



JLT Aerospace



PLANE TALKING

JUNE JULY 2007

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Editorial

If you know anyone who would like to be added to our mailing list or your email address changes, please advise by emailing details to:
lucy.potter@jltre.com

Editorial Team:

Richard Adams
John Boler
Saskia Cosgrove
Trevor Howard
Lucy Potter

Comment

All Change

On 17th July 2007, an Airbus A320 of TAM Airlines of Brazil attempted to land at Sao Paulo's Congonhas Airport in bad weather. The result was the destruction of the aircraft, buildings and other property and the tragic loss of 199 lives.

This has the potential to be the most significant claim to the airline related insurance market for several years, in view of the apparent (as of now) involvement of at least three parties in the legal process for compensation:

- The Operator
- The Airport
- The Manufacturer

All have been mentioned in the press as targets to receive blame, however it will be some time before investigations reveal a clearer picture. What seems to be true

however is that there were distinct and different contributory factors.

This loss alone, regardless of future events, could influence whether calendar 2007 is a profit or loss for the airline sector.

At the moment the most likely outcome is an overall loss for insurers but this is not absolutely certain. From a rating point of view, reductions continue to be granted and whilst there is no obvious diminution of the scale of reduction, our experience shows that it is becoming far more onerous for the brokers to complete risks within indicated budgets as insurers restrict their capacity to limit exposure. What is perhaps apparent is that the brokers' task is becoming more difficult despite the 'surplus' capacity that exists. Regardless, there is little evidence of fundamental change in the run up to the end of the year furore of renewals.

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June Renewals

The first half of the year concluded with just a handful of airlines renewing their policies in June, much the same figure as this time last year. One difference was the Mexican group placing of Aeromexico and Mexicana known as Cintra, the former airline extending renewal to September and the latter being placed separately, this month with growth in fleet value, revenue passenger kilometres and passenger numbers.

Eva Air now becomes the largest individual operator by way of fleet value to renew in the month with a value now in excess of US\$4 billion, the second biggest airline in Taiwan after China Airlines.

Other renewals include Ethiopian Airlines which has shown the greatest increase in exposures and Uzbekistan Airways again anticipating higher passenger numbers than last year.

Over these airlines exposures continue to grow with fleet values up by 6%, revenue passenger kilometres by 4% and passenger numbers up by 6%. Premiums as expected came down over last year amounting to a reduction of 18%.

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July Renewals

With nearly three times the number of renewals compared to June, this month is bound to generate a lot more interest with some heavyweights among them. They are made up of a very cosmopolitan collection with a broad mixture of sizes and types from all over the world.

Among them are a number of major passenger flag carriers such as Aeroflot and Air India plus the biggest airline in the world by fleet value, American Airlines. One other prominent operator is the freight and small package airline Federal Express now the second largest of its type worldwide.

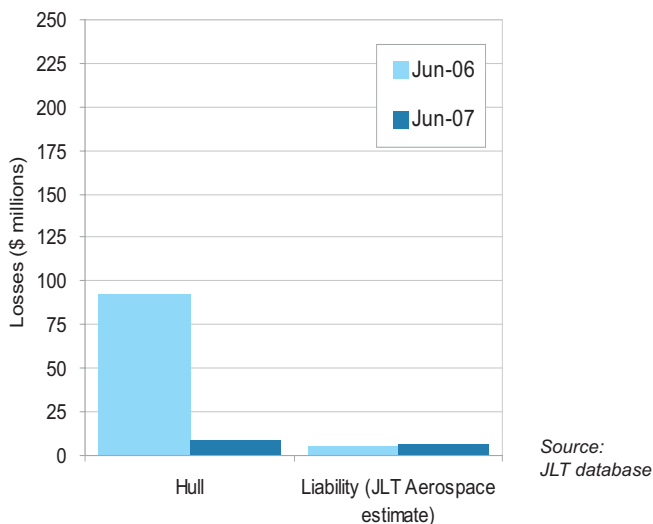
By sheer numbers July is on a par with April and just short of November, and will thus generate a substantial block of premium.

This will be diminished somewhat compared with last year by the move of the Turkish Airlines renewal which will be placed under the umbrella of Lufthansa which does not renew until December, thus denying a substantial portion of premium from the market at mid-year.

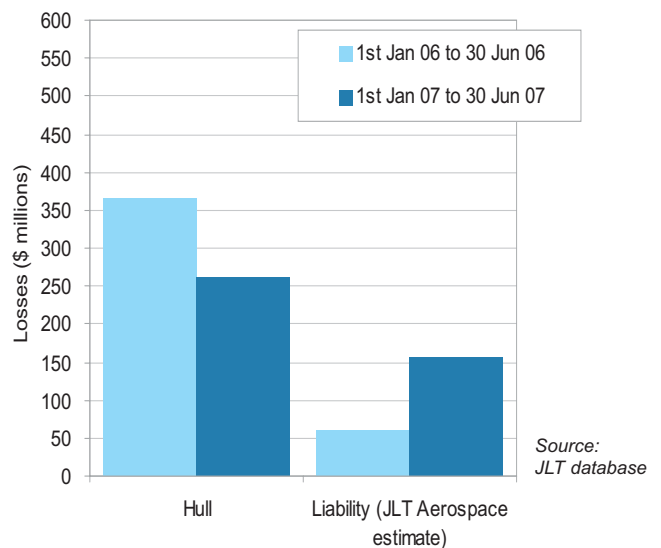
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Loss Analysis

June Losses



Major Airline Losses for Year to Date



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June Losses

1st June	Trigana Air Service	DHC-6-300 PK-YRU	Papua	No Fatalities	Reserve US\$575,000
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During the landing run the aircraft veered off the runway damaging the nose and wing tip. There were no injuries to the passengers and crew.

5th June	Gemini Air Cargo	MD-11F N-705GC	Dubai	No injuries	Reserve US\$3,000,000
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The aircraft suffered tail damage during loading operations in high winds at Dubai Airport.

18 th June	Eagle Airways	Beech 1900D ZK-EAK	Blenheim, New Zealand	No fatalities	Reserve US\$950,000
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En route the pilots learned of a fault with the landing gear mechanism and elected to divert to Blenheim. After unsuccessful attempts to lower the gear, the aircraft made a wheels-up landing causing considerable damage to both engines, wings and underbelly. No injuries among passengers and crew reported.

20 th June	Karibu Airways	Let 410	Kamina area of Congo	1 passenger killed	Approx value US\$500,000
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Shortly after take off the aircraft lost height and crashed into a swamp coming to rest upside down with its fuselage submerged in mud. At least one person is understood to have been killed.

25 th June	PMT Air	AN-24 XU-U4A	Mountains, southern Cambodia	16 pasengers and 6 crew killed	Insured value US\$100,000
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On a scheduled flight the aircraft crashed into densely wooded mountainous jungle 150 km's north of Phnom Penh. There were no survivors.

28 th June	TAAG	B737-200	M'Banza Congo airport, Angola	4 passenger killed	Insured value US\$3,500,000
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On landing the pilot lost directional control causing the aircraft to veer off the runway. The Boeing then hit a building breaking in two and coming to rest minus its undercarriage and engines.

A major accident occurred on July 17th when a TAM Airbus A320 reg PR-MBK built 1998 crashed on landing at Congonhas Airport, Sao Paulo killing all 170 passengers and six crew. The aircraft was operating a scheduled domestic flight from Porto Alegre and upon landing in wet conditions the pilots were unable to stop within the length of the runway, the aircraft veering off to the left and crossed a road before hitting a petrol station and ending up in a storage building where the aircraft caught fire and was totally destroyed. It is thought that 23 people were killed on the ground. The accident happened a day after another aircraft skidded of the same runway on landing which had recently been resurfaced. The aircraft was valued at US\$41,558,997 and was insured in the London Market through broker Marsh.

June Loss Summary

Hull Losses	Liability Losses (JLT Estimate)	Total
US\$	US\$	US\$
8,620,000	6,150,000	14,770,000

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SECOND QUARTER UPDATE

Insurance Renewal Data

Comparing the First and Second Quarter 2007 with the First and Second Quarter 2006 - % Movement

% Movement	AFV	RPK	Passengers	Hull Rate	Liability Rate	Premium
1st Quarter 2007	+7%	+10%	+13%	-32%	-30%	-25%
April	+20%	+21%	+20%	-28%	-33%	-18%
May	+10%	+11%	+8%	-25%	-32%	-23%
June	+6%	+4%	+6%	-37%	-12%	-18%
2nd Quarter 2007	+16%	+16%	+16%	-29%	-31%	-19%
THE YEAR TO DATE	+11%	+13%	+14%	-30%	-30%	-22%

Major Loss Summary

Period	Number	Hulls (US\$)	Liabilities(US\$)*	Total (US\$)
1st Quarter 2007	17	103,780,000	61,100,000	164,880,000
April	7	72,900,000	3,450,000	76,350,000
May	4	74,800,000	85,850,000	160,650,000
June	6	8,620,000	6,150,000	14,770,000
2nd Quarter 2007	17	156,320,000	95,450,000	251,770,000
THE YEAR TO DATE	37	260,100,000	156,550,000	416,650,000

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Insurance Industry News

The halfway point of the year passed in unspectacular fashion with June being a quiet and a predictably undistinguished event. Thus the year continues to progress with the ongoing familiar pattern of premium reductions for airlines still representing the prevalent attitude of the marketplace.

Although the main hull all risks and liability policies have shown an "average" premium deterioration of around 20% this has not taken into account the fact that the pound sterling continues to strengthen against the US dollar recently reaching one of its highest levels for years and effectively giving an even greater dilution than just on a pure rating basis. This obviously has a significant impact on underwriter's bottom line and also brokers commissions.

Elsewhere, other aspects of an aviation underwriter's book of business also continues to show signs of the soft market. War rates are being trimmed to a degree that some risks are being turned down or lines reduced due to the low levels of premiums being achieved.

The aerospace sector is no different and where loss history and ample capacity allow, the year to date has seen quite a marked impact on premium levels with a very mixed bag of reductions in an area much more sensitive to exposures.

We could almost reproduce word for word what we said at this time last year, with values and exposures continuing to rise and with premiums going the other way due to exactly the same old reasons. Therefore has nothing really changed in a year? There is now some evidence to suggest it has, with marginal risks being treated with some caution, lines being reduced where circumspection and discretion is the name of the game and where vertical marketing differentials are narrowing.

Although loss figures compared to this time last year show a slight improvement in monetary terms the number of passengers killed is double (141 at end of June 2006 compared with 282 in 2007). This suggests that there will probably be no overall improvement to the year-end loss statistics once attritional losses are included.

Consideration will be given to the events at Sao Paulo on July 17th where nearly 200 people died in the TAM accident and where liability claims are expected to be the worst for a single loss in over five years.

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Arrivals and Departures

The majority of the aviation team headed by Geoff Deal from Ratner Mackenzie are leaving to join Gallaghers.

Vanessa Powell is leaving Catlin as Claims Manager to join the new Mitsui operation at Lloyd's.

David Hart and Peter Buckley have resigned from Heath Lambert Group and Halligan respectively to join Alain Burguiere and Antoine Lamy at Catlin Syndicate. David will be responsible for wordings and will act in the role of technical support manager and Peter will be class underwriter.

Jon Woodrow has been appointed head of the Aviation Business Unit at St Paul Travelers Syndicate. He will assume overall responsibility for the Aviation account and will be supported by Angus Roberts and the existing team. Steve Eccles will remain in the role of Active Underwriter for the Syndicate although he will no longer be underwriting the aviation book.

Steve Brown of Willis (previously Marsh) is replacing Nigel Christian (who agrees policy wordings (along with Mark Gimson)) at Ace.

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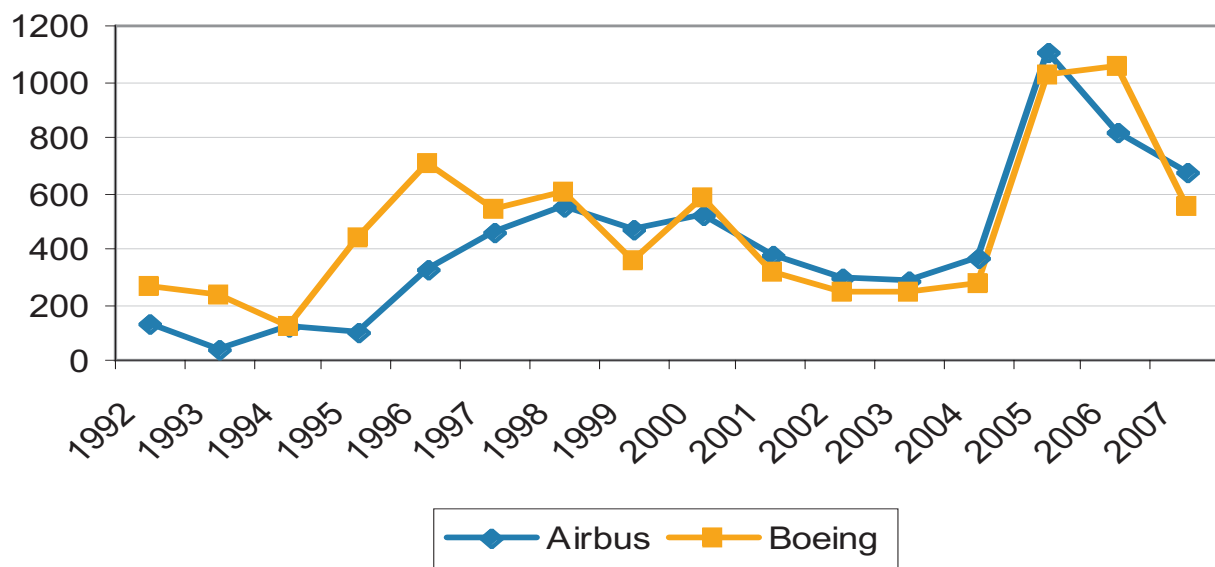
Airline Industry News

SPECIAL REPORT

Low Cost Operators are no longer 'fledglings' – Some 10 years into the 'Revolution' How is the Industry Faring?

Order books are bursting at the seams and the last year has seen the worldwide airline market grow by 5%. And the market continues to be 'infiltrated' by Low Cost Carriers (LCCs) with an annual increase in Low Cost flights of 22%. The Low Cost innovation pioneered by the likes of Southwest then Ryanair and easyJet in the 90's has taken hold throughout the globe. 16% of flights worldwide are now 'budget' compared with only 6% of all flights in 2001. The most recent development is the entrance of 'budget' all business carriers and in response full service operators have been investing heavily in their premium services.

Airbus and Boeing Orders



To illustrate the development of the industry here are some interesting facts:

- Budget airline flights doubled in 5 years between 2001 and 2006 – there were 300,000 flights in April 2006 compared to 142,000 in April 2001
- This year Asia accounted for half the increase in LCC flights
- The Middle East showed the strongest growth in passenger flights with 12% increase in international flights and 13% increase in intra-regional operations
- Africa has also shown strong growth over the last year with a 10% increase in flights to and from the region
- LCC capacity represents 27% in the US and 24% in Europe (the latter has grown from 16% in 2005)
- Asia's LCC capacity offering totals a share of 9%, this follows 55% growth since 2005
- The number of worldwide airline flights increased 5% from 2006 to 2007 whilst only 17% from 2002 to 2006

While the LCC phenomenon has swiftly spanned the globe, nowhere has it taken hold quite like Asia. Sceptics doubted the viability of such operators in the region's more regulated aviation environment and a distinct geography to that of Europe and the US but it seems that an industry will adapt to anything if it is the right price. From September 2005 to September 2006 low cost flights in the Asia Pacific region rose by 63% and while the LCCs share of the market is still only around 9% compared to some 24% in Europe and 27% in the US this can only mean there is much room for expansion.

The development in India and China has been unprecedented. In India there were a mere 600 budget flights and 28,000 seats at September 2004, in 2 years this expanded to 12,000 flights and 1.1million seats. China's low cost operations amounted to just 48 low cost flights at September 04 growing to 2,000 by September 2006.

In spite of the sceptics, in India it seems that low cost operations have been the perfect model to supply the country's extensive population of travellers while overcrowded railways were the only mode of transport in most parts of the country. Timing has also been key as the economy is booming. While in Europe and the US the budget carriers had to compete in an already well established airline travel market looking to win business from the traditional carriers in addition to opening up the air travel industry to others for whom air travel was not previously an option. In India the LCCs have had a much greater void to step in to. Air travel was previously limited to the wealthy and the business traveller but now airfares compare well with mid range train prices. And this is in the context of an Indian population of some 1.1bn. The current air travel population is estimated at 150m up from 19m in 2005. With some 8 new carriers being established in the country in the last 3 years this market has well and truly been tapped into.

Two years ago low cost operators in China did not in theory exist, with so many fare restrictions and other regulations that hindered any development in the field. The Government has since relaxed – to some extent - fare levels and the market has expanded rapidly.

And the Support?

With such huge expansion in the airline industry one must celebrate, however there are questions to be asked and one in particular is how the infrastructure is coping?

The infrastructure that supports the booming industry – and one can attribute the boom very much to low cost operators – is an area that has in some cases been little considered. Its all very well for someone to buy a few aircraft and declare itself a budget airline and decide that it will fly from x to y because there is a lack of airline passenger service in those areas. Clearly slots at airports will have been negotiated but the services in the background seem to be less well accounted for in the overall viability of the business. The timescale for setting up an airline can be pretty minimal while airport expansion,

for example, is a whole different ball game and would not be done at the drop of a hat. Investment in expansion of airports is a long-term commitment, it is a drawn out and expensive process unlike the freedom that a low cost operator has in its business strategy – whereby a seasonal adjustment can easily be made, opting in and out of certain routes as business dictates.

Airports are only one element amongst others that should be taken into account:

- Airports and boundaries
- Ground handlers etc.
- Maintenance and repair services
- LCC management staff to deal with such issues
- Air Traffic Control – ground and airspace
- Qualified pilots
- Environment - noise and pollution

In India the state-run airports have had next to no investment during the recent advent of the LCCs and only now are they reacting. Passengers are having to deal with huge delays in landing and taking off, baggage issues as airlines share all the facilities, the parking is inadequate and the list goes on. Air Traffic Control (ATC) delays are leading to considerable wastage of fuel as aircraft circle waiting to land. Airspace is also hindered by substantial restrictions placed on it by the Ministry of Defence, technology is dated and scheduling disorganised.

While all seems positive for the Indian passenger airline industry reports are suggesting that the LCCs are bleeding money due to aggressive competition. There are few established airports and it seems that the LCCs lack of consideration to ensure supporting infrastructure is in place is only putting on added financial pressures.

It seems that early speculation with respect to the recent TAM tragedy is centred around different demands being placed on the airport. Reports have suggested that the runway was re-opened due to pressures from the National Civil Aviation Agency and airline representatives who were concerned about the inconvenience to passengers. The runway had been closed to aircraft in excess of a certain weight (although not including the A320) however this decision was overturned subject to the runway being resurfaced. The resurfacing had taken place but the runway had been reopened before it had been grooved, which assists with drainage in the case of heavy rain. Was it business that was responsible for dictating the early re-

opening of the runway? Particularly in a highly pressurised environment that is the Brazilian airline industry (having recently seen the complete and somewhat swift downfall of the national flag carrier following the entrance of new low cost operators). While this is not necessarily the cause of this tragedy (reports suggest that the aircraft was travelling much faster than it should have been in addition to the right thrust reverser being inactive at the time) it has been an insight into the current demands that are being placed on the infrastructure.

The budget airline industry in Indonesia has expanded rapidly but the country's airlines have been the subject of some scrutiny this year as their safety records have been rather chequered with a spate of fatal crashes in the last 2 years. Jakarta's Cengkareng Airport is considered to be operating at some 50% above its capacity. Overcrowding on the ground restricts aircraft from flying as many hours as they would like to and quick turnarounds are central to the LCCs business strategy. This can only serve to put further financial strains on the airlines.

All over the world Air Traffic Controllers are voicing their concerns at overcapacity in the skies and on the ground, systems are dated and there is a need for a complete overhaul in the face of the growing airline industry. There has been an increase in the number of ground related incidents in recent years and although small, the risk seems to be ever more present.

Not to dwell on Brazil but amongst others the ATC System has been the subject of extensive criticism since the mid-air collision between a Gol Airlines Boeing 737 and a private jet in September 2006. The Brazilian ATC which is overseen by the Defence Ministry, is said to be suffering from poor planning, equipment failures and underfunding and is considered to be largely at fault for this incident. Just last week the Brazilian Defence Minister was dismissed. It must be noted however that the US pilots that were in control of the private jet involved in the mid-air collision were also implicated for their role in the crash.

The Brazilian Airline Industry is considered to be growing at rate of 12% per year with low cost flights having increased over the last year by 40%. Flight controllers are struggling to cope as are the airports and according to reports officials admitted that Sao Paulo Garulhos and Congonhas have been pushed beyond capacity.

Brazil is by no means alone, the overcrowded skies of Europe are estimated to lead to wasted fuel which costs the industry some EUR1.1bn as a result of an extra 350,000 flight hours a year being flown due to Air Traffic Management (ATM) delays. Eurocontrol, which controls

the upper airspace for the EU above 24,500 feet is attempting to standardise the ATM System across the region but is forever coming up against sensitivities of national airspace, a lack of transparency between military and civilian airspace controllers and other issues. The lower airspace is governed by individual countries ATC bodies meaning handovers between each country as an aircraft flies over Europe can be numerous. One can only imagine how complicated this is with such a densely populated area as Europe with so many small countries.

It was precisely the handover from German to Swiss airspace that resulted in the mid-air collision between the Bashkirian Airlines TU-154 passenger jet and the DHL B757 in July 2002 over Germany. There were however secondary factors involved including the differing reactions of pilots to their Terrain and Collision Avoidance Systems.

In the US the head of the FAA was recently reported (Cox News Service) to have said that "2006 was the worst in history for air transportation delays and 2007 will be worse" The FAA is calling for an urgent funding review to take place in order to address how to finance much needed airport expansions and air traffic control upgrades to relieve congestion and improve safety margins to an ATC system that is 50 years old. This month a Delta Airlines jet came within 100 feet of colliding with a United Airlines aircraft at a Florida Airport. And all this is before the expected revolution in the Very Light Jet market that is expected to present major challenges to the system.

It is interesting to compare how the development of the A380 by Airbus has demanded airports undertaking infrastructure modifications in order to accommodate the double decker. There is a physical requirement for new bridges to be built to accommodate the new aircraft while there is no such specific requirement to accommodate the LCC carriers. The challenge to airports from the LCCs however is probably greater than the A380 yet few airports have acknowledged the need to formally address this.

There are exceptions however. For Ryanair, regional airports have been central to their business strategy and the airline has approached the airport before anything else. Their idea has been to tap into previously unserved regions and therefore ensuring that destination airports are established has been a requirement. In India and Thailand the LCCs have largely relied on the services already being in place at the main hubs and the spectacular growth in passenger levels has been less than anticipated.

Pilots have also been the subject of recent reports that have suggested that there is a lack of experienced pilots to supply the Industry. In Asia it seems that the custom of

poaching is a major problem often leading to airlines employing pilots straight from training college. One would suggest that there are the same pressures with regards to personnel in other areas of the supporting industry.

The stance with respect to these challenges from relevant aviation authorities is varying. The Chinese are characteristically on top of the situation with plans to build a number of new terminals. Malaysia has built a whole new terminal to specifically cater for LCCs at Kuala Lumpur. Other countries however are not so proactive with their strategy. India, already suffered from poor airport infrastructure before the boom but only now, is proposing various plans to improve the situation. Proposals are going forward for a second Delhi airport and in the meantime the current Delhi airport has just commenced a major expansion operation. There are also discussions surrounding building airports in destinations that currently do not have airports. A proposal to build an airport in one of India's textile centres at Kannur, Southern India is considered to cost some US\$196 million which is just one example of how infrastructure planning and funding is that much more involved than setting up a new airline.

Thailand's airport capacity is under the spotlight at present having recently opened the 125m baht, new Suvarnabhumi Airport in Bangkok to replace the congested 92 year old Don Muang Airport. The new airport has some serious flaws and is already nearing its 45 million passenger capacity (2006 recorded passengers of 42m). The issues that plagued the airport as it opened were long waits for luggage, delays at check in and poor air conditioning amongst other unpleasanties. The low cost carrier phenomenon is the main contributor to the congestion problems and proposals to build a new 1.3bn baht LCC terminal are slow in progress with some suggesting re-opening the old airport to cater for the LCCs. It is estimated that in Thailand, whose main income is from tourism, largely made up of the budget traveller, LCC passenger volume through Bangkok will grow by a further 15m over the next two years.

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What does this mean for the Insurance Industry?

While baggage delays and overcrowding are uncomfortable it is the issue of Air Traffic Control and congestion, both in the air and on the ground that is of much more concern. One might suggest that while safety in the air has improved with the quality of modern day aircraft there are other areas that could be considered more questionable. The order books are a sign that there are many more aircraft due to enter the arena, both emanating from the low cost industry and the majors and the increased capacity and exposure as A380s enter the skies will be an additional strain. One can only emphasise how much greater the pressure will be on the industry that support the airlines and recent trends are already suggesting that cracks are beginning to appear.

In the context of staggering global air passenger growth of 6.3% for the first six months of 2007 (announced by IATA Chief, Giovanni Bisignani at 30th July 2007), it seems that airlines have in many cases shown little concern for the capacity of the airline industry infrastructure in their expansion plans. While airline fares are getting cheaper the supporting industry needs to give more consideration to passengers and in turn needs more funds. Everyone wants to fly more and at the same time expects safety to improve and services to be better but nobody wants to pay!

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And Finally...

You've been Sminted

Anyone looking to fly from Dusseldorf to Nagoya will have the option to smoke en route. While all other airlines have now banned smoking one character is refusing to be beaten by launching his own airline for smoking's sake. German stockbroker, Alexander Schoppmann's SMINTAir or Smokers International Airways will be equipped with a specialised air conditioning system that will work harder to keep the cabin air clean. Ambience will be the order of the day with special lounges with sofas dotted around and cocktail and caviar bars on the upper deck in addition to a duty free shop. The airline also has its sites on other heavy smoking destinations such as Sao Paulo and Johannesburg although probably one of the most likely destinations, Shanghai has been scrapped from plans due to limited traffic rights.

And what with Fly Pink launching pink planes from Liverpool to Paris with complimentary pink champagne and manicures being offered in the departure lounge, what next will be taking to the Airwaves?

Launch Log

July Launches

2nd July

Site Plesetsk
Launcher Kosmos 3M
Payload SAR-Lupe 2

5th July

Site Xichang
Launcher CZ-3B
Payload Zhongxing 6B

2nd July

Site Baykonur
Launcher Proton M
Payload DirecTV-10

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Registered office: 6 Crutched Friars, London EC3N 2PH England.

Registered in England Number: 5523613 VAT No. 244 2321 96