



War Market Considerations

ASPA Meeting September 2022



Gallagher

Insurance | Risk Management | Consulting

Leading airline insurance broker

An update on Gallagher

Representing

400+

airlines worldwide

Airline clients in over

90+

countries worldwide

Representing

48%

of all registered IATA
airline members

Representing

58%

of Star Alliance airline
members

Representing

53%

of Skyteam airline
members

Representing

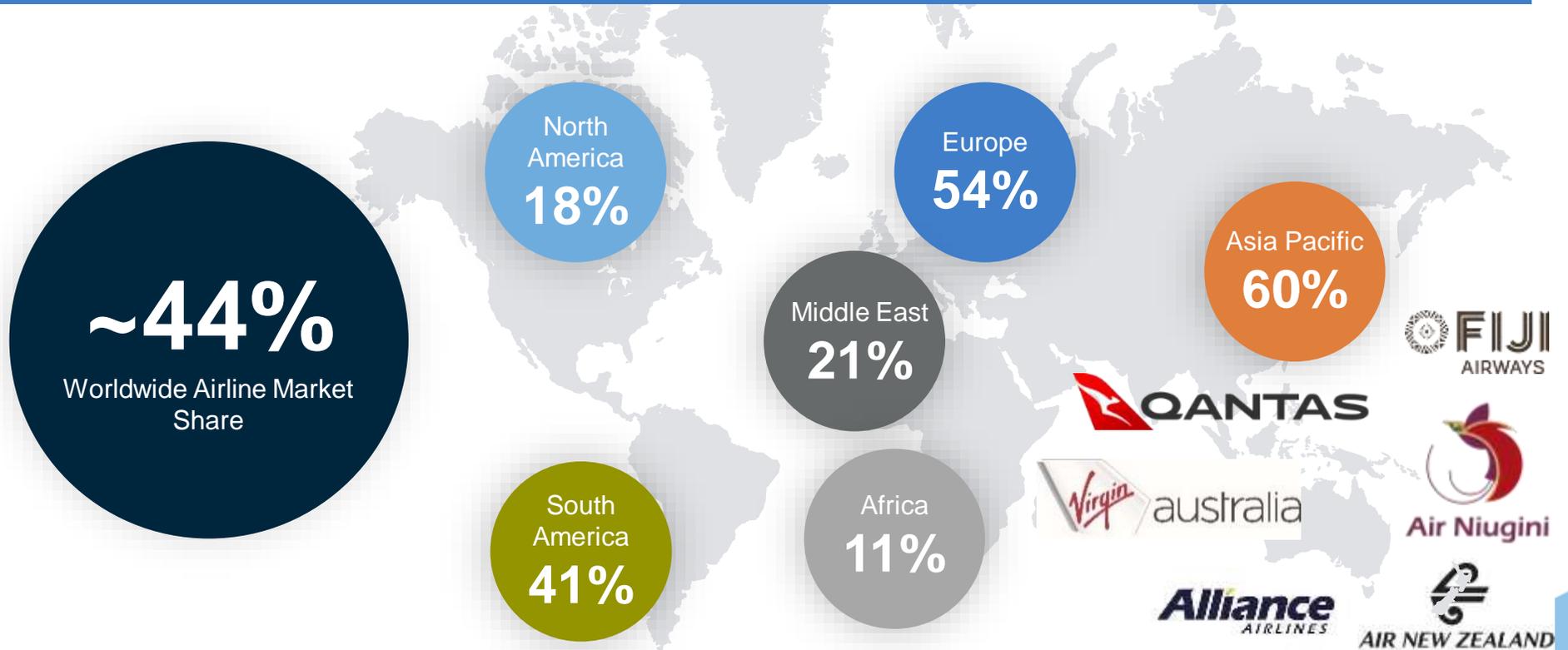
23%

of Oneworld Alliance
airline members

Our airline market shares

The leverage to drive competition and deliver results

Gallagher's aerospace team holds a leading position within the airline insurance market and has a strong and growing presence in all regions of the world.



Based on the number of airline operators represented from the CAPA Aviation fleet data. Figures include operator's with 10 or more aircraft in service (excluding GA equipment) and where Gallagher act in either a sole or co-broking capacity. Figures as at October 2021.



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Russian invasion of Ukraine

Background

Event Timeline

- 21 Feb 22 — ○ Russia recognises two self-proclaimed breakaway states in the Donbas region
- 22 Feb 22 — ○ Russia authorised the use of military force, and Russian troops entered the region
- 24 Feb 22 — ○ **The full scale invasion began** when Putin announced a "special military operation" to "demilitarise and denazify" all of Ukraine
- 19 Apr 22 — ○ Russia decides to refocus all its efforts on eastern Ukraine

The death toll

- NATO estimates 7,000 to 15,000 Russian troops have died
- The UN verified 4,169 civilians deaths as at 1 June
- Ukrainian President Volodymyr Zelensky said some 2,500 to 3,000 Ukrainian troops have been killed



What is the current situation?

- Heavy fighting continues in eastern Ukraine
- Key locations under intense bombardment
- Russia has taken several key cities and locations
- Russian nuclear forces now on "special alert"
- Focus was on eastern Ukraine but recent strikes have been seen in other regions
- Heightened tensions between Russia and international community
- Severe sanctions have been imposed on Russia with others in discussion
- Several countries are supporting Ukraine with aid, military equipment and weapons – which has been condemned by Russia.

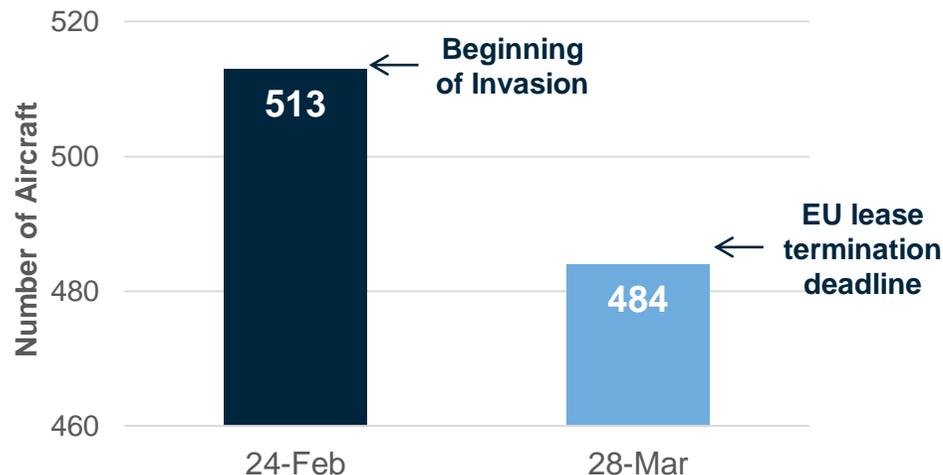


Market drivers

Russia/Ukraine conflict – impact on lessors

The number of foreign owned aircraft operated by Russian airlines has decreased since the start of the conflict but over 400 aircraft still remain in Russia with their recovery posing a significant challenge.

Foreign Exposure to Russian Operated Aircraft



Source: IBA Insight as at April 2022.

Lessors have started to write-off billions of dollars worth of assets and file formal claims with their insurers. The specifics and just how much these companies will recover remains unknown at this stage.

There are market discussions taking place regarding potential insurance loss triggers and how they match up with cancellation clauses, policy coverage and wordings.

Ultimately, claims will be complex and may take lengthy litigation to resolve. A final industry loss number is not expected for some time but regardless, losses will be substantial.

Market drivers

Russia/Ukraine conflict – impact on insurers

The Russia/Ukraine conflict represents a major claim to the insurance market with specialty lines most exposed, and aviation the hardest hit.

S&P provided three different scenarios for Specialty Insurance Losses

	Rationale	Potential Insured Loss
1	Assumes some recovery of aircraft, that some coverage has been cancelled and some potential court decisions do not award the highest sums insured and coverage.	\$16bn (\$6bn aviation / \$10bn other)
2	Assumes most policies are not cancellable and that most potential court decisions fall in favour of lessors rather than insurers.	\$27bn (\$12bn aviation / \$15bn other)
3	Assumes most policies are not cancellable and that most potential court decisions fall in favour of lessors with the highest possible insured awards.	\$35bn (\$15bn aviation / \$20bn other)

Source: S&P Global Ratings

Most insurance companies are taking a step-reserving approach so Q1 loss disclosures were low, and most excluded aviation. Q2/Q3 figures are likely to provide greater insight.

Aviation represents the biggest unknown in what the ultimate loss to the insurance market will be. S&P forecast aviation losses of \$6bn-\$15bn but much will depend on whether these claims fall on the war or all-risks policies.

Ultimately, this is a cross-class loss and market estimates vary. Some sources suggest that after litigation, total insurance losses (all lines) will eventually fall in the \$10bn-\$20bn range but it is still a developing situation.



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Tactical nuclear weapons

The threat

What are tactical nuclear weapons?

- A tactical nuclear weapon (TNW) is a nuclear weapon which is **designed to be used in military situations** to strike specific targets such as facilities or soldiers on a battlefield, **at short distance**
- Tactical nuclear weapons are **generally smaller in explosive power** in contrast to strategic nuclear weapons, which are designed to strike a much larger surface area and cause substantial damage.

How powerful are they?

- There is no typical tactical weapon — they vary in power. Modern weapons have yields of 1 or up to 10 kilotons.
- For comparison, the strategic nuclear bomb used on Hiroshima during World War II, which killed 140,000 people, was 15 kilotons
- Russia is believed to possess **about 2,000 tactical nuclear weapons** of varied yields.

How are tactical nuclear weapons launched?

- These weapons can be **launched on the same missile platforms and artillery vehicles** that are currently **being used by Russia in Ukraine** at present

Why would Putin use them against Ukraine?

- Experts believe Russia hoped to take Ukraine quickly, but this hasn't happened
- Russia is suffering heavy losses and the international community continues to support Ukraine with military equipment and weapons
- In June, both the US and UK agreed to send new longer-range weaponry to Ukraine
- As the days add up, Russia could turn to tactical nuclear weapons to try to intimidate a surrender
- They could **target a remote area** of Ukraine such as its crop fields or **strike Ukraine's army and military bases**.

Russian invasion of Ukraine

Media quotes

Russian officials, have made more than one reference to Russia's nuclear weapons

"I decided to conduct a special military operation. Whoever, would try to stop us, and furthermore, create threats to our country, our people, should know that Russia's response will be immediate and lead you to such **consequences as you have never seen** in your history. We are ready for any situation that arises. All necessary decisions in this regard have been made. I hope that I will be heard".

Source: President Vladimir Putin

"Senior officials of the leading Nato countries also allow aggressive statements against our country, therefore I order the minister of defence and the chief of the general staff [of the Russian armed forces] to **transfer the deterrence forces of the Russian army to a special mode of combat duty**".

Source: President Vladimir Putin

"Russia has a special document on nuclear deterrence. This doctrine **does not require an enemy state to use such weapons first**, but when an act of aggression is committed against Russia and its allies".

Source: Dmitry Medvedev, Deputy Chairman of Russian Security Council

"We continue ahead-of-schedule delivery of weaponry and equipment by means of credits. The priorities are long-range, high-precision weapons, aircraft equipment and **maintenance of engagement readiness of strategic nuclear forces**".

Source: Russia's defence minister, Sergei Shoigu

"If they threaten our state, it's good: here is the hypersonic Sarmat for you, and **there will be nuclear ashes from you if you think that Russia should not exist**. We can hit with a Sarmat from Siberia, and even reach the UK".

Source: Aleksey Zhuravlyov, Deputy Chairman of the Kremlin's Defence Committee



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Hostile detonation of nuclear weapons

Standard wordings position

Hull War (LSW 555D)

- Automatic review of premium rates and/or conditions and/or geographical limits effective 7 days from time of hostile detonation
- Policy cancelled if review not accepted.
- Not dealt with under this specific solution

AVN52E

- Automatic termination of any cover in respect of deletion of AVN48B paragraph (a) upon hostile detonation, this being:
 - “War, invasion, acts of foreign enemies, hostilities (whether war be declared or not), civil war, rebellion, revolution, insurrection, martial law, military or usurped power or attempts at usurpation of power”.)
- Insurers may issue 48 hours notice of cancellation of any cover in respect of deletion of AVN48B paragraph (c), (d), (e), (f) and/or (g) upon hostile detonation

Excess AVN52E

- Dependent upon conditions of individual policy concerned (see below) – however will usually follow AVN52E automatic termination of AVN48B paragraph (a) coverage upon hostile detonation of nuclear weapons



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Hostile detonation of nuclear weapons

What would this mean?



Automatic cancellation

- Following hostile detonation of a nuclear weapon, airlines would be faced with automatic cancellation of cover in respect of Passenger Liability War and War Third Party Liability
- This would apply regardless of where the nuclear weapon was used and what type it was

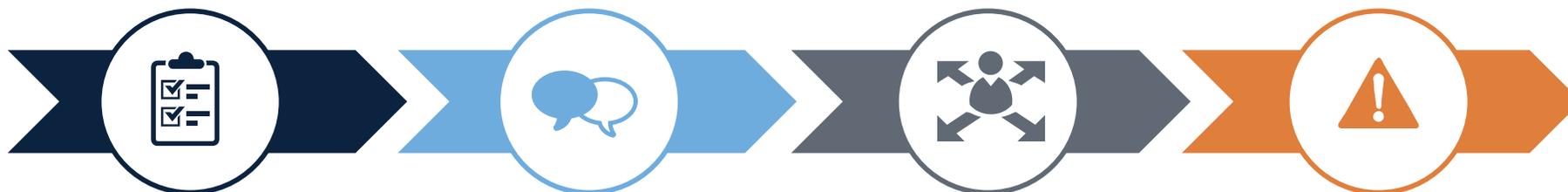
Worldwide grounding

- Automatic cancellation of cover would potentially ground every airline worldwide
- Emergency government solutions may arrive but these will not be global and they will likely take some days or weeks to implement
- It is possible that some airlines could attempt to self-insure or forego this cover but this is high risk and we aren't clear if this is legal due to regulatory and/or lease requirement reasons

It would be catastrophic for the world's airlines to be grounded by the firing a tactical nuclear device!

Market actions

Aviation Insurance Clauses Group (AICG)



The London market Aviation Insurance Clauses Group (AICG) are currently in discussions on the implications of automatic cancellation

The design of these clauses was to protect insurers in the event of a nuclear war – rather than the use of a smaller tactical nuclear device

The AICG are exploring ways of updating current clauses so they would not automatically cancel the policies should a smaller tactical nuclear weapon be used

Discussions are extremely complex and very time consuming with multiple industry parties involved (direct and reinsurance) who all need to agree

The AICG will formulate a clause, which will then undergo a minimum 30 day consultation period, followed by any amends, review and sign-off. The entire process from start to finish can therefore take several months.

In the meantime, we have a window of risk of Russia turning to tactical nuclear weapons in its attempt to win its war

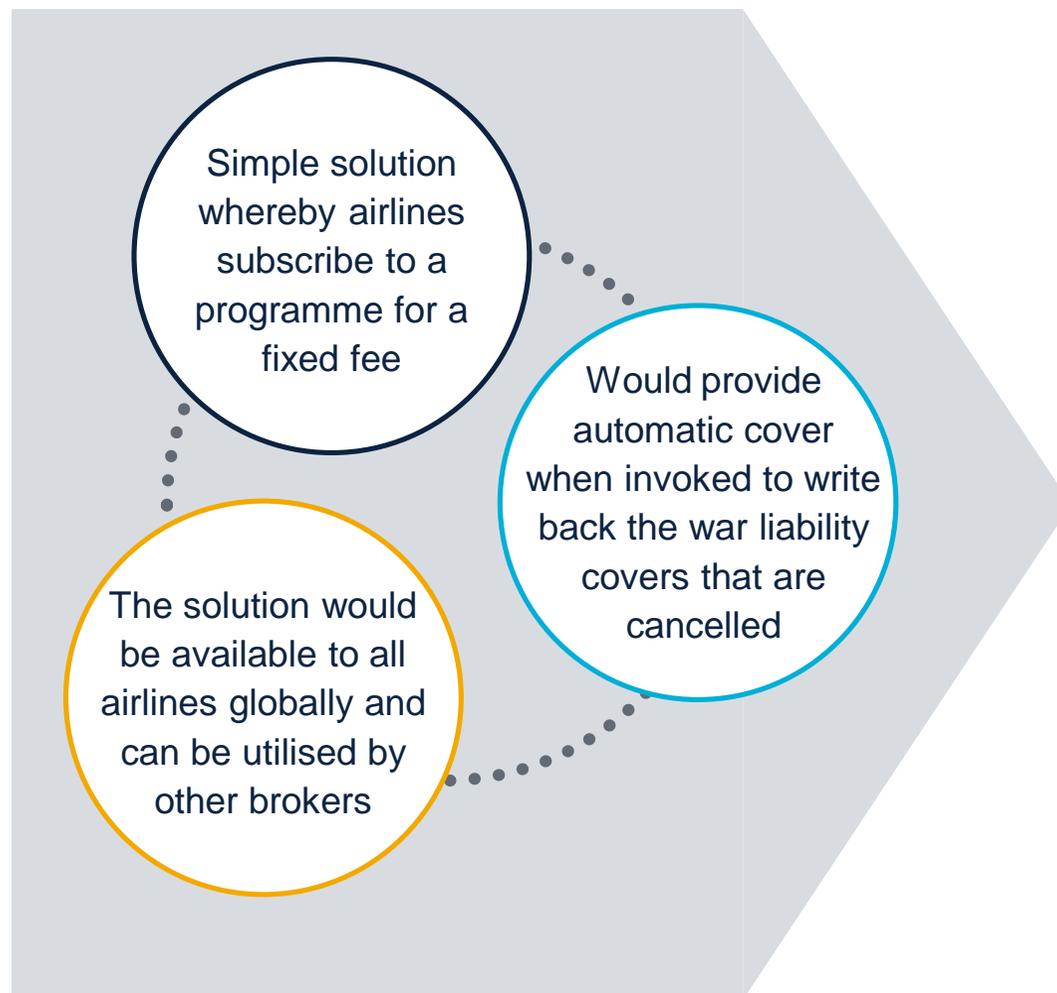
In our opinion the best and quickest solution to this issue is a commercial solution.

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The commercial solution

Our concept



How would this work?

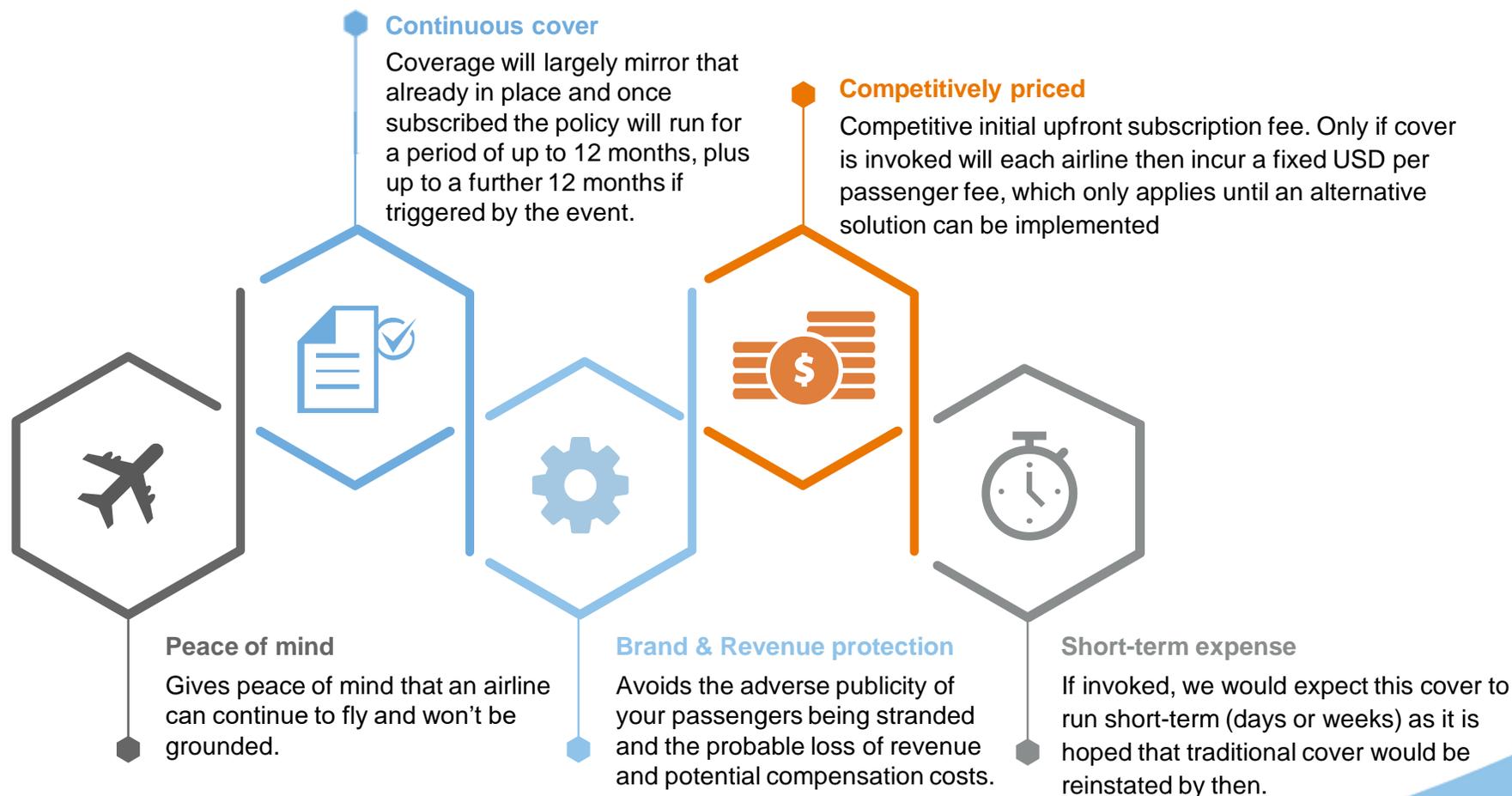
- The airline would pay an initial upfront non-returnable subscription fee
- If cover is invoked then each airline will incur a fixed USD fee per passenger
- A small group of leaders will be appointed any one of which will have the authority on behalf of all insurers to determine the geographic limits to be reinstated
- The leaders will monitor developments and review coverage as needed
- The Broker (Gallagher) would handle the distribution of certification by way of a dedicated online platform
- Once subscribed, if an event happens and coverage is incepted then this will then run for up to 12 months from that date.



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The commercial solution

What are the benefits to airlines?



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In summary

Gallagher leading the way to help all airlines

The threat of the use of a tactical nuclear weapon is real

Triggering any device would see the entire world's airlines grounded

Coverage will be reinstated but this is likely to take some days/weeks to implement

Our proposed solution is simple, and competitively priced to keep you flying!

A solution designed to provide peace of mind in uncertain times, and leave you more time to focus on your post-pandemic recovery and other operational matters.

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