



Having left the summer months behind us, we reach the point of the year where market activity gathers pace and focus turns to the renewals of the fourth quarter, a decisive period for aviation insurers and the market alike.

Aviation insurance pricing trend

With the third quarter now concluded, we can report little change in market conditions with definitive upwards rating movement across most business segments in-line with that seen throughout the year. Analysis would suggest that the level of rating increase accelerated slightly in the third quarter. Yet, we must be mindful that renewal activity is more substantial during this period with several major accounts renewing which have a more significant influence on the overall figures.

Looking ahead, the fourth quarter is undoubtedly the most significant transactional period for the aviation insurance market. It is a time in which a substantial portion of the world's airlines and aerospace accounts renew. Considering the high volume of renewals taking place, it is typically this period which will determine the year-end results for aviation underwriters and set the tone for the forthcoming year. With this in mind, all indications point to a continuation of the current market hardening.

Impact of COVID-19 on the insurance market and aviation insurers

As we reported in our last edition, it will be some time before we understand the true impact of COVID-19 on the insurance market as the pandemic continues and a number of moving factors remain in play. While positively, recent commentary has been slightly more upbeat suggesting the level of claims may not be as high as initially feared, industry opinion still suggests that COVID-19 will represent one of the worst ever years for the insurance market. The impacts of continued losses, reduced income/investment returns and low-interest rates are impacting profitability and these drivers add further impetus to rate increases in an already hardening market environment.

For aviation insurers, from a business perspective, the brunt of the pandemic related impact is on the sector's overall premium pot which is anticipated to suffer a sizable hit. Unfortunately, aviation is still among the worst affected industries by the pandemic and the various premium relief measures, client defaults and reduced operations are all negatively impacting premium levels, despite the underlying upwards rating trend. In the airline sector in particular, at the start of the year pre-pandemic, market consensus suggested insurers were aiming to grow 2020 airline premium from circa USD 1.6 billion (2019) to circa USD 2 billion, a number earmarked as a more sustainable market figure. As we approach the final quarter of the year however, despite significant rate increases the overall premium pot may be significantly down if exposure projections continue on current pessimistic levels, driven by continued widespread travel restrictions. Of course much will

depend on the results of the fourth quarter renewals however whatever the overall hit on premium volume is for insurers, it should be viewed in context that it is still likely to be substantially less than the reduction in revenues suffered by our mutual aviation clients.

Renewal and placement negotiations

There can be little doubt that we have experienced significant changes in respect of renewal negotiations. For the past six months or so everyone has been busier than usual, partly because of lockdown and changes in day to day working but also due to increased workloads in respect of policy changes and the negotiation of various client support measures. Since the initial UK lockdown began in early March, brokers have been busy re-negotiating with insurers (where possible) large numbers of contracts and amending policies to reflect a myriad of changes including premium adjustments/returns, payment extensions/changes and various other relief measures. This has been a significant task across a large portion of business since each negotiation is dependant on the individual circumstances and policy specifics of each client.

We have observed distinct variation in the individual attitudes and responses of each insurer and disappointingly it must be said that a select few have been far less accommodating to negotiations and/or slower to react. At the start of the pandemic these insurers adopted a harder standpoint, limiting their underwriter's authorities and subjecting almost every renewal to higher management sign-off. Fortunately in recent weeks these outliers have since softened their positions, albeit it's taken time, perseverance and a sustained effort from Brokers to achieve this.

Looking ahead, we anticipate that renewal negotiations will remain more complex and challenging. Significant attention must be given to changes in operations and each client's circumstances taking

into consideration as to how this may require the altering of terms and influence negotiations, both now and how in the future, at least until travel restrictions lift further and operations start to return to somewhere near post-pandemic levels. In light of the current situation, more so than ever it is essential that insurance buyers ensure that they have specialist broking representation with the resource, experience and tools in place to manage the situation and mitigate volatility.

Capacity

Overall capacity levels reduced further during the third quarter following the rating downgrade of two insurers by rating agency AM Best. Both General Insurance Corporation of India (GIC Re) and New India Assurance Company Limited (New India) saw AM Best downgrade their respective financial strength ratings to 'B++' (Good) from 'A-' (Excellent).

While ratings and outlook changes are not uncommon, these particular downgrades are significant in that they put these insurers below the crucial 'A-' threshold that most buyers and broker security teams deem the minimum rating requirement. The impact of a major downgrade such as this can be two-fold, in that 1) it triggers security clauses in existing policies meaning the affected insurer may need to either be replaced mid-term or another insurer persuaded to increase their participation to cover the shortfall, and 2) it may lead to reduced overall available capacity levels for the forthcoming renewal. While ultimately downgrades add further pressure to negotiations, the actual impact will very much depend on each client's individual position and whether they are willing to retain/use a downgraded insurer at the expense of heightened security risk.





On a separate note, in recent negotiations some insurers have suggested they may be looking to take a more selective underwriting approach in the coming months, potentially limiting their participation or shares on select business and or exiting certain territories and lines. This would undoubtedly impact some accounts, and so we will be continuing to monitor these insurers closely.

There are some positives for capacity however, as market hardening has also lead to the entry of some new capacity and expanded offerings. Those entrants that joined last year have raised capital and are establishing themselves as credible players, meanwhile in 2020, Rokstone entered the market in Q2 while Hive Aero recently announced their expansion into underwriting Aviation Hull and Liabilities. This new capacity does not offset the overall capacity lost, but it does help mitigate some of the difficulties mentioned earlier and provide options. It is important to note however, that any new entrants are likely to be selective and, as with established markets, will only participate at what they see as the right price.

Losses

To date, the overall aviation loss figures remain lower than those recorded for the same period last year due in part to the significant reduction in operations seen as a result of the ongoing pandemic. That said, as reported in our previous edition we have continued to observe a steady flow of claims throughout 2020 and the third quarter was no exception with further significant losses and ground incidents seen across the airline, aerospace and general aviation segments. Ultimately this demonstrates that despite reduced numbers of aircraft movements, the underlying risk inherent in aviation has not decreased and the costs of just a few individual losses can quickly mount up.

In the airline segment, the Air India Express Boeing 737-800 which skidded off the end of the runway at Kozhikode-Calicut Airport during heavy rain and tailwinds was perhaps the most publicised incident during the third quarter. The flight was part of a COVID-19 repatriation mission and tragically of the 188

onboard, 18 passengers and both pilots were killed. Another much-publicised incident was that of the Ethiopian Airlines Boeing 777 freighter which caught fire while being loaded with cargo at Shanghai Pudong International Airport. This loss is rumoured to have a substantial claim reserve. It could become one of the most expensive hull losses in history should the aircraft be deemed uneconomical to repair and declared a constructive total loss. Factoring in current travel restrictions however it is likely to be some time before loss adjusters and other necessary parties can visit the site to assess the extent of damage fully and so at this point it is too early to speculate on the outcome and values.

In the general aviation segment, excluding private owned or military aircraft, we recorded a handful of fatal losses the most high profile of which involved a mid-air collision between a de Havilland DHC-2 floatplane and a Piper PA-12 aircraft in Alaska. Both pilots and the five passengers onboard the DHC-2 were killed. Fatal losses aside, we also witnessed several other claims in this segment, including damage and destruction of various aircraft across multiple locations in the USA following extreme weather events.

In the aerospace Manufacturers and Infrastructure segment, the aforementioned extreme weather events in the US are also reported to have caused damage of varying degrees to airport buildings, hangars and equipment. Similarly, in Pakistan, Islamabad International Airport is reported to have suffered damage when parts of its ceiling collapsed following heavy rain. In Beirut, the devastating port explosion that killed more than 100 people and injured thousands, is reported to have caused damage at Beirut International Airport with the shockwave impacting the site despite being over 9km away. At Liege airport in Brussels, a hangar suffered damage when a fire broke out. Meanwhile, at Sheremetyevo airport, a fuel truck collided with an Airbus A321 causing damage to the aircraft nose and fuselage. It is not yet known what claims will arise following these incidents and indeed whether they would fall on aerospace policies and so at this point, it is too early to speculate on on any figures and/or outcomes.

As aviation activity increases following the further opening up and easing of pandemic related travel restrictions, it is probable that we will observe an increase in claims, albeit levels are likely to fluctuate by different regions and or countries, at least in the short-term as recovery rates vary. As discussed later in an article from Holman Fenwick Willan, there is concern that a long period of reduced operations may have increased some risk factors and so, insurers are likely to continue to monitor claims levels closely and scrutinise individual risk elements such as aggregation of aircraft/assets on the ground, pilot training and pandemic safety plans. As mentioned in our last edition, many new safety support programmes have been announced in recent months, and aviation companies and operators could find value in exploring the resources and benefit that these solutions can provide. Your Gallagher service team can provide further information on these providers and services on request.

What is happening in the different aviation segments?

Airlines

Pricing remains under pressure for all airline risks in line with the ongoing market rating trend. Although pandemic travel restrictions are easing, and many airlines are gradually restarting operations, uncertainty exists, and schedules and risk exposures continue to change week by week. For insurers, the airline industry is currently representing a different profile than which was the case pre-pandemic. Many airlines still have large numbers of aircraft grounded and on renewal are presenting substantially reduced exposure forecasts for the year ahead, as the pandemic continues to affect operations.

Whilst aviation insurers are sympathetic to the situation of their clients, profitability and premium income is a key concern for underwriters as they seek to provide greater assurance to their senior management and ensure that they are able to continue to operate. In the current environment, many underwriters are now trying to mitigate reduced exposure volumes (where possible) by changing rating requirements and or imposing measures such as minimum premium levels. Insurers are also pushing hard to remove any favourable coverage enhancements and conditions which may also impact premiums. On renewals seen to date and from our initial conversations on other Q4 renewals, it is important to note that despite exposure reduction clients may still receive no premium reduction or a non-proportional reduction and in some cases even an increase in premium. The actual result will depend on the individual circumstances of each client and in part the skill of the broker, but it is important to understand that the catastrophe nature of the aviation sector remains unchanged and an underwriters exposure to risk is far from proportional with volume of exposure.

With exposures down for most airlines there is a danger that premium measures and targets could lead to over inflation of rates. Therefore it is essential from a broker perspective that negotiations are undertaken carefully, considering the particular circumstances of each account. In the coming months and years, recovery levels will undoubtedly differ between each airline, therefore, it is equally as important that insurers recognise their need to be flexible and understanding with respect to future renewals and ratings as the situation continues to evolve.





In terms of capacity, overall levels have reduced in 2020, and most accounts now approach their renewals with some level of expiring capacity unavailable due to withdrawals, consolidation and/or rating downgrades. Finding replacement markets can be challenging, particularly for high-limit and or loss active risks, and often this involves engaging with insurers who may have in the past either quoted uncompetitive terms and/or declined to participate.

Looking ahead to the fourth quarter with such a high volume of renewals taking place, accounting for a large portion of the segments total premium income, all indications point to a continuation of the current trending with the possibility of further acceleration in rates.

General Aviation (GA)

Insurers continue to exercise strong discipline in this diverse business segment. With the third quarter now concluded, it is clear that both the upwards rating trend and underwriting behaviour remain in-line with that seen earlier in the year. Rates continue to rise in this segment, albeit there remains significant variation in levels between risks in different geographies and operational sub-sets, i.e. rotor-wing, fixed-wing, military, private, business etc. The negative impact of the pandemic on premium levels in other segments is now having some knock-on effect, as aviation underwriters are looking to other less affected areas of their portfolio, such as GA, to try to mitigate the overall impact on their year-end figures.

Capacity levels have reduced further in recent months, and the downgrading of GIC Re and New India has brought added strain for GA risks, particularly those which require the participation of two or more insurers. GIC Re in particular provided notable capacity to the GA market, both directly and via Managing General Agents (MGA's). Following these recent downgrades and the continued reduction of GA capacity seen throughout 2020 some underwriters are attempting to use this opportunity to target larger rate increases and so early renewal engagement is important.

As aviation insurers continue to focus on profitability, much like in other segments, certain covers and conditions are now under greater pressure and any return or discount premium features within policies now face significant scrutiny. Additionally individual risk elements such as pilot training, safety plans and numbers of aircraft/assets on the ground are all subject to increased scrutiny on renewal. There has been a number of parked/stored GA aircraft damaged in recent months and the heightened risk of aircraft on the ground due to the pandemic remains a concern for insurers especially in those countries and regions deemed more susceptible to extreme weather events.

Looking ahead to the fourth quarter, given the above factors and the growing focus of insurers on year-end results it is expected we will continue to witness a challenging market environment and further upwards movement in rates cannot be discounted.

Aerospace Manufacturers and Infrastructure

Since our last edition, we have seen limited positive change in the approach that insurers are prepared to take with regards to the Aerospace Manufacturers and Infrastructure segment. Due to the non-adjustable in-full premium basis of these policies, mid-term return premiums to take in to account the reduction in exposures during 2020 are still not being entertained. At renewal stage, as one would expect, due to COVID-19, the vast majority of Aerospace companies in this sector are still reporting significant downturns in their exposures both for 2020 updates and estimates for 2021.

The increases that insurers were seeking in 2019 were largely focussed on rate, due to the market taking the view that the aviation sector, along with the global economy, was generally in good health at the time and would continue to grow over the short to medium term. Insurers believed that they could repair their balance sheets by benefitting from a general growth in exposures (via the traditional measures of revenue, passenger numbers, aircraft movements or fuel throughput) combined with sustainable rate increases to ultimately increase premium income over a two to three year period to what they perceived as a sustainable level. With the advent of COVID-19, and the global economy now

significantly below 2019 levels, insurers approach has changed. We are now seeing a greater demand for not just rate but premium increase too, irrespective of exposures. Insurers are seeking that 'right pricing level' that will re-float their account and ensure sustainability in the event of future losses.

Compounding the impact upon this business segment is the relatively low number of aviation insurers in a lead quoting position. There is little appetite amongst insurers for undercutting pricing to take over the lead position in this class and this is particularly true for the larger and/or loss active accounts. As is the case in the airline and GA insurance market, it is now not uncommon to see some insurers quoting above lead premium levels and trying to re-adjust premiums on loss active accounts to ensure profitability right now, rather than over the course of the next few years, which was the plan that insurers had 12 months ago. However, whilst the number of lead insurers is low, there is still capacity available in the marketplace. For those insureds with lower exposures and good loss ratios, there is capacity available to replace the insurers that have left the market over the last 12 months or so, without having to pay over and above lead terms.

There also appears to be further concern amongst insurers with regards to the ongoing litigation cases against Boeing in respect of the Lion Air and Ethiopian Airlines crashes. On 17 September 2020, the House of Representatives Committee on Transportation and Infrastructure released its final report on the Boeing 737 MAX investigation in which it identifies serious flaws and missteps in the design, development, and certification of the aircraft, which entered commercial service in 2017. Following the release of this report, there could be negative repercussions for Boeing and their insurers in respect of the apportionment of liability and the associated passenger awards in respect of those incidents.

Space

Launch activity in the third quarter crept back to expected pre COVID-19 levels and it is pleasing to report that we did not record any space insurance losses during this period, a stark contrast to the losses seen in the previous quarter. To date, 2020 has suffered approximately USD 280 million of losses this year, but positively after recording a clean sheet in the third quarter there still remains a chance for insurers to return an underwriting profit should the rest of the year be loss free. Recording a clean sheet in the third quarter was quite an achievement considering from mid July to mid August four heavily insured launches took place totalling in excess of USD 1.5 billion. The year to date experience is a prime example of the narrow margin between profit and loss and further demonstrates the volatility inherent in the space insurance industry.

Other good news for the space insurance market is that there has been a sharp upturn in the number of geostationary satellite orders from US satellite manufacturers. Fuelled by the rush to meet C-band spectrum clearing targets as mandated by the Federal Communications Commission (FCC) in order to pave the way for high-speed 5G networks, the GEO Sat industry has been regenerated which can only be good news for the space insurance industry. It will take some time for these projects to come to fruition, but insurance programmes for these could begin to be purchased within the next twelve months or so.



The 'New Space' segment, which refers to the recent commercialisation of space, continues to develop, albeit not at the pace predicted by many a few years ago. A good number of new SmallSat launch vehicles are currently in testing with varying degrees of success. Skyrora's two-stage Skylark Micro launch vehicle flew a perfect mission from the Icelandic coast. Virgin Orbit's air-launched LauncherOne rocket demonstrated partial success with a successful drop and main rocket engine ignition, albeit an anomaly occurred shortly after. And the Chinese built KZ-1A rocket launch ended in failure after 9 straight successes. There is increasing interest in SmallSat launch vehicles, but in the commercial arena, it is competition from larger launch vehicles coupled with uncertainty around some SmallSat business models which will ultimately determine the profile of this new launch segment.

Numerous SmallSat projects continue with between 300 to 400 satellites launched each year for the past 3 years. This figure is expected to grow sharply as telecommunications companies plan to launch tens of thousands of SmallSats in the race to control global telephony and internet supply.

Growth in the space industry can only be good for the space insurance industry but many challenges lie ahead. Projects will come and go, delays are inevitable and new technologies will continue to test this small but highly dynamic segment of insurance.

In summary

- The aviation insurance market continues to harden and rates are increasing
- Capacity levels have reduced further in recent months and are strained in some segments
- Overall aviation loss activity has reduced but we continue to observe claims
- Each renewal and insurer offering is viewed on a case-by-case basis making risk differentiation critical
- Profitability and protecting premium income is the key driver for insurers
- The results of the fourth quarter are crucial to the year-end results and future trending
- Looking ahead, further rate acceleration in 2021 is possible
- It remains the case that buyers must ensure they are partnered with an insurance broker which has the resource, experience and leverage to navigate this challenging period and mitigate volatility.

Would you like to talk?

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