AVIATION

Up, up and away

Ready to take your business to new heights? The aviation sector offers producers a vast and stable market

EVER SINCE 9/11, news from the aviation sector seems to be fraught with horror stories, from the disappearance of Malaysia Airlines Flight 370 somewhere in the South Pacific in 2014 to the deliberate crash of Germanwings Flight 9525 in southern France last year.

But the specter of such disasters is only a small part of the aviation industry. The sector is populated by a diverse array of business classes that present interesting and unexpected opportunities for insurers who want to engage in a potentially lucrative and steadily growing market.

From the ground up

Major lines of business within the aviation sector include both international and domestic airlines, aviation manufacturers, airport service providers (such as fuelers, baggage handlers and caterers), privatized air traffic control and drones. There's also general aviation, which includes anything that flies that is not airline or military, such as corporate aircraft, chartered aircraft, utilities, emergency medical services and news helicopters.

While it may seem strange to lump firmly grounded business classes such as caterers into the aviation sector, there is a good reason for it, says Lori Hunter, a California-based aviation specialist with surplus lines wholesale broker Worldwide Facilities.

"In order to take the food out to the commercial aircraft, the caterers have to put it on lift trucks on the tarmac and load it onto the plane," she explains. "In a typical claim scenario, the driver operating the lift with the food cart could damage the aircraft, resulting in a very expensive proposition."

Such a varied sector naturally requires a broad spectrum of insurance products. Manufacturers require aircraft products liability coverage. This product serves several tiers of buyers. At the apex are the people building the aircraft. After that come Tier 1 suppliers – people who make things like engines, avionics and flight control actuation systems. After that come sub-tiers – for instance, people making one piece of metal that goes into those complex items.

"It's a straightforward coverage, addressing bodily injury and property damage arising out of an aviation product," says Eric Donofrio, XL Catlin's North American regional manager for aviation insurance. "If someone alleges your product caused

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or contributed to an accident, and people on the aircraft were injured or there was property damage on the ground, that's what this would cover."

Another common coverage, known as grounding coverage, is more of a financial loss cover. If something happens to an airplane that results in bodily injury or property damage – the engine blows up, for example, and hurts a person or the aircraft – the FAA may ground all of that type of aircraft until the problem is resolved.

"If the FAA mandates grounding, the airlines come to the manufacturer of the product that caused the grounding and say, 'We are losing revenue because your part caused our aircraft to be grounded,'" Donofrio explains. "This coverage responds to the financial loss a manufacturer might have because their product caused the grounding."

Airline/general aviation hull and liability coverage responds to bodily injury and property damage if the plane crashes. The coverage works the same way for commercial airlines and the general aviation business class. "Corporate aircraft have the same exposures as a commercial airline – people riding in the aircraft, and people and property outside of aircraft in the event of a crash," Donofrio says.

Coverage for airport service providers consists of an airport general liability form with coverage specific to airport premises. The coverage is required because P&C policies have exclusions for airport exposures. It is geared toward people providing services inside the airport – aircraft repair, maintenance, fueling, etc.

Products and completed operations coverage insures the airline itself, including its employees. However, if an airline pilot makes a mistake, they derive their protection from the airline's hull and liability policy.

All aviation policies also have a war exclusion, covering things like terrorism-related incidents or outright acts of war. Generally speaking, Hunter says, commercial airlines and major airports are the typical business classes that purchase stand-alone war coverage.

In the global airline industry, there are two different ways of placing insurance coverage: on a quota share basis or on a 100% basis. The way the coverage is placed revolves around the size of the limit. Often, when it comes to the giants of the industry, "the exposure is so significant that no one insurer wants to do it on their own," Donofrio says.

Airlines tend to buy $1.5 to $2.25 billion worth of cover for any one occurrence. "No one market wants to put out that much limit," he says. "In a co-participation basis, everyone pays a share."

Even an aviation manufacturing company buying a comparatively low limit of $5 to

AVIATION

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GENERAL AVIATION LIABILITY EXPOSURES

Airports
- Private airports
- Government airports
- Small airports
- Regional airports
- Major airports

Helipads
- Hospital helipads
- Private helipads
- Commercial helipads

Fixed base operators
- Landlords
- Hangar and fueling operations
- Repair and service operations
- Overhaul operations
- Military contractors
- Paint shops

Aviation service providers
- Ground handlers
- Wheelchair assist
- Cargo services
- Baggage handlers
- Airport maintenance providers
- Airport contractors

Source: Starr Companies

$10 million might have a product that is so significant and so likely to cause a loss that one market wouldn’t want to cover it on their own because of the exposure, even though the limit is low.

The other way to place coverage is on a 100% basis, which comes into play for a business with a very low loss exposure, or where the frequency of loss is very low. Smaller, owner-flown aircraft such as corporate jets would fall into this category.

“From a global perspective, most business is transacted on a quota share basis, and people that play on that business in the US are the same internationally,” Donofrio says. “It truly is a global marketplace.”

A soft market with tremendous capacity

The aviation insurance market has changed quite dramatically in recent years. As recently as 1999, there were three major players in the US and three to four niche players. Today there are six to seven major carriers and at least 12 niche players, signifying a huge expansion in the US from a capacity standpoint.

“Right after 9/11, rates jumped for a couple of years depending on market segment, and ever since then, they have been slowly coming down,” Donofrio says. “The theme of the aviation market is that there is tremendous capacity, keeping rates very low.”

The rate decrease has been most dramatic in the last couple of years; the main driver has been overcapacity in the market.

Capacity in the aviation marketplace also ties into another trend. “We have seen a reduction in the number of catastrophic losses [in commercial airlines] since early 1990s, driven by improving aircraft technology,” Donofrio says. “Airlines have put a lot of work into safety culture.”

That may seem counterintuitive, given the high-profile aviation tragedies that have occurred since 9/11. But the number of catastrophic crashes not related to terrorist activity has indeed gone down dramatically over the last 20 years. In the ’70s, Donofrio says, there were a couple of major accidents every year. But the last major non-commuter airline to crash in the US was in October 2001. Since then, there have been just two commuter airline crashes.

“It’s pretty amazing that, over that time span, there have been very few losses,” Donofrio says.

Along with the excess capacity in the sector has come more willingness among carriers to be flexible in their terms. As an example of this phenomenon, Hunter recalls a policy she placed last year with a high-net-worth individual who owns two private jets.

“When you provide this kind of coverage, there is generally a pilot warranty, where the carrier says it will provide insurance, but will warrant that only a limited number of specifically named pilots can fly the planes, and that they have to maintain a certain level of training and retraining during the year,” she says. “Last year when we quoted the risk, underwriters would only offer terms that mandated a very specific and rigorous level of pilot training. This year, when we quoted the renewal, several companies were willing to relax their requirements because the marketplace is so competitive.”

A stable sector

As antithetical as it might seem, the aviation sector is not terribly dynamic.

“I’m sometimes jealous of other lines of coverage like cyber that are really growing and popping," Donofrio says. "Aviation is mature, and there are tremendous barriers to entry. Financial networks talk about disrupters, but we don't see that in the aviation world. There are regulatory and capital barriers to entry. You don't come in and say, 'I will be the next aircraft manufacturer.'"

The aviation market is also going through a period of consolidation. "Not only are we not seeing new people coming in, but we are seeing airline mergers and manufacturer mergers that are reducing the number of insureds in the market over time," Donofrio says.

On the bright side, global airline growth tracks the global economy, so if the global economy is growing at 3%, so is the aviation sector.

The general aviation market in the US is also quite mature. "It will be more flatline than anything in the coming years, while some markets such as owner-flown aircraft are actually contracting," Donofrio says. "Flying doesn't have same wow factor that it used to have. Thrill-seekers these days seem to have a lot of other competing interests."

The one exception to this rule is the recent phenomenon of drones, or as the insurance industry refers to them, unmanned aerial vehicles [UAVs]. "That may be the one area where there will be substantial growth in coming years," Donofrio says.

The insurance market for UAVs is still very much up in the air. It remains to be seen whether these projected opportunities will ultimately land in the aviation market. Regardless, insurance carriers are racing to create innovative new coverages.

"We have specifically designed a policy to cover physical damage and liability, similar to an aircraft policy," says Joe Trotti, president and CEO of AIG's Aerospace division. "In terms of client base, it's not always an aviation client. Major corporations use drones as part of their business model and wouldn't necessarily be buying coverage from the aviation market."

The gamut of drones is pretty broad, from something that would be purchased by a weekend enthusiast to something as large as a commercial aircraft. With an estimated 1 million drones sold in the US to date, "it's an area that's growing significantly," Trotti says, "and we anticipate that it will continue to grow over the next five years or so at a fairly rapid rate."

While the perils associated with operating a drone are very similar to those of a traditional aircraft, "there are far more dangerous things than flying a small UAV," Donofrio points out. "And the reason the aviation market exists is because the non-aviation market is concerned about harm to passengers when you have a crash. With the major aspect of liability stripped out of that coverage, you can certainly see where non-aviation markets would be fine with covering those risks."

But, he adds, "once you start seeing UAVs flying outside of the line of sight of the operator, and if the UAVs are operating in same space as an airline, it changes the game significantly," both from an ethical and risk standpoint, and would ultimately demand more of an aviation-driven coverage.

Where the opportunities are

"It's hard to find opportunities in the aviation sector right now," Donofrio admits. "It's a mature sector, the client base is shrinking, and brokers are having to fight very hard to keep the clients they have. With the market coming down, brokers' revenue is coming down, too, because they are on commission, and their fees are under competitive pressure."

But despite that rather bleak landscape, Donofrio adds, "If you provide value-added services beyond the renewal transaction, such as contractual reviews or risk management, that creates an opportunity for the savvy broker."

It is also possible, he says, to look for ways to cross-sell other coverages to aviation clients. "We deal with a lot of brokers who are purely aviation brokers, specialist brokers, and some specialists are able to provide non-aviation coverages such as P&C, auto, etc. That tends to be a differentiator."

Trotti agrees. "It's important to look for those emerging opportunities and really try to find those niches to best serve your client and offer a full suite of expertise to support it."

Hunter, meanwhile sees unique opportunities for insurance producers in the aviation manufacturing sector.

"There continue to be a number of manufacturers that don't insure their aviation products," she says, "either because it's not required or because they are ignorant about the fact that the products policy they purchase to cover their other products might not cover the aviation products as well. There is an opportunity to have a discussion with your client, and ask them if the product they are making is going into any sort of aviation product, and if so, give them the quote, because the market is so soft." IB

AVIATION SAFETY BY THE NUMBERS

1,287
Total number of civil aviation accidents in 2014

439
Total fatalities in 2014

0
Number of fatalities on large scheduled commercial airlines in 2014

4
Number of accidents on small commuter airlines in 2014

35
Number of small on-demand airline (air taxi) accidents in 2014

Source: Insurance Information Institute