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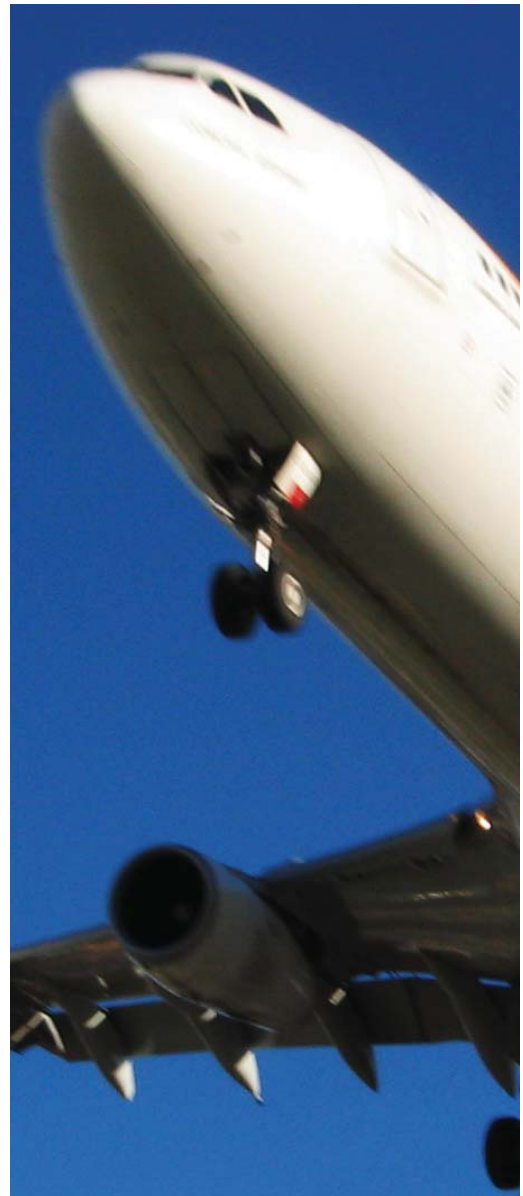
With the airline industry challenges being well documented and understood the challenges facing the insurance market that serves the airlines are less widely communicated. We therefore asked Nick Brown, Chief Underwriting Officer of Global Aerospace Underwriting Managers (GAUM) to kindly provide his views on both the industry and the market in the short and medium term.

The market statistics have demonstrated that the airline insurance market has shown signs of firming in recent months. It is not clear how long and to what extent this hardening will continue however, Nick agrees that the market is less soft today than it has been, but for now is “bumping along the bottom of the cycle” but like all market stakeholders can’t predict how long it will be before rates actually start going up again in a “meaningful way.”

This is probably due to the level of capacity still committed to airline underwriting. This could lead people in the broking community to believe that there is the potential for a lack of “true market forces.” Nick disagrees strongly emphasising that market forces depend not only on the amount of available capacity but also “on the willingness of that capacity to be sold at a given price.” Prices have stabilised because they are so low that much of the capacity is simply not willing to be committed. “The abundance of capacity is what is hindering prices from going up, it does not mean that prices should be going down.”

Some of the capacity exists as a result of recent moves by insurers looking to diversify their portfolio into the niche area of aviation which could have an influence on the willingness of markets to withdraw from aviation in the near future. It was however highlighted by Nick that “Aviation is high risk and therefore a highly capital-intensive insurance class. These days, insurers are required to allocate capital according to risk rather than premium in order to prove their solvency, and for this reason alone it is not credible that they will be happy to retain aviation as a loss making “niche.” Sooner or later we will see withdrawals, although I am not going to try and predict who or when.”

With all the talk of the global “credit crunch” Willis is interested in news of how it will impact the insurance and reinsurance market investors? “Right now, I do not believe that the insurance industry has fully recognised the extent of its own exposure to the crisis which will ultimately come from many directions. The first impact has been on those insurers who were themselves involved in trading mortgage backed securities and derivative products. That’s the visible part so far. Next comes the question of how extensive will be the D&O losses as aggrieved shareholders start to take legal actions. Some estimates put the potential insurance losses from this source at tens of billions of dollars. Then there’s the whole issue of the value of insurers’ equity, property and bond portfolios if those markets continue to decline. That would put pressure on insurers’ solvency margins and hence create capital constraints.”





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“All of these factors taken together suggest we will sooner or later see a return to a much more disciplined approach to capital allocation and hence underwriter pricing. It could also mean that riskier classes like Aviation will go out of fashion again, especially if they have been underperforming.”

The aviation insurance market has already been described as more disciplined for a number of years. With the increased use of models and technical analysis we wondered if underwriting is truly now more science than art and in a changing market how will good records, fleet modernisation and growth be rewarded and will we ever achieve full risk related pricing? “At Global, we think we have developed very sophisticated pricing tools, and I am sure that many of our competitors feel the same about theirs. The trouble is that we have to trade in a market in which we all have different ideas about what the right price should be for a given risk. Ultimately, then, pricing will always be a mixture of science and commerce. Art doesn't come into it, unfortunately.”

The industry experience and challenges are varied and severe in many parts of the world. Willis wondered how this affected underwriters views on the airline risk profile and premium volumes that need to be contributed regionally.

“One consequence of high oil prices is that as airlines cut capacity it is likely that load factors will increase and therefore the number of passengers potentially involved in any one accident is also likely to be higher. But the old model of dividing airlines into different regional peer groups is becoming increasingly less relevant to underwriters because liability settlement levels are becoming ever more “globalised” maybe “Americanised” would be a more accurate description.” What about the market reliance on the continued growth of the industry for generating premium volume? “In a weak market, industry growth is an underwriter's only hope for



# “WE HAVE TO RECOGNISE THAT MANY CUSTOMERS ARE PURE COMMODITY BUYERS.”



generating more premium. As a general rule I think that the market discounts too much for volume. Exposure is exposure.” When it comes to volume there is no bigger discount achieved than through group buying. As the size of buying groups grows through merger, acquisition of purely financial economies, where do you feel group buying will take the market? “Group buying is nothing new, and has always had the effect of taking premium out of the market. Having said that the real question is what happens after a major loss is suffered by one member of the buying group because lower rates are only justified if the quid pro quo for underwriters is better pay-back.”

This has always been a cyclical market where history continues to repeat itself. Will long-term policies and a review of deductibles be back on the market agenda? “It is unlikely that deductibles will be revisited despite good technical reasons why they should be going up” and “I think we are highly unlikely to see underwriters selling long-term “en masse” with rate levels being so woefully inadequate.” What about the merger of the AV52 premium back into the core hull and liability programmes? “This has been happening to a certain extent, but limited, by the reluctance of reinsurers and other capital providers to take back this exposure because of their property accumulations. A successful conclusion to the “New Rome” negotiations would certainly be helpful in restoring reinsurer and capital provider confidence in this area of exposure.”

The value proposition of brokers has developed into increasingly broad cross class

solutions and is therefore looking to be more comprehensive in its risk management and insurance offering to buyers. We asked if insurers who are able to match up to this approach will be more successful? “Yes and no. We have to recognise that many customers are pure commodity buyers. This is especially true in the Airline business. Having said that, there are still many buyers out there that value additional services of one sort or another. The trick is to understand that there is no “one size fits all” solution.”

Alongside the broader offering the largest brokers now enjoy truly global networks and there has been a move by many markets to open regional offices and get closer to the client. We asked Nick if he feels the London market will in the future focus purely on the larger aviation risks? “No I don’t. I still think that London has the greatest concentration of expertise (underwriting, broking, legal, loss adjusting etc.) and provided it can trade efficiently it will remain an important market for all sizes of aviation risks. Our business model at Global recognises the unique trading environment of London and its continued importance, but we also want to be able to offer underwriting and claims services in convenient locations for our producers and customers where that makes more sense.” And the emergence of Bermuda as an international insurance hub? “Bermuda may have significant tax advantages, but it also has many disadvantages, particularly in terms of availability of experienced staff and in licensing. I am not losing any sleep over the Bermudan market, nor am I investing in a pair of purple shorts.”

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With the drive for greater efficiency and to reduce the cost of transaction, what role do you envisage technology playing with respect to risk transaction in future and what areas are you specifically addressing within Global Aerospace? “We strongly believe that technology can still do a lot not only to reduce transaction costs but also to increase efficiency and reduce errors. For some years now we have been trading light aircraft business through our PBO Online platform in the U.S. and our Aeroinsure platform in the U.K. We are also trading simpler aerospace and GA risks through various e-platforms in London with a number of brokers. As far as Airlines are concerned we are now handling a high proportion of endorsements electronically.” Do you feel the aviation insurance process will be traded electronically end to end? “There is no reason why not, but let’s not forget the significant value of the “Face to face” negotiation that is the London market’s unique selling point.” With this face to face activity being so important and the likelihood that some of the leading figures in the market likely to depart in the next few years Nick is clear on his views that the market possesses the expertise and characters to replace these market figures. “As Charles de Gaulle pointed out, the graveyards of the world are full of indispensable men. I am 46 and there are plenty of my peers still around the market. Most of us probably hope to be working for some time to come yet.”

With GAUM being the leader to a large number of airline programmes you are better placed than most to understand if the role of the leader will change in the future? “The leader has already become less responsible for pricing (because of the vertical market) and more responsible for making sure that all agreements and documentation are correct (because of the end to “bureau” checking and the increase in “leader only” agreements). Like most Nick is very confident that the leaders and market as a whole will be able to continue to meet the changing needs of the airline industry. Quite rightly this is based on the fact that the market has an excellent track record of having responded to every new technological advance, every new demand for increased capacity and every new legal development. “We are also pretty good at responding to accidents when they happen and dealing with the consequences. I don’t see any reason why this would be different in the future.”

We offer a big thank you to Nick for his views and honesty on the market and its direction and are sure that the whole broking and underwriting community joins him in his final message to insurance buyers. “Don’t undervalue us.”

**Contact:**

steve.doyle@willis.com or  
airline.insight@willis.com

**www.willis.com**

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