

# Feature: Pricing after an aircraft accident

---

JoAnn De Luna

26/07/2010

When an airline has a crash, it does not only affect its own insurance price, but also it could affect prices for the entire industry. Lead hull and liability prices rose by 124% after the terrorist attacks on the US on September 11 2001.

"You had every aviation policy in the world cancelled because underwriters wanted to change the conditions on the policy, and the only mechanism they had to do that was cancelling the policies and re-issuing them," says Paul Hayes, a safety director, Ascend.

That is an extreme case. However, the Air France commercial flight 447 from Rio de Janeiro to Paris in June 2009, also made insurance prices rise quickly. The reasons for these price hikes depend on a number of factors.

An airline's accident history plays a role, but brokers and loss adjusters say costs can vary significantly based on an insurer's perception of risk, which is influenced by factors such as geographical area, fleet make and size, among other factors. Pricing is also influenced by how many insurance providers are in the market.

## Improvements in air safety

As of May 31 the International Air Transport Association (IATA) has recorded a total of eight fatal accidents and 413 fatalities for 2010 for both IATA and non-IATA members combined. Africa leads with 13.88 hull losses per million sectors so far this year, with Latin America following - yet trailing far behind - with 2.40 hull losses per million sectors. In 2009 there were 18 fatal accidents recorded, and 23 in 2008. IATA says accident rates have improved by 36% in the past 10 years.

Aon data covers incidents that are valued at \$1 million or above and involve western-built aircraft. Magnus Allan, an Aon aviation analyst, says 2009 was an expensive year driven by a small number of major losses totalling \$2.3 billion, compared with \$1.5 billion in 2008. The total number of incidents for 2009 was 59, while there were 72 in 2008.

This year has improved with only 16 accidents totalling \$458 million in losses reported to the end of June, compared with \$1.3 billion for the same period in 2009. Of those 16 incidents, two are likely to have a preliminary value of more than \$100 million.

Allan says improvements in technology and efforts to increase safety standards from organizations such as IATA have also contributed to preventing accidents. In 2004 the Federal Aviation Association in the US approved IATA's Operational Safety Audit (IOSA) programme that first launched in 2003. IOSA is an internationally recognized audit that assesses the operational management and control systems of airlines which is carried out by IATA. All IATA members are required to complete the audit.

"There is always a potential for catastrophic incident in the airline industry, but generally the number of incidents are falling and fatality rates are improving - as these factors improve and insurance underwriters are responding," says Allan.

## How to buy it

Airlines can purchase insurance through an insurance broker who will go to the market on behalf of the airline and get the coverage needed. While airlines have the option of buying insurance for individual assets, they normally choose to insure entire fleets.

Carriers can divide their fleet splitting it between Boeing and Airbus aircraft, or widebodies and single-aisle, or western- and eastern-built aircraft. In the US smaller airlines insure their fleets with a larger carrier to get lower insurance prices.

"In North America you have a lot of regional organizations insured through the major flag carriers," says Allan.

Insurance companies will accept new policies at any time during the year, while renewals are common towards the last quarter of the year.

Policies are for 12 months, with possible extensions, and will normally have a maximum hull value limit.

Airlines are allowed to add or delete aircraft throughout the life of the policy depending on whether they are expecting deliveries later in the year or are planning to cut capacity. The new value will then get averaged out. In such occasions airlines should give the insurance company notice beforehand or at the time of negotiating the policy.

"The only thing to watch for is that there will be a max hull value limit on the policy at inception. So if you're adding an aircraft which happens to have a value higher than the agreed maximum, you have to adjust that as well," says Paul Hayes of Ascend.

## **Passenger, war and violence liability**

This all-risk insurance not only covers the asset, but also passengers and third parties in case of an accident, damage, injury or death. Hayes stresses that insurance policies are policies of indemnity and are not an attempt to value human lives.

"The insurance is intended to put you back in the same position as before the loss," he says. "If you're paying for death or injury to passengers, it's not an attempt to value a human life - it's beyond price - but to indemnify the people depending on his or her support."

John Trevett, director of Flight Safe, a company that advises international businesses and intergovernmental agencies on managing travel risk, says a big uncertainty in pricing insurance is the liability, because there is an enormous potential for losses on third parties.

"Most cases gravitate to the American courts because that's where the biggest claims are all ordered," he says.

Under the AVN (aviation) 48 clause, all-risk policies automatically exclude war and deliberate acts of violence such as terrorism, riot, civil commotion or arson. The International Underwriting Association and Lloyd's of London Market Association issue the clause.

In order to be covered for the above, airlines need to buy a war-hull policy that covers the airline for most of the things excluded in the all-risk policy. The war-hull policy will not cover passengers or liabilities to third parties. However, under the AVN 52 clause - and for a premium - insurers will accept the liabilities for passengers and third parties back on the policy.

"So, one clause excludes that liability and then they accept most of it back at an additional premium," says Hayes.

## **Pricing**

Analysts are hesitant to give exact prices for policies as they vary greatly from airline to airline and it comes down to an insurer's perception of risk.

Hayes says a big airline with a few hundred aircraft and with a good loss record may pay about 0.05% on the value of the aircraft hulls and perhaps 40 cents or 50 cents per passenger. For example, an airline with a couple of hundred aircraft, based in either the US or Europe, with an average fleet value of about \$10 billion or \$11 billion that carries about 50 million to 60 million passengers per year should expect to pay about \$35 million.

"But the cost can vary by a couple of orders of magnitude depending upon the type of operator, its loss record, how underwriters see the risk and so on," says Hayes.

The price changes if there are changes to the fleet. In this instance the average fleet value will have to be re-evaluated and pro-rated for the rest of the year. Some of these other influencing factors include how the aircraft are cared for, the make and size of the fleet and where the carrier operates.

## **Insurance Market**

Allan says one of the biggest factors that influences insurance costs is the capacity in the insurance market. There are fewer providers today than 20 years ago. The insurance market eventually softened after the September 11 2001 terrorist attacks as the perception of risk weakened and prices fell by 17% in 2006 and 11% in 2007.

The falling prices, coupled with the challenging economic conditions, meant that underwriters became less willing to take risk. This resulted in rising prices in 2008. This year the increases have not been as steep because the 20% increase that was added in 2009 has satisfied the market's perception of risk, according to Allan.

"Despite the aviation market overall being likely to have made a loss last year, there is more insurance capacity and insurance prices are rising by between 5% and 10%," says Allan.

Similarly, Trevett says an aircraft accident does not influence an airline's insurance costs much because the insurance market is weak with only a few underwriters.

"Many insurance deals are based on different brokers trying to do the same insurance deal with the same underwriters," says Trevett. "So it almost becomes a beauty parade of brokers eager to do the deal."

## When accidents happen

The payout an airline receives is agreed at the start of a policy. In the case of an accident, the insurance provider or broker will decide whether the claim is valid - for example determining if the aircraft is damaged beyond repair. If it is, then the insurance pays. This differs from car insurance, because motorists will get the market value of the car, which can be less than what the owner originally paid for it.

Hayes says an airline's insurance price may increase about 20% to 30% for the next two or three years after a crash, but again he emphasizes that this varies from airline to airline.

Allan says insurance costs are affected depending on the cause of the incident, how the incident was handled and, most importantly, what the airline has done to prevent crashes from re-occurring.

"When underwriters examine an insurance programme, they don't just look at what's happened historically. They also look at the likelihood of it happening again," he says.

Unlike with car insurance, an operator is not necessarily granted a reduction on their insurance if it has not had a crash within a certain number of years. However, having a good safety record does place the airline in a better position to bargain for better pricing.

Low-cost carriers generally have a good safety record, because their geographic coverage is less than larger carriers. Trevett says insurance companies can more easily define their risk. In contrast, cargo airlines have bad crash records, so may be paying more for insurance.

"For any business dealing in millions and billions of dollars, things are never simple," says Hayes. "The outline may be simple but variations can be very sophisticated."

On an individual airline basis, crashes are rare. Organizations such as IATA are improving measures to make flying safer. Insurers and brokers will take that into consideration when pricing insurance. An airline's safety record is important, but insurers understand that incidents happen. What matters most is that the airline has taken steps to prevent them from happening again.

[ideluna@euromoneyplc.com](mailto:ideluna@euromoneyplc.com)

*Thank you for printing this article from Airfinance Global, your essential intelligence resource for aviation finance. If you have been given this article by a subscriber, you can contact us through email at [accountmanager@airfinanceglobal.com](mailto:accountmanager@airfinanceglobal.com) or call us on +44 (0)20 7779 8015 to discuss our subscription options.*