

Emerging from the global financial crisis: Flying out of the storm



The world economy is picking up again and it is expected that the aviation sector will likewise grow again especially in Asia, after a year of zero if not negative growth. **Mr Toby Palham**, Senior Manager – Aviation, Allianz Global Corporate & Specialty Division Allianz SE Reinsurance Branch, is positive about this growth but also notes the downward pressure on aviation insurance rates.

There is no doubt that the Global Financial Crisis (GFC) has had an impact on the aviation industry. Airlines have experienced a significant drop in passenger and cargo levels from pre-2008 years, aircraft orders have been cancelled, put on hold or delayed and the demand for business jets has slowed significantly.

2009 saw demand for business jets decline for the first time in five years. In the first nine months of 2008, approximately 1,000 jets were delivered. For the corresponding period in 2009 this reduced sharply to 620.

Potential growth in General Aviation market

The company jet was a status symbol of wealth and success especially in the US. After numerous government bailouts and company losses, board members who turned up in the company jet were heavily criticised. Consequently, the multinational and global corporations have scaled back their use of business jets in response to the GFC and public perception.

With the economy picking up again and the recent security scare over terrorism on commercial flights and the rapid response by airports for more thorough security measures (which are absolutely necessary) where one can expect longer check-in times and delays, business jet travel is once again proving to be attractive.

Business jet travel can offer a simpler process for the Global CEO and his management – they say time is money and by chartering or having your own jet, hours of delays can be saved. In addition, the company will be comforted by the increased security for their own high level management.

In fact, for individuals or corporations that have spare funds, now is the time to buy a jet as prices reflect the slump in demand and manufacturers look to offload surplus stock caused by cancelled orders.

We expect business jet demand to increase in 2011-12 as we emerge from the GFC. Asia will be one of the growth areas with specific focus on India and China reflecting the wealth creation in these two highly populated countries.

Competition for the aviation business

In contrast, the downward trend in insurance premiums for business jet insurance continues and we have seen rates reduce further in the past 12 months as many insurers consider this to be excellent business.

To a degree this is correct, as the corporate jet is often flown with very experienced pilots with specific time on the type of jet being flown (Citation, Global Express, Falcon,

Gulfstream etc). These pilots also undergo annual recurrency training on a simulator.

Incidents involving jets usually result in partial losses (minor frame damage, bird strikes, ingestion of foreign objects in the engine) and rarely involve a total loss. However, when a total loss does occur, insurers (who have made the insured a promise to pay out on a loss) are faced with a claim up to US\$50 million for the hull plus any liability exposure which with high worth individuals can also run into the millions of dollars.

Based on an average jet premium of between US\$100,000 and US\$150,000 (depending on the aircraft value and liability limit involved), this would result in a 400 year payback period before insurers recovered their money.

Business jet owners are currently enjoying extremely competitive pricing for their insurance due to excess market capacity and competition for this class of business.

Pilot shortages?

Two years ago, the airline industry was facing severe pilot shortages. Worldwide demand was running at 18,000 new commercial pilots per annum when only 15,000 pilots were being trained. In addition, around 24,000 new pilots are required per annum just to replace those retiring from or leaving the industry.

As a result, we were seeing an expansion of existing training schools and new ones being set up – both independent and in association with the airlines themselves.



A great deal of the aviation growth was expected to come from Asia, where Boeing and Airbus were seeing increased demand for their aircraft.

The GFC put a brake on this global airline expansion allowing the industry breathing space – a new pool of pilots became available as airlines filed for bankruptcy or merged their operations.

As the credit crunch resolves itself, economies pick up and airline passengers regain the urge to travel, the pressure for new pilots will return once business picks up in late 2010 and 2011. We will then encounter growth for pilots in India, China, Asia and the Middle East as well as other countries around the world competing for the same resource.

Insuring a pilot training school

From an insurance perspective, training schools are high risk prospects. The school usually takes in raw cadets with little or no previous experience who are lured by the glamour and rewards of being an airline pilot (a process that can take two to three years and thousands of dollars in fees).

Asia is a very cost effective location in which to train pilots – there are numerous schools throughout the region especially in the Philippines, Malaysia, Australia, Thailand and Singapore.

As an insurer, we are insuring students being trained with no experience (referred to as ab-initio instruction) and covering the school's aircraft up to where the pilot obtains his Airline Transport Pilots Licence (ATPL).

Even the best run training school will have incidents or accidents due to the fact that cadets are being trained and “accidents do happen”. What we look at as an insurer is the frequency and severity of losses, and how well managed the school is.

When rating a risk, we consider location, the experience of the instructors, past loss history and type of aircraft being used.

With the past expansion in training schools (and expected future growth), we are also concerned with the quality of the instructors being used as there have been shortages in this area as well.

New training aircrafts more costly to repair

Historically, a typical training aircraft used was the Cessna 150 (and then 172) or the Piper Cherokee/Arrow which are metal aircraft. When damaged, they can be repaired more easily and there are numerous accredited repair facilities throughout Asia to deal with claims.

Recently, we have seen a trend in a new generation of training aircraft (including the Diamond DA40 & 42 and the Liberty XL2) – whilst these aircraft have excellent cockpit visibility, space and all the new digital/navigational equipment, they are made from composite materials.

Therefore, in the event of an accident, the repair costs are significantly higher than with the older Cessna/Piper aircraft. Composite materials require special repair jigs and moulding equipment, and there are also very few repair facilities in Asia for these new generation aircraft. Often they will have to be sent back to the manufacturer in Europe or the US, adding to the repair cost and time in getting the repaired aircraft back to the school for further use.

General Aviation (GA)

The local Asian GA insurance market has established itself as a genuine market place with sufficient capacity to insure the majority of Asian GA risks. GA business refers to small-to-medium aircraft with up to 50 seats (or 30 seats if operating a scheduled commercial service), where hull values are smaller and the maximum liability limit required is around US\$500 million.



As a consequence, the rates for a flying school risk are significantly higher than a normal private risk and higher deductibles/excesses apply.

The insurance of these schools will be based on strict underwriting principles as mentioned above. It can be expected that rates for training schools will continue to remain higher than those for private individuals and with schools with adverse loss records paying much higher rates.

Conclusion

Air travel will pick up again in Asia where the prospect remains positive and with new aircraft deliveries, comes the demand for pilots – this will lead to the continued growth and expansion of the training schools. We will also experience expansion in the number of business jets owned in Asia.

We will continue to see downward pressure on business jets rates as highlighted earlier. Fixed wing commercial operation rates remain stable but for commercial helicopters, rates are seeing marginal increases as poor loss experience has affected this sector (especially in the oil offshore support sector and emergency medical services).

Allianz have insured a variety of risks from the training school to private individuals, commercial helicopter and fixed wing operators and business jet owners. Backed by Allianz Group's strong capital position and local expertise, we are well equipped to provide our producers and clients with comprehensive insurance solutions.▲