CAR DCA/1
IP/24
30/09/02

INTERNATIONAL CIVIL AVIATION ORGANIZATION

FIRST MEETING OF DIRECTORS OF CIVIL AVIATION OF THE CARIBBEAN REGION (CAR/DCA/1)

(Grand Cayman, Cayman Islands, 8-11 October 2002)

Agenda Item 8: **Air Transport**

8.2 War Risk Insurance

(Presented by the United States of America)

SUMMARY

This paper provides information on the US Government efforts in providing assistance for third party war risk liability coverage after the terrorist acts of September 11.

1. Introduction

1.1 The September 11th terrorist attacks drastically changed insurance perspectives with respect to aviation security on a global basis. Commercial war risk insurance rates are determined by an assessment of risk based on the perceived probability of an occurrence and the expected severity of the occurrence loss. Prior to September 11, terrorists' attacks were viewed as rare and the consequences limited to airline passengers and the targeted aircraft. Third party liability loss was not expected to constitute a major portion of potential claims. On September 11, terrorists used commercial aircraft to target society in general raising the specter of future attacks with potential catastrophic third party loss results.

1.2 Following the attacks, the commercial insurance industry cancelled third party war risk liability coverage with seven days notice and offered to renew coverage at significantly increased premiums and vastly reduced coverage limits. While the private insurers continued to provide hull and passenger liability war risk insurance, they did so at approximately triple the pre-September 11 premium rates which were unrealistically low. In order to maintain commercial air transportation, Governments were compelled to provide short-term assistance to air carriers. In the United States, the Secretary of Transportation provided FAA aviation third party war risk liability insurance to about 75 U.S. airlines at premium rates which collect approximately $75 million per year. Other countries similarly reacted by providing Government insurance and/or indemnification to replace the loss of reasonable third party liability war risk commercial insurance.

2. Discussion

2.1 The FAA is now providing third party war risk liability insurance to 74 U.S. airlines. Coverage is for liability in excess of $50 M up to $4 billion per occurrence. Premiums are based on individual policy coverage limits and the activity level of the airline. The U.S. Secretary of Transportation is authorized to continue current FAA aviation insurance coverage if he deems it necessary because of the unavailability of commercial insurance on reasonable terms. There have been 6 extensions for 60-day periods to date. Further extensions may occur if commercial insurance markets remain disrupted when the term of the current policies expires on October 16, 2002.

2.2 During the fall of 2001, the European Union (EU) initially gave and subsequently extended permission for member Governments to indemnify or provide aviation insurance assistance. The assistance methods employed in the countries varied. For example, the UK created a Troika program to insure airlines, airports, and aviation service providers. However, in recent months a number of European governments (Switzerland, Sweden and Norway) have stopped providing government insurance support, causing their airlines to rely exclusively on private insurance. There has been growing pressure within the EU governance structure to withdraw its acceptance of government insurance support. This could occur in October 2002.

2.3 Since September 11, three private insurers (AIG – Frankona, Berkshire Hathaway and Allianz) reentered the commercial third party liability war risk market providing limited coverage at premium levels the air carriers perceive to be excessive. For $1 billion of coverage, these premiums are now about $1.20 per passenger for large airlines.

2.4 The aviation industry and the insurance market perceptions of risk and justified premium returns vary widely. These conditions continue to be disruptive and are not expected to stabilize in any near-term timeframe. General industry opinion is that it may take 2-3 years to settle down. Consequently, alternative insurance facilities (risk retention groups) are being proposed by airlines to augment coverage offered by the commercial insurance industry.

2.5 In the U.S., the Air Transport Association (ATA) has proposed Equitime, a risk retention group (RRG), which would rely initially on the U.S. Government for reinsurance as the RRG accumulates sufficient reserves. Equitime would, if implemented as conceived, provide both passenger and third party war risk insurance. Initially Equitime would insure the first $300 million while the Government would reinsure the excess up to $2 billion per occurrence. The United States government is considering this proposal, but has not yet agreed to provide the proposed reinsurance.

2.6 The International Air Transport Association (IATA) has proposed a Global RRG to be backed by ICAO member nation indemnification guarantees. ICAO member states have been asked to declare their intentions with regard to participation by October. The U.S. government's agreement to participate in the global RRG will require new legislative authority from the U.S. Congress.

2.7 The European Airline Association has proposed to establish its own RRG – Eurotime. The EU is considering the need of the Eurotime RRG insurance facility.

2.8 The U.S. Congress has passed two bills to provide war risk insurance assistance to all segments of the U.S. economy. A conference committee is now considering these bills. If a conference bill is passed, the legislation may increase available terrorism coverage for all segments of the U.S. economy (including aviation) and reduce costs for insured parties.

2.9 In mid September, the House and Senate introduced bills that would extend the term of FAA aviation war risk insurance through 2003 and expand the coverage to include hull and passenger liability in addition to third party liability. There is substantial support for these proposals and they may be enacted by the end of 2002.

3. Conclusion

3.1 The FAA aviation insurance program will probably continue to provide direct third party liability war risk insurance in the near term. There is a significant prospect that Congress will direct the FAA to increase the scope of risks covered.

3.2 Future actions of the FAA insurance program and its potential participation in either a domestic or international RRG depends to a large degree on pending federal legislation.

3.3 The U.S. government hopes that the commercial market will continue to stabilize and that there will be further reductions in the cost of private insurance. It is not expected, however, that premiums will return to their pre-September 2001 levels.

-END-