

## *Market Conditions First Quarter 2006*

### *Your Insurance Renewal Should Be A Pleasant One*

*By Thomas H. Chappell*

Following the 9/11 catastrophe, we noticed a more difficult underwriting environment in general aviation. In addition, we began to realize increased insurance rates and premiums. Blame 9/11 if you want to, but the underwriting market had already begun to firm up. We were entering a hardening market. As I have said in many articles, the September 11th attack just accelerated the inevitable.

Nearly five years have passed and the general aviation underwriting community has settled into a relatively flat to slightly down market plateau. Thanks to modest losses in both the general aviation and commercial airline sectors, most aviation underwriters have been turning a comfortable and consistent underwriting profit.

If we could promise the aviation reinsurers a long-term consistent profit, industry capacity and competition for the available consumer dollar would increase. This increased capacity, of course, would force prices down, end underwriter profitability and trigger the beginning of a new soft market cycle.

The forecast for general aviation insurance prices for 2006 is stable. Here's a recap of where we are now, and where we're headed.

#### **Market Environment.**

#### **Underwriting and Pricing**

2006 brought with it a flurry of activity in the aviation underwriting world. We began the year with two mutinies and one acquisition.

#### ***The Mutinies***

American International Group (AIG), one of the leading aviation insurance underwriting facilities, welcomed the New Year by losing a large number of management and underwriting personnel to American International Aviation Agency (AIAA), a managing general agency owned in part by Hank Greenberg, former CEO of AIG. This change affected not only AIG's United States Aviation Division, but AIG United Kingdom (UK), as well.

At approximately the same time this shake-up was taking place at AIG, the west coast underwriting staff of XL Specialty Insurance Company resigned and joined W.R. Berkley Company, leaving the west coast office of XL Specialty temporarily un-manned.

Both AIG and XL Specialty are extremely strong insurance companies and very resilient. Both are quickly repositioning themselves, re-staffing and continuing operations. In a recent discussion with one of AIG's senior managers, it was quite apparent that all systems are "go". This is good news because the aviation industry simply cannot afford to lose another underwriting facility.

AIG offers aviation insurance products to the entire industry, from general aviation to airlines. Due to AIG's size and scope, we expect to see no noticeable change in the service it provides its agents.

XL Specialty is principally focused on corporate non-owned liability, space, satellite, and airline business. XL Specialty serves the general aviation industry through an underwriting agreement with W. Brown, one of the industry's most respected managing general agencies. Because of W. Brown's dominance in their market niche, the general aviation consumer will notice no interruption in XL Specialty's service.

### ***The Acquisition***

Aerospace Insurance Managers was sold in its entirety to an investment conglomerate, Hallmark Financial Services. We are told that all personnel including managers and underwriters will remain with the company. No changes should be seen in Aerospace's market capability or service to its agents. This was virtually a non-event for the aviation insurance consumer.

Although these early 2006 market changes were exciting to the aviation insurance insider, we see no real impact in market capacity for 2006 and beyond. Then why are these changes noteworthy? Because of what could have been. Because general aviation insurance consumers dodged the proverbial bullet – three of them really. One possible outcome of these changes could have been the concurrent disappearance of three aviation insurance markets. A significant percentage of our market capability could have been lost. As it turns out, each company has rallied and will remain virtually unchanged to the industry and to the ultimate consumer. We may, in fact, see a small increase in capacity in certain underwriting sectors due to the emergence of the AIAA and W.R. Berkley facilities.

### **Aircraft Types**

#### ***Light Single Engines***

We're seeing no significant increase in premiums. In fact, a number of insurance companies have automated the underwriting and rating of small pleasure and business aircraft, streamlining the quoting process with a user-friendly online computer program for agents. This automation helps to reduce handling cost at both the company and agency level. Translation: lower overhead cost equals more stable premium cost for the owner.

#### ***Piston Twins***

This market is active. We are receiving numerous requests to quote insurance for the transitioning multi-engine pilot. There are, however, very few underwriters willing to underwrite inexperienced multi-engine risks. Commercial use of piston twin-engine aircraft is difficult to insure and if placed, high liability limits are nonexistent.

#### ***Single Engine Turbines***

Market remains positive. Underwriter receptivity is especially strong for the TBM and the PC-12. During the mid 1990s, underwriters were taking a "wait and see" attitude toward the single engine turbine. By 1998, a plan was developed by the West Coast distributor for the TBM 700, Terry Winson, for the transition of low to mid-time pilots into the TBM. This, coupled with SimCom's commitment to Socata and their development of the first TBM simulator, was a major turning point for the single engine turbine in the eyes of the underwriting community.

Today, with a proper transition-training program, the single engine turbine aircraft is very acceptable to the underwriting community as a whole, and very desirable to some insurance companies. Although we have

seen the average hull rate in this market sector decline over the past several years, it seems to have bottomed out and stabilized.

### ***Corporate Aircraft***

Good news! Renewal premiums are flat to slightly down. In addition, we are seeing the availability of higher liability limits.

### ***Older Aircraft***

Loss ratios for the older aircraft market segment have exceeded 400% for some companies. This is why we are seeing several underwriting trends significant to the aviation insurance consumer. Probably the most noteworthy is a reduced appetite for older aircraft, whether piston, turboprop or jet. Several key underwriters are making efforts to gradually reduce their older aircraft books of business. USAIG has held this posture for some time and is now joined by another industry leader, Global Aerospace. This may be just the beginning of a trend, as other underwriting facilities remain open to older aircraft.

### ***Very Light Jets (VLJs)***

We are frequently asked if the VLJ will be insurable. The answer is yes, BUT...

The Eclipse is poised to be the first production VLJ to be delivered sometime this year. The Eclipse public relations people have done a great job of introducing their new aircraft to the underwriting community, and have stated they have a commitment from underwriters to insure this new generation aircraft. Willis Global Aviation has even published premium quotations for the Eclipse on their website. When reading this you are led to believe that AIG and Global Aerospace offer these rates through an exclusive program for Willis. When questioned, AIG acknowledged publishing insurance rates provided the pilot is trained by Eclipse through their manufacturer's approved pilot training program. Global Aerospace confirmed that they would accept and price the Eclipse on a case-by-case basis. The posted rates I have seen were quoted strictly by AIG underwriters. Most underwriters will reserve judgment in underwriting each submission individually. This just makes sense. Certainly, any good underwriting risk must start with a good aircraft. Regardless of aircraft type and technology, piloting skill and experience is of importance when underwriting a risk. Is the VLJ insurable? Absolutely. But any aviation insurance risk must be underwritten with attention given to pilot qualifications, training, and other underwriting information specific to the risk.

Transition training? Yes, Eclipse has developed a strong program, but no training program will completely level the playing field of pilot capability. In the eyes of the underwriting community, there is no substitute for experience and basic ability.

Does Willis Global Aviation have an exclusive program with AIG Aviation or Global Aerospace? Do they have a corner on the VLJ market? No. They have done an enviable job of early publicity. Any aviation insurance company that will quote the Eclipse, Mustang, Adam, or any quality new generation aircraft will quote it for any insurance agency with whom they are contracted. At this writing, we know of no exclusive program for the Eclipse.

You can stay with your present aviation insurance agent and insure your new VLJ. Rest assured, there are no special deals.

### ***Are There Problem Areas?***

You bet. There are still aircraft that have a limited number of available markets, such as the Mitsubishi MU-2, the Aerostar, and the Merlin. Underwriters continue to welcome with open arms the traditional “fair-haired maidens” of the industry including Citation jets and the King Air line of turboprops.

### **Aircraft Uses/Operations**

#### ***Turbine & Jet Single Pilot Operations***

Many underwriters are beginning to increase their demands for a two pilot crew in the turboprop and jet market sectors. Certainly we can still place single pilot risks but the surcharge is mounting. Higher liability limits than have been available in the past are now accessible for single pilot operations if you are willing to answer some questions and open your wallet. In order to quote these higher liability limits, underwriters now require more information about high-density airport operations and equipment on the aircraft, including the Traffic Collision Avoidance System (TCAS).

#### ***Instruction and Rental***

Flying schools and rental operations that operate older equipment continue to rack up losses and be hard hit by the underwriting community. There are few underwriters who will accept these types of risks, and the pricing continues to be firm. Flying school losses continue to cause distress among underwriters. In most cases, we can attribute these high loss ratios to poor management practices and failure to control and manage pilots (both instructors and renters). This is especially true for flying clubs.

The larger flying schools that operate new, state-of-the-art equipment tend to be better managed and better maintained. In this environment, losses are few and the underwriting community is more forgiving.

#### ***Commercial Operations***

In general, commercial operations continue to be high premium but stable. We are seeing improved loss experience in the ground hangarkeepers sector. Claims are down for products liability at the manufacturer’s level. But products liability and completed operations exposures continue to rack up lawsuits at the maintenance shop and the FBO level. As a result of this claims activity, we continue to see a somewhat restricted availability of high liability limits.

Our legal system is out of control. Regardless of the cause of a loss, those involved in maintenance, line service, or aircraft sales are routinely being named in products liability and completed operations lawsuits. To further exacerbate the problem, we’re seeing unrealistic claims settlements on operations found negligent.

And then you have the contingent liabilities. The two primary contingent liabilities are loss of use and diminution (loss) of value as a result of damage history. The high costs of contingent liability settlements are pushing loss ratios to new highs among the ground liability driven risks.

Why is the cost of the FBO’s insurance important to the aircraft owner? Think about it. If your service center pays more for their overhead expenses, they must pass it along to you, the consumer.

#### ***Fleet Operations***

Single fleet type operations (having only one or two kinds of aircraft) reduce challenges in the area of training pilots as well as maintenance personnel. In addition, the trend among underwriters seems to be

that charter operations with younger fleets and state of the art equipment will receive the most favorable treatment in both pricing and underwriter acceptance.

Many underwriters have discontinued offering monthly reporting policy forms for aircraft fleets. This lack of availability of monthly audited policies has added to the difficulty of accounting for large, highly transitional aircraft fleets such as sales demo and active charter operations.

When asked why the move away from monthly reporting forms, the insurance companies simply state that they want the investment benefit of annual insurance premiums. They fail to consider the increased workload in the accounting and underwriting sectors for the client, the agents and their own underwriting offices. They give no thought to what is best for the client or the agent. I know this sounds like just another insurance agent whining about the mean old insurance companies, but I do get the feeling sometimes that decisions are made not in the underwriting branches by those who best understand the client, but in some obscure home office back room by “bean counters” who have little knowledge of the industry they serve.

Boy, I'm glad to get that off my chest!

### **Optional Coverages**

#### ***War Risk Hull and Allied Perils***

Enough time has now passed that the London war risk underwriter has recovered his anticipated loss from the September 11th attacks. Rates for war related coverages have returned to pre-2001 prices. Some companies including Global Aerospace and USAIG are pricing non-commercial War Hull rates at two cents. This is a .02% rate or \$200 per \$1,000,000 of hull value. Others range from five to seven cents to a high of twelve cents. In short, War Hull coverage is very much worth the cost if for no other reason than the confiscation and seizure coverage that is included in the twenty-eight perils of the War Hull and Allied Perils coverage form.

#### ***Mexican Liability***

This is one segment of the insurance industry that is in constant flux. If the Mexican government isn't changing the rules, the Mexican insurance companies are. The U.S. insurance companies are at Mexico's mercy when trying to offer a Mexican policy issued by a Mexican insurance company to its U.S. insurance customer. In fact, most aviation insurance companies make no profit on this service and only pass through the direct cost of the Mexican insurance to the client.

Today, many of the U.S. companies have lost their master certificates with the Mexican companies. This has resulted in these companies discontinuing this service. In many cases, it now falls to the agents/brokers to approach Mexican facilitators for the coverage. The results are the same for the insurance buyer, but Mexican insurance can be a bit more expensive and it can take longer to have the Mexican certificate issued. Don't wait until the last minute to buy your coverage.

They say no good deed goes unpunished and that certainly is the case here. The only mission the U.S. insurance company has is to help their clients stay legal when traveling south of the border.

#### ***Excess Liability***

Excess liability continues to be offered by only one market. The Menger facility offers the pleasure and business and industrial aid client the ability to purchase \$4,000,000 excess liability over a \$1,000,000

primary limit of liability totaling \$5,000,000. If you can buy \$2,000,000 in the primary, Menger will offer a maximum of \$6,000,000 excess totaling \$8,000,000.

Although somewhat restrictive and rigidly underwritten, the Menger facility is a true blessing for the light aircraft owner. It is often the only source for increased liability limits in an industry where liability limits really count.

### **Effects from the 2005 Hurricanes**

We continue to receive questions asking for predictions of future underwriting trends due to Katrina and the other hurricanes in 2005. At this point we have seen no change, but would not expect to until 2007.

Treaty renewals (reinsurance contract renewal) generally occur on January 1st, with trailing renewals in July. As of January 1, 2006, the full calculations and assessment of damages and underwriting reserves for Katrina and other storms in 2005 were not yet tallied. There's no question that these storms and heavy underwriting losses could affect all market sectors including aviation. At this point, any firming of the market seems to be tied primarily to loss trends within the aviation community with no outside influence.

### **New Aviation Product**

Accidental Death insurance is now available for pilots age 60 and under. It is very inexpensive and solves a real problem employers have in offering death benefits for corporate pilots, especially pilots of small firms. An added feature is the total portability of this product. If the pilot flies for someone other than his primary flying job, this product pays. If the pilot is killed accidentally while involved in any activity other than flying that is not specifically excluded, it also pays.

This new product is low cost and is available exclusively through the Employee Benefits Division of Chappell, Smith & Associates, Inc. dba CS&A Insurance (800-999-1109).

### **Future Trends**

We cannot say that the aviation insurance market is on an increase. In most market sectors it seems to be fairly flat to slightly down. Premium increases are certainly being seen in some of the more stressful sectors as mentioned above. In short, however, your next insurance renewal should be a pleasant one. →