

UNDERINSURING THE AIRCRAFT PHYSICAL DAMAGE.

There is no question that the value of used aircraft has decreased during the current economic downturn. In fact, certain makes and models of aircraft have dropped by as much as one third. In cases such as this, it only makes good sense to reduce the amount of hull insurance to the true replacement value of the aircraft. The *Aircraft Blue Book Price Digest* is the quick reference that the underwriter uses to establish a general value for insurance purposes. I am not saying that this guide is always accurate for a specific aircraft, but it gives us a place to start. Of course, our goal is to insure the aircraft for its replacement value. Remember, your insurance policy is written on an agreed, or stated value basis. It is the amount of hull value shown on your policy that will be used to adjust all hull claims.

“But I only owe the bank half the value of the hull and I am willing to take the risk (self insure) for my half.” Unfortunately, the contract (insurance policy) doesn’t work like that. As mentioned above, the policy is written on an agreed amount basis. If your aircraft would cost \$200,000 to replace and you insure it for \$100,000, it could be said that you are 50% insured to value. In the event of a total loss, the insurance company would write you a check for \$100,000 and take the salvage. If this makes you and your banker happy and you have saved valuable premium dollars, you have accomplished your goal.

But what if the loss does not result in a total loss? In most aircraft accidents, the loss is a partial loss. In our example, this means the insurance adjuster will establish a cost to repair. He will also obtain salvage bids. If we carry \$100,000 hull insurance on a \$200,000 aircraft and have a \$70,000 partial loss, and the adjuster obtains a \$130,000 salvage bid, what do you think you will receive in the form of a settlement? If you were the adjuster, would you repair the aircraft? Or, would you declare the loss a constructive total loss, take title to the salvage and pay the insured the face amount of the policy, \$100,000.

How much did you save in premium? If you were quoted a 2% hull rate for the \$200,000 aircraft, you would have been charged a premium of \$4,000. If you decreased your hull value to \$100,000, would you expect to pay \$2,000?

Unfortunately, things are not always so simple. The underwriters charge more per \$100 of hull protection for a lower valued hull than they do for a higher value aircraft. As the value decreases, the hull rate per \$100 increases.

In our above example, the \$100,000 hull might be charged with a 3% or higher rate. This would result in a lower savings and may not be worth the risk.

This is referred to as rate banding. It is easily seen in the life insurance industry. An individual who purchases \$1,000,000 in death benefit will pay less per \$1,000 of coverage than if he purchased a \$100,000 policy.

Although I cannot understand the reason for rate banding in the life insurance industry, in aviation insurance it does make some sense. The aviation underwriter is simply looking for some minimum amount of premium in the policy to handle the most frequent, small, partial loss.

In short, be careful when drastically reducing your hull values. Moderation may be the best solution. A slight reduction in insured hull value may not result in increased rates or in problem claims. The best advice, however, is to fully insure your aircraft. Insure it for the estimated replacement value.