the underlying conditions in the aviation sector have shifted somewhat.

**Fewer but more expensive?**

Trends suggest that the nature of claims is changing. Between 1995 and 2009 there were 67 claims on average that meet the criteria for inclusion in the statistics that Aon uses in its analysis. Three of the last five years has seen the number of losses fall below this number.

A potentially more concrete statistic comes from the fatality figures. In 2010, there were 601 airline related fatalities, compared to the long term average of 621. While this could simply be a statistical anomaly, the fact that fatality rates have been below the average in all of the last five years does at least suggest an improvement.

**The trouble with statistics**

Statistics can be used to justify any position that anyone chooses to take, and while the claims value average figures may continue to point upwards, the majority of airlines continue to take steps to reduce losses and ultimately insurance claims.

The main point to make is that it is fundamentally important that airlines keep the insurance markets informed about the measures that are being taken to reduce losses and improve the claims position.

While this is naturally important after a major loss, it also stands for day-to-day improvements that are being made to ensure that underwriters price an insurance programme based on the actual risk it represents rather than simply the prevailing market trends.

We are in the process of putting together the Aon Airline Insurance Market Outlook 2011, a report which brings together all of Aon’s aviation insurance research for 2010 and extrapolates what it could mean for 2011.

The 2011 report will examine the data that we have for movements in the sector, examining market direction by region, fleet size, and operation type. It will also examine the losses that occurred in 2010 by region against long term historical averages.

To ensure that you get a copy of the document as soon as it is available, please follow the subscription instructions on Aon’s Aviation Insight page (www.aon.com/aviationinsight) or speak to your Aon representative.

We will also be producing a similar report that examines the aerospace sector.

“We aim to help clients understand developments in the airline insurance markets,” observes Simon Knechtli, aviation practice leader at Aon Risk Solutions. “The outlook reports only represent the top level of analysis that we can provide, but we feel that they provide an excellent window onto the airline insurance market.”

If you would like to read the last editions of either the airline or aerospace reports, please follow the links from the Aon Aviation Insight page www.aon.com/aviationinsight

As a result of the low level of activity expected in the first quarter, we do not intend to publish an Airline Insurance Market Newsletter in February or March.

Looking at the 2010 data, January and February renewals represented less than 0.5% of the total annual lead hull and liability premium, while March was under 2%.

We will be issuing regular top level updates on aviation related developments via our Twitter feed, www.twitter.com/aonaviation, so please feel free to follow us there.

Airline quarterly premium profile (Proportion of lead hull and liability premium)

Source: Aon loss data *2010 estimate

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 covers western built equipment only 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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