



## AVIATION INSURANCE IN PRACTICE

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**Abstract--**Insurance market and aviation industry corresponds with each other in their growth pattern. Aviation insurance attracts comparisons with other similar insurance like marine and automobile insurance. Navigational risks are closer to those covered in marine insurance while passenger and third party liability has close resemblance with motor insurance. Though there are many similarity in these insurance, the aviation insurance has its own unique characteristics due to highly technical character and national as well as international operations of aircrafts as well as use of aircraft for criminal and terrorist activities. This article aims to give some insight into the specific aspects of aviation insurance, as well as its categories and market practises in the area.

**Key words:** aviation, insurance, aircraft, categories, practices, Lloyd's.

### INTRODUCTION

In India, aviation insurance risks are still in their infancy. Before the liberalisation period, three big businesses controlled the aviation industry: Air India, Indian Airlines, and Vayudoot (no more in existence). Small planes from flying schools, businesses, and people were also present. However, they only had a minor part in the aviation industry. Because the three major airlines are government-owned, they are obligated to carry insurance. General Insurance Corporation took care of their insurance needs (GIC). National Insurance Company Limited, Calcutta, New India Assurance Company Limited, Mumbai, Oriental Insurance Company Limited, New Delhi, and United Insurance Company Limited, Chennai, were GIC's other four subsidiaries with little involvement in the industry. As a result, the necessity to promote insurance services in this sector did not develop. In 1991-92, the Indian government moved to liberalise the economy by opening up key sectors, including air transport, in a restricted fashion at first. For the General Insurance industry, this ruling had far-reaching consequences. A large number of gamers first invaded this area. In light of the quick growth of the aviation industry, GIC decided to delegate underwriting of this type of business to its subsidiaries. The procurement of general aviation business was available to competition for the first time since the insurance sector was nationalised. More crucially, a hitherto untapped source of large sums of premia became available.<sup>1</sup> In India, the General Insurance Corporation (GIC) was the principal underwriter of aviation insurance. All other aviation insurance business, including that related to private aircraft, is written by GIC's four subsidiaries: (a) National Insurance Companies Ltd., Calcutta, (b) New India Assurance Co. Ltd., Mumbai, (c) Oriental Insurance Co. Ltd., N. Delhi and (d) United Insurance Co. Ltd. Chennai.

Aviation insurance is characterised by extremely large aircraft values and liabilities, as well as a relatively modest capacity of the Indian insurance market. As a result, the Indian market is forced to outsource a significant portion of its risks to reinsurers in international reinsurance markets. London's 'Lloyds' is home to the world's largest aircraft reinsurance market. France, several European countries, and the United States all have rather substantial markets. GIC and other insurance firms negotiate terms with underwriters in London and other aviation insurance markets through brokers on behalf of India's major aircraft operators.<sup>2</sup>

<sup>1</sup> Papers presented at Workshop on aviation insurance 1997 at Oriental staff Training College, Faridabad, organized by Oriental Insurance company Ltd. (Aviation Department)

<sup>2</sup> *supra* f.n. 1.



#### UNIQUENESS OF AVIATION INSURANCE

At first inspection, aviation insurance appears to be quite similar to the forms designed for automotive insurance. The coverage is much the same. Direct loss and liability coverage are the two types of coverage available. The risk, however, is extremely different in terms of some of the hazards, and as a result, the coverage as it applies to automotive insurance has been significantly adjusted to match the aviation risks.

Aviation insurance is more expensive than automotive insurance. Direct loss insurance, depreciation, and obsolescence are all extremely important considerations in aviation. Finally, the dangers associated with aeroplanes and air travel are in some cases higher than, and in many cases distinct from, those associated with automobiles. The physical condition, training, and experience of the pilot are among the most critical factors. While it is true that unskilled car drivers are to blame for many accidents, a pilot's negligence is devastating. As a result, the cliché "Good pilots die in bed" has emerged.

Because of the large sums at stake, the unusual nature of the risk, and the small number of risks covered, interested businesses have opted to join syndicates to write aviation risks, with underwriting issues handled by agents or managers who specialise in aviation coverage.

#### CATEGORIES OF AVIATION INSURANCE

Aviation Insurance is divided into several categories. There is a distinction between ground coverage and flight coverage in aviation insurance. The ground coverage only pays out if the loss happens when the plane is stationary and not in flight. Damage to the machine caused by flight as well as liability coverage are included in the flying coverage. Under all circumstances, an aircraft is considered not in flight for insurance purposes, except for the period beginning with the actual takeoff run and continuing until it has successfully completed its landing run. The distinction is critical, as borderline circumstances regularly arise, raising questions about the coverage's actual status. Even if both ground and flying coverage are included in a single policy, if the insured is covered under a participating or deductible form under flight coverage and has full protection under ground coverage, the amount of the company's liability will vary depending on whether the accident occurred just prior to takeoff, immediately after landing, or during flight.

Because the pilot's competence and experience are considered to account for 90% of a company's risk, underwriting aviation insurance places a premium on the credentials and character of the pilots who will fly the covered planes. The continued validity of the flying crew's certification is a requirement for the continued validity of aviation insurance.

At first appearance, aircraft coverage appears to be similar to vehicle coverage. To some extent, this is correct, but the risk in aviation insurance differs from that in automotive insurance in so many ways that coverage has been devised that differs greatly from automobile plans in many key areas.

The policies cover: (a) hull policies, which cover the risk of loss or damage to the insured aircraft; (b) aircraft liability coverage, which covers public and passenger liability as well as property damage liability; (c) hanger keeper's liability, which covers the bailee's liability with respect to aircraft stored for safekeeping or repair; (d) admitted aircraft liability, which provides for voluntary settlements to injured passengers; and (e) medical payments regardless of liability; (f) Similar to the owner's landlord's and tenant's forms that are commonly produced for property owners, airport and air meet liability plans give protection. (g) products liability, which protects manufacturers, sales or repair organisations, and others against lawsuits arising from defective products or work:

(h) aircraft workers' compensation and employer's responsibility; (i) aviation personal accident insurance and certification insurance; and (ii) cargo liability, which covers legal liability for cargo or luggage loss or damage.

Freight responsibility should not be confused with cargo insurance. Cargo insurance isn't really an aircraft line; instead, it's written by fire companies' inland marine divisions. The hanger fire risk



windstorm hazard, and theft losses come within the scope of ground coverages . Accident damage or "crash insurance", public liability , passenger liability, and property damage form the important coverages of the flying classification.

#### AVIATION INSURANCE AT A GLANCE: CATEGORIES

1. Hull All Risk
2. Hull War Risks
3. Spares All Risks
4. Hull Deductible Insurance
5. Mechanical Breakdown Insurance
6. Loss of Use Policy
7. Profit Commission Insurance
8. Unearned Premium Insurance
9. Passenger Legal Liability
10. Third Party Legal Liability
11. Cargo/Mail/Baggage Liability
12. Hanger keeper Legal Liability
13. Products Legal Liability
14. Airports Owners/Operators Liability
15. Air Traffic Control Liability
16. Aircraft Refuelling Liability
17. Satellite Insurance
18. Personal Accident (Aviation) Insurance
19. Aircrew Loss of License

These categories may include sub-categories. In addition to these, there are other types of coverages also depending upon the demands of parties.

#### PRACTICES

##### **1. *International Market of Aviation Insurance***

Airlines throughout the world have long relied on insurance to safeguard them from loss or liability.<sup>3</sup> Traditionally, this insurance was almost entirely placed in the London insurance market, where highly skilled brokers worked with similarly qualified insurance underwriters to obtain the requisite coverage. Few airlines were fully aware of all the subtleties of their insurance policies. It was enough that their brokers were aware of the circumstances and that the insurance was in place in London. A London insurance has the same level of security as gold.<sup>4</sup> Lloyd's of London, as well as British and international firms permitted to transact insurance, make up the London insurance market.

##### **a) *Lloyd's of London***

Originally, Lloyd's began as a coffee shop operated by Edward Lloyd on Tower Street in London, where businessmen congregated over coffee for casual chats about commercial issues in the late seventeenth century. Because there was no structured insurance market back then, insurance was done on a personal level, with people seeking insurance requesting reputed merchants to assume a percentage of a risk by putting their names on a slip of paper under a declaration of the risk. As a result, they were dubbed

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<sup>3</sup> Aviation insurance was first written in London in 1908. *See* Insurance Institute Of London Report

H. R,10, A Short History Of Aviation Insurance In United Kingdom(1966) ; *See also* Ian Ormes, "*Leading Edge: The Pioneering Years of Aviation Insurance*" Michael Rainbird Publishing Limited; 1st ed. (1988)

<sup>4</sup> Rod. D. Margo, "Insurance in Aviation Finance", 62 *JALC* 47 1996



"underwriters." Lloyds Coffee House was an ideal location for meeting such people, and those looking for insurance began phoning in to check if anybody was interested. Lloyd promoted the practise by supplying resources, and insurance soon became a big concern for his clients. Lloyds used runners to provide the latest news and produced a news sheet called Lloyd's News for a brief time.

The facilities continued to function as an insurance centre after Lloyd's death in 1713, and the Lloyd's List, which began publication in 1734, is one of London's oldest daily newspapers. The Corporation of Lloyd's was created by an Act of Parliament in 1871. In 1982, this Act was amended to create the Lloyd's Council, which was given expanded powers. It is made up of sixteen working members who are elected by the Council, eight non-working members who are elected by the Council, and three nominated members.

Lloyd's is an organisation whose members, known as Lloyd's underwriting members, transact insurance on their own account as principals. The Corporation does not conduct insurance; instead, its Committee offers clerical and commercial services to the underwriters and ensures that the Corporation's high requirements are followed. Because the institution's typical monolithic structure has been substantially impacted by serious losses over a number of years, these high requirements are under tremendous strain. For the first time, the internal self-regulatory mechanism has proven ineffective in resolving the issues, and a number of court proceedings have been filed in which 'name' is suing key underwriters in some syndicates. Traditionally these people have been called underwriting members of Lloyds and they have traded with unlimited liability.

#### ***b) Lloyd's Underwriters***

Until recently, the only persons eligible to accept insurance at Lloyd's were the underwriting members. This group included men and women of any country who had been suggested by other members and had shown their honesty and financial status to the committee. They were required to adhere to the Corporation's strict guidelines. The following were among them.

I Personal and unlimited accountability for any contracts they entered into.

(ii) Providing suitable security in proportion to the volume of transaction conducted. The Corporation of Lloyd's retained this money in trust and utilised it, together with the member's personal assets, to pay his or her underwriters' responsibilities.

(iii) The premiums generated have to be deposited into premium trust accounts established by the Corporation and the Department of Trade through deeds of trust. These trust funds could only be used for claims, costs, and demonstrated profits.

(iv) Members were required to purchase a guarantee insurance whose value was proportional to their premium income. Other members of Lloyd's subscribed to the policy in accordance with the Committee's guidelines.

(v) To cover underwriting responsibilities, members were required to contribute to a central fund at a rate that constituted a levy on premium revenue. The underwriter's personal fortune, combined with his security held in trust, was only sufficient to meet the underwriting commitments, and funds could only be withdrawn to the extent that the underwriter's personal fortune, together with his security held in trust, was sufficient to meet the underwriting commitments.

(vi) Submitting to a yearly audit This is now a legal requirement, but the United Kingdom Assurance Companies Act gives legal force to the Corporation of Lloyd's long-standing requirement that members submit to an audit that would detect not just a bookkeeping error or something similar, but any fundamental weakness in the underwriter's position. In this regard, the current trend in his or her underwriting efforts may be more important than previous trends and might, for example, indicate a tendency to take too large a share of more risky business. The audit's goal was to halt any such trend and set reserves at a level that would protect the insured party's position.

From the above, it is evident that the Lloyd's system has always been exceedingly stringent, based on the underwriters' limitless responsibility. The notion of unlimited responsibility, which was usually





abandoned in company affairs as early as 1856, has survived at Lloyd's to this day. It may have ultimately broken down as a result of the enormous dangers that must be covered in the current environment. The London underwriters despatched a representative to the San Francisco earthquake in 1908 with roughly \$30 million in banknotes to pay claims on the spot. At any one time of day or night, around 1 million people from across the world are in the air, all of whom are insured, and even a single challenged claim can result in millions of dollars in damages. It has proven to be a serious issue for parts of the London reinsurance market that have taken up commitments in this area.

Despite the Corporation's sincere efforts to settle the issues by establishing funds from which some of the worst-affected members may be helped to satisfy their obligations, legal action has proceeded. Aside from that, the Corporation is taking extraordinary measures to decrease expenses and encourage underwriters to charge reasonable rates in order to reduce losses. It is doing everything it can to preserve the market's integrity by continuing to accept claims in difficult areas like aviation and attracting additional capital from both individual members and, for the first time, incorporated names structured as limited companies dedicated to Lloyds underwriting.

#### **c) Syndicates**

Because today's insured values are so high, it's hard for any single underwriter to take on a considerable portion of any given risk. Finding enough underwriters to cover any given 'slip' would be extremely time consuming if it weren't for the 'syndicate' method. A syndicate might include up to 100 underwriters. Although not all syndicates are as large as 100, when one signs on behalf of a group, he is allowed to accept for all of the 'names' in his syndicate. As a result, he assumes a reasonable portion of the risk, but the load on an individual underwriter will not be too burdensome. These are the underwriters who sit in the 'boxes' on the floor of the Underwriting Room, writing business for syndicates, and who appear in most of the photographs of Lloyd's of London at work.

#### **d) Insurance Agents and Brokers**

Insurance brokers place the majority of aviation insurance on the market.<sup>5</sup> Brokers are utilised because of their specialised understanding of current insurance market circumstances, their ability to work with several insurers concurrently throughout the world, and their competence in counselling customers on their individual insurance requirements.<sup>6</sup> In most cases, the broker acts as the insured's agent in the insurance placing process.<sup>7</sup> In addition to distributing the policy and collecting premiums, the broker may also function as an agent for the insurers.<sup>8</sup>

The placement of insurance in the London market is indicated by the broker's issuing of an insurance "policy slip," which outlines the coverage requested in abbreviated form.<sup>9</sup> The broker will next choose an underwriter who, in his opinion, will quote a fair premium and whose lead will be respected by other underwriters. This underwriter will be approached by the broker, who will offer him a part of the insurance to be written. If the parties can agree on the premium and other insurance terms and

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<sup>5</sup> Insurance can only be placed at Lloyd's by an admitted Lloyd's broker. See Lloyd's brokers byelaw no. 5(1988). (as cited in Rod D. Margo, "Insurance in Aviation Finance" *JALC*, vol. 62, p. 435 1996.

<sup>6</sup> Rod D. Margo, Insurance in Aviation Finance; *Journal of Air law and Commerce*, 62, 435 1996.

<sup>7</sup> *General Accident Fire and Life Assurance Corp. v. Tanter*, (1984) 1 Lloyd's Rep. 58, 62 (Eng. Q.B.) (per Hobhouse, J.), rev'd on other grounds, (1984) 2 Lloyd's Rep. 529; *American Airlines Inc. v. Hope*, (1974) 2 Lloyd's Rep. 301,304(Eng. Q.B.) (per Lord Diplock). (as cited in Rod D. Margo, See note 6 above.)

<sup>8</sup> See, e.g., *Transamerica Interway Inc. v. Commercial union Assurance Co. of S. Africa*, 97 F.R.D. 419 421 (S.D.N.Y.1983).

<sup>9</sup> *Supra* f.n.6

*Eagle Star Ins. Co. v. Spratt*, (1971), 2 Lloyd's Rep. 116,123 (Eng. C.A.); *Insurance Co. v. Grand Union Insurance Co.* (1990) 1 Lloyd's Rep. 208,209 Hong Kong C.A.



conditions, the underwriter will take the risk and sign the slip, so becoming a party to the insurance contract with the insured.<sup>10</sup>

The underwriter will be known as the "leading underwriter" or "leader" and will be in charge of technical concerns such as policy writing and claim management. The remaining element of the risk will be put in the market in the same manner, albeit in the case of airline risk, the broker is likely to contact underwriters in places other than London in order to obtain the best premium rate or the requisite capacity. The issue of an insurance policy or cover letter to the insured confirms the placement of insurance.

#### CONCLUSION

Aviation insurance is a difficult topic to grasp. The vast majority of aviation hazards are classified as vertical. This means that the placement is built up from the bottom up, with the initial slice being placed at the lowest price and subsequent slices being added according to the available rates and capacities. While there will be a single policy leader, the airline's complete insurance programme may have up to eight or more separate sets of premium rates.

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<sup>10</sup> Eagle Star Ins. Co. v. Spratt, (1971), 2 Lloyd's Rep. 116,123 (Eng. C.A.); Insurance Co. v. Grand Union Insurance Co. (1990) 1Lloyd's Rep. 208,209 Hong Kong C.A.