

Aircraft Lease Operations – Integrating Aircraft Insurance and Maintenance Reserves

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In aircraft lease operations, insurance and maintenance reserves serve distinct purposes and are critical for ensuring the financial and operational stability of both the lessee (airline) and the lessor (aircraft owner).

Insurance provides risk management against unforeseen incidents, whereas maintenance reserves ensure funds are available for scheduled and necessary upkeep.

Insurance is about transferring risk to an insurer, whereas maintenance reserves are about managing and pre-funding the predictable expenses of aircraft upkeep

Note - The lessee is responsible for securing insurance & Maintenance reserves are a contractual requirement managed by the lessor but funded by the lessee.

Potential Insurance Claims Could Include any of the following:

- Accidents and collisions pose significant risks to aircraft hulls. This includes runway mishaps, mid-air collisions, and ground handling damage.
- Natural disasters like storms, hurricanes, hail, and lightning can severely damage aircraft.
- Terrorist attacks and acts of sabotage can lead to catastrophic hull losses.
- Human errors during operations, such as improper loading, fueling mistakes, and maintenance errors, can cause significant damage.
- Malfunctions in critical systems like avionics, engines, and flight controls can lead to accidents.

Here's a detailed comparison between the Role of Insurance & Maintenance Reserves:

Insurance

Purpose - Insurance is designed to protect against financial losses resulting from unforeseen events such as accidents, natural disasters, or mechanical failures.

Types of Coverage:

- **Hull Insurance:** Covers physical damage to the aircraft.
- **Liability Insurance:** Covers legal liabilities arising from the operation of the aircraft, such as passenger injuries or third-party damage.
- **War Risk Insurance:** Covers losses due to war, terrorism, or other hostile acts.

Responsibility:

- The lessee (airline) typically is responsible for procuring and maintaining insurance coverage throughout the lease term.

- The insurance policy must meet the minimum requirements set by the lessor.

Cost:

- Insurance premiums are a recurrent operational expense for the lessee.
- Costs are influenced by factors like the aircraft type, age, operational routes, and the airline's safety record.

Claims and Coverage:

- In the event of an incident, the lessee files a claim with the insurance provider.
- Payouts are made to cover repair costs, replacement, or legal liabilities as stipulated in the policy.

Maintenance Reserves

Purpose:

- Maintenance reserves are financial provisions set aside to cover the cost of future maintenance and overhauls of the leased aircraft.

Types of Maintenance Covered:

- **Engine Overhaul Reserves:** Funds allocated for periodic major engine maintenance.
- **Airframe Maintenance Reserves:** Funds for structural inspections and repairs.
- **Landing Gear Reserves:** Funds for the overhaul and replacement of landing gear components.
- **Auxiliary Power Unit (APU) Reserves:** Funds for the maintenance of the APU.

Responsibility:

- The lessee makes periodic payments into maintenance reserves, typically based on flight hours or cycles.
- The lessor manages these funds to ensure they are available for maintenance activities.

Cost:

- Maintenance reserves are calculated based on the expected cost of maintenance over the lease term.
- Payments are often structured as part of the lease agreement and are a significant ongoing expense for the lessee.

Usage:

- When maintenance is due, the lessee performs the required work and may draw from the reserve fund to cover the costs.
- Any unused maintenance reserves may be refundable to the lessee at the end of the lease term, depending on the lease agreement.

Typical Clauses Found within Aircraft Hull Insurance Policies:

- The party receiving the monetary benefits from insurance coverage must have an "insurable interest" in the aircraft.
 - This includes any lawful and substantial economic interest in the safety or preservation of property from loss, destruction, or pecuniary damage.
- **Declarations:** Information including the identity of the named insured, policy number, insurers, effective dates, description of the named insured's business, type and amount of coverage purchased, premium charged, and a list of endorsements.
- **Endorsements:** Specific changes or amendments to the terms and conditions of the standard-form policy language.
- **Named Insured:** The person or organization to whom the policy is sold.
- **Additional Insured:** A party who is not automatically insured under the policy but is extended a measure of protection under the policy by the named insured.
- **Limits of Insurance:** A ceiling on the amount the insurer will pay, regardless of the number of insureds, losses, claims, or claimants.
- **Deductibles:** Clauses requiring payment by the named insured of a specified portion of the loss before the insurer's obligation is triggered.
- **Cancellation and Changes:** The insurer owes no duties to provide notice of cancellation, non-renewal, or changes to additional insureds or loss payees; these duties are owed only to the named insured.
- **Loss Payee Clause:** Names a person to whom the hull insurance proceeds are to be paid if a loss occurs. Lessors and financiers can arrange to be named as loss payees under the policy.
- **Breach of Warranty Endorsement:** Provides that the insurance maintained by a lessee or borrower shall not be invalidated as to a lender or lessor by reason of any act or neglect of the named insured.
- **Subrogation:** The right of the insurer to "take over" the rights of a party receiving an insurance payment.
- **Geographical Limits:** Traditionally, insurances have been worldwide, with exceptions based on operational departures.
- **Reinsurance/Cut-Through Clause** - Ensures reinsurers make direct payment of a claim to the loss payee in the original policy.
- **Political Risk Insurance** - Protects financiers from inability to recover possession of their aircraft due to governmental actions or inactions.

- **Tail Coverage:** Extends liability coverage for lessor or lenders for an agreed period after the transfer or lease/loan expiry.

Considerations Related to Insurance Premiums and Payments

- **Premiums:** Lessors and financiers should not be liable for any premiums, although insurers may deduct any due premium from any claim payment.
- **50/50 Clause:** Deals with claims where it is unclear if they are covered by the "all risk" or "war and allied perils" policy.

Summary

Integrating maintenance reserves with insurance claims in aviation ensures comprehensive risk management and financial planning. By addressing the key challenges and implementing best practices, organizations can optimize their operations, reduce risks, and achieve significant cost savings. This integration fosters a culture of safety, enhances asset management, and provides better protection for both insurers and insured parties.

Next Steps

Sofema Aviation Services (www.sassofia.com) and Sofema Online (www.sofemaonline.com) provides Classroom, Webinar and Online Training related to Aircraft Lease and Maintenance Reserves. Please see the websites or email Team@sassofia.com.

Please take a look at the following course - **Aircraft Leaseholder & Maintenance Reserve Insurance Considerations – Essentials – 1 Day** – for details see the following link <https://sassofia.com/course/aircraft-leaseholder-maintenance-reserve-insurance-considerations-essentials-1-day/>