

<b>Title:</b> Ratification of the Convention on International Interests in Mobile Equipment and the Protocol thereto on matters specific to Aircraft Equipment  <b>IA No: BIS0362</b>  <b>Lead department or agency:</b> Department for Business, Innovation and Skills <b>Other departments or agencies:</b> Department for Transport, Civil Aviation Authority, Insolvency Service	<b>Impact Assessment (IA)</b>		
	<b>Date:</b> 18 <sup>th</sup> February 2014		
	<b>Stage:</b> Consultation		
	<b>Source of intervention:</b> International		
	<b>Type of measure:</b> Secondary legislation		
<b>Contact for enquiries:</b> Hayley Gowen - 020 7215 6096			
<b>Summary: Intervention and Options</b>			<b>RPC Opinion:</b> Green

Cost of Preferred (or more likely) Option				
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out?	Measure qualifies as
£-0.98 m	£-0.48 m	£0.04 m	Yes	IN

**What is the problem under consideration? Why is government intervention necessary?**

UK airlines require large amounts of finance to hire or purchase helicopters, airframes and/or engines (“aircraft objects”). Following the economic downturn, the availability of traditional sources of finance for UK airlines, such as bank debt, has reduced and a number of airlines have looked to diversify their sources of finance. The Convention on international interests in mobile equipment and the Protocol thereto on matters specific to aircraft equipment (“the treaty”) is a private international law instrument which aims to facilitate asset-based, cross-border aircraft finance transactions by providing creditors with greater legal certainty that they can recover their assets in cases of default, which may lead to lower financing costs for purchasers and lessees.

**What are the policy objectives and the intended effects?**

The policy objective is to reduce the cost of raising aircraft finance to UK businesses. The treaty aims to reduce the risk to creditors of lending to airlines and leasing companies by creating a harmonised international legal framework for the creation and registration of *international interests* (such as mortgages and leases) and to deal with related disputes, including insolvency. A reduction in the risk to financiers in aircraft finance transactions should lead to a reduction in the cost of raising finance for airlines and others looking to purchase and/or lease aircraft and may result in increased sales by UK manufacturers. The policy therefore aims to overcome an information asymmetry issue, where foreign entities may give UK businesses higher risk ratings than they would if the UK adopted a harmonised international legislative system. Ratification of the treaty would enable interests created under the treaty and registered with the International Registry to be enforced through the UK courts.

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**

Option 0 – Do nothing. This option was rejected as UK businesses would not benefit from the potential lower cost of raising finance and a potential related increase in sales for UK aircraft and engine manufacturers.

Option 1 – Ratify the treaty. This is the government’s preferred option as the provisions of the treaty could be enforced in the UK courts. UK businesses could benefit from a reduction in the cost of raising aircraft finance with potential benefits for UK manufacturers through increased sales.

Alternatives to regulation are unlikely to be suitable as they would not provide financiers with legal certainty that they can recover their asset if a purchaser or lessee defaults on repayments. The treaty contains a number of optional provisions. BIS intends to consult on these options to understand which of the provisions would bring the greatest benefits for business in the UK.

<b>Will the policy be reviewed?</b> It will be reviewed. <b>If applicable, set review date:</b> 12/2019					
Does implementation go beyond minimum EU requirements?				No	
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.		<b>Micro</b> Yes	<b>&lt; 20</b> Yes	<b>Small</b> Yes	<b>Medium</b> Yes
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)				<b>Traded:</b>	
				<b>Non-traded:</b>	

***I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.***

Signed by: \_\_\_\_\_ Neil Golborne \_\_\_\_\_ Date: 18<sup>th</sup> February 2014

# Summary: Analysis & Evidence

# Policy Option 1

Description: Option One

## FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2014	Time Period Years 10 years	Net Benefit (Present Value (PV)) (£m)		
			Low: -1.92	High: -0.58	Best Estimate: -0.98

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.4	0.0	0.6
High	0.7	0.2	1.9
Best Estimate	0.5	0.1	1.0

### Description and scale of key monetised costs by 'main affected groups'

Businesses involved in aircraft financing and UK airlines will incur familiarisation costs to understand the changes to UK legislation. Those businesses which choose to register interests with the International Registry are likely to incur additional familiarisation costs to understand how to use the International Registry. These costs will not be incurred by UK businesses already familiar with the International Registry such as legal firms advising non-UK airlines and UK financiers lending to airlines whose home state has already ratified the treaty. As registration with the International Registry is not mandatory, it would be up to business to decide whether the benefits of using the International Registry would outweigh the costs.

### Other key non-monetised costs by 'main affected groups'

Some businesses may face additional fees to register on the International Registry instead of, or in addition to, registering interests on the UK's National Register of Aircraft Mortgages, however registration of interests on the International Registry will not be mandatory allowing business to decide how best to protect its interests. Therefore we expect businesses will only choose to incur additional costs to the extent that they believe these costs are outweighed by the benefits.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low			
High			
Best Estimate			

### Description and scale of key monetised benefits by 'main affected groups'

Although there may be considerable benefits to UK businesses from reduced financing costs, it is not possible to monetise these benefits. However the benefits are very likely to outweigh the very small familiarisation costs, as even a slight reduction in financing costs for one airline would easily cover familiarisation costs for all airlines given the size of aircraft financial deals (in the order of \$60-400m for a single aircraft).

### Other key non-monetised benefits by 'main affected groups'

UK businesses may benefit from a reduction in the cost of raising finance to purchase and/or lease aircraft objects. This is difficult to quantify as airlines can raise finance in a number of ways and the circumstances of individual airlines differ. Lower financing costs may result in increased investment in aircraft and therefore increased sales by UK manufacturers. Depending on the maximum take-off weight of the aircraft, businesses could benefit from a reduction in the fee to register their interest on the International Registry compared with the UK's National Register of Aircraft Mortgages. Secondary benefits may include a reduction in administrative burdens as interests can be registered with the International Registry 24 hours a day, 7 days a week.

### Key assumptions/sensitivities/risks

Discount rate (%) 3.5

The costs and benefits are based on an assumption that the amount of aircraft finance needed globally will continue to grow and that a number of UK businesses are already familiar with the International Registry. The benefits to individual airlines will depend on how the airline intends to raise finance and its individual circumstances. In some cases, individual airlines may not benefit from any reduction in the cost of raising finance due to factors outside the scope of this treaty.

## BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 0.04	Benefits: 0.00	Net: 0.04	Yes	IN

# Evidence Base (for summary sheets)

## Background

1. The aviation and aerospace industries make a significant contribution, both directly and indirectly, to the UK economy. The air transport sector's turnover is around £26 billion and the sector provides around 120,000 jobs in the UK, supporting many more jobs indirectly.<sup>1</sup> These figures exclude the aerospace industry which includes manufacturing. The aerospace sector contributes £24 billion to the economy every year and supports 230,000 jobs across the UK. UK aerospace has a 17% global market share, making it the number one aerospace industry in Europe and second globally behind the US and it exports circa 75% of what it produces<sup>2</sup>. In 2012, the UK's aerospace export balance was positive totalling £5.2 billion<sup>3</sup>
2. The purchase and/or leasing of new aircraft objects is expensive. Average prices for different models of aircraft can range from around \$60m-\$400m with prices varying according to factors such as engine choice, performance capability, fuel capacity and other design requirements specified by the customer. The cost of leasing a spare engine for a month can vary from between \$25,000 and \$120,000 per month. UK airlines and leasing companies therefore need to raise large amounts of finance in order to purchase or lease new aircraft objects. These transactions often involve multiple parties located in more than one jurisdiction across multiple time zones which can increase the legal and administrative complexity of the transactions.
3. The purchase and/or leasing of new helicopters, airframes and aircraft engines therefore requires high levels of financing. Boeing estimates that the global aircraft finance requirements in 2014 will be \$112 billion<sup>4</sup>. Airlines and leasing companies have access to a wide range of different sources of finance. Most airlines purchasing aircraft objects use asset-backed financing, usually over 10-12 years for airframes. Spare engines can be leased on timescales ranging from a single day to several years. Airlines and leasing companies can finance aircraft in a number of ways as set out in Morrell (2007)<sup>5</sup>. Funding options include:

## Company financing

Airline companies finance the purchase and/or leasing of new aircraft themselves either through cash reserves or income. They may also raise the necessary funds from equity capital raised from their shareholders.

## Commercial bank lending

Banks may provide airlines with the necessary finance either in the form of an overdraft or asset-secured loans. In the same way as mortgages, with asset-secured loans the bank would repossess the aircraft if the airline defaults on its loan repayments.

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<sup>1</sup> *Draft Aviation Policy Framework* – Department for Transport – July 2012

<sup>2</sup> *Lifting off – Implementing the Strategic Vision for UK Aerospace* – HM Government – March 2013

<sup>3</sup> BIS analysis of data from HMRC Uktradeinfo.com

<sup>4</sup> Boeing Capital Corporation, *Current Aircraft Finance Market Outlook 2014-2018*, <http://www.boeingcapital.com/cafmo/2013/brochure.pdf>

<sup>5</sup> Morrell, P.S. (2007) *Airline Finance* 3<sup>rd</sup> Edition

## **Export Credit Agencies (ECAs)**

ECAs are government or government supported organisations which promote exports by offering guarantees or insurance on loans. In aircraft financing, the ECA would usually step in and cover the bank's financial losses in the event that the airline defaulted on its loan or went into insolvency, seeking to repossess and remarket the asset to make recoveries. ECA guarantees or insurance may often be used in cases where banks are reluctant to lend the full amount owing to the large risks associated with the loan and the airlines.<sup>6</sup>

## **Operating leases**

Operating leases cover arrangements where one entity purchases an aircraft and then leases it on a temporary basis to an airline. Where an airline uses this to provide finance on delivery, the arrangement is referred to as sale/leaseback. The lessor would still need to find its own source of funds/finance to make the purchase. Aircraft leases come in a variety of forms, and an operating lease refers to an arrangement where ownership does not transfer to the lessees at the end of the term. Leases can be either dry or wet leases. Dry leases involve just the leasing of the aircraft while wet leases include the leasing of the crew and the pilots as well.

## **Financing Leases**

Under financing leases, a financier purchases the asset and leases it to the airline or leasing company. At the end of the lease, the airline or leasing company has the option to purchase the helicopter, airframe or aircraft engine. Financing leases are similar to hire-purchase agreements.

## **Enhanced Equipment Trust Certificates (EETCs)**

EETCs are bonds which airlines issue to finance aircraft. Under an EETC, the airline establishes a trust which issues certificates to investors and uses the raised funds to purchase the required aircraft which is then leased back to the airline. The airline makes lease payments to the trust which passes these on to the investors in the form of bond interest. These bonds are rated by credit agencies. EETCs involve financing leases and therefore ownership will transfer to the airline at the end of the lease.

## **Manufacturer support**

On occasion, manufacturers may provide airlines with the necessary finance. This may take the form of an operating lease or a residual value guarantee arrangement whereby the manufacturer guarantees the aircraft's value at the end of the lease or loan.

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<sup>6</sup> National ECAs include Ex-Im Bank (USA), UK Export Finance (formerly the Exports Credits Guarantee Department – ECGD), COFACE (France), Euler Hermes (Germany), NEXI (Japan), Export Development Corporations (EDC) (Canada), BNDES (Brazil) and SACE (Italy). All these institutions generally only provide guarantees, with actual finance being provided by banks, but BNDES, Ex-Im and EDC can lend money directly.

4. The terms and conditions attached to many forms of aircraft finance will depend on the level of perceived risk. The risk may be specific to the individual transaction, the airline itself or the wider industry. Golbeck and Linetsky (2010)<sup>7</sup> identify three types of risk that will influence the price of aircraft financing and leasing.
- (a) Credit risk – the likelihood the borrower or the lessee will default
  - (b) Collateral asset price risk – second hand market value of aircraft declines, the collateral is worth less than the expected value due to market volatility
  - (c) Repossession risk – difficulties reclaiming owned assets such as a delay in repossession, fixed costs and distressed sale discount
5. In 1999, the International Institute for the Unification of Private Law (UNIDROIT), the International Civil Aerospace Organisation (ICAO) and UNIDROIT's members recognised that there are particular challenges in raising finance for large, high-value, mobile assets which cross borders, particularly aircraft objects, due to the large sums involved and the different laws in different countries relating to mortgages, leasing and insolvency. These challenges result from the risk of bankruptcy and uncertainty for creditors regarding where an asset is located when the transaction is completed and where it will be should they need to take possession of it<sup>8</sup>. As a result, work began under the auspices of UNIDROIT and ICAO to create a private international law treaty consisting of an over-arching Convention which would create a harmonised international legal framework to try to reduce some of the difficulties identified in financing large, high-value mobile assets. The aim of the work was to address the problems which Golbeck and Linetsky highlighted in their study some years later, and provide creditors with greater certainty that they could enforce interests such as mortgages and leases and, if needed, repossess their asset from any jurisdiction, thereby reducing the cost of raising finance for companies seeking to purchase or lease high-value mobile assets.
6. The Convention was designed to provide an over-arching framework which would only be effective when accompanied by a Protocol addressing the particular difficulties faced in financing a specific class of asset. The first of the Protocols to be signed was the Protocol on matters specific to aircraft equipment. Aircraft equipment is defined as helicopters, airframes and aircraft engines above a certain size and engine capacity<sup>9</sup>.
7. The Convention and aircraft Protocol ("the treaty") were signed in Cape Town on 16<sup>th</sup> November 2001 and they fully came into force on 1<sup>st</sup> March 2006. Since the treaty was signed in Cape Town it is commonly known as the "Cape Town Convention". Currently the Convention is in force in 59 countries and the Protocol is in force in 53 countries. Countries which have already ratified the treaty include Brazil, Canada, China, the European Union, Ireland, New Zealand, Norway, Singapore, the United Arab Emirates and the United States. Australia is in the process of ratifying the treaty and the treaty is expected to come into force in Australia in early 2014<sup>10</sup>.

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<sup>7</sup> Golbeck, St. and Linetsky, V. (2010) *Asset financing with credit risk*

<sup>8</sup> *Introduction to the Cape Town Convention and the Aircraft Protocol (Module for Law School Courses on Public International Law)* Brian F. Havel <http://www.law.ox.ac.uk/conferences/ctc/papers/HavelBrianB.pdf>

<sup>9</sup> It does not include military, customs or police equipment

<sup>10</sup> [http://www.infrastructure.gov.au/aviation/international/consultation\\_cape\\_town.aspx](http://www.infrastructure.gov.au/aviation/international/consultation_cape_town.aspx)

8. Since the conclusion of the over-arching Convention and the Protocol on matters specific to aircraft equipment, UNIDROIT has agreed two further protocols, one for railway rolling stock (signed in 2007) and one for space assets (signed in 2012). Neither of these two latter protocols are currently in force. This Impact Assessment only considers ratification of the Convention and the Protocol on matters specific to aircraft equipment.

### **Problem under consideration**

9. UK airlines need to raise large amounts of finance in order to purchase or lease helicopters, airframes and aircraft engines (“aircraft objects”). Boeing estimates that the global aircraft finance requirements in 2014 will be \$112 billion rising to \$139 billion in 2018<sup>11</sup>. When businesses are looking to add to their fleet, they have the option to purchase or hire helicopters, airframes and/or engines. Whichever option they choose, it is likely that they will need to raise finance through third parties. Boeing estimated that of the \$112 billion of aircraft finance requirements in 2014, 23% would be funded through cash, 22% through the capital markets, 9% through lessors self-funding, 25% through bank debt and 18% through export credit with the remainder of financing needs met through a variety of means including finance provided by manufacturers<sup>12</sup>.
10. For the third parties, providing finance for aircraft transactions is risky as helicopters, airframes and aircraft engines are expensive to purchase and/or lease. Secondly, aircraft objects are a moveable asset and should a creditor need to take possession of the aircraft object, they cannot be sure in which jurisdiction the aircraft object will be located and therefore how easy or difficult it will be to take possession of the aircraft object. It is important that creditors can repossess their assets quickly so that they can be put to use and generate an income as the depreciation rate is very high on an idle aircraft. Repossession of an aircraft object prevents the helicopter, airframe or aircraft engine deteriorating through non-use as these assets have a limited lifespan. In order to protect themselves, creditors factor this level of risk into aircraft finance transactions.
11. Pricing the level of risk for creditors is complicated not only by the fact that a creditor does not know where an aircraft object will be located at a particular time, but also by the differences in how various jurisdictions treat claims against aircraft objects by creditors and by the differences between insolvency laws in different jurisdictions. The treaty aims to reduce some of this risk by creating a single harmonised international framework for the creation and registration of international interests (such as mortgages and leases) and a framework to deal with disputes arising under the treaty, including insolvency related matters. This should provide greater certainty to creditors that they will be able to recover their aircraft object from a jurisdiction which has ratified the treaty. Since creditors should no longer need to price as high a level of risk into aircraft finance transactions for airlines based in these jurisdictions, these airlines and leasing companies should benefit from a reduction in the cost of raising finance.
12. There is evidence to suggest that the traditional sources of finance for airlines and leasing companies in the UK is changing with new investors, such as investors in the capital markets who have traditionally invested in US airlines, providing a greater proportion of aircraft finance for airlines outside of the US. Following the economic downturn, the availability of commercial bank financing decreased as many banks sought to build up their capital reserves. Boeing expects the

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<sup>11</sup> Boeing Capital Corporation, *Current Aircraft Finance Market Outlook 2014-2018*, <http://www.boeingcapital.com/cafmo/2013/brochure.pdf>

<sup>12</sup> Boeing Capital Corporation, *Current Aircraft Finance Market Outlook 2014-2018*, <http://www.boeingcapital.com/cafmo/2013/brochure.pdf>

total share of aviation financing to be met by commercial banks to fall from 28% in 2013 to 25% in 2014<sup>13</sup>. In addition, the Basel III rules began to take effect in 2013 which impose stricter requirements on banks' capital reserves and the holdings of risky assets. This could lead to reduced lending to markets which are perceived to be too risky and higher lending costs in order to cover the cost to banks of holding increased levels of capital. As a response to this, a number of airlines have looked at alternative sources of finance<sup>14</sup>.

13. In the wake of the economic downturn, Export Credit Agencies (ECAs) increased the amount of support they provided to the sector through providing guarantees to bank loans. However, a new Aviation Sector Understanding (ASU), governed by the Organisation for Economic Co-operation and Development (OECD), came into effect in 2013 which increased the cost of export credit support to airlines. Under the 2007 agreement, airlines expected to pay upfront fees of 4-7.5%, however this rose to 7.72% under the 2013 agreement. In addition, the limit on loan-to-value arrangements which airlines will be able to secure will fall from 85% to 80%<sup>15</sup>. The European Export Credit Agencies, including UK Export Finance (UKEF) covered aircraft with a value of over \$10bn in 2012. However, the amount of support they will provide to the sector in 2014 is expected to fall.
14. In contrast to the expected fall in the total share of global aviation finance from commercial banks and ECAs, Boeing expects the share of finance provided by the capital markets to increase from 14% in 2013 to 22% in 2014<sup>16</sup>. Airbus' *Global Market Forecast 2013-2032* estimates that global air traffic will grow by 4.7% per year during that time which will require approximately 29,000 new aircraft with a total value of approximately \$4.4 trillion<sup>17</sup>

### Rationale for intervention

15. UK and other European airlines have historically been more dependent on commercial bank financing than American airlines which have traditionally raised finance through the capital markets. So far, only one UK airline, British Airways, has chosen to raise finance through the capital markets in a deal in 2013<sup>18</sup>.
16. As the balance of sources of aircraft financing is expected to shift and as UK, European and other non-US airlines explore other sources of financing (such as the capital markets), creditors and investors who are new to the aviation financing industry or to UK airlines and the UK legal regime in particular are likely to require security that they will be able to recover the aircraft object should an airline or leasing company default on repayments or enter insolvency. These investors may base decisions on incomplete information about the UK legal system. This could result in an increased risk for creditors, reflected in the cost of finance. Therefore there is potentially an asymmetric information problem which adopting an international framework, already in force in a number of other jurisdictions, would reduce. This may provide non-traditional investors in aircraft

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<sup>13</sup> Boeing Capital Corporation, *Current Aircraft Finance Market Outlook 2014-2018*, <http://www.boeingcapital.com/cafmo/2013/brochure.pdf>

<sup>14</sup> Airline Fleet Management: *the next credit crunch*, published Mar-Apr 2012 <http://www.afm.aero/magazine/trading-legal-and-finance/item/283-the-next-credit-crunch>

<sup>15</sup> OECD *Arrangement on officially supported export credits*, October 2013

[http://search.oecd.org/officialdocuments/displaydocumentpdf/?doclanguage=en&cote=tad/pg\(2013\)11](http://search.oecd.org/officialdocuments/displaydocumentpdf/?doclanguage=en&cote=tad/pg(2013)11)

<sup>16</sup> Boeing Capital Corporation, *Current Aircraft Finance Market Outlook 2014-2018*, <http://www.boeingcapital.com/cafmo/2013/brochure.pdf>

<sup>17</sup> Airbus *Global Market Forecast 2013-2032 "Future Journeys"*, <http://www.airbus.com/company/market/forecast/>

<sup>18</sup> Financial Times, *Airlines tap capital markets for financing*, 10<sup>th</sup> December 2013 <http://www.ft.com/cms/s/0/42f1d9be-6197-11e3-916e-00144feabdc0.html#axzz2qYZYYXWK>

finance, or investors new to the UK legal system, with greater confidence that they can recover their assets under a system they already know and use.

#### Policy objective

17. The treaty aims to address some of the difficulties faced by facilitating cross-border asset-based aircraft finance transactions. The treaty created an international legal framework to govern the creation and registration of international interests (such as mortgages and leases) in helicopters, airframes and aircraft engines over a certain size and engine capacity<sup>19</sup>. The treaty also provides a framework to deal with any issues arising on insolvency such as the ability of creditors to recover their aircraft object should there be a default on repayments and the remedies available to creditors whilst a court considers a creditor's claim.
18. UK airlines which choose to continue to utilise traditional forms of finance and do not wish to explore alternative sources of finance may not see a benefit in reduced financing costs from ratifying the treaty, as they will be working with financiers who are likely to already be familiar with the circumstances of the particular airline and the UK legal structure, which already affords a good level of protection to creditors. Therefore, the greatest benefits are likely to be realised if investors who are unfamiliar with the UK's legal system reduce the cost of lending to UK airlines or leasing companies because the UK has adopted an international framework, providing better information to creditors about the protections available to them. However, ratification of the treaty is only one factor considered by investors, financiers and the ratings agencies involved in rating capital markets transactions. Parties to these transactions consider a number of other factors outside the scope of this treaty such as an airline's own credit rating and repayment history. Therefore, depending on an airline's individual circumstances, airlines may not see any reduction in the cost of raising finance.
19. Currently, UK businesses can register interests with the International Registry and use the International Registry's search facilities to ascertain whether any interest has already been registered against a particular aircraft object. However, interests registered on the International Registry are not recognised under UK law and therefore creditors are unable to enforce international interests created under the treaty and registered with the International Registry through the UK courts. Ratifying the treaty would enable creditors to enforce interests created under the treaty through the UK courts and may provide greater certainty to creditors that they can recover their asset and redeploy it quickly in the event that an airline defaults on repayments, reducing the level risk to investors. If this reduction in risk is factored in to asset-backed aircraft finance transactions, this may lead to a reduction in the cost of raising financing for airlines. A reduction in the cost of raising finance may lead to increased investment by airlines and leasing companies in their fleets and therefore increased sales of helicopters, airframes and aircraft engines from UK manufacturers.
20. Ratification of the treaty would provide additional benefits to financiers, leasing companies and airlines involved in financing arrangements for aircraft engines. The provisions of the treaty extend to aircraft engines over a certain capacity. It is not possible to register interests against aircraft engines separately on the UK's Register of Aircraft Mortgages; they have to be included as part of an aircraft mortgage. Under the treaty, interests in respect of aircraft engines can be created and registered separately with the International Registry, which may provide greater security for financiers and manufacturers of aircraft engines that their interests are protected.

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<sup>19</sup> The treaty excludes aircraft used in military, customs and police services

This provision is particularly important for creditors in transactions involving aircraft engines since engines, which are valuable assets in their own right, are routinely moved between aircraft frames for maintenance reasons. It is common practice for airlines to lease spare engines on a short or long-term basis. As such, creditors to aircraft engine transactions not only face uncertainty as to which jurisdiction the aircraft engine will be in at any one time but they also face uncertainty as to which airframe the engine will be attached to.

21. The Department for Business, Innovation and Skills held a call for evidence in 2010 asking for views on whether the UK should ratify the treaty. The majority of respondents were in favour of the UK ratifying the treaty stating that they expected ratification to lower the cost of raising finance as financiers *“would no longer need to charge higher rates to borrowers as the risk of lending capital would be reduced”*<sup>20</sup>. The Department for Business, Innovation and Skills published a response to the call for evidence on 6<sup>th</sup> December stating its intention to proceed with ratification<sup>21</sup>.
22. There are a number of secondary benefits to ratifying the treaty which may be available to UK businesses. The majority of these benefits are administrative benefits as a result of using the International Registry. Unlike the UK Register of Aircraft Mortgages maintained by the Civil Aviation Authority (the CAA), the International Registry allows interests to be registered electronically twenty-four hours a day, seven days a week. This will make it more convenient for creditors to register interests, taking the pressure off closing complex finance transactions which may be taking place across multiple jurisdictions and time zones. Under the treaty, prospective interests can be registered on the International Registry, something that is not possible on the UK Register of Aircraft Mortgages other than in the form of a “priority notice”. Ratifying the treaty would make it more convenient for business to register prospective interests on the International Registry compared with the current system of priority notices in the UK.
23. The International Registry enables companies and individuals to search for interests registered against a specific aircraft object and the order of priority for any existing registered interests. This allows interested parties to see whether any other party has an interest which would have priority over its own. The intention of the treaty is that any interests registered with the International Registry would take priority over an interest registered on the relevant national register, in the case of the UK, the National Register of Aircraft Mortgages. UK businesses are already able to make use of the search facilities on the International Registry, however, interests registered with the International Registry are not currently enforceable under UK law. There may be an administrative benefit to companies and individuals of searching a single International Registry rather than searching for relevant interests on multiple national registers alongside the International Registry as well as a reduction in costs to search multiple registers. However, the full benefits of searching on the International Registry will only be realised if a critical mass of countries ratify the treaty and if businesses choose to register their interests with the International Registry. It will not be mandatory to register charges on the International Registry and businesses will be able to decide how best to protect their interests.

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<sup>20</sup> *Convention on International Interests in Mobile Equipment and Protocol thereto on matters specific to aircraft equipment – Government Response to the Call for Evidence* <https://www.gov.uk/government/consultations/call-for-evidence-convention-on-international-interests-in-mobile-equipment-and-protocol-thereto-on-matters-specific-to-aircraft-equipment>

<sup>21</sup> <https://www.gov.uk/government/consultations/call-for-evidence-convention-on-international-interests-in-mobile-equipment-and-protocol-thereto-on-matters-specific-to-aircraft-equipment>

## Description of options considered (including do nothing)

24. Two options have been considered

Option 0 - Do nothing. This would involve maintaining the current national system of registration. This option was rejected on the basis that UK businesses would not be able to benefit from the potential lower cost of finance to be gained through ratification of the treaty.

Option 1 - Ratify the treaty. This is the government's preferred option and would introduce the provisions of the treaty into UK law. This means that international interests created under the treaty and registered on the International Registry would be enforceable through the UK courts.

25. The treaty contains a number of optional provisions which the UK can choose whether or not to adopt. These optional provisions are contained in the form of declarations within the treaty. There is one mandatory declaration which requires the UK to outline the remedies available to a creditor without leave of the court. The greatest economic benefits from ratifying the treaty are gained by adopting some of these provisions. The optional provisions are the part of the treaty that provide creditors with greater certainty that they can repossess an aircraft object in cases of default. If the UK does not adopt any of these provisions, it is unlikely that the risk to creditors in lending finance to airlines and leasing companies will be reduced and therefore it is unlikely that those airlines and leasing companies will benefit from a reduction in the cost of raising finance. The treaty allows parties to an aircraft finance transaction to agree to exclude the majority of provisions in the treaty, therefore we would expect businesses to exclude any provisions of the treaty which they did not believe are of benefit.

26. The treaty is a shared competency treaty which the EU has already ratified. The Council of the EU issued a Decision on 6<sup>th</sup> April 2009 which sets out the EU's ratification of the treaty and the declarations under the competence of the EU<sup>22</sup>. The EU's decision states that the EU will not make a declaration with regard to insolvency related provisions. However Member States are free to make changes to their national law in order to align it with any of the insolvency provisions in the treaty. The UK is able to decide whether to make any or all of the declarations outside the competence of the EU and the UK will consult on which of these declarations will lead to the greatest economic benefit to the UK. The UK does not intend to go beyond the minimum declarations within the competence of the EU and any additional declarations made will relate to areas where the UK rather than the EU has competence. Matters contained in the treaty within the competence of the UK are not covered by the EU's Decision and therefore the EU has not set out any minimum requirements in these areas. A description of the areas within the competence of the EU and within the competence of the UK is set out below.

### Declarations within the competence of the EU

27. There are a number of areas of the treaty which fall within the competence of the EU. These mainly relate to matters of jurisdiction and court procedure. The relevant declarations are:

- (a) Interim relief pending final determination of a creditor's claim by the courts – The EU has made a declaration stating that where a debtor is domiciled in an EU Member State, that Member State should only apply this provision in accordance with the existing EU Regulations as interpreted by the European Court of Justice.

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<sup>22</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:121:0003:0007:EN:PDF>

- (b) Parties may choose which law will govern their contractual obligations, either wholly or in part – The EU has not made a declaration allowing parties to choose which law will govern their contractual obligations therefore current EU Regulations will continue to apply within the UK.
- (c) Co-operation with courts in another Contracting State in insolvency proceedings under the treaty – The EU has not made a declaration with regard to the provision of Insolvency Assistance under the treaty and therefore current EU Regulations will continue to apply within the UK.

### **Areas within the competence of the UK**

28. There are a number of other provisions which fall outside of the EU's competence. Some are provisions the UK can opt-out of and some are provisions the UK can opt-in to. The UK can decide to adopt some, none or all of these provisions, except for (f) which is a mandatory declaration the UK must make. The UK cannot make a declaration under (i), as set out under the EU decision but can change national law to reflect the provisions of the treaty:
- (a) Non-consensual rights (e.g. unpaid charges for the provision of air safety services (Eurocontrol charges) or unpaid airport charges) which will take priority over interests registered with the International Registry and retention of all rights under national law to *arrest or detain* an aircraft object for payment of amounts owed directly related to the provision of public services in respect of that object or another object.
  - (b) Other categories of non-consensual rights (such as liens for unpaid charges or court judgments) which can be registered with the International Registry and treated as international interests
  - (c) Whether interests arising out of internal transactions (i.e. transactions where the asset and all parties to the transaction are located in the same state when the transaction is concluded) can be registered with the International Registry
  - (d) The courts that will have jurisdiction over matters covered by the treaty (other than in insolvency)
  - (e) Whether creditors can grant a lease of an aircraft object when the aircraft object is situated in the Contracting State
  - (f) Extra-judicial remedies that are available to creditors without leave of the court
  - (g) A requirement for creditors to re-register interests registered on the UK's national register with the International Registry for them to maintain their priority following ratification of the treaty by the UK – transitional provisions
  - (h) Whether the term *speedy* relief available to creditors whilst their claim is being determined by the court should be defined and, if so, how
  - (i) Whether on commencement of insolvency proceedings creditors may repossess an aircraft object after a certain number of days if the aircraft object has not been returned to the creditor by the insolvency practitioner or the defaults have not been cured and a commitment made by the insolvency practitioner to keep up to date with all future repayment. Alternatively, should national law continue to apply which may require the creditor to obtain leave of the court to repossess an aircraft object?
  - (j) To allow the expeditious de-registration and export of an aircraft object
  - (k) Designating any entry points to pass information and/or registrations to the International Registry

If the UK adopts a certain set of declarations, UK airlines may be eligible to receive a discount of up to 10% from ECAs (this is at the discretion of ECAs). Further detail on the relevant declarations is given under paragraph 72.

29. The government intends to consult on these options to understand the impacts on business and to decide how to implement the treaty. The government believes that the UK currently provides a good level of protection for creditors and intends to ask for views on which of these options will bring the greatest economic benefit to the UK and to UK businesses. During the call for evidence and in subsequent discussions with UK businesses, the majority of stakeholders have said that the greatest benefit for the UK would come from adopting some of the optional provisions as this would provide greater certainty to creditors that they would be able to recover their asset and therefore would lead to a lower cost of finance. A number of stakeholders have commented that without adopting some of the optional provisions, UK businesses would not see a benefit from ratification of the treaty in terms of a reduction in the cost of raising finance.
30. The table below sets out the current situation in the UK (the baseline case) and compares this first with the situation if the UK ratifies the treaty and only adopts the provisions within the competence of the EU and does not adopt any of the provisions within the competence of the UK (i.e. opts-out of or does not opt-in to the relevant provisions) and secondly, if the UK ratifies the treaty with the provisions within the competence of the EU and the government's proposed approach to the declarations within the competence of the UK. The italicised text highlights the difference between ratifying the treaty with only the declarations within the competence of the EU and ratifying the treaty with the EU declarations and the government's proposed approach to declarations within the competence of the UK.

	<b>Baseline</b>	<b>Ratification with only the declarations in the competency of the EU (the UK opts-out of or does not opt-in to provisions within the competence of the UK)</b>	<b>Ratification with the EU declarations and the government's proposed approach to areas within the competency of the UK</b>
<b>Recognition of interests under UK law</b>	Interests registered with the UK's National Register or Aircraft Mortgages against a specific aircraft object are recognised under UK law. <b>UK business may register interests with the International Registry, however any interests registered with the International Registry are not recognised under UK law.</b>	Interests registered with the International Registry against a specific aircraft object are recognised under UK law. Interests on the UK's National Register of Aircraft Mortgages against a specific aircraft object are also recognised under UK law but are subordinate to interests registered on the International Registry.	Interests registered with the International Registry against a specific aircraft object are recognised under UK law. Interests registered on the UK's National Register of Aircraft Mortgages against a specific aircraft object are also recognised under UK law but are subordinate to interests registered on the International Registry.
<b>Type of interest that can be registered and recognised under UK law</b>	Aircraft mortgages and any other agreement where the aircraft is used as security for the loan, with no restriction on the size of the aircraft can be	Interests can still be registered as outlined in the baseline case on the National Register of Aircraft Mortgages and Register of Civil Aircraft.	Interests can still be registered as outlined in the baseline case on the National Register of Aircraft Mortgages and Register of Civil Aircraft.

	<b>Baseline</b>	<b>Ratification with only the declarations in the competency of the EU (the UK opts-out of or does not opt-in to provisions within the competence of the UK)</b>	<b>Ratification with the EU declarations and the government's proposed approach to areas within the competency of the UK</b>
	<p>registered on the National Register of Aircraft Mortgages and are recognised under UK law. Interests against engines cannot be registered separately – they must be included as part of an aircraft mortgage. Leases can be recorded on the UK Register of Civil Aircraft if there is a charter by demise to a qualified body. Prospective interests, assignments and contracts of sale cannot be registered</p>	<p>Additional interests can be registered on the International Registry – mortgages and leases can be registered separately against airframes, helicopters and aircraft engines above a certain size and engine capacity (this excludes military, customs and police aircraft equipment). Interests concerning leases and assignments can also be registered.</p>	<p>Additional interests can be registered on the International Registry – mortgages and leases can be registered separately against airframes, helicopters and aircraft engines above a certain size and engine capacity (this excludes military, customs and police aircraft equipment). Interests concerning leases and assignments can also be registered.</p>

	<b>Baseline</b>	<b>Ratification with only the declarations in the competency of the EU (the UK opts-out of or does not opt-in to provisions within the competence of the UK)</b>	<b>Ratification with the EU declarations and the government's proposed approach to areas within the competency of the UK</b>
<b>Can prospective interests be registered?</b>	No – only in the form of a priority notice	Yes	Yes
<b>When can interests recognised under UK law be registered?</b>	10-4, Mondays to Fridays. Certain transactions (such as registration and de-registration of aircraft) can be carried out 24 hours a day, 7 days a week by prior arrangement.	24 hours a day, 7 days a week on the International Registry.  Registration on the UK's National Register of Aircraft Mortgages remains the same as the baseline case.	24 hours a day, 7 days a week on the International Registry.  Registration on the UK's National Register of Aircraft Mortgages remains the same as the baseline case.
<b>Electronic or paper filing system to register interests recognised under UK law?</b>	Mixture of electronic and paper filing system	Electronic for the International Registry  Filing on the UK's National Register of Aircraft Mortgages will remain the same as the baseline case.	Electronic for the International Registry  Filing on the UK's National Register of Aircraft Mortgages will remain the same as the baseline case.
<b>AREA UNDER EU COMPETENCE</b>			
<b>(a) - Interim relief pending final determination of a creditor's claim by the courts</b>	Interim relief is available to creditors pending final determination of a claim under existing EU Regulations.	The EU has made a declaration that these provisions should only apply in accordance with existing EU Regulations – this does not change the position under the baseline case	The EU has made a declaration that these provisions should only apply in accordance with existing EU Regulations – this does not change the position under the baseline case
<b>(b) - Parties may choose which law will govern their contractual obligations</b>	The EU has competence and the UK has adopted the relevant EU Regulations regarding choice of law.	The EU has not made a declaration and therefore existing EU Regulations will continue to apply – this does not change the position under the baseline case	The EU has not made a declaration and therefore existing EU Regulations will continue to apply – this does not change the position under the baseline case
<b>(c) - Co-operation with courts in another Contracting State in insolvency proceedings under the treaty</b>	The EU has competence and the UK has adopted the relevant EU Regulations regarding provision of assistance in insolvency proceedings.	The EU has not made a declaration and therefore existing EU Regulations will continue to apply – this does not change position under the baseline case	The EU has not made a declaration and therefore existing EU Regulations will continue to apply – this does not change position under the baseline case
<b>AREA UNDER THE UK'S COMPETENCE</b>			
<b>(a) - Non-consensual</b>	Non-consensual rights	Non-consensual rights	The government

	<b>Baseline</b>	<b>Ratification with only the declarations in the competency of the EU (the UK opts-out of or does not opt-in to provisions within the competence of the UK)</b>	<b>Ratification with the EU declarations and the government's proposed approach to areas within the competency of the UK</b>
<b>rights</b>	such as unpaid airport charges or outstanding charges for the provisions of air safety navigation services have priority over interests registered with the UK's National Register of Aircraft Mortgages. Rights to arrest or detain aircraft for payments of amounts owed for the provision of public services exist.	would be subordinate to any interests registered with the International Registry and therefore lose their priority status under UK law. Detention rights for payments of amounts owed for the provision of public services would not be retained.	proposes to declare that <i>all current and future non-consensual rights would retain their priority over interests registered with the International Registry and rights to detain or arrest aircraft objects for the payment of the provision of public services are retained – this is in line with the baseline case.</i>
<b>(b) - Other categories of non-consensual rights which can be registered with the International Registry and treated as international interests</b>	UK law recognises other rights against aircraft objects such as liens for unpaid charges or court judgments which are not registered with the UK's National Register of Aircraft Mortgages	Other rights and liens would be subordinate to any interests registered on the International Registry	The government proposes to consult on whether <i>unpaid court judgments can be registered as international interests. Holders of these interests would be able to register their interest with the International Registry so that it would have priority over any interest subsequently registered with the International Registry.</i>
<b>(c) - Whether interests arising out of internal transactions (i.e. transactions where the asset and all parties to the transaction are located in the same state when the transaction is concluded) can be registered with the International Registry</b>	Aircraft mortgages arising out of internal transactions can be registered with the National Register of Aircraft Mortgages. Leases can be recorded on the UK Register of Civil Aircraft if there is a charter by demise to a qualified body. Prospective interests, assignments and contracts of sale cannot be registered with the National Register of Aircraft Mortgages. Interests against aircraft engines cannot be registered separately – they must be part of an	Interests arising out of internal transactions cannot be registered with the International Registry.  Aircraft mortgages arising out of internal transactions can still be registered with the National Register of Aircraft Mortgages or UK Register of Civil Aircraft in line with the baseline case.	The government proposes to <i>allow interests created in internal transactions including leases, mortgages, assignments and contracts of sale to be registered with the International Registry. Interests can be registered separately against aircraft mortgages.</i>  Aircraft mortgages arising out of internal transactions can still be registered with the National Register of Aircraft Mortgages or

	<b>Baseline</b>	<b>Ratification with only the declarations in the competency of the EU (the UK opts-out of or does not opt-in to provisions within the competence of the UK)</b>	<b>Ratification with the EU declarations and the government's proposed approach to areas within the competency of the UK</b>
	aircraft mortgage.		Register of Civil Aircraft in line with the baseline case.

	<b>Baseline</b>	<b>Ratification with only the declarations in the competency of the EU (the UK opts-out of or does not opt-in to provisions within the competence of the UK)</b>	<b>Ratification with the EU declarations and the government's proposed approach to areas within the competency of the UK</b>
<b>(d) - The courts that will have jurisdiction over matters covered by the treaty (other than in insolvency)</b>	Relevant courts in England and Wales are the County Court and the High Court, the Court of Session in Scotland and the High Court in Northern Ireland.	The EU does not have competence to make a declaration and therefore the courts with jurisdiction over the treaty would not be specified. In practice they are likely to remain the same as the baseline case.	The government proposes to declare that the relevant courts in England and Wales will be the County Court and the High Court, the Court of Session in Scotland and the High Court in Northern Ireland – this is in line with the baseline case
<b>(e) - Whether creditors can grant a lease of an aircraft object when the aircraft object is situated in the Contracting State</b>	Creditors may grant a lease of an aircraft object when it is situated within the UK	Creditors cannot grant a lease of an aircraft object within the UK	The government proposes to <i>allow creditors to grant a lease of an aircraft object when it is situated within the UK – this would be in line with the baseline case</i>
<b>(f) - Extra-judicial remedies (remedies available to creditors without leave of the court) that are available to creditors</b>	Extra-judicial remedies are available to creditors without leave of the court	N/A – This is a mandatory declaration outside the EU's competence	The government proposes to declare that <i>extra-judicial remedies currently available under UK law without leave of the court will continue to be available to creditors without leave of the court – this is in line with the baseline case</i>
<b>(g) - A requirement for creditors to re-register interests on the UK's national register with the International Registry in order for them to maintain their priority following ratification of the treaty by the UK</b>	N/A	The treaty would not apply to pre-existing interests registered on the UK's National Register of Aircraft Mortgages and therefore these interests do not need to be re-registered to maintain their priority.	The government does not propose to declare that the treaty applies to pre-existing interests registered on the UK's National Register of Aircraft Mortgages and therefore these interests would not need to be re-registered to maintain their priority.
<b>(h) - Whether the term <i>speedy relief</i> available to creditors whilst their claim is being determined by the court should be defined and, if so, how</b>	The UK courts are not required to provide <i>speedy relief</i> as defined by the treaty.	<i>Speedy relief</i> would not be defined.	The government intends to <i>consult stakeholders on whether, and if so how, speedy relief should be defined.</i>
<b>(i) – Remedies on insolvency</b>	There is no specified time by which an insolvency practitioner	National law is retained – this is in line with the	The government proposes to consult on two options:

	<b>Baseline</b>	<b>Ratification with only the declarations in the competency of the EU (the UK opts-out of or does not opt-in to provisions within the competence of the UK)</b>	<b>Ratification with the EU declarations and the government's proposed approach to areas within the competency of the UK</b>
	or debtor must give possession of an aircraft to the debtor or cure all defaults and agree to perform all future obligations. A creditor may require leave of the court in order to take possession of an aircraft object. On administration a general moratoria is imposed preventing the commencement or continuance of legal proceedings against the company in administration without the permission of the court or the insolvency practitioner.	baseline case	(i) <i>Alternative A - Amend national insolvency law so that on the commencement of insolvency proceedings creditors may repossess an aircraft (without a requirement to obtain leave of the court) after a certain number of days if the aircraft object has not been returned to the creditor by the insolvency practitioner or the defaults have not been cured and a commitment made by the insolvency practitioner to keep up to date with all future repayment</i> (ii) Retain current insolvency law – this is in line with the baseline case
<b>(j) - To allow the expeditious de-registration and export of an aircraft object</b>	<p>Creditors can obtain a court order to request that the CAA de-register an aircraft from the UK's register for nationality purposes.</p> <p>Creditors can obtain de-registration of an aircraft without a court order by providing documentary evidence of their right to de-register an aircraft.</p>	Creditors would be entitled to request the de-registration of an aircraft for nationality purposes. Creditors can obtain a court order to request that the CAA de-register an aircraft from the UK's register for nationality purposes or obtain de-registration of an aircraft without a court order by providing documentary evidence of their right to de-register an aircraft. This is in line with the baseline case.	The government proposes to <i>allow creditors to present an "irrevocable de-registration and export request authorisation" (IDERA) to the CAA for aircraft registered in the UK for nationality purposes where both the creditor and debtor agree. This would formalise the process enabling creditors to request the de-registration of an aircraft for nationality purposes without a court order. The CAA could prevent an aircraft object from being exported if there is a safety concern.</i>
<b>(k) - Designating any entry points to pass information and/or registrations to the</b>	UK businesses may pass information and/or registrations to the International Registry	There are no designated entry points and UK businesses may pass information and/or registrations to the	The government proposes that UK businesses may pass information and/or registrations to the

	<b>Baseline</b>	<b>Ratification with only the declarations in the competency of the EU (the UK opts-out of or does not opt-in to provisions within the competence of the UK)</b>	<b>Ratification with the EU declarations and the government's proposed approach to areas within the competency of the UK</b>
<b>International Registry</b>	directly.	International Registry directly – this is in line with the baseline case	International Registry directly and that no designated entry points are created – this is in line with the baseline case
<b>Aviation Sector Understanding – If Contracting States make a specific set of declarations, airlines from that Contracting State are eligible for a discount of up to 10% on the premium rate of export credit support. This is at the discretion of Export Credit Agencies.</b>	UK airlines are not eligible for the Aviation Sector Understanding discount.	UK airlines are not eligible for the Aviation Sector Understanding discount	The government intends to ask stakeholders on whether the UK should make the relevant declarations to enable UK airlines applying for export credit support to be considered for the Aviation Sector Understanding discount. The declarations made by the UK need to be considered as a whole.

**Monetised and non-monetised costs and benefits of each option (including administrative burden)**

31. Option 0 maintains the status quo and there are therefore no additional costs or benefits associated with this option.
32. Option 1 is that the UK ratifies the treaty and this is the preferred option. The treaty aims to reduce the risk of lending to airlines and leasing companies and this may lead to lower financing costs for airlines by reducing the risk for creditors lending to UK airlines and leasing companies. This may enable airlines to access new sources of funding and diversify their sources of finance. A reduction in the cost of raising finance may also lead to increased investment by airlines and leasing companies and therefore increased sales of helicopters, airframes and aircraft engines by UK manufacturers. There may be a number of secondary administrative benefits to ratifying the treaty through using the International Registry. However, this is not the primary reason to ratify the treaty.
33. Ratification of the treaty will affect the UK aviation industry, helicopter, airframe and aircraft engine manufacturers, aircraft financiers such as banks and investors in the capital markets, legal firms specialising in aircraft finance transactions, insolvency practitioners and the CAA, the public body which operates the UK's National Register of Aircraft Mortgages.

## Costs

### Costs to businesses – Familiarisation costs

34. There are approximately 30 national, regional and local airlines offering passenger or freight services or both in the UK<sup>23</sup> which are expected to incur familiarisation costs as a result of ratification of the treaty. These familiarisation costs will relate to the need for airlines to familiarise themselves with the regulatory changes made as a result of ratifying the treaty. In addition there are a number of UK legal firms, banks and other financial institutions involved in the aircraft finance industry which will be directly affected by ratification of the treaty and may also incur familiarisation costs. There are approximately 250 entities with interests registered on the UK's National Register of Mortgages, over half of these entities are international banks or international legal firms. This indicates that there is a small group of financiers and legal firms with expertise in the global aircraft finance market. Approximately 100 of the entities or individuals with interests registered on the UK's National Register of Aircraft Mortgages are UK entities. Businesses which have registered interests on the National Register of Aircraft Mortgages tend to be financial institutions, manufacturers, leasing companies or legal firms acting on behalf of clients rather than airlines since airlines are unlikely to be the holders of mortgages or leases. The number of UK entities with a current interest registered on the UK's National Register of Aircraft Mortgages provides an estimate of the number of UK businesses which would need to familiarise themselves with the changes to UK regulations as a result of ratifying the treaty as it provides an estimate of the number of UK businesses involved in the aircraft finance industry and who may wish to make use of the provisions under the treaty.
35. Based on the number of airlines in the UK (approximately 30) and current usage of the UK's National Register of Aircraft Mortgages by British companies (approximately 100), it is assumed that a maximum 130 UK businesses may incur familiarisation costs with the new legislation. However, the treaty has been in place for several years and has been ratified by a number of countries including Brazil, Canada, China, Ireland, New Zealand, Norway, Singapore, the United Arab Emirates and the United States with Australia in the process of ratifying the treaty. This indicates that the provisions of the treaty are familiar to the global aircraft finance industry, including UK businesses which advise clients or provide finance to businesses in jurisdictions which have already ratified the treaty. It is expected that the majority of UK legal firms and financial institutions are already familiar with the main provisions of the treaty as they advise clients or provide funding for airlines in jurisdictions which have already ratified the treaty. However, it is likely that the majority of these businesses will still incur some familiarisation costs as they will need to understand how the UK has implemented the treaty compared to other countries and which optional provisions the UK has decided to adopt.
36. Not all of the 100 businesses or individuals who use the current UK system of registration for interests against aircraft objects will need to familiarise themselves with the new UK regulations as the treaty only covers helicopters, airframes and engines above a certain size and engine capacity. Therefore some businesses and individuals using the UK National Register of Aircraft Mortgages are likely to have interests relating to small aircraft objects which fall outside of the subject matter of the treaty. Creditors who only have interests in aircraft objects below the minimum requirements of the treaty will not incur the familiarisation costs.
37. We are unable to provide an estimate of how many of the registrations made on the UK National Register of Aircraft Mortgages would be covered by the treaty. However, the figures below estimate the familiarisation costs for UK financiers and legal firms based on a maximum of 130 UK entities which would need to familiarise themselves with the International Registry. The best estimate is based on 100 businesses needing to familiarise themselves with the International Registry and assumes that around 30 businesses and individuals only have interests in aircraft objects which do not meet the minimum requirements of the treaty with regard to size of

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<sup>23</sup> <http://www.caa.co.uk/default.aspx?catid=80&pagetype=88&pageid=1&sqlid=1>

helicopter or airframe or engine capacity. The low estimate is based on 75 businesses incurring the familiarisation costs which assumes that some UK banks and legal firms will not need to familiarise themselves with how the UK has implemented the treaty as they will already be familiar with the provisions of the treaty through advising clients or providing finance for businesses in jurisdictions which have already ratified the treaty. It also assumes that a number of aircraft registered on the UK's National Register of Aircraft Mortgages will not meet the treaty's requirements regarding aircraft and helicopter size and engine capacity. A study for the Aviation Working Group (AWG) estimates that there will be an additional one-off legal cost of £5,000 per transaction in the first year for businesses to familiarise themselves with the International Registry and set up the necessary documentation to register interest with the International Registry<sup>24</sup>. In the absence of further evidence, we have used this £5,000 estimate from the AWG as a conservative proxy of the costs to business to familiarise themselves with the new regulations and we will consult on this figure. This is a conservative estimate as not all UK businesses will need to familiarise themselves with all of the provisions of the treaty as they will already be familiar with the main provisions of the treaty through their business in jurisdictions which have already ratified the treaty. These businesses (e.g. UK legal firms and financiers) will only need to familiarise themselves with any optional provisions the UK has adopted. UK businesses, such as airlines or UK legal firms or financiers which have only financed UK aircraft to date, will need to familiarise themselves with the main provisions of the treaty as well as any optional provisions adopted by the UK. These familiarisation costs will all be incurred in the first year after implementation, i.e. 2015.

<b>Low estimate</b> (based on 75 UK businesses incurring familiarisation costs)	<b>Best estimate</b> (based on 100 UK businesses incurring familiarisation costs)	<b>High estimate</b> (based on 130 UK businesses incurring familiarisation costs)
£375,000	£500,000	£650,000

## **Costs to business – costs that businesses would choose to incur**

### **Familiarisation costs to use the International Registry**

38. UK businesses are likely to incur costs to familiarise themselves with the International Registry and prepare the necessary documentation to register interests with the International Registry. This is a cost businesses would choose to incur since it would not be mandatory to register interests with the International Registry and business could choose to continue to register their interests with the UK's National Register of Aircraft Mortgages, with both registers or neither. Therefore, if any business decided against registering interests with the International Registry, they would not incur the familiarisation costs. However, in practice we expect the majority of UK businesses to use the International Registry as the intention of the treaty is that interests registered with the International Registry would take priority over interests registered with the relevant national register.
  
39. A number of UK businesses are already familiar with how to use the International Registry, particularly UK financiers, legal firms and leasing companies which are parties to transactions where the airline or leasing company is in a jurisdiction which has already ratified the treaty. Data from the International Registry shows the number of UK entities which have already registered with the International Registry. This figure has increased from 99 in 2007 to 156 in 2012, down from a peak of 197 in 2009, suggesting that the International Registry is widely used

<sup>24</sup> Linetsky, Vadim *Accession to the Cape Town Convention by the UK: An Economic Impact Assessment Study*, December 2010, <http://www.awg.aero/assets/docs/UKCTC%20Econ%20Impact%20Final%20Version.pdf>

by UK businesses. The difference in the number of UK entities which have registered with the International Registry compared to the number of UK entities which have an interest registered on with the UK's National Register of Mortgages may be due to one company registering separate parts of its business with the International Registry or the UK based arm of international banks or legal firms registering separately with the International Registry.

<b>Year ended</b>	<b>Number of UK entities registered with the International Registry</b>
2007	99
2008	199
2009	197
2010	155
2011	155
2012	156

Source – International Registry

40. Data from the International Registry indicates that a number of registrations have been made on the International Registry relating to aircraft frames or helicopters which have the UK as their State of Registry<sup>25</sup>.

<b>Year</b>	<b>Number of Airframe registrations</b>	<b>Number of helicopter registrations</b>
2006	25	1
2007	86	N/A
2008	23	2
2009	74	4
2010	134	2
2011	66	9
2012	105	43
2013	74	82

Source – International Registry

41. Since aircraft engines are not registered with a national aviation authority in the same way for nationality purposes, comparable figures for aircraft engines are not available. However, data from the International Registry on the number of transactions where one of the named parties is based in the UK includes information on registrations against aircraft engines. The data shows that a number of UK businesses are already using the International Registry to register interests against aircraft objects. This is likely to be for transactions where one party is located in a jurisdiction which has already ratified the treaty since interests on the International Registry are not currently enforceable through the UK courts. This suggests that UK financiers and legal firms rather than airlines are currently the predominant users of the International Registry. The high number of engine registrations compared to airframes is expected since every airframe carries a number of engines and interests can be registered against each engine separately.

<sup>25</sup> Under the Chicago Convention on International Civil Aviation, aircraft must be registered with a national aviation authority for nationality purposes and can only be registered with one national aviation authority at any one time.

<b>Aircraft Object</b>	<b>Number of Registrations</b>
Engine	9018
Airframe	3553
Helicopter	389

Source – International Registry

42. Therefore, it is likely that the majority of UK businesses which will incur familiarisation costs will be UK airlines which have not previously used the International Registry. These familiarisation costs are likely to be in the form of increased legal fees as legal firms advise their clients on the documentation required by the International Registry. A study for the Aviation Working Group (AWG), a group of airframe and aircraft engine manufacturers, leasing companies and financiers, estimates that there will be an additional one-off legal cost of £5,000 per transaction in the first year to set up the necessary documentation<sup>26</sup>. Discussions with businesses have indicated that this would be a small fraction of the total legal costs an airline would pay during an aircraft finance transaction.
43. Since registration with the International Registry is not mandatory, it is possible that not every finance transaction will involve registration on the International Registry and therefore that not every airline will incur these costs. However in practice it is likely that the vast majority of financiers will register their interests with the International Registry to give them the greatest possible protection. In addition, creditors from outside the UK who may not be familiar with the protection provided by the UK's National Register of Aircraft Mortgages may wish to have their interests registered on the International Registry, a system of registration they may already be familiar with. The table below gives a low, high and best estimate of the one-off legal costs for airlines, based on different numbers of airlines making use of the International Registry. Discussions with businesses involved in the aircraft finance industry have indicated that the majority would require their interests to be registered on the International Registry as this would give them greater priority over other creditors. Therefore, it is expected that the majority of airlines will need to familiarise themselves with the International Registry so that their creditors' interests can be registered. Consequently the best estimate assumes that the majority of airlines will face these familiarisation costs.
44. As airlines do not purchase helicopters, airframes or aircraft engines every year, any familiarisation costs related to the International Registry may be spread across several years, depending on when airlines renew their fleet. Since airframe mortgages last on average 10-12 years, it is assumed that these familiarisation costs are spread evenly across ten years, starting the year after implementation, as it may be several years before airlines need to renew their fleet and need to familiarise themselves with the workings of the International Registry.

<b>Year</b>	<b>Low Estimate</b> (based on 15 airlines using the International Registry)	<b>Best Estimate</b> (based on 25 airlines using the International Registry)	<b>High Estimates</b> (based on 30 airlines using the International Registry)
2015	£7,500	£12,500	£15,000
2016	£7,500	£12,500	£15,000
2017	£7,500	£12,500	£15,000
2018	£7,500	£12,500	£15,000

<sup>26</sup> Linetsky, Vadim *Accession to the Cape Town Convention by the UK: An Economic Impact Assessment Study*, December 2010, <http://www.awg.aero/assets/docs/UKCTC%20Econ%20Impact%20Final%20Version.pdf>

2019	£7,500	£12,500	£15,000
2020	£7,500	£12,500	£15,000
2021	£7,500	£12,500	£15,000
2022	£7,500	£12,500	£15,000
2023	£7,500	£12,500	£15,000
2024	£7,500	£12,500	£15,000
2025	£7,500	£12,500	£15,000
	Total - £75,000	Total - £125,000	Total - £150,000

### Fees to register interests with the International Registry

45. Businesses registering interests with the International Registry will be required to pay fees set by the International Registry. Depending on the maximum take-off weight of an airframe, the fees to register interests against airframes on the UK's National Register of Aircraft Mortgages are higher than the fees of the International Registry and so businesses which chose to register interests against airframes on the International Registry instead of the UK's National Register of Aircraft Mortgages may see a benefit in terms of reduced fees. However, businesses which choose to register interests against aircraft engines will face additional fees as it is not possible to register interests against aircraft engines separately on the UK's National Register of Aircraft Mortgages, they must be included in an aircraft mortgage. The information below outlines the fees charged by the International Registry and the UK's National Register of Aircraft Mortgages to register interests and to search the register.

#### Charge for entry of Aircraft Mortgage on National Register of Aircraft Mortgages<sup>27</sup>

Charges depend on the maximum take-off weight of the aircraft that is the subject of the mortgage.

Maximum take-off weight	CAA Charge
<= 5700 kg	£174
5701 kg - 15000 kg	£346
15001 kg - 50000 kg	£577
> 50000 kg	£1038

Source - CAA

If one mortgage covers several aircraft, the fee payable is as shown above for the heaviest aircraft, plus £174 for each additional aircraft. This is based on all the aircraft mortgages being submitted at the same time.

The charge to search the register is £29.

<sup>27</sup> <https://www.caa.co.uk/default.aspx?catid=121&pagetype=90&pageid=112>

Charge for entry on International Registry and for searches<sup>28</sup>

Service	Fee
Controlled entity set-up fee (1 year)	\$180/£109
User set-up fee (1 year)	\$200/£121
Registration fee	\$100/£61
Spare engine fee	\$50/£30
Priority search fee	\$22/£13

Source – International Registry

The exchange rate between US dollars and pounds was 1.65 on 24<sup>th</sup> January 2014 and this has been used as the conversion rate for all pound to US dollar conversion in this Impact Assessment.

46. The table below compares the total estimated cost to register an interest against an airframe and four engines with the International Registry and with the National Register of Aircraft Mortgages to highlight the difference in fees between registering with the two different registers. The table also contains data on the number of aircraft mortgage registrations with the CAA by maximum take-off weight in 2012-13 to indicate how many airframes are likely to fall into each category. Not all of the aircraft mortgage registrations with the CAA last year will fall in scope of the treaty and since the treaty only covers aircraft frames and mortgages above a certain weight, this is likely to particularly be the case for airframes with a maximum take-off weight below 5,700kg. Therefore these figures are only indicative. For the purposes of the comparison, it has been assumed that the controlled entity set-up fee and the user set-up fee are payable, however since both of these fees only have to be paid once a year, they may not apply to every transaction.

### Comparison of fees

	International Registry	UK National Register of Mortgages	Aircraft Mortgage registrations with the CAA in 2012-13
Cost to register an airframe with a maximum take-off weight of 5,700kg	Controlled entity set-up fee (\$180) + User set-up fee (\$200) + Registration fee (\$100) = <b>\$480/£291</b>	<b>£174</b>	124
Cost to register an airframe with a maximum take-off of 5,701 – 15,000 kg	Controlled entity set-up fee (\$180) + User set-up fee (\$200) + Registration fee (\$100) = <b>\$480/£291</b>	<b>£346</b>	28
Cost to register an airframe with a take-off weight of 15,001 – 50,000kg	Controlled entity set-up fee (\$180) + User set-up fee (\$200) + Registration fee (\$100) = <b>\$480/£291</b>	<b>£571</b>	27
Cost to register an airframe with a take-off weight greater than 50,000kg	Controlled entity set-up fee + User set-up fee (\$200) + Registration fee (\$100) = <b>\$480/£291</b>	<b>£1038</b>	111

<sup>28</sup> <https://www.internationalregistry.aero/ir-web/faq>

	<b>International Registry</b>	<b>UK National Register of Mortgages</b>	<b>Aircraft Mortgage registrations with the CAA in 2012-13</b>
Cost to register four engines on either aircraft	User set up fee (already paid) + Registration fee (\$100 x 4) = <b>\$400/£243</b>	N/A	N/A

47. The government does not intend to make it mandatory to register interests with the International Registry, therefore some businesses may decide not to use the provisions of the International Registry and therefore may not be affected by these costs. However, discussions with businesses specialising in aviation finance have indicated that most financiers register interests on the International Registry and the relevant national register to give them the greatest possible protection. For example, if one party to an aircraft finance transaction is based in a jurisdiction which has not ratified the treaty, that party may request that the interest is registered on the relevant national register as interests registered on the International Registry may not be recognised in their home country. In this case, there may be some duplication as the National Register of Aircraft Mortgages and International Registry would provide similar protection to creditors and business would be required to pay two sets of fees. It is unclear how many businesses would choose to register their interests on both registers. However, this would be a business decision and it is expected that businesses would only register with the International Registry and the UK's National Register of Aircraft Mortgages if they saw clear benefits to this.

#### **Public costs – Loss of income to the CAA through a reduction in number of registrations on the UK's national register**

48. There are some potential costs to the Civil Aviation Authority, a public body, in terms of a loss of income in registration fees should businesses register their interests with the International Registry in place of registering with the National Register or Aircraft Mortgages. It is unclear how many businesses will stop registering with the CAA and discussions with businesses have indicated that the vast majority of businesses register their interests with the International Registry and the relevant national register to give them the greatest level of protection.
49. In 2012-13, the CAA's total income from aircraft mortgages was £210,000 of which an estimated £187,000 came from transactions which would fall within scope of the treaty. This was an increase from a total income from aircraft mortgages of £176,000 in 2011-12 of which an estimated £149,000 came from transactions likely to fall within scope of the treaty.
50. The table below shows the number of aircraft mortgage transactions handled by the CAA over the last three years, inclusive and exclusive of requests to search whether a mortgage already exists against a particular aircraft object. It is estimated that approximately two thirds of the transactions would fall within scope of the treaty:

<b>Year</b>	<b>No. of transactions (including searches)</b>	<b>No. of transactions (excluding searches)</b>
2010-11	1573	746
2011-12	1930	827
2012-13	1477	679

51. As mentioned in paragraph 48, discussions with experts and businesses involved in aircraft finance have indicated that creditors like to have their interests registered on both the International Registry and the relevant national register to afford them the greatest possible protection. The table below provides a low, high and best estimate of the income to the CAA based on 25%, 75% and 90% of businesses registering their interests with both the National Register of Aircraft Mortgages and with the International Registry based on an estimated income of £187,000 for 2012-13 from transactions within scope of the treaty. The best estimate has been set at 75% based on discussion with business which suggests that the majority of creditors would register their interests on both the International Registry and the UK's National Register of Aircraft Mortgages. The second table shows the estimated loss to the CAA based on 25%, 75% and 90% of businesses continuing to register their interests with the National Register of Aircraft Mortgages based on an estimated income of £187,000 for 2012-13. Since businesses register interests with the CAA every year, the cost to the CAA is expected to be incurred every year.

**Estimated income to the CAA – baseline income of £187,000**

<b>Low Estimate – 25% of businesses register with CAA and International Registry</b>	<b>Best Estimate – 75% of businesses register with CAA and International Registry</b>	<b>High Estimate – 90% of businesses register with CAA and International Registry</b>
£46,750	£140,250	£168,300

**Estimated reduction in income to the CAA based on a baseline income of £187,000 per year – this is an expected annual cost**

<b>Low Estimate – 90% of businesses continue to register with the CAA</b>	<b>Best Estimate – 75% of businesses continue to register with the CAA</b>	<b>High Estimate – 25% of businesses continue to register with the CAA</b>
£18,700	£46,750	£140,250

**Public costs – Costs to the courts of enforcing interests under the treaty**

52. By ratifying the treaty, international interests created under the treaty and registered with the International Registry will be enforceable through the UK court system. However, creditors with interests registered on the UK's National Register of Aircraft Mortgages can already enforce their interests in cases of default through the UK courts and therefore this is not a new provision for creditors. Since creditors can only enforce their interests registered with the National Register of Aircraft Mortgages where an airline or leasing company has defaulted on repayments, it is not expected that the treaty will lead to additional cases coming before the UK courts. Therefore there are no expected increased costs to UK courts as a result of ratifying this treaty.

**Summary of costs**

53. The majority of UK businesses involved in aircraft financing (an estimated 30 airlines and approximately 100 businesses with interests registered on the UK's National Register of Aircraft Mortgages) are likely to incur familiarisation costs as they will need to understand the changes made to current UK legislation in order to implement the treaty. However, a number of UK legal firms, leasing companies and financiers which provide advice to or are parties to transactions with airlines in jurisdictions which have already ratified the treaty are likely to be familiar with the over-arching provisions of the treaty and so may not incur the full familiarisation costs. Since the treaty only covers helicopters, airframes and aircraft engines above a certain weight and engine capacity, some of the current users of the UK's National Register of Aircraft Mortgages may have interests relating to aircraft that would fall outside the scope of this treaty. These businesses would not need to familiarise themselves with the new regulations either. The best estimate for the total familiarisation costs to business relating to the changes in regulations is £500,000.
54. Airlines may incur familiarisation costs associated with understanding how to register interests with the International Registry. UK legal firms and financiers which are already familiar with the International Registry through providing advice to clients or providing financing for airlines in jurisdictions which have already ratified the treaty, will not incur these familiarisation costs. Since it will not be mandatory to register interests with the International Registry, these are costs business will choose to incur and it would be a business decision whether to register interests with the International Registry, the UK's National Register of Aircraft Mortgages, on both registers or on neither. Therefore, businesses which choose not to use the International Registry will not incur these familiarisation costs, nor will businesses with interests relating to aircraft objects outside the scope of this treaty. These costs are likely to be incurred over several years as airlines do not purchase airframes or engines every year. In practice, we expect the majority of financiers to require their interests to be registered with the International Registry and therefore the best estimate of familiarisation costs relating to use of the International Registry is £12,500 per year for ten years.
55. Businesses may face additional costs in terms of increased fees to register with the International Registry. However, since it would be a business decision whether or not to register interests with the International Registry, some businesses may not incur these costs. Depending on the maximum take-off weight of the airframe, there may be a benefit to businesses in registering with the International Registry compared to the fee to register interests on the UK's National Register of Aircraft Mortgages.
56. There are likely to be some public costs to the CAA as a result of ratifying the treaty through a loss of fee income if businesses choose to register interests with the International Registry instead of the UK's National Register of Aircraft Mortgages run by the CAA. Discussions with business have indicated that the majority of businesses will register their interests on both registers, therefore the cost to the CAA is estimated to be a small annual cost. The best estimate of a loss of income to the CAA per year is £46,750. Ratification of the treaty is unlikely to result in an increased number of cases coming before the UK courts and therefore there are no expected costs to the UK court service.

## **Benefits**

57. The aim of the treaty is to reduce the cost of raising aircraft finance by providing creditors with greater security over aircraft objects covered by the treaty. The overall costs to business outlined above are expected to be small in comparison with the potential benefits in terms of a reduction in the cost of finance. Although these benefits are difficult to quantify, the government is

confident that they will outweigh the costs. However, based upon the quantifiable costs and benefits analysis, we present this policy as a net cost “IN”.

58. There are a number of different funding options available to airlines (see paragraph 3). Each airline will consider which funding option is right for them and may use all of these options at different times and in different circumstances. However, in all of these transactions, the level of a creditor’s financial risk is important in determining the price of finance.
59. Ratification of the treaty is just one of many factors which financiers consider when making their decisions on the cost of financing for a particular airline or leasing company. Other factors financiers may consider include the airline’s repayment history, its credit rating, the type of asset and the duration of the loan. It is difficult to quantify the difference that ratification of the treaty will bring as its benefits will vary from airline to airline and is dependent on factors outside of this treaty, such as the airline’s own circumstances and the relevant finance structure. Depending on an airline’s individual circumstances and how it chooses to raise finance, some airlines may not see a reduction in the cost of raising finance as a result of ratification of the treaty.
60. In 2010, the Aviation Working Group commissioned a study by Professor Linetsky to estimate the benefits of ratification of the treaty to the UK<sup>29</sup>. This study concluded that the UK based airlines could benefit from a reduction in funding costs of between £538 million and £2.705 billion (with a best estimate of £1.2 billion) for aircraft deliveries over the next twenty years on an estimated £98 billion of aircraft finance. This study made a number of assumptions with regard to how UK airlines would meet their future financing needs, the delays faced by creditors in repossessing aircraft objects on insolvency based on current UK law, and how the UK would ratify the treaty. As a result of these assumptions, this study should be seen as a high estimate of the possible benefits to the UK. Professor Linetsky’s study assumes that UK airlines will meet their future aircraft financing needs as follows:

Export Credit Agencies	20%
Capital Markets	20%
Commercial finance (including banks)	40%
Equity	20%

Although the majority of aviation finance experts expect capital markets to make up a greater share of aircraft financing in the future and Boeing expects 22% of the global share of aircraft finance to come from the capital markets this year<sup>30</sup>, only one UK airline has so far raised finance through the capital markets and it is unclear how many other UK airlines intend to raise part or all of their financing needs through the capital markets in the short and long term.

61. Secondly, some of the benefits from Professor Linetsky’s study come from the assumption that the UK will adopt one of the optional provisions in the treaty called “Alternative A” which provides for additional benefits for a creditor on insolvency. Professor Linetsky assumed a worst case scenario of 4-8 months for a creditor to recover an aircraft object in the UK without the provisions

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<sup>29</sup> Linetsky, Vadim *Accession to the Cape Town Convention by the UK: An Economic Impact Assessment Study*, December 2010, <http://www.awg.aero/assets/docs/UKCTC%20Econ%20Impact%20Final%20Version.pdf>

<sup>30</sup> Boeing Capital Corporation, *Current Aircraft Finance Market Outlook 2014-2018*, <http://www.boeingcapital.com/cafmo/2013/brochure.pdf>

of Alternative A. The majority of respondents to the government's call for evidence thought that, in economic terms, Alternative A is the most important provision in the treaty and would bring the greatest benefits to the UK. Alternative A requires that on insolvency, the insolvency practitioner must either (i) give up possession of the aircraft object to the creditor or (ii) cure all defaults and agree to perform all future obligations under the relevant transaction documents by the end of the specified waiting period. If under national insolvency law a creditor is entitled to possession prior to the end of the waiting period, that entitlement takes precedence to the waiting period. Alternative A requires the insolvency administrator or the debtor to preserve the aircraft object and maintain it and its value in accordance with the transaction documents until possession of the aircraft object is given to the creditor. Alternative A does not require a creditor to obtain permission from the court before taking possession of the aircraft object at the end of the waiting period. The majority of countries which have ratified the treaty have adopted Alternative A with a waiting period of 60 days.

62. The majority of respondents to the call for evidence thought that this provision would provide creditors with greater certainty that they could recover the aircraft object within a specified number of days and therefore reduce the risk to creditors. Alternative A would not affect the right of a secured creditor to take possession of an aircraft on winding up or bankruptcy. However it would displace UK insolvency law on administration and on company voluntary arrangements ("CVAs") for this type of asset. Current UK insolvency law on administration and CVAs creates a moratorium so a creditor will need to obtain leave of the court in order to repossess an aircraft object as there is no requirement to handover the aircraft object to a secured creditor without a court order.
63. The government believes that UK insolvency law works well and is not aware of any problems where creditors have been unable to recover an aircraft object in the UK. Discussions with experts in aircraft finance have indicated that creditors have been able to recover an aircraft object in the UK within 60 days. A minority of respondents to the government's call for evidence stated that adoption of Alternative A was not necessary in the UK since UK insolvency law is robust and well-established and would not be improved by adopting Alternative A. The government would like to consult further on whether or not adopting the provisions of Alternative A would benefit UK businesses or whether to retain current national law.
64. For these reasons it is difficult to quantify the benefits of ratifying the treaty in the UK as a number of factors are involved in pricing aircraft finance transactions and many of these factors are outside the scope of this treaty. However, given the high value of aircraft objects, if only a small percentage of the benefits estimated in the AWG commissioned study materialise, or if only a small number of businesses benefit from a reduction in the cost of finance, the benefits are expected to far outweigh the small additional costs to business. As businesses can choose whether or not to register interests on the International Registry, we would only expect businesses to choose to incur these costs if they are outweighed by the benefits of using the provisions of the treaty.
65. If UK airlines and leasing companies benefit from a reduction in the cost of raising finance, this may lead to increased investment in the aircraft objects covered by this treaty. This may result in a benefit for UK manufacturers through increased sales of helicopters, airframes and aircraft engines. Increased sales of aircraft objects may lead to knock-on benefits for customers in terms of improved comfort and environmental benefits through reductions in carbon dioxide and nitrogen oxide emissions and a reduction in noise levels from purchasing or leasing newer aircraft objects.

66. Although not the primary reason to ratify the treaty, UK businesses may see some secondary benefits from using the International Registry in a reduction in administrative burdens. UK engine leasing companies and financiers will benefit from the provisions in the International Registry to register interests against aircraft engines separately. This is important as engines are routinely moved between aircraft for maintenance reasons. Aircraft engines are high value assets in their own right and airlines routinely lease spare engines (both in the long-term and the short-term) which they can move between aircraft frames as required to match their needs. As such a creditor cannot be certain which airframe an engine will be attached to or in which jurisdiction that engine will be located at any one time. Comparatively, aircraft engines retain their value well over time and therefore these provisions are particularly important for engine manufacturers and engine leasing companies. Ratifying the treaty will recognise rights created and registered against aircraft engines separately under UK law and this may lower the cost of raising finance for engines as creditors will have greater confidence they can recover an aircraft engine if necessary.
67. If the UK ratifies the treaty with a certain set of declarations (see paragraph 72 for further detail), UK airlines may be eligible for a discount of up to 10% on export credit support. This discount is discretionary and export credit agencies can decide how much of a discount to give. Since the discount is discretionary and not all airlines will apply for or be granted export credit support, it is difficult to quantify the potential benefits. The government intends to consult on whether or not the UK should make the relevant declarations regarding the 10% discount on export credit support.
68. As noted in paragraph 45, some UK businesses may benefit from a reduction in the fee to register an interest with the International Register compared to registering an interest with the UK's National Register of Aircraft Mortgages. However, this would only relate to registrations made against airframes and helicopters since it is not possible to register interests against engines separately on the UK's National Register of Aircraft Mortgages. As stated in paragraph 47, discussions with businesses have indicated that creditors are likely to register their interests on the International Registry and the relevant national register, therefore it is unclear whether and to what degree these benefits will materialise.
69. UK businesses choosing to use the International Registry may benefit from a reduction in administrative costs as the International Registry, unlike the UK's National Register of Aircraft Mortgages, is open twenty-four hours a day, seven days a week. It may therefore be more convenient to register interests with the International Registry, particularly as the parties to an aircraft finance transaction may be located in several different jurisdictions and time zones. UK businesses may benefit from provisions to register prospective interests with the International Registry for the same reasons. A single International Registry would make it more convenient for financiers to check whether any party held an interest which would take precedence over its own as they may not need to check multiple national registers. However, these benefits will only be fully realised if a critical mass of countries ratifies the treaty.
70. The benefits to business of ratification of the treaty will depend on how the UK chooses to ratify the treaty. As outlined previously, there are a number of options available to the UK. Whilst the government intends to use the consultation document to develop a greater understanding of the costs and benefits involved and how to ratify the treaty in the best interests of the UK, the government's intentions and current understanding of the costs and benefits of each option are

outlined below. Without implementing any of these optional provisions, it is highly unlikely that UK businesses will benefit from a reduction in the cost of raising aircraft finance since it is the optional provisions that provide greater certainty for creditors that they can recover an aircraft object if an airline or leasing company has defaulted on repayments. The majority of respondents to the government's call for evidence on whether the UK should ratify the treaty stated that the greatest benefits to UK businesses would come through adopting some of these optional provisions. In other cases, the optional provisions are consistent with protection already available to creditors under UK law and so by not adopting the provisions, creditors would be in a worse position than under current UK law. Some of the options concern matters such as the courts which would have jurisdiction in the UK and are not expected to increase costs to business.

71. Under the terms of the treaty, the parties to an aircraft finance transaction can agree to exclude the majority of the provisions of the treaty, including optional declarations made by the UK. Therefore, businesses would be expected to only include these provisions in their financial agreements if the benefits outweigh the costs.

## **Options for Consultation**

### **Declarations within the competence of the EU**

- (a) The courts having jurisdiction to grant creditors relief pending final determination of their claim  
The EU has made a declaration stating that where a debtor is domiciled in an EU Member State, that Member State should only apply this provision in accordance with the existing EU Regulations as interpreted by the European Court of Justice. This declaration does not change the current position under UK law and is not expected to have any impact on business.
- (b) Allowing parties to choose which law will govern their contractual obligations, either wholly or in part  
The EU has not made a declaration allowing parties to choose which law will govern their contractual obligations, therefore current EU Regulations will continue to apply within the UK. This does not change the current position under UK law and so is not expected to have any impact on business.
- (c) Courts in one Contracting State are obliged to co-operate with courts in another Contracting State in respect of insolvency proceedings  
The EU has not made a declaration with regard to the provision of Insolvency Assistance under the treaty and therefore current EU Regulations will continue to apply within the UK. This does not change the position under UK law and so is not expected to have any impact on business.

**Areas within the competence of the UK – The government will consult on whether or not to adopt these provisions. Option (f) is a mandatory declaration and the government will consult further on this provision.**

- (a) Non-consensual rights (e.g. unpaid Eurocontrol charges or unpaid airport charges) which will take priority over interests registered with the International Registry

The government proposes to declare that all current and future non-consensual rights with priority under UK law (including rights of detention) will retain their priority under the treaty (this includes outstanding airport charges and Eurocontrol charges for the provision of air navigation services). This would not change the current position under UK law and therefore is not expected to lead to additional costs for business.

- (b) Other categories of non-consensual rights (such as liens for unpaid charges or court judgments) which can be registered with the International Registry and treated as international interests

The government proposes to consult on whether unpaid court judgments can be registered as international interests. This will allow anyone searching the International Registry to clearly see who has priority over an asset in the event of a default and will protect the rights of creditors who would otherwise lose their priority over an aircraft object. The government intends to consult on whether any other types of non-consensual rights or liens should be included within this declaration. If the government declares that other non-consensual rights can be registered with the International Registry, it would be up to the holders of these rights to decide whether or not to register them with the International Registry. Any creditors choosing to register these rights with the International Registry would face an increased cost in terms of the fee to register interests with the International Registry.

- (c) Whether interests arising out of internal transactions (i.e. transactions where the asset and all parties to the transaction are located in the same state when the transaction is concluded) can be registered with the International Registry

The government does not intend to opt-out of a provision which applies the treaty to internal transactions. This will enable internal transactions to be registered on the International Registry and will create one system to register national and international interests and therefore would ensure that the system is as simple as possible to use. This will change the current position under UK law but is not expected to lead to additional costs for business. It is expected to reduce costs as businesses would not be required to use two systems.

- (d) The courts that will have jurisdiction over matters covered by the treaty (other than in insolvency)

The government proposes to declare that as with other types of civil and commercial cases, the relevant courts in England and Wales will be the County Court and the High Court, the Court of Session in Scotland and the High Court in Northern Ireland. The government does not believe that this will impact on business as this is consistent with other types of civil and commercial cases.

- (e) Whether creditors can grant a lease of an aircraft object when the aircraft object is situated in the Contracting State

The government proposes to declare that creditors can grant a lease of an aircraft object situated in the UK. This will enable creditors to make use of the aircraft object so that it generates an income as quickly as possible and may reduce the outstanding debt due to the creditor, benefitting both creditor and debtor. Adopting this declaration would benefit creditors by reducing

the risk of lending to airlines and may benefit debtors by leading to a reduction in the cost of finance. This is consistent with the position under current UK law and is not expected to lead to any additional costs for business.

(f) Extra-judicial remedies that are available to creditors

The government must declare whether extra-judicial remedies (remedies available to creditors on default without leave of the court) contained in the treaty are available to creditors under UK law. The government proposes to declare that extra-judicial remedies which are available under UK law will continue to be available under the terms of the treaty. This would not change the current position under UK law and is not expected to have any impact on business.

(g) A requirement for creditors to re-register interests registered on the UK's national register with the International Registry in order to maintain priority following ratification of the treaty by the UK

The government does not propose to make a declaration that business would need to re-register pre-existing interests by a set date in order for them to maintain their priority. The government believes that this would create confusion for businesses who would be unsure as to the exact priority of interests and would increase costs to businesses since they would have to pay to re-register their interests with the International Registry, having already paid to register the interest on the UK's National Register of Aircraft Mortgages. Instead, any interests registered before the treaty comes into effect in the UK would retain their priority over any interest subsequently registered on the International Registry.

(h) Whether the term *speedy* relief available to creditors whilst their claim is being determined by the court should be defined and, if so, how

The government can see the benefit of defining *speedy* relief in legislation to reduce uncertainty and to direct the courts as to how quickly interim relief must be granted. However, the government would like to hear the views of stakeholders on whether, and if so, how *speedy* relief should be defined and intends to use the consultation to gather views on this issue. It is not expected that defining *speedy* relief would increase costs to businesses as it may give creditors greater certainty on when they can expect interim relief to be granted by the courts.

(i) Whether on commencement of insolvency proceedings creditors may repossess an aircraft object after a certain number of days if the aircraft object has not been returned to the creditor by the insolvency practitioner or the defaults have not been cured and a commitment made by the insolvency practitioner to keep up to date with all future repayment. Alternatively, should national law continue to apply which may require the creditor to obtain leave of the court to repossess an aircraft object?

In the response to the call for evidence in 2010, the majority of respondents were in favour of the UK adopting a provision in the treaty which would require an insolvency practitioner to return the aircraft object or cure all the defaults by a specified date which the Contracting State can set. This is called "Alternative A". Adopting this provision may increase certainty to creditors that they can recover the aircraft object at the end of the waiting period and therefore may reduce the cost of raising aircraft finance to business. The majority of Contracting States which have already ratified the treaty have adopted this provision with a waiting period of 60 days.

However, the government believes that UK insolvency law works well in practice and BIS is not aware of any examples of where creditors have been unable to recover an aircraft object on insolvency under UK law. In fact, in many cases it may already be possible to recover an aircraft object within 60 days. The government intends to consult further on this area to understand whether Alternative A is needed in the UK or whether current national law should be maintained. Under current national law, there is no specified time by which an insolvency practitioner or debtor must give possession of an aircraft to the debtor or cure all defaults and agree to perform all future obligations. A creditor may require leave of the court in order to take possession of an aircraft object. On administration a general moratoria is imposed preventing the commencement

or continuance of legal proceedings against the company in administration without the permission of the court or the insolvency practitioner.

If national insolvency law is changed to reflect this provision in the treaty, these changes would affect company voluntary arrangements (CVAs) and administration in respect of aircraft objects covered by the treaty, unless the parties choose to exclude Alternative A in their finance agreement. Adoption of Alternative A will not affect other forms of insolvency such as liquidation of assets other than aircraft objects. If the UK makes this declaration, businesses operating in jurisdictions which have already ratified the treaty with these insolvency provisions would not incur any familiarisation costs. However, insolvency practitioners in the UK would incur some costs to familiarise themselves with the changes to insolvency regulations.

(j) To allow the expeditious de-registration and export of an aircraft object

The government proposes to allow creditors to present an “irrevocable de-registration and export request authorisation” (IDERA) to the CAA for aircraft registered in the UK for nationality purposes where both the creditor and debtor agree. This would provide creditors with greater certainty that they can recover the aircraft object in question quickly and therefore may reduce the cost of raising finance for airlines. This would also allow creditors to gain possession of the aircraft object quickly in cases of default so that it can be re-sold or leased and begin to generate income, preventing the value of an aircraft object deteriorating through non-use. An IDERA would increase certainty for creditors that they can export an aircraft asset quickly if they wish to sell or lease it to an airline based outside of the UK and re-register it for nationality purposes. As this provision places a requirement on the CAA it is not expected to lead to any additional costs to business. It may lead to a benefit to business as it may take less time to export an aircraft object with an IDERA and, if it can be re-sold or leased quickly, the creditor will quickly begin to receive an income from the aircraft object.

(k) Designating any entry points to pass information and/or registrations to the International Registry

The UK does not propose to designate any entry points to pass information to the International Registry as this would add an additional step in the process to register interests and could increase burdens on business as well as increase costs as entry points would need to charge a fee to cover their costs. In order to keep the costs to business to a minimum, the government intends to enable business to register interests with the International Registry, an established organisation, directly.

72. If the UK adopts a specific set of provisions, UK airlines may be eligible for a discount of up to 10% on the premium rate of export credit support. The Sector Understanding on Export Credits for Civil Aircraft is an annex to the OECD Arrangement on Officially Supported Export Credit, commonly referred to as the Aviation Sector Understanding (ASU), it sets out the internationally agreed rules for officially supported export credits in the aviation sector. The ASU provides a framework for export credit agencies (ECAs) to set the price and levels of cover for export credit support so that all participating states use the same principles creating a level playing field. The current participants in the ASU are Australia, Brazil, Canada, the EU, Japan, Korea, New Zealand, Norway, Switzerland and the US. The ECA in the UK is UK Export Finance (UKEF).

73. Under the ASU, a buyer/lessor in a Contracting State which has ratified the Cape Town Convention and Protocol, incorporating certain declarations, is eligible for a discount of up to 10% on the premium rate of their export credit support. The level of the discount is at the discretion of the ECA. The ASU states which declarations must be made and which must not be made in order for a Contracting State to meet the requirements of the ASU. The declarations that Contracting States must make are:

- (i) Adoption of Alternative A on insolvency proceedings with a maximum waiting period of 60 days

- (ii) Ability to de-register and export an aircraft object
- (iii) Allowing parties to agree which law should govern their contractual rights and obligations – this falls within the competency of the EU

The Contracting State must also make one of the following two declarations:

- (iv) Declare that the remedies available to creditors on default, which are available in the treaty without leave of the court, are indeed available without leave of the court
- (v) Declare that the additional remedies available to creditors pending final determination of their claim are available (with the exception of the requirement to allow parties to an agreement to disapply the ability of the court to protect debtors as set out in the treaty). The term *speedy* should be defined as no more than a maximum number of days depending on the type of additional remedy

In addition, Contracting States should not make the following declarations:

- (i) A declaration to exclude the remedies available to creditors pending final determination of their claim unless the Contracting State has made declaration (iv) above.
- (ii) A declaration opting-out of provisions which state that the Convention supersedes the Convention for the Unification of Certain Rules Relating to the Precautionary Attachment of Aircraft – the UK is not a party to the Convention for the Unification of Certain Rules Relating to the Precautionary Attachment of Aircraft and therefore will not make this declaration
- (iii) A declaration preventing the granting of a lease in the Contracting State's territory

If the UK adopts the necessary declarations, airlines applying for export credit support may be eligible for this discount of up to 10%. The government intends to consult on whether the UK should make these declarations as part of the consultation since it needs to be considered based on the responses to the other questions in the consultation document.

## Summary of benefits

- 74. Ratification of the treaty is expected to lead to a reduction in the cost of raising aircraft finance for UK airlines and leasing companies. However, the expected benefit to UK airlines is difficult to quantify for a number of reasons. Airlines and leasing companies have a number of different funding options available to them and ratification of the treaty is only one of the factors financiers consider. Other relevant factors include the credit rating of the airline, the type of asset and the duration of the loan, factors which fall outside the scope of this treaty.
- 75. A study by Professor Linetsky, commissioned by the Aviation Working Group, estimated that UK airlines could benefit from a reduction in funding costs of between £538 million and £2.075 billion (with a best estimate of £1.2 billion) for aircraft deliveries over the next twenty years on an estimated £98 billion of aircraft finance. If only a small percentage of these benefits are realised, the benefits are expected to far outweigh the costs of ratifying the treaty to UK businesses.
- 76. A reduction in the cost of raising finance may lead to increased investment by UK airlines and leasing companies in the aircraft objects. This in turn may lead to increased sales for UK manufacturers and knock-on benefits for customers in terms of increased comfort and

environmental benefits through reduced carbon dioxide and nitrogen oxide emission and reduced noise pollution.

77. UK businesses may benefit from a reduction in administrative burdens through using the International Registry which is open twenty four hours a day, seven days a week. This will make registering interests where the parties are located in multiple jurisdictions across different time zones more convenient.
78. The provisions in the treaty which allow interests to be created and registered separately against aircraft engines are expected to benefit UK aircraft engine manufacturers, creditors and airlines through a reduction in the cost of raising finance.
79. The UK can choose whether or not to adopt a number of optional provisions in the treaty. Discussions with businesses have indicated that the greatest benefit to UK companies will be achieved by adopting some of these optional provisions. The government plans to consult on these provisions, the majority of which are not expected to lead to any additional costs for businesses. Since the treaty allows the parties to an aircraft transaction to exclude by agreement many of the provisions of the treaty, businesses would only be expected to choose to bear any additional costs if they believed the benefits outweighed the costs.

#### **Summary and preferred option with description of implementation plan.**

80. Overall the government believes that ratifying the treaty will benefit UK businesses by reducing the cost of raising finance to UK airlines and leasing companies. This reduction in the cost of raising finance is likely to be as a result of a reduced risk to creditors of lending to UK airlines. In turn, this may lead to increased investment in helicopters, airframes and aircraft engines and therefore increased sales by UK manufacturers. There may be additional benefits for airlines and leasing companies seeking to purchase or lease aircraft engines since interests against aircraft engines can be registered separately on the International Registry.
81. UK businesses may also see some secondary benefits through using the International Registry which is open 24 hours a day 7 days a week. This is likely to take some of the pressure off the aircraft finance transactions involving parties located in multiple jurisdictions. Some businesses may pay less in fees to register an equivalent interest with the International Registry compared with the UK National Register of Aircraft Mortgages. However, this will depend on the maximum take-off weight of the aircraft and will depend on whether the business decides to register their interest with the International Registry and with the UK's National Registry of Aircraft Mortgages, with just one of the registers or with neither.
82. UK businesses involved in aircraft financing will incur some costs to familiarise themselves with the new regulations. This is estimated to be a maximum of 130 UK businesses based on the number of UK airlines and the number of UK companies with a current interest registered with the UK's National Register of Aircraft Mortgages. Some businesses, mainly the 30 or so UK airlines, are likely to face some costs in the form of additional legal costs, to familiarise themselves with the International Registry. However, not all UK businesses will incur these costs since a number of UK businesses already use or are familiar with the International Registry. Therefore a very small number of UK airlines are likely to be affected by these familiarisation costs.
83. Some airlines may pay increased fees to register their interest if they choose to register with both the International Registry and the National Register of Aircraft Mortgages. However, since the

government is not proposing to make registration on the International Registry mandatory, it will be up to business to decide how best to protect its interests. Businesses can decide whether to register interests on the UK National Register of Aircraft Mortgages, the International Registry, on both registers or on neither. Businesses would only be expected to pay two sets of fees if they believe the benefits outweigh the costs.

84. The benefits individual airlines will receive will depend on a number of factors, some of which are outside the subject matter of this treaty and the benefits are therefore difficult to quantify. However, if only a small proportion of the benefits estimated in the study commissioned by the AWG materialise, the benefits are expected to far outweigh the costs and lead to a net benefit to the UK. This is due to the very small costs to business as a result of ratifying the treaty and the high value of helicopters, aircraft frames and aircraft engines and large amounts of financing required by UK airlines and leasing companies. If ratification of the treaty results in a small number of additional sales by UK manufacturers of helicopters, airframes or aircraft engines, the benefits of ratifying the treaty would again outweigh the costs of ratification.
85. Following a consultation on how to implement the treaty so as to achieve the greatest benefits for the UK, the government intends to implement the treaty through secondary legislation using Section 2(2) of the European Communities Act. The government intends to implement the treaty during 2014.

#### **Small and micro business assessment**

86. Small and micro businesses are not exempted from regulations to ratify the treaty. Since the aim of the treaty is to reduce the cost to business of raising aircraft finance, excluding small and micro businesses from regulations to ratify the treaty would not enable them to benefit from a reduction in the cost of finance. If small and micro businesses were excluded from the provisions of the treaty, they would therefore pay a proportionately higher cost for aircraft finance compared with medium and large businesses. This would disadvantage small and micro businesses, including start-ups, in this sector. The majority of airlines, aircraft manufacturers, financiers and legal firms involved in the aircraft finance industry are medium and large firms and therefore the number of small and micro businesses who would be affected by the treaty is expected to be small.