LATTAL→ADR

Insurance and World Events

Part 1: Aviation Insurance

Significant world events over the last 24 months have created global tensions the number and severity of which have not been greater in the last 40 years. The real short term and potential longer-term impacts of COVID-19, the war in Ukraine, tensions between China and the United States, domestic protests and violence in many countries and the struggling world economy all present risk to individuals and businesses and to their assets and investments.

Many insurance policies and programs may be called upon to respond to the myriad of claims that may occur as a result of one or more of these ongoing world events. To help understand the variety of claims and issues that might arise as a result global tensions, the next several Insights will provide some commentary on what the world might see from underlying claims and potential insurance coverage available to respond to them.

Aviation Insurance

The broad range of economic sanctions implemented by much of the world after Russia's actions in Ukraine in February 2022 prompted Russia to issue a decree prohibiting the export of aircraft operated in Russia. Informed estimates suggest that at least 500 foreign owned aircraft remained in Russia at the time of the decree. The situation presents significant obstacles for owners of the aircraft to repossess and recover these assets. The situation presents likely insurance claims arising from these actions.

Historically, insurers in the aviation market have provided coverage on a ground-up basis. Aviation insurance is both similar and different from other commercial property and casualty markets. The similarity is found in basic principles of risk management, underwriting, and the law of large numbers…. As the number of exposure units (insureds) grows, the probability that the actual loss per exposure unit will equal the expected loss per exposure unit is higher. This results in the principle that it is easier to reduce risk exposure (charge the “correct” premium) as more policies are issued within a given insurance class assuming a stable and independent probability distribution for loss exposure.

The difference from other commercial markets (and specific challenge to aviation insurers) is that the customer base, and therefore, the premium base is limited. There are fewer potential customers as there exist a small number of aircraft manufacturers, component part suppliers, airlines, airports, and service providers. And the actual risks insured in the aviation industry are massive. As a result, most aviation exposures are insured by several insurers each taking on a percentage of the overall exposure.

Reinsurance plays an important part in the aviation industry. Reinsurance of aviation risks is normally provided on an aggregate excess of loss basis because the direct insurers require coverage for the aggregation of multiple events each year. Aviation reinsurance policies normally provide a single aggregate limit and potentially several reinstatements.

The history of aviation insurance reveals that the business of transporting passengers and freight is done so with great success as the rate of accidents in the airline industry is lower than all other transportation industries. When incidents do occur, they are typically significant and produce large claims with the resulting emotional and financial stress.

Primary Aviation Insurance

Primary insurance provided to airline operators and aircraft owners usually consist of the following:

- Hull "All Risks" – Covers loss or damage to aircraft while flying or on the ground for an agreed value. Loss or damage caused by war, hijacking, and a number of other listed events related to violence, hostilities or government action are normally excluded the "All Risk" coverage and is written separately under a "War Risk" policy (see below).

- Passenger – Covers liability for death or injury of passengers.

- Third party – Covers general third-party liability of the insured for death, bodily injury, and property damage external to the aircraft including indemnity obligations that may exist under leases.

- War Risks - This coverage is provided for losses that are excluded from the Hull "All Risks" policy and normally includes loss or damage arising from claims caused by war, invasion, acts of foreign enemies, hostilities, confiscation, nationalization, seizure, restraint, detention, appropriation, and other listed acts. The coverage is available for both hull damage and for injury to passengers and third parties.

It is not uncommon for there to be questions as to whether a covered loss of or regarding an aircraft falls within the "All Risks" or the "War Risk" policy. To address this issue, many policies include a clause referred to as AVS 103 wording. This clause provides for a provisional settlement where both the Hull and War Risk insurers agree in advance to equally split the hull costs for claims when the cause of the loss is unclear. The insurers agree to a subsequent arbitration to determine coverage liability if they cannot agree to a resolution among themselves. In such an arbitration the "All Risk" insurers must convince a tribunal that the loss was due to an excluded peril.

A recent example of the interaction of the two insurance programs involves the loss of Malaysia Airlines flight MH370 in March 2014. That claim involved that unexplained loss of the aircraft and all 239 passengers and crew. Pursuant to the A VS103 clause, the issue of causation was resolved in an arbitration after which it was reported that the War Risk insurers would absorb the full claim.