

17th Annual Aircraft Registry Forum

General / Corporate Aviation Insurance in a Recession

Tuesday | February 23, 2010




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Aviation Insurance in a Recession

Legal Framework for Insurance in the U.S.

- The McCarran-Ferguson Act of 1945 – state regulation
- “Admitted” vs “non-admitted or Surplus lines” insurers
- Insurer cannot avoid liability because not authorized to do business in a particular state
- Aviation excluded from business & personal insurance – must be purchased under specific aviation policies

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Aviation Insurance in a Recession



Types of Coverage for General / Corporate Aviation

- **Physical Damage (Hull)**
 - Agreed Value / War-risk / Deductibles / Purpose of Use Territory / Auto-attachment / Pilot Warranty
- **Aircraft Liability**
 - Bodily Injury / Passenger Bodily Injury / Property Damage Guest Voluntary Settlement
- **Medical Coverage**

Aviation Insurance in a Recession

Cyclical nature of insurance pricing

- Aviation insurance market is cyclical – rates and coverage terms rise / fall over time! Insurers come / go over time.
- In 2000 and 2001 the market was beginning to harden. Rates going up. Coverage terms contracting.
- 9/11 resulted in further hardening of the market with significant price increases and coverage reductions



Aviation Insurance in a Recession

Cyclical nature of insurance pricing

- Subsequent to 9/11, favorable loss experience in the airline industry resulted in profits for the insurance carriers. . .

The aircraft-insurance market has grown increasingly competitive this decade thanks to a sharp decline in major disasters. Between late 2001 and 2007, insurers faced few big claims.

Wall Street Journal – Jan 16, 2008

- Profitability of the industry resulted in the entry of insurers new to aviation.

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Aviation Insurance in a Recession

Cyclical nature of insurance pricing

As of 1st Quarter 2006 (11)

- ACE
- Aerospace (AIM)
- Chartis Aviation (formerly AIG)
- Global Aerospace
- London Aviation (LAU)
- Menger Underwriting
- Phoenix
- USAIG
- United States Specialty (USSIC)
- W. Brown
- XL Aerospace

New entrants (7). . .

- Allianz Aviation
- AXA / Britt Paulk (run-off)
- Berkley Aviation
- International Aerospace
- SAU Dallas
- Starr Aviation
- Travelers Aviation (run-off)

By number of participants, a 63% increase in capacity. . .

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Aviation Insurance in a Recession

Cyclical nature of insurance pricing

- Underwriters new to aviation, but certainly not new to the insurance business, moved into the space and set up divisions to compete with long-time established carriers
- Underwriters for Corporate and Passenger Charter operations increased from 3 to 6 – doubling of capacity.

Aviation Insurance in a Recession

Cyclical nature of insurance pricing

Impact on Operators?

Rate reductions

Improved coverage terms

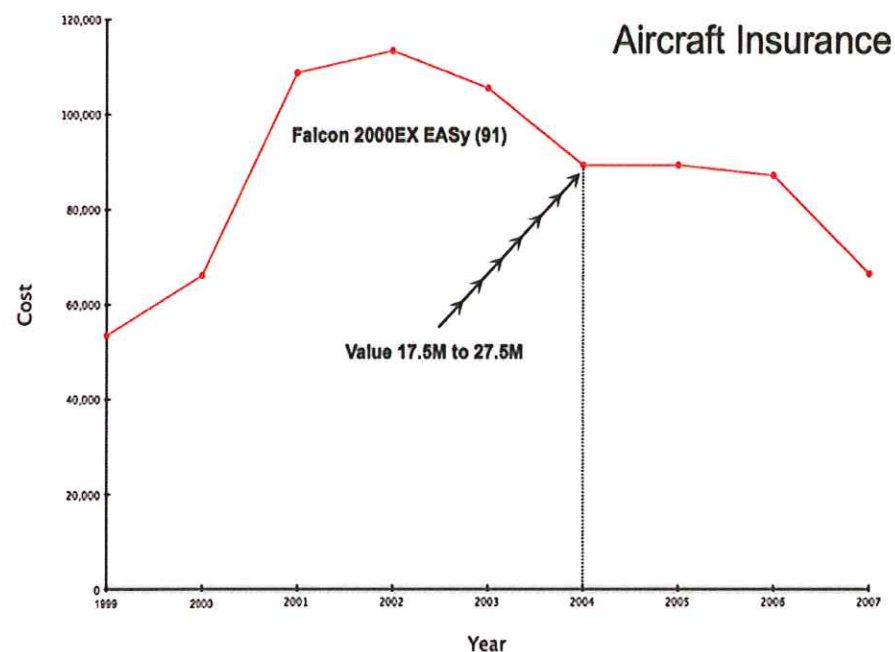
- Higher liability limits
- Secondary coverages

Relaxed requirements

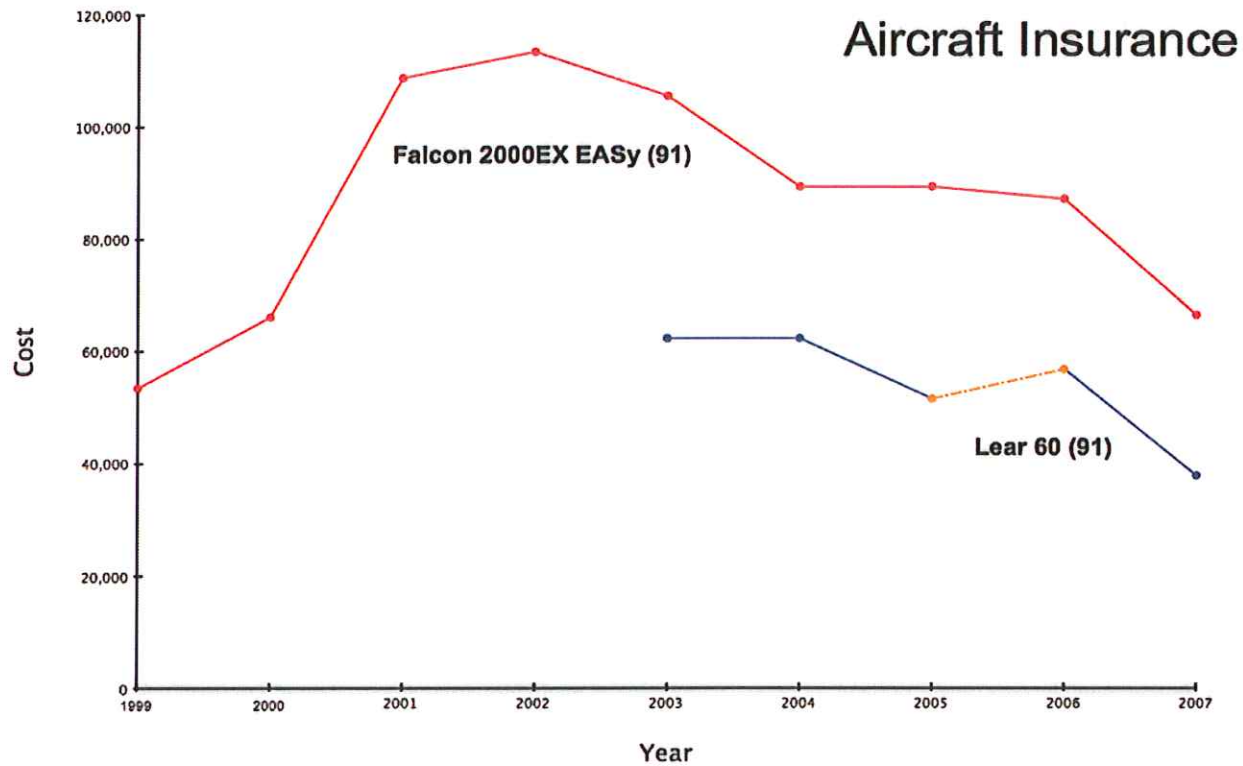
- Training
- Pilot experience

Underwriter appetite for

- Vintage A/C
- Use



10 Year Premium View



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Aviation Insurance in a Recession

Cyclical nature of insurance pricing - Looking forward...

- Q1 2010 - Soft market continues. Stable rates and availability of limits.
- Beware, change is inevitable due to significant decline in financial performance of industry
 - Reduced revenues from soft market
 - Poor claims experience
 - Reduced return on investments



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Aviation Insurance in a Recession

Cyclical nature of insurance pricing - Looking forward...

- 2009 aviation insurance industry performance
 - Estimated premium \$1.9B
 - Estimated losses \$2.3B
- 2010 – expect consolidation or further exiting of the space by insurers resulting in “hardening” of market.
 - Airlines experienced rate increases in the range of 20% in Q4 2009.
 - GA traditionally follows suit

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Aviation Insurance in a Recession

Aircraft prices in a freefall



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Aviation Insurance in a Recession

Aircraft prices in a freefall

- Physical Damage – Agreed Value
 - Owner and insurer agree on value
 - Range is often +/- 10-15% of “current retail value”
 - Economic recession – most values have decreased
 - » In many cases – below the financed amount
 - » Challenges for owner, insurer and financial institution
- Example:

July 2008 Corporation purchases Challenger 604 for \$24.5M. Finances \$22.0M. Uses “agreed value” of \$24.5M for insurance policy. July 2009, “average retail” is now \$19.5M. Owner, insurer and bank all agree to use \$22.0M as the new “agreed value” on the policy.



Aviation Insurance in a Recession

Aircraft prices in a freefall

Retail value vs. Agreed Value on insurance policy – what are the ramifications?

What happens in the event of a total loss?

What is a total loss?

- » Cost to repair equals or exceeds Agreed Value – company pays Agreed Value less deductible
- » Cost to repair plus salvage value equals or exceeds Agreed Value – company pays Agreed Value less deductible

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Aviation Insurance in a Recession

Aircraft prices in a freefall

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- » Cost to repair plus salvage value equals or exceeds Agreed Value >> company pays Agreed Value less deductible

What if the aircraft is significantly damaged – but the Agreed Value is significantly above the “average retail”?

- » Agreed Value = \$15,000,000
- » Market Value = \$10,000,000
- » Cost to repair = \$10,000,000

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Aviation Insurance in a Recession



The aircraft insurance purchase transaction

- Selecting the right coverage
- Breach of Warranty – loan to value ratios
- Named Insured vs. Additional Insured – which do you want?

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Aviation Insurance in a Recession

The aircraft insurance purchase transaction

Selecting the right coverage

- Liability limit - how much is enough?
- Physical damage limit & deductibles
- Guest Voluntary Settlement
- Medical Payments
- Supplemental Coverages
 - » Extra Expense for aircraft or parts
 - » Non-owned aircraft coverage
- Diminution of Value coverage



Aviation Insurance in a Recession

The aircraft insurance purchase transaction



Breach of Warranty – loan to value ratios

- What does it do?
- When is it available?
- Beware of loan to “agreed value” ratio

Invalidation Clause with respect to liability coverage

- What does it provide?
- When is it available?

Aviation Insurance in a Recession



The aircraft insurance purchase transaction

Named Insured vs. Additional Insured – which do you want?

Named Insured

- » Responsible for the policy
- » Directs settlement of losses

Additional Insured

- » Party to whom liability coverage is extended
- » Coverage is less comprehensive than the NI
- » No rights under the policy to direct settlements

Which do you want? Will underwriter provide?

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Aviation Insurance in a Recession

Coverage issues you want to avoid

- Purpose of use or approved use
- Pilot warranty clause
- Non-operating owners – managed or leased aircraft
- Dilution of limits
- Diminution of value
- Non-owned aircraft exposures
- Indemnification
- Cancellation Notice – or material change, non-renew or a/c deletion
- Independent Contractors

