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Turbulent times expected for aviation industry in Asia

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As many countries continue to battle the effects of COVID-19, it is becoming clear that a mutual appreciation and understanding of the future challenges faced is critical to everyone's ultimate survival. This is certainly true of the aviation industry in Asia, and the trading relationship between aviation underwriters and the airlines, airports, manufacturers, MROs, and other industry-related organisations in the region. **Marsh JLT Specialty**'s **Tim Blakey** provides expert insight.

The year 2019 was challenging for the aviation insurance market. In the airline sector, it was the seventh consecutive year where claims equalled or exceeded premiums.

Lloyd's saw significant capacity being withdrawn from the market and future business plans came under significant scrutiny as aviation underwriters fought internally to get their plans signed-off based upon a priority to return to profitability. Inevitably, this resulted in an increase in rates and premiums and the first real 'hard' aviation market for many years. This same market environment has continued into 2020.

As is so often the case, these new market conditions are now running parallel with the challenging industry conditions created by COVID-19. Countries are struggling with the health and economic crisis created by the pandemic.

Having been the first region to deal with the immediate impact of COVID-19, Asia is now leading the global aviation recovery and showing the first signs of improving passenger traffic, particularly in China and other countries with a strong domestic market.

To emphasise this point, May 2020 was the first month in which Chinese airlines operated more passenger jet flights than their US counterparts.

Underwriters rise to the challenge

Aviation underwriters to date have shown that they understand the severity of the situation, and that they will treat requests by insurance buyers with a level of sympathy.

Liquidity remains a challenge for airlines and underwriters have been reasonably accommodating with deferring and easing premium instalment payments. In some cases, premium levels have been reduced based upon the buyer's ability to prove that actual exposures are significantly down on original estimates when rates were negotiated in 2019.

The pandemic has also thrown up new challenges with multiple aircraft being grounded and airlines trying to manage the different phases of restarting operations.

As of late April, over 65% of the pre-COVID-19 fleet of 27,500 commercial aircraft have been parked and it is anticipated that it will take several years before a full recovery is achieved. As a result, underwriters are concerned around hull exposures on the ground and the vulnerability and value aggregations of grounded fleets to, for example, weather-related events in a single location, which is particularly relevant in Asia.

Importance of credit ratings

The aviation insurance market is also coming under increasing scrutiny about the future long-term health of its underwriters. The major buyers will insist upon their insurance underwriters having a financial rating that gives them confidence that they are adequately capitalised to meet their potential future financial commitments, and they rely on the global rating agencies to provide this reassurance.

Any downgrade is met with consternation from both sides – buyers and insurers.

Despite a constriction of available market capacity, major buyers in Asia are still able to access sufficient market support to continue to buy 'catastrophic' levels of coverage. The aviation insurance product provides multi-million dollars of coverage every time an aircraft takes off, and the owners of commercial aircraft (particularly the aircraft leasing companies) still want the peace of mind that the market will respond to all claims – no matter how big or small.

Future in focus

As we turn towards the remainder of 2020, it is certainly true that an increased awareness from underwriters about their advanced negotiating position on capacity risks is continuing to drive pricing upwards. This awareness needs to be balanced against an aviation industry in survival mode and desperately looking to reduce costs wherever possible.

From a claims perspective, 2020 shows no immediate sign of delivering the same level of financial impact to the aviation market as we saw in 2019. However, the continued fallout following issues from multiple OEMs aligned to the complexity and cost of future claims involving new generation aircraft means that despite a lower frequency of claims, an increased severity of the cost of claims could still place the market in a loss-making position overall.

The client/underwriter relationship is being truly tested and the market is finely balanced between the underwriter promise to deliver true differentiation to the client against their own needs for increased rates and premiums across the entire portfolio to deliver a positive margin of profit and dividend to their shareholders and capital providers.

Whilst rising insurance premiums is not a message being well-received by clients right now, insurance buyers understand that based upon recent market performance and a lack of profitability, aviation underwriters are also fighting for their own survival. One cannot survive without the other particularly in Asia where partners are chosen carefully and where personal connection plays a very important part in the business culture. A

2019 airline insurance performance

Sources: Cirium database and airline safety review, Marsh market understanding and Lloyd's business reports.

(https://www.asiainsurancereview.com/Portals/0/ImageLibrary/archivesAIR/2020/Jul/21-2019%20airline%20insurance%20performance.jpg)

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