

The Impact of The War in Ukraine to Aircraft Leasing Companies and Aviation Insurers

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KPMG

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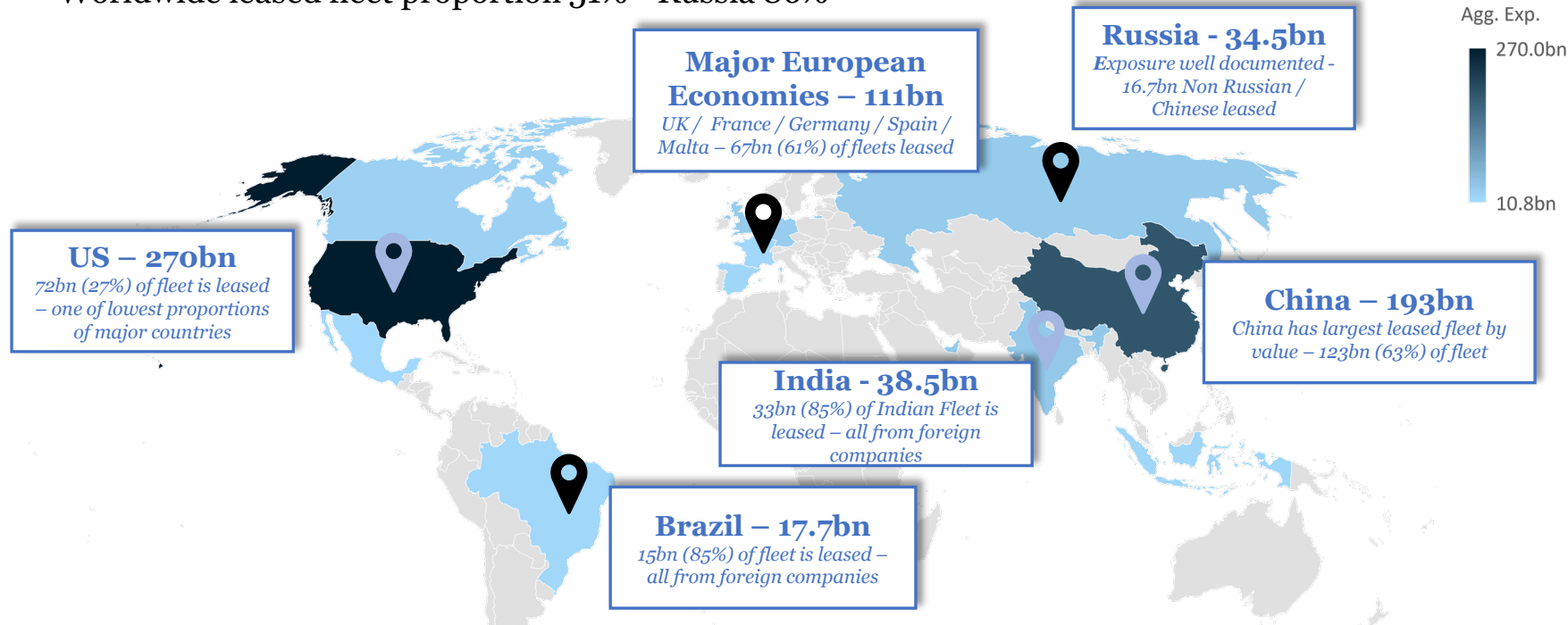
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The Evolution of Commercial Jet Leasing in Russia

- The decline of Russian aircraft production
 - 60 years ago, a well-developed industry
 - The dissolution of the Soviet Union
 - In 2005, only six commercial aircraft produced nationwide!
- Yet, the expansion of Aeroflot and Rossiya, etc.
- Wide-scale leasing of narrow/wide body Airbus and Boeing jets
- Jefferies – 728 Western-built aircraft; 515 leased by foreign lessors; \$10B

Aircraft Exposure Distribution – Leased Proportion

Worldwide leased fleet proportion 51% - Russia 86%



Which countries are now attracting greater focus – China?

USA Leasing Breakdown

USA:	30.3bn
Ireland:	29.8bn
Singapore:	3.4bn
China:	2.9bn
ROW:	5.7bn

Russia Leasing Breakdown

Russia:	9.6bn
Ireland:	8.6bn
USA:	4.7bn
China:	3.2bn
ROW:	3.5bn

China Leasing Breakdown

China:	81.5bn
Ireland:	22.2bn
USA:	7.6bn
Singapore:	4.9bn
ROW:	6.2bn

by Bing
ikipedia

The Invasion of Ukraine

- Initial build up in March 2021-April 2021
- Russian troops massed along the borders of Ukraine in October 2021
- Invasion began on February 24, 2022

Sanctions and Other Responses to Invasion

- Russian expulsion from SWIFT
 - Russia decrees that contracts “in the transport sphere” converted to rubles, so type C-ruble denominated accounts (lessors cannot accept)
 - “We are ready to fulfill our contractual obligations to lessors” – Aeroflot
- Suspension of carrier permits and airspace restrictions
 - February 24, 2022 – the U.K. suspended Aeroflot’s foreign carrier permit; Russia restricted all U.K. aircraft from airspace and landing
 - February 28, 2022 – the EU banned all Russian aircraft from landing, taking off and flying over; Russia responded re: 36 EU nations
 - March 2022 - FAA NOTAM prohibiting Russian flight operations

Sanctions and Other Responses to Invasion (cont.)

- EU Regulation 2022/328 (February 25, 2022)
 - Export ban to Russia regarding goods, technology and technical assistance for use in aviation
 - Aircraft lessors given until March 28, 2022 to obtain return of aircraft
 - Prohibited provision of aviation insurance or reinsurance to Russians
- U.S. BIS export restrictions
 - Export Administration Regulations regarding aviation-related goods and services to Russia
 - Broad export denial orders (TDOs) to specific Russian airlines – Aeroflot, Azur Air, Utair, Aviastar-TU and Rossiya (Boeing aircraft a focus)
 - Third-country entities subject to sanctions (e.g., China has closed airspace)

Sanctions and Other Responses to Invasion (cont.)

- Western countries including Bermuda and Ireland have pulled operating certificates for aircraft leased in Russia
- Russia's response to airworthiness suspensions
 - Passed laws allowing dual registration of aircraft
 - New aircraft registry still shows actual owners as named owners
 - Article 18 of 1944 Chicago Convention

Developments Regarding Leases

- Lessors cancel leases by March 28, 2022 and request aircraft back
- Most aircraft have not been returned by Russian lessees
 - Ongoing discussions with lessors and lessees reported
 - “We have many of them basically tell us ... ‘look we’re not crooks. We didn’t steal your airplanes ... we’re both stuck.” – Air Lease Corp.
 - Most leased aircraft continue to operate domestic flights only in Russia
- Some but not many aircraft repossessions by owners
 - Sri Lankan court grounded then released leased A330 in Colombo
 - On 2/27/22, an Irish lessor prevented aircraft leased to Aeroflot subsidiary from flying from Turkey to Russia; close call in Egypt, etc.
 - Airastle repossessed 2 of 12, AerCap 22 of 135, etc.

Issues Regarding Product Support

- Airbus and Boeing have halted supply of parts /services to Russia
- All aircraft have maintenance requirements
 - Limited cycles (landing gears, engines, etc.)
 - Major maintenance checks: A Check (400-600 hours); B Check (6-8 months); C Check (20-24 months); D Check (6-10 years)
 - Additional parts will break down and need replacing
 - Shorter domestic flights could call for more maintenance
- Will maintenance schedules be kept?
 - Available intel. – promising to date
 - Russian aviation history, MRO infrastructure, spares inventory, etc.
 - Long term challenges – advanced software issues (e.g., MCAS) and engines

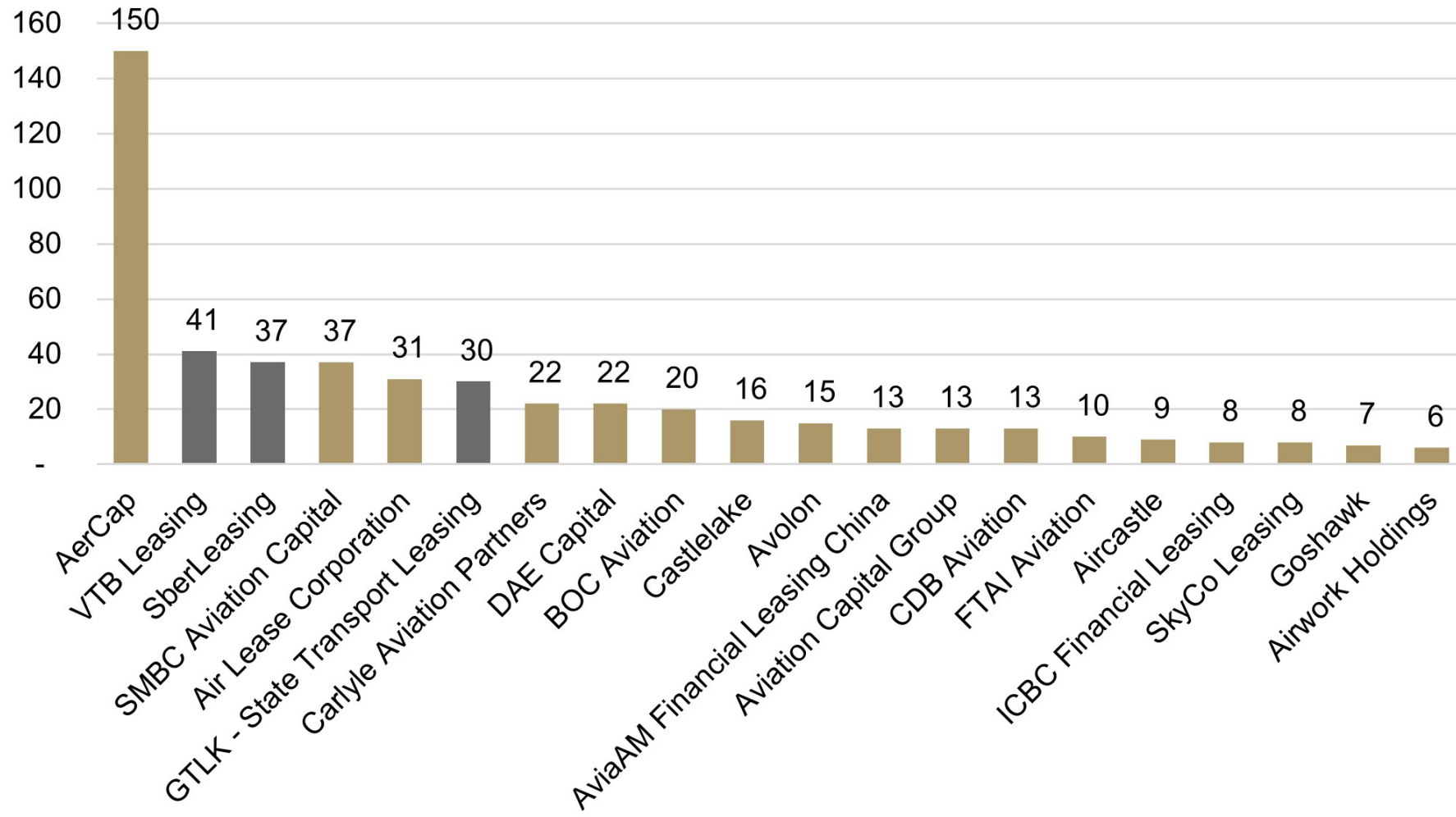
Issues Regarding Product Support

- Aftermarket and black market parts
- Potential aircraft part cannibalization
 - Hundreds of western aircraft in Russia, with certain redundancies
 - 30-40% of aircraft could be used for parts
 - Iran as model
- So, aircraft could operate for years e.g., AirInsightGroup – 4 to 5 years for newer aircraft
- Broader issues
 - Could these approaches affect safety?
 - Long term valuation issues

Insurance Industry Developments

- Policy cancellations throughout industry
 - Varying notice of cancellation provisions
 - Carriers issued NOC's from late February to early March
 - Common throughout industry, March 15, 2022 cancellation dates for war coverage arising out Russia, Ukraine, Belarus and Crimea
- Per reports, many lessors have submitted non-specific precautionary notices to both all risk and war risk hull carriers
- Also, some highly publicized claim submissions in industry
 - AerCap reportedly made \$3.5 billion claim under all risk policy
 - Air Lease Corp. says it is pursuing "vigorous" insurance claims

Lessor Market Exposure – Number of Aircraft



Owner Financial Disclosures

- Disclosed write offs
 - AerCap \$2.7B
 - DAE Capital \$1.0B
 - Air Lease \$800M
 - SMBC \$384M
 - Aircastle \$252M
- Many news reports referencing ongoing insurance recovery pursuits and the potential for extensive litigation

AerCap Disclosure

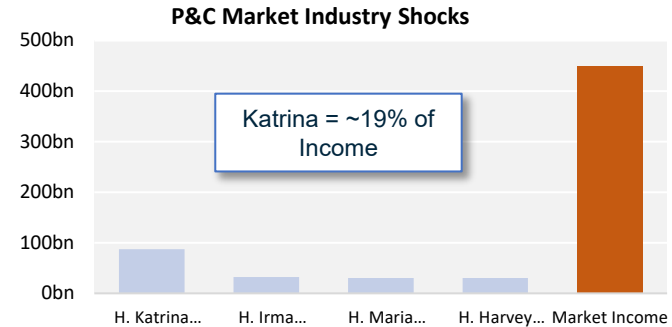
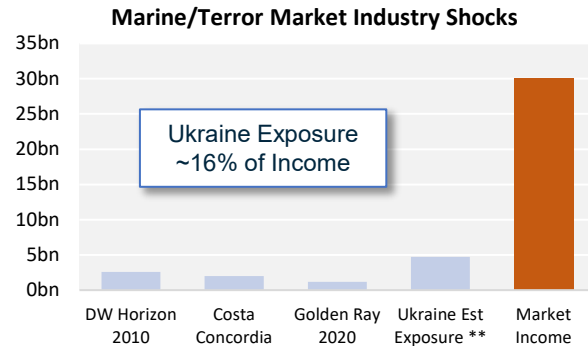
Financial Overview of Russian Exposure

Russian Exposure (\$bn)		Potential Offsets
Net Book Value	\$3.3	Letters of Credit
Maintenance Rights Asset and Other Assets	0.5	Removed Assets
Less: Maintenance Reserves and Other Liabilities	(0.7)	Insurance Claims
Net Carrying Value	3.1	Other Claims

- ▶ The net carrying value of our 135 owned aircraft and 14 owned engines on lease to Russian airlines was ~\$3.1 billion as of December 31, 2021
- ▶ We had ~\$260 million of letters of credit related to our aircraft and engines leased to Russian airlines, of which we have received ~\$175 million to date
- ▶ As of March 30, 2022, we had repossessed and removed from Russia 22 of our owned aircraft and 3 of our owned engines, with a net carrying value of ~\$400 million as of December 31, 2021
- ▶ We expect to recognize an impairment on our assets in Russia that have not been returned to us as early as 1Q 2022, although we have not determined the amount of any impairment
- ▶ We continue to make efforts to repossess additional aircraft and engines from our former Russian airline customers, but it is unclear if we will be able to do so, or what the condition of these assets will be at the time of repossession

Contextualizing The Loss Potential – Market Comparisons

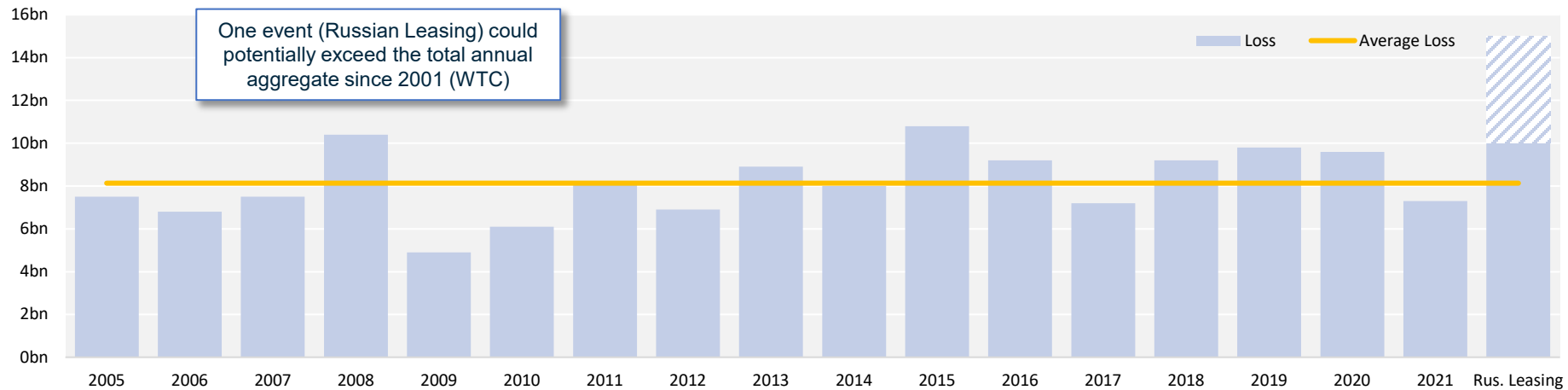
Unprecedented level of loss from One Event Industry wide – potentially 230% of income



** 'Ukraine Es Exposure' based on estimate of Exposure only for WoL in Ukraine, Marine War and Cargo

Source: Swiss Re Sigma No 5/2021

Average Man- Made Annual Agg Insurance Losses \$8.1Bn since 2005



Source: Swiss Re Sigma Full Year 2021 Preliminary Natcat Loss Estimates

Common Insurance Format

- Aircraft sold by Airbus to ABC Leasing Corp
- ABC Leasing Corp enters into a leasing agreement with Russian operator
- Russian operator required to maintain and insure ABC's aircraft
- Russian law requires a local Russian insurance company to insure the aircraft
- The large values force Russian insurance companies to seek reinsurance from US, UK, and EU insurance companies
- ABC Leasing Corp procures a contingent policy for all risks and war risks



Commonly Discussed Insurance Issues

- Sanctions and Russian, EU and US underwriters
- Hull all risk and hull war risk insurance comparisons, generally
 - Hull all risk product – occurrence based
 - Hull war risk product – occurrence based and in the annual aggregate
 - 50/50 clauses
 - Notices of cancellation provisions
 - Both subject to various coverage requirements, limitations and exclusions
- War coverage often provided by limited writeback to war exclusion
- The concept of dual submissions

AVN 48B

WAR, HI-JACKING AND OTHER PERILS EXCLUSION CLAUSE (AVIATION)

This Policy does not cover claims caused by

- (a) War, invasion, acts of foreign enemies, hostilities (whether war be declared or not), civil war, rebellion, revolution, insurrection, martial law, military or usurped power or attempts at usurpation of power.
- (b) Any hostile detonation of any weapon of war employing atomic or nuclear fission and/or fusion or other like reaction or radioactive force or matter.
- (c) Strikes, riots, civil commotions or labour disturbances.
- (d) Any act of one or more persons, whether or not agents of a sovereign Power, for political or terrorist purposes and whether the loss or damage resulting therefrom is accidental or intentional.
- (e) Any malicious act or act of sabotage.
- (f) Confiscation, nationalisation, seizure, restraint, detention, appropriation, requisition for title or use by or under the order of any Government (whether civil military or de facto) or public or local authority.
- (g) Hi-jacking or any unlawful seizure or wrongful exercise of control of the Aircraft or crew in Flight (including any attempt at such seizure or control) made by any person or persons on board the Aircraft acting without the consent of the Insured.

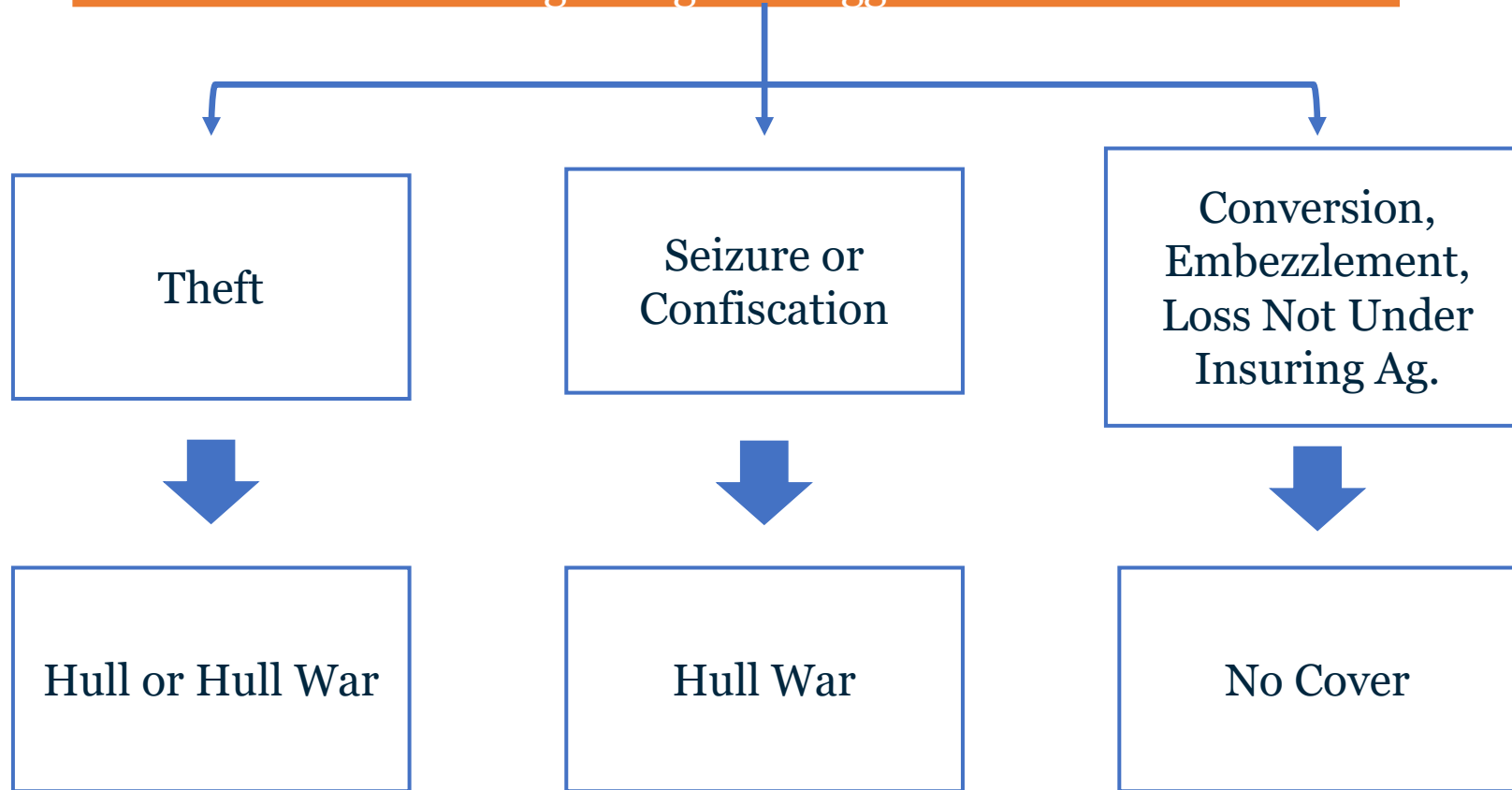
Furthermore this Policy does not cover claims arising whilst the Aircraft is outside the control of the Insured by reason of any of the above perils. The Aircraft shall be deemed to have been restored to the control of the Insured on the safe return of the Aircraft to the Insured at an airfield not excluded by the geographical limits of this Policy, and entirely suitable for the operation of the Aircraft (such safe return shall require that the Aircraft be parked with engines shut down and under no duress).

Commonly Discussed Insurance Issues

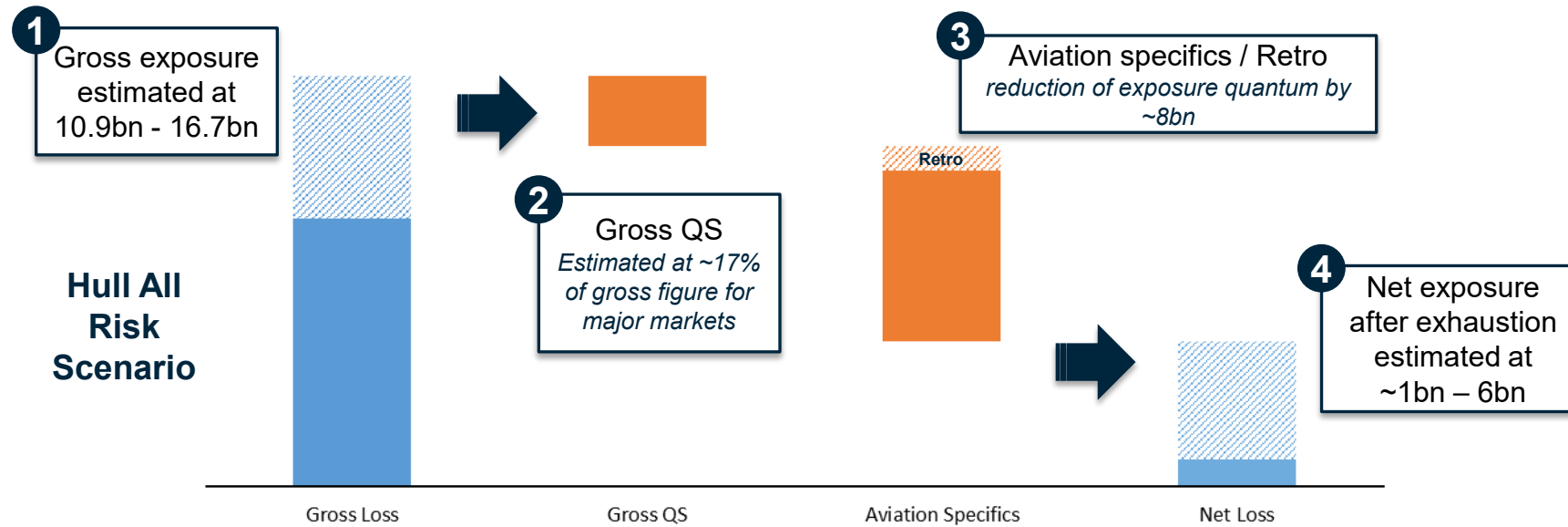
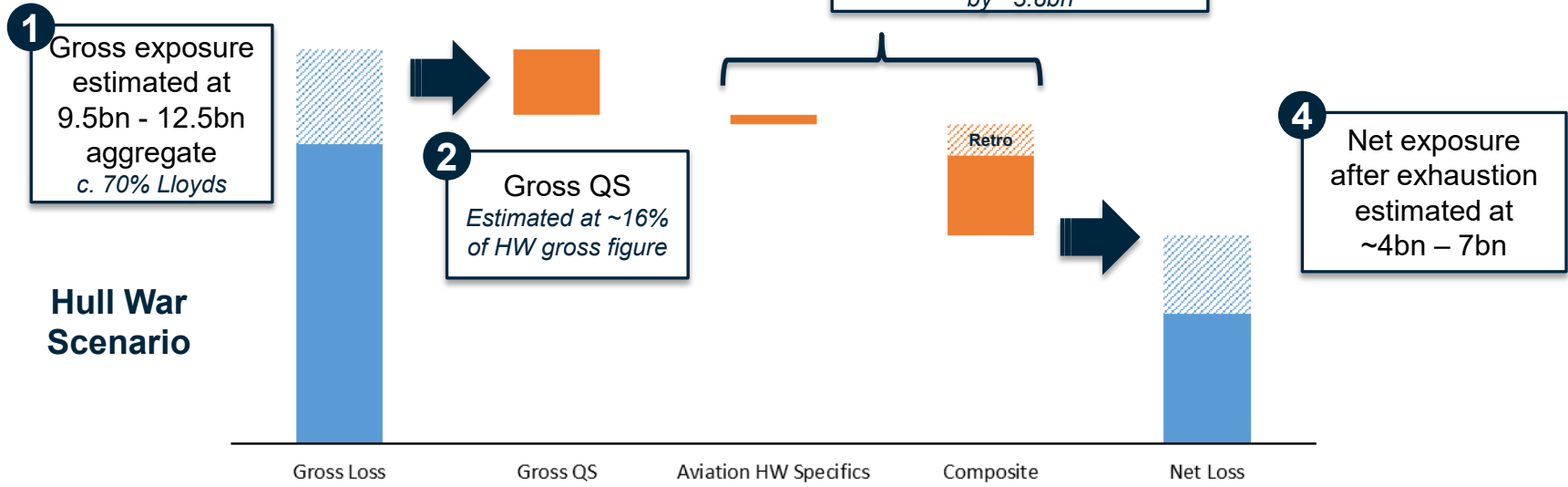
- First, case by case and policy by policy
- Whether insuring agreement is implicated or not
 - Most hull policies relate to actual partial or total destruction of scheduled aircraft in an accident; this has not happened
 - Some policies cover theft or disappearance but not aircraft voluntarily leased to lessees who refuse to pay or return
 - What is the covered loss alleged under the policy at issue?
- Common policy exclusions
 - Embezzlement, conversion, etc.
 - Loss of use
 - War
 - Etc.

Commonly Discussed Insurance Issues

What coverage positions may policyholders and carriers argue regarding loss triggers?



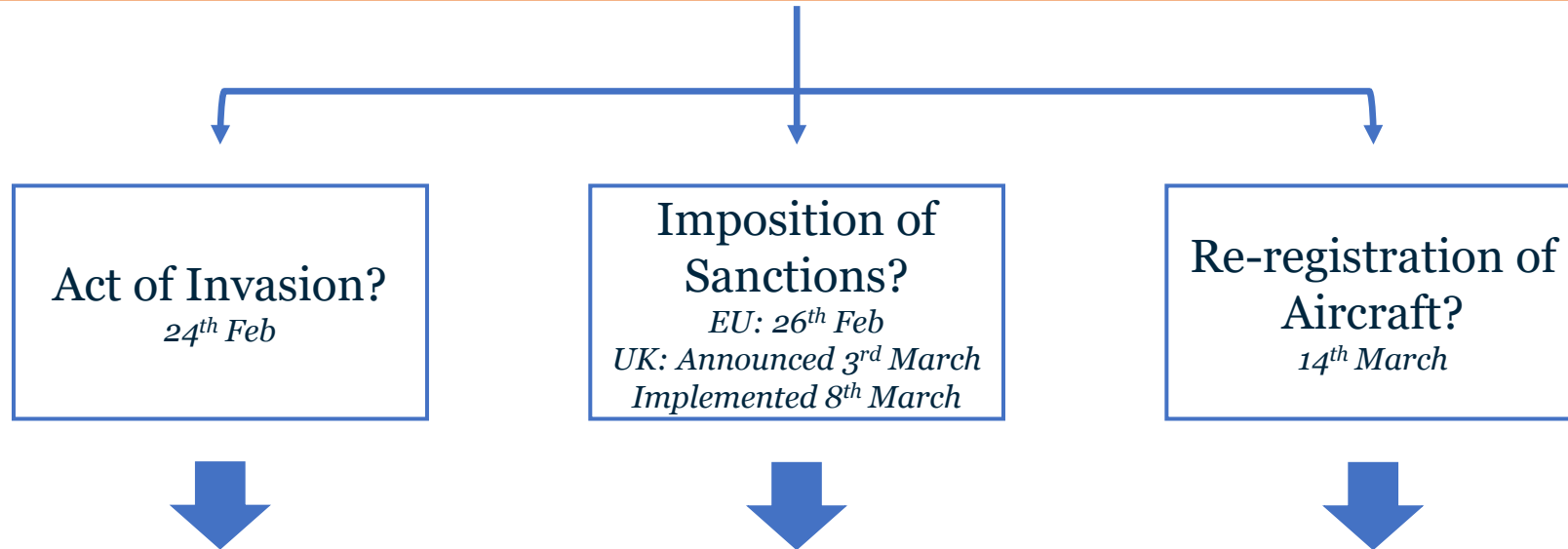
Theoretical Exposure Scenarios



Theory of exposure flow – with no assumption of potential validity of claims, if made

Commonly Discussed Insurance Issues

What may policyholders attempt to allege regarding peril triggers and dates of loss?



- AVN48B - Proof of peril required in order to ascertain if matters are excluded from All-Risk market and/or fall under War market
- What is the alleged trigger for the alleged peril and the alleged date of loss? Act of invasion? Imposition of sanctions? Re-registration of aircraft? Something else?
- Alleged dates of loss may be significant for certain War submissions due to notices of cancellation

QUESTIONS ???

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