

Aviation International News®

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Premiums are stabilizing, but recent bizav accidents and new EU coverage requirements might increase rates

Various aviation insurance professionals seem to agree that the overall market has stabilized with premiums still significantly higher than pre-9/11 levels but with decreases in various segments. Some brokers have reported decreases in premiums as high as 25 percent, but those have turned out to be unusual cases. For those bizav operators who have seen decreases, the average reduction has been 5 to 10 percent.

"With respect to corporate aviation, about 12 months ago premiums overall started decreasing," said Jeff Bauer, president of NationAir Insurance, a brokerage firm based in St. Charles, Ill. "Charter operators who fly all turbine aircraft, have good loss records and pilots who consistently receive recurrent training have seen good decreases." According to Bauer, turboprop operators have seen some decreases in rates, although not to the level that pure turbine operators have.

The entry of new underwriters into the business aviation insurance market might be a contributing factor in the recent decrease of overall rates. Since 2002, at least three new underwriters—a significant addition to a field that included four players just a year earlier—have begun writing insurance for business aviation. The segment's relatively high safety and low loss record (recent losses notwithstanding) and the high premiums being charged by underwriters still in the market after 9/11 are likely among the factors that brought new underwriters to the business.

"The insurance business is cyclical," said Bauer. "If rates get high in a certain segment, then underwriters will go after that business. The new underwriters are usually willing to lower rates to increase market share."

Not only do the new underwriters directly affect premiums through competition, but they also provide additional insurance capacity, which can also indirectly influence premiums through the effects of supply and demand.

"The market diminished considerably after 9/11, with several insurers pulling back, returning to their core businesses or going out of business," said Larry Marrs, president of Minnesota-based Wings Insurance Agency. "Rates went up considerably because the demand was higher than what was available in the marketplace, but they have been coming down for the last two years as a result of more capacity becoming available."

Although rates have started coming down, there's little hope that they will return to pre-9/11 levels unless insurance companies can supplement lower underwriting profits, or even insurance losses (as was the case for many years in the mid to late 1990s), with investment profits. A booming stock market during those years turned invested premium dollars into investment profits that offset underwriting losses.

"After the stock market began its downward spiral in the late 1990s, many insurance companies decided to go back to their core business—taking in more premium dollars than they paid out in claims—which required raising rates, which had been artificially low for some time. The approximately \$6 billion insurance loss from events of 9/11 just provided the impetus to make the market adjustment that had been needed to make aviation insurance profitable again.

"There were a couple of years when rates were just brutal," said Eric Barfield, with South Carolina-based Hope Aviation Insurance. "They've stayed up and stabilized, but they haven't gone down tremendously. What that means is that money has flowed back into the aviation insurance marketplace. The reserves have built back up."

Will Recent Accidents Affect Rates?

One factor that might affect the rate stabilization is the recent rash of high-profile business aircraft accidents that has tarnished business aviation's otherwise exemplary safety record.

"The rash of losses over the last several months has obviously been of concern," said Kyle Sparks, senior vice president of general aviation for underwriter AIG Aviation. "You can never call losses anomalies; there are obviously going to be losses at certain times. But it's certainly bringing to light more issues regarding crew coordination, documentation and aircraft control procedures."

Bill Behan, principal of Golden, Colo.-based AirSure, does not believe the accidents will affect rates. "While the 'recent rash of bizjet accidents' is unfortunate, especially with respect to injuries or loss of life, it doesn't appear to have made an impact upon the steady market softening for this class of aircraft," Behan told **AIN**.

"It remains to be seen what the future impact may be as a result of these losses, but my prediction for the near term is that the market will continue to soften through this year and next, without a dramatic drop in pricing as opposed to a steady decline in rate. This is what the market has experienced through past cycles, historically rising in pricing (or market hardening) swiftly when a market 'correction' occurs and a steady softening thereafter over a period of three to seven years."

But although the accidents may not be overriding the market softening caused by other factors, they are making some insurers hesitate about insuring corporate aircraft that offer high-density seating, as illustrated by last year's Hendricks Motor Sports King Air 200 crash, which killed all 10 aboard.

The King Air 200 is not an aircraft you'd associate with high-density seating, but this particular airplane was stuffed to capacity, resulting in a higher loss than if the two to four passengers typically found on small business aircraft had been on board.

Risk-sharing Plans

With the relatively recent entry of true high-density seating commuter aircraft making their way into the business aircraft arena, more underwriters are taking a closer look before writing the insurance. "A lot of underwriters look at [the Hendricks] loss and then they see these other corporate airplanes with 19 seats, and they get a little antsy," said Barfield.

Barfield says that one solution the underwriters use is to split the risk with quota-share placements. "Let's say that I have a 19-seat airplane that's due to enter the marketplace and no one insurance company wants to insure it on its own. So one company will insure half of it and go to another insurance company to insure the other half. Or the first insurer gets the second to do 25 percent and yet another insurance company to insure the other 25 percent."

The quota-share placements spread the risk among multiple insurance companies, which can help ensure that a risk gets insured but can also cause numerous complications if there's a claim. Quota-share placements are different from re-insurance, where one insurance company issues a policy on the full liability limits for the aircraft and then purchases insurance for a portion of its exposure.

For example, a company writes a \$100 million policy on a Citation but intends to pay only the first \$10 million on a claim. It will purchase insurance from another company (or multiple companies) for the other \$90 million. That second company may purchase insurance for part of its exposure. The re-insurance scenario also spreads risk among a number of insurance companies, so that no one company must pay the entire \$100 million claim.

New EU Liability Limits Might Mean Higher Rates

One issue that is rocking the aviation insurance industry, especially in terms of business aircraft, are the new European Union liability limits that took effect on April 30. The new regulations require all commercial operators to carry third-party liability and war/terrorism coverage limits based on the aircraft's mtow.

For example, a Citation X that falls into the 30,000- to 55,000-pound-mtow category will require approximately \$115 million in both liability and war/terrorism coverage. At nearly 100,000 pounds mtow, a Global Express would require coverage of approximately \$216 million. The insurance requirements apply when an operator is flying to, from or within a European Union member state as well as when it is simply overflying a member state or its territorial waters.

"I think operators are becoming aware that if they fly through Europe, they're going to need those higher limits," said Marrs. "When we get up into those higher limits, it's not as expensive as it used to be following 9/11. The capacity's there, the companies are certainly willing to write the insurance, and they have the re-insurance in place. I don't think owners will find it prohibitively expensive to carry the required limits."

But not all industry personnel agree.

"The operators that I've talked with have reported premium increases of between 30 and 300 percent," said Mike Nichols, NBAA tax and finance manager. "Some operators have said that they are going to discontinue all flights to Europe and focus on Asia...There are a lot of pilots who think it's just unfair."

Whether the new limits are "unfair" is a matter of opinion, but the fact is that several EU member states already had high liability limit requirements for corporate and commercial aircraft before the change went into effect. The new aspects of the EU regulation causing most of the premium increases are the application of the limits to aircraft merely overflying the EU territory, the mtow-dependent coverage scale that hits large intercontinental aircraft the hardest and the added war/terrorism coverage requirement.

"The biggest issue with this change is the war coverage requirements," said Sparks. "Probably 70 to 80 percent of operators already carry aircraft liability limits high enough to meet the requirements. What they don't carry is the war and terrorism coverage."

Sparks estimated that the annual premium for the required war/terrorism insurance could range from \$20,000 for a Citation X to \$35,000 for a Global Express for worldwide coverage. Per-trip coverage is available at an estimated \$3,000 to \$15,000 per trip. However, those figures are for the war/terrorism coverage only; if an operator also needs to increase its liability coverage, the premium amount can increase dramatically. One source estimated that a Global Express operator currently carrying \$100 million in liability and \$50 million in war/terrorism coverage may see its annual premium increase by \$70,000 to meet the required minimum coverages.

What's on the Horizon for VLJs?

A hot topic among aviation insurers is requirements for pilots of very light jets (VLJ). Although certification for any of the front-running VLJ manufacturers won't occur for 10 to 12 months, insurers are starting to determine what they will require in terms of pilot experience, simulator training and mentor pilot flight time.

"We will evaluate each owner on an individual basis," said Christopher O'Gwen, vice president of general aviation underwriting for United States Aviation Underwriters. "Annual simulator-based training is always a core component of operating any turbine aircraft, which will present an interesting hurdle as there may not be simulators available for some of the new VLJs for a while."

Underwriters are shying away from setting specific hourly requirements for flying with a mentor for owner-operators moving into VLJs with little or no turbine experience. Instead, because each pilot will have a different experience level, underwriters will depend on the CFI to sign off the pilot when he is ready rather than at a 25- or 50-hour block.

"I can't tell you how many phone calls we get asking how many hours it will take [to get signed off in a VLJ for insurance purposes]," said AIG Aviation underwriter Jim Anderson during the Aviation Insurance Association conference held in late April. "I really don't know; I'm just the underwriter. I'm not the person's flight instructor. I don't profess to be your flight instructor but at the same time I need to manage risk for AIG."

Manufacturer Training Guidelines

Ultimately, it may not be the insurance industry that sets the standard for VLJ pilot proficiency. Eclipse Aviation's mandatory training program pairs a prospective Eclipse 500 owner with a mentor pilot only after the owner has completed upset training in the L-39 Albatros (a light tandem two-seat single-engine jet manufactured in the Czech Republic), high-altitude training in an altitude chamber and simulator training with United Airlines instructors. If the owner-pilot does not pass all of the training, Eclipse cancels delivery of the airplane and refunds the deposit.

"This is a revolutionary step," Anderson said. "We're not trying to keep people out of VLJs. But at the same time I think we all have to realize that as aviation insurance professionals we have to maintain standards. People need to follow an established training curriculum for this new technology."

The NBAA Safety Committee also recently published a set of VLJ training guidelines that could help underwriters determine requirements for pilots flying VLJs that don't already fall under manufacturer programs. Incorporating input from insurance brokers and underwriters, as well as other aviation professionals, the NBAA guidelines contain a chart recommending certain blocks of mentor flight time depending on the pilot's experience.

Barfield, one of the insurance professionals involved with writing the NBAA guidelines, cautioned that the document is only a guide; individual underwriters will still determine the actual mentor flight time required for each owner/operator.

"The first three years, from 2006 to 2009, will be critical. If VLJs don't get introduced into the marketplace just right, they could give business aviation a black eye," Barfield said. "An owner's guidelines will really be dictated by the underwriter. So even though this chart suggests that a pilot might have to fly 50 hours with a mentor pilot, when he takes his credentials to the underwriter, the underwriter might make him fly 100 hours."

Experience will be a key factor in determining the training requirements, but according to Anderson, the industry is used to dealing with low-time pilots who buy aircraft they are not yet qualified to fly.

The questionable qualifications of low-time pilots "are not a new subject," Anderson said. "We get these phone calls every Friday afternoon: somebody's picking up a King Air, twin Cessna or even a Cessna Citation and they have a long way to go before they're qualified to fly it...I do believe that [VLJ manufacturers] are creating a bridge between these low-time pilots with programs such as Eclipse's, where pilots will need to demonstrate flight proficiency and fly with a mentor pilot. Not because the underwriters say so, but because the manufacturer says so."

Underwriters are also concerned about the single-pilot operations of VLJs, especially when combined with the low-time, inexperienced turbine pilot. The insurance industry has long held the view that two pilots are better than one, citing higher accident rates occurring during single-pilot operations.

While no underwriter has said yet that it will not insure a single-pilot-flown VLJ, operators who keep two professional pilots in the cockpit at all times should enjoy an easier time getting their VLJs insured as well as lower premiums than operators who plan to fly with one pilot.

The number of VLJs forecast to enter the marketplace may have a positive impact on underwriters' bottom lines, assuming a very low loss record, which may in turn keep premiums lower for all business aircraft operators.

"The FAA recently predicted that 20,000 general aviation aircraft will be added to the U.S. fleet during the next 12 years, 4,500 of which will be VLJs," Anderson said. "This is good news; we'll have more business to write!"

Bizav FBOs Better Off than Others

While most business aircraft operators are enjoying modest decreases in aircraft hull and liability premiums, the same cannot be said of FBOs and other maintenance facilities, which might see rates for commercial general liability (CGL) insurance continue to rise.

"It's not easy for service centers to obtain insurance," said Barfield. "[Aviation maintenance] has been one of the toughest lines of insurance in the last five years, so underwriters are just now getting comfortable with commercial repair stations."

The CGL policy most FBOs and service centers purchase consists of three different coverages: premises and operations (which covers such events as a customer slipping on an oily spot in the FBO facility); products and completed operations (which provides protection in the event that a faulty repair performed by one of the FBO mechanics contributes to an accident); and hangar keeper's (in case an FBO employee damages an aircraft while moving it out of the facility).

An increase in the number of hangar keeper's claims in the past few years has been partially responsible for a corresponding rise in CGL premiums. But it's not only the number of hangar rash incidents that has gone up; the cost of the claim has risen as well, especially when dealing with business jets.

If an FBO employee dings a Cessna Skyhawk wing, the overall cost of the claim might be a relatively reasonable \$25,000. However, if an employee dings a wing on a large business jet, not only does the insurance pay for the actual cost of the repair, which is significantly higher than the cost of repairing the Skyhawk wing, but many operators also sue for the time that the aircraft is down, compensation for replacement chartered aircraft and reimbursement for the loss of resale value incurred by having an incident and repair on the aircraft's record.

The total cost of a dinged business jet wing can reach several hundred thousand dollars. An even worse case is when more than one aircraft is involved, such as when the wing of one aircraft strikes the wing of another because the FBO failed to employ a wingwalker when moving aircraft around the hangar.

Despite the rise in hangar rash cases, however, FBOs and maintenance facilities that concentrate solely on business aircraft are likely to have an easier time purchasing CGL insurance than shops that perform work on piston aircraft due to repercussions of the General Aviation Revitalization Act of 1994 limiting manufacturers' liability to 18 years. Because manufacturers of older aircraft can no longer be targeted for liability damages after an accident, plaintiffs' lawyers have turned to maintenance shops to pad settlements after the aircraft owners' liability insurance reaches its cap.

"There is an issue with doing work on piston aircraft since the aircraft owners do not have the ability to purchase significantly high liability limits," said O'Gwen. "The best small aircraft owners can buy is \$1 million in liability

coverage subject to \$100,000-per-person caps. What this has done is shift the liability burden to the aircraft maintenance center [which may have a multimillion-dollar policy]."

Since corporate operators insuring turbine aircraft generally carry \$100 to \$300 million liability policies, service centers working on these aircraft are not likely to be dragged into a lawsuit unless the plaintiff can demonstrate actual negligence. Bizjet service centers that keep their staff well trained by sending them to periodic refresher training also enjoy an easier time shopping for insurance.

"Training and safety go hand in hand," Barfield said. "A huge factor [in determining insurance premiums] is being able to show your training program and the types of operation that training will cover."

"The heavier the maintenance, the more [the operation] will be scrutinized," said Bauer. "A shop performing complete engine overhauls will be scrutinized more than one performing only light maintenance. If the shop works on a critical part, such as the engine or propeller, it will be more difficult to insure."

Insurance companies are trying to stem the losses caused by hangar rash by raising deductibles. Whereas several years ago the typical deductible for an FBO would be \$1,000 for piston air-craft and \$2,500 for turbine aircraft, \$5,000 and \$10,000 deductibles for piston and turbine aircraft, respectively, are more common now. This also has an added effect of making safety programs a high priority at more FBOs.

"If an FBO owner knows that the first \$10,000 of an incident will come out of his pocket, he'll ensure that his employees are taking their safety program more seriously," Barfield said.