

ITEM FOR FINANCE COMMITTEE

APPROVAL FOR PUBLIC OFFICERS TO GIVE GUARANTEES UNDER THE PUBLIC FINANCE ORDINANCE (CAP. 2) AND THE AIRPORT AUTHORITY ORDINANCE (CAP. 483)

Members are invited to give approval for the Government to provide guarantees to indemnify Hong Kong based airlines, the Airport Authority and, through the Airport Authority, its related service providers, for third party liabilities arising from war, hijacking and other perils for a period of six months commencing GMT 0000 on 25 September 2001 subject to certain principles being followed.

PROBLEM

Aviation insurers worldwide have given notice to airlines, airport operators and related service providers that third party liability coverage in the case of war, hijacking and other perils will be reduced drastically or totally withdrawn with effect from GMT23.59 on 24 September 2001 (7.59 am on 25 September, HK time). We need to put in place an indemnity arrangement by Government to prevent Hong Kong based airlines, the Airport Authority (AA) and its related service providers from ceasing operation.

PROPOSAL

2. In order to avoid any major disruption to the Hong Kong International Airport (HKIA) and the local aviation industry, we propose that the Finance Committee gives approval for -

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- (a) the Secretary for Economic Services (SES) to give a guarantee to indemnify Hong Kong based airlines for third party liabilities covering the scope excluded by insurers commencing GMT 0000 on 25 September 2001 (list at Annex A), for six calendar months under section 28 of the Public Finance Ordinance; and
- (b) the Financial Secretary to give a guarantee to indemnify the AA and, through the AA, its related service providers, for third party liabilities covering the scope excluded by insurers commencing GMT 0000 on 25 September 2001 (**Annex A**) for a period of six calendar months, under section 29 of the Airport Authority Ordinance.

Each of the two guarantees proposed above should embody the following principles -

- (a) It is not intended to provide an insurance cover or subsidy to the parties concerned. This is meant to be a temporary measure whereby Government fills a short-term gap in recognition of the unique circumstances;
- (b) The maximum level of indemnity from Government should be the difference between the prevailing level of coverage being withdrawn and any new coverage made available;
- (c) In the legal instruments to be entered into with the parties concerned, it will provide terms for review, termination and amendments as and when necessary subject to mutual agreement; and
- (d) A charge would be imposed by reference to the rate available in the evolving market to provide sufficient incentive to the recipients of the guarantee to continue to seek commercial insurance coverage.

3. Both guarantees will take the form of indemnity agreements to be signed between the SES (in the case of the agreement with the airlines) or the Secretary for the Treasury (in the case of the agreement with the AA)¹ and the relevant parties. Indemnity for related service providers at the HKIA will be provided by the AA under Government's guarantee to the AA.

/JUSTIFICATION

¹ According to section 3 of the Interpretation and General Clauses Ordinance, Cap.1, the Financial Secretary means also the Secretary for the Treasury.

JUSTIFICATION

4. There are legislative requirements in many places for airlines to take out insurance coverage. In the case of Hong Kong, the combined single limit for the biggest type of aircraft is US\$1 billion (HK\$7.8 billion)^{Note}. Some airports also have similar insurance requirements. The reduction or withdrawal of insurance coverage by insurers will leave operators in the aviation industry exposed to huge third party liabilities. A comparison of the existing and proposed coverage for Hong Kong based airlines, the AA and the 17 related service providers operating at the HKIA is at **Annex B**.

5. Hong Kong-based airlines have the following problems -

- Contractual requirement – most of the aircraft owned by airlines are leased from financing companies which require insurance coverage for the aircraft leased. The level required for incidents in Annex A is much more than the revised offer of US\$50 million (HK\$390 million) by insurers; and
- Risk management – setting aside the legal, operational and contractual requirements, Hong Kong airlines have indicated that they will not be prepared to take on such huge risk exposure and operate without adequate third party insurance coverage.

6. The withdrawal of the insurance coverage would also leave the AA and its related service providers exposed to huge third party liabilities. The AA have indicated that they are not prepared to operate without an alternative form of risk coverage. Neither are they prepared to allow their related service providers to operate at the HKIA without some coverage.

7. We believe that the issue of aviation insurance should be resolved eventually between insurers and the aviation industry. Indeed we understand some Hong Kong based airlines are engaged in intensive discussion with insurers to seek adequate coverage and may eventually not require a Government guarantee. But a new arrangement may not be available in time before the expiry of the current arrangement. There is a need for Government to fill the temporary gap to prevent disruption to Hong Kong's international air services. Under the principles in paragraphs 3, the guarantee is meant to be a temporary arrangement under special circumstances and the recipients will have to make best endeavours to seek commercial insurance coverage.

/FINANCIAL

^{Note} Under the Civil Aviation Ordinance (Cap. 448), all airlines operating to or from Hong Kong have to hold a policy of insurance which covers liabilities in respect of third party, passengers, baggage, cargo and mail. The Combined Single Limit for such coverage should be not less than US\$1 billion for large aircraft.

FINANCIAL IMPLICATIONS

8. On the basis of the existing offer by insurers as indicated in Annex B, the guarantee will commit the Government to provide a maximum indemnity of US\$1.95 billion (HK\$15.21 billion) per occurrence to Hong Kong based airlines, US\$1.25 billion (HK\$9.75 billion) per occurrence to the AA and, through the AA, US\$1 billion (HK\$7.8 billion) per occurrence to related service providers operating at the HKIA when required. The staffing resources required for implementing the recommendations will be absorbed by relevant bureaux and departments.

BACKGROUND INFORMATION

9. It is a worldwide practice for airlines, airports and related service providers to take out insurance coverage for third party liabilities arising amongst others, from war, hijacking and other perils (list at **Annex A**). Insurers gave these operators in the aviation industry advance notice to totally exclude these areas from the insurance coverage or reduce the coverage level. The existing coverage will expire at GMT23.59 on 24 September 2001.

10. Airlines are now discussing with insurers to find a new insurance arrangement but this may not be concluded in time before the expiry of the current arrangement. To fill the temporary gap left in the commercial insurance market, governments in a number of countries (including the US, UK, Germany and Australia) announced measures with the effect of indemnifying airlines, airports and related service providers for third party liabilities not covered commencing GMT 0000 on 25 September 2001. The International Civil Aviation Organisation have also appealed to governments “to take such measures, as necessary, to ensure that aviation and air transport services are not disrupted and to support the airline operators and, as required, the other parties, by providing a commitment to cover the risks left open by the recent developments, until such time as the insurance markets stabilise.”

Economic Services Bureau
Finance Bureau
September 2001

Insurance Coverage Reduced or Withdrawn

Liabilities arising from bodily injury and property damage to third parties (excluding passengers) caused by the following -

- (i) War, invasion, acts of foreign enemies, hostilities (whether war be declared or not), civil war, rebellion, revolution, insurrection, martial law, military or usurped power or attempts at usurpation of power.
- (ii) Strikes, riots, civil commotions or labour disturbances. (Note 1)
- (iii) Any act of one or more persons, whether or not agents of a sovereign power, for political or terrorist purposes and whether the loss or damage resulting therefrom is accidental or intentional.
- (iv) Any malicious act or act of sabotage.
- (v) Confiscation, nationalisation, seizure, restraint, detention, appropriation, requisition for title or use by or under the order of any Government (whether civil military or de facto) or public or local authority.
- (vi) Hijacking or any unlawful seizure or wrongful exercise of control of the aircraft or crew in flight (including any attempt at such seizure or control) made by any person or persons on board the aircraft acting without the consent of the insured.

Explanatory Note:

- For airlines, the maximum limit of coverage arising from the above events will be reduced to US\$50 million for any one occurrence and in the annual aggregate.
- For the AA and the franchisees operating at the HKIA, liabilities arising from the above events will not be covered.

Note 1

From what we understand from airlines' insurance policy, this clause excludes liabilities to bodily injury and property damage in respect of airline passengers.

Annex B

Insurance Coverage for Airlines and the Hong Kong International Airport (HKIA)

Party	Old Insurance policy coverage	Revised Insurance Policy Coverage
HK Airlines	US\$2,000M (This coverage applies to aviation hull and liabilities to all parties i.e. third party, passengers, cargo, baggage and mail <i>per occurrence</i> .)	US\$50M (A new sub-limit of US\$50M <i>per year</i> for liabilities arising from war, hijacking and other perils to <i>third parties (other than passengers)</i> is imposed. Other elements of the policy remain unchanged.
Airport Authority (including AVSECO)	US\$1,250M (This coverage applies to all liabilities to <i>all parties per occurrence</i> .)	Nil ^{Note 1} (No insurance coverage for third party liabilities arising from war, hijacking and other perils. Other elements of the policy remain unchanged.)
AFSC Refuelling and AFSC Operations (fuel storage)	US\$1,000M	Same as AA
Worldwide Flight Services Fuelling	US\$500M	Same as AA
Jardine Air Terminal Services (JATS) (ramp handling)	US\$750M	Same as AA
HK Airport Services Limited (HAS) (ramp handling)	US\$1,200M	Same as AA
Menzies (ramp handling)	US\$800M	Same as AA
Asia Airfreight Terminal Ltd. (AAT)	US\$1,000M	Same as AA
HK Air Cargo Terminal Ltd. (HACTL)	US\$1,000M	Same as AA
HK Business Aviation Centre (HKBAC) (business and private planes)	US\$500M	Same as AA
Cathay Pacific Catering Services (CPCS)	US\$2,000M ^{Note 2}	Same as AA

Note 1 Nil insurance coverage for third parties liabilities arising from damages caused by war, terrorism, hijacking, malicious damage, acts of sabotage, strikes, riot, civil commotions etc.

Note 2 Cathay's insurance policy also covers CPCS

Party	Old Insurance policy coverage	Revised Insurance Policy Coverage
Lufthansa Services HK Ltd. (LSG) (catering services)	US\$1,000M (not confirmed)	Same as AA
Gate Gourmet HK Ltd. (catering services)	US\$1,000M (not confirmed)	Same as AA
HK Aircraft Engineering Co Ltd. (HAECO) (line maintenance)	US\$1,000M	Same as AA
China Aircraft Services Ltd. (CASL) (line maintenance)	US\$500M	Same as AA
Pan-Asia Pacific Aviation Services Ltd. (PAPAS) (line maintenance)	US\$500M	Same as AA
HK International Airport Services (HIAS) (ground handling)	US\$750M	Same as AA
Secure Air (security company for the automated baggage reconciliation system)	US\$500M	Same as AA
Mobil Oil HK Limited	Not available	Same as AA