



PLANE TALKING

OCTOBER NOVEMBER 2006

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Editorial

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Gathering speed - cliff edge in sight!

The rating reductions continue to accelerate and the bottom line for underwriters (and brokers to some extent) is being eroded. The competition for business and a share of it is intensifying.

Losses are occurring but in monetary terms are not significant. Nevertheless, on a pure pro-rata basis they look set to become the highest since 2001/2002. The premium to claims lines on the graph are now converging at a quicker pace than before.

New capacity is putting pressure on the established markets and, whilst it is not as naïve as some has been in past years, it is acting to widen the vertical marketing discounts available at a time when the longer term players are pushing to close the gap. This conflict means that the excess capacity is tempered by some caution from the more conservative existing markets.

Furthermore, The consolidation between insurers (e.g. Swiss Re / Frankona and now Catlin / Wellington) is becoming more evident and will have its own impact on rates. There is therefore a very fine line between success and failure for the brokers when promising attractive deals to their clients.

The cliff edge is undoubtedly in sight – how far away is a matter of the pace of the animal. One must put trust in the assumption that this particular beast is not a lemming.

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October Renewals

The busy fourth quarter tends to indulge in a rather slow and unspectacular take off run with just seven airlines of widely differing size and character making up our cosmopolitan portfolio.

China Airlines of Taiwan is by far the biggest operator by way of fleet value - US\$7 billion and with passenger numbers expected to exceed 9.5 million for the forthcoming year, makes it one of the biggest airlines in the Far East.

Air Algerie trails behind with its fleet valued at under US\$2 billion and sustains its passenger expectations from last year at over 3 million. Indian Airlines is of similar size at US\$1.6 billion and predicts very little growth for the forthcoming year.

Pakistan International makes up the larger of the carriers with over 20% of fleet growth plus a significant rise in passenger numbers and revenue passenger kilometres.

Air Malta, JAT and Syrian Arab Airlines complete this month's participants and are all much smaller and generate far less premium than the others. ATA Airlines of the USA has moved its renewal to December and changed broker from Aon to Willis thus moving a large chunk of premium to year-end.

Average fleet values across all airlines increased by 3%, revenue passenger kilometres by 5% and passenger numbers by 4%. The all important premium difference compared with last year was a reduction of 23%.

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November Renewals

The tempo begins to pick up as we enter the second busiest month of the year for airline renewals with a healthy mix of world-class operators renewing their programmes.

Our criteria has always been to ascertain market trends by using information on the larger airlines and of the 17 in this months collation their sizes range from the Gulf Corporation Council which is the largest placing with a collection of fleets valued at over US\$30 billion in 2005, the smallest being British West Indian Airlines at just over US\$470 million.

Other notable major carriers include Cathay Pacific, Singapore and Korean Airlines from the Far East plus South African and the two biggest cargo and small package operators DHL and UPS.

British Airways is reported to have extended its policy to April and will include Lan Chile in its renewal.

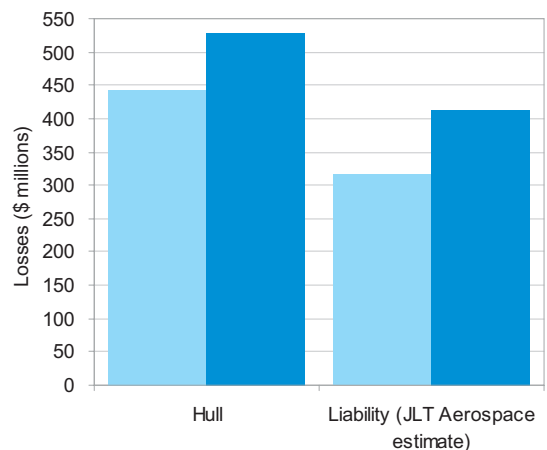
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October Loss Analysis

Of the incidents and occurrences reported during the month that numbered well into double figures only four were of sufficient importance to warrant further consideration. They were:

A Mandala Airlines B737-200 reg PK-RIE crash-landed at Tarakan Airport in Borneo on the 3rd, due to the pilot being unable to see the runway because of thick haze surrounding the airport. One report suggested that the pilot was unaligned with the runway, clipped the ground with a wing causing the aircraft to smash into a swamp. Remarkably there were no fatalities or serious injuries to the 104 passengers and six crew. The aircraft was insured in London for US\$2,500,000 and is a CTL.

Major Airline Losses for Year to Date



Source: JLT Aerospace database

■ 1st Jan 05 to 31 Oct 05 ■ 1st Jan 06 to 31 Oct 06

A BAe 146-200 reg OY-CRG belonging to Faroe Islands operator Atlantic Airways overran the runway on landing at Stord Airport in western Norway on the 10th and slid down a steep embankment before catching fire. Of the 16 people on board, four passengers were killed. The aircraft was chartered to Aker Kvaerner to fly personnel from Stavanger to Molde via Stord and was insured for US\$6,000,000.

A Swedish Coast Guard Casa 212 reg SE-IVF crashed into the sea near Falsterbo during a demonstration in front of visitors to the coastguard centre, killing the crew of four. Reports suggest there might have been a wing separation. The aircraft was valued at US\$2,000,000.

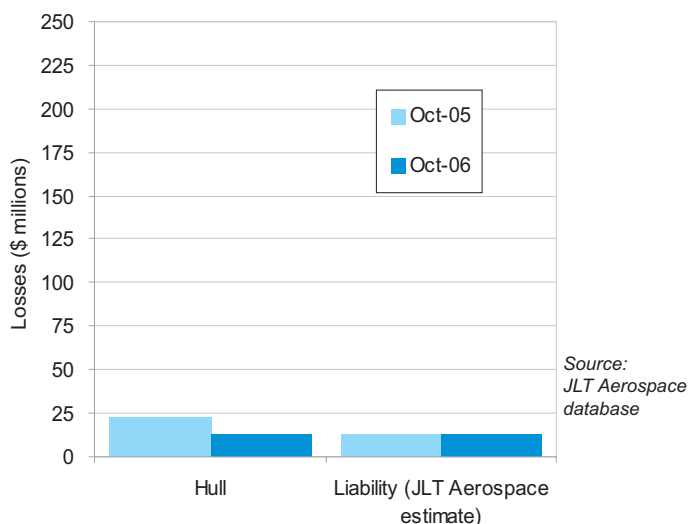
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Immediately after take off from Abuja International Airport, Nigeria on the 29th, an ADC Airlines Boeing 737-200 reg 5N-BFK en route to Sokoto crashed killing 92 passengers and four crew. The aircraft came down within two miles of the runway, weather at the time was poor with thunderstorms and some wind shear. The aircraft was 23 years old and was insured for US\$2,500,000 in the London market. Six passengers and one crewmember survived the accident.

Nigeria lost two passenger jets in the last quarter of 2005 with the loss of 213 lives that resulted in an investigation by the President and the grounding of a number of operators.

Overall hull losses for the month total US\$13,000,000 plus an estimate for liabilities of US\$12,600,000 giving a total of US\$25,600,000.

October Major Airline Losses



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Insurance Industry News

We are firmly in the midst of the airline renewal season and there is now plenty of evidence as to the pattern and direction of the market.

In the mix of over-capacity (currently thought to be in excess of 185%), low loss level, small increases in exposure, large credit balances, a looming US\$2 to £1 exchange rate and the natural and cyclical adjustment to premiums since the heady days following 2001 when income reached an all-time high, it is not difficult to see why October and November will produce record premium reductions.

In addition to these ingredients, consolidation adds a little salt to define the flavour as to what is becoming an interesting pattern.

By taking an airline out of market circulation and tying it in to a group placing it is difficult to calculate just how much difference it makes to overall premium levels. We have seen or will see Mandarin Airlines go in with China Airlines, Jazeera Airways of Kuwait into the Gulf Cooperation Council, and Macedonian Airlines into Lufthansa, but at the same time witness Thomas Cook Airlines leaving Lufthansa and being placed independently and Portugalia also leaving to join TAP which is part of the SAFIT placing.

One of the biggest surprises is that British Airways will extend its policy from November to next April and at the same time include the South American airline Lan Chile into the programme thus moving a very large chunk of premium into the early part of 2007.

The Catlin-Wellington takeover could also be significant. In creating the biggest overall managing agency in the Lloyd's market with capacity of over US\$2.3 billion, the question remains: is this the dawn of fewer but bigger players in the London market, with the muscle to take on the rest of the world?

Another very good month for losses, despite the Nigerian B737 and Atlantic Airways accidents that killed 99 passengers, will continue to provide a cushion of comfort to an already cock-sure marketplace which seems to be able, for the time being, to do no wrong.

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Airline Industry News

The proposed merger between US Airways and Delta has prompted speculation that it will be followed by a number of other consolidations in the US passenger airline industry. With over capacity and costs still to be addressed, and with Delta dallying in bankruptcy protection, it makes a tempting target that will be sure to find favour especially with this particular airlines creditors.

Statistically it will create the biggest airline in the US and the sixth in the world with a fleet valued at over US\$25 billion. This might be followed by the long-rumoured merger of United with Continental and American with bankrupt Northwest. US Airways has twice filed for bankruptcy reorganisation, in 2002 and 2004.

Speculation remains that despite these mergers, badly managed carriers will still remain in business knowing Chapter 11 will be their saviour in allowing them to void contracts so aircraft leases could be cancelled and union deals with pilots and flight attendants torn up. Without this protection many carriers today would have disappeared for good.

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The big worry seems to be that despite every effort by airlines to attract more passengers the first six months of the year attracted an anaemic 0.90% more enplanements over the same time last year.

It looks as if Ryanair has failed in its bid for Aer Lingus and on the other side of the world analysts are chewing over the surprise buyout proposals by Texas Pacific for Qantas and questioning whether a private equity company is the right move for the airline industry. News of the bid prompted investors to snap up shares in airlines across Europe on optimism that a bid could be made for airlines such as British Airways.

Sitting underneath the majors, the regional carriers also provide an indication as to the temperature of the market and the thermometer is showing the atmosphere to be a little cooler than in recent years. The number of these smaller airlines has declined by 15% over the last five years and since 1978 has seen overall numbers fall from 228 to 80. The number of regional jets in storage has ballooned to an all time high of almost 360, 150 of which are newer models and although enplanements continue to grow it is now at a much slower rate.

Despite these prognostications, both Boeing and Airbus are predicting another good year for sales and orders, especially for narrow-bodied aircraft. One source suggests there are over 200 start-up airlines in various stages of gestation as potential customers.

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Emissions Trading

The European commission has announced that it will produce a formal proposal for the inclusion of aviation within the EU emissions trading scheme by the end of 2006. In anticipation of the proposal, Barlow Lyde and Gilbert in association with Ascend recently held a seminar outlining the main areas of the debate that is likely to be played out. The key features of the seminar, which was attended by JLT Aerospace, are provided below as an overview.

What is Emissions Trading?

Emissions Trading is an economic mechanism. A cap is set for the total amount of greenhouse gas (GHG) emissions that a particular industry or sector is allowed to produce. The total allowance is then allocated to all the participants in that industry. At the end of the year, each participant needs to make sure that it has enough allowances to cover its actual emissions. If they exceed

their allowance they may buy extra allowances from other participants and they may sell any unused allowances.

Why does the Aviation industry need to have Emissions Trading?

Whilst aviation is a key to the economic success of many countries this does not exempt it from its environmental responsibilities. Since the Intergovernmental Panel on Climate Change (IPCC) wrote their report on "Aviation and the Global Atmosphere" in 1999 it has been virtually accepted as fact that aviation contributes 2% of man-made carbon dioxide (CO₂) emissions. However, it is estimated that the total contribution to global warming is 3.5% due to other emissions such as Nitrous Oxides (NO_x) and the altitude at which they are emitted. So far, the Kyoto protocol has excluded aviation but instead has required countries to limit or reduce GHG emissions.

What are the benefits of an Emissions Trading Scheme (ETS) for Aviation?

Emissions trading is environmentally effective because it punishes "unclean" behaviour and rewards buyers of clean technology. It is therefore more effective than other possible measures such as increased fuel taxes or environmental charges which are both controversial and legally difficult to implement. Also it has been shown that other taxes are likely to simply depress demand, reduce load factors and therefore decrease environmental performance. Consequently, ICAO has given its approval for the inclusion of international aviation within existing emissions trading schemes.

What are the issues with an ETS for aviation in the EU?

1. Stand alone scheme or incorporation into an existing scheme?

Production industries such as energy, iron and steel, mineral, and pulp and paper already participate in an EU ETS. Indeed a multi-sector ETS is believed to be more environmentally effective than single sector and aviation as a net purchaser of allowances might struggle as a stand alone scheme. However, aircraft are more mobile than power stations and their carbon footprint stretches further than just the boundaries of one country or of the EU. Therefore, the fairest scheme would be to include all aviation globally into one scheme. However, the current discussion is for an EU scheme.

2. EU departures or Intra EU?

The European commission seems to be favouring an ETS that includes all EU departures. An Intra EU scheme would catch only 40% of the emissions of an all

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departures scheme. Similarly, the Commission seems to be favouring a scheme that would apply equally for EU and non-EU carriers. This is problematic because it could provide a competitive advantage to global carriers with fewer EU departures and any increase in costs in the EU would cause imbalances in the global market.

3. Which emissions?

At this stage, any ETS for aviation will be restricted to CO₂ emissions only. This is because the effects of CO₂ are equal no matter where they are produced or by whom. By contrast, the impact of other emissions by aircraft is technically difficult to measure and is scientifically uncertain.

4. How to allocate the allowances?

Grandfathering, benchmarking, and auctioning are just 3 different ways that have been suggested for allocating the CO₂ allowances to each company. Grandfathering would take into account the historic emissions performance of the individual carrier although this could be a disadvantage depending on the timing of fleet renewal but could also increase the value of newer fleets. Benchmarking would use an industry average as the method for allocation but this would mean that any carrier that had already made improvements wouldn't have the explicit benefit of their investment. Auctioning would be economically most pure but also the most expensive way for the allocations to be made.

It is evident that reducing carbon emissions and energy efficiency are political priorities in Europe. However, recent press reports suggest that US diplomats are less than enthusiastic about the proposals and in their recent discussions in Brussels have indicated that it might even jeopardise the Open Skies agreement, which was aimed at making it easier for the EU and US to use each others' airspace and airports. Just how the international aviation industry responds to these inevitable changes is likely to be fiercely debated by all concerned and will be a hot topic to follow.

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And finally...

What would the golf professional say about that stance?

Tiger Woods would seem to have little to fear from a man perched on a narrow ledge, hitting a golf ball one-handed and with a dreadful follow through. But then Tiger doesn't have the restrictions of a space suit to contend with....

Russian cosmonaut Mikhail Tyurin recently made history by hitting a lightweight golf ball away from the International Space Station with a gold-plated six iron, thanks to sponsorship received by the Russian space agency from a Canadian golf club manufacturer.

Opinions differ as to how long the ball will survive before re-entry, but it certainly went further than the first-ever space golf shot. When Alan Shepherd took the shot on the surface of the moon in 1971, the ball ended up in the kind of bunker that would have reduced any golfer to tears....

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Launch Log

November Launches

4 November

Site: Vandenberg
Launcher: Delta 4M
Payload: DMSP-5D3-F17

8 November

Site: Baykonur
Launcher: Proton M
Payload: Badr 4

10 November

Site: Biscarosse
Launcher: M51
Payload: Dummy Warhead

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