Aviation insurance

What you don’t know could cost you big money

by Chad Trautvetter

“If you think the premiums are expensive,” said aviation underwriter Bruce Carman, “then try covering a loss.” Carman, who specializes in aviation war insurance at Atrium Underwriters, spoke these words at an aviation insurance conference last month. He was mostly preaching to the choir—the room, after all, was full of flight departments that own their own workers’ compensation policy separate from their own workers’ compensation policy separate from their parent firm to avoid an across-the-company rise in this insurance due to the riskier aviation exposure, according to Mike Elliott, a broker at Blais Aviation Insurance Services.

Flight departments that own their hangars and/or have a fuel farm should also consider coverage for these aspects of their operations, as should FBOs, maintenance operations and other aviation ground-services companies. Here, building and property damage liability and, especially, environmental liability should be considered, noted NationAir Aviation Insurance president Jeff Bauer.

“Environmental policies are excluded from aviation policies, so a separate policy might be needed for a fuel farm,” he said. “FBOs or your airport will specify coverage requirements.”

One director of a Midwest-based flight department that has a fuel farm told AIN that his operation has a $40 million environmental liability policy. “However, with today’s regulations and tank design, as well as monitoring, we feel we are safe from spills, so we have a $1 million deductible,” he said.

There is also specialty coverage available. One such example is war hull insurance, which covers your aircraft asset against terrorism, vandalism and seizure/confiscation. If your aircraft is financed, the bank will require war hull insurance, but probably not for the reasons you’d expect. “It’s not because of terrorism,” Elliott said. “Primarily, they want the coverage in case the aircraft were to be seized.”

The aviation insurance industry does not operate in the same manner as auto or home insurance. Those with business aircraft cannot simply call one of the aviation underwriters directly to get coverage. In a thinly veiled reference to Geico, one aviation insurance broker, who didn’t want to be identified, quipped, “There aren’t any lizards in this business.” If you want aviation insurance,

then you’re going to have to use a broker.

While brokers can be viewed just as middlemen who collect insurance commissions, a good one can be the insured’s best friend—so be sure to choose wisely. “Be sure to ask questions when choosing a broker,” said NationAir broker Gregory Reba. “What’s their experience with your aircraft type?”

Brokers help those buying insurance navigate the complex system to get the best rates and/or best coverage. So don’t think of the broker as costing you money, but rather as someone who will likely save you money for the coverage you need. The important thing to remember is that a broker works for you, not the insurance underwriters.

Brokers will first gather as much information about your operation—pilot qualifications and ratings, aircraft flown, safety culture, type of operation and where you fly, and so on—and then communicate these details to the more than one dozen aviation underwriters. “A broker’s job is to market you to the underwriter,” noted Reba.

The underwriters will use the information provided by the broker to determine the level of risk your operation poses and whether they want to underwrite that risk. If they determine your operation to be an acceptable risk, they send a quote to the broker.

A good broker will be able to compare and contrast the returned quotes for you, not just on pricing but, more important, from a coverage standpoint. “Sometimes I recommend a more expensive policy with better coverage for the client,” said Blais’ Elliott. “It’s about coverage and price, not just price alone.”

The pool of aviation insurance underwriters includes Aerospace Insurance Managers; Allianz Insurance; Berkley; Chartis; CV Starr; Global Aerospace; London Aviation; Phoenix Aviation; Specialty Aviation Underwriters; US Specialty; USAIG; W Brown Associates and XL Specialty.

A newcomer to the U.S. general aviation insurance market is QBE Aviation, a 125-year-old Sydney, Australia firm that has been writing aviation policies in Australia, Asia and Europe for many years. According to Elliott, QBE is interested in writing policies only for business aircraft up to midsize jets.

And another new entrant could be coming to the U.S. aviation market. “Swiss Re is rumored to be entering the business for aviation underwriting in the U.S.” Elliott told AIN. But unlike QBE,

Weather-related incidents can result in insurance claims, as attendees of this year’s Sun ‘n’ Fun Fly-In in Florida learned. The annual event was interrupted by a tornado that touched down at the show site and damaged more than 60 aircraft.
Swiss Re is interested in taking bigger risks, meaning it would write policies for midsize to large-cabin business jets. If it does enter the market, Swiss Re would pick up where QBE trails off.

All of the underwriters use reinsurance to some degree. Reinsurers allow the underwriters to spread their risk. “Think of reinsurance as a pebble being dropped into the water, with the ripples going outward diminishing with distance,” said one broker. “Like the ripples, the more the risk gets spread out, the less the capital outlay there is for insurers if there is a loss.”

### Where Are Rates Headed?

The aviation insurance market typically works on a seven- to 10-year cycle, according to NationAir’s Bauer. And 2011 was expected to be the end of the current cycle, which meant that rates were expected to go up this year. Fortunately for aircraft operators, that didn’t happen. “Aviation insurance has been in a soft cycle since 2005,” Bauer told AIN. “Underwriters lost money last year, so we expected rates to go up.

The current cycle started in 2000, when the market became “hard,” he explained. “After 9/11, the market got really hard for three years.” But losses also went down after 2001 due to lower flight activity, while rates remained high as supply decreased as some insurers bailed to reduce their aviation risk exposure.

This set the stage for the remaining aviation insurers to be highly profitable. Underwriters not in the business then saw this as an opportunity to jump in and make money, Bauer said. Allianz entered the market in 2004, soon followed by CV Starr and then by some smaller players, including Travelers. (Travelers left the aviation market after three years.)

“What happened is we had static demand but huge supply in aviation insurance,” Bauer said. “So prices dropped in 2005 and have been substantially down since then.”

The aviation insurance industry expected to reach the bottom floor last year, with rates increasing this year. However, QBE entered the market in February, increasing supply during a time when demand has slid as some operators have closed or scaled back operations. “Less demand and a new entrant means low rates,” said Bauer.

In fact, all of the brokers and underwriters contacted for this article termed rates for business airplanes as “stable.” According to Elliott, some operators might see slight increases, while others see slight decreases. However, Bauer said that rates for helicopters did rise this year.

Recent natural disasters in Asia and Latin America could affect insurance rates, noted Graham Barden, a specialist aviation insurance broker at Lockton. Underwriters estimate that the losses created by natural disasters in Chile, Japan, New Zealand and Australia are in the region of $60 to $70 billion, but with events still occurring the figure for the year could top $100 billion. “Any series of disasters causing this much loss will inevitably put insurance premiums up for similar coverage in the future,” Barden said. “While the aviation insurance market loses for these events have not been particularly high, it is likely that increases in other classes of business will have a knock-on effect.”

At Sendai Airport in Japan, about 30 military aircraft were damaged by the tsunami. In addition, Barden said, a number of general aviation aircraft were affected, including Piper’s, Cessnas, Beechcraft and Eurocopters. Also, two Boeing 777s belonging to JAL and ANA sustained minor damage. “I understand that these aircraft are likely to be covered by the Japanese Aviation Pool, so it is difficult to put a total loss figure on the aviation damage caused by the Japanese earthquake and tsunami at this stage,” Barden told AIN.

### Hot Issues

Several hot-button issues for operators have roots in aviation insurance. This list includes risks of over-insuring aircraft, safety management systems and contract pilot insurance coverage. And then there’s the unusual issue that came up recently in Japan—does insurance cover flight into or over radiation plumes?

At face value, over-insurance seems to be a problem only in that you’re likely to be paying too much in premiums. While that’s certainly true, there is also a hidden risk, according to aircraft sales broker Jay Mesinger of J. Mesinger Corporate Jets. “If you over-insure on the aircraft hull, insurers could decide to fix your aircraft rather than write it off if there’s a loss,” he warned.

This means that if you insure your $20 million aircraft for $30 million and it incurs $18 million in damage from a hangar collapse, then the insurer will likely repair your aircraft. If it had been insured for the current value of $20 million, then the insurer would most likely have written off the aircraft and sent you a $20 million check to buy a replacement aircraft. So when you over-insure your hull, you’re not only paying too much in premiums, but you could get stuck with owning an aircraft with damage history that has a commensurate lower value, said Mesinger. “It’s important to align your hull insurance with the aircraft’s current market value,” he advised.

But those who bought and financed an aircraft in 2008 during the market peak are forced by the bank to over-insure their hull. The banks want coverage equal to the outstanding loan amount when a typical 12-month aviation insurance policy is written. Aircraft values have dropped considerably over the past three years, leaving some aircraft owners “underwater,” meaning they owe much more than the aircraft is worth.

These operators are most at risk for having their aircraft repaired, instead of written off, should there be a loss. However, Elliott suggested that over-insured operators who experience a hull loss should try to negotiate with the insurer. “If your $20 million aircraft is insured for $25 million and you have a loss that would normally be written off if you were insured for the current value, negotiate with the insurer—perhaps they’ll meet you halfway by writing it off for $22.5 million,” he said. “You’ll lose a little bit of money, but you’ll come out of the situation with a replacement aircraft with a clean accident history.”

Another topic that came up in conversations with aircraft owners, aviation brokers and underwriters is safety management systems (SMS) and International Standard of Airline Operations–IS-BAO registration—the big question is if having SMS or IS-BAO qualifies operators for a discount on insurance. “If you’re looking for a percentage discount, then the answer is no,” said Bauer. “Aviation insurance just doesn’t work that way.”

What SMS or IS-BAO does do is show an insurer that your operation has a good safety culture. “But a good safety culture can be demonstrated to insurers in other ways besides having SMS or IS-BAO,” Bauer said. This is why it’s important to work with your broker who is willing to find out everything about your flight department and then communicate this to the insurer. “The more the insurer knows about the good things about your operation, the better your rates will be,” he added.

Contract pilots are another issue that companies are concerned about. “Aviation insurance policies that are written with an open-pilot warranty in their aviation insurance policies can add qualified contract pilots to their operation without having to contact the broker or insurer, their coverage under workers’ compensations insurance is the murky part.”

For workers to be covered by a company’s workers’ comp policy, they need to be on the payroll. Contract pilots, especially ones engaged on short notice, are typically not on the payroll. So if a contract pilot is injured while prelighting the aircraft, he might not be covered under your policy and the company could be directly liable for his loss.

There are two lines of defense here, according to insurance brokers. One is to hire only contract pilots who have incorporated as their own business or work for a contract pilot placement agency—these pilots will be covered by their employers’ workers compensation policy, eliminating the gray area.

Another option, according to Elliott, is to put the contract pilot on the payroll. “HR departments can get really creative,” he said, “so they will likely be able to find a way to add a contract pilot to the payroll.”

An unexpected issue arose a few months ago when the earthquake-damaged nuclear plants in Japan started to send radioactive plumes into the air, thus posing a potential hazard for aircraft. All aircraft hull and liability policies contain a “Radioactive Contamination or Nuclear Risks” (RCNR) exclusion clause in some form, Barden said. “And the nuclear exclusion clauses remain paramount on aviation policies and are not overridden by any other exclusions.”

The RCNR exclusion states that the policy does not cover loss or damage to the aircraft or any legal liability that can be directly or indirectly attributed to a number of radioactive situations—and the radiation from the damaged nuclear reactors in Japan falls into this category. According to Barden, the RCNR exclusion applies both to loss and damage to the aircraft, and also to liabilities of anything or anyone if the nuclear fallout or contamination is found to have been the proximate cause of the loss or claim.

Additionally, Barden said aircraft policies normally contain certain “conditional precedent.” These conditional precedents are conditions with which the insured must comply before coverage is granted. “Failure to do so will allow insurers to void the policy,” he noted. “These conditions state that the insured has to at all times use due diligence to avoid accidents and to comply with all air navigation orders.”

Flying through or close to plumes of radiation is a known hazard with foreseeable consequences that fall foul of the conditional precedent. As a result of these exclusions, insurers would be able to void any aviation policies if they became aware of such a breach.

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Insurance survey sheds light on industry’s most costly claims

by Curt Epstein

Newly hired general aviation industry workers are most at risk for suffering on-the-job injuries, according to a study released recently by United States Aviation Underwriters (USAU). In an attempt to categorize the areas where most injuries and worker-compensation claims occur in the GA industry, USAU studied the last 10 years of insurance claims from its clients. USAU manages the pool of insurers that make up the United States Aircraft Insurance Group (USAIG), the nation’s largest aviation insurance organization, which has provided coverage to the National Air Transportation Association’s workers’ compensation plan since its inception in 1975. As a result, USAU was able to draw upon thousands of claims from participating NATA members in its study—ranging from FBOs and charter operators to airport authorities and MRO providers—and divide them into categories such as the overall most expensive and most frequent types of accident from the viewpoint of workers’ compensation.

“We did it because we wanted to make NATA members aware of the types of claim they are having,” said John Matthews, senior v-p at USAU. “We want to draw attention to where the claims are coming from, and also to let them know that we are there to partner with them to find ways to control those losses.”

Compensation Claims

The overwhelming majority of claims and claim values come from newly hired workers. “What’s surprising here is that if you happened to be on the job for less than a year, you’re the person having all the claims,” Matthews told AIN. “It didn’t make a difference if somebody had worked someplace for 10 years; when they went to a new place and they were working for a new company for less than a year they were having claims also.”

To combat this, Matthews emphasized, all employers should make sure their new employees are properly trained in their duties and are assigned additional responsibilities only once they have demonstrated proficiency. “You can’t treat people who have been there for two months in the same fashion as people who have been there five years just because they’ve performed well to that point,” he said. Industry programs such as NATA’s Safety 1st are aimed at identifying areas where new employees could falter. “It all comes back to training,” said Matthews.

While the study includes dozens of accident types resulting in injury claims, the single most expensive category of loss for the 10 years of the study (approximately $20 million) came from airplane crashes. This was nearly 72 percent higher than the next closest category, injuries due to lifting. The top 10 accident types accounted for approximately 70 percent of the most expensive claim types.

While aircraft crashes were clearly the most expensive, their cost was out of proportion to their frequency of occurrence, which ranked at 32nd place on USAU’s list. In terms of the number of claims in the study, those resulting from more mundane tasks such as lifting were predictably the most common.

In addition to protecting employee health and curbing lost productivity hours, USAIG customers have an additional incentive to promote on-the-job worker safety, according to Matthews. The NATA workers’ compensation program has grown from 76 members at its inception in 1975 to more than 800 today. The program was designed to provide NATA members with a stable long-term market for workers’ compensation insurance and was structured so that if the overall loss experience of the participating members was favorable, all program participants would receive a “good experience” premium at the end of the year. Since its start, the program has returned $75 million to its customers.