QUESTIONS AND ANSWERS ON THE ESTABLISHMENT OF A GLOBAL SCHEME IN THE FIELD OF AVIATION WAR RISK INSURANCE

Note. — This document is intended to provide additional information on the proposal of the Special Group on Aviation War Risk Insurance (SGWI) for the establishment of an international mechanism (see SGWI/2 Report) through questions and answers.

1. What are the objectives of the Global Scheme?

The objectives of the Global Scheme are: to allow air transport operations to continue under reasonable conditions; to spread the aviation war risk and related risks (including hijacking, sabotage and other unlawful interference) amongst the parties including all participating States involved; and to provide adequate insurance coverage in the short- and medium-term while allowing the private insurance markets to come back gradually into this market.

2. What is the Global Scheme?

The Global Scheme is to provide U.S.$ 1.5 billion of third-party war risk liability insurance cover for all aviation industry entities (a lower limit of U.S.$ 500 million shall apply to small entities) of a participating State through a not-for-profit special purpose Insurance Entity backed by State guarantees. For the majority of airlines and aviation service providers, it would provide the cover to a level previously provided by commercial aviation insurers prior to cancellation of cover in September 2001. The Global Scheme would make available to all parties in the aviation industry a reasonable level of third-party war liability cover, which would be, save exceptions, non-cancellable.

3. How will the Global Scheme work?

It was determined that the scheme would be viable subject to participation by a sufficient number of Contracting States, the sum of whose ICAO contribution rates, as indicated in Assembly Resolution A33-26: *Assessments to the General Fund for 2002, 2003 and 2004,* should amount to at least 51%. Thereafter, when a State participates in the Global Scheme by signing a participation agreement with the Insurance Entity to be set up under the scheme, all aviation entities in that State are eligible to be covered once they have acquired the required primary third-party war risk liability insurance cover (U.S.$ 50 million at present) from the commercial insurance market. The aviation entities will each pay a premium for this insurance that will build a pool. For airlines, the calculation of this charge or premium would be based on the number of transported passengers for an amount equivalent to 50 cents per passenger. No premiums would be paid by the Insurance Entity to participating States for their guarantee of last resort.

4 **What is the exact scope of the insurance cover to be provided? What will the Insurance Entity <u>not</u> cover?**

The insurance cover to be provided under the Global Scheme is a third-party war risk liability insurance. Passenger liability will not be covered but if the market issues another 7-day cancellation of the primary third-party and passenger war risk liability cover, the Insurance Entity will include the primary and passenger war risk liability cover in its policies and extend the limit to U.S.$ 2 billion (U.S.$ 750 million for smaller entities). Since it will entail coverage not only for third-party liability coverage but for passenger liability coverage as well, U.S.$ 500 million are provided for this latter purpose (U.S.$ 250 million for smaller entities).

5. **Who will the scheme cover? Who will it not cover? Why do manufacturers, financiers and lessors need to be covered?**

The scheme is to cover all aviation entities including airlines, airports, ground handlers, air navigation services, manufacturers, equipment lessors and financiers, refuellers, air taxi and general aviation operators. All these entities purchased war and terrorism insurance prior to 11 September 2001 and the scheme will return them to this position. All policyholders will pay a policy fee and premium charge, not just the airlines.

6. **When will the Global Scheme commence?**

The Insurance Entity can be formed in 8-12 weeks. The Global Scheme can commence when States representing 51% of ICAO contribution rates have confirmed their participation and each signed the participation agreement with the Insurance Entity.

7. **How long will the Global Scheme last? When will the scheme end?**

The Global Scheme has a minimum period of 3 years and can last for up to 5 years in all. If more than 25% of the total State participation gives notice to withdraw at the end of 3 years then the remaining 75% shall be automatically entitled to review their position. The scheme may also end earlier if commercial aviation insurers look to adopt a similar model, which will allow them to provide adequate levels of cover to all aviation entities at reasonable rates on a non-cancellable basis.

8. **Is it mandatory to participate?**

It is not mandatory for ICAO Contracting States to join the scheme. The scheme would be subject to double voluntary participation, i.e voluntary participation of ICAO Contracting States as guarantors, and voluntary decision of the participating States' airline operators and other entities to sign policies.

9. **Will a State have to make any payment upon joining? What are the obligations of a State that participates?**

Participating States do not have to release any up-front funds when joining. The obligation of any participating State is to provide a guarantee to the Insurance Entity when joining the Global Scheme, in the amount referred to under paragraph 10 below. Should the guarantee be called, in case the IE's accumulated reserve funds are insufficient, then a participating State must pay its share of any claim settlement when called upon by the Insurance Entity. Any call of the States' guarantee will automatically reduce their residual financial exposure as their respective caps will be decreased correspondingly.

10 **What is a State's maximum financial exposure under this scheme?**

A participating State's maximum exposure is the amount of its ICAO contribution percentage share applied to the U.S.$ 15 billion maximum scheme 'Cap'. (This 'Cap' represents 10 occurrences of war risk losses.) For example, a State with a 3% ICAO contribution rate has a 'Cap' of U.S.$ 450 million, which remains constant whatever the total State participation in the Global Scheme will be.

11. **When the scheme has less than 100% participation (as it will from commencement at 51% participation), how will a State's share of any potential individual claim payment, when required, be calculated?**

The participating States' guarantee of last resort is several, not joint, and limited to their individual share in accordance with their ICAO contribution rates. A State's claim settlement share will be calculated by grossing up the total contribution percentages to 100%. For example, if the total participation in the scheme is 51%, then each State's contribution percentage would be grossed up by a multiple of 1.96. Thus a State with a 3% ICAO contribution percentage would have a potential claim settlement share of 5.88%, or U.S.$ 88.2 million on a loss of U.S.$ 1.5 billion, its residual cap being then decreased from U.S.$ 450 million to U.S.$ 361.8 million.

12. **How will participating States benefit from the scheme?**

The Global Scheme ensures that the international air transportation system continues in the event of another cancellation arising from another terrorist attack whether in the aviation sector or otherwise. The Global Scheme not only makes third-party war risk liability insurance cover available to a participating State's aviation industry entities but also to those of other participating States thus increasing the likelihood that the airlines flying to and from participating States and the aviation service providers that support them are properly insured. If, as a result of claims, the Insurance Entity requires funds to be advanced from the participating States' guarantees to meet claim obligations, the entity shall repay these monies through increased premiums, or by any other appropriate means as approved by its Board. At dissolution, participating States will receive a share of the surplus funds prorated to the share of their guarantees, in recognition of the risk they agreed to bear.

13. **How will airlines, airports, other aviation service providers, financiers, manufacturers and equipment lessors benefit from the scheme?**

The benefits to airlines, aviation service providers (airports, ground handlers, caterers, air traffic services (ATS) providers, etc.), financiers, manufacturers and equipment lessors include: the Global Scheme provides cover to meet financing, regulatory and operational requirements; being non-cancellable in principle, such war risk cover ensures that the air transportation industry can continue to operate in the event of another terrorist attack; extension of cover to all aviation providers (airports, ground handlers, caterers, ATS providers, etc.) removes the need for airlines to provide indemnification for war risk liability beyond normal business practice.

14. **Will the Global Scheme be consistent with and not prevent or delay the recovery of the commercial aviation insurance market? How will the scheme ensure that there is a transition to commercial market insurance cover?**

The recovery of the commercial aviation insurance market will be dependent on the absence of further losses over the short- to medium-term. Limited coverage is available through the commercial market (now up to U.S.$ 50 million), but beyond this limit not at an economically viable price and not for all aviation service providers alike. The scheme is also intended to provide one major element which cannot be obtained from the commercial market, i.e. a cover not cancellable upon a 7-day notice. The Global Scheme is designed to easily adapt itself to any new situations in the market: it will provide for a successive raising of the lower threshold of cover during the lifetime of the scheme, to induce the market to successively raise its coverage.

15. **Where will the Insurance Entity be located? What will be its status?**

It would be conceptually a non-profit entity. Once conditions would be met to establish the Insurance Entity, i.e. receipt by ICAO of a sufficient number of expressions of intent by States to participate in the Global Scheme, the issue of the most suitable location will be addressed, in consultation with the industry. Such consideration should include comparison of local regulatory requirements for the entity's incorporation, capitalization, operation and taxation, and the location offering the most favourable conditions, taking all relevant factors into account.

16. **How is the set up and incorporation of the Insurance Entity envisaged? How will government interests be protected on the Board? What will be ICAO's role? Who else will be on the Board?**

A steering group will look at all matters pertaining to the establishment of the scheme once there is clear indication that the level of participation by States will be equivalent to 51% ICAO contribution rates at least. ICAO would coordinate such effort, in partnership with the private industry. The participating States, through the Organization, would be represented on the board of the entity once operational. In addition, private industry (airline operators, insurance industry, aviation financiers and lessors, airports, etc.) would also be represented on the Board. The Council of ICAO would receive an annual report on the activities of the entity.

17. **How will the start-up capital for this Insurance Entity be provided? How will the expenses of incorporation, start up and operation be borne?**

Start-up capital will be borrowed from the commercial market and the costs associated with the establishment of the Insurance Entity will be recovered from the Insurance Entity once operational. Similarly, the costs associated with the start up and operations of the Insurance Entity will be disbursed from the revenues of the Insurance Entity under the direction of the Board of Directors.

18. **What role will ICAO have in the establishment of this Insurance Entity?**

In generally acting as a facilitator, ICAO would to the extent required be involved in those aspects of the set up and operation of the entity dealing with the guarantee to be provided by participating States, including the entity's statutes, the finalization of the participation agreement and its signature by Contracting States.

19. **Will States be taking on a greater risk than if they continued to provide State guarantees for their own airlines and aviation service providers?**

Currently, States providing insurance protection to their national air carriers are assuming the risks associated with their airlines in the event of another attack. By sharing the risks, the exposure of individual States is significantly reduced.

20. **How would the premium amounts be set? What will be the premium for smaller regional operators?**

Options for allocations being considered, and to be finalized by the entity once in place, include flat rate per passenger segment, flat rate per departure flight, flat rate per aircraft proportional to the maximum take-off weight, flat rate per ton/km performed and even flat rate premium. It is intended that the bulk of the premium will be obtained from large passenger airline operators.

21. **Can the premium amount increase? Is there any other fee payable?**

When there is an occurrence that is likely to lead to a substantial claim being made on the Insurance Entity, in order to properly manage the claims exposure and ensure that State guarantees need not be used, premiums can be increased with a 30-day notice. A policy fee is payable by all policyholders (private insured parties) in addition to premium charges.

22. **Will there be a "retention" amount (deductable for each policyholder)?**

It will be up to the entity's management to decide on policy for premiums, taking into consideration that deductibles are quite classical in insurance business. However, there will be a "natural" retention in excess, as the scheme will intervene only as from the excess point (U.S.$50 million at present).

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