FOCUS/AVIATION

A sustainable aviation reinsurance market needs more than higher rates

After a long soft market and the coronavirus pandemic, carriers have to consider the implications of imposing higher rates at a time when passenger volumes and exposures are around 50% of that experienced in 2019

David Bell
Gallagher Re

The grounding of Boeing 737 Max planes generated huge losses for aviation insurers
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As we journey through November, attention inevitably turns to the January 1 renewal season and predictions about how reinsurers will react and respond to the multiple market dynamics that continue to play out.

Are we set for clearer skies in 2022 in terms of pricing, premium, exposure and profitability or will new clouds of challenge take shape to obscure the outlook? The market tensions continue from a prolonged soft market and the largest loss in history, driving demand for higher technical rates, set against a global pandemic that has had a devastating impact on the underlying aviation industry and its ability to dramatically increase total market premium.

If we take catastrophic losses first, with no further deterioration in the development of the Boeing 737 Max losses experienced since October 2020, we should see aviation reinsurers refocus their previous spotlight on the impact of these compared with previous renewal periods.

At the same time, we are seeing increased airline premium forecasts, with continued improvement in expected travel numbers, including those related to the reopening of the US/UK tourist travel corridor on November 8 after a 600-day stop. With rates still rising in other aviation segments, client premium income should be increasing.

Does that mean January 1 will present an opportunity to increase rates? Will the Boeing losses enable carriers to drive for higher base rates or are there dangers ahead in pressing for more now when passenger volumes and therefore exposure are still only around 50% of that experienced in 2019? Moreover, what future factors might emerge as new challenges to clear skies?

Proportional covers

The question of pricing adequacy is inevitably answered differently by different market players. If you are talking to reinsurers such as Swiss Re and Hannover Re, which offer comprehensive proportional and non-proportional across all aviation segments, their view will likely differ from that of a non-proportional specialist, such as Lancashire or Atrium.

Proportional contracts should be showing a continuing positive impact from reduced flights, with a decrease in attritional loss total, as well as a dramatically better large loss figure than in 2020, with only one commercial jet loss so far in 2021. In addition, total premium will be up. This means reinsurers should continue to offer attractive ceding commission levels to key clients as results and near-term exposure outlook will be favourable and will allow some advantage with maintaining shares on the accompanying excess of loss layers.

As regards non-proportional covers, markets may desire more premium but they will be under pressure to take less of any pure premium lift and less of any income coming from increased exposure, especially with the larger clients. Maintaining increased rates may be easier to achieve for reinsurers when it comes to smaller clients but with actual large loss level exposure still being suppressed by the sustained effects of the pandemic on passenger traffic, we would be surprised if not all clients were pushing back hard against this argument.

These discussions will also be set against a backdrop of some uncertainty as to what rates or share of market income reinsurers will be technically targeting when full flight levels return later in 2022/23, as well as what price increases insurers could realistically apply to clients that are still in a battle for economic survival. In addition, with most reinsurers experiencing a truly challenging 2021, the expectation of specialty managers might still be for aviation rates to continue increasing. If the reality is less than anticipated, will we then see a resulting reduction in appetite?

Whatever happens, we expect increased capacity to come in to the non-proportional side, with IQUW being the most notable in ambition and new resource but with others also eager to try to build their book. This will naturally offset any reduction in existing capacity and if new capacity is unbiased by legacy losses and payback desire, it will be good news for buyers.

New challenges

Against the challenge of seeking higher technical rates after a long soft market and the largest loss in history, coupled with a pandemic that has radically impacted the prospect of any dramatic increase in market premium total, what other challenges are on the horizon to navigate?

Increasing non-major fatality awards in North America: this trend has been experienced in many liability classes over the past few years (and noticeably in aviation), when extreme cases go to full jury outcome trials. The latest to make the headlines was only last month when a Houston jury awarded $352m to the family of an airport worker paralysed when a van struck him from behind on the airport tarmac. Although unlikely to be of major impact to many programmes, the inability to model both occurrence and outcome will continue to be a concern while aviation coverage extends to comprehensive liability exposure.

Product differentiation: as insurers begin to consider greater flexibility in terms of rating and charging premium in response to challenges from their clients and the impact of the pandemic, can reinsurers respond and increase their differentiation to their clients beyond the minimum deposit premium within the excess-of-loss product? There have been previous market attempts with risk-scoring systems but there must be an attraction to some reinsurers to drive a new product offering.

Passenger exposure in space: we are getting ever closer to small but potentially hugely expensive human payloads operating on a fare basis, such as Virgin Galactic. Space law is evolving fast to try to deal with this new commercial area of risk beyond government employees and what was therefore in the past a controlled, defined liability. If aviation insurers take up the space tourist coverage challenge then they will naturally expect reinsurers to follow.

Climate change-driven technology: the environmental challenges levelled at the aerospace sector will ultimately become challenges that insurers and their reinsurers need to devise solutions for. Pressure to minimise climate change impact will require new technology in manufacturing, components and the engine/fuel used, which will mean not only new risk evaluation, but the inevitability of industry winners and losers altering the insurance client base, as well as the potential opportunity of new or extended coverage requirements.

Taking all that into account, we would have to agree with Mike Hansen, head of aerospace at Convex, who said, when reflecting on the aerospace industry and aviation insurance market: "There's never a dull moment after all." ■

David Bell is head of aviation specialty at Gallagher Re