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Insurance | Risk Management | Consulting

AEROSPACE MARKET UPDATE



MARKET UPDATE

As parts of the global aviation community slowly start to return to some form of normality in their daily business activities after months of lockdown on account of COVID-19, businesses continue to weigh the impact of the virus. As the road to recovery begins, COVID-19 and the damage done is likely to accelerate trends that were already shaping the insurance market globally and this means the current challenges are expected to continue.

1. At the mid point of the year how have conditions in the aviation insurance market developed?

In our last edition, we commented that the direction of travel in the underlying rates was upwards as the market attempts to address poor profitability following a long and sustained soft market together with some exceptional claims activity in recent years. This position still remains the same as the second quarter of 2020 closes, but the on-going effects of COVID-19 continue to add pressure.

At this point, the pandemic has not changed the current market-rating environment and aviation insurer's ambitions remain to continue to increase technical rates, albeit while providing relief measures and trying to remain sympathetic to their client's plight. Looking ahead post lockdown, with the expectation that the overall loss to the insurance industry will be substantial, it is reasonable to assume that COVID-19 will act as a catalyst for rate increases and may translate through to a harder global insurance market. Just how this will impact the aviation class it is too early to say, however, we were already experiencing market hardening and upwards pricing pre-COVID-19 and therefore any added pressure or future change in capacity could exacerbate this trend.

2. How will COVID-19 impact the insurance market and aviation insurers?

This is dependent on a number of moving factors and much will be contingent on how long the pandemic continues. Lloyd's of London recently estimated 2020 underwriting losses covered by the global insurance industry as a result of COVID-19 are approximately USD107 billion, on par with some of the biggest major claims years for the industry, such as when three catastrophic windstorms have struck (2005: hurricanes Katrina, Rita and Wilma; 2017: hurricanes Harvey, Irma and Maria). However, it is important to recognise that these natural catastrophes were geographically contained events, occurring over the course of hours and days, vastly different in nature to the global, systemic and longer-term impact of COVID-19.

In the aviation class, the direct impact of COVID-19 on aviation insurers is relatively small (when compared to their aviation clients and colleagues in other lines of business) in that pandemic losses are not covered under traditional aviation insurance policies. That is not to say that the pandemic is not having an impact on aviation insurers as it is. Aviation is arguably one of the industries most impacted by the pandemic and the damage done will take some years to recover. The aviation market is relatively small in size and so the impact of any casualties, coupled with a forecast decrease in future passenger demand and exposures will undoubtedly result in a significant drop in premium income levels for insurers, at least in the short term. Each client's situation is however, unique and so the overall hit on premium volume is unlikely to correlate proportionately to the overall global reduction in exposures and passenger numbers.

3. How are aviation insurers reacting during this challenging period?

On the whole, aviation insurers continue to respond sympathetically towards their clients. They understand the severity of the situation and their client's current focus on liquidity to ensure their survival. Through our negotiations, we have been successful in gaining agreement to a wide range of measures to support our mutual clients such as premium adjustments and returns, reductions in deposits and instalments and various payment extensions and deferrals. Understandably, the actual result depends on the circumstances of each client, its policy specifics and structure and in part the skill and relationships of the broker. Insurers are taking differing approaches but all are undertaking strict analysis of each proposal on a case-by-case basis reviewing claims history, credit risk, relationship and past payment record amongst other factors. While a select few insurers have disappointingly been less flexible in their negotiations and response and or attempted to introduce COVID-19 related policy exclusions, fortunately the majority have reacted positively. As our Lead Lines contributor comments, "the market is trying to find the path between what is both the fairest way for clients and insurers alike".

On a separate point, it should be noted that one consequence of the current situation and the support efforts taking place is that everyone is busier with workloads having increased significantly for both brokers and insurers at a time when most employees continue to work remotely from home and navigate new ways of working. Positively, in our experience, all parties are dealing with this challenge excellently but insurer response times have increased and the situation is likely to severely test resources at some entities in the coming months as we approach the final quarter, the busiest renewal period for aviation insurance. Gallagher clients can be assured during this difficult period that we remain highly resourced and we will continue to engage and work collaboratively with your insurers in order to maintain excellent service and manage the hurdles that all parties continue to face from this pandemic.

4. Capacity

As the second quarter concludes, capacity levels have reduced further following the withdrawal of four markets. Cincinnati Global Syndicate 318 has ceased accepting new or renewal aviation business, Antares has exited the class, Trust Re have ceased underwriting Facultative Aviation business, meanwhile Starstone International and its operating companies have stopped writing new and renewal business, putting their business into immediate run-off.

In contrast we have only witnessed one new entrant, this being Rokstone Underwriting, an MGA which has started underwriting aviation business using the security of existing carrier Best Meridian International Insurance Company (BMI) and its panel of reinsurance markets. While we have seen numerous reports of other new entrants and syndicates planning to launch in the fourth quarter of 2020, it is unclear at this stage whether any of these companies will target aviation business.

It can be said that some markets are showing an increased appetite for aviation business and have been willing to deploy greater capacity on some risks, however this is very much dependent on particular circumstances and the underlying pricing levels. While a number of insurers have also moved to raise capital in recent weeks citing plans to increase capacity as well as expand into new lines of business, it would seem this move is primarily driven by the hardening market and insurers wanting to take advantage of higher prices.

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Ratings activity has also increased in recent weeks with multiple ratings agencies publishing negative outlooks for the property/casualty and global reinsurance sectors and or downgrading some insurance companies. Fortunately this has, so far, only applied to a small percentage and these revisions have not been so severe as to have impacted aviation capacity levels. Positively, in recent weeks various ratings agencies such as AM Best and Fitch have also undertaken insurer stress tests and the results have highlighted good news in that their indications suggest most insurers have sufficient capital levels to buffer against near-term large insured losses. Insurer results in the forthcoming months will continue to be closely monitored and it is unwise to rule out the potential possibility of some impact on future capacity.

Notwithstanding the above, with positive signs of recovery from the pandemic now being seen and insurer optimism that rate increases will continue through 2021, we believe that in the short term the majority of insurers will remain committed to the aviation class. That said, much will depend on how the pandemic continues to play out, how quickly aviation recovers and the individual year-end results of each insurer. With months of the year still to run and the 2020 Atlantic hurricane season now underway many insurers still remain vulnerable to additional losses which would only further compound the situation.

5. Have aviation losses reduced due to COVID-19?

At the mid point of the year the overall aviation loss picture, both catastrophic and attritional, looks better than during the same period last year. However, with a significant portion of the world's fleet still sitting idle and travel restrictions ongoing across most of the sector, this must be taken in context. Even during this period of reduced operations, we have continued to record major claims activity, including the tragic loss of Pakistan International Airlines flight PK8303 in which some 97 people were killed, and costly satellite and space launch vehicle losses amongst others. We have also observed various miscellaneous mishaps such as a foaming incident in an American Airlines hangar in Chicago, alongside other bumps, scrapes and ground incidents, some of which have led to costly repair claims.

While one might make assumptions that given the duration of this reduced period of operations the year-end figures will appear positive in comparison to other years, the fact is that there is still a significant proportion of the calendar year to run. Catastrophic loss events are unpredictable and can happen any time, meanwhile we cannot discount the potential that we might see a spike in attritional claims as operations return from lockdown, fleets come out of storage and aircraft are relocated.

We must also consider that until airlines return to full operations the aggregation of aircraft/assets on the ground will remain a larger than usual risk. With many airports accommodating larger numbers of parked aircraft, terror risk, malicious acts, wildlife hazards and or extreme weather events such as a hurricane or typhoon will continue to pose a considerable threat. Indeed, two US regional airports were struck by tornadoes in April, suffering substantial damage and resulting in the destruction of a number of parked aircraft. Fortunately, for airline insurers these aircraft were not large commercial jets and were smaller lower value aircraft, but they serve as an example of the inherent risk aviation faces.

Considering the above and against the backdrop of reduced annual income for aviation insurers, it is still entirely feasible that 2020 could become another consecutive loss year on a premium versus claims basis.

As operators and businesses start to resume services, a number of new safety support programmes are being offered by different companies designed to support operators with their transition back to service in a safe and compliant manner. With insurers looking closely at client's preparedness and transition plans and loss ratios being scrutinised more than ever, we believe that it is important risk managers and insurance buyers carefully review the additional challenges faced and consider the value in exploring these useful resources and solutions.

6. What is happening in the different aviation segments?

Airline segment update

In terms of airline insurance, pricing rates have continued to increase in-line with the on-going trend, albeit at a slightly slower level than we might have predicted pre-COVID-19. As mentioned earlier, most insurers have adopted a measured response in terms of both requests for temporary premium relief and also renewal pricing, based on a considered impact assessment and the underlying risk profile of each individual airline. While practically all airline clients are presenting significantly reduced risk exposures on renewal, insurers are cautious of their need to provide some certainty to their management of potential impact on premium income and so where possible a number have reverted to offering renewal terms based on minimum earned premium allocations.

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General Aviation (GA) segment update

In terms of COVID-19 and its impact, many GA clients have been fortunate in that they have been able to operate at far higher capacity levels throughout this pandemic than their bigger airline relatives. A large proportion of non-leisure related GA business such as medevac services and contract operations including pipeline inspection flights, oil rig support work, calibration flights, police and governmental services etc., have to some extent been largely unaffected by the pandemic restrictions. Ad-hoc charter flights have also remained steady throughout with increased numbers of repatriation and medical supply flights.

Recognising this, many of the measures being deployed in the airline segment such as premium adjustments/returns and reductions in deposits/instalments have not been necessary and or accepted by underwriters. Many of our GA clients have effectively remained in full flight risks as GA has not, in many countries, been officially locked down. That said, understandably there have been some exceptions and the actual result again depends on the circumstances of each client and its policy specifics.

In terms of renewal pricing, rates continue to rise in this segment albeit with significant variation between different geographies and operational sub-sets i.e. rotor-wing, fixed-wing, military, private, business etc. Capacity levels have reduced further in recent months following additional withdrawals and are now extremely low for some risks resulting in some challenging renewals. Insurers continue to exercise strong discipline in this segment and we are also witnessing an overall tightening of conditions on things such as lay ups, good experience returns, search and rescue limits, UPI and extension for crew members amongst others.

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Aerospace Manufacturers and Infrastructure segment update

One of the key differences between the aerospace class versus that of airline or general aviation is that the cover provided in this segment has 'long-tail' liability, meaning that incidents from several years ago can come to fruition as liability claims many years later. So far in 2020, we have not seen any new major incidents that we expect to impact the segment in the future. However, the events of 2018/19 with the Boeing Max grounding and the liabilities resulting from two major airline losses are yet to be fully understood and accounted for as third party passenger claims remain outstanding. Certainly, the magnitude of these combined claims is having a significant impact on insurers within this segment. With insurers yet to recover from the substantial losses seen in the last few years and at the current premium level, income is not sufficient to cover the seemingly higher frequency of attritional losses in this sector, capitalise for the catastrophe and also make a profit.

COVID-19 is still having just as much of an impact in this sector of the aviation industry as the airlines. Insurers are sympathetic to the financial issues that COVID-19 has brought to the aerospace industry but they are still not offering mid-term premium adjustments in this segment, largely due to that long-tail nature of liability risks as mentioned earlier. They are however, trying to take the reduction in exposures in to consideration at renewal, but as witnessed in the other aviation segments each risk continues to be assessed and rated individually.

The premium/rate increases that we were experiencing in this sector at the end of 2019 and through the beginning of 2020 are still being sought by insurers. Whether that increase is premium or rate based very much depends on the sum insured provided and the exposures of the individual risk. Many insureds in this sector have premiums that are very much determined by the level of cover that they are buying (often as per a contractual requirement). With the cost of capital on the rise, even with significant reductions in exposures, these individual risks may incur a higher 'rate' increase than a larger risk that has a higher base premium because ultimately their premium is driven more by exposures or claims than the capital needed. For those purchasing low to moderate limits with good loss records and low risk exposures, capacity remains readily available, allowing for competition and leverage to temper large premium increases. However, the market is a far more challenging and restrictive market for those with critical exposures and or are loss active.

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Space update

Just prior to the start of Q2 an in-orbit anomaly on-board the Russian satellite Express-AM6 resulted in a loss to the market in the region of USD20m. This was quickly followed by the launch vehicle failure of the Long March 3B rocket carrying the Palapa-N1 satellite that was insured for circ. USD250m. This brings the total amount of notified claims to the space insurance market over the past 12 months to be in excess of USD1.1bn. These claims have brought further scrutiny from underwriters and their management following poor results in 2019.

COVID-19 effects have been seen in the space industry, with business disruption due to offices being closed, however for most company's business remains strong. One particular effect of COVID-19 has been the closure of many launch sites, however, these are now starting to open with US ranges operating with social distancing and Arianespace in French Guiana due to open in June. If all goes to plan, this will allow those launch providers to start to address the current launch backlogs.

Reduced premium due to launch delays and an overall reduction in satellite orders for major operators means that 2020 so far has been a very slow year for premium income. Nevertheless, rating levels remain the same as at the start of the year with no additional increases or restrictions directly attributable to COVID-19 as of yet.

Ample capacity remains available for most risks, but the higher level of underwriting scrutiny means some technically challenging risks and large sums insured are proving to be a challenge to place. That being said, due to the low premium level earned so far this year, competition is strong amongst insurers for good risk profiles and risks which can bring significant income.

In summary

- The direction of travel in the underlying rates is still upwards.
- Market expectation that the overall COVID-19 related loss to the insurance industry will be substantial.
- COVID-19 could act as a catalyst for future rate increases and insurer optimism is that the current rating trend will continue through to 2021.
- Capacity levels have reduced further in recent months and will continue to be closely monitored.
- Aviation loss activity has reduced but claims continue and there is still a significant portion of the calendar year to run.
- On the whole insurers have adopted a measured response in terms of both requests for temporary premium relief and also renewal pricing, albeit based on a considered impact assessment and analysis of each proposal on a case-by-case basis.
- It is vital that buyers partner with an insurance broker that has the resource, experience, leverage and insurer relationships to navigate this challenging period.

TO FIND OUT MORE >

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