



Society of Actuaries in Ireland

A Novel Solution to Aviation War Claims?

by

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Introduction

In April 2022, the Banking and Aviation Finance Committee published a briefing note entitled *Leased Aircraft in a time of War* which dealt with aviation war risk insurance claims likely to be submitted by aviation lessors in respect of aircraft and engines which they allege are ‘trapped’ in and possibly never to be recovered from Russia following the Russian invasion of Ukraine. In that briefing note, it was noted that: (i) the claims process is likely to be very difficult and lengthy; and (ii) ultimately, claims will have to be settled in the courts.

This briefing note examines:

- (i) the lawsuits known to have been brought by aviation leasing companies against insurers for losses in respect of aircraft; and
- (ii) discusses a novel development reported in Insurance Insider¹ which might simultaneously reduce the costs of the aviation war insurance claims for insurance companies and speed up compensation payments to lessors for the loss of their aircraft.

Quick Recap

In 2022, the supply of aviation goods and services to Russia was prohibited by the imposition of sanctions. Following on from the prohibition, several aircraft lessors issued notices to Russian lessees to: (i) terminate the lease of the aircraft and engines belonging to such lessors; and (ii) require the return of such aircraft and engines. In cases where the aircraft were not returned, the associated aviation authority rescinded the certificates of airworthiness of those aircraft as they were unable to verify the airworthiness of those aircraft. Russia then passed a law which allowed Russian airlines to place aircraft leased from foreign aviation lessors on Russia’s aircraft register. The law did not instruct airlines to re-register their leased aircraft on the Russian aircraft register. It is understood that several such aircraft were ‘re-registered’ in Russia and continued to operate flights.

It was reported² that Russian airlines have in general been unresponsive to requests to return leased aircraft. Several lessors affected by the failure to return their aircraft filed claims against

¹ Insurance Insider is an insurance news organisation for wholesale, specialty, and reinsurance companies.

² <https://www.reuters.com/business/acrospace-defense/air-lease-says-russian-law-leased-aircraft-help-with-insurance-claims-2022-03-16/>

their insurers alleging the loss of their aircraft. The vast majority of the claims for compensation have been denied by the insurers.

Escalation of Estimated Claims Costs

At the time of writing of the April 2022 briefing note, one aviation insurance broker estimated that, in the case where the aircraft cannot be recovered by lessors, the global aviation insurance market could suffer a loss of the order of USD5 billion. Since then, worst-case insured losses for the seizure of leased aircraft by Russia have been estimated³ to be more than USD12bn.

Claims by Aviation Leasing Companies Against Insurers

Table A lists some of the claims known to have been made by aviation leasing companies against insurers. While it is not possible to analyse the detail of the individual claims in a short briefing note, the general nature of the claims made by lessors is that they allege:

- (i) they have suffered the loss of their aircraft by being deprived of their physical possession; and
- (ii) the recovery of their aircraft is either uncertain or unlikely and this is tantamount to being forever deprived of the physical possession of the aircraft.

Their alleged claims are grounded by reference to either the “War Risks” section or the “All Risks” section or both sections of their policies and they submit as supporting evidence for their alleged claims one or some combination of the following arguments:

1. The fact that their aircraft are being operated despite the rescinding of their certificates of airworthiness mainly by Irish and Bermudan aviation authorities.
2. The alleged re-registration of the lessors’ aircraft in Russia.
3. The failure of their lessees to return their aircraft.
4. The lack of manufacturer approved spare parts in Russia because of sanctions and the implications of that for the maintenance of aircraft in line with manufacturers’ guidelines.

Broadly speaking, the Lloyd’s syndicates and insurers against which the claims have been filed put forward the following counter arguments to the alleged claims:

1. There is no cover under the policies because of the imposition of sanctions.
2. The reason for the lessors’ alleged loss is a question of whether the lessors have taken all reasonable steps to recover their aircraft following the chain of events in Russia, the proof of taking all reasonable steps, and the possibility that the aircraft may yet be recovered. Further, relatively little time has passed since the war began, the political situation could change, and some lessees have indicated that they would return the

³ Source: Insurance Insider, 23 February 2023, *Aviation market eyes multi-billion claims benefit on potential seized planes deal*

aircraft if they received permission from the Russian government.

3. The constructive total loss event only applies where the aircraft has suffered damage amounting to more than 75% of the value of the aircraft. It does not apply in cases where the insured lessor has simply been deprived of possession of the aircraft.
4. The lessors' aircraft are not lost, they are simply in the possession of the lessees, and they have not been permanently deprived of the aircraft.

The legal costs of the litigation for both the claimants and their insurers are estimated to have already reached hundreds of millions of U.S. dollars.

Novel Solution to the Problem?

In February 2023, in an article in **Insurance Insider** it was reported that multiple sources had told the magazine that the aviation insurance market stands to avoid billions of dollars in claims if *“confidential talks between Russian airline Aeroflot Group and aviation leasing giant AerCap about the purchase of seized planes yield a deal that does not fall foul of the international sanctions regime.”*

Insurance Insider noted that AerCap denied⁴ that it is engaged in any discussions with Aeroflot or other Russian airlines and that AerCap added: *“AerCap continues to pursue recovery from all relevant insurers.”*

Earlier this year, the **Aviation Leaders Report 2023: New Horizons** published jointly by Airline Economics and KPMG reported that *“... other lessors are reported to have been able to sell their aircraft to Russian carriers under a European Union amendment to sanctions.”*

Two key issues in any negotiation between a lessor and a Russian airline are likely to be:

1. What value should be placed on the aircraft for the purposes of a payment for the seized aircraft? Insurance Insider quotes sources as saying the haircut to the insured value of aircraft might be in the range 20% to 25%.
2. Whether: (a) the EU sanctions regime covering insurance and reinsurance would permit an insurance settlement with Russian insurers to be executed; and (b) Office of Foreign Assets Control in U.S. would provide clearance for any deal.

The extent of the losses arising from the haircut to insured values may be partly mitigated by security deposits and maintenance reserves held by lessors assuming these are not offset against the percentage of insured value to be paid for the seized aircraft.

Further, if the aircraft were returned to their lessors, it is likely that the status of the aircraft records, a vital component of aircraft value, would render them unmarketable unless a major overhaul of the aircraft was carried out at the cost of millions of U.S. dollars.

⁴ Insurance Insider states: *A spokesperson for AerCap said of the report: “The information is incorrect in all respects.” They added: “Your sources are incorrect: we are not engaged in any sale discussion with Aeroflot or any other Russian airline and have not sought regulatory approval for any such transaction.”*

Advantages of the Novel Solution

Where lessors can agree deals with Russian lessees for payments in respect of their ‘trapped’ aircraft, it is unlikely that insurers would be ordered by the courts to pay out under policies thereby lowering their claims cost and presumably the size of any increase in future aviation insurance premiums which the alleged claims would have triggered if they were successful.

For lessors, the solution would provide certainty as to the size of recoveries and potentially reduce the size of the impairments taken in their accounts in relation to their Russian lessee exposures.

For Russian airlines, the solution significantly increases their chances of leasing aircraft at reasonable lease rates once the war in Ukraine ends.

Lessors and their insurers would also benefit by avoiding the expected further payments of hundreds of millions of U.S. dollars in the legal fees in pursuing and defending claims respectively.

Where the approach has been adopted by a lessor, it supports the argument that all reasonable steps have been taken to recover the aircraft. This may provide a basis for an ex-gratia payment by the insurer provided the reinsurers can be persuaded to fund their share of the ex-gratia payment.

Table A⁵
Summary in Date Order of Claims Made by Leasing Companies Known to have Brought Lawsuits

Airline	Filing Date	Insurers	Jurisdiction of Filing of Claim	Claim Size and Number of Aircraft
AerCap Ireland Ltd.	June 2022	Two major insurers	High Court, England & Wales	The claim is in respect of 116 aircraft and 23 engines
US-based Aircraft Leasing Company	August 2022	Hive Underwriters and Other Insurers	Florida, USA	The claim is for USD147m and is in respect of 4 aircraft and 3 engines.
AIRCASTLE, a US-based Aircraft Leasing Company	October 2022	Several Insurers	Supreme Court of New York, USA	The claim is in respect of 9 aircraft and other equipment. Aircastle has booked impairment losses of USD252m in respect of the aircraft.
US-based Aircraft Leasing Company	October 2022	Several Insurers	Florida, USA	The claim is for USD700m and is in respect of 23 aircraft and 3 engines. In addition to compensatory damages the claim also seeks punitive damages.
SMBC Aviation Capital	November 2022	Major Insurer	High Court, Ireland	The filing did not include details on the size of the claim. The company booked an impairment charge of USD1.6 billion over its inability to recover 34 aircraft leased to Russian airlines following Russian invasion of Ukraine.
Major Ireland-based Aircraft Leasing Company (Subsidiary of a Chinese Bank)	November 2022	Several Insurers	High Court Ireland	The lessor was reported to have 9 aircraft trapped in Russia. No details of the size of the claim were available.
Major Aircraft Leasing Company (Subsidiary of a Chinese Bank)	November 2022	Several Insurers	High Court, Ireland	In August 2022, the aircraft leasing company wrote down by USD804m the value of 17 aircraft it owns that have been stuck in Russia since the Russian invasion of Ukraine.
Major Aircraft Leasing Company	November 2022	Several Insurers	High Court, Ireland	The company did not confirm the amount of the claim or that the proceedings relate to aircraft lost to Russia, but it is understood that this is case.
US-based Aircraft Leasing Company	November 2022	Several Insurers	Minnesota, USA	The claim is for USD367m and is in respect of 18 aircraft.
Dubai Aerospace Enterprises Ltd (DAE)	December 2022	Well-known insurer in the major insurance markets for the aircraft	High Court, England & Wales	The claim relates to aircraft that were taken by Russia in response to Western sanctions on the country.
Irish Aircraft Leasing Company	December 2022	All risk and war risk underwriters	High Court, England & Wales	The claim relates to an aircraft stranded in Russia.
Regional Aircraft Leasing Company	December 2022	Several Insurers	High Court, Ireland	The claim is in respect of a total of eight one Embraer 190 aircraft and seven ATR 72-600 aircraft.
US-based Aircraft Leasing Company	December 2022	Several Insurers	Supreme Court of New York, USA	The claim is for USD147m and is in respect of 4 aircraft on lease to a Russian airline.

⁵ Source: Table A was constructed from data in an article written by Katten Muchin Rosenman LLP entitled *Leased Aircraft Stranded in Russia: A Survey of the Pending Insurance Claim Litigation in Different Jurisdictions*. 3 January 2023. The briefing note reflects the situation as it is known to the Banking and Aviation Finance Committee on the date of publication. In a fast-moving environment such as this, aspects of the briefing note may be superseded by subsequent developments.