

Market Conditions

by Thomas H. Chappell

The Aviation Insurance Industry Structure:

The aviation insurance industry is small compared to other insurance market sectors. In the United States, we have eight full-line standard underwriting companies and one direct writer. A direct writer is a company that markets and sells its products through in-house agents. These insurance products are not made available to independent agencies nor are they made available to national or international brokerage houses. Conventional underwriting companies market their products through independent agents and brokers.

Privately owned agencies (usually aviation specialists) account for the majority of the general aviation insurance industry's distribution of insurance products. This includes insurance sold to independent aircraft owners and operators, fixed base operators (FBOs), general aviation maintenance facilities, flying schools, small corporate aircraft fleets, airports, etc. The "national brokerage firms" (the alphabet houses) such as Marsh, Willis, and Aon, lead the independents in their market share of U.S. commercial airline insurance. Start-up airlines and the smaller regional airlines are usually too small to be of interest to the national brokerage houses. As a result, this segment of the airline industry usually finds an insurance home with the independent aviation insurance specialist. There are only a few general aviation insurance specialists (such as CS&A Aviation Insurance) with expertise in handling insurance placement for commercial airline accounts.

In addition to the full line underwriting companies, the aviation insurance industry relies heavily upon specialty product underwriters in filling the coverage gaps to complete many accounts. Such products as aircraft excess liability insurance, corporate non-owned liability insurance, airport ground liability, and aviation products liability are just a few of the products offered by "restricted line underwriters."

When accounts cannot be placed domestically, the London and European underwriting markets are a great resource. In addition, the London and European insurance facilities provide much of the reinsurance for the U.S. domestic reinsurance contracts. It is this support that makes aviation insurance products available in this country and worldwide.

Capacity:

Over the past thirty years, the aviation insurance industry has transitioned from what I would call "fast and loose" to the current day condition, which is very rigid. Although this transition has occurred through a series of hard to soft to hard market cycles, the trend most vividly is an overall worldwide market tightening. Today, we have the fewest number of underwriting facilities since I began in this business more than 30 years ago. In addition to the fewest number of aviation underwriters in thirty years, the investment capital supporting these underwriters is at an all time low. This lack of capacity, not the 9/11 tragedy, is the true cause of the hard market in which we find ourselves today. (The

September 11th tragedy caused a temporary firming in the market not the hard market cycle.)

Market Trend:

The result of this cyclical trend on today's aviation industry is more rigid underwriting and higher insurance prices. At this writing, the post 9/11 hard market has relaxed a bit and 2004 renewal prices are flat to slightly down in many market sectors. Be advised, however, that the overall long-range trend is a continually hardening market.

I believe we have found a new baseline. We will never return to the loose underwriting standards of the past, and the pricing of aviation insurance products will remain at or above a breakeven profitability (the industry burn rate). It must or we will see a further retreat of the reinsurance investor from this insurance sector. Times have been tough over the past ten underwriting years. Underwriters have learned a lot since the 9/11 tragedy. I cannot see them ever again allowing themselves to underestimate the funding necessary to sustain themselves should a similar or worse tragedy occur.

What is the cause of this underwriting uncertainty, this loss of capacity? Of course, a tragedy such as 9/11 is a shock to any economic system. I will be the first to admit that the terrorist caught the entire insurance industry, not just the aviation sector, with its "pants down." The aviation industry was under-funded for such a shock loss. This is not the true cause of today's lack of capacity, however.

Without exception, most reinsurance underwriters will tell you their biggest fear is the legal system in the U.S. When I make this next statement, I may offend some of you in the legal profession, but the statement must be made. Our legal system in this country is out of control. At least it is out of control in the opinion of the insurance community. Everyone sues everyone for anything.

A lower paid employee sues his employer and the employer's worker's compensation insurance company for a disability settlement. Although the employee had been with the current employer for a short time and his alleged carpal tunnel injuries were sustained over the past 24 years, charges were brought. Both the insurance company and the employer were afraid to fight the complaint due to the expense of a court battle and a possible bad faith judgment. A lump sum payment was paid in settlement for the claim. Incidentally, the employee received his disability payment and returned to work doing the same job with apparently no discomfort.

An aircraft engine malfunctions and results in a crash. The engine overhaul facility that did the last overhaul was sued and the court awarded a \$1,000,000 judgment that was the policy limit of the facility's insurance policy. This all sounds fair. There is one problem, the engine was overhauled nearly twenty years earlier for a different aircraft. The original aircraft crashed, the engine was salvaged at some later date and was hung on the aircraft in question.

Not all lawsuits are unjust and I will be the first to admit it. It is those frivolous suits that the courts uphold and those ridiculous judgments that are handed down that do the damage to the reputation of the U.S. court system in the eyes of the insurance community.

What is the solution? I have heard this argued for many years. The only solution in my opinion is "TORT REFORM." Tort reform could eliminate frivolous lawsuits. It could reduce ridiculous court awards and cap the attorney's compensation. Again, I have made an unpopular statement around the legal community. However, until some control is placed upon the legal community and until the insurance underwriter can quantify the exposure under any liability policy, we will continue to see nervousness among the underwriters. This nervousness will translate to higher premiums and lack of capacity when you purchase your insurance. I guess it can be said, "We all pay for the indiscretions of our system."

I do not think we will see broad tort reform in the near future. Is it because most of our politicians are attorneys that I make that statement? No. It is because the general population has not yet demanded tort reform.

It could happen if the need were great enough. We have seen some move in Mississippi for medical malpractice reform. The doctors were retiring or leaving the state to practice elsewhere due to the many medical malpractice lawsuits filed in Mississippi. The insurance companies could not endure the lofty settlements being handed down and responded either with huge premium increases or by discontinuing writing insurance for the Mississippi medical community. Tort reform was the only solution.

**Today's (October 2004)
Market Condition:**

As stated above, much of the post 9/11 hard market has relaxed. No, the premiums and rates have not fallen to pre 9/11 prices. There is no reversal in pricing trend. The market has simply leveled off and in most sectors of general aviation, we are seeing renewal quotations coming in flat with no increase. Although we are seeing no increases, we are also seeing very few premium decreases being quoted by the expiring carrier. Currently, when an underwriter quotes a decrease, it is because he is afraid he will lose the business and the quote is reduced only slightly. The term is a "flat market."

Does this mean the entire general aviation industry is going to renew without an increase? No. Certain market sectors, especially those still operating at an industry wide underwriting loss, are continuing on an up trend. This is the case with commercial accounts that are heavily dependent upon products liability insurance. Although the last several products liability renewals I have processed have been at no increase, the trend is up. Solution? I will refer you back to the tort reform discussion.

Accounts with a need for high limits of liability are renewing on a "no increase" basis but the underwriters all say they need more money in this market sector to break-even. This

is an up trend interrupted for a short time by the desire to retain good accounts. I see no real softening of this sector until we see capacity increase. No new underwriters will come into the market until, you guessed it, we have some assurance that court decisions will settle into a predictable pattern for the judgments they render. Should I say it? Tort reform.

CS&A Aviation Insurance's Approach To Renewal:

How does Chappell, Smith & Associates, Inc. (CS&A) work the underwriting market for our clients' renewals?

It depends upon the market sector. Some sectors are showing signs of weakness and others are continuing in an upward trend. Although a break in this upward move may be seen from time to time, believe me when I say the trend is up. The 2004 / 05 policy renewal cycle may be one of those breaks in the action.

CS&A Aviation Insurance represents all the domestic aviation insurance underwriters, all the specialty underwriters, and the London and European aviation communities. This is with the exception of AVEMCO, the industry's only direct writer.

At CS&A Aviation Insurance, we try to assess your risk from an activity as well as a personality standpoint and approach those insurance companies we think will appreciate the submission. There is no aviation insurance risk that appeals to all aviation underwriters. There is no reason in submitting an insurance account to an underwriter that we know has no appetite for a particular risk. Prior to submission, we try to discuss our marketing plan with the client.

If the client has been with a particular underwriter for a number of years, he may state that he would be unwilling to change carriers unless there is a huge difference in premium. If the market is stable (flat) as it is today and we know no competing company would beat the current underwriting company by a substantial margin, we might suggest not "shopping" the risk that year.

Don't shop every year. Why is this a good idea? Remember, we said there are only eight standard domestic underwriting facilities. Let's say your aircraft or business appeals to four of them. If the market is flat and there is little chance anyone will quote substantially under your expiring company, why upset the market? If a company receives a submission every year and never gets to write the business, they will soon label the account "a shopper." When something happens and you really need a serious quotation, they won't be there. This could be referred to as "the little boy who cried wolf" syndrome.

At CS&A, we plan with you when it is best to shop your account and when it is best to renew with the same company. The aviation industry is a very small segment of the insurance industry and loyalty still counts with many, though not all, of the underwriters.

Some of our clients want to poll the entire underwriting community every year whether recommended or not. In the end, it is your money. If you want to shop every year, that is what we do. We always give you a complete report of the market's response to your submission.

Can I Change Agents But Keep The Same Company?

What if I do not want to change insurance companies, but I want CS&A Aviation Insurance to be my agent? This is a very mature approach to the placement of your insurance. We can provide you with an agent of record letter stating your desire to change agents or brokers. Once signed by you, this letter is sent to your current agent and to your new agent, CS&A Aviation Insurance. We will process the change with the insurance company for you and begin managing your insurance immediately.

When you file an agent of record letter with your insurance company, you are replacing your old agent or broker and hiring your new agent. It is always best to do this before your renewal negotiations begin (approximately 60 days before policy expiration). If your current agent has begun the marketing process, any underwriter response he receives from a company will be that company's position with every agent that approaches them for that policy year.

When Is The Best Time To Move Your Account?

The best time to move your account is anytime you become dissatisfied with your current agent.

At CS&A Aviation Insurance, we will gladly accept your account at any time during the policy year. However, we do prefer to handle your renewal negotiations from the beginning. →