WORKING PAPER

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ASSEMBLY — 35TH SESSION

LEGAL COMMISSION

Agenda Item 35: Assistance in the field of aviation war risk insurance

PROPOSED AVIATION INSURANCE WAR RISK EXCLUSIONS

(Presented by the International Union of Aviation Insurers (IUAI))

INFORMATION PAPER

SUMMARY

This paper describes aviation insurance coverages and market changes post-911. It then explains the concept of insurability and the related problem of accumulation. Finally, it describes existing policy exclusions and new exclusions proposed by some aviation insurers.

1. INTRODUCTION

1.1 The International Union of Aviation Insurers (IUAI) comprises aviation and space risk insurers and reinsurers across the globe. Aviation insurance is a fiercely competitive market and inevitably there is a wide spectrum of views on the various issues across the IUAI membership. IUAI, as with all trade associations, is subject to rigorous antitrust and competition law regimes, and therefore it does not address, nor seeks to influence, prices, terms and conditions of insurance.

2. INSURANCE COVERAGES

2.1 Aviation insurers provide insurance cover for insureds (airlines, manufacturers, airports, service providers (refuellers, caterers, security screeners and the like)) against loss, damage and liability, in return for premiums. Insurers in turn pay premiums to reinsurers to offset part of the risk. The risk that an insurer can prudently cover is determined by the sum of: funds from his capital providers; retained profits; and any reinsurance he has purchased.

(4 pages)

2.2 The principal insurance coverages, all of which exclude war risks (through exclusion clause AVN48), are:

Hull – damage to the aircraft itself.

Passenger – liability for death or injury.

Third party – liability for death and bodily injury (BI) and property damage (PD) external to the aircraft.

2.3 War risks coverages ("war, hijacking and other perils" including terrorism) are:

Hull – insured in a separate war risk insurance market.

Passenger and third party – but only if added ("written back") to the principal liability policies by an extension clause known as AVN52. This cover (with limits as high as US$2bn for each and every occurrence for each insured) was traditionally provided at nominal cost, given the historical absence of major loss.

2.4 War risk coverages have traditionally contained a seven-day notice clause which allowed insurers to review and reassess the risk and, if necessary, amend or cancel the cover in the event of a radical and adverse change in conditions or circumstances.

3. 911 AND THE IMMEDIATE AFTERMATH

3.1 Until 911 there had never been a case of airliners being used as weapons of mass destruction against civilian targets. The terrorist attacks were an unprecedented event with losses on a scale never before contemplated, either by governments or the insurance industry. Accordingly, insurers invoked the seven-day cancellation provision for all war risk covers on 17th September 2001 in order to preserve their solvency and ensure the survival of the aviation insurance market in the event of further such attacks. Their reserves were already severely depleted due to soft market conditions in the years immediately prior to 2001, and they were under pressure from their capital providers and reinsurers, who in turn were under pressure from their capital providers, to control their exposure to risk. Clearly, underwriters from then on would have to take into account this previously unforeseen exposure, and it will continue to be an element of the overall risk profile.

3.2 This was the first time that the seven-day cancellation had been invoked worldwide. It should be noted that non-war hull, passenger and third-party covers were unaffected. War risk cover, again with a seven-day cancellation provision, was then provided as follows:

Full policy limits for passenger liability arising out of war risks.

Cover limited to a maximum of US$50m for all third-party BI and PD claims during any one 12-month policy period.

3.3 Subsequently, some insurers deployed additional capacity, offering layered cover above the US$50m third-party limit. Some of these excess war risk policies are non-cancellable (although of course subject to annual renewal), others are subject to cancellation only after four major events, and the remainder have a thirty-day cancellation provision.

4. INSURABILITY

4.1 For a risk to be insurable it should be, *inter alia*:

Financially quantifiable.

Financially limited, i.e. bounded.

Fortuitous (happening accidentally, by chance, or with lack of intention).

Within the resources, or capacity, of the market.

4.2 Where risks, or elements of those risks, do not meet one or more of these criteria, insurers may seek to limit them, or exclude them from policies.

5. THE PROBLEM OF ACCUMULATION

5.1 The underlying principle of traditional insurance markets is that the premiums of the many pay for the losses of the few. The aviation insurance market has always differed from most other insurance markets in that both the premium base and the customer base are very narrow, with just a small number of insureds: this is reflected in the fact that IATA has only some 270 airline members. At the same time, the potential exposure of each airline is huge. Because of this very large exposure it is almost unknown for a single insurer to underwrite the entire amount of an airline's overall risk. Usually, a number of insurers will each underwrite a small percentage of that risk, thus keeping the exposure for any one insurer within acceptable limits. However, a concentration of events, such as a coordinated bombing attack at an airport leading to mass casualties and large scale property destruction, can nullify the spread of risk because the losses will all fall on the aviation insurance market. This could present individual insurers, and also the market as a whole, with an overwhelming accumulation of losses.

6. EXISTING EXCLUSIONS

6.1 Claims arising from war, hostile detonation of nuclear weapons, civil commotion, terrorist acts, sabotage, political seizure, hijacking, and the like, are all excluded from aviation policies through clause AVN48. Although the majority of these can be written back into policies through the extended coverage clause AVN52, nuclear detonation and the associated radioactive contamination cannot, since the potential magnitude, spread, and persistence of damage is such that the insurance industry will not cover it. It is a weapon of mass destruction (WMD) that could give rise to a major loss accumulation and clearly fails to meet the insurability criteria.

7. PROPOSED NEW EXCLUSIONS

7.1 Intelligence analyses post-911 have repeatedly identified threats of terrorists using chemical, biological, radioactive ("dirty bombs"), and electromagnetic weapons in pursuit of their aims. These are perceived as WMDs because they are similar to nuclear detonations in the magnitude, spread and persistence of their effects. In the view of most insurers and reinsurers they also fail to meet the insurability criteria, and could generate major loss accumulations.

7.2 Some aviation insurers are therefore proposing that these more recently identified WMDs are also excluded through AVN48. It should be noted that all other major insurance markets, for example property, marine, and energy, already operate such exclusions. Thus the proposed amended aviation exclusions are neither novel nor extraordinary. These proposals are the subject of a lengthy and continuing consultation involving a wide-cross section of interested parties including insurers, brokers, regulators and airlines.

8. ACTION BY THE ASSEMBLY

8.1 Assembly 35 is requested to note the above.

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