AIRCRAFT ACQUISITION IN AFRICA: BUILDING LOCAL UNDERWRITING CAPACITY

OVERVIEW

The increase in the volume of commercial air traffic on the African continent has occasioned the upsurge in the acquisition of aircrafts in the aviation industry. Aircraft acquisition can be undertaken either through a lease or an outright purchase of an aircraft. In either instance, insurance has a major role to play in the acquisition process. Where the aircraft is under a lease such as a dry lease [whereby, the aircraft is provided without crew] the lessee bears the responsibility of taking out the insurance as the aircraft will be put on the lessee's Air Operators Certificate. Even where the transaction is an outright purchase the purchaser will be required to take out insurance on the aircraft before commencing air operations.

Aviation insurance has become the lifeblood of the aviation industry, right from the development of commercial aviation after World War II
Broadly speaking, it embraces the insurance of risks associated with the manufacture, ownership, operation and maintenance of aircraft on the one hand, and the operation of aviation facilities on the surface on the other. In fact, Aviation insurance provides cover specifically for the operation of the aircraft and the risk involved in aviation.
The common types of insurance covers available for an aircraft owner are

- Passenger liability insurance;
- Hull/Aircraft insurance; and
- Public liability insurance.

Most aviation business in the insurance market is placed by means of brokers so that the risks may be spread and the necessary capacity obtained. It is the duty of the broker acting on behalf of the insured to decide which underwriters to approach to insure the risk.

CHALLENGES OF AVIATION INSURANCE IN AFRICA

Notwithstanding the increase in the growth of the aviation market in Africa, underwriting of risks has not gained much ground, owing to capital inadequacy in the industry, in terms of human and financial capacity.

No single insurer for instance has the resources to retain a risk the size of a major airline or even a substantial proportion of such risk. The catastrophic nature of aviation insurance can be measured in the number of losses that have cost insurers hundreds of millions of dollars. When there are accident losses, dependants of victims are only compensated where there is adequate cover.

In Nigeria for example, the insurance companies are not sufficiently capitalized to bear the operating demands including insurance costs, despite the minimal percentage of risks ascribed to be written locally.

The lack of capacity to underwrite large risks has in effect enabled foreign insurers and brokers to undertake such activities, leading to loss of foreign earnings through capital flight.

Also, the cyclical nature of the aviation market makes it difficult for risks to be underwritten at certain times when the market experiences extreme price fluctuations. This makes insurance companies and reinsurers to be more active in the aviation insurance market at times when surplus capital is at their disposal. However, when capital is scarce as is usually the case in Africa, the insurance companies and reinsurers retreat. The market in such instances takes the form of a residual market, thereby occasioning instability and in effect scaring away local insurance companies from underwriting risks.

Another challenge faced by insurance companies in underwriting risks is the lack of a re-insurance community. Reinsurance companies in Africa face problems relating to their ability to source for capital for large and complex risks associated with the aviation industry. The essence of reinsurance is the spreading of huge risks in the aviation insurance industry through the ceding of risks by the reinsured and the acceptance of a certain fixed share of the risk by the reinsurer in consideration of the payment of a reinsurance premium. The lack of a reinsurance community makes it impossible for risks to be spread among the insurance companies and reinsurers and as stated above, no single insurer has the capacity to retain a risk the size of a major airline or even a substantial proportion of such risk. Also, reinsurance companies in Africa are not rated favorably by international rating agencies due to country risks and the costs involved. This in effect hinders the ability for these companies to source for adequate capital and also to write external business and earn foreign currency.

Other challenges faced in the African Aviation insurance market include the lack of a credit rating system in the insurance market in Africa, insufficient information in the insurance market, general lack of public awareness for insurance and a flagrant disregard of the law by local airline operators. In Nigeria for example, on the issue of victim compensation, domestic airlines still apply the Warsaw Convention of 1929, which stipulates that $10,000 compensation must be paid to victims of air accidents, instead of the modern Montreal Convention of 1999 (domesticated in the Nigerian Civil Aviation Act 2006 in Chapter III of the Schedule to the Act) which stipulates a liability limit of $100,000, despite several warnings by the regulatory authority (NCAA).

A BRIGHT FUTURE?

However, inspite of these challenges there is hope of remarkable improvement in local content aviation insurance in various African nations.

Different options exist in order to build local underwriting capacity amidst these challenges.

A. Recapitalisation

The first and most important is the recapitalization of the industry in the various African nations, in order to restore traveller confidence in the market and also to enhance international competitiveness of the local market. The recapitalisation exercise will require active participation of financial institutions to assist in boosting the capital base of the various insurance and reinsurance companies.

B. Strengthening Reinsurance

In addition, though reinsurance companies in Africa face problems in sourcing capacity for large and complex risks associated with the industry, reinsurance can serve as a means of spreading the huge risks in the aviation insurance industry through reputable organizations like Lloyds of London. This will allow for the reduction of liability exposure for insurers who do not wish to bear the entire burden of the insurance they have written and it will also assist insurance and reinsurance companies in Africa to boost their international rating.

C. Shareholder Funding

Additionally, reinsurance companies can increase their capital through share holders funding beyond the various statutory minimum levels and other risk financing techniques such as syndicated capitalization.

D. Aviation Insurance Pool

A fourth option is the creation of an Aviation insurance pool, such as the African Oil & Energy and Aviation Insurance pool set up by African Insurance Organisation (AIO), to boost the capacity of insurers in these sectors. This will deepen the African Insurance market and enable underwriting of large risks in the volatile energy and aviation insurance business.

In Nigeria, the National Insurance Commission and the Nigerian Civil Aviation Authority recently set up a committee (NCAA/NAICOM Committee on Aviation Insurance) to address and articulate solutions to overcoming aviation insurance challenges. It is suggested that a syndicate system should be formulated for the underwriting of large risks as adopted by Lloyd's underwriters, which enables insurers to co-operate in underwriting risks or proportions, which would otherwise be too large for an individual to cover.

E. The Role of Government

Government also has a major role to play in developing the insurance market. Although many African Countries are today undertaking substantial privatisation programmes which essentially is taking Government out of businesses, it is my submission that for the African Aviation market to deepen, Governments should together with the private sector create pool of funds which can be deployed to the industry, in order to create the necessary depth that will enable them stand on their own. A commendable example which can be adopted by other African nations is the N500 Billion Special Aviation Fund set up by the Nigerian Government to assist the industry. Naturally, proper monitoring is required to ensure that these funds are not wasted.

F. Consolidation

Insurance companies can be created with strong balance sheets through consolidations, in order to compete favourably with international and regional players. Regional and local stock exchanges can also be instrumental in building capacity by raising capital for insurance companies. African countries should open up to each other in the form of cross border shareholding and build Intra-African capacity, in order to attract capital and business from outside Africa.

G. Strong Regulation

African Countries should strengthen their regulatory regime through a methodical system which enforces regulations and punishes abuse. A faithful application of sanctions is a panacea for creating confidence in the investing public and also reduces Country risks in the industry. In the past, there were instances where premiums paid especially by Government owned carriers were phenomenally higher than the original reinsurance premium which meant that in claim situations either for partial and total loss, what was recoverable may not have enabled the airline to survive a loss or accident as the airline cannot be paid an amount higher than the original premium insured.

For the perception of corruption to ease and also reduce the Country risk, there must be a strong and viable Corporate Governance and Anti-Corruption regime in the industry.

CONCLUSION

The prospects for the growth of aviation insurance in Africa are good. However, there must be an increase in ethical standards among the various insurance and reinsurance companies to gain the full benefits of a potentially huge market. The aviation insurance business has to be conducted with sound principles and a high premium placed on corporate governance within the industry. This way, Africa can attract foreign capital to support its home grown capital to provide the pool of funds that is so critical to the growth and sustenance of the Aviation industry in the continent.

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