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Report to Congressional Committees

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AVIATION INSURANCE

Federal Insurance Program Needs Improvements to Ensure Success

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Resources, Community, and
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Congressional Recipients

The Federal Aviation Administration (FAA), within the Department of Transportation (DOT), has authority under the Aviation Insurance Program to insure commercial airlines that perform airlift services considered necessary to the foreign policy interests of the United States when insurance is not available commercially or is available only on unreasonable terms and conditions. The government sometimes calls on commercial airlines to move troops and supplies when it has insufficient airlift capacity readily available to perform these missions. The insurance FAA issues, commonly referred to as war-risk insurance, covers losses resulting from war, terrorism, or other hostile acts. FAA does not charge the airlines an insurance premium for flights performed directly for the government but does charge a premium to insure other flights that are considered necessary to support the foreign policy interests of the United States.

During the Persian Gulf conflict, many commercial insurers canceled war-risk coverage or dramatically increased the airlines' insurance premiums because of the elevated risks to aircraft flying to that region. Because of concerns raised about the Aviation Insurance Program during the Persian Gulf conflict, the Congress mandated that GAO evaluate the program. Specifically, this report discusses (1) whether sufficient funds are available to pay the insurance claims, (2) how the war-risk coverage provided by FAA compares with that provided by commercial insurers, and (3) how FAA administers the program.

Results in Brief

The Aviation Insurance Program does not have sufficient funds available to pay potential insurance claims for many of the aircraft registered for the program. While the program has accumulated about $56 million in revenues and paid out only about $150,000 in claims since its inception in 1951, one major loss could liquidate all the available funds and leave a substantial portion of the claim unpaid. About 20 percent of the registered aircraft had hull values—the value of the aircraft itself—that exceeded the available funds. In addition, liability claims could total hundreds of millions of dollars more than the aircraft's hull values. If a loss exceeded the available funds, FAA would have to seek supplemental funding to pay the claim. FAA's inability to pay a claim promptly could cause a financial hardship for the affected airline, jeopardize other airlines' confidence in the program, and reduce these airlines' willingness to provide needed airlift services.

The war-risk insurance policies that FAA used during the Persian Gulf conflict did not specifically provide the same comprehensive coverage as the airlines' commercial policies. For example, the commercial policies specifically provided coverage for search and rescue missions and wreckage removal, but FAA's policies did not. Although FAA recognized the need to revise its war-risk policies as early as May 1990, the agency did not complete new nonpremium policies until April 1994. The new nonpremium policies, which more closely reflect commercial war-risk policies, became effective on June 1, 1994. However, FAA has not established a date for issuing its new premium policies.

Several administrative issues we identified could hamper the effectiveness of the Aviation Insurance Program and result in delays in the timely payment of claims. For example, FAA did not have copies of the current war-risk policies to verify the levels of coverage provided by commercial insurers for four of the five airlines included in our review. Also, there were discrepancies in the insured values of some aircraft covered under FAA's and commercial insurers' war-risk policies. Such discrepancies could result in delays in the payment of an insurance claim. In addition, we found ambiguities that need to be clarified in the language of the legislation authorizing the Aviation Insurance Program and in FAA's implementing regulations regarding whether a presidential determination is required before war-risk insurance can be issued.

Background

Commercial airlines normally carry insurance to cover both "all risks" and war risks. All-risk insurance covers losses caused by such things as mechanical failure, weather, and pilot error. War-risk insurance covers losses resulting from war, terrorism, and other hostile acts. The Aviation Insurance Program was established in 1951 by title XIII of the Civil Aeronautics Act of 1938, as amended,[1] to provide war-risk insurance for commercial aircraft that supply essential airlift services when such insurance is not available commercially or is available only on unreasonable terms and conditions. In November 1977, the Congress amended the act to expand FAA's authority to provide all-risk insurance, but none has been issued to date.[2]

[1]The Civil Aeronautics Act of 1938 was repealed by the Federal Aviation Act of 1958. The Aviation Insurance Program was continued under the Federal Aviation Act of 1958.

[2]Since FAA has never issued any all-risk insurance, this report discusses only war-risk insurance.

FAA, which has been delegated responsibility for the program by the Secretary of Transportation, issues both hull and liability war-risk insurance. Hull insurance covers the aircraft itself, while liability insurance covers bodily injury to or the death of the crew and passengers and the loss of or damage to cargo, property, and people on the ground. The maximum amounts of hull and liability coverage that FAA provides under its war-risk policies is limited to the amounts insured by an airline's commercial policy. The insured value of the hull cannot exceed the fair and reasonable value of the aircraft.

FAA issues two forms of war-risk insurance, one at no cost to the airlines (nonpremium insurance) aside from a one-time registration fee and the other requiring the airlines to pay premiums (premium insurance). FAA registers aircraft for nonpremium insurance when the carriers perform contract services for federal agencies that have indemnification agreements with DOT. Under the indemnification agreements, these federal agencies reimburse FAA for the insurance claims it pays to the airlines. Over 99 percent of all war-risk insurance issued by FAA has been nonpremium insurance for flights sponsored by the Department of Defense (DOD). These flights have moved troops, cargo, and relief supplies (such as food and medical supplies) to foreign locations subject to civil and military unrest.

For its premium war-risk insurance, FAA charges a premium that is commensurate with the risks involved. FAA only provides premium insurance when the President makes a determination that travel to specific foreign locations is necessary to carry out the foreign policy interests of the United States. This type of insurance is provided for an initial period of 60 days, with additional 60-day extensions granted when considered necessary by the President. FAA has not issued any premium insurance since March 1991.

The Aviation Insurance Program is self-financed through the Aviation Insurance Revolving Fund (the Fund). Moneys deposited into the Fund to pay claims are generated from insurance premiums, the one-time $200-per-aircraft registration fee charged for nonpremium insurance, and interest on investments in U.S. Treasury securities. From fiscal year 1959 through fiscal year 1993, the Fund accumulated approximately $56 million in revenues and paid out net claims totaling only about $150,000.

Airlines that provide airlift services as part of the Civil Reserve Air Fleet (CRAF)[3] and DOD contracts can also obtain reimbursement for damages or losses under the Air Force Indemnification Program (authorized by P.L. 85-804, as amended).[4] Although this program is not an insurance program, DOD can reimburse airlines for damages or losses not covered by FAA's nonpremium policies. However, unlike the Aviation Insurance Program, this program has no separate fund for paying claims. According to Air Force officials, they would have to seek an additional appropriation from the Congress to pay claims under this program or to reimburse FAA for claims paid under DOD's indemnification agreement with DOT.

Requests to FAA for both premium and nonpremium insurance increased immediately after the Persian Gulf conflict began on August 2, 1990, because commercial insurers canceled or dramatically increased premiums for war-risk insurance and imposed surcharges on insurance for all flights to the Middle East. For example, the commercial insurance premiums for one airline's war-risk coverage increased from $210 per flight before the conflict to over $54,000 per flight after the conflict began. When CRAF was activated on August 17, 1990, the commercial insurers canceled war-risk coverage for those airlines that had clauses in their commercial policies excluding CRAF activities. According to FAA, DOD, and airline officials we interviewed, the typical CRAF exclusion clause specifically states that the commercial insurer is not liable for any losses resulting from war risks while an aircraft is participating in CRAF. In addition, many commercial insurers refused to provide war-risk liability coverage for any flights carrying troops and increased their liability rates for nonmilitary passengers to unreasonable levels.

During the conflict, FAA issued war-risk insurance that covered over 5,100 flights flown by over 25 different airlines. FAA provided premium insurance for 36 flights, which generated about $605,000 in revenue for the Fund. The remaining flights were covered by nonpremium insurance. According to Air Force officials, commercial airlines transported about 25 percent of the cargo and over 64 percent of the passengers to and from the Persian Gulf area during the conflict. Since the conflict, FAA has continued to provide nonpremium insurance to commercial airlines. For example, it has insured flights to Somalia in support of Operation Restore Hope.

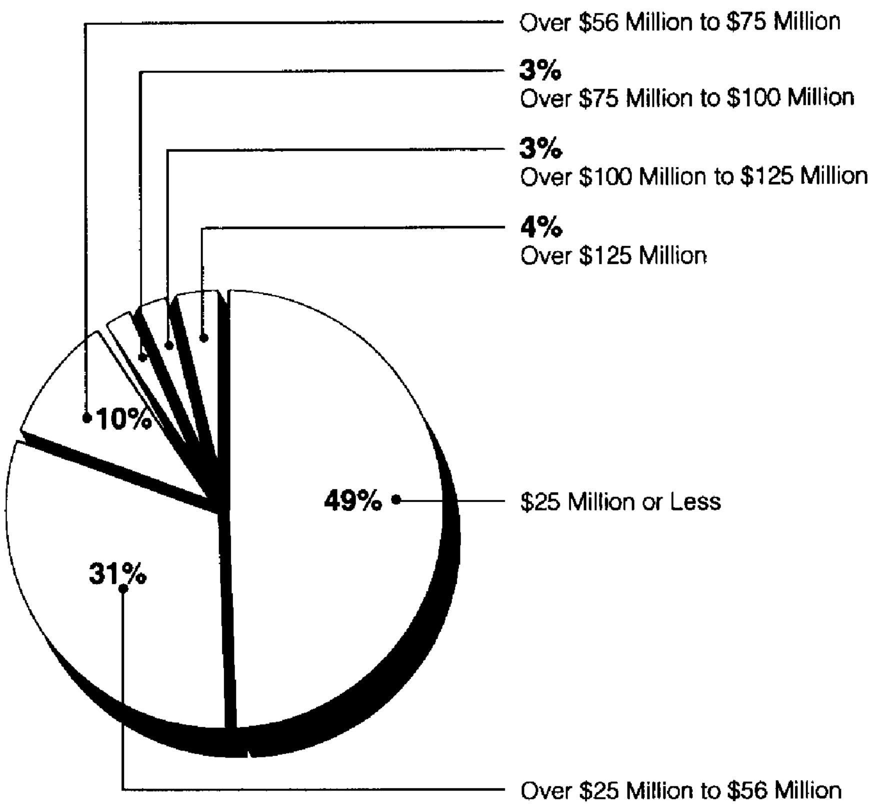
[3]CRAF is composed of commercial aircraft and crews that airlines commit to support military airlift requirements during national emergencies. The Persian Gulf conflict was the first and only time CRAF has been activated since its inception in 1952.

[4]50 U.S.C., sections 1431-1435 (1988); Executive Order No. 10789; and 23 Fed. Reg. 8897 (1958), as amended.

Funds Available Are Insufficient to Pay Major Claims Under FAA's War-Risk Policies

The Fund's balance of $56 million is insufficient to reimburse airlines for the insured hull values of many of the aircraft registered for the Aviation Insurance Program. For example, a claim for the loss of one aircraft—such as a Boeing 747-400, which can cost over $100 million—could liquidate the Fund's entire balance and still leave a substantial portion of the claim unpaid for an indeterminate period of time. As shown in figure 1, the hull value alone of 128 (or about 20 percent) of the 659 aircraft registered for nonpremium insurance as of May 1994 exceeded the Fund's balance. In addition, FAA estimated that the average contingent liability per incident for each registered aircraft is about $350 million. The largest single liability loss in aviation insurance history occurred in 1988 when a Pan American aircraft exploded over Lockerbie, Scotland, killing 258 passengers and 11 people on the ground. The liability claims paid as a result of this disaster are expected to total about $470 million.

Figure 1: Insured Hull Values of Aircraft Registered for FAA's War-Risk Insurance as of May 1994



Delays in Reimbursement Can Cause Severe Financial Problems for Airlines

Because the funds are insufficient to pay for a major loss, all the airline officials we interviewed said that they are concerned about how long it would take FAA to obtain supplemental funds to pay any claims that exceed the Fund's balance. The officials were particularly concerned about the time it would take to settle insurance claims for damage to or the loss of hulls. They said that untimely reimbursements of such claims could cause severe financial hardships, and possibly bankruptcy, because many of the aircraft are leased. Under agreements with the aircraft's owners, the airlines must maintain leased aircraft in an acceptable condition at all times. In the event of damage or loss, airlines must either fully restore or replace an aircraft or pay the outstanding balance under their financial agreement within a specified time frame, usually 30 to 60 days. According to the FAA, airline, and insurance officials we interviewed, commercial insurers normally fully reimburse claims for hulls within 30 days. This arrangement allows airlines to fulfill the requirements of their financial agreements without severe financial disruptions.

Officials for one airline explained that having to pay an outstanding balance unexpectedly is a risk they were not willing to absorb. Officials at two other airlines told us that untimely reimbursements could result in their filing for bankruptcy because they would not have the financial resources readily available to satisfy the terms of their agreements.

While no claim had exceeded the Fund's balance as of May 1994, FAA officials acknowledged that having a claim exceed the balance was possible and agreed that there was uncertainty about how long it would take to obtain additional moneys through supplemental appropriations or from the indemnifying agency. However, these officials predicted that claims totaling less than the Fund's balance could potentially be paid in full within 30 days after verification of the extent and cause of the loss.

Government's Interests Could Also Be Affected by Problems With Reimbursement

In addition to creating financial problems for the airlines, the lack of sufficient funds and delays in reimbursements could also adversely affect the government's interests. FAA's inability to pay potential major claims promptly has resulted in airlines' increased reluctance to commit expensive aircraft to CRAF and other military airlift operations. For example, the number of international long-range passenger aircraft committed to CRAF has declined from 252 to 158, or by about 37 percent, since the Persian Gulf conflict. According to FAA officials, the Fund's low balance was a significant factor cited by the airlines in their growing hesitancy to participate in CRAF. If the airlines' confidence in FAA's insurance program continues to erode, the government may not be able to obtain a sufficient level of essential and uninterrupted airlift services in the future.

This problem could be significant, since commercial airlines give DOD access to additional airlift capability without the expense of owning and maintaining a massive air fleet. For example, FAA has estimated that it could cost DOD from $17 billion to over $50 billion to acquire a fleet with CRAF's airlift capacity. CRAF participants can provide up to half of the nation's strategic airlift capacity without the government's having to purchase additional aircraft, pay personnel costs, or fly and maintain the aircraft during peacetime.

Alternative Financing Sources Have Been Proposed

In light of the benefits of using commercial aircraft to perform essential airlifts, FAA and Air Force officials told us that they had investigated using alternative financing sources to make additional funds available for the reimbursement of major claims. These alternatives included (1) obtaining a permanent appropriation from the Congress or authority to borrow funds from the U.S. Treasury to pay claims that exceed the Fund's balance, (2) increasing FAA's one-time registration fee for nonpremium insurance and charging an annual fee for each aircraft registered, and (3) using moneys in DOD's Defense Business Operations Fund.

In January 1994, FAA officials told us that they had submitted a proposal to the Secretary of Transportation requesting that the Congress give the agency a permanent appropriation or the authority to borrow funds from the U.S. Treasury to pay claims for hull losses within the commercial insurers' normal time frame of 30 days. FAA would use the permanent appropriation to pay claims under premium insurance. FAA would use the borrowed moneys to pay claims under nonpremium insurance while awaiting a supplemental appropriation from the Congress or reimbursement from the indemnifying agency. Once FAA received the appropriation or reimbursement, it would repay the loan and interest to the U.S. Treasury. As of May 1994, DOT had not acted on the proposal.

The Budget Enforcement Act of 1990 (P.L. 101-508) requires that all direct spending[5] and tax legislation enacted for a fiscal year must be deficit neutral in the aggregate. If such legislation causes a net increase in the deficit, it must be offset by either increasing revenues or decreasing direct spending in another program in the same fiscal year. We asked the staff of the Congressional Budget Office whether this requirement would apply to FAA's proposal. A budget analyst in that office told us that the requirement would apply. However, the analyst told us that an offset would probably not be needed for the proposal since it would likely be judged to have no effect on the deficit because losses in the Aviation Insurance Program have historically been low.

As of May 1994, FAA was drafting a proposal to obtain additional moneys for the Fund by increasing the one-time registration fee for each aircraft registered for nonpremium insurance and charging an annual fee to each airline that had aircraft registered for this insurance. Nevertheless, increasing the registration fee would have a limited effect on the Fund's

[5]Direct spending is defined as entitlement authority, the Food Stamp Program, and budget authority provided by law other than appropriations acts, such as what would be provided under FAA's proposal.

balance in comparison with the potential costs resulting from even one major loss.

Air Force officials told us that they have explored the possibility of using moneys deposited in the Defense Business Operations Fund to reimburse airlines for damages or losses covered under the indemnification agreement between DOT and DOD and the Air Force under the Air Force Indemnification Program. Initially, in June 1993, the Deputy General Counsel in DOD's Office of General Counsel ruled that moneys from the Defense Business Operations Fund could not be used to pay war-risk claims because the statute prohibits the use of the moneys to pay any expenses other than routine business operating expenses. As of April 1994, Air Force officials were actively seeking DOD's approval to use money in the Defense Business Operations Fund to reimburse FAA for claims paid under the Aviation Insurance Program. In addition, the officials were completing a legislative proposal that would give DOD the authority to reallocate any moneys appropriated to it, regardless of the fiscal year of the appropriation, to immediately reimburse airlines for their losses. However, no firm date has been established for completing this effort.

FAA's Policies Did Not Specifically Provide the Same Comprehensive Coverage as Commercial Policies

Officials at the airlines and airline associations told us that the war-risk policies FAA issued during the Persian Gulf conflict did not specifically provide the same comprehensive war-risk coverage customarily provided by commercial policies. For example, while commercial policies enumerated coverage for items such as search and rescue, wreckage removal, foaming of runways, and ground-based operations, FAA's policies did not enumerate coverage for these items.

FAA officials acknowledged that the war-risk policies issued during the Persian Gulf conflict did not specifically provide the same coverage as commercial policies. Although the officials recognized the need to revise the premium and nonpremium policies as early as May 1990, the agency did not complete the new nonpremium policies until April 1994. FAA's new nonpremium policies became effective on June 1, 1994. However, the agency has not revised its premium policies or established a date for completing this effort. FAA officials told us they have not done so because of a lack of staff resources and other higher work priorities.

Table 1 shows the differences in the war-risk coverage provided under FAA's premium and nonpremium policies and under the commercial policies. The table also shows the war-risk coverage specified in the new nonpremium policies that became effective on June 1, 1994.

Table 1: Comparison of FAA's and Commercial War-Risk Policies as of May 1994

	FAA's policies		
Provision	**Premium policy**	**Nonpremium policy**	**Commercial policy**
Covers loss or damage from			
War, invasion, insurrection, and other hostilities	Yes	Yes	Yes
Detonation of atomic or nuclear weapons	Yes	Yes	No
Strikes, riots, and civil commotions	Yes	Yes	Yes
Sabotage	Yes	Yes	Yes
Confiscation or seizure	Yes	Yes	Yes
Hijacking	Yes	Yes	Yes
Payment is prompt	No[a]	No[a]	Yes
Covers costs related to			
Search and rescue mission	No[b]	Yes	Yes
Wreckage removal	No[b]	Yes	Yes
Runway foaming	No[b]	Yes	Yes
Ground-based operations (such as baggage handling, security, refueling)	No[b]	No	Yes
Claim settlement is 50/50[c]	Yes	No	Yes
Covers ransom and extortion[d]	No	No	Yes
Covers war between the Great Powers (e.g., United States, France, Great Britain, territories of the former Union of the Soviet Socialist Republics (USSR), and China)	Yes	Yes	No

[a]Payment is prompt only for claims that do not exceed the Fund's balance.

[b]FAA officials told us that these costs are covered under FAA's war-risk policies. However, these costs are not specifically enumerated in the policies.

[c]Under a 50/50 claims provision for a hull, the all-risk insurer, usually the commercial insurer, and the war-risk insurer, FAA, each agree to pay 50 percent of the payable insured amount under the policy if it cannot be readily determined whether a loss resulted from a war-risk or an all-risk peril (such as mechanical failure, weather, or pilot error).

[d]According to FAA officials, it is against the U.S. government's policy for FAA to pay ransom and extortion costs.

As a result of actual or perceived gaps or deficiencies in the war-risk coverage, the airlines relied on both FAA's insurance and the Air Force Indemnification Program to cover potential damages or losses during the Persian Gulf conflict. In fact, officials at all five airlines we contacted said they did not fly any missions without assurance from FAA and the Air Force that they were covered by both programs. However, even with coverage under both programs, the airline officials admitted that they were uncertain about what war risks were covered under the two programs. Furthermore, they felt that having coverage under both programs was the best approach to minimizing their financial risks, particularly if a claim exceeded the Fund's balance. Nevertheless, most airline officials we interviewed agreed that FAA needed to issue new policies to provide more assurance that the transition from commercial to FAA war-risk coverage would not result in gaps or deficiencies in coverage. FAA's recent actions to revise its nonpremium policies should address several of these concerns, but similar revisions to its premium policies have yet to be completed.

Administrative Concerns Could Hamper Program's Effectiveness

We identified several administrative concerns that could hamper effective administration of the Aviation Insurance Program and delay prompt payment of potential claims. These concerns include the following:

- FAA did not maintain copies of current commercial war-risk policies for airlines registered for nonpremium insurance, and there were discrepancies in the amount of hull insurance coverage provided under FAA's war-risk policies and the commercial policies.
- There are ambiguities in the language of the Federal Aviation Act and FAA's implementing regulations about whether a presidential determination is required before nonpremium insurance can be issued.

According to FAA officials, they collect copies of airlines' commercial war-risk policies to verify the amount of hull and liability coverage provided by commercial insurers. However, in reviewing FAA's files, we found that the agency did not have current commercial policies for four of the five airlines included in our review. The commercial policies in FAA's files had expired a year or more before. Although the commercial policy for the fifth airline was in effect, we found some discrepancies in the amounts of hull insurance provided under FAA's and the commercial war-risk policies. For example, FAA's policy provided hull coverage for five aircraft that was $8 million higher for each aircraft than the insured values shown in the airline's commercial policy.

FAA officials acknowledged that they did not have copies of the latest commercial policies for many airlines and that discrepancies sometimes exist between the agency's war-risk policies and commercial war-risk policies. They explained that although they periodically request copies of the airlines' commercial policies, they do not require the airlines to submit these documents as a condition for obtaining war-risk insurance. Furthermore, the officials said that they try to maintain continuous communication with the airlines and their insurance brokers to keep abreast of changes in the commercial policies. They also explained that discrepancies sometimes occur because the airlines or commercial insurers fail to inform FAA in a timely manner about changes affecting the commercial policies. Nevertheless, the officials told us that they plan to change their regulations for implementing the Aviation Insurance Program to require that airlines submit copies of their commercial war-risk policies and any subsequent revisions as a condition for obtaining FAA's war-risk insurance.

In practice, FAA does not obtain a presidential determination before issuing nonpremium insurance for the initial 60-day period or any subsequent periods. There are ambiguities in the language in both the relevant legislation and FAA's implementing regulations as to whether a presidential determination is required.

Section 1302 of the Federal Aviation Act of 1958, as amended, which authorizes the Secretary of Transportation to issue war-risk insurance, requires that as a condition for providing such insurance, the President make a determination that the aircraft operations for which the insurance is sought must be continued to carry out the foreign policy interests of the United States. However, section 1304 of the act, which authorizes the Secretary to provide nonpremium insurance on behalf of other federal agencies, does not mention that a presidential determination is required before this form of war-risk insurance is issued. Nevertheless, the language of subsection 1302(c), which places a 60-day limitation on "all insurance provided under this subchapter [title XIII]," seems to require that a presidential determination be made as a condition for issuing both premium and nonpremium insurance.

FAA's regulations on this issue are also unclear. The regulations indicate that a presidential determination is one of the criteria that must be met before both premium and nonpremium insurance can be issued. No distinction is made in the regulations between the requirements for issuing the two forms of insurance.

In 1984, the Air Force questioned whether a presidential determination was required to issue nonpremium insurance since the Air Force is in charge of overseeing all the airlift services provided under the CRAF and DOD contracts that would be covered by nonpremium insurance. On December 9, 1984, FAA's Acting Chief Counsel concluded, on the basis of a review of the act and its accompanying legislative history, that the requirement for a presidential determination applied only to premium insurance. He further concluded that the President's signature on an interagency indemnification agreement was all that was required to issue nonpremium insurance.

The December 1984 determination was somewhat different from the position taken by an Assistant Chief Counsel at FAA in a memorandum dated February 2, 1984. That memorandum recommended that (1) legislative clarification be sought on the issue because the statute was unclear and (2) FAA obtain a presidential determination before issuing nonpremium insurance until the legislation was clarified.

While FAA's current practice has the advantage of being easier to administer, we believe it lacks sufficient foundation in the authorizing legislation and implementing regulations. It is difficult to reconcile the phrase "under this subchapter" in subsection 1302(c) with the authority granted to the Secretary in section 1304. Furthermore, FAA's implementing regulations fail to make a distinction between premium and nonpremium insurance, in contrast with the position FAA's Chief Counsel took in the December 9, 1984, memorandum.

Conclusions

During the Persian Gulf conflict, the Aviation Insurance Program provided a valuable service by filling the insurance void left when commercial insurers dramatically increased premiums or cancelled the airlines' war-risk coverage. However, the program's success during future airlifts could be jeopardized because (1) the available funds are insufficient to pay for potential losses and (2) delays in the payment of claims could have substantial adverse consequences for both the airlines and the government. One alternative for dealing with the problems of funding and the timeliness of payments would be for the Congress to provide DOT with access to a source of funds to pay claims that exceed the Fund's balance.

The success of the program is also jeopardized by the airlines' uncertainty about FAA's war-risk coverage and concerns about perceived gaps in the coverage as compared with the coverage provided by commercial policies.

If left unresolved, these concerns could diminish the airlines' confidence in the program and reduce their participation in future airlifts. FAA's recent effort to revise its nonpremium policies should help alleviate these concerns; however, the agency has not yet revised its premium policies or established a date for doing so.

Weaknesses in the administrative process used to issue war-risk insurance could also delay the timely payment of claims and adversely affect the program's success. Thus, we believe that FAA should require airlines registered for war-risk insurance to routinely submit to the agency copies of their current commercial war-risk policies and any subsequent changes as a stipulation for receiving insurance under the Aviation Insurance Program. This requirement would help FAA systematically verify and reconcile the levels of coverage provided under its policies and the commercial policies. It would also help ensure that the insured values under FAA's policies do not exceed those in commercial policies. Finally, ambiguities in the language of the law and the implementing regulations about the need for FAA to obtain a presidential determination before issuing nonpremium insurance and extending the policies for an additional 60 days have led us to conclude that the Congress should clarify this issue.

Recommendations to the Congress

We recommend that the Congress provide a mechanism by which DOT can obtain access to financial resources so that it can pay claims that exceed the Fund's balance within the normal time frames for commercial insurance. The source of funds could include a permanent appropriation for losses under premium insurance and the authority to borrow funds from the U.S. Treasury to pay losses under nonpremium insurance, which DOT would repay when it was reimbursed by the indemnifying agency.

We also recommend that the Congress clarify the issue of whether a presidential determination is required before nonpremium insurance can be issued and for each subsequent 60-day extension.

Recommendations to the Secretary of Transportation

We recommend that the Secretary of Transportation direct the Administrator, FAA, to

- set a date for completing the revision of FAA's premium war-risk policies to make them more consistent with commercial war-risk policies and
- require airlines to submit copies of their current commercial war-risk policies and any subsequent revisions as a condition for obtaining

premium and nonpremium insurance, and periodically verify the information submitted by the airlines.

Agency Comments and Our Evaluation

We discussed a draft of this report with the Director and other officials in FAA's Office of Aviation Policy, Plans, and Management Analysis and with officials in FAA's Office of Chief Counsel. They generally agreed with the findings, conclusions, and recommendations presented, and we incorporated their comments where appropriate. The officials stated that FAA and the Air Force were giving greater attention to resolving the funding problem by actively seeking alternative financial sources to pay claims that exceed the Fund's balance. They also pointed out that FAA plans to revise its regulations to require airlines to submit copies of their commercial war-risk policies and any subsequent revisions as a condition for obtaining insurance.

Scope and Methodology

During our review, we contacted officials at FAA's headquarters in Washington, D.C.; the Air Force Air Mobility Command at Scott Air Force Base, Illinois; the Congressional Budget Office; five airlines; two commercial insurance brokerage companies; and two airline associations. We conducted our review from April 1993 through May 1994 in accordance with generally accepted government auditing standards. Appendix I contains a detailed explanation of our objectives, scope, and methodology.

We are sending copies of this report to the Secretaries of Transportation, Defense, and the Air Force; the Administrator, FAA; and other interested parties. We will also make copies available to others on request.

This work was performed under the direction of Kenneth M. Mead, Director of Transportation Issues, who can be reached on (202) 512-2834 if you or your staff have any questions. Other major contributors to this report are listed in appendix II.

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Objectives, Scope, and Methodology

In section 403 of the Airport and Airway Safety, Capacity, Noise Improvement, and Intermodal Transportation Act of 1992 (P.L. 102-581), the Congress mandated that GAO review and report on how the Aviation Insurance Program was administered during the Persian Gulf conflict. Specifically, this report discusses (1) whether sufficient funds are available to pay insurance claims, (2) how the war-risk coverage provided by FAA compares with that provided by commercial insurers, and (3) how FAA administers the program.

We performed our work at the Office of Aviation Policy, Plans, and Management Analysis at FAA headquarters in Washington, D.C., and the Air Force Air Mobility Command at Scott Air Force Base in Illinois. We also interviewed officials at the Congressional Budget Office, two insurance brokerage companies (Alexander & Alexander of Texas, Inc., and Rollins Hudig Hall of Virginia, Inc.); two airline associations (the National Air Carriers Association, Inc., and the Air Transport Association); and five airlines (American Airlines in Dallas/Fort Worth, Tex.; Federal Express in Memphis, Tenn.; Northwest Airlines, Inc., in St. Paul, Minn.; Tower Air in Jamacia, N.Y.; and World Airways, Inc., in Herndon, Va.). We selected these airlines on the basis of a number of factors, including the types of essential airlift services they provided and the number and types of aircraft they committed to perform airlift services during the Persian Gulf conflict.

To address the first objective, we reviewed pertinent documents and interviewed FAA and Air Force officials to determine the procedures and amounts of moneys readily available to pay claims for damages or losses covered by FAA's war-risk insurance. In addition, we discussed alternative funding sources that could be used to pay any claim that exceeds the balance in the Aviation Insurance Revolving Fund.

To address the second objective, we interviewed officials at FAA, five airlines, insurance brokerage companies, and airline associations to obtain their views on (1) what differences existed between the coverage provided by FAA and by commercial insurers in their war-risk insurance policies, (2) whether any identified differences were major concerns to the airlines, and (3) what actions FAA had taken or needed to take to make its insurance policies more like commercial war-risk policies. In addition, we analyzed and compared FAA and commercial war-risk policies for the five airlines included in our review to identify differences in insurance coverage.

For the third objective, we reviewed applicable FAA and Air Force regulations, procedures, and guidance documents to obtain a thorough understanding of the administrative process FAA uses to issue war-risk insurance. We then interviewed FAA, Air Force, and airline officials to confirm our understanding of the process and to identify weaknesses or ways the process could be managed more efficiently.

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