

Piiq Perspective **Aviation Insurance Market Insights – ‘Navigating Turbulent Times’**

Volume 3, 4th May 2020

Welcome to our third Piiq Perspective piece and our first long-form aviation insurance market commentary. We have brought together commentary from our senior leadership and included a variety of input from aviation insurers, who we thank for their contribution. The intention is to release subsequent market insights as and when appropriate.

Throughout these reviews we intend to offer a balance of client, insurer and our own input addressing how the aviation insurance market is responding / will respond to client needs through these challenging times and once we get through them.

View From Philip Smaje, Piiq Risk Partners CEO

The global insurance markets are heading for a fascinating period. In many P&C and specialty classes the pricing environment was already moving from “firming and complex” to “hard” before the recent global “lockdown”. That being said, COVID-19 has created further complexity. There is now a requirement for the entire market to work remotely, but more than this, current circumstances appear to be giving rise to a complex web of future claims negotiations. From a remote working standpoint, adversity creates an opportunity to modernise and transform the industry and our experience thus far is that market stakeholders are responding positively.

Beyond this, the stakes regarding how individual insurers respond to contentious claims and managing client expectations are extremely high. There are both fiscal and reputational elements to consider. At Piiq we are monitoring very closely the market dynamics and consequences. It is interesting to note in a sustained period of contract certainty that despite the intent, there remains coverage uncertainty. We suspect there will be a lengthy period of forensic scrutiny around policy construction/language and underwriting intent. Some lessons will be learnt no doubt. Whatever the outcome it is likely that the impact will be profound and felt by all insurance purchasers to some degree.

From an aviation perspective the industry is extremely challenged, with the majority of airline fleets for the most part grounded. A return from this situation to normality will only be achieved in time, the open question is how long will this take and what will the industry look like? Although it is worth noting that following previous ‘black swan’ events the airline/aerospace market has in time reverted to the trend line in terms of RPK / Passenger growth. We suspect that this will be the case again, the more pertinent question is how long will this return take and how will it manifest itself? Initial indications show that Freight is in demand and we have seen an early recovery domestically in China.

Going forward we are thinking carefully, not only around the insurance market transaction for clients in this area, but other considerations and what clients really need and where they might require help. The role of the broker will evolve differently. Deep industry knowledge and expertise, technical skills, strategic planning throughout the year and execution on placement strategy underpinned by effective use of analytics will all be important ingredients.

The aviation insurance market, much like industry more generally is facing an unprecedented level of uncertainty. However, unlike other industries or some other classes of insurance, the aviation market is confronting the challenge posed by COVID-19 whilst already experiencing substantial and existentially necessary change. Despite the impact of COVID-19, the consensus among insurers is that the tide is not going to dramatically turn.

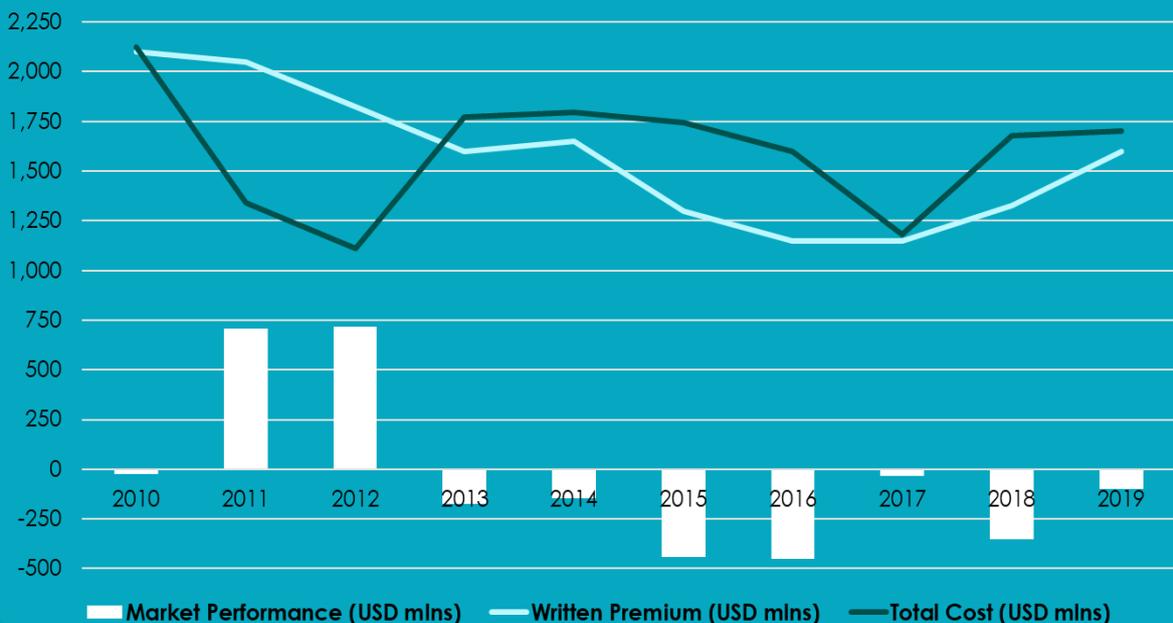
The expectation is that the current rating trend will continue, checked perhaps, but certainly in

the same direction. For insurers current circumstances do not fundamentally alter the underlying profitability equation. Re-basing the total market premium to a 'sustainable' level remains their primary objective following a decade of premium shrinkage. In the current climate with all of the challenges facing the aviation industry, and given the notable drop in exposures, aviation insurers are providing some degree of assistance to aviation clients (ranging from return premiums to instalment deferrals), which is further eroding the premium base and causing an even greater focus on rate increases.

Sector Outlook: Airline Market

- This segment remains challenged. Recent reductions in competitive capacity, the continued flow of attritional losses and the increased repair costs associated with newer generation aircraft continue to drive insurer attitude
- Beyond this, COVID-19 and the associated impact give rise to both an opportunity for insurers to demonstrate value / flexibility but also a premium base challenge
- Most airline policies are 'adjustable', thus there is an expectation that the decrease in exposures will lead to a meaningful erosion of the c.USD1.6bn premium base
- It is likely that insurers will try to manage this reduction through the implementation of further rate increases, though the quantum of these remains to be seen and consideration should be given to the expected decrease in claims frequency
- Restraint from insurers will be required, the underlying insurance equation needs to be balanced against an industry seeking to recover from turmoil

10 year Airline Insurance Market Performance



Source: FlightGlobal 2019 Airline Safety & Loss Review

From the macro perspective of the market, there needs to be sufficient premium to cover underwriting costs and expected losses. Given the extent of recent loss activity, and the anticipated reserve development, without a re-alignment of rating, the required surplus will likely not be available to respond. Aviation entities require a viable insurance market and a viable insurance market has minimum premium base requirements.

However, Piiq is advocating that basic rate changes are not the only tool that insurers, brokers and the insurance market can deploy to assist clients at this time of need. Cognisant of current challenges Insurers are being encouraged to both innovate and differentiate for the benefit of aviation clients.

Innovation, both in nature and extent, will vary for each client, as they will have their own unique requirements. Matching the needs of the insured with the capability of the market will be of paramount importance. Some alternatives to consider might include consultancy services, reviewing limits, deductibles/retentions, layers, coverage and policy wordings.

Differentiation remains a key part of the value proposition that the insurance market can provide to an individual client. The danger in an upwards turn of the insurance cycle is that differentiation gets lost and 'blanket increases' become the norm. Thus, we continue to seek reinsurance from insurers that client outcomes will be differentiated based on individual risk profile and insurer / client relationships.

It is testament to the flexibility of the aviation insurance industry that there is recognition that conventional wisdom does not necessarily produce optimal outcomes. As such, it is important to not disregard the counter-intuitive, especially during difficult times. Whilst there is a balance to strike and a need to act quickly and decisively, unprecedented levels of uncertainty should call into question 'traditional' approaches.

Perhaps, counter-intuitively, those in a position to do so should explore purchasing products from the insurance market differently. Insurers will be seeking the income (particularly given the adjustments currently being made to existing airline policies) to cover expected losses and to make a contribution towards the

Sector Outlook: Aerospace Manufacturers Market

- The Aerospace sector was already experiencing mixed results prior to 2018, yet 2018 and 2019 saw a marked deterioration of the loss position
- Moving into 2020 areas of focus surrounded recent significant claims, a tightening of grounding capacity and coverage challenges. Together this had given rise to a hardening of insurer attitudes pre COVID-19
- While the Full impact of COVID-19 on manufacturers is still evolving, the impact is likely to be significant for many. Insurers will need to respond to this in a considered manner while maintaining a sustainable marketplace
- For some a response might involve a move back towards exposure based rating, which could lead to 'adjustable' policies
- Civil and defence manufacturing likely to be impacted in different ways but supply chain issues likely to compound the challenges for most with the effects spreading into Q3/4 2020 and beyond while the aviation sector overall begins to recover
- Although sales turnover / new product deliveries are likely to be disrupted, insurers will need to find a practical way of addressing this in rating while the main rating metrics remain existing delivered / in service product base and historic claims.
- Assessment of disruption to utilisation of existing in service products will be challenging but needs to be a focus. Expected claims frequency should therefore reduce during this time and needs to be recognised in pricing
- Once again, restraint from insurers will be required, the underlying insurance equation needs to be balanced against an industry seeking to recover from turmoil

catastrophic loss scenario and should be able to innovate, differentiate and consider alternative products / structures.

For aviation clients, the adoption of further risk management / risk transfer solutions will provide additional protection at a time when the vulnerability of business to unforeseen challenges is becoming abundantly clear. Beyond this, possessing a larger or different suite of risk and insurance products could provide aviation entities with additional negotiating tools in the future.

If, as is the expectation, the insurance market is going to harden or structurally adjust to a 'new normal' in the medium term, it is only prudent to investigate the possibility of utilising the

competitive capacity currently available for mutual benefit. A crisis should provide motivation for restructuring programmes and reassessing risk appetite and not trigger a retrenchment to the lowest common denominator.

On a concluding note, the insurance market, and indeed aviation as a class of insurance, has always responded to client needs and this will not change. Products, risk appetites, rating philosophies and exposures evolve but market fundamentals endure. As experienced insurance market practitioners Piiq is encouraging the market to once again respond appropriately to current challenges.

View From Nick Brown, Global Aerospace CEO

I feel fortunate to be in a business that supports remote working. At Global we have been able to continue operations without interruption, at a time when some of our customers have faced an almost total shut down. Certainly, we expect cash flow and revenue issues as a result of the crisis, but the principal financial challenges for our business are more long term.

Aviation insurers have suffered very heavy losses in recent years and those losses are part of what has driven a need for higher premiums, but the cost of capital (including reinsurance) is an equally important factor because we are a capital intensive business – we need a lot of it to build a product characterised by high limits of liability and high volatility. Cheap capital funded the soft market, but that is a thing of the past now.

So here we are in 2020 with an unprecedented drop in exposure, temporary we all hope, and the big question is to what extent can we or should we reflect that dip in exposure in the premiums we charge?

The first point to make is that rates do still have to increase: we had been cutting rates for nearly 15 years so inevitably it is going to take more than one round of increases to get back to the right level.

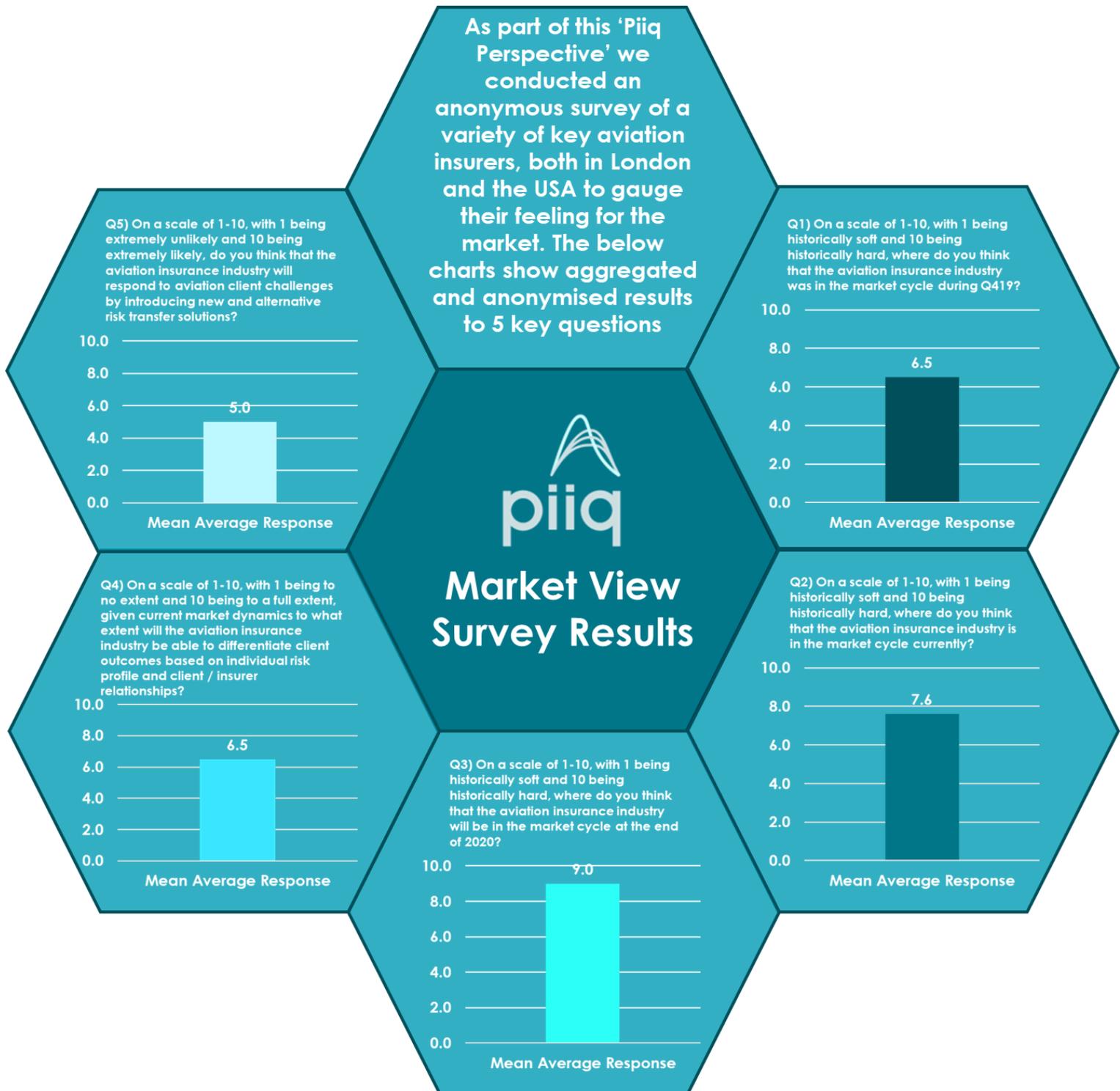
The second is that premiums on many accounts are driven primarily by their loss experience and the cost of capital associated with their risk, rather than by year-to-year exposure changes.

Overall, however, aviation insurers will certainly finish 2020 with revenues well below those originally anticipated, as a result of premium adjustments and, potentially, as a result of collection issues. I am sure we will not see a reduction in reinsurance pricing, nor indeed any softening of the expectations of capital providers generally, so without a strong bounce-back in the air transport industry our finances will remain very tight.

In future 'Piiq Perspective' pieces we hope to incorporate the views of other stakeholders

Piiq Market View Survey

The below survey questions were distributed to numerous leading insurers, both in the UK and USA. As well as providing analysis and our perspective on the next page, their sentiment is echoed in the main body of the document.



For ease of illustration results have been rounded to the nearest 0.5. We intend to use additional and more 'in-depth' surveys going forward where we will delve deeper into identifiable trends

Survey Analysis

- 'Market View Survey Results' suggest insurers anticipate a further firming in position as 2020 progresses
- Most respondents indicated that to at least some extent the aviation insurance industry will be able to differentiate client outcomes based on individual risk profile / insurer relationships
- We received 'mixed' responses from survey participants regarding the introduction of new and alternative risk transfer solutions

The 'Piiq Perspective'

- **Given insurer expectations those clients that are able to provide appropriate forward guidance should seek to engage with the insurance community as soon as is practical**
- **In these unprecedented times achieving optimal results will require clear, concise and constructive analysis in conjunction with client advocacy delivered by experienced and knowledgeable market practitioners**
- **Now more than ever strong partnership, flexibility, innovation and collaboration for mutual benefit is required**
- **Piiq would encourage aviation insurers to continue to actively differentiate client results based on individual account dynamics / performance**
- **Markets with a long-term view are more engaged in discussions around supporting alternative structures and offering new products**

Closing Remarks

Market Fundamentals

- The market is highly segmented in terms of both challenges and opportunities
- Underwriters are working with insureds to provide flexibility around cash flow and reduced 2020 exposures while trying to balance their own earned income
- The potential for catastrophic loss has reduced significantly yet insurers still have a concern around the adequacy of a reduced premium base. This should be considered alongside the expected drop off in operational and attritional losses due to decreased aviation activity
- Whilst some insureds have limited claims activity, many insureds have realised 'good value' and others have experienced 'full value' from their insurance programmes in recent times

The 'Piiq Perspective'

- **Differentiating client outcomes based on individual circumstances is an area that insurers need to remain focused on**
- **As we have already mentioned insurers will need to show restraint, the underlying insurance equation needs to be balanced against an industry seeking to recover from turmoil**
- **More than ever client and insurer interests are aligned in that aviation insurers have a vested interest in supporting the industry they exist to service that goes beyond their obligation to 'treat customers fairly'**

If you would like to provide feedback, input for subsequent editions, join future surveys or discuss this content or related issues further, please do not hesitate to contact us.

AUTHORS

BILL PARNELL

SENIOR PARTNER

Bill is a core member of the Piiq Risk Partners leadership team who brings over 20 years of valuable experience working for two of the largest broking houses in the industry. Over the course of his career Bill has worked with a diverse group of global clients across all sub-sectors of aviation. He is committed to providing exceptional client advocacy and bespoke risk and insurance solutions.

Bill has held a variety of senior roles in the aviation insurance industry, most recently he was Placement Leader for the Aviation Practice at Marsh. Thus, Bill also has an interest in placement activities and helping design mechanisms that empower colleagues to deliver value for clients both now and in the future.

T: +44(0)20 8148 3693 | **M:** +44(0)7513 135900 | **E:** bill.parnell@piigrp.com | London, UK

KEVIN WAGNER

PARTNER

Kevin is a Partner working from the US office and joined Piiq in September of 2019. Prior to this, he most recently held the position of Senior Vice President at Marsh Aviation responsible for team leadership and brokerage for key clients in the aviation and aerospace sector.

He began his career with Marsh Aviation in 2006 and has developed a specific focus on aerospace manufacturers, complex risks and analytics. Kevin has a bachelor's degree in Risk Management & Insurance from Temple University.

T: +1 (312) 469 7536 | **M:** +1 (330) 687 5263 | **E:** kevin.wagner@piigrp.com | Chicago, USA

HENRY BEXSON

ASSOCIATE PARTNER

Henry joined Piiq Risk Partners London Office in February 2020 and has a background in analytics and market intelligence, as well as client service delivery. Henry occupies a multi-faceted role for Piiq and is therefore well placed to deliver valuable strategic insight to aviation clients. He has particular experience in the Airline sector and a sophisticated understanding of the aviation insurance market.

In his previous role at Marsh Henry was responsible for the Analytics function of the Aviation Practice alongside engagement around placement and renewal strategies for major airline accounts.

T: +44(0)20 8148 3517 | **M:** +44(0)7850 914890 | **E:** henry.bexson@piigrp.com | London, UK

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*Piiq Risk Partners Inc at 222 West Adams St. Suite 1900, Chicago, IL 60606
329-0320*