Aviation Insurance

Cover your assets.

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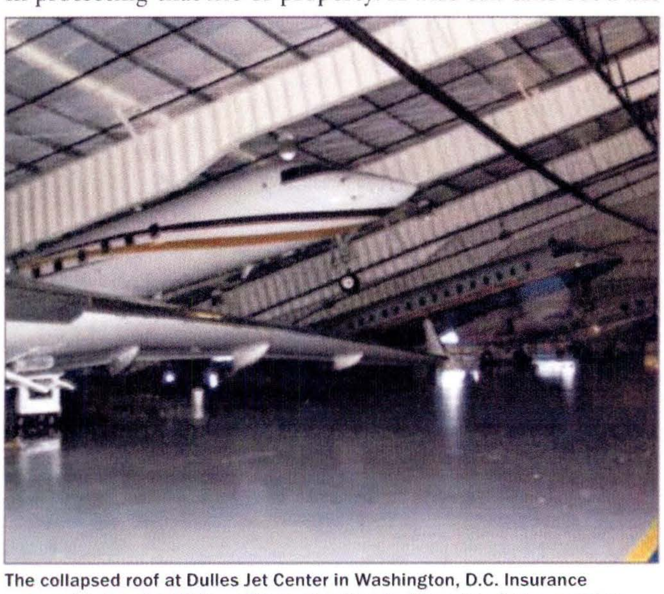
THE RISK AND FINANCIAL PHYSICS THAT CONTROL AVIATION insurance are more complex than the aerodynamics that control the aircraft that we fly. The insurance industry in turn controls our industry more directly than the FAA in a number of ways. Insurance underwriters have often lowered premiums to encourage the of use two-pilot crews in "single-pilot" aircraft, or to ensure that flight departments use more simulator training. Do underwriters lower premiums out of the goodness of their hearts? No. They are simply improving their odds. Insurance is gambling, without the free drinks.

In a typical situation, a flight department manager works with an aviation insurance broker, who places a policy with an insurance underwriter, that in turn buys insurance for itself, called "reinsurance." Then the insurance and reinsurance companies do their best to invest premiums well and minimize claims.

The complex relationship between insurance underwriters, reinsurers and the financial markets explains why premium costs often fluctuate wildly even in years where insurance claims are low. The insurance companies gamble that you won't crash, but they also take bets on the markets and on each other.

Like all businesses built on games of chance, the insurance industry tries to make "house" rules that improve their odds. One of the first rules established centuries ago in the London insurance market was that of an "insurable interest." We take it for granted now that you cannot buy an insurance policy on someone else or their property, unless you have an "interest" in protecting that life or property. A wife can take out a life insurance policy on her husband because she has an interest in keeping him alive and would be in dire straits financially if he died. But history is littered with the bodies of spouses who became more appealing dead than alive because they were insured for more than their apparent worth.



The collapsed roof at Dulles Jet Center in Washington, D.C. Insurance companies faced a bill for millions of dollars in damages after a massive snowstorm hit the U.S. East Coast in February 2010.

How does this connect to aviation insurance? Imagine that an aircraft was bought with substantial financing shortly before a drastic drop in aircraft prices. The owner can't save on premiums by reducing the insured value because the financing documents require that the insured value remains above the loan amount. If the owner sells the airplane in the down market, the owner will have to find cash to pay off the loan. If only there was a fire. Or better yet, a hangar-crushing snowfall would do the trick.

Or would it? What if your aircraft is damaged but not totaled? Generally speaking, insurance policies do not pay for "diminution of value," which is the loss of market value due to the fact that the aircraft will now have a damage history that most buyers will simply choose to avoid.

Although policy language varies, generally speaking, insurers will choose to fix a damaged aircraft unless the cost of repair exceeds the insured value of the aircraft. Diminution of value insurance is available in the market, but because it is rarely purchased, it is not cheap.

Since you can't control the financial markets and you don't want to hope for a windfall snowfall, what can you do to control insurance costs? Get your broker and/or underwriter to visit your operation. Show them everything that you do that goes above and beyond. Do you have SMS? Does your team participate in professional development programs? Aim to pay for these safety improvements with a cut in premiums.

While you are showing off the operation, make sure that your insurance not only gives you credit for all that you do, but also covers all of "you." Is your corporate structure complicated? Do you operate the same aircraft for different companies? Your insurance broker needs to know everything that you are doing in order to cover every aspect. In a perfect world, you discuss leases and timesharing agreements with your insurance broker before you sign them. Your world may get ugly fast if you don't reveal these agreements until after an accident. One of the easiest ways for an insurance company to deny coverage after an accident is to show that the insured "materially misrepresented" their operation. In those cases, the insured may believe that the insurance underwriter simply didn't ask enough questions. That argument doesn't sway courts. The insurance companies can make a persuasive case that the courts send a safety message to the industry by denying coverage when an insured crashes while running "undisclosed" operations (particularly for "guests"). BCA