

Preface

The saying that the terrorist events of September 11, 2001, changed the world forever is true not only in respect of how it changed the conduct of international relations between states but also in respect of the manner in which it affected the provision of insurance coverage for aviation war and terrorism risks. Although the quantum of loss and compensation that insurers had to pay as a result of the events of September 11, 2001, was unprecedented, events of such nature were not entirely new to the insurance market particularly the London aviation market where coverage of aviation war and terrorism risks was commonly provided. Indeed, the 1968 Israeli attack on Beirut airport is on record as the first major event of that nature that targeted the international air transport system. This marked the beginning of the exclusion of war and allied risks from aviation insurance policies issued in the London market, a practice that was successively expanded and developed as many more such events occurred over time. A few days after the fateful events of September 11, 2001, however, it became abundantly clear to everyone who had something to do with the air transport industry that the business-as-usual era in which airlines could obtain from commercial insurers as much insurance coverage for aviation war and terrorism risks as they desired was over and that the time had come to begin the difficult process of finding other reliable risk transfer mechanisms to serve as alternatives and/or complements to traditional insurance.

A review of the literature at the time indicated that the question of how to provide or ensure the provision of sustainable insurance (or other financial) coverage for aviation war and terrorism risks had not been addressed in a comprehensive manner by academicians, insurance practitioners, and government policymakers. What really complicated the issue is the fact that, in most countries, the law requires an air transport operator to maintain adequate insurance coverage (including coverage for war and terrorism risks) as a condition for the initial grant and continuing validity of an air operator's certificate. There being no mechanism to ensure that what the law requires as minimum insurance requirements would be available commercially or otherwise to airlines, events such as those of September 11, 2001, almost brought the global air transport industry to a halt. Proposals of all kind and manner were advanced, driven by the urgent desire to find a solution to the

problem and the tendency to transpose solutions that have been successfully implemented in other areas of economic endeavor. Unfortunately, very little effort was directed toward determining what the root cause(s) of the problem were. As a result, most of the solutions that were implemented have either failed or remained stillborn.

In light of the foregoing, the rationale underlying my research and ultimately this book was to take a step back and look critically at the problem of how to provide sustainable insurance coverage for aviation war and terrorism risks, not only from a legal perspective but also taking into account various other nonlegal phenomena that could help delineate the exact boundaries of the problem before prescribing any solutions. In order to do so, it was important as a first step to provide readers with an overview of aviation insurance as practiced in the London market (and, subject to some marked differences in a few places, throughout the wider Common Law world). This is followed by a specific focus on how the commercial insurance market has addressed marine and subsequently aviation war and terrorism risks over the years. The book then analyzes the behavior of the commercial insurance markets to extreme events such as September 11, 2001, by resorting to a number of concepts and models propounded by eminent scholars in the fields of law and economics as well as behavioral law and economics. One of the major findings is that as a means of risk management, insurance works best under circumstances where the law of large numbers applies—large population size characterized by high frequency of occurrence of the risk concerned but a significantly low financial impact on each occurrence. Aviation war and terrorism risks on the other hand belong to the class of risks that are typically low frequency/high financial impact. As such, insurer appetite for those types of risks decreases as the size of the latest occurrence (payout) increases.

Clearly, if the commercial insurance markets alone cannot be expected to insure these risks at societally desirable levels and in a sustainable fashion, then it is imperative that alternatives and complementary solutions be found. The book therefore considers the extent to which capital markets, governments, and the international community of states (three of the many proposed solutions) may provide alternative or complementary mechanisms to the coverage of aviation war and terrorism risks by commercial insurers. Each of these raises peculiar issues which are discussed from a multidisciplinary perspective. Thus government-run insurance and guarantee schemes for air transport operators in a number of countries are analyzed along with the numerous issues associated therewith. For instance, it has been alleged that a domestic war and terrorism insurance market for air transport operations has not been able to develop due mainly to the federal government's continued provision of premium war risk insurance coverage to US airlines. At the international level, most states consider that aviation war and terrorism risks are a direct manifestation of each state's foreign policy. As such it has been difficult to develop an international mechanism that will address the insurance and financial aspects of such risks to the satisfaction of all (or at least a majority of) states. Capital market solutions on the other hand offer unique opportunities and deeper capital reserves for the insurance of such risks. However,

it is important to tread with caution and to learn lessons from the recent economic crisis.

It is my hope that this exposition will enable policymakers, decision makers, government regulators, air transport operators, airlines, and their insurers to have a broader view of what aviation war and terrorism risk insurance really entails. It is intended to encourage and facilitate discussion and reflection about the way forward.

Montreal, QC, Canada

Yaw Otu Mankata Nyampong

Insuring the Air Transport Industry Against Aviation War
and Terrorism Risks and Allied Perils

Issues and Options in a Post-September 11, 2001

Environment

Nyampong, Y.O.M.

2013, XX, 324 p., Hardcover

ISBN: 978-3-642-32432-1