FINANCIAL INSTITUTION PROPOSAL

AIRCRAFT FINANCING & LEASING: *POTENTIAL RISKS*

PROVIDED BY

AERO-ALLIANCE INSURANCE SERVICES

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INTRODUCTION

The state of the economy, combined with the increased cost of fuel, is placing a hardship on both the private and commercial aviation industry, resulting in an increased risk of potential default on a loan or lease agreement secured by an aircraft and the bank's immediate right to repossess an aircraft.

Over the past two years, estimates show that aircraft operating costs have risen by 150%, placing many flight departments under economic pressure to reduce costs. Unfortunately, aircraft maintenance is one way that companies cut costs by either deferring necessary maintenance or falsifying maintenance logs. This would include non-compliance with scheduled heavy checks, structural and corrosion directives, major component overhaul, and interior deterioration. The costs for any of these items could easily exceed $250,000 just to restore the aircraft to an airworthy condition.

Aero-Alliance Insurance Services recommends that financial institutions consider incorporating a two-prong approach to their risk mitigation strategy: to identify potential risk with aircraft financing and leasing, and to then transfer existing risk to a third-party insurer. While banks rely on the insurance and indemnity sections of the aircraft finance agreement for protection, there are important factors to consider when transferring risk to a third party. This program will allow you to confidently increase your aircraft portfolio while protecting your investors, stockholders, and your future growth.
RISK MITIGATION STRATEGY: TRANSFERRING RISK

The coverages described below are instrumental in reducing or transferring risks associated with aircraft financing and leasing.

- **Contingent Liability:** Provides the bank with additional liability protection in the event of an aircraft accident and they are joined in any lawsuit after the Lessee/Mortgagee’s coverage is exhausted or fails.

- **Repossessed Aircraft Liability & Repossessed Hull Coverage:** In the event the bank must repossess an aircraft for default on a loan or lease, the insurance covering the aircraft may also be cancelled for non-payment of premium. The bank will want to arrange insurance to cover the repossessed aircraft; however, the aviation insurance market typically does not want to underwrite/insure a single repossessed aircraft for a bank. The Financial Institution Aviation Insurance Program is designed to cover this type of potential risk. In the event the aircraft needs to be repositioned to a selected airport location for safekeeping, you will also require coverage for the repossession flights in addition to coverage for future ferry flights, aircraft maintenance flights and sales demonstration flights.

- **Liability for Sale of Aircraft:** Once the physical repossession is accomplished, the bank will opt to sell the aircraft to satisfy the balance due on the loan. The bank will likely want to address any aircraft maintenance needs, prior to selling the aircraft. In the event of an aircraft accident after the sale, the bank could become legally liable for bodily injury and property damage for selling a faulty aircraft. Our annual Aviation Insurance Program is designed to cover this potential risk.

- **Legal Defense:** Should you have to defend any suit for bodily injury and property damage. Defense is a supplementary payment, which will not erode the liability coverage limit. The insurer shall not be obligated to defend any suit after the applicable limit of liability has been exhausted by payment of judgment or settlements. Therefore, buying adequate limits needs to be considered as part of your risk management strategy. Aero Alliance Insurance Services provides our bank clients with alternative liability limits ranging from $10 Million to $1 Billion.

Other aviation insurance coverages included in our program include:

- Liability arising out of Use of Non-Owned Aircraft by or on behalf of the Bank;
- Liability arising out of the Use of Airport Premises;
- Physical Damage Coverage including Mysterious Disappearance of the aircraft which results in impairment to the Bank’s interest in leased or financed aircraft;
- Errors and Omission Physical Damage Coverage pays when such interest is impaired through a lack or insufficiency of physical damage insurance covering the Bank’s interest as required by the lease or loan interest where such lack or insufficiency is due to error or accidental omission by the Insured;
- Territory Coverage is worldwide.
As part of our team of aviation experts, Craig Pereira with Aero Tropics LLC is available to consult with banks and private owners interested in overseeing the maintenance and compliance activities of their aircraft assets. With 30 years experience in aircraft management and air carrier operations, Aero Tropics can:

- Review aircraft records for missing supporting data to quantify current and historic maintenance is in proper compliance by trained and qualified personnel.
- Verify that approved maintenance schedules are being performed in the required time period to remain compliant with regulations. (This is where many of the problems start by operators altering the maintenance schedules)
- Evaluate a sampling of critical maintenance items to ensure that maintenance was completed in accordance with the required technical entries during our physical inspections.
- Verify the aircraft had major alterations and major repairs (including avionics, interior modification, and hidden damage repair) utilizing FAA accepted data.

Unfortunately, many financial institutions learn about these maintenance deficiencies after repossessing the aircraft and/or during the pre-buy inspection. The audit service performed by Aero Tropics will assist the bank by identifying potential maintenance deficiencies while the aircraft is in possession of the lessee/operator, who will be motivated to bring the aircraft into compliance to avert defaulting on the aircraft finance/lease agreement and possible regulatory action by the FAA.

CONCLUSION

With the current state of the economy, record high fuel prices, and increased maintenance costs, many aircraft operators are facing the “perfect economic storm”. All banks need to re-evaluate the potential risks with aircraft financing and leasing, while considering transferring certain liabilities to third party insurers. Our team’s experience, competence, and ability to assist you with your risk mitigation strategy will allow you to maintain a leadership position in the aircraft financing industry. The aviation insurance program negotiated through Aero Alliance will protect shareholders, potential investors, and your balance sheet, thus allowing you to concentrate on your growth strategy.

Thank you for your time and consideration,

William S. Soldan, President & CEO
Aero Alliance Insurance Services, Inc.