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AVIATION INSURANCE

Issues Related to the  
Reauthorization of FAA's  
Aviation Insurance Program

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Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify before the Subcommittee on the reauthorization of the Federal Aviation Administration's (FAA) Aviation Insurance Program (the program). The program, which is scheduled to lapse on September 30, 1997, provides insurance coverage for aircraft operations that are deemed essential to the foreign policy interests of the United States when commercial insurance is unavailable on reasonable terms. It is an important program for maintaining both the financial security of U.S. airlines and U.S. foreign policy interests, because the government must call on commercial airlines to move troops and supplies when it has insufficient airlift capacity. The U.S. Department of Defense (DOD) and the Department of State have relied on the program, as have different commercial airlines.

Our statement today reviews changes made to the program since we last reported on it in 1994.<sup>1</sup> In that report, we found that the program did not have sufficient funds available to pay potential insurance claims in the unlikely event of a catastrophic loss. We are pleased to note that progress has been made in addressing this matter. Specifically, the National Defense Authorization Act for Fiscal Year 1997 made funds available to indemnify the program for losses incurred under DOD-sponsored flights, which account for the majority of flights insured.

While our major concern has been addressed, two other concerns that we raised in our 1994 report remain unresolved. First, gaps remain in the program's ability to pay claims for non-Defense flights. Although these flights account for a relatively small percentage of the flights that have been insured by the program, a single major loss could liquidate the program's available funds and leave a substantial portion of the claim unpaid. FAA would need to seek supplemental funding to pay the claim, but the delay could cause financial hardship for the affected airline. Second, we believe that some uncertainty about the program continues to be caused by ambiguity in the statutory language and FAA's current implementing regulations about whether the President must make a determination that a flight is in the foreign policy interests of the United States before issuing insurance.

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<sup>1</sup>Aviation Insurance: Federal Insurance Program Needs Improvements to Ensure Success (GAO/RCED-94-151, July 15, 1994).

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## Types and Uses of Aviation Insurance

Commercial airlines normally carry commercial insurance to cover losses caused by such things as mechanical failure, weather, and pilot error. In addition, they carry war-risk insurance to cover losses resulting from war, terrorism, or other hostile acts. Commercial war-risk insurance, however, can be canceled or restricted in the event of a major war, its geographical coverage can be restricted, and its rates can be raised without limit. Therefore, to provide the insurance necessary to enable air commerce to continue in the event of war, the Aviation Insurance Program was established in 1951. The program authorized FAA to provide war-risk insurance for those commercial aircraft operations deemed essential to the foreign policy of the United States when such insurance is not available commercially or is available only on unreasonable terms. In 1977, the Congress authorized the program to provide aviation insurance due to any risk, not just war risk, under the above conditions. To date FAA has issued only war-risk insurance.

The fundamental premise underlying the program, according to FAA, is that the government should not provide insurance on a regular or routine basis; rather, the government should be the insurer of last resort. Consequently, FAA is not statutorily required to issue insurance to air carriers. Rather, FAA may issue aviation insurance only when certain conditions are met: (1) The President must determine that the continuation of specified air services, whether American or foreign flag, is necessary to carry out the foreign policy of the United States and (2) the Administrator of the FAA must find that insurance for the particular operation cannot be obtained on reasonable terms from the commercial insurance market.

FAA issues two types of aviation insurance: nonpremium and premium. FAA issues nonpremium insurance for airlines performing contract services for federal agencies that have indemnification agreements with the Department of Transportation (DOT). Under the indemnification agreements, the federal agencies that contract for aircraft reimburse FAA for the insurance claims it pays to the airlines. This insurance is provided at no cost to the airlines, except for a one-time registration fee of \$200 per aircraft. At present, only DOD and the State Department have such indemnification agreements with DOT. Nonpremium insurance accounts for about 99 percent of the aviation insurance issued by FAA. Since 1975, about 5,400 flights have been covered.

For example, in 1990 and 1991, during Operation Desert Storm/Shield, FAA issued nonpremium insurance for over 5,000 flights of commercial airlines

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that provided airlift services as part of the Civil Reserve Air Fleet (CRAF).<sup>2</sup> The commercial insurers had canceled war-risk coverage for those airlines that had clauses in their policies excluding CRAF activities. In addition to the CRAF program, the commercial air carriers insured under the program have flown many other important airlift missions for the United States, such as 111 flights to Tuzla, Bosnia, in 1996.

For other regularly scheduled commercial or charter service, FAA issues premium insurance. With premium insurance, airlines pay premiums commensurate with the risks involved, and FAA assumes the financial liability for claims. As a condition for obtaining premium insurance, the aircraft must be operating in foreign air commerce, or between two or more points both of which are outside of the United States. In total FAA has provided this insurance for 67 flights since 1975. For example, FAA provided premium insurance in 1991 for flights operated by Tower Air to evacuate U.S. citizens from Tel Aviv.

Both forms of FAA's insurance cover loss of or damage to the aircraft (hull insurance), along with coverage for bodily injury or death, property damage, and baggage and personal effects (liability coverage). The maximum amount of hull and liability coverage that FAA provides under its policies is limited to the amounts insured by an airline's commercial policy.

The 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 registration fee charged for nonpremium insurance, and interest on investments in U.S. Treasury securities. From fiscal year 1959 through March 1997, the Fund accumulated approximately \$65 million in revenues and paid out net claims totaling only about \$151,000. Appendix I summarizes the major attributes of the program.

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<sup>2</sup>CRAF is composed of the commercial aircraft and crews that airlines commit to support military airlift requirements during national emergencies. CRAF provides up to half of the nation's strategic airlift capability without the government having to purchase additional aircraft, pay personnel costs, or fly and maintain the aircraft during peacetime. According to information from the U.S. Transportation Command, which oversees the CRAF program, as of December 1996, 34 different airlines had contracted with DOD to provide up to 674 aircraft during CRAF activations. The Persian Gulf conflict was the first and only time CRAF has been activated since its inception in 1951.

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## National Defense Authorization Act for Fiscal Year 1997 Addressed the Majority of Problems With Insurance Program Funding

In 1994, we reported that the Fund's balance was insufficient to pay many potential claims and that delays in the payment of claims could cause a financial hardship for affected airlines. Since then, however, the National Defense Authorization Act for Fiscal Year 1997 (P.L. 104-201) has addressed these problems for DOD-sponsored flights.

When we reported on this issue in 1994, about 20 percent of the aircraft registered for nonpremium insurance had hull values—the value of the aircraft itself—that exceeded the Fund's balance of \$56 million. According to FAA's most currently available information, about 15 percent of the aircraft registered for nonpremium insurance have hull values that exceed the Fund's March 31, 1997, balance of about \$65.2 million.<sup>3</sup> In other words, the loss of any one of those aircraft would liquidate the entire balance and leave the liability portion on any claim unpaid. FAA estimates that the average contingent liability per incident for each registered aircraft is about \$350 million. Clearly, the Fund's balance is inadequate to settle claims of this magnitude. We also reported in 1994 on a related problem with the timeliness with which the government could reimburse an airline for a major loss. Because the FAA would have needed to seek supplemental funding to pay any claims that exceeded the Fund's balance, airline officials had expressed concern that untimely reimbursements could cause severe financial hardships and possible bankruptcy.

The National Defense Authorization Act directed that the Secretary of Defense promptly indemnify the Secretary of Transportation for any loss covered by defense-related aviation insurance within 30 days. Second, the act authorized the Secretary of Defense to use any available operations and maintenance funds for that indemnification. The appropriations made to the Defense Department's operations and maintenance accounts for fiscal year 1997 totaled approximately \$91 billion. The unobligated balance remaining at the end of fiscal year 1997 is estimated to be \$0.9 billion. Thus, sufficient funds appear to be available to reimburse the airlines for defense-related aviation hull losses, and there is a legislative requirement to do so in a timely manner. According to the FAA, industry, and airline officials with whom we spoke, these provisions generally resolve much of the uncertainty that they had earlier expressed about the Fund's insufficient balance.

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<sup>3</sup>FAA's June 1996 listing of registered aircraft showed that of the 834 aircraft registered, 114 (14.5 percent of the 783 that had hull values listed) had hull values that exceeded the Fund's March 31, 1997, balance. FAA's April 21, 1997, listing showed that 970 aircraft were registered; however, individual hull values for these aircraft were not readily available from FAA.

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## Further Changes Are Needed in the Aviation Insurance Program

We have two remaining concerns about the program. The first is making sure that the program has sufficient funds available to pay potential insurance claims for non-Defense-related flights in a timely manner. The second involves clarifying whether an explicit presidential determination of the foreign policy interests of the United States is needed before FAA can issue insurance.

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## Making Sure That the Fund Is Sufficiently Capitalized

For the relatively rare flights for which FAA may extend nonpremium insurance at the request of the State Department (one flight since the program's inception) and for the flights for which FAA provides premium insurance (67 flights since 1975), the Fund may still be undercapitalized in the event of a catastrophic loss. The insured State Department flight occurred in January 1991, when U.S. personnel were flown from Oman to Frankfurt because of the increasing unrest in Somalia. FAA also has extended premium insurance relatively infrequently. Most recently, premium insurance was issued for 37 flights to or from the Middle East between August 1990 and March 1991, which included evacuating U.S. citizens from Tel Aviv and ferrying cargo to Dhahran.

While FAA has paid no claims for premium insurance flights in the history of the program, if there should be a catastrophe, the Fund may not have sufficient money to pay the claim in a timely manner. Not counting the liability associated with the loss of a flight, a claim for the loss of a single aircraft—which can cost \$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.

In 1994, FAA proposed alternative financing sources to make additional funds available for the reimbursement of major claims. Those alternatives included obtaining a permanent indefinite appropriation from the Congress and the authority to borrow funds from the U.S. Treasury to pay claims that exceed the Fund's balance. FAA proposed using the permanent appropriations to pay claims under premium insurance, and the borrowing authority to pay claims under nonpremium insurance while awaiting a supplemental appropriation from the Congress or reimbursement from the indemnifying agency. However, the Office of Management and Budget did not approve the proposal, and the administration therefore did not forward the proposal to the Congress. Thus, the Fund remains potentially undercapitalized.

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FAA is proposing to raise the one-time fee that the airlines pay to register each aircraft for nonpremium insurance. FAA published a notice of proposed rulemaking in the Federal Register on April 17, 1997, that would raise the registration fee from \$200 to \$550; the increase is based on the changes in the consumer price index since the fee was set in 1975. However, such an increase would have a limited impact on the Fund's balance in comparison with the potential costs resulting from a major loss of a non-DOD flight.

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## Clarifying That Flights Are in the Interests of the United States

In our 1994 report, we recommended that the program's authorizing legislation be clarified because there were ambiguities in the legislation and in FAA's implementing regulations about the need for FAA to obtain a presidential determination that a flight is in the foreign policy interests of the United States before issuing nonpremium insurance. No clarification in the legislation nor in the current FAA regulations have been made, and we believe that ambiguities still exist.

FAA does not see this situation as a problem. FAA considers presidential approval of the indemnity agreement between DOT and other government agencies to constitute the President's having determined that the flights covered by these agreements are in the foreign policy interests of the United States.<sup>4</sup> This position is based on FAA's Acting Chief Counsel's 1984 review of the legislation and its accompanying legislative history. He concluded that the requirement for a presidential determination applied only to premium insurance and that the President's signature on an interagency indemnification agreement was all that was required to issue nonpremium insurance.<sup>5</sup> FAA published a proposed rulemaking in the Federal Register on April 17, 1997, that would revise its regulations to point out specifically that the presidential approval required for the issuance of nonpremium insurance is demonstrated by the standing presidential approval of the indemnification agreements with other government agencies.

We disagree with FAA's position. We believe that while FAA's current practice has the advantage of being easier to administer, it lacks sufficient foundation in the authorizing legislation and current implementing regulations. We believe that the act, as currently written, requires that a presidential determination be made as a condition for issuing both nonpremium and premium insurance.

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<sup>4</sup>The last agreement was signed by President Bush on April 12, 1990.

<sup>5</sup>FAA obtains a presidential determination before issuing premium insurance.



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In our 1994 report, we recommended that the Congress consider legislative changes that would address the Fund's capitalization and the ambiguities about presidential determination. During this reauthorization process, we continue to believe that the Congress should consider providing 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 for those few flights not sponsored by DOD. The source of funds could include (1) a permanent indefinite appropriation to cover the potential losses incurred during premium-insured flights and (2) the authority to borrow sufficient funds from the U.S. Treasury to pay the losses incurred during nonpremium flights made for qualifying government agencies other than DOD. DOT would repay the Treasury after it was reimbursed by the indemnifying agency. According to an analyst in the Congressional Budget Office, such changes would have no perceptible effect on the federal budget.<sup>6</sup> We also continue to believe that the Congress should clarify the issue of whether or not a presidential determination is required before FAA can issue nonpremium insurance.

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This concludes our prepared statement. I would be happy to respond to any questions that you or members of the Subcommittee might have.

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<sup>6</sup>The Budget Enforcement Act of 1990 (P.L. 101-508) requires that all direct spending and tax legislation enacted for a fiscal year must be deficit neutral in the aggregate. (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.) If such legislation causes a net increase in the deficit, it must be offset either by increasing revenues or by decreasing direct spending in another program in the same fiscal year. According to an analyst in the Congressional Budget Office, although this requirement would apply to a proposal such as this, an offset would probably not be needed for the proposal, since it would likely be judged to have no effect on the deficit on the basis of the historically low losses in the program.

# A Summary of the Major Attributes of the Aviation Insurance Program

Item	Nonpremium	Premium
Definition	Insurance issued for American or foreign-flag aircraft under contract to any federal department or agency that has an indemnification agreement with DOT	Insurance provided to American or foreign-flag aircraft for regularly scheduled commercial or charter service between two or more points outside the United States
Coverage	Hull and liability insurance	Hull and liability insurance
Insurance premium	None	Applicant pays FAA commensurate with risk
Registration fee	One-time registration fee of \$200 per aircraft	None
Payment of claims	Paid out of Aviation Insurance Revolving Fund	Paid out of Aviation Insurance Revolving Fund
Claims paid since the program's inception in 1951	\$151,000	None
Reimbursement	The indemnifying agency reimburses FAA for insured losses	None
Flights insured since 1975	About 5,400 (over 99 percent of the total), most of which occurred in support of Operation Desert Storm/Shield	67
Sponsors/users of insured flights	DOD—All but one flight sponsored by DOD as part of the Civilian Reserve Air Fleet or under individual contracts with DOD  State Department—one flight	Commercial air carriers
Aircraft currently registered	970 specific aircraft with 46 carriers under contracts with DOD  10 carriers with State Department policies—but only two carriers have registered aircraft	Not applicable
Mechanism for reimbursement	The National Defense Authorization Act for Fiscal Year 1997 authorized the Secretary of Defense to use any available operations and maintenance funds for indemnification  Department of State has no specific source of funds	Not applicable. FAA assumes the financial liability for claims payable

Source: GAO's analysis of information from FAA.

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# Related GAO Products

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Military Airlift: Observations on the Civil Reserve Air Fleet Program  
(GAO/NSIAD-96-125), March 29, 1996.

Aviation Insurance: Federal Insurance Program Needs Improvements to  
Ensure Success (GAO/RCED-94-151), July 15, 1994.

Military Airlift: Changes Underway to Ensure Continued Success of Civil  
Reserve Air Fleet (GAO/NSIAD-93-12), December 31, 1992.

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