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# PlaneTalking

AEROSPACE DECEMBER 2011

## Executive Summary

### GEARING UP FOR 2012

“Despite some very impressive firework celebrations, marking the close of 2011 and welcoming 2012, our markets closed the year with far less spectacle. Notwithstanding, the usual rash of frantic activity compressed into the closing days, all renewals appear to have been concluded and generally in line with plans.

Market capacity continues to hold firm, however we must note the differing appetites between the various markets, seemingly driven more by “tweaks” to portfolio mix rather than wholesale changes.

We witnessed a continuation of the narrowing between the leader’s and following market prices, heralding an increasing challenge to complete placement at the agreed / acceptable terms.

2011 ended up an undeniably good year for losses, coming in significantly below the average of recent years, and this is also before making any allowance for inflation / increased exposures. As a consequence, it appears likely that without external events forcing the market’s hand, we are unlikely to witness any significant changed attitude to rates any time soon.

At the next renewal, each risk will undoubtedly benefit (or suffer) from its own loss experience. Whilst this echoes equity we

continue to move away from one of the fundamental principles of insurance, the losses of the few are paid for by the many.

Premium in 2011 ended up at a level very similar to 2010, and whilst there were minor differences in relative contributions from Hull and Liability, overall these were largely irrelevant.

Exposures showed a marked increase over 2010, with Average Fleet Values up by 8% on average and Passengers even more at 11%. These growth rates appear in excess of Industry opinions, particularly in respect of mature markets of North America and Europe, the latter also likely to suffer from the effects of the Euro zone uncertainties.

Despite the continuing groans from our market for increased rates, overall underwriting results for 2011 should appear OK in most cases, and actually very good for some. Consequently there is nothing really visible on the (near term) horizon that is likely to act as the “tour de force” for change.

Perhaps we should not be surprised that the market’s appetite to innovate appears suppressed; but we echo John Blair’s comments in this edition’s Lead Lines, in that we would very much like to see some more creativity within the market for everyone’s benefit.”

Are you interested in featuring in Lead Lines, or do you know someone who is, if so please contact us at: [publications@jltgroup.com](mailto:publications@jltgroup.com)

“

Aviation insurers are strong and valuable partners to airlines in this critical but volatile industry. I would love to see that partnership develop creatively into new areas of mutual upside.

”

# Lead Lines



John Blair LLM (Hons)

General Counsel & Company Secretary - Air New Zealand Ltd.

## Biography

After 15 years of in house corporate legal work in Europe, John returned to New Zealand in 1996 to the General Counsel role at Air New Zealand. Since then, over fifteen years experience in the aviation industry have provided numerous regulatory, liability, corporate governance and aviation insurance issues. Managing a small team of lawyers and a couple of insurance professionals in this complex industry has provided interesting challenges and required a good understanding of airline business strategies and the role of in house professionals in dealing with commercial, legal, insurance and management issues.

## UPSIDE DOWNUNDER

We won the Rugby World Cup! Already it is “last year’s news” and most of the world has forgotten it by now and is thinking about 2012 and resolving global economic woes and the Euro crises – but for New Zealand it was a huge “upside” in a year many of us would like to put behind us and forget.

Natural disasters seem to have been an increasing around the world for at least the last two years (underwriters will tell me “every year”) but New Zealand was literally rocked by a series of devastating earthquakes in Christchurch, a mining tragedy, volcanic ash from Chile and a minor maritime oil spill.

### **What do all these natural disasters have to do with aviation insurance?**

Aviation seems uniquely placed as an industry to be affected by almost every major event the world can throw at it. Economic crises affecting demand and cost, pandemic diseases, weather effects, earthquakes and even major sporting events.

The most significant of recent events was Aya...Eyaaah...Ejayfet...the “Icelandic Volcano”. We stared at clear skies devoid of aircraft trails, no one was injured and not an aircraft was scratched. But the industry lost millions. No damage, but people couldn’t fly. No damage, so no business interruption insurance.

In the Christchurch earthquake, Air New Zealand suffered minimal property damage – all insured. Our facilities were operational again within hours, but our business changed dramatically. Business and leisure travellers were replaced by search and rescue teams, volunteer helpers and many other wonderful people assisting in so many ways. Outbound traffic was initially evacuees and tourists heading home in distress. Airline revenue on Christchurch routes fell substantially.

With the benefit of what we had learned from the “Icelandic Volcano”, we managed to maintain operations around, over and under the Chilean volcanic ash cloud which circled the southern hemisphere for many days. Great for customer service, but expensive on extra fuel. No insurance covered that.



Even our highly treasured Rugby World Cup – the tournament and the trophy – has delivered mixed fortunes to many businesses, including airlines. Even with everything going generally to plan, the event disrupted general demand patterns for travel, restaurants, cruise ships and countless other industries. Imagine if ash cloud or weather had disrupted it?

My short point is that there is an upside opportunity from such events – natural or man-made.

Airlines' insurance is a wonderfully comprehensive product, but it has changed very little in my 16 years of buying it. The aviation industry responded incredibly well to the upheavals of 9/11, but subsequently settled back to something remarkably familiar. In the same 16 years the airline industry has changed dramatically, forced into continual innovation by the need to survive and change, to find new markets and new ways to create revenue. We haven't seen anything similar from insurance. We hear continually about the total claims exceeding the total premium income, but

nothing of new insurance solutions to some of the airline industry's challenges.

The opportunity exists for insurers to get into the game of sharing some of the risks to airlines of events such as natural disasters. Airlines don't bring these on themselves – they have to be quick to adapt. Therein lies a problem and a solution. The problem is that the financial consequences of a particular event are wildly variable depending on the nature of the event, the location and its importance to an airline's network, the duration and timing of the event and the willingness and ability of the airline to adapt in response. These factors make it almost impossible to calculate future exposures. The losses to revenue and the increased cost of working are hard to predict but very real when they arrive.

The solution must first involve recognition that the losses may not be a consequence of any physical damage – the touchstone for any traditional Business Interruption claim. Added to this, only a few BI underwriters would understand the airline industry sufficiently to appreciate the flexibility.

Aviation underwriters on the other hand could realistically work with airlines to assess potential risks and responses.

A co-insurance approach sharing that risk would incentivise airlines to respond efficiently, create a new market for insurance and collectively build the knowledge of response possibilities. That still leaves the thorny question of the premium but many clever underwriters and brokers have resolved more difficult problems than that. Minimum and deposit premiums, profit sharing and the like can create the flexibility that allows airline executives some peace of mind about a potential major loss at an affordable premium. Even the most widespread natural disasters don't affect all the world's airlines so underwriters can spread their risks too.

Aviation insurers are strong and valuable partners to airlines in this critical but volatile industry. I would love to see that partnership develop creatively into new areas of mutual upside.

# Market Meters

## Introduction...

The new JLT market meters that can be seen on the following page, are designed to provide the insurance buyer with a more realistic guide to what is happening in the market.

Based on a *composite* rather than just the *leader's* rate change it reflects the effect of both the change in rate and the change in differentials between markets (i.e. the "vertical marketing" process). In the current climate with differentials typically narrowing this can have a significant impact on what the final result will be.

We have excluded any abnormal renewals from consideration (where rates have been recalibrated due to the influence of claims, major changes in exposure or other anomalies) to give a more realistic and accurate reading of the market trend.

## The Rate Meter...

This meter provides an indication of what core rate change a good quality, clean renewal with no growth can expect. Currently a 4% reduction in JLT's opinion. This may appear a low figure to some but remember the big rate changes have tended to come as a result of acquisition, grouping or extraordinary growth and this is the composite figure not solely the leader's.

## The Growth Meter...

This meter reflects the amount of growth that a buyer may get "gifted" by insurers on a good quality renewal. For example, an Airline with 20% growth may only pay for 60% of the growth amount in increased premium. Therefore the premium would be only 12% higher than the previous year. Combine this with the 4% rate reduction and the premium would increase by 7.50% (or an overall rate reduction of 10.40%).

## The Market Climate Meter...

This meter gives an indication of where we see the negotiating environment of the market. For some time "neutral" would have been our view, with capacity stable, losses average and underwriting results poor but not bad enough to bring about significant change. Now we are predicting a slight movement to a "hard" market as capacity becomes more selective (rather than withdrawing) and negotiations are tougher. Differentials in the vertical market are narrowing and in extreme cases some following markets may be higher than the lead.

## The Claims Meter...

Balanced against the market climate meter, as shown on the following page, losses are lower than average this year which has probably postponed the arrival of a harder market environment than otherwise might have been expected. Unfortunately, loss figures can change overnight.

**"Notwithstanding all the above, remember no two renewals are exactly alike".**

# Market Meters

## THE COMPOSITE MOVEMENT IN AVIATION RATES

### The Rate Meter



This meter shows the typical combined composite hull and liability rate change at renewal for a good quality airline with no losses and no growth. As indicated above the typical rate reduction is -4%.

### The Growth Meter



This meter shows the typical amount of growth not charged for at renewal. Are your exposures increasing? You may get just under half for free.

### The Market Climate Meter



This meter shows the current market climate position. As indicated above we are moving slightly towards a hard market as signified by greater selectivity and a narrowing of vertical market discounts.

### The Claims Meter



These meters indicate the year to date and 5 year average claims figures (including attritional estimates). As indicated above our figures show year to date claims are currently 59% below the 5 year average.

# Renewal Analysis

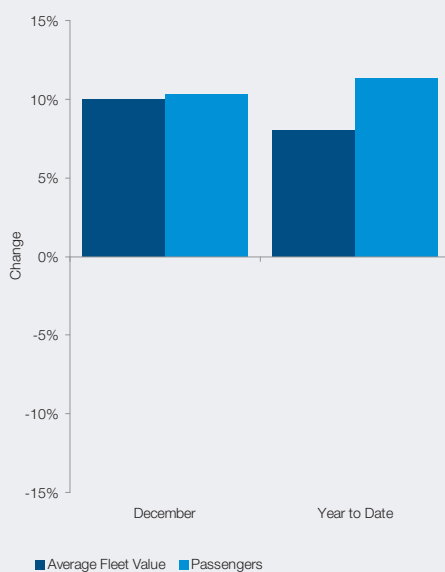
## EXPOSURES

December fleet value movements mirror what has happened throughout 2011 with airlines continuing to move onwards with new aircraft. This is reinforced by the rise in anticipated passengers numbers.

### Year on Year Exposure % change.

December / Year to date - based on the latest Information at 30 December 2011

Source: JLT Database



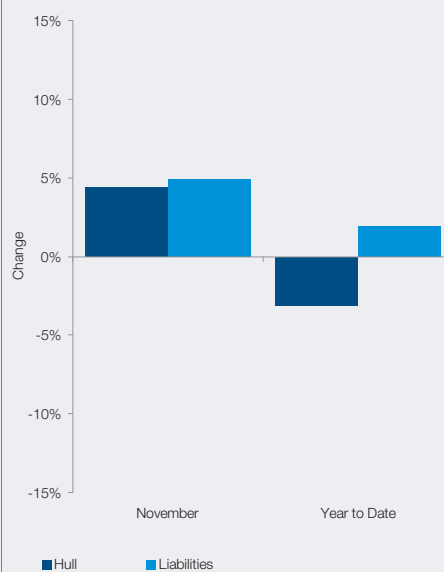
## PREMIUMS\*

The increase in overall premium is not huge but reflects the fact that the market has pitched prices to react to increases in exposures and, considering levels of capacity, remains entirely commercially competitive.

### Year on Year Premium % change.

December / Year to date - based on the latest Information at 30 December 2011

Source: JLT Database



Year to Date (Like for Like)	Hull USDm	Liability USDm	Total USDm
2010	652	1,109	1,761
2011	631	1,131	1,762
% Change	-3%	2%	0%

\* Net of brokerage and at lead terms

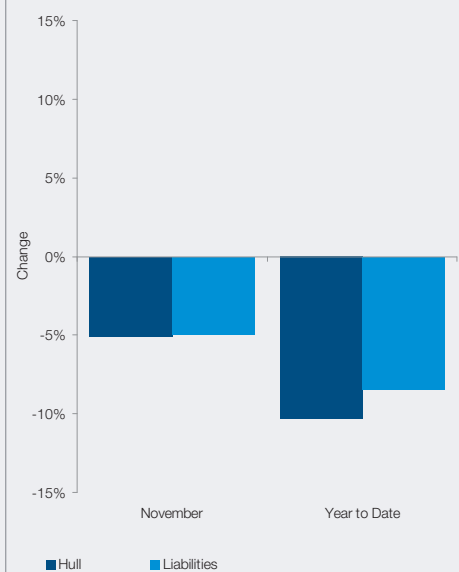
## RATES

Hull and Liability rating as discussed many times is fairly inconclusive and merely acts as a vehicle to achieve a certain level of premium. Therefore, December reductions can be interpreted as the usual underwriting adjustment in order to achieve the required balance between exposure movement and an equitable underwriting return.

### Year on Year Rate % change.

December / Year to date - based on the latest Information at 30 December 2011

Source: JLT Database





## COMMENT

December traditionally is the busiest month for airline renewals by far, and is expected to represent about 50% of annual hull and liability premiums. We have nearly sixty operators renewing including some of the biggest Airline groupings in the world.

The largest of these groupings is the Civil Aviation Authority of China (CAAC) which has shown double digit increases in fleet size and passenger numbers as has the Lufthansa Group which has taken on a number of additional airlines to bring its overall fleet value to nearly USD50 billion. The other major European consortium is Air France / KLM which includes the Alitalia group and Czech Airlines.

Another grouping that comes to market in December is new entrant, FIN Group, made up of 12 airlines, some of whom were previously under SFIT. The SFIT placement no longer exists leaving SAS / TAP being placed under one slip.

Some of the biggest operators in the United States also renew including United Continental Holdings, Delta, Southwest, US Airways, and Jetblue.

The Far East has provided a large number of major players and flag carriers, the biggest being Cathay Pacific, renewing with considerable fleet growth, followed by All Nippon, Japan Airlines, Korean, Thai, Malaysian, Asiana from South Korea, Garuda and Vietnam Airlines.

## FORTHCOMING AIRLINE RENEWALS

January is traditionally a very quiet month for the market, and this year is even quieter than last year with only three airlines renewing their insurance policies with fleets valued in excess of USD100 million. The largest is Conviasa from Venezuela which has an expiring fleet valued at USD150 million.

Airline	Renewal Date	Expiring AFV USDm
Great Lakes Airlines	1 Jan	102
Airlinair	7 Jan	142
Conviasa	16 Jan	150

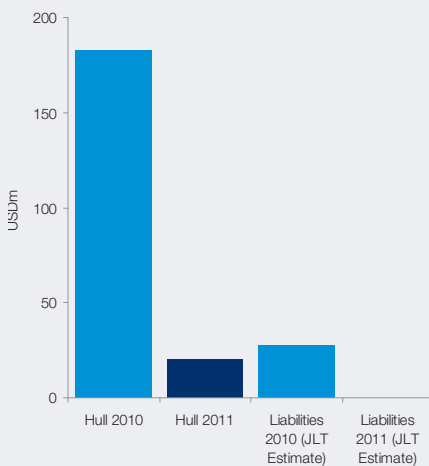
*Source: JLT Database, based on current risks with AFV in excess of USD100m*

# Loss Analysis

## NOVEMBER - AIRLINE LOSS SUMMARY

- Hull losses:  
USD 20.20m
- Liability loss estimate of:  
Nil
- Number of airline fatalities:  
1

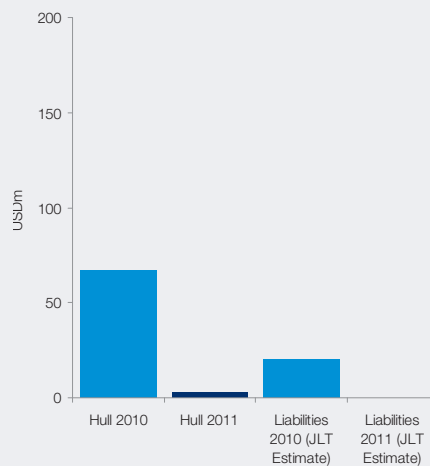
All Known Airline Losses Net of deductible



## DECEMBER - AIRLINE LOSS SUMMARY

- Hull losses:  
USD 2.75m
- Liability loss estimate of:  
Nil
- Number of airline fatalities:  
0

All Known Airline Losses Net of deductible



\* The JLT liability estimates are provided merely as a guide.



## DECEMBER LOSSES

- 17 December 2011- Bangkok Airways, ATR72-500 (HS-PGA), Thailand  
After removal of the chocks prior to departure from Samui, the aircraft began to roll forwards. The crew failed to stop the movement and the nose wheel fell into a ditch and the aircraft's nose struck a wall. No injuries were reported amongst the 38 passengers and 4 crew.
- 20 December 2011- Sriwijaya Air, Boeing 737-300 (PK-CKM), Indonesia  
Whilst operating a scheduled passenger flight from Jakarta the aircraft reportedly landed fast on a wet runway at Yogyakarta and overshot causing the starboard undercarriage to collapse. A small number of minor injuries were reported.
- 23 December 2011- Austrian Airlines, Airbus A321-211 (OE-LBF), UK  
Landing at Manchester on a scheduled passenger flight from Innsbruck in gusty wind conditions, the aircraft suffered a tail strike.
- 25 December 2011- AMC Aviation, Douglas MD-83 (SU-BOZ), Pakistan  
On approach to Quetta on a flight from Tabuk, Saudi Arabia, the nose undercarriage would not lower. The flight was diverted to Karachi where a landing was made with the nose undercarriage retracted. No injuries amongst the 72 passengers were reported.
- 28 December 2011- AK Kyrgyzstan Airlines, Tupolev Tu-134A-3 (EX-020), Kyrgyzstan  
Landing in low visibility conditions at Osh on a scheduled flight from Bishkek, the aircraft drifted to the side of the runway where the wing struck some obstacles. The wing became detached and the aircraft rolled inverted and caught fire. No fatalities were reported amongst the 73 passengers and 6 crew though there were a number of injuries.

# Market News

## EU COURT BACKS ETS

### **Air Transport Association of America and Others v Secretary of State for Energy and Climate Change.**

The directive including aviation activities in the EU's emissions trading scheme (ETS) is valid.

Application of the emissions trading scheme to aviation infringes neither the principles of customary international law at issue nor the Open Skies Agreement.

In 2003, the EU decided to set up a scheme for greenhouse gas emission allowance trading, as a central element of European policy to combat climate change. Initially, the EU emissions trading scheme did not cover greenhouse gas emissions from air transport. Directive 2008/101 provides that aviation activities will be included in that scheme from 1 January 2012. Accordingly, from that date all airlines – including those of third countries – will have to acquire and surrender emission allowances for their flights which depart from and arrive at European airports.

A number of American and Canadian airlines and airline associations contested the measures transposing Directive

2008/101 in the United Kingdom. They contend that, in adopting the directive, the EU infringed a number of principles of customary international law and various international agreements. According to them, the directive infringes, first, the Chicago Convention, the Kyoto Protocol and the Open Skies Agreement in particular because it imposes a form of tax on fuel consumption, and second, certain principles of customary international law in that it seeks to apply the allowance trading scheme beyond the European Union's territorial jurisdiction.

The High Court of Justice of England and Wales has asked the Court of Justice whether the directive is valid in the light of those rules of international law.

In its judgment delivered on 21 December 2011, the Court of Justice confirmed the validity of the directive that includes aviation activities in the emissions trading scheme.

First of all, the Court establishes that only certain provisions of the Open Skies Agreement and three principles of customary international law (namely the sovereignty of States over their airspace, the illegitimacy of claims to sovereignty over the high seas and freedom to fly over the high seas) may be relied upon for the purposes of examination of the directive's validity. Of the principles and provisions mentioned by the High Court, they alone fulfil the criteria laid down by the Court of Justice's case-law.

In particular, the Court establishes that the EU is not bound by the Chicago Convention because it is not a party to that convention and also has not hitherto assumed all the powers falling within the field of the convention. As regards the Kyoto Protocol, the Court observes that the parties to the protocol may comply with their obligations in the manner and at the speed upon which they agree and that, in particular, the obligation to pursue limitation or reduction of emissions of certain greenhouse gases from aviation fuels, working through the International Civil Aviation Organisation (ICAO), is not unconditional and sufficiently precise to be capable of being relied upon.

Whilst the Court agrees to examine, within the limits of review as to a manifest error of assessment, the validity of the directive in the light of three of the principles of customary international law relied upon, it finds however, in the case of the fourth principle, that there is insufficient evidence to establish that the principle that a vessel on the high seas is governed only by the law of its flag could apply by analogy to aircraft.

Next, the Court examines whether the directive is compatible with the principles of customary international law and the Open Skies Agreement.

It observes that the directive is not intended to apply as such to aircraft flying over the high seas or over the territory of the Member States of the EU or of third



States. It is only if the operators of such aircraft choose to operate a commercial air route arriving at or departing from an airport situated in the EU that they are subject to the emissions trading scheme.

In this context, application of the emissions trading scheme to aircraft operators infringes neither the principle of territoriality nor the sovereignty of third States, since the scheme is applicable to the operators only when their aircraft are physically in the territory of one of the Member States of the EU and are thus subject to the unlimited jurisdiction of the EU. Nor can such application of EU law affect the principle of freedom to fly over the high seas since an aircraft flying over the high seas is not subject, in so far as it does so, to the emissions trading scheme.

As for the fact that the operator of an aircraft is required to surrender emission allowances calculated on the basis of the whole of the flight, the Court points out that EU policy on the environment aims at a high level of protection. Thus, the EU legislature may in principle choose to permit a commercial activity, in this instance air transport, to be carried out in its territory only on condition that operators comply with the criteria that have been established by the EU. Furthermore, the fact that certain matters contributing to the pollution of the air, sea or land territory of the Member States originate in an event which occurs partly outside that territory is not such as to call into question, in the light of the principles of customary international

law capable of being relied upon, the full applicability of EU law in that territory.

Finally, the Court responds to the assertion that the emissions trading scheme constitutes a tax, fee or charge on fuel in breach of the Open Skies Agreement. It holds that the directive does not infringe the obligation to exempt fuel from taxes, duties, fees and charges. In contrast to the defining feature of obligatory levies on the consumption of fuel, in the case of the scheme in question there is no direct and inseparable link between the quantity of fuel held or consumed by an aircraft and the pecuniary burden on the aircraft's operator in the context of the emissions trading scheme's operation. The actual cost for the operator depends, in as much as a market-based measure is involved, not directly on the number of allowances that must be surrendered, but on the number of allowances initially allocated to the operator and their market price when the purchase of additional allowances proves necessary in order to cover emissions. Nor can it even be ruled out that an aircraft operator, despite having held or consumed fuel, will bear no pecuniary burden resulting from its participation in the emissions trading scheme, or will even make a profit by assigning its surplus allowances for consideration.

The Court concluded by stating that "the uniform application of the scheme to all flights which depart from or arrive at a European airport is consistent with the

provisions of the Open Skies Agreement designed to prohibit discriminatory treatment between American and European operators".

Further information on this judgement can be found via the link below:

The Court of Justice of the European Union (CURIA) website: <http://curia.europa.eu/>

# Market News

## NEWS IN BRIEF

### IATA revises 2012 outlook

Airlines appear headed for another bumpy ride in 2012, according to the International Air Transport Association (IATA), which this month slashed its central forecast for airline profits from USD4.9 billion to USD3.5 billion. At an estimated USD3.5 billion, airline profits next year would account for a net margin of just 0.6 percent—compared with an anticipated 2011 net margin of 1.2 percent on total profits of USD6.9 billion.

IATA's pessimism stems mainly from the financial crisis in Europe. Under a worst-case scenario, should the situation deteriorate, into a large-scale collapse of the banking system, and a descent back into recession, IATA say that the global air transport industry could incur an USD8 billion loss next year.

With Europe's airlines already tagged as 2012's big losers, IATA sees operators in the Asia-Pacific region accounting for 60 percent of global airline profits, at USD2.1 billion. As world airlines face what IATA estimates will amount to a 4.5-percent rise in costs next year, revenues will increase by only 3.7 percent.

### Groupama to leave LRA

It was announced that Groupama Transport has decided to withdraw from the La Reunion Aérienne (LRA) underwriting pool, with effect from 1 January 2012.

### ATA changes name

The Air Transport Association of America (ATA), has changed its name to Airlines for America (A4A) to emphasize the industry's role in connecting the US to the global economy. The association also rolled out a redesigned website this month, and a new logo of five connected aircraft with the tagline, "We Connect the World."

### XL Group to Establish Brazil Insurance Operation

XL Group announced that it has received final approval from the Brazilian insurance and reinsurance regulator, Superintendencia de Seguros Privados (SUSEP), to establish an insurance operation in the country.

XL Seguros Brasil S.A. in Sao Paulo will offer a range of Casualty, Property, Professional and Specialty insurance products. The insurance offerings will expand XL's capabilities in Brazil and complement its existing reinsurance operations. Expected to start operations in the first quarter of 2012, the insurance office will be led by Juan Bragadin, country manager.

## ARRIVALS AND DEPARTURES

- Amlin have announced that with effect from the 1 January 2012, James Greenhalgh will be transferring from Amlin Aviation to Amlin Reinsurance. There he will focus on the continued growth of the Aviation Reinsurance inwards business for Amlin London.

The Space portfolio will transition with James at the same date.

Amlin also announced that with effect from 1 January 2012, Lawrie Capp will join the Aviation Underwriting team from the Aviation Claims team as an Underwriter working across all product lines.

- Torsten Gerhards will join Swiss Re's Aviation team in Munich on 1 April 2012 reporting to Stefan Lenhardt. Torsten joins Swiss Re from Munich Re where he had positions as aviation underwriter and more recently property underwriter.

In addition Oliver Dlugosch has been appointed Head Global Markets at Swiss Re effective 1 January 2012. Oliver will be responsible for large aviation, space, large lawyers and accountants business.

## SIGNIFICANT RATING ACTIONS

### AM BEST

#### **Allianz**

Ratings agency AM Best placed under review with negative implications the financial strength rating of "A+" of Allianz Societas Europaea (Allianz SE) (Germany) and its main subsidiaries.

#### **Assicurazioni Generali**

Ratings agency AM Best downgraded the financial strength rating to "A" from "A+" of Assicurazioni Generali S.p.A. (Generali) (Italy) and its main subsidiaries. The ratings were placed under review with negative implications.

#### **CCR**

Ratings agency AM Best placed under review with negative implications the financial strength rating of "A++" of CCR (Caisse Centrale de Réassurance).

#### **MAPFRE Group**

Ratings agency AM Best downgraded the financial strength rating to "A" from "A+" of MAPFRE S.A. (Spain), and its subsidiaries. The ratings have been placed under review with negative implications.

#### **Swiss Re**

Ratings agency AM Best has upgraded the financial strength rating to "A+" (Superior) from "A" (Excellent) and issuer credit ratings to "aa-" from "a+" of Swiss Reinsurance Company Ltd (Swiss Re) and its subsidiaries. The outlook for all ratings has been revised to stable from positive.

### STANDARD & POORS

#### **Groupama**

Standard & Poor's Ratings Services further downgraded its financial strength ratings on Groupama S.A. and its guaranteed subsidiaries to "BBB-" from "BBB". The ratings remain on CreditWatch with negative implications.

#### **Eurozone Sovereigns**

Ratings agency Standard & Poor's placed its long-term sovereign ratings on 15 members of the European Economic and Monetary Union (EMU or eurozone) on CreditWatch with negative implications. The members are: Austria, Belgium, Finland, France, Germany, Luxembourg, Netherlands, Estonia, Ireland, Italy, Malta, Portugal, Slovak Republic, Slovenia and Spain.

### FITCH RATINGS

#### **MAPFRE Group**

Ratings agency Fitch has placed its "A+" Insurer Financial Strength rating of MAPFRE and its core operating subsidiaries on rating Watch Negative.

### MOODY'S

#### **Flagstone Re**

Ratings agency Moody's has affirmed its "A3" insurance financial strength rating of Flagstone Re and removed the rating from review for a possible downgrade.

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