



JLT Aerospace



PLANE TALKING

SEPTEMBER OCTOBER 2007

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Editorial

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Comment

On the Edge

Negotiations for the all-important final quarter are now in full swing. With losses up for the year to date compared to 2006 and premium levels, in relation to exposures, down, it is a testing environment for both brokers and insurers.

While capacity remains buoyant, insurers are working against the run of play. In general insurers are still granting mild reductions but rating models are buckling as they push the boundaries.

There are some anomalies that have occurred for specific account sensitive reasons.

Some leader changes have occurred often as a result of the latest market trend for clients to hold leader "tenders" as an extension of the traditional broker review.

History indicates that we are approaching a trough in the insurance cycle and we are in the midst of a battle as to the turn coming about. So far the brokers are winning but how long will this be the case?

The next month to six weeks will be very fraught for brokers and underwriters alike.

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September Renewals

As one of the quietest months of the year, the airlines renewing in September have shown a similar pattern of treatment by underwriters as seen throughout 2007.

The largest renewal for the month by fleet value was Aeromexico and due to fleet and passenger growth it is now the largest operator in Mexico. This has in the past been placed in conjunction with Mexicana which renewed in June and for the first time has been placed separately.

The next largest in size was Lion Airlines of Indonesia which has driven for considerable growth recently but suffered a serious accident at the end of last year giving it a poor loss ratio at renewal. Underwriters treated this renewal accordingly, as they have with other airlines in Indonesia where there has been a number of serious incidents.

India's Air Sahara merged with Jet Airways and therefore its renewal was moved to April. The airline had a fleet valued in excess of US\$1 billion.

As a result of a small and very mixed bag of renewals for September, fleet values showed an average overall increase of 24%, passenger numbers by 7% and a premium increase of 8%. As is common for a large part of the year, these low volume months are in no way indicative of an overall change of market direction and should be taken in context with the quarterly figures shown.

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October Renewals

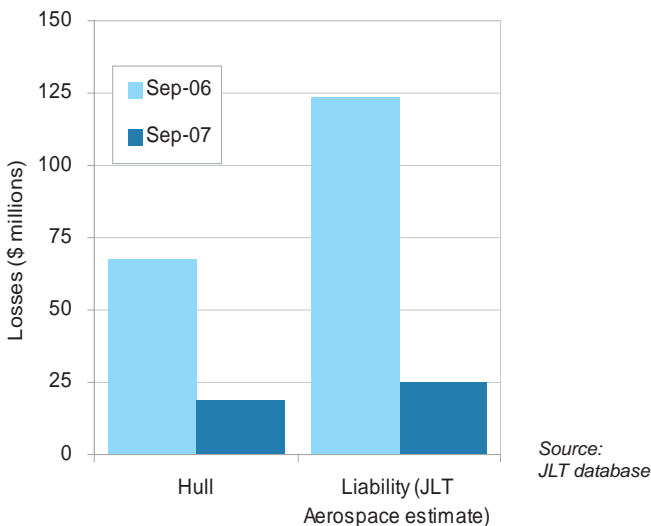
The number of renewals for October has diminished greatly in recent years due to new groupings, mergers and extensions and it is now November and December that are dominating the airline renewal calendar. Although the final quarter is generally regarded as the real renewal season, there are now only five significant airlines renewing in October. The operators renewing include Air Algerie, Air Malta, JAT, Pakistan and Syrian Arab.

China Airlines has moved its renewal to July and with a fleet valued in excess of US\$7.5 billion, this previously generated a very large level of premium the month. Indian Airlines has teamed up with its bigger sister airline Air India and therefore now renews in July as a joint placement. This leaves just one large airline valued at over US\$1.5 billion renewing in October.

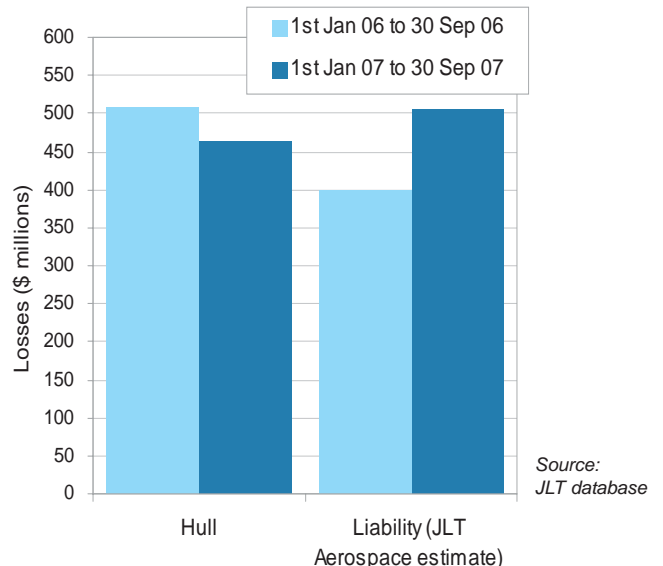
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Loss Analysis

September Losses



Major Airline Losses for Year to Date



September Losses

Among the losses in September, there was yet another passenger jet accident resulting in a high number of fatalities. It appears that weather played a major part in causing the MD-82 belonging to One-Two-Go Airlines to leave the runway on landing in Phuket. Although the hull insured value was relatively small, liability settlements for the dead and injured could be substantial. Two incidents that set alarm bells ringing was the gear collapse on two SAS Dash 8 Q400 aircraft. This resulted in all Dash 8 Q400 aircraft being grounded on September 12th after Transport Canada issued an Airworthiness Directive. It appears that there was a corrosion problem with the main gear actuator piston which controls gear deployment. After a thorough investigation, the type was eventually given the all clear. There has now been a further development with a third incident on 27th October when the right hand main landing gear of one of SAS Dash 8 Q400 failed to fully deploy and as a result the airline is withdrawing the whole fleet of the type. While SAS had replaced landing gear components on all of their Q400 aircraft, this incident was the final straw and the airline feels it is coming to the point of damaging the brand.

7th Sep	Galaxy Kavatsi	An-12 cargo reg 4L-SAS	Goma Airport, Congo	All crew killed	Insured value unknown
The aircraft overshot the runway on landing and hit a petrified lava flow where it burst into flames and was totally destroyed. An unknown number of crew were on board.					

9th Sep	SAS	Dash 8-Q400 Reg LN-RDK	Alborg Int'l Airport, Denmark	some passengers injured	Reserve US\$7,400,000
On approach the crew received indication that the gear position was unsafe. Moments after touchdown the right main undercarriage collapsed causing the right wing to strike the ground. Fragments of the propeller blades penetrated the fuselage, fortunately without injuring any passengers although some suffered minor injuries during the evacuation of the aircraft.					

12th Sep	SAS	Dash 8-Q400 Reg LN-RDS	Vilnius Int'l Airport	No injuries	Reserve US\$5,400,000
The aircraft received substantial damage during an emergency landing when its main gear failed to lock in position. The aircraft came to rest in soft ground off the runway, while all on board escaped without serious injury.					

16th Sep	One-Two-Go Airlines	MD82 Reg HS-OMG	Phuket Airport, Thailand	91 passengers killed	Insured value US\$4,500,000
On landing from Bangkok in heavy rain and wind the aircraft left the runway and ran across a drainage ditch before hitting an embankment, breaking up and catching fire. On board were 123 passengers and seven crew. Many survivors suffered serious injuries and burns. Windshear is thought to be a contributory factor in the accident.					

16th Sep	Grupo Aereo Monterrey	B737-200 Reg XA-MAC	Guadalajara , Mexico.	No injuries	Reserve tba
The aircraft made a wheels up landing.					

21st Sep	Augsburg Airways	Dash 8-400 Reg D-ADHA	Munich, Germany	No injuries	Reserve tba
The nose undercarriage failed to extend on approach to Florence so crew elected to return to Munich where it landed with the nose gear retracted.					

September Loss Summary

Hull Losses	Liability Losses (JLT Estimate)	Total
US\$	US\$	US\$
18,800,000	24,700,000	43,500,000

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THIRD QUARTER UPDATE

Insurance Renewal Data

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

% Movement	AFV	RPK	Passengers	Hull Rate	Liability Rate	Premium
1st Quarter 2007	+7%	+10%	+13%	-32%	-30%	-25%
2nd Quarter 2007	+16%	+16%	+16%	-29%	-31%	-19%
July	+7%	+1%	+5%	-12%	-27%	-20%
August	+4%	0%	+26%	-11%	15%	-12%
September	+24%	+13%	+7%	-11%	-5%	-8%
3rd Quarter 2007	+8%	+1%	+13%	-7%	-24%	-16%
THE YEAR TO DATE	+10%	+9%	+14%	-22%	-28%	-20%

Major Loss Summary

Period	Number	Hulls (US\$)	Liabilities(US\$)*	Total (US\$)
1st Quarter 2007	17	113,780,000	61,700,000	175,080,000
2nd Quarter 2007	17	159,320,000	95,450,000	254,770,000
July	8	95,230,000	316,750,000	411,980,00
August	7	75,890,000	7,550,000	83,440,000
September	4	18,800,000	24,750,000	43,550,000
3rd Quarter 2007	19	189,920,000	349,050,000	538,970,000
THE YEAR TO DATE	53	462,620,000	506,200,000	968,820,000

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Insurance Industry News

Anticipation and expectation go hand in hand and no more so than during the build up to the long awaited airline renewal season. We call it a renewal "season" although it is only two months in duration but around 65% of the annual airline insurance premium is generated during this period.

Our assessment on the airlines we have seen so far (up to the end of the third quarter) gives an overall premium reduction of around 20% even after significant exposure growth. This must however, be tempered by the fact that there have been a number of mergers, airlines joining consortia, operators failing and on the plus side a number of new entrants.

All this differentiation has probably made little impact to the overall picture of a continued decline in premium levels and certainly this has progressed into October. With available capacity still being attracted into the market both in London and overseas, the creation of this deep, soft and accommodating cushion remains the comforter for negotiators who can still be rewarded however trying the placement may be.

Another antagonist refusing to become a benefactor is the US dollar. With another run of disappointing US economic data, the US Dollar sank to a record low against the Pound and the Euro in late October.

Losses continue to remain containable although September produced another major accident in the Far East costing the lives of 91 people.

One interesting aspect of the current scenario is allegedly the part that Lloyd's plays when trying to dictate to the market. Reports are surfacing that Lloyd's franchise board have been making comments to the effect that they condemn undisciplined underwriting. This has been robustly defended by some underwriters in so far as it is the franchise board that has allowed new capacity to enter the market thus exacerbating the whole problem. It is the new capacity that has been suggested by some as the cause of the continual decline in airline premium.

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Arrivals and Departures

We would like to welcome Theresa Spillane who has joined us at JLT Aerospace from Swiss Re in Munich.

Jim Joannou has resigned from Marsh to set up an XL Aerospace office in Toronto, Canada.

Simon Fuller has resigned from Catlin.

Simon Clarke has resigned from Marsh Aviation claims and is joining ACE Aviation claims.

Chris Churcher has resigned from AIG to join ACE on the claims side.

David Johnston is joining Gates and Partners in Asia on 1st November 2007 and will be Managing Partner of their new Singapore office which opened at the end of September. He is joining Peter Boys, Trudy Seow and Angela Pinto.

Barlow Lyde & Gilbert LLP has announced that partner Mert Hifzi has been appointed as head of the firm's Aerospace practice in Asia and will be based in Singapore. Mert will be joined by associate director Keith Richardson and by associate Carlene Johnson.

Lorenzo Signor has resigned from Sirius to join Flagstone Re.

Stefano Balest has resigned from Converium/Scor and is expected to join Sirius at the beginning of next year.

Correction

Further to our comments last month in respect of Doug Wicks who is going to Catlin, Toronto not Chicago.

MISR Expansion

A new insurance company has resulted from a merger between Al-Chark Insurance, Egyptian Reinsurance Companies and MISR. The new entity continues to be a subsidiary of the recently established Insurance Holding Company (IHC).

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SPECIAL REPORT

A Decade - Approaching the Trough?

At this crunch time when losses look likely to equal or exceed premium levels for 2007 this may be an appropriate time to review the last decade, 1998, being the last trough in the airline insurance market cycle. The good news (for all) is that premiums have not sunk to the excessively low levels that the airline market was bearing 10 years ago. This is not to say that there is room for more significant reductions going forward. 1998 was a depressing time for the aviation market when competition forced insurers to reduce premiums to dangerous levels, the reality of such imprudence was brought home by the financial impact of September 11th and should still be remembered today.

While current combined premium levels are around 50% lower than 2002 levels when they were at their peak, they are in fact 12% higher than 1998 levels for hull and more significantly, 94% higher for liabilities, liability premium providing the greater percentage of premium compared to hull. The lessons from September 11th were clear: liability rates were previously well short of a true representation of the risk being underwritten and going forward a higher threshold had to become standard.

While rates are still reducing, the market is being cautious as annual claims near annual premium levels. Nevertheless combined premiums are still 53% higher than 1998 levels.

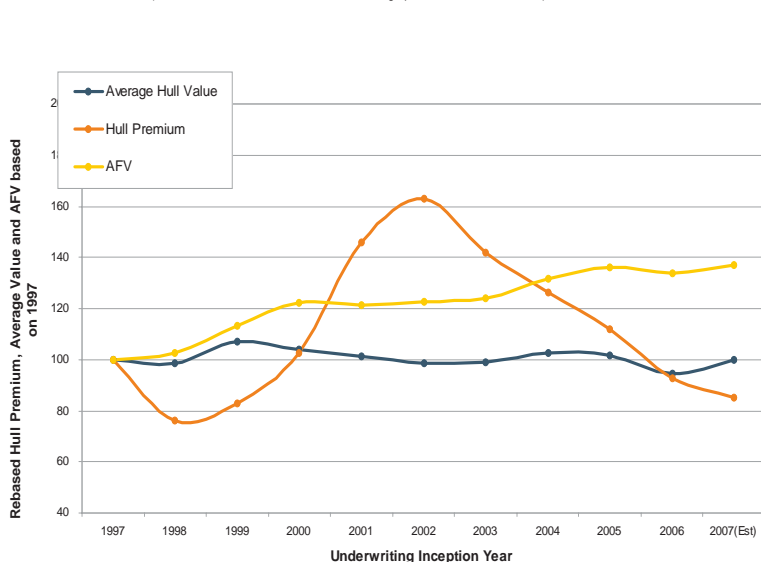
While superficially it may seem illogical that insurers would continue to write at levels that on an annual basis do not show a reasonable margin of profit the fact that insurers are enjoying profits of around US\$4.5bn since September 11, creates a commercial reluctance to withdraw from this class (and this is the situation today). The six year (in order to incorporate 2001 figures) loss ratio from 2001 to 2006 of some 71% demonstrates that insurers have amply recouped their historic losses. On a 10 year basis however the loss ratio is much worse, around 90% and this confirms how rates had dropped to unacceptable levels in the years preceding September 11 when it was a very soft market. This suggests that a repeat of this scenario should very much be avoided. For insurance buyers this is also in their interest as it was the buyers who were landed with the extreme insurance bills in the aftermath of the tragedy as a result of poorly funded prior years.

Capacity providers will expect aviation insurers to deliver profits year on year and in the future a failure to do so may lead to a withdrawal of capital. A reduction in capacity will signal the beginning of the upward cycle in rating levels.

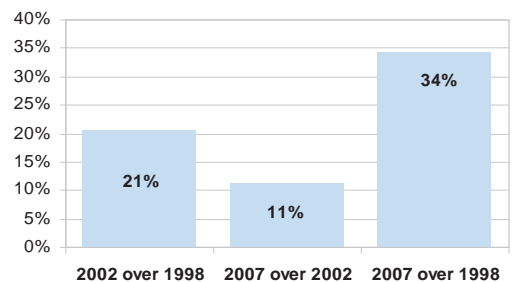
Exposures on the Up?

Exposures have grown at a more accelerated rate in recent years after a short depression in the airline industry in the aftermath of September 11th. This event was the catalyst for the industry to address its damaging overcapacity. While some areas of the industry are still struggling to pull through (primarily the US airlines) other areas are literally taking off particularly the Asian Sector which has seen huge growth over the last few years.

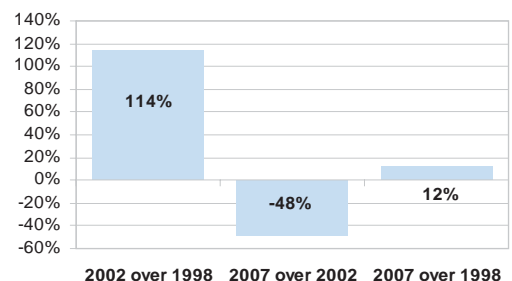
Global Airline Hull Premium v Exposure Measures (Rebased from 1997)
(Premium based on London Lead Prices. Excluding Specific War Related Premium)



AFV % Movement

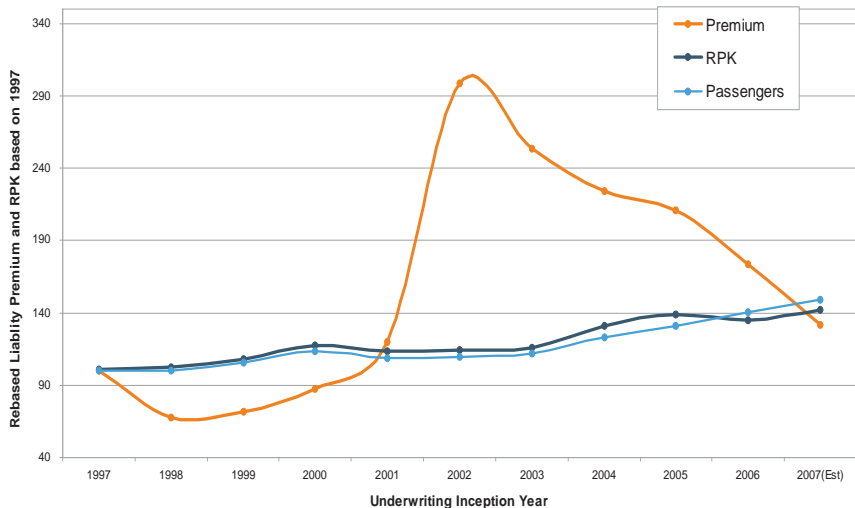


Hull Premium % Movement



Notes:
Rebased takes 1997 as 100 and subsequent years indicate the annual percentage change from this point.
AFV - Average Fleet Value
RPK - Revenue Passengers

Global Airline Liability Premium v Exposure Measures (Rebased from 1997)
(Premium based on London Lead Prices. Excluding Specific War Related Premium)

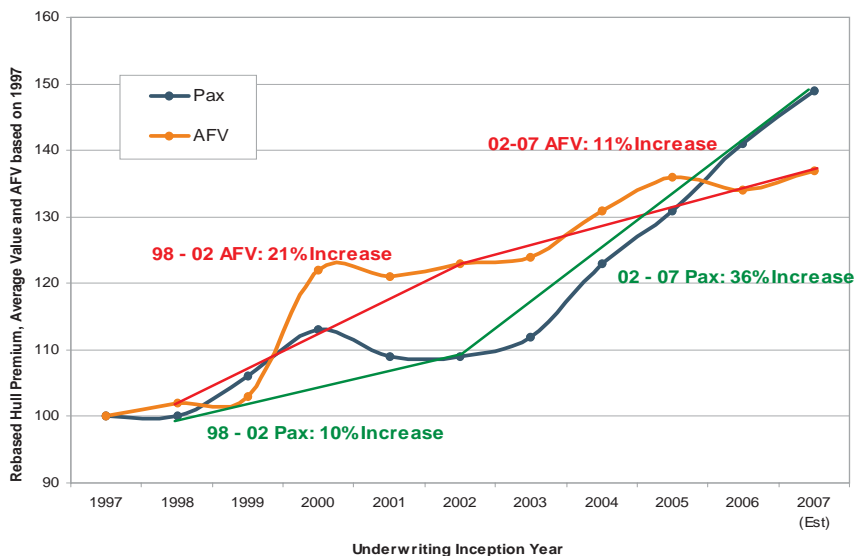


It is interesting to note that while the impression may be that the world's fleet has grown excessively in recent times in fact there has been a marked levelling of growth for Average Fleet Value (AFV) since 2002 amounting to just 11%. This compares with AFV growth of 21% for the 1998 to 2002 years. Conversely the growth of passenger numbers for the earlier 1998 to 2002 period was just 10% while the level of growth has more than tripled for the later 2002 to 2007 period at 36%.

The graph below puts this into perspective illustrating how extreme the overcapacity was becoming prior to 2002 for AFV and in effect how tenuous the airline industry was when it was hit with the devastation of September 11.

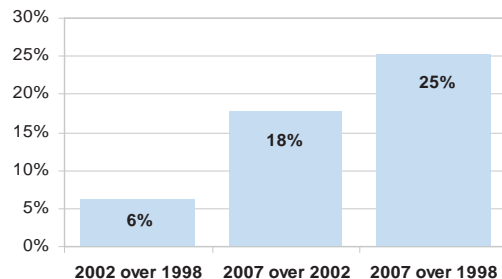
This demonstrates that recovery in the industry has been very healthy since the depression following September 11 with more congruence being introduced into the business environment. At the same time as passenger numbers have increased there has been a regulation in AFV levels, effectively, load factors have improved.

Global Airline Exposure Measures (Rebased from 1997)

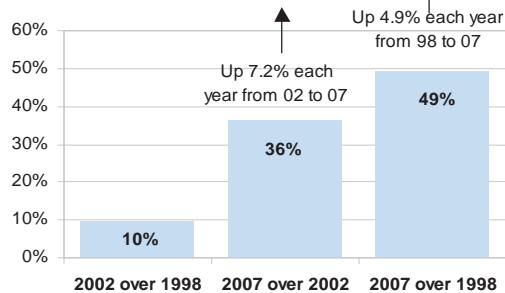


The overall picture is that exposures are increasing with liabilities being very much the more volatile and expensive of the two but as we can see premiums are heading in the opposite direction. While it is acceptable that when fleets and passenger numbers expand their rates reduce but how far are they going to reduce before the level of risk to reward becomes out of line with what is acceptable. On reviewing the statistics it seems there is still some margin for the airline

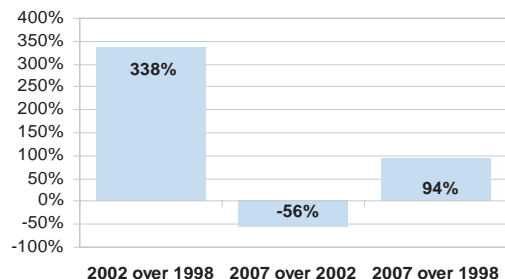
RPK % Movement



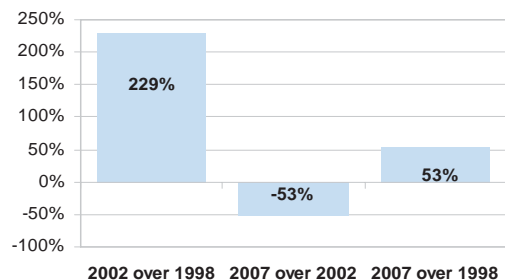
Passengers % Movement



Liability Premium % Movement



Combined Premium % Movement



customers to make savings but for how long this will go on is questionable.

There are certain factors that must also be considered with regards to exposure. It is worth commenting that the recent growth in the airline industry has not simply been the consequence of natural growth but a shift in the composition of the exposure. There is a much higher element of fledgling operators, largely as a result of the low cost carrier phenomenon sweeping the globe. Terrorism has a much greater presence at this time. Certain factors as a result can only be important to the consideration of exposure such as:

- More fragmented industry: a larger number of smaller operators rather than a lesser number of larger operators
- More short haul flights: demonstrated by the greater increase in passengers than RPKs
- Number of qualified personnel under pressure
- Less established industry players
- Infrastructure under pressure in certain parts of the world where rapid expansion is taking place
- Air Traffic Control under increasing pressure in all parts of the world
- Security operations requiring more investment that is not always being recognised
- Next generation of aircraft entering the arena
- Claims inflation

Worldwide Fleet Facts

On reviewing recently published OAG statistics it was interesting to discover that the low cost operators have the youngest in service fleets, the average age being 7.2 years for narrow body jets. This compares with an average age of 13.5 years for narrow body jets operated by scheduled network carriers. While one may dwell on the old aircraft that are often purchased by the fledgling low cost operators in their attempts to start up with the lowest costs possible, the likes of Easyjet, Ryanair and JetBlue are all undergoing huge fleet renewal programmes. Ryanair has had 27 new B737s delivered so far this year and have in recent years ordered 308 new B737-800s around half of which have already been delivered. The Irish airline has one of the youngest fleets in Europe. Easyjet has a total of 315 A319s on order, including options, of which 88 have been delivered. Jetblue is being delivered a new A320 every few weeks which will bring the total new Airbus aircraft to 202 by 2012. The airline has also placed a 100 aircraft order for the new Embraer 190

and these are being delivered at a rate of 18 each year. One should consider however that these fleets do distort the average figures to a certain extent where in reality there are also many fledgling operators that are at the other end of the spectrum, surviving by flying older equipment. Regional jets average out at an age of 6.4 years.

It should be taken into consideration that the low cost and regional sectors are smaller whereas the definition of the scheduled network carrier is a more all inclusive term which would encompass a more variable type of operator in all areas of the world. One would suggest that this represents more of a true average than the low cost and regional sector by themselves.

External Factors Influencing the Airline Insurance Market

Capital markets appear to be slowing their interest in the insurance markets as the sub-prime mortgage crisis takes effect. This should not have much impact on current capacity but may slow the entrance of new insurers into the market. This will be no bad thing as far as incumbent insurers are concerned. As discussed in earlier pages, a number of Lloyd's insurers are unhappy with the Lloyd's Franchise Board for allowing new capacity into the market while in the same breath, allegedly condemning insurers for giving in to market pressure and continuing to allow rate reductions.

While the reinsurance market is succeeding more than their direct market colleagues in asserting a fairly firm stance with regards to renewals, the crux of it is that the reinsurance industry has had a relatively benign loss year. The main concerns are usually around September and October time and they are now breathing a sigh of relief as the only two major hurricanes failed to make the US mainland and in fact there has been no significant US hurricane damage since Wilma in 2005.

There have been some other weather related losses, the largest of which, the Cyclone Gonu in the Middle East totalled US\$1bn. The UK and New South Wales floods and Windstorm Kyrill were quite expensive but the costs pale in comparison to the Hurricane Katrina losses in 2005 which were reported to reach between US\$50 and US\$60bn.

As a result the direct market has borne the brunt of insurance losses this year with little overspill into the reinsurers balance sheet and therefore reinsurers may have to weather this fact when it comes to the 1st January renewal negotiations.

Airline Industry News

Easyjet Branches Out Further

Easyjet is widening its reach in making a significant purchase in GB Airways, the British Airways franchise largely based at Gatwick for a price of US\$211m (GB£103.5m). The UK operator has a fleet of 15 Airbus aircraft and mainly serves Southern Europe and North Africa. Easyjet now will have 24% of Gatwicks slots. GB Airways also has some slots at Heathrow which are being sold in a separate deal.

Confirmed Delay of Dreamliner

Boeing has finally conceded that the first deliveries of its new baby the 787 Dreamliner will now be in delay. The US manufacturer is still putting itself under pressure with the proposed new timetable for delivery of mid-November to mid-December 2008 as the first flight is now slated for May 2008. This allows only a 6 month window for testing the all new aircraft. The first flight was originally scheduled for the end of August this year.

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Launch Log

September Launches

Date 5th
Site Cape Canaveral
Launcher Atlas 5/401
Payload NRO L-24

Date 10th
Site Baykonur
Launcher Soyuz FG
Payload Soyuz TMA-11

Date 15th
Site Pacific
Launcher Zenit 3SL
Payload Thuraya 3

Date 20th
Site Kennedy
Launcher Discovery STS-120
Payload U.S. Manned NASA/JSC

Date TBA
Site Baykonur
Launcher Dnepr 1
Payload THEOS

Date TBA
Site Tanegashima
Launcher H-2A
Payload WINDS

Date TBA
Site Baykonur
Launcher Proton K
Payload Kosmos

Date TBA
Site Baykonur
Launcher Proton M
Payload Thor 5

Date TBA
Site Sriharikota
Launcher PSLV-C
Payload OceanSat 2

Date TBA
Site Baykonur
Launcher Soyuz 2-1a
Payload Radarsat 2

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