



JLT Aerospace



PLANE TALKING

END OF YEAR 2007

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Editorial

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Comment

Clouds on the Horizon

As we bid farewell to 2007 we find ourselves in the midst of uncertain times. While the facts are certain that the airline insurance market has transformed from one that is profitable to one that is unprofitable and that the airline insurance market will turn from soft to hard - the uncertainty is when will renewal results turn from negative (reductions) to positive (increases).

At present, with capacity still technically buoyant and a certain level of reluctance remaining by insurers to (officially) withdraw from the market following some bumper years both in terms of high premiums and low loss activity, this is exacerbating the now unhealthy finances of the market. While 2007 has presented the market with a couple of 'scares' due to a number of high value jet total losses, the financial extent of these losses has

still not placed sufficient pressure on the underwriting community to fully turn rates around. There appears to be a 'hang on in there' attitude emanating from the market. The anticipation of rate increases coming into play is serving to retain airline insurers' subscriptions but at the same time is the 'antibody' for a turn to come about.

Nevertheless there was a clear firming in stance by airline insurers during the critical November and December renewals albeit rates on average still reduced. We estimate that on average hull rates reduced by 11% and 14% in November and December respectively and liability rates by 8% in both November and December.

We are estimating that the overall result for 2007 for the airline 'all risks' market is that claims rose to approximately US\$1.6bn including attritional losses against estimated premium income of US\$1.47bn based on the information we have to date.

At this juncture we find ourselves entering 2008 with a few quiet months ahead in terms of renewals. We wonder whether the impetus of insurers to firm up that the 'renewal season' of 2007 inspired will still be prevailing when April comes and the first significant renewals of the year take place, or will this adrenalin have become diluted and insurers' resolve to harden up rates with it?

The key to this will, in all probability, depend on loss activity during the first quarter. Nevertheless it is apparent that capital providers are applying firm pressure on their underwriting units to put a stop to reductions.

While our figures are centred on the 'all risks' airline insurance market most insureds also have interests in other areas of the aerospace market that should have buffered up their bottom line such as war, products, general aviation and ground operations.

What has been prevalent during the end of the year 'renewal season' is the firm stance being adopted by the following markets as they have shown much greater reluctance to underwrite to the same levels below lead rates as they were prepared to a year ago. Brokers have encountered a much tougher marketplace as they have attempted to complete 100% placement of a risk at the right price.

While technical capacity is still high, in practice insurers have been reducing their lines particularly on those accounts that have poor loss records and poor underwriting criteria. Criteria such as location, average age of fleet amongst others has been more crucial to insurance negotiations with those airlines considered to have negative underwriting criteria encountering particular resistance by insurers at renewal.

As we can appreciate from the year end results, with our current estimates stating that annual premiums were exceeded by claims, it is likely that while lead insurers may make a small gain, the following markets that have been party to the major losses occurring in 2007, are likely to be working at a loss. And of course there may also be some who have missed a major loss.

When the market is on the verge of a turning point, the vertical marketing variance is a strong indication of the

degree of change and this margin has markedly narrowed during the recent, critical, negotiations of the final quarter.

A FULL END OF YEAR ANALYSIS WILL APPEAR IN OUR NEXT ISSUE

Reinsurance Renewals

The outcome of the 1st January renewals was more or less as predicted with most General (Major Risk Type) Excess of Loss programmes demonstrating a sizeable profit balance to reinsurers and fairly static exposure, experiencing around a 10 - 15% reduction in price. General Aviation (Non-Airline) and mainstream Retrocession programmes on the other hand, either received 'as before' renewal terms in a number of cases or some modest reductions in the region of 5 - 7.50%. In a few cases (particularly the larger companies/organisations) clients opted to run larger retentions and/or take co-insurances on parts of their reinsurance programmes in order to reduce their outward reinsurance spend.

The yearly 1.1 reinsurance renewals can have a distinct influence over the direct market pricing and these outcomes take some pressure off the direct underwriting community.

Financial Headaches Ahead

Aviation - and particularly 'airline' - insurance has always been subject to dramatic changes in underwriting climate. Now climatic change is more seems to be the subject of environmental scrutiny.

As we go forward it is aviation that is under the spotlight in terms of global climate change. This together with the more obvious pressures of the price of fuel and the uncertainties of the global credit crisis, all put extra strain on the world's airline industry. Now it seems likely that a further burden will be added to the airline sector - the cost of insurance.

Whilst this latter factor is probably of least concern to the world's airline industry financiers it remains one of the most serious direct problems for those involved in providing this necessary commodity for the sector in the short term.

In the long term the cost of making aviation 'environmentally friendly', is the probable highest cost to the industry. 'Credit Crunch' problems currently seem serious but difficult to quantify. Insurance costs will rise - maybe in 2008 - maybe in 2009 - but they will rise.

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November Renewals

Due to a mix of movements, extensions and mergers November has now evolved to become the third busiest month of the year for generating premium after December and July.

The actual number of airlines making up our assessment has diminished from 15 to 12. In some cases this is due to programmes moving to December or airline mergers and take-overs which happen often, somewhat distorting specific monthly figures. In among these movements was Korean Airlines, Air Tahiti Nui and Kuoni who all extended their policies to December and ATA Airlines of the US, previously a December renewal, recently merged with World Airways to form part of the November figures.

There are still a number of significant operators renewing in the month among them Qantas, Cathay Pacific, Singapore Airlines, South African Airways, UPS, DHL and the Gulf Consortium of Airlines which include Saudi Arabian Airlines, Kuwait Airways, Gulf Air, Emirates, Qatar Airways and Etihad. Exposures were up considerably for the Consortium and the overall fleet valuation now approaches US\$40

billion. There were also a number of flag carriers from Cyprus, Iceland, Colombia and the Caribbean amongst the renewals.

As we have witnessed throughout the year, exposures continue to rise and fleet values showed an increase of 8% with revenue passenger kilometres up by 15% and passenger numbers by 6%. In the interests of realism if we limit our comparison to like-for-like renewals we come to a premium reduction of about 5% on average.

December Renewals

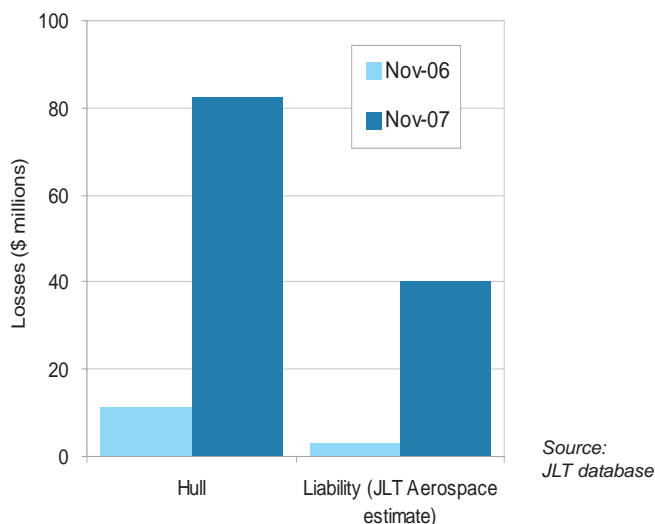
This is the one month that remains consistently head and shoulders above the others in renewal numbers, airline size and premium volume. It is therefore a critical time of year and our attention should be drawn to the outcome of these renewals.

Apart from most of the prominent European operators headed by the Lufthansa grouping and Air France / KLM, the month also contains the majority of the US major carriers. Their results alone should be worthy of scrutiny.

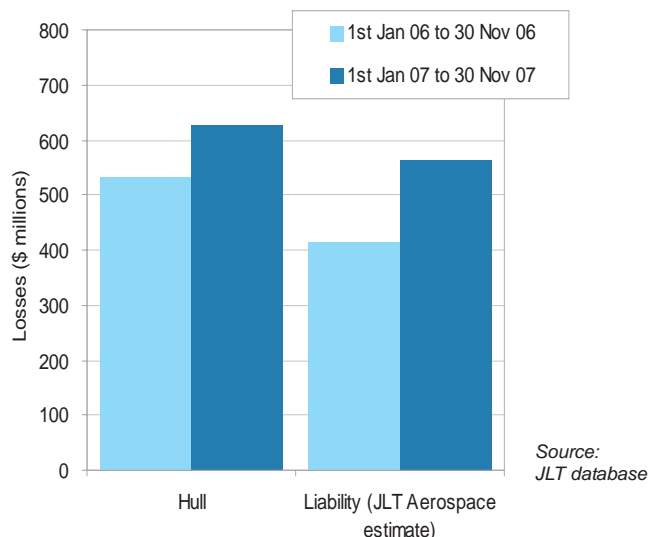
Due to various factors, a number of airlines have migrated to year-end and thus altered the monthly premium balance. It is now reckoned that December probably accounts for more than 50% of the annual airline premium income and therefore takes on even greater significance than previously.

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November Losses



Major Airline Losses for Year to Date



November Loss Summary

The most significant loss in the month and for that matter the year was the destruction of a brand new A340-600 which was being given final engine checks prior to delivery to the Middle East. This was a most unusual incident and it was fortuitous that nobody was killed. There was however one catastrophe involving a commercial jetliner that resulted in loss of life when the Turkish MD-83 collided with a hillside during a night approach to Isparta resulting in all passengers and crew being killed. This was the third MD-80 series aircraft to be destroyed in 2007. Ramp accidents never seem to go away and there were two serious losses that breached the deductible threshold of the airline policies and represent just the tip of the iceberg when seeing the overall number of these types of incidents throughout the year.

7th Nov	Juba Air Cargo	An-12	Khartoum	Two third parties killed on the ground	Insured value US\$800,000
Following suspected engine failure the aircraft attempted to return to Khartoum but crashed outside the airport on a military area killing two soldiers.					
9th Nov	Iberia	A340-600 Reg EC-JOH	Quito International Airport, Ecuador	No injuries	Hull reserve \$70,000,000
The aircraft overran the runway on landing and ran into soft sloping ground which caused the left main undercarriage to collapse. Both left hand engines sustained damage plus the fuselage and wing. The overall damage is thought to be substantial.					
15th Nov	Airbus Industrie	A340-600 MSN 856	Airbus facility, Toulouse-Blacnac	five personnel injured	Insured value in the region of US\$200,000,000
During pre-delivery engine checks the aircraft rolled forward and struck a 10 m high concrete wall where it came to rest. The whole of the cockpit area and forward underbelly being destroyed. The A340 was due to be delivered to Etihad Airways on the 23rd					
19th Nov	Air Deccan	ATR 72-500 Reg VT-DKA	Chennai International Airport	No injuries	Hull reserve \$1,400,000
The aircraft received substantial hull damage when a vehicle collided with the aft service door during early morning darkness. The aircraft will be out of commission for about 6 months.					
23rd Nov	Astraeus	B737-700 Reg G-STRH	Gatwick Airport	No injuries	Hull reserve US\$1,750,000
During towing operations the tug jack-knifed causing considerable damage to the nose area of the aircraft.					
25th Nov	Air Berlin	A320-200 Reg D-ABDM	Tegal Airport, Berlin	No injuries	Hull reserve US\$750,000
Aircraft ran over tug while being moved on the airport apron.					
30th Nov	Atlasjet	MD-83 Reg TC-AKM	Near Isparta, Turkey	49 passengers and seven crew killed	Insured value US\$8,000,000
On approach to Isparta from Istanbul the aircraft hit high ground in darkness and was totally destroyed. Weather conditions at the time were good and there was no indication of any mechanical problems during the flight.					

November Losses

Hull Losses	Liability Losses (JLT Estimate)	Total
US\$	US\$	US\$
82,700,000	40,300,000	123,000,000

Insurance Industry News

We still very much regard the fourth quarter as the renewal season for the airline account despite July now providing us with an important mid-year indication as one of the busiest months in the year. It therefore remains that now is the traditional moment for strategic decisions to be made and for the first time in six years it is a critical time.

Premium levels have fallen by degrees ever since the severe measures imposed at the tail end of 2001 following 9/11, which included various surcharges, some of which remain today.

The general picture at present is crystal clear for the market to see. From a premium perspective it is obvious that airline income continues to toboggan downhill liberally assisted by ample lubricity in the form of extensive capacity. The end of the ride must surely now be in sight with a caution sign being hung out with the warning "Danger ahead, beware of losses".

From an underwriting perspective the accident to the Airbus A340-600 at the Airbus facility in November has to be included and although not an airline loss as such, the circa US\$200 million estimated insured value will have to be paid from within the aerospace insurance market's book of business.

Maybe this incident - the highest valued single aircraft loss ever to be paid by underwriters will be the catalyst for change and act as a stark reminder of the very real level of exposures now prevailing.

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Arrivals and Departures

Steve Doyle is departing from his role as Senior Airline Analyst at Aon and will be joining Willis.

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Airline Industry News

As Christmas-time filled up the commercial aircraft taking to the skies, exacerbating the congestion at the main hubs, we saw the price of a barrel of fuel hit a record US\$95 (and is now verging on US\$100) and witnessed the conclusion of the rapid decline of MaxJet which ceased operations on Christmas Eve.

2007 has been something of a leveller for the airline community. Where 2006 could be considered to be a boom year for the airline industry for all but a few, the knock on effects of a huge influx of new airlines entering the arena are now starting to be felt.

India has been a prime example of too much too quick as the country's passenger airline infrastructure is struggling to cope. The winners are now being sorted from the losers as cracks are starting to appear at those airlines with less than watertight business plans, who are now losing money by the day.

The Chinese Government whose industry has been expanding at a similar rate of knots has seen fit to curb the extreme increase in activity in order to allow an adjustment to take place.

The order books for the airframe manufacturers have been extremely healthy this year as their customers seek a higher quality product to entice their valuable customer base. Nevertheless it seems that both Boeing and EADS are struggling to make ends meet. The delays in both of their flagship new products will no doubt prove costly and EADS is almost being crippled by the weakness of the dollar. This and possibly having compromised their pricing structure just that little bit too much in bids to establish their new products in the marketplace are challenging these major rivals.

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