JLT

This edition includes...

PlaneTalking

AEROSPACE / AUGUST EDITION 2013

Executive Summary

MAINTAINING CURRENT HEADING

Despite the recent major loss to hit aviation underwriters, the continuing market trend of premium reductions does not seem to have faltered this month. This accident which occurred to an Asiana Boeing 777 on 6th July is now expected to cost the insurance market in excess of USD300m. This loss however did not affect the excess of loss market and as we have commented upon in past editions the general market consensus is that one loss of this size is not enough to have any impact on rating levels. From looking at this month's renewal analysis it would almost certainly appear that this assumption is justified.

There is no doubt however that this loss highlights to all just how the position of the market is very finely balanced with profit for underwriters resting on that same good fortune that avoided a full fatality loss from the Asiana accident and has for the year to date lead to a very low fatality count once again.

The rate reductions seen this month, in the face of the recent loss, also reinforce our observation that a two-tiered market has developed. We have seen a distinct difference in the renewal results of large-limit buying major carriers and those airlines requiring lower limits of cover and/or with significant growth dynamics.

The renewals this month (few as they are) are dominated by high growth, low limit, low cost carriers and it is these carriers, which are now seen as the "safe havens" for Insurers and are receiving a substantial amount of growth for free and therefore receiving some of the best rate reductions available. That is in contrast to the more traditional high limit/flag carrier airline that has been the favourite of the market for so long.

Aviation premium continues to decline and a number of underwriters have commented that the major carriers with wide-bodied equipment are becoming less attractive due to the cost of attritional losses, versus the "low-cost carriers" which have lower attritional losses and a lower probable maximum loss. In addition these carriers are experiencing phenomenal growth and the competition to gain market share on these risks has increased.

Lead Lines

Michael McGrory

Partner - SmithAmundsen

Biography

Aviation Experience: 10 years

Michael McGrory is a partner with SmithAmundsen's Aerospace Practice Group in Chicago. He represents all variety of aviation industry businesses, including airlines, airports, manufacturers, and insurers, in lawsuits arising out of accidents and commercial matters. Mike is also the Vice-Chair of the Chicago Bar Association's Aviation Law Committee and Membership Chair of the Defense Research Institute's Aviation Law Committee. He publishes and presents frequently on aviation law topics.

Before entering private practice, Mike was a prosecutor for the Cook County State's Attorney's Office, and he currently serves on his community's Board of Fire and Police Commissioners.

Beware the Peril of Punitive Damages

It is fairly common for a U.S. plaintiff in an aviation personal injury lawsuit to request punitive damages. The plaintiff will allege in his complaint that the defendant's conduct was "willful" and "reckless" and "outrageous," but there will often be scant factual support for these assertions. Moreover, punitive damage awards in aviation personal injury cases are relatively rare. For these reasons, insurance claims professionals and their counsel will often be tempted to disregard a claim for punitive damages out of hand. But a couple of recent cases stand as a stark reminder that punitive damages are possible in aviation cases, and that insurers and counsel alike ignore the potential for punitive damages at their peril.

Unlike compensatory damages, which are designed to make a plaintiff whole, punitive damages are designed to punish the defendant and to deter others from similar conduct. The defendant's conduct is generally irrelevant to compensatory damages, which focus solely on the nature of the plaintiff's loss. Punitive damages, however, focus on the defendant, and the jury can consider the defendant's motivations and how outrageous the defendant's conduct was. And since punitive damages are designed to punish and deter, the jury can also consider the defendant's wealth. Thus, the "formula" for punitive damages is highly subjective and, more so than with compensatory damages, susceptible to the whims, sympathies, and prejudices of the jury.

> ... punitive damages are designed to punish the defendant and to deter others from similar conduct.

Punitive damages are not commonly awarded. The vast majority of personal injuries are caused by simple negligence, not outrageous or reckless conduct. This is especially true in the aviation industry, with its stringent regulations and emphasis on safety, training, and professionalism. At the same time, because aviation accidents can result in multiple deaths or severe injuries—circumstances that are more likely to inflame the passions and sympathies of a jury—when punitive damages are allowed, they tend to be significant.

In Delacroix v. Doncasters, Inc. (---S.W.2d---, 2013 WL 1890267 (Mo. App. 2013)), a DHC-6 Twin Otter carrying seven skydivers lost power in its right engine shortly after takeoff. The crash killed the pilot and five of the parachutists. The NTSB determined that the loss of power was due to the fracturing of the engine's compressor turbine blades ("CT-blades"). At some point prior to the accident, the engine's original CT-blades were replaced with CT-blades manufactured by the defendant. The plaintiffs in the wrongful death lawsuits contended that the replacement CT-blades were defective because the defendant used a coating that was prone to cracking and a base metal alloy that had a low oxidation resistance. The jury sided with the plaintiffs, awarding each estate USD4 million in compensatory damages. While USD4 million per plaintiff (USD20 million total) is no doubt a substantial sum, it is not a shocking verdict for a suit like Delacroix. What makes this case remarkable is that the jury found not only that the defendant's CT-blades were defective, but also that the defendant knew they were defective and exhibited a complete indifference to or conscious disregard for the safety of others

by selling the defective CT-blades. Based on this finding, the jury awarded USD28 million in punitive damages, which the court divvied into an additional USD5.6 million for each plaintiff. After rejecting many of the defendant's appellate arguments for failure to raise them at the trial level, the appellate court upheld the jury's punitive award.

Another recent example of a large punitive damages award in an aviation case is the King County (Seattle) case Estate of Becker v. Avco Corp. (10-2-26593-7). The Becker plaintiffs argued that a Cessna 172 crashed, killing three, as a result of a defective carburetor float. When the defendant did not comply with pre-trial discovery to the court's satisfaction, the court deemed all allegations in the plaintiffs' complaint admitted and held a jury trial solely on damages. Given that the court prevented the defendant from contesting liability, and even allowed the jury to hear evidence of the defendant's purported contempt of court for failure to comply with discovery, it is not surprising that the resulting award was USD26 million, USD6 million of which was punitive damages.

... a couple of recent cases stand as a stark reminder that punitive damages are possible in aviation cases, and that insurers and counsel alike ignore the potential for punitive damages at their peril.

So, as Delacroix and Becker illustrate, even though punitive damages remain rare, they can dramatically increase the value of a case when allowed. Moreover, both cases illustrate that the parties' conduct during litigation—whether it is a failure to produce documents or the failure to properly preserve objections for appeal—can have an outsized impact on punitive damages. It thus behooves claims professionals and their counsel to thoroughly assess the prospect of punitive damages right away. If an early assessment reveals that punitive damages are unwarranted, perhaps because the facts as alleged establish only negligence, a quick motion on behalf of the insured could resolve the issue without much fuss. If, on the other hand, the assessment reveals punitive damages to be a real possibility, the claims professional and counsel must develop a strategy to combat punitive damages not only at the outset, but throughout the life of the litigation.

One aspect of punitive damages that should be considered in devising a defense strategy is the stark difference between the approaches different states take. Most states allow punitive damages under some circumstances, but a few impose limits on the amount of punitive damages available. The states also differ as to whether a plaintiff must prove punitive damages by a preponderance of the evidence or the higher standard of clear and convincing evidence. Importantly, from the perspective of both the insurers and insureds, some states have found that public policy forbids insurers from indemnifying punitive damages. Thus the location of a lawsuit will factor heavily into the availability and likelihood of punitive damages, and, when facing litigation in an unfriendly forum, claims professionals and their counsel should develop a plan to either seek transfer to a more conservative locale or to convince the court to impose the more conservative state's punitive damages law.

... even though punitive damages remain rare, they can dramatically increase the value of a case when allowed.

Despite the relative rarity of punitive damages in aviation cases, insurers and their counsel must resist the temptation to give short shrift to a punitive damages claim, as the result can be a jackpot for the plaintiff. An early evaluation of the likelihood of punitive damages, an understanding of the patchwork of punitive damages laws in the U.S., and a clear defense strategy employed throughout litigation should go a long way toward making the unlikely nearly impossible.

Contact Us

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publications@jltgroup.com

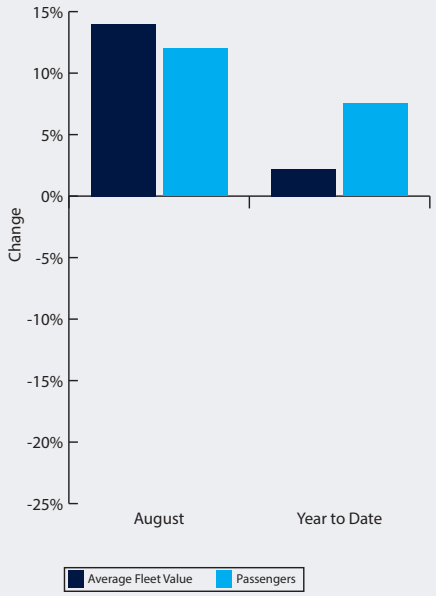
Renewal Analysis

EXPOSURES

Fleet values and passenger numbers for the month show a marked increase over year to date, albeit this is down to the relatively small number of airlines included. The ongoing trend in exposure growth continues upwards as expected which yet again highlights the current good health of the commercial airline industry.

Year on Year Exposure % change.

August / Year to date - based on the latest Information as at 30 August 2013. *Source: JLT Database*

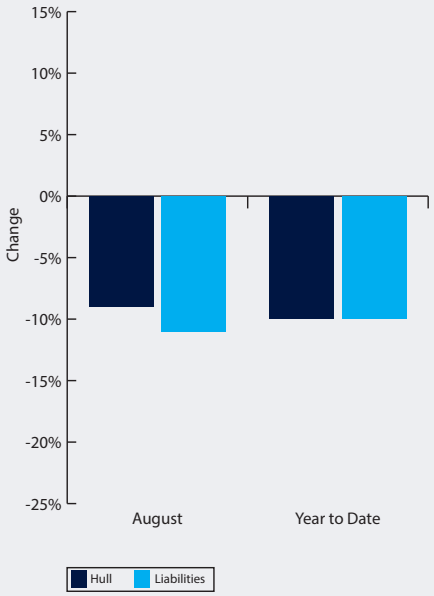


PREMIUMS*

The reduction in the levels of premium for August mirror that seen for the year so far. Both hull and liabiliity premiums continue to decline overall and the 15 airlines that renew in the month, despite their size are an indication of the progressive drop in income for the airline class.

Year on Year Premium % change.

August / Year to date - based on the latest Information as at 30 August 2013. *Source: JLT Database*



Premium	Hull USDm	Liability USDm	Total USDm
2012	212	293	504
2013 YTD	192	264	456
% Change	-10%	-10%	-9.6%

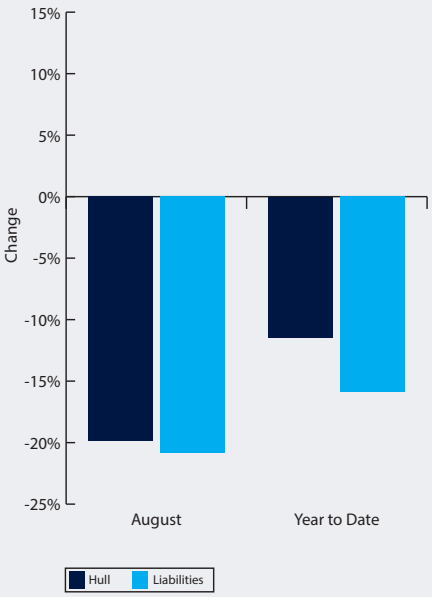
* Net of brokerage and at lead terms

RATES

Both hull and liability rates for August are showing significant reductions somewhat higher than those witnessed so far this year. This is driven largely by high exposure growth, highlighting that airlines can still get the majority of their growth for free. This trend as mentioned before will inevitably continue providing the existing soft market conditions prevail.

Year on Year Rate % change.

August / Year to date - based on the latest Information as at 30 August 2013. *Source: JLT Database*



COMMENT

August has never been the most anticipated month of the year for airline renewals and this year follows suit remaining relatively quiet.

With the renewals in question this month, of those included in our analysis only four airlines have fleet values in excess of USD1 billion.

The largest renewal in August by far is Alaska Airlines which increased its fleet slightly to USD4.46 billion. Alaska and its regional subsidiary Horizon Air now have 176 aircraft flying nearly 28 million passengers.

Pegasus Airlines, the low-cost operator from Turkey follows next with a fleet less than half the size of Alaska's at USD2.1 billion. Pegasus continues its growth and passenger numbers are expected to be in excess of 17.1 million.

Skymark Airlines a domestic budget airline in Japan has also grown recently and now stands at over USD1.8 billion fleet value with passenger numbers at 8 million. The only other airline with a fleet valued in excess of USD1 billion is UK based Monarch Airlines.

The rest of the months renewals are much smaller in fleet size, notable in name are national flag carriers such as TAME from Ecuador, Bangladesh Biman and TAROM of Romania.

FORTHCOMING AIRLINE RENEWALS

Although there are 17 airline renewals in our books for September, just two of them have substantial fleet values.

The largest renewal is Interjet Airlines of Mexico which has shown substantial fleet growth and domestic success over the years and has now a fleet of Airbus and Russian Superjet aircraft valued at over USD1.7 billion. The airline renews this term with a change of broker.

The second largest renewal of the month is the Ukranian Aviation Group – or Fin Avia, a consortium which includes Aerosvit, Donbassaero Airlines, Wind Rose Aviation, Goiania and Dniproavia. Their fleet is valued at around USD1.2 billion and has seen fairly modest growth over the last few years.

In contrast the remaining airlines that come to market are significantly much smaller; these include Atlasjet of Turkey, Aerorepublica of Colombia, and National Airlines of the USA.

The September airline renewals with fleets valued in excess of USD1billion are shown in the table below:

Airline	Renewal Date	Expiring AFV USD
Interjet Airlines	9 Sept	1.747bn
Ukranian Aviation Group	30 Sept	1.227bn

Source: JLT Database

Loss Analysis

LOSS SUMMARY FOR AUGUST

- **Hull losses:**

  USD 68.76m

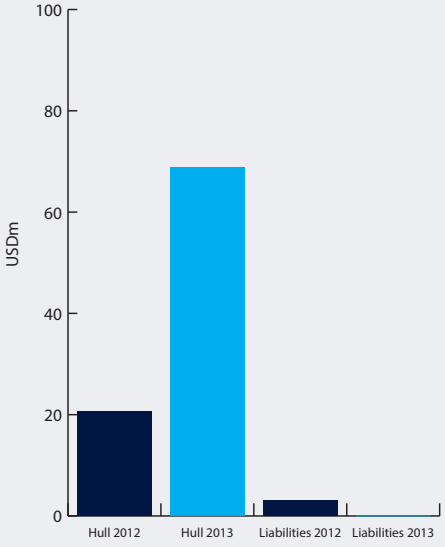
- **Liability loss estimate of:**

  Nil*

- **Number of fatalities:**

  2

All Known Airline Losses Net of deductible



** The JLT liability estimates are provided only as a guide.*

AUGUST LOSS DETAILS

- **06th August, Mid Airlines, Fokker F50 (ST-ARG), Sudan**

  During engine start-up at Khartoum, the tips of the starboard propeller struck the Ground Power Unit, breaking off and puncturing the fuselage.

- **09th August, Ukraine Air Alliance, Antonov AN-12BP (UR-CAG), Germany**

  The aircraft's engines were being started prior to a flight from Leipzig to Mineralnye Vody when a fire broke out. The aircraft's cargo consisted of 49,000 live chicks. The crew were able to vacate the aircraft. The aircraft however was completely burnt out.

- **14th August, United Parcel Service, Airbus A300F4-622R (N155UP), USA**

  The aircraft crash landed in a field outside the perimeter fence of Birmingham airport, US, on a freight flight from Louisville, KY. The reason(s) for the crash, in which both crew members lost their lives, is currently being investigated.

LOSS SUMMARY

The combined 2013 Hull and Liability figure continues to rise and now stands at almost USD700 million for the year to date (excluding attritionals). As mentioned in last month's edition the loss figure now exceeds the total combined loss figure for the whole of 2012, and it is continuing to close the gap on the 5 year average figure which stands at around USD1.16 billion (excluding attritionals).

The largest loss in August was that of UPS Airbus A300F4-622R which crashed near Birmingham Airport in the US, with a hull valued just over USD68 million. The cause of this crash is yet to be determined.

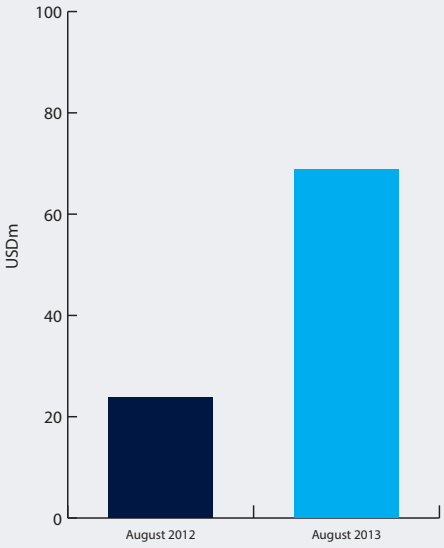
However the most significant contributor to this year's current loss figure remains that of the Asiana accident, and indeed for this loss we are now seeing a substantial liability reserve reported in excess of USD200 million.

Although the combined loss figure to date is higher than that of last year the number of fatal accidents to date (8) remains significantly lower than that of last year (22). This years current low figure could perhaps be related to chance, especially considering we have witnessed a number of remarkable accidents which could so very easily have resulted in a full fatality loss. A prime example being the Lion Air Boeing 737-800 that crashed into the sea short of the runway at Denpasar in Indonesia, which saw injuries among its seven crew and 101 passengers, but no fatalities. Nevertheless, many would argue that crash survivability in modern hulls continues to be a favourable factor.

Whatever the reason, with just four months of the year still to go, there is every indication that 2013 will prove to be another good year for airline safety but much less benign to underwriters than the last two years.

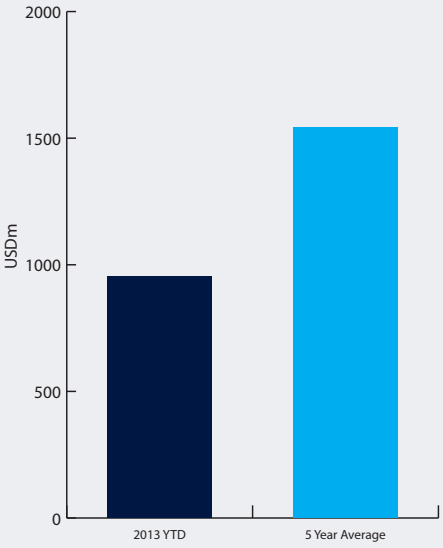
Losses: August 2012 vs. August 2013

Based on the latest Information as at 3 August 2013. Hull & Liability combined, excluding attritionals. *Source: JLT Database*



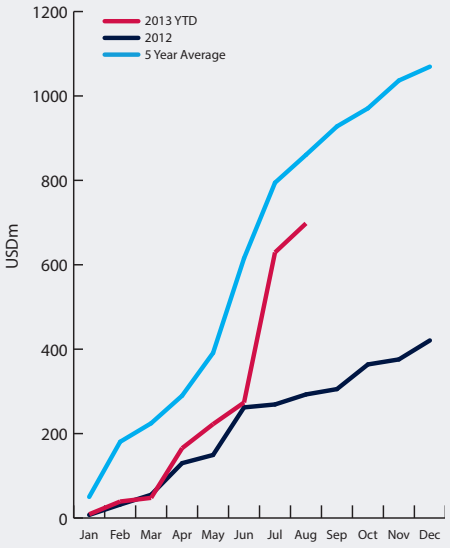
Year to Date vs. 5 Year Average Losses

Based on the latest Information as at 30 August 2013. Hull & Liability combined, figures include an attritional estimate. *Source: JLT Database*



Cumulative Losses

Based on the latest Information as at 30 August 2013. Hull & Liability combined, excluding attritionals. *Source: JLT Database*



Market News

NEWS IN BRIEF

WR BERKLEY TO ADD NEW AVIATION LINE

WR Berkley Syndicate 1967 is reported to be adding a new aviation line to its 2013 account. This follows recent news that it has hired a team of three aviation underwriters from Lloyd's peer Travelers.

The new hires include Angus Roberts, deputy head of aviation at Travelers Syndicate 5000, fellow deputy head Jason Jenkins and underwriter Paul Clarke. The trio are currently believed to be working their notice and are expected to arrive at WR Berkley in late November.

The move, which is subject to Lloyd's approval, will see the team open up a new line of business for Syndicate 1967. If the proposals are approved, it is thought that the new employees will write a broad range of the aviation products spectrum, including airlines and general aviation.

It is reported that the new Lloyd's operation will work in close co-operation with WR Berkley's US-based underwriting manager Berkley Aviation, which will henceforth focus principally on the North American market.

LANCASHIRE TO BUY LLOYD'S OF LONDON INSURER CATHEDRAL

Lancashire Holdings Ltd. is to acquire Lloyd's of London insurer Cathedral Capital Ltd. from private-equity firm Alchemy Partners and the management of Cathedral for GBP266 million (USD406.6 million).

Lancashire said in a statement that the "transaction represents a rare opportunity to acquire a high-quality Lloyd's business with a short-tail focus, strong business model fit and robust underwriting performance."

Cathedral writes insurance and reinsurance business exclusively through its Lloyd's Syndicates 2010 and 3010, in the property, aviation, satellite, marine cargo and contingency classes.

ALLIED WORLD EUROPE TO HIRE ALTERRA AVIATION TEAM

Global insurance company Allied World Europe is reportedly set to hire Markel's aviation team, which is headed by aviation specialist Olivier Marre.

Marre has led Alterra's aviation insurance division since it opened in 2006 under the Max Capital banner, and its five-strong team currently underwrites a wide portfolio of airlines, aerospace and general aviation from London.

It is reported that the team is set to join Allied World Europe in October and will begin underwriting from its Lloyd's Syndicate 2232 as soon as possible, subject to Lloyd's approval.

RATING CHANGES

- Ratings agency Standard & Poor's has lowered it's outlook on Argo Groups' "A-" financial strength rating from stable to negative.
- Ratings agency AM Best has affirmed the financial strength rating of "A" (Excellent) and issuer credit ratings of "a" of Assicurazioni Generali S.p.A. (Generali) and its main subsidiaries. The outlook for all ratings remains negative.
- Ratings agency AM Best has downgraded the financial strength rating to "B++" (Good) from "A-" (Excellent) and issuer credit ratings (ICR) to "bbb+" from "a-" for the subsidiaries of Meadowbrook Insurance Group, Inc. (MIGI), which operate under an intercompany reinsurance pooling agreement. AM Best also downgraded the ICR to "bb+" from "bbb-" for MIGI. The outlook for the financial strength rating has been revised to stable from negative, while the outlook for the issuer credit ratings is negative.

ARRIVALS AND DEPARTURES

- Richard James has resigned from his position in the Aon aviation team to join Willis.

Special Feature

CYBER RISKS

INTRODUCTION

The last decade has seen a number of highly publicised and costly cyber incidents which have impacted organisations across the globe and more importantly across a range of industry sectors. As a result, Cyber Risk is now widely accepted as being one of the top emerging risks.

As the pace of technological change continues unabated, organisations reliance on computer networks and the information which they hold has become critical to their ability to offer products and services, interact with customers and employees as well as most importantly generate revenue. However, whilst embracing technological change delivers clear benefits in terms of cost savings and operational efficiencies, it is not without risk and recent incidents have shown that computer attacks, operational mistakes and network outages can completely paralyse even the largest organisations.

THE EXAMPLE

The Sony Playstation Network outage (detailed below) which occurred in 2011 was an interesting example of the far reaching implications which can flow from a cyber incident. Whilst the total organisational cost of this incident remains unknown, studies estimate the total direct and indirect cost of a data breach in the US to be in the region of $200 per record. Even if the actual cost per record breached is only a fraction of this, based on 77 million records globally, the total cost easily runs into tens of millions of dollars.

SO WHY IS SONY RELEVANT TO THE AVIATION SECTOR?

Whilst Sony are obviously not operating in the Aviation sector the underlying cause of the incident (i.e. an external malicious act) is something that all organistaions are exposed to and in terms of the various financial implications it is easy to draw parallels from both a business interruption and data privacy perspective:

Sony Playstation Network - Case Study

The Facts:

The PlayStation Network outage was the result of an "external intrusion". Personal details from approximately 77 million accounts were stolen. It prevented users playing online through the PlayStation network. The network outage lasted 24 days.

Direct costs:

- Loss of revenue
- Engaging forensic experts
- Customer hotline support
- Providing identity theft insurance / credit monitoring services
- Discounts for future products and services
- Marketing / public relations campaign

Indirect Costs:

- Management time
- In-house investigations & communication
- Loss of customers
- Reputational damage

Total estimated cost: USD171m

1) BUSINESS INTERRUPTION:

A report commissioned by IATA estimated that in 2012 around 35% of bookings were made via websites with this estimated to increase to 59% by 2017.

The availability of IT infrastructure such as online booking systems will therefore continue to be critical to generating revenue. In the event of a network outage the loss of revenue from customers' inability to make or process a booking is likely to increase rapidly. Whilst some customers may return to try again at another time, for those bookings where time is critical, the opportunity to achieve a sale is lost.

As was seen with the Sony outage, the longer the network is unavailable the less likely customers will remain loyal to your offering.

2) DATA PRIVACY:

The online booking process requires the collection of a vast amount of confidential customer information be it names, addresses, passport numbers and perhaps most importantly, credit / debit card information when completing the transaction.

As with any other industry, the collection of this information brings a responsibility to protect it from being lost, accessed or stolen. In the event of a data breach the implications be they regulatory, reputational or directly financial have been shown to be significant. This is further complicated by the fact that from a regulatory perspective the position differs in each territory across the globe.

HOW CAN CYBER LIABILITY INSURANCE HELP?

Cyber liability insurance products have been available for a number of years. They have been developed to addresses the first- and third-party risks associated with e-business, the Internet, computer networks and confidential information.

WHY GET COVERED?

Whilst the historical focus of these policies has been the risk of hacking, the risks have evolved and products can now cover:

- Malicious acts
- Negligent acts of employees
- System malfunction

Policies are provided on a modular basis meaning that cover can be tailored to specific elements of the risk to protect against:

- Loss of revenue from network downtime
- Liability to third parties
- Data restoration costs
- Regulatory defence costs, fines and penalties
- Reputation / Crisis management costs (including customer notification and credit monitoring services)
- Cyber extortion costs
- Limits available of up to USD250m

IN SUMMARY

It’s clear that when it comes to Cyber Risk:

- The frequency of cyber incidents is increasing
- The origin and sophistication of the threats is increasing
- The business impact and financial cost for organisations is increasing
- Direct and indirect costs to your business could be critical

This is a risk which is not going away and no organisation is 100% secure. With this in mind it’s essential that consideration is given to the way the specific risks are identified, managed and also to the risk transfer options which exist to deal with the potentially significant financial consequences.

CONTACT US

To find out more about Cyber Risks and our services, please contact us using the details below:

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Email: Glyn_Thoms@jltgroup.com

Frequently Asked Questions

1) Why would anyone target us?

Statistics suggest that transportation and tourism sectors are among the top 5 industries in terms of exposure to cyber risk whether this is as a result of malicious acts, operational errors or system errors.

2) We outsource the management of our IT network and payment processing to a third party so we’re not exposed?

There is a common misconception that by using third party providers you are outsourcing the risk but unfortunately this is not usually the case as outsource contracts will normally restrict liability in respect of network downtime and data security. Cyber policies can cover the acts of your outsourced service providers.

3) It’s a long and complicated process to obtain a quotation.

We can usually obtain an initial indication of premium with just a copy of your report and accounts. If more detailed information is required this can be provided at a later date.

4) It’s too expensive.

There is now a better understanding of the exposures which exist and the increase in available capacity has meant that premium levels have reduced significantly. You can also target the cover towards certain exposures thus eliminating the cost of unnecessary elements of cover.

5) The policy coverage contains lots of sub-limits and exclusions.

The scope of policy coverage has continued to expand but at JLT we will always seek to bespoke standard policy forms to try to remove onerous and potentially restrictive terms and conditions.

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