

Title:

Reforming the Air Travel Organisers' Licensing (ATOL) Scheme

Lead department or agency:

Department for Transport

Other departments or agencies:

Civil Aviation Authority

Impact Assessment (IA)

IA No: DfT00092

Date: 20/05/2011

Stage: Consultation

Source of intervention: Domestic

Type of measure: Secondary legislation

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Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

The ATOL scheme, which protects consumers when their package holiday tour operator becomes insolvent, needs updating to reflect how holidays are sold in the internet age. Developments in the travel industry have made it increasingly difficult for consumers to know whether or not their holiday is a 'package' as legally defined and so protected under the ATOL scheme. Intervention is needed to restore clarity for consumers and the travel trade. Also, for historic reasons the scheme's finances are in deficit of £35m. Intervention is needed to put the scheme back on a sustainable basis, allowing the Government guarantee underpinning ATOL to be withdrawn and so that holidaymakers and travel firms fund the scheme rather than taxpayers.

What are the policy objectives and the intended effects?

The overarching objectives are i) to provide greater clarity to consumers about if their holiday is ATOL protected, and ii) to ensure that the scheme's finances are returned to sustainability. The intended effects are that i) consumers, the travel industry and the Civil Aviation Authority (the ATOL regulator) have more clarity and legal certainty about whether a holiday is ATOL protected ii) the Government's guarantee is safeguarded and can be withdrawn so that holidaymakers and travel trade meet the full cost of ATOL and iii) in the medium term once the Fund's finances are stable, to reduce the £2.50 per booking ATOL Protection Contribution (APC) .

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Three options are considered, based on measures consulted on by the previous Government in 2009/10: 1) creating a new 'flight plus' category in the ATOL scheme to make clear that 'mix and match' as well as traditional package holidays are protected and standardised information for passengers when they book an ATOL protected holiday or flight :.2) as for 1), but also with all flight only sales excluded from ATOL and 3) standardised information for passengers only

Option 1 best achieves the policy objectives. The range of net benefits is between -£2.7m and £40.9m. There are also important non-monetised benefits, as well as some non-monetised costs. The other options do not meet the objectives or deliver superior net benefits as discussed in the evidence base.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 1/2017

What is the basis for this review? Duty to review. **If applicable, set sunset clause date:** Month/Year

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review? Yes

SELECT SIGNATORY Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: Date:

Summary: Analysis and Evidence

Policy Option 1

Description:

Including 'flight plus' in ATOL and better information through an ATOL certificate

Price Base Year	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -2.7	High: 40.9	Best Estimate: 19.1

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	NA	16.6	144.2
High	NA	22.1	195.4
Best Estimate	12.0	19.4	169.8

Description and scale of key monetised costs by 'main affected groups'

Businesses selling 'flight plus' holidays brought into ATOL face transitional costs from obtaining licences and providing bonds to CAA for 4 years. All businesses selling 'flight plus' holidays face would pay the ATOL Protection Contribution (APC), initially £2.50 per booking. There would be additional costs to the ATTF from providing refunds and repatriation to holidaymakers brought into ATOL.

Other key non-monetised costs by 'main affected groups'

All businesses selling ATOL protected holidays and flights would face a transitional cost from developing systems to provide improved information to consumers, in place of existing information requirements. There may also be recurring costs from producing and distributing it, net of savings from removing existing requirements. Further information is being sought through consultation with stakeholders about these costs with the objective of minimising them.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	NA	16.5	141.6
High	NA	28.5	236.2
Best Estimate	0	22.5	188.9

Description and scale of key monetised benefits by 'main affected groups'

Consumers on 'flight plus' holidays would benefit from full ATOL protection. The ATTF would benefit from additional APC receipts.

Other key non-monetised benefits by 'main affected groups'

The Government will benefit from the stronger position of ATOL finances, safeguarding its guarantee, which supports the Fund's borrowing, currently of £42m. The CAA will benefit from reduced exposure to the Fund's debts that are not supported by the guarantee. All ATOL customers will benefit from greater clarity about whether their holiday is ATOL protected or not. Accordingly, the FCO's Consular Service should benefit from reduced demands for assistance from holidaymakers.

Key assumptions/sensitivities/risks

Discount rate (%) 3.5

The number of passengers on flights and holidays that are fully protected by ATOL rises by 6 million p.a. This is due to reversing the trend of holidays being removed from the ATOL scheme and also fully covering holidays where at present only the flight is ATOL protected.

It is assumed that the APC falls from £2.50 to £2.00 or £1.50 per booking after 4 years of the assessment period, reflecting the improved state of ATOL finances.

Benefits to passengers from full ATOL protection are valued at £4.30 (high estimate) and £2.15 (low estimate) per booking, on a Willingness to Pay basis.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs: -14.2 to -15.8	Benefits: 8.6 to 4.3	Net: -5.5 to -11.5	Yes	IN

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	United Kingdom				
From what date will the policy be implemented?	01/01/2012				
Which organisation(s) will enforce the policy?	CAA				
What is the annual change in enforcement cost (£m)?	Low				
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	No				
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)	Traded: N/A		Non-traded: N/A		
Does the proposal have an impact on competition?	Yes/No				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	Costs: N/A		Benefits: N/A		
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)		< 20	Small	Medium	Large
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
Statutory equality duties¹ Statutory Equality Duties Impact Test guidance	No	Annex 2A
Economic impacts		
Competition Competition Assessment Impact Test guidance	No	Annex 2B
Small firms Small Firms Impact Test guidance	Yes	Annex 2C
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

¹ Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Summary: Analysis and Evidence

Policy Option 2

Description:

Including 'flight plus' in ATOL and better information through an ATOL certificate, excluding flight only sales

Price Base Year 2010	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -1.22	High: 24.5	Best Estimate: 11.6

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	NA	4	NA	NA
High	NA		NA	NA
Best Estimate	12.0		22.1	192.4

Description and scale of key monetised costs by 'main affected groups'

As for option 1, although business selling 'flight only' under ATOL would now be exempt and no longer pay the APC.

Other key non-monetised costs by 'main affected groups'

As for option 1. There would be little improvement to ATOL finances, with the Government's guarantee and CAA remaining at risk to the ATTF's liabilities.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/A		23.2	191.6
High	N/A		26.6	216.9
Best Estimate	0		24.9	204.3

Description and scale of key monetised benefits by 'main affected groups'

As for option 1, although consumers benefits are lower due to 'flight only' sales being removed from ATOL. Business whose sole ATOL activity was selling 'flight only' sales would be exempt from ATOL and so would not face licence renewal costs.

Other key non-monetised benefits by 'main affected groups'

All ATOL passengers will benefit more clearly from knowing whether their flight or holiday is ATOL protected or not. Accordingly, the FCO's Consular Service should benefit from reduced demands for assistance from holidaymakers.

Key assumptions/sensitivities/risks

Discount rate (%) 3.5

The number of passengers on holidays that are fully protected by ATOL rises by 6 million p.a. This is due to reversing the trend of holidays being removed from the ATOL scheme and also fully covering holidays where at present only the flight is ATOL protected. 4 million 'Flight only' sales are removed from ATOL.

It is assumed that the APC remains at £2.50 throughout, as ATOL finances do not improve as quickly as in option 1 allowing scope for the APC to be reduced.

Benefits to passengers from full ATOL protection are valued at £4.30 (high estimate) and £2.15 (low estimate) per booking, on a Willingness to pay basis.

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: -19.0	Benefits: 9.7	Net: -9.4	Yes	IN

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	United Kingdom				
From what date will the policy be implemented?	01/01/2012				
Which organisation(s) will enforce the policy?	CAA				
What is the annual change in enforcement cost (£m)?	Low				
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	No				
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)	Traded: NA		Non-traded: NA		
Does the proposal have an impact on competition?	No				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	Costs: NA		Benefits: NA		
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)		< 20	Small	Medium	Large
Are any of these organisations exempt?	No	No	No	No	No

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Economic impacts		
Competition Competition Assessment Impact Test guidance	No	Annex 2B
Small firms Small Firms Impact Test guidance	No	Annex 2C
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

¹ Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Summary: Analysis and Evidence

Policy Option 3

Description:

ATOL certificate only

Price Base Year 2010	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: NA	High: NA	Best Estimate: NA

COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	NA	NA	NA	NA
High	NA		NA	NA
Best Estimate	NA		NA	NA

Description and scale of key monetised costs by 'main affected groups'

NA

Other key non-monetised costs by 'main affected groups'

Businesses would face transitional costs in developing the format of the ATOL certificate and making any changes to IT and other systems in order to produce and distribute it. There would be recurring costs to businesses from providing the ATOL certificate with each ATOL protected holiday. Further information to quantify these costs will be sought as part of consultation. There would be little improvement to ATOL finances, with the Government guarantee and CAA remaining at risk to the ATTF's liabilities.

BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	NA	NA	NA	NA
High	NA		NA	NA
Best Estimate	NA		NA	NA

Description and scale of key monetised benefits by 'main affected groups'

NA

Other key non-monetised benefits by 'main affected groups'

Consumers of ATOL protected holidays, some 18 million p.a. would have recurring benefits from greater clarity that their holiday is ATOL protected. Consumers and CAA should benefit from prompter claims handling when an ATOL business fails. Business would have recurring benefits from not having to produce the current information required to be provided to consumers. Further information on these benefits will be sought as part of the planned consultation.

Key assumptions/sensitivities/risks

Discount rate (%)

3.5

There is no impact on the number of holidays that are ATOL protected as a result of this measure.

The APC remains at £2.50 throughout. There is a risk that this would need to be increased to £3 or more in order to ensure the Fund's financial sustainability and allow the Government guarantee to be withdrawn.

The current legal framework for determining which holidays are ATOL protected would remain, with some continuing uncertainty for consumers and the travel trade

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs:	Benefits:	Net: TBC	Yes	IN

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	United Kingdom				
From what date will the policy be implemented?	01/01/2012				
Which organisation(s) will enforce the policy?	CAA				
What is the annual change in enforcement cost (£m)?	Low				
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	No				
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)	Traded: NA		Non-traded: NA		
Does the proposal have an impact on competition?	No				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	Costs:		Benefits:		
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)		< 20	Small	Medium	Large
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

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Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

¹ Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

No. Legislation or publication

- 1 Regulating Air Transport: Consultation on Proposals to Update the Regulatory Framework for Aviation
<http://www.dft.gov.uk/consultations/closed/regulatingairtransport/>
- 2 Written Ministerial Statement on ATOL reform
<http://www.dft.gov.uk/press/speechesstatements/statements/villiers20110203>
- 3
- 4
- + Add another row

Evidence Base

Option 1 - annual profile of monetised costs and benefits* Low consumer benefit estimate £2 APC- (£m) constant prices

	Y ₀	Y ₁	Y ₂	Y ₃	Y ₄	Y ₅	Y ₆	Y ₇	Y ₈	Y ₉
Transition costs	-5	-3	-2	-1	0	0	0	0	0	0
Annual recurring cost	-19	-22	-25	-29	-21	-21	-21	-21	-21	-21
Total annual costs	-24	-26	-28	-30	-21	-21	-21	-21	-21	-21
Transition benefits	0	0	0	0	0	0	0	0	0	0
Annual recurring benefits	20	23	26	30	22	22	22	22	22	22
Total annual benefits	20	23	26	30	22	22	22	22	22	22

Option 1 - annual profile of monetised costs and benefits* High consumer benefit estimate £1.50 APC- (£m) constant prices

	Y ₀	Y ₁	Y ₂	Y ₃	Y ₄	Y ₅	Y ₆	Y ₇	Y ₈	Y ₉
Transition costs	-5	-3	-2	-1	0	0	0	0	0	0
Annual recurring cost	-19	-22	-25	-29	-10	-10	-10	-10	-10	-10
Total annual costs	-24	-26	-28	-30	-10	-10	-10	-10	-10	-10
Transition benefits	0	0	0	0	0	0	0	0	0	0
Annual recurring benefits	22	26	31	35	18	18	18	18	18	18
Total annual benefits	22	26	31	35	18	18	18	18	18	18

Option 2 - annual profile of monetised costs and benefits , low consumer benefits

	Y ₀	Y ₁	Y ₂	Y ₃	Y ₄	Y ₅	Y ₆	Y ₇	Y ₈	Y ₉
Transition costs	-5	-3	-2	-1	0	0	0	0	0	0
Annual recurring cost	-12	-16	-19	-22	-25	-25	-25	-25	-25	-25
Total annual costs	-17	-19	-21	-23	-25	-25	-25	-25	-25	-25
Transition benefits	0	0	0	0	0	0	0	0	0	0
Annual recurring benefits	-13	-17	-20	-23	-27	-27	-27	-27	-27	-27
Total annual benefits	-13	-17	-20	-23	-27	-27	-27	-27	-27	-27

Option 2 - annual profile of monetised costs and benefits , high consumer benefits

	Y ₀	Y ₁	Y ₂	Y ₃	Y ₄	Y ₅	Y ₆	Y ₇	Y ₈	Y ₉
Transition costs	-5	-3	-2	-1	0	0	0	0	0	0
Annual recurring cost	-12	-16	-19	-22	-25	-25	-25	-25	-25	-25
Total annual costs	-17	-19	-21	-23	-25	-25	-25	-25	-25	-25
Transition benefits	0	0	0	0	0	0	0	0	0	0
Annual recurring benefits	13	18	22	27	31	31	31	31	31	31
Total annual benefits	13	18	22	27	31	31	31	31	31	31

* For non-monetised benefits please see summary pages and main evidence base section

BACKGROUND

The ATOL scheme

1. Air Travel Organisers Licence (ATOL) is a statutory financial protection scheme managed by the Civil Aviation Authority (CAA). Its intention is to protect consumers buying package holidays including a flight and some 'flight only' sales by 3rd parties from the insolvency of their tour operator or travel agent.
2. The potential for consumer detriment in this market from the insolvency of a tour operator is significant. Payment for holidays and flights is often made many months in advance of travel and before suppliers have to be paid, while barriers to entry can be low with little capital required. This gives rise to a real risk of businesses becoming insolvent between the payment for services and their delivery. If a tour operator becomes insolvent while a holiday is in progress, consumers face the risk of being stranded abroad without accommodation or a flight home. This may be compounded where large numbers of other holiday makers are in the same position with limited airline capacity to repatriate them. In addition to the detriment to consumers, there would be large calls on the consular service of the Foreign and Commonwealth Office (FCO) from UK residents stuck abroad.
3. It was against this background that a statutory ATOL scheme was established in the early 1970s, following the failure of a large tour operator. In economic terms, the argument for a compulsory protection scheme could be seen in terms of an 'adverse selection' problem in the market for insurance to protect against insolvency of tour operators. If insurance was only sought by high risk businesses, insurance companies might raise premia to the extent that low risk businesses were driven from the market. Insolvency protection for package holidays became a requirement of EU law from 1992 through the Package Travel Directive (PTD).
4. Businesses selling air holiday packages and some third party sellers of flights in the UK are required by law to hold an ATOL licence. This is granted after the company has met CAA's licensing requirements, including financial fitness checks. New ATOL licence holders and some others are also required to provide a bond as a condition of their ATOL licence. Airlines are excluded by law from the ATOL scheme, possibly as they are subject to a separate licensing system, but are still required by the PTD to provide financial security for package holidays they sell. In practice a number of UK airlines have established subsidiary companies with an ATOL licence to sell package holidays.

Package Travel Directive

5. As noted above, the PTD requires insolvency protection to be provided by tour operators for all package holidays sold in the EU. It also requires a number of other protections for consumers, including:
 - information to be included in brochures (or on websites)
 - restrictions on price increases between booking a holiday and departure
 - making the tour operator responsible for the proper performance of all aspects of the holiday

The last bullet means that if a supplier such as an airline or hotel became insolvent or otherwise couldn't provide the services contracted for, the tour operator has to provide alternatives or in some cases provide a full refund.

6. The Package Travel Regulations 1992 (PTRs) implement the PTD in the UK. Under the PTRs, holding an ATOL licence is specified as the way in which the insolvency protection requirements of the PTD can be met for businesses organising package holidays including a flight. The ATOL scheme predates and is broader than the PTD as it also provides insolvency protection for some sales of 'flight only' tickets by 3rd parties such as travel agents. It applies when consumers do not get a valid ticket straight after paying for one, with the aim of protecting consumers from insecure 'bucket shop' operators with potentially lengthy periods between payment for and receipt of an air ticket, so exposing consumers to insolvency risk.

Funding arrangements

7. Since 2008, for each passenger booked on an ATOL-protected holiday or 'flight only' seat, an ATOL licensed company has to pay an ATOL Protection Contribution (APC), currently £2.50 per person, into the Air Travel Trust Fund (ATTF). In the event of insolvency, the ATTF reimburses passengers any money paid in advance, and pays for those already abroad to be repatriated at the end of their holiday as planned.
8. For historic reasons, the ATTF has operated at a deficit since the mid-1990s as - until the APC was introduced in 2008 - it had had no income for many years. It has only been able to meet its obligations from a commercially provided credit facility, supported by a Government guarantee. CAA have reported that the Fund's deficit stood at £35m in March 2011.
9. The APC was initially introduced at £1 per booking. This level was assessed to be sufficient to pay off the Fund's deficit in the medium term and to meet future refund and repatriation costs.
10. The failure of XL leisure group in September 2008, caused by the emerging global financial crisis, led to an unprecedentedly large call on the Fund, which could not have been foreseen in the analysis that established £1 as the value of the APC. It necessitated the APC being increased to £2.50 as of October 2009. Also as a consequence of the XL crisis, the Government guarantee was increased so the Fund could access sufficient commercial borrowing to continue to meet its obligations. The Guarantee was also changed to reflect the latest projections of the ATTF's deficit and when it was likely to return to surplus, based on assumptions about income and the cost of future failures. It was raised to £55m in August 2009, then reduced to £42m in August 2010. It is scheduled to fall to £30m in 2011 and £20m in 2012 before being withdrawn in 2013.

ATOL numbers

11. ATOL protection is currently provided to approximately 21 million passengers in the year ending March 2010. Some 2,500 businesses are ATOL licensed. They range from major publicly quoted companies licensed to sell millions of package holidays per year, such as Thomas Cook and TUI, to a large number of very small enterprises selling less than 500 ATOL holidays per year. Table 1 shows the numbers of consumers over the past 6 years who have benefited from ATOL protection.

Table 1 ATOL Protected Passenger Bookings

Year to end March	Total ATOL bookings	ATOL company failures	Passengers repatriated	Passengers refunded	Total Expenditure £000
2005	28.3m	14	11,634	21,960	10,294
2006	26.7m	25	1,754	21,858	8,792
2007	26.7m	27	4,706	54,116	14,251
2008	25.7m	12	1,650	20,771	5,321
2009	20.3m	46	47,482	236,691	84,215
2010	20.9m	29	2,445	45,114	18,866

Source: Civil Aviation Authority

PROBLEM UNDER CONSIDERATION

Lack of clarity for consumers

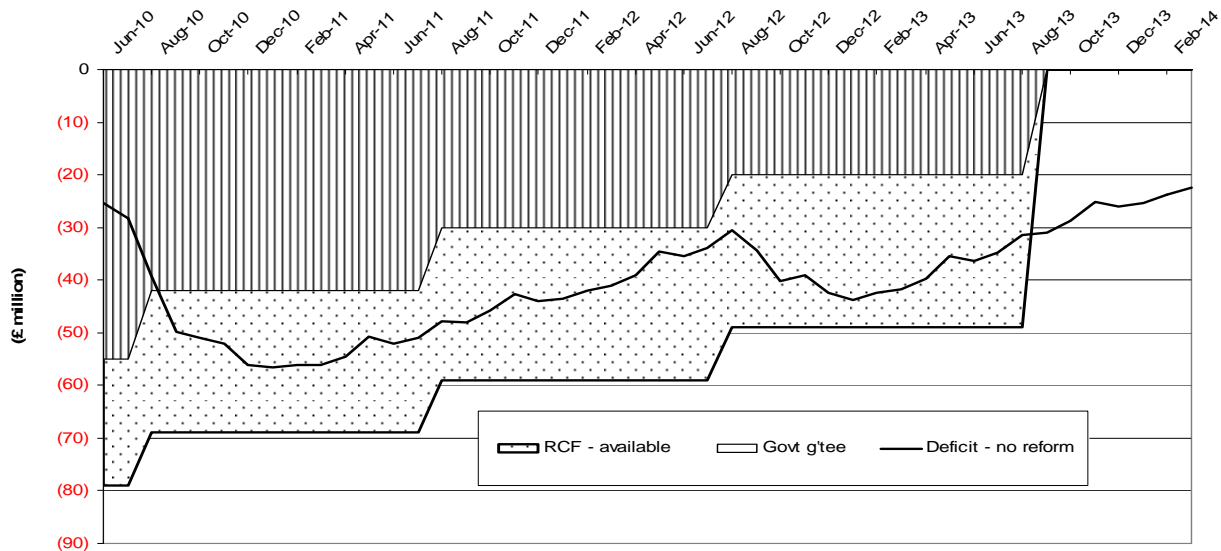
12. In recent years there have been major shifts in the way that holidays are sold. This partly arises from an increasing demand for independent travel, facilitated by low cost airlines. But the internet has also enabled travel companies to allow consumers to 'mix and match' or 'dynamically package' the components of a holiday in a way that can often mean it is outside the ATOL scheme. As a consequence, the share of ATOL protected holidays of leisure trips by air abroad has fallen significantly over the past 20 years.
13. If the original intention of ATOL was to protect consumers taking overseas holidays by air, it is clear that the current position is far from this. ATOL sales as a share of all leisure flights have fallen from over 90% in 1998 to just under 50% in 2009. The absolute number of annual ATOL sales has also fallen in recent years, although in 2009/10 was still around 20 million.
14. As noted above, the internet and other market developments have allowed tour operators and travel agents to tailor holidays to consumers' specific requirements through 'mixing and matching' holiday components, sometimes referred to as 'dynamic packaging'. Until recently, it was not clear if these were 'package holidays' as defined in legislation and so required to be covered by the ATOL scheme and the PTD, or were in fact sales of separate holiday components falling outside the requirements for statutory insolvency protection. Many of these holidays are sold without ATOL protection, while other very similar holidays are covered by the scheme, essentially depending on the decision of individual tour operators. However, consumers buying a non-ATOL protected holiday face similar risks from the insolvency of their tour operator or travel agent to those which the ATOL scheme protects against.
15. As a result, understanding whether or not a package holiday or flight-only ticket is covered by the ATOL scheme can be very confusing for consumers, both when they are booking a trip and in the (unlikely) event of being caught up in a travel company failure. There can be delays in identifying holidaymakers that are eligible for a refund. This confusion can extend to the travel trade itself.
16. The CAA attempted to clarify the definition of a 'package holiday' through the Courts, arguing that 'mix and match' holidays should be considered as package holidays and so covered by the ATOL scheme. However, the Courts have ruled that holidays made up of components sold at the same time, but separately, may not be package holidays. As a consequence:
 - It is increasingly easy for businesses to sell 'mix and match' holidays without an ATOL licence and associated financial fitness check.

- Companies are beginning to leave the ATOL scheme, or (even more confusing for consumers) retain their ATOL licence/logo but arrange most of their sales in a way which does not constitute a package. This can also cause problems for the ATTF in determining its liabilities after a failure. It also reduces the number of holidays protected by ATOL.
 - Consumers of 'mix-and-match' holidays do not have guaranteed financial protection if their tour operator or airline fails, and travel agents do not bear the consequences of booking passengers on airlines facing financial difficulties.
17. The confusion caused by lack of clarity regarding ATOL protection was evident in a number of tour operator failures over the past 3 years, including XL Leisure Group in September 2008 and, more recently Goldtrail, Sun4U and Kiss flights in summer 2010.

ATOL finances

18. As noted above, the ATTF is in deficit and can only continue to operate through a Government guarantee that allows it access to a commercially provided credit facility. The expenditure on refunds and repatriation arising from the failures in summer 2010 will also cost the ATTF an estimated £40m to £45m that had not been anticipated. The potential reduction in APC income from companies changing their business model to sell holidays outside ATOL is likely to put further pressure on the ATTF's finances in the medium term, increasing the risk to the Government's guarantee.
19. Chart 2 below shows the CAA's financial projection for the ATTF's deficit until spring 2014 in the absence of reforms and taking into account the costs arising from failures in the summer. The Fund remains in deficit throughout. New commercial borrowing facilities would be required from August 2013, and there would also no doubt be pressure to extend the Government guarantee. In the worst case scenario, if ATTF income is well below the projected increase or costs are significantly higher than expected, the Fund may breach its banking covenants potentially of triggering a claim under the Guarantee. The ATTF's borrowing that is not explicitly supported by the Government guarantee might also be at risk in these circumstances. If banks demanded repayment of this, it would fall to the trustees of the ATTF who are supported by the CAA. Ultimately, under EU law the Government is responsible for ensuring that the insolvency protection obligations in the PTD are met.
20. The projection makes allowance for the long term average annual cost of ATOL failures and also for the failure of a medium to large ATOL business in 2012. This is included as a prudent modelling assumption, but does not indicate that CAA expect a failure of any specific business at this time.

Chart 2: ATTF projection, 2010 to 2014, base case



Source: CAA

POLICY OBJECTIVES AND RATIONALE FOR INTERVENTION

21. In light of the above, the Department believes that it needs to intervene to improve clarity for consumers about what holidays are protected under the statutory ATOL scheme. Doing so should restore the clarity about consumer protection that would have existed when a statutory ATOL scheme was initially established. Greater clarity is also needed to help the travel trade and the CAA as regulator. The Department also believes that intervention is necessary to address the ATTF's deficit, so that holidaymakers and travel companies meet the full cost of the ATOL scheme not taxpayers.
22. Accordingly we have set the following objectives for reform of the ATOL scheme:
 - To ensure that passengers are clearer about when they are covered by the ATOL scheme and when they are not.
 - To provide clarity for the travel trade and the CAA as regulator about when financial protection is required including which holidays and 'flight-only' bookings are entitled to protection.
 - To safeguard the Government's guarantee that supports the ATTF and allow for its withdrawal in the medium term as the ATTF is restored to financial sustainability. This follows from the Department's view that it should be for holidaymakers and travel trade to fund the ATOL scheme, with no ongoing role for taxpayers.
 - Linked to the above, in the medium term once the scheme is financially sustainable to lower the cost of ATOL protection to the travel trade by reducing the APC from its current level as well as considering alternative mechanisms for funding ATOL protection.
23. The intervention should allow consumers to take well informed decisions about what holiday to purchase in light of clear information about financial protection provided with it. Where consumers know that their holiday is not ATOL protected, they can then consider what, in any, alternative arrangements to make to provide similar protection. It should end the current confusion and uncertainty about the scope of ATOL protection, most evident when a travel company fails leaving consumers that thought they were ATOL protected out of pocket without a holiday or facing the potentially high cost of returning home from abroad.

24. The intervention should also restore the Fund to financial sustainability, allowing the Government guarantee to be withdrawn and also paving the way for further reforms about how the scheme operates and is financed.

Experience in other EU countries and the review of the Package Travel Directive

25. The PTD is currently under review by the European Commission. The motivation for the review comes from similar issues to those outlined above which have led to the proposals to reform ATOL. The way holidays are sold has changed significantly across the EU since the PTD became law in 1990, with ensuing lack of clarity, and other detriment, for consumers. This is set out in the Commission's 2009 report 'Study on consumer detriment in the area of dynamic packages'.
26. The Commission has already consulted stakeholders about possible options for reform. The Department understands that its current intention is to bring forward proposals for new legislation to address current problems with the PTD late in 2011.
27. This would then be subject to negotiation and agreement between the Council, Commission and European Parliament before a revised Directive was finalised. This process varies in length, but would be unlikely to be completed within a year. Typically, Member States have 2 years to transpose EU Directives into domestic legislation. It would therefore be 2014 at the very earliest before a revised PTD would be in place, and it is not possible to know what its provisions would contain. The Department believes that in light of the current lack of clarity for consumers and the financial position of the ATTF that it cannot wait for the possibility that a revised PTD may address these issues in 3 or 4 years time.
28. All EU countries are covered by the PTD. The way in which its insolvency protection requirements in it are implemented varies considerably between Member States. For example Ireland has a licence based system involving bonding. In Germany, tour operators are required to obtain insurance or a guarantee from a financial institution to meet refund and repatriation costs if they become insolvent, while in the Netherlands there is an industry organised fund to meet such costs. In the longer term, once the ATTF is financially sustainable, and in light of any proposals to amend the PTD, there is a good case for reviewing alternatives to the current arrangements based on the ATTF.

Non-Regulatory Options

29. The Department has considered alternative self regulatory or non-regulatory approaches that might be used to address the objectives identified above in terms of addressing the lack of clarity for consumers about what holidays are ATOL protected and putting the ATTF back on a sustainable financial basis.

Clearer information to consumers

30. The Department has sought to provide consumers with greater clarity about holiday protection through non-regulatory action by means of providing better information to consumers about their rights under ATOL and the PTD.
31. Following the failure of XL, the Department worked with CAA and the travel industry on a publicity campaign to increase public understanding of the options for protection against airline or tour operator insolvency. The resulting guidance was posted on the Directgov website in spring 2009. Drawing up the guidance showed the complexity of relationships in the travel trade and the multiplicity of products sold, making it very difficult for the guidance to provide definitive advice. The use and definition of terms such as 'dynamic packaging', 'mix and match' holiday, 'DIY package' or 'tailor made holiday' vary from company to company and may not correspond to the legal definition of a package on which the ATOL regulations and PTRs rely. The internet technology available to put together holidays from different components parts, while providing additional choice to consumers and valuable convenience, can further add to the confusion about whether a holiday is protected. As a consequence the Department

considers that the concept of “buyer beware” is no longer viable in relation to holiday protection, even with the provision of better information to consumers.

32. A different way of providing clearer information to consumers who have purchased ATOL protected holidays is to provide clear, standardised information to them, so there can be no doubt that they are protected. Businesses selling ATOL protected holidays and flights are already required to do this, although in a way that may not be fully effective. This approach is discussed further below.

Consumer insurance based approach

33. A more radical alternative would be to move away from a statutory scheme such as ATOL to one based on consumer insurance; either entirely voluntarily or with an obligation on those selling holidays to offer consumers insolvency protection insurance. There are some attractions to the concept in terms of creating a genuine consumer demand for insolvency protection. Potentially it could provide an effective way of protecting consumers' money prior to departure on holiday. However, one issue to address would be how it might cope with repatriation, particularly where large numbers of consumers were involved, for example if the failure occurred in high season. In the absence of a body, such as the CAA, to organise and facilitate repatriation, consumers would potentially be exposed to significant detriment while waiting to arrange their repatriation flights, particularly in locations that were not well served by scheduled airlines or at peak season where there might be insufficient capacity on alternative flights. Also consumers may not have sufficient funds available to pay for flights and accommodation if needed in advance of claiming under their insurance. This would be likely to put additional pressure on FCO Consular Services to assist stranded passengers.
34. This approach would require changes at a European level to amend the PTD. At present this requires that tour operators must provide protection against their insolvency, and so it would not be possible to introduce in the short term. It would also do nothing in itself to address the ATTF's finances. The Fund would need to be returned to financial sustainability by other means before it could be considered.

Credit card protection

35. Consumers can also get some insolvency protection when they pay for their holiday by credit card, under the terms of the Consumer Credit Act 1974, as amended. This makes the credit card provider jointly liable with the business for the goods and services purchased with the card. In the context of the package holiday market, if a tour operator became insolvent, consumers who had paid by credit card would be entitled to reimbursement of the amount paid, if this was over £100. Some debit card providers also offer similar arrangements, although for commercial reasons rather than as a legal requirement. (At present CAA has in place agreements with major credit card providers about how claims arising from the insolvency of an ATOL licensed business are shared with the ATTF).
36. Relying solely on credit cards for insolvency protection for package holiday makers would put this market on a similar basis to others across the economy. It would however not provide consumers with the same level of protection from which they currently benefit from under ATOL, for example if the purchase was for less than £100. Similar issues as regards repatriation arise as for a consumer insurance based option discussed above. Further, credit card providers may not pay for additional costs incurred in repatriation above the amount paid for the holiday. There are also often complicated questions about the applicability of the Consumer Credit Act where payment is made by the consumer to an agent of a tour operator, rather than directly to the tour operator as 'principle' in the transaction.
37. This approach would also require a change to the PTD, and could not be considered until the ATTF deficit had been repaid.

Consultation of reform options - 2009/10

38. Given that most non-regulatory options would not on their own sufficiently meet the objectives of the reforms, the Department consulted on regulatory options for changes

to the ATOL scheme to improve clarity for consumers between December 2009 and March 2010 as part of the “Regulating Air Transport” (RAT) consultation. The consultation included 5 measures on which views were sought:

- Closing loopholes by creating a new “flight-plus” category in the ATOL scheme
- Protection of 'flight-plus' holidays sold by airlines and linked online sales
- Either a) exclusion or b) inclusion in ATOL of all 'flight-only' sales by 3rd parties,
- Requirements for better consumer information in ATOL documentation
- An option to allow existing ATOL-licensed companies to protect their non-air package holidays through a similar mechanism to the APC and ATTF.

In principle decision - February 2011

39. In February 2011 the Government announced its 'in principle' decision to implement a package of the measures comprising:
 - i) Closing loopholes by creating a new “flight-plus” category in the ATOL scheme
 - ii) Linked to the above, ensuring that where businesses sell holidays that look like packages, but where the travel agent has arranged matters so they are technically acting as an ‘agent for the customer’ and so remain outside of ATOL, consumers are made fully aware of this, so that they can make an informed decision about their purchase.
 - iii) Requirements for clearer, standardised information to consumers when an ATOL protected holiday is bought, potentially through an ATOL certificate.
40. The Department has decided not to implement at present the 2nd, 3rd and 5th bullets set out in paragraph 38. Including flight plus holidays sold by airlines (the 2nd bullet) would require new primary legislation, the case for which is currently being considered.
41. There was some support in the consultation responses for both options in relation to the treatment of 'flight only' sales (bullet 3). The option of removing all flights from ATOL as part of a set of reform measures is considered further below (see option 2 below). The final bullet is primarily an issue for the ATTF trustees to take forward, working with the relevant ATOL licensed businesses.
42. The reforms announced in February are expected to be implemented by new secondary legislation, powers under existing legislation and changes to ATOL licence standard conditions. They will be subject to consultation in spring 2011. In the first half of 2012 CAA also intend to consult on detailed issues about how the ATOL scheme and ATTF operate. This is partly in response to questions from the travel trade about the governance of the ATTF and the desire to have greater travel trade involvement with this. The consultation is also expected to consider the medium term role and functions of the ATTF, once the current deficit has been repaid and it is restored to financial sustainability. These might include the scope for other mechanisms, such as insurance, to be used to meet part of the ATTF's current obligations.
43. The possibility of using primary legislation to carry out further reforms to ATOL, including some of those consulted on previously is also being considered. These might include, for example, requiring airlines selling package holidays and 'flight plus' holidays to offer ATOL protection. Many in the travel trade are concerned about the impact on their competitiveness if all those selling holidays including a flight are not covered by the same consumer protection regime, seeing this as an unfair advantage for airlines that don't offer ATOL protection. New primary legislation would also allow 'agent for the consumer' transactions to be brought into ATOL, rather than relying on general consumer protection legislation to ensure consumers are given adequate information about the implications of this approach for insolvency protection. If Ministers decide to take forward the option of new primary legislation, the expectation is that a further Impact Assessment would be produced.

44. Based on the above, going forward the possible timing of the various elements may be as follows:

June to September 2011 - Consultation on ATOL reforms using secondary legislation (as set out in this IA)

Autumn 2011 - consideration of case for primary legislation to further reform ATOL

Late 2011 - EU proposals to revise PTD expected to be published

January 2012 - ATOL reform secondary legislation comes into effect (planned)

1st half 2012 - CAA consult on potential changes to management and funding of ATOL scheme, including the ATTF

May 2012 - Earliest date for primary legislation to reform ATOL to be introduced in to Parliament, if this option chosen

2nd half 2012/early 2013 - possible changes to management and funding of ATOL scheme, including the ATTF

1st half 2013 - New primary legislation to reform ATOL may come into effect, subject to Parliamentary process

1st half 2013 - Revised PTD agreed, subject to EU legislative process

2nd half 2013/2014 and beyond- Regulations to put in place reforms from arising from new primary legislation and revised PTD implemented

There are a number of uncertainties about the above steps, many of which are subject to Government decisions, the outcome of consultations and the legislative process in the UK and EU. The timetable must therefore be seen as broadly illustrative only and likely to change.

Do the proposed reforms constitute gold-plating?

45. The Department is of the view that there is no gold-plating. The relationship between the ATOL reforms and EU legislation is complex. As noted above, the ATOL scheme predates the PTD and has applied to persons selling flights in the UK, irrespective of whether that flight is part of a package. The PTRs (which implement the PTD) regulates tour operators selling package holidays and specify ATOL as a way in which the insolvency protection requirements under the PTD can be met for businesses organising air package holidays. This will continue to be the case under the proposed new regulations. The purpose of the reforms is to develop further the ATOL scheme to address domestic issues.
46. Both the ATOL regulations and the PTRs were drafted well before the internet age and although the Commission has already consulted on similar issues, we are anticipating these reforms in advance of any announcement of new EU proposals because of the urgent need to address ATTF's deficit – and because arguably the UK holiday market is one of the most innovative and diverse amongst EU member states. The UK market is very competitive with a wide range of suppliers including many small businesses and new entrants offering a wide variety of products through a complex supply chain enabled by specialised travel technology. This is of course good, but one down side is that it can be very hard for consumers to be sure where the responsibility lies for the components they have bought and what protection they have. Information is currently being sought from other EU member states about the number and magnitude of recent travel company failures, for comparison with experience in the UK. An additional complexity is that a court case in the UK defined the current ATOL legislation so that it does not cover 'flight plus'. The judge said he was not referring the case to the European Court as both the Commission and the UK Government were consulting on reform in this specific area. To date there has been no such challenge to the PTD.
47. In parallel to developing these proposals we have also begun to prepare for a more holistic review of EU consumer protection in this area – including by researching how other Member States have implemented the PTD. We will be using this information to seek to influence the Commission's position on the PTD review.

DESCRIPTION OF THE OPTIONS CONSIDERED

48. The Base case or do nothing option is the continuation of the ATOL scheme under its existing regulatory framework. This option would mean the continuation of the issues identified above in terms of increasing lack of clarity for consumers and the trade about the coverage of ATOL, as highlighted by recent travel company failures. It is estimated that the number of ATOL protected holidays would continue to decline, both relative to total leisure trips by air and in absolute terms. Under the base case, ATOL protected holidays fall from 18 million to 16 million over 4 years, then remains at this level for the rest of the 10 year assessment period.
49. The Department considers the current ATOL framework, and the do nothing option, to be unsatisfactory. As described above non-regulatory actions have been considered, but do not appear wholly sufficient in creating clarity for consumers, the trade or CAA as regulator as well as delivering other objectives.
50. In the absence of new regulation, it is likely that the scope of the ATOL scheme would become increasingly un-clear for consumers as its application would become inconsistent across different businesses. This could lead to an increase in detriment to consumers whose travel company became insolvent if only then to discover it was not covered by ATOL.
51. A lack of reform could also undermine the financial viability of the scheme. The ATTF was £35m in deficit in March 2011. The ATOL company failures in summer 2010 are likely to cost between £40m to £45m, delaying the time by which the Fund can become financially sustainable. If the number of holidays protected by ATOL continues to fall in the absence of reforms, the viability of the ATTF would become further threatened. This could jeopardise the Government guarantee, currently £42m, supporting the ATTF's commercial borrowing, or at least lead to calls for the Guarantee to be increased or extended. The Government's position is that it should not be for taxpayers to fund the ATOL scheme, but those who are directly involved with it, holidaymakers and the travel trade. The CAA is also at risk if the ATTF cannot repay its borrowings that are not backed by the Government guarantee, potentially running to £10s of million.
52. In the base case, the APC is assumed to remain at £2.50 throughout the 10 year assessment period. An objective of the reforms is to restore the schemes finances to sustainability. When this is achieved, it should allow the level of the APC to be reconsidered and potentially reduced so lowering the burden to all businesses.
53. Option 1 is a set of 2 measures to help meet the objectives of improve clarity for consumers and the travel trade about the scope of ATOL coverage. These are:
Measure i): Closing loopholes by creating a new "flight-plus" category in the ATOL scheme and addressing holidays sold on an 'agent for the consumer' basis.
54. As noted above, a number of travel agents and tour operator operate by allowing consumers to 'mix and match' flight, accommodation and other holiday components in order to create a holiday. Some of these holidays are sold with full ATOL protection, but others are not. These approaches create considerable uncertainty for the consumer about whether their holiday is ATOL protected or not. In many cases the holidays sold are indistinguishable from an ATOL-protected package holiday i.e. comprising the same flight and hotel arrangements.
55. To help address this, a new category of ATOL protection would be created, 'flight plus', which would cover flights bought together with accommodation, car hire or other significant components for use in the same holiday. The purchases of holiday elements would need to be at the same time, or within a short specified time, and have a business organising the arrangements. The precise time period between purchases will be subject to consultation, but the Department has in mind a period of between 24 or 48 hours. This would restrict the 'flight plus' category to cases where consumers were buying a holiday. The much longer time period favoured by some consultation responses would cover a greater number of purchases, adding to regulatory burdens, and arguably would cover holidays that did not resemble package holidays to consumers.

56. This would increase clarity for the consumer and bring the regulations up to date with the sales practices of the modern travel market, addressing concerns about the interpretation of the legal definition of a package. New secondary legislation would be required.
57. As well as protection against the insolvency of the travel agent or tour operator, 'flight plus' would also include protection for consumers against the insolvency of the airline providing the flight or the insolvency of one of the other key suppliers, for example of accommodation. The business selling the flight plus holiday would be required to provide alternatives or in some circumstances offer a refund.
58. A further approach used by some travel agents and tour operators is to act, or claim to act, as an 'agent for the consumer' which would put them outside the ATOL scheme. To be covered by ATOL, a business has to be acting as an agent or principle for a supplier of a flight or package holiday. Consumers are often unaware of the implications of this approach for the protection of their holiday. In Summer 2010, a number of consumers were left without a holiday or a refund when a business trading in this way failed. To bring such transactions into the ATOL scheme would require new primary legislation, which the Department is considering. In the mean time the CAA intends to work with other enforcement bodies to use existing consumer protection legislation to ensure that consumers are, at the very least, informed of the implications of purchasing holidays in this way.
59. In addition to improving clarity for consumers and the travel trade, by increasing the number of holidays brought into the ATOL scheme and also APC payments, this option would also help meet the objective of safeguarding the Government guarantee and helping the Fund return to financial self sustainability.

Measure ii): ATOL Certificate for passengers

60. This measure would provide consumers with much clearer confirmation that their holiday is ATOL protected. Current requirements, set out in the terms of ATOL licences, are concerned with wording which must be shown on ATOL confirmation invoices. This measure would standardise this requirement so that those consumers buying ATOL-protected holidays always receive a standard, recognisable document (whether electronic or paper) with a clear declaration of their protection. This would replace the current requirements for an ATOL confirmation invoice and ATOL receipt so would not constitute additional documentation. In some cases, it may mean a reduction in documentation provided. This measure has been supported by the travel trade, and CAA has already begun discussions with the trade about the content and format of the certificate. As CAA has previously announced its intention to introduce the Certificate this measure could be considered as part of the base case. However, it is included in the options to provide a complete and transparent picture of the reforms, and as the Certificate will only be given full effect once the proposed new regulations comes into force which will require ATOL licence holders to provide one to consumers.
61. Option 2 is the same as option 1, but also includes removing all 'flight only' sales by 3rd parties from ATOL, as a potential means of reducing the regulatory burden of the reforms, and also to provide a clear demarcation for consumers that holidays including a flight are protected, flights sold on there own are not. Under this option 4 million of these sales included in the Base case and Option 1 are removed from ATOL. While this option meet the improved clarity objectives, it may not address the self-sustainability of the Fund.
62. Option 3 is to rely solely on measure ii) in option 1 - the ATOL certificate - as a means of providing consumers with better information when their holiday is ATOL protected. If a consumer did not receive a certificate, it would be their decision whether or not to make their own arrangements for any protection against the insolvency of their tour operator (for example by taking out travel insurance including airline or supplier failure cover).
63. Although the requirement to provide the ATOL certificate would come from regulations, this option is much more light touch than option 1. Its main focus would be addressing

the lack of clarity about what holidays are and are covered by ATOL, rather than restoring the schemes finances to sustainability.

64. This option only directly addressed the improved consumer and travel trade clarity objective.

Moratorium on regulations affecting micro businesses

65. This IA was prepared before the announcement on 24 March 2011 of a moratorium on new regulations for micro businesses and start ups, to be effective from April 2011 until April 2014. The proposals to include 'flight plus' holidays in ATOL comes within the proposed scope of the moratorium. The cost and benefit estimates in the Summary sheets and evidence base in this IA are based on all businesses selling 'flight plus' holidays being required to protect them under the ATOL scheme.
66. An initial assessment of how the moratorium might affect micro businesses selling 'flight plus' holidays and associated issues is set out in the Small Firms Impact Assessment at Annex C.2 below. Views on whether to apply the moratorium to the reforms will be sought as part of the consultation. Ministers will then decide whether to put the moratorium in place or seek approval not to implement it.

Other options considered

67. One other option for addressing the objectives set out above was considered, but not assessed in detail, that of increasing the APC for existing ATOL protected package holidays and flights.
68. Increasing the APC to £3 or £3.50 for a period, perhaps in conjunction with the ATOL certificate, but without extending ATOL to 'Flight plus' holidays, might help restore the Fund's finances to sustainability and protect the Government guarantee. The burden of paying off the deficit would therefore fall solely on current ATOL licensed businesses and holidaymakers.
69. This option would have little benefit in terms of the improved consumer clarity objective. There is also a risk that increasing the APC would incentivise current ATOL licence holders to move to 'flight plus' or other models that are outside the ATOL scheme, with a reduction in the number of APC contributions, and, depending on the extent of this, lower overall income to the Fund, albeit set off to an extent by lower expenditure on failures. This would also reduce the current level of protection and also lead to increased consumer uncertainty. It would be unlikely to restore the Fund to financial sustainability. For these reasons, this option was not developed further.

COSTS AND BENEFITS OF THE OPTIONS

Option 1

Measure i - 'Flight Plus'

70. Costs and benefits arising from this measure are summarised in table 2 below. CAA estimate that 6 million holidays p.a. will, over time, be brought fully into ATOL as a result of this measure. This includes 'flight plus' holidays that are currently sold with no or only partial ATOL protection (often just for the flight). The 2 million reduction in ATOL holidays over the initial 4 years of the assessment period in the base case is also reversed. Although the reforms would increase costs to business which would be expected to at least in part be passed on the consumers through higher holiday prices, the extent of any increase in costs is expected to be small so the potential impact on the demand for holidays has not been considered.
71. ABTA estimate that 600 of their members - mainly travel agents- that have not previously required an ATOL licence would be required to obtain one or make other equivalent arrangements, for example by joining a 'consortium' (see below).
72. Businesses brought into ATOL for the first time will face two types of transitional costs: those associated with getting an ATOL licence, both the cost of the licence itself and the resources needed to apply for one; and the costs of providing a bond usually for an initial 4 years of trading.

Transitional costs - new licence application

73. There are 3 types of ATOL licence or equivalent, each with a cost of application and an associated administration cost: a Full ATOL licence, a Small Business ATOL (SBA) and becoming a member of a consortium (where the consortium organiser holds an 'umbrella' ATOL license covering all its member businesses). These costs and the estimated number applying for each type are set out in table 2 below.
74. The license costs are set by CAA, or by the consortium organiser. Small businesses selling less than 500 holidays or flights a year can apply for a small business ATOL (SBA) at a reduced cost of £930. Small businesses can also meet ATOL licensing requirements for 'flight plus' holidays through memberships of a 'consortium'. Many small business travel agents are already members of these organisations, which provide commercial and other services in return for a membership fee. To summarise, under new arrangements the consortium itself would hold an ATOL licence, subject to meeting financial and other fitness checks specified by CAA. Businesses would pay an annual fee to belong to the consortium to benefit from the licence. CAA estimate that some 550 businesses will need an SBA or to use their membership of a consortium. Based on the relative cost of the options, CAA further estimate that 25% (138) of these businesses would get an SBA with 75% (412) joining a consortium.
75. The administration cost is based on 50 hours work for senior managers to apply for a full ATOL licence, and half that amount for an SBA and half again for a consortium, reflecting the lower inputs needed for these types of arrangements. The total transitional cost relating to obtaining ATOL licences of all types is estimated to be £0.7m.

Table 2 - Cost of new ATOL licence and consortium membership

Type of licence	Cost of 'licence' (£)	Associated administration cost (£)	Total per 'licence' (£)	Number of businesses	TOTAL £'000
Full	1,760	1,264	2,920	50	151
SBA	950	632	1,550	138	217
Consortium member	500	316	1,100	412	158
All				600	732

Transitional costs - bonding

76. CAA require new ATOL holders, except those in a consortium, to provide a bond for an initial period, usually 4 years, as a means of protecting the ATTF in the event of their failure - evidence has shown that new ATOL companies are most likely to fail in this period. The bond is initially set at 15% of annual turnover, or for SBAs a flat rate of £40,000. Businesses pay an annual fee for the bond estimated at 4% of its value. A bond of £500,000 would therefore cost £20,000 p.a. Usually, the bonding amount is reduced over 4 years as the company becomes established, before the requirement is removed. CAA have said they would be prepared to be flexible about bonding requirements in cases where a business required to hold an ATOL licence as a result of this measure has already traded for a number of years. This is reflected in the estimates in this IA. Details of the assumptions used in calculating bonding costs, estimated to be £10.6m in total over 4 years, are at annex 3. Consortium bodies effectively provide bonds or other financial security for their members, reflected in the annual membership fee.

Transitional costs - familiarisation

77. The ATOL scheme has been a feature of the travel trade for many years, which most participants in the market will be at least broadly familiar with. Businesses that will be brought into ATOL for the first time may incur further familiarisation costs of understanding what the scheme is and how it operates. A significant part of these are

likely to be included in the resource costs associated with applying for a licence, as set out above in table 2.

78. In total, transitional costs amount to £11.3m (NPV over 10 years. All figures in this section are on this basis unless otherwise stated).

Recurring costs - license renewal

79. In terms of annual recurring costs, businesses will need to renew their ATOL licence each year which requires payment of a fee and associated resource costs based on 25 hours work for a Full ATOL licence.

Table 3 - Cost of ATOL licence and consortium membership annual renewal

Type of licence	Cost of 'licence' (£)	Associated administration cost (£)	Total per 'licence' (£)	Number of 'licences'
Full	1,005	632	1,637	50
SBA	905	316	921	138
Consortium member	500	158	658	412
All				600

80. Over the assessment period, total licence renewal and consortium membership renewal costs are £3.5m.

Recurring costs - ATOL Protection Contribution

81. However, the main annual recurring cost arises from the new liability to pay the APC by those selling 'flight plus' holidays. This is currently £2.50 per person booked, but under this option is assumed to reduce to £2 or £1.50 after 4 years, reflecting the improvement in the position of the ATTF arising from the reforms. The range reflects the uncertainty about the likely financial position of the ATTF in future which depends in part on the frequency and cost of ATOL business insolvencies. While these are plausible assumptions for the purposes of this Impact Assessment, they should not be taken as a commitment by the Secretary of State to agree to reduce the APC to either of these amounts. APC payments in respect of 'flight plus' holidays are either £99.1m or £85.2m for an APC reduction to £2.00 or £1.50 respectively. The reduction in the APC after 4 years will apply to all ATOL protected holidays and flights, not just 'flight plus' holidays. The total benefit of reduced APC payments for these holidays and flights is £37.1m or £74.3m.

82. The ATTF operates as a pooled fund. The additional APC payments will be used partly to help reduce the existing deficit in the ATTF and partly to meet the costs of future travel company failures. As such the APC payments represent a transfer payment, whereby current holidaymakers and travel firms help meet the costs of the previous travel company failures that gave rise to the deficit. While representing a cost to businesses, the additional APC payments are also an equal and offsetting benefit to the ATTF.

Recurring costs - supplier failure insurance

83. A further recurring annual cost to businesses is supplier failure insurance cover. As well as paying the APC to protect consumers against their own insolvency, the proposal is that businesses selling 'flight plus' holidays will have to provide consumers with alternative arrangements in the event of the insolvency of the provider of the flight or other element of the holiday. This provides a degree of consistency with key consumer protections for package holidays in the PTRs.

84. Many businesses selling flight plus holidays are expected to protect the flight element of a 'flight plus' holiday against this risk by buying 'flight only' seats from another ATOL licensed business, continuing their current business model. These 'flight only' seats

are themselves ATOL protected, with the APC paid. Should the ATOL licensed business supplying the 'flight only' seat become insolvent, the consultation proposal is for the ATTF to meet all or part of the cost to the 'flight plus' holiday seller of providing an alternative flight to the consumer.

85. The 'flight plus' seller can decide whether to purchase flights in this way or buy them from other sources without ATOL protection. In the latter case, they would then need to purchase insurance - or take other steps - to protect against the risk of supplier failure. For this assessment, 3 million flight plus holidays are assumed to be protected through 'flight only' sales purchased from other ATOL businesses for which the APC has been paid. An additional cost of 50p per passenger to cover the failure of non-airline suppliers has been assumed. A further 3 million holidays are assumed to be covered by supplier failure insurance at a cost to businesses of £3.00 per passenger. In total, recurring costs for supplier failure insurance are £73.3m over 10 years.
86. In a competitive insurance market, the total of premiums paid by policyholders should be equal to the expected total payout together with the cost of administering the policies. It is the administration cost that represents the net cost, as the total payouts will, in aggregate, offset the premiums paid. Administration costs are assumed to be of 30 % of premiums based on data from the Association of British Insurers about property and motor insurance markets. (This will need to be tested through consultation.) The benefits from pay outs net of administration costs is £51.3m.

Recurring cost - additional travel company failures from expanding ATOL

87. By increasing the number of businesses and holidays protected by ATOL, the number of travel company failures each year is likely to increase. The ATTF will meet the cost of repatriating holidaymakers already abroad and providing refunds. It is also proposed that the ATTF will meet the cost to 'flight plus' sellers of providing alternative flights in some cases (see above). This represents a cost of this option.
88. It has been assumed that the additional holidaymakers covered by the scheme experience travel company failures in the same proportion as existing holidaymakers. Using data for the past 6 years, 0.3% of ATOL protected passengers are affected by a travel company failure. The average cost per affected passenger (for refund and repatriation costs) is £316. The total cost over 10 years is £45m.

Recurring cost - additional enforcement expenditure

89. A further cost would be any additional enforcement expenditure by the CAA, to ensure the new regulations and other requirements are complied with. Initial additional enforcement activity would be funded from licence fees paid to CAA by ATOL businesses (see above), and is so not a further additional cost of this option. The Department for Transport generally funds any criminal prosecutions undertaken by the CAA under the ATOL regulations. The number of such prosecutions is not expected to increase in this option relative to the base case.

Recurring benefits - passenger protection

90. In terms of benefits the consumers brought into ATOL will benefit from having financial protection provided on a statutory basis for all elements of their holiday. Three approaches have been considered to assess how much value these consumers would attach to this:
- Avoided cost. This approach estimates the potential financial savings to consumers from being covered by the ATOL scheme. Using data for the past 6 years, on average CAA spent £316 per affected passenger on refunds and repatriation under the ATOL scheme. The probability of an ATOL protected customer experiencing the insolvency of a tour operator is small on average, at 0.3% (or 1 in every 300 consumers, see data in table 1). This means that the benefit is around £1 per year for each ATOL protected passenger.
 - Willingness to pay (WTP). The European Commission funded a telephone survey in 2009 on consumers willingness to pay for insolvency protection for all airline flights (flights purchased directly from airlines are not covered by the ATOL scheme or the PTD). The survey was carried out in 5 EU Member States, including the UK,

and had 2,500 responses in all. This found that in the UK, the median that those surveyed would be willing to pay for this protection was close to 5 euros or £4.30⁴. There were similar results in the other EU countries surveyed.

- Estimate of consumer detriment. A separate study funded by the European Commission sought to estimate the consumer detriment (in terms of financial and time costs) experienced by consumers on 'dynamic packages'. Dynamic packages cover a range of holidays, including many that would be classed as 'flight plus' under the proposed ATOL reforms. The study was based on a survey of consumers across 17 EU member states asking about problems that had arisen when on dynamic package holidays and the costs of resolving them. For UK residents, it found net detriment (i.e. after any refunds etc) was 8.1euros (£6.97) per person amongst all those that had brought dynamic packages.
91. Of the approaches above, the Willingness to Pay estimate seems most relevant, given its focus on the benefit from airline insolvency, albeit from stand alone purchase of airline seats rather than as part of a holiday. The avoided cost approach is likely to underestimate the loss to individual consumers from having to make alternative arrangements for repatriation, compared to arrangements made for many passengers by CAA under the ATOL scheme, on which the costings are based. It also does not take account of some of the other benefits of 'flight plus' such as supplier failure protection.
 92. The 8.1 euro figure of consumer detriment from the dynamic packaging study is likely to be an overestimate of the benefits from flight plus, as it covers detriment from a much wider range of sources than supplier or travel agent insolvency. Also, some holidays classed as 'dynamic packages' in the study would also not be covered by the flight plus proposals.
 93. £4.30 (or 5 euros) is therefore the starting point for the estimate of consumer benefit used in this assessment. As noted above, it might be argued that this is an underestimate, as the 'flight plus' proposal would provide protection of the whole holiday from the insolvency of the flight plus seller or any other supplier. On the other hand, many flight plus holidays are currently sold comprising an ATOL protected flight, which might mean a lower value of benefit from bringing flight plus holidays fully into ATOL. In light of the uncertainty, two values for consumer benefit have been used - the £4.30 from the survey, and half that amount, £2.15. The range reflects the second factor mentioned above, as well as a prudent approach in considering the potential benefits of the reforms. It may also be that 'flight plus' consumers have a lower marginal valuation of the benefit of insolvency protection. It should also be noted that these estimates are averages; some consumers may well value this protection more highly, others much less so. Using the £2.15 and £4.30 figures gives an estimated benefit to consumers from ATOL protection for 'flight plus' holidays of between £79.4m and £123.0m p.a. respectively.
 94. The WTP value is also likely to cover the direct benefits to consumers in terms of refunds received and costs incurred in repatriation. The best proxy for this is the £45m cost to the ATTF of meeting claims arising from ATOL failures, as mentioned in para 85. The difference between this and the total WTP benefit from flight plus mentioned above reflects the additional 'utility value' of the insurance to consumers.

Recurring benefits: APC receipts to ATTF and supplier failure insurance payouts

95. As mentioned above in paragraphs 79 and 83, other recurring benefits from this option are i) the value of APC income to the ATTF of £10.9 or £62.0m and ii) payouts to 'flight plus' sellers from supplier failure insurance policies, net of administration costs, of £51.3m.

⁴ Exchange rate used is 1 euro = 86p, taken from XE.com on 25 November 2010, mid point of high and low closing rates for the past 12 months

Table 4 : 'Flight Plus' monetised costs and benefits summary, 10 year NPV, £m

Costs			£m
- Transitional	<i>Licence application</i>	<i>See table 2 above</i>	-0.7
	<i>Bonding</i>	<i>See annex 3</i>	-10.6
- Recurring	<i>Licence renewal</i>	<i>See table 3 above</i>	-3.5
	<i>APC payments comprising:</i>	<i>£2.50 to year 4 then £2 or £1.50</i>	-10.9 to -62.0
	<i>APC payments - 'flight plus'</i>		-85.2 to -99.1
	<i>APC payments - reductions for all</i>		74.3 to 37.1
	<i>Supplier failure insurance cover</i>	<i>£3 per holiday where used</i>	-73.3
	<i>Refund and repatriation costs from additional failures</i>	<i>Based on past trends</i>	-45.3
Total			144.3 to 195.4
Benefits			
Recurring	<i>Benefits of increased passenger protection</i>	<i>£2.15 or £4.30 per passenger</i>	79.4 to 123.0
	<i>Net APC receipts to ATTF</i>	<i>£2.50 to year 4 then £2 or £1.50</i>	10.9 to 62.0
	<i>Supplier failure insurance payouts, net of administration costs</i>	<i>Admin costs 30% of premiums</i>	51.3
Total			141.6- 236.3
Net Benefits			-2.7 to 40.9

Costs and net costs are expressed as negative numbers, benefits and net benefits as positive

96. Overall, measure 1 produces monetised net benefits of -£2.7 (a cost) to £40.9 m (a benefit) depending on the assumption about the value of passenger benefits. The mid point of the net benefits is £19.1m, a benefit.

- **Measure ii): ATOL Certificate**

97. Businesses selling ATOL protected holidays currently have to provide certain information to consumers on invoices and receipts for their holiday, as a means of confirming they have purchased a ATOL protected holiday or flight. This measure would standardise the information provided to consumers, making it much easier to recognise when a holiday or flight was ATOL protected. On 24 October 2010, CAA announced their intention to proceed with this approach and to begin discussions with the travel trade about the format and content of a possible certificate.⁵ This has been

⁵ As noted above, although the ATOL certificate has already been announced, it has been include as part of the options rather than the base case, to provide a comprehensive picture of the reforms and as it will be implemented through the proposed regulations

welcomed by stakeholders. More detailed discussions with stakeholders about the form of the certificate began in March 2011. More information about the monetised costs and benefits of this option will be sought through the planned consultation on the reforms.

98. There would be a transitional cost to businesses in discussing with CAA the appropriate format and content of the Certificate, and also potentially in adapting IT and other systems to produce and distribute it.
99. There would also be a recurring cost to ATOL businesses from producing and distributing the revised information requirements to all consumers who have purchased ATOL protected holidays. The precise figure will depend on the format and content agreed. For existing ATOL protected holidays, the certificate will replace the current requirements for ATOL confirmation receipts and invoices to be provided so the net cost is likely to be low, potentially zero. For 'flight plus' holidays brought into ATOL due to the reforms it will represent an additional cost. This too will be dependent on the final form and content of the Certificate. Cost estimates will be developed once the form and content of the Certificate are clearer, including through consultation on ATOL reform planned for spring 2011.
100. The benefits would go to consumers who would be clearer that their holiday was ATOL protected. This would be of general benefit to 18 million consumers per year. Over time, consumers might be expected to recognise that not having the Certificate meant they were not ATOL protected, prompting them to consider alternative arrangements if desired. It would be particularly important in the rare event of the insolvency of an ATOL holder. The certificate should allow consumers to receive refunds more promptly and for repatriation assistance provided to those who are entitled to it under the ATOL scheme. In some recent ATOL failures, consumers have had to wait several months to get a refund while CAA examined complex paper work to determine if they in fact were on an ATOL protected holiday. Table 1 shows that at least 20,000 claims for refunds are made to CAA each year for the past 6 years. Related to this, there would also be benefits to CAA, as ATOL regulator, in being able to administer refunds and repatriation more easily, as entitlement to ATOL protection would be clearer. These benefits have not been monetised.

Table 5: Option 1 ATOL certificate costs and benefits summary £m, 10 year NPV

		£m
Costs - transitional	<i>Design of certificate and changes to systems to produce it</i>	To be confirmed
Costs - recurring	<i>Production and distribution of certificate</i>	Net effect likely to be small
Benefits- recurring	<i>Savings from not distributing existing information documents</i>	
	<i>Clarity about ATOL protection</i>	18 million ATOL passengers p.a
	<i>Quicker processing of refund claims</i>	Thousands of passengers p.a.

- **Other benefits and costs**

101. In addition to the costs and benefits outlined above, there are other significant and important non-monetised benefits that arise from this option as taken as whole, rather than individual measures.

De-risking the Government guarantee

102. The reforms should help safeguard the Government's guarantee supporting commercial borrowing by the ATTF, reducing the likelihood, compared to the base

case, of it being increased in value or even called on. The Guarantee is a contingent liability in the Department's account so it is not appropriate to include it in monetised costs or benefits, but its protection is a real benefit from the reforms. In the medium term once the deficit has been removed and the ATTF is operating sustainably the Department intends to remove the guarantee, as it should not be for taxpayers to be at risk financially from the scheme. Holidaymakers and the travel trade should be solely responsible for funding ATOL..

103. The Government guarantee supports a share of the ATTF's commercial borrowing. The remainder of the Fund's borrowing is effectively supported by APC payments to the Fund. Should the ATTF be unable to repay its borrowings due to the reduction in income in the base case, the debt not supported by the Government guarantee would fall the ATTF to be repaid. The Fund's Trustees would in turn look to the CAA to meet these costs, which could run to £10s of million. The reforms should significantly reduce or remove this risk, delivering further significant benefits to the CAA.
104. The effect of the reforms should be to eradicate the ATTF's deficit within 3 years, so helping the fund return to financial sustainability and protecting the Government's and CAA's potential liabilities.

Reduction in demand for Consular support

105. When a tour operator or other travel company becomes insolvent, the Consular Service of the Foreign and Commonwealth Office (FCO) is often called on to provide assistance and support by UK residents who are abroad on holiday and wanting to return. This can in part be a consequence of the lack of clarity about the coverage of the ATOL scheme which holidaymakers may have incorrectly been relying on to repatriate them. The greater clarity provided by the reforms should reduce this confusion, so reducing demand for Consular support in travel company failures and freeing resources for other purposes.

Agent for the consumer

106. As mentioned above, part of the set of reforms announced on 3 February is action to ensure that travel companies selling holidays on an 'agent for the consumer' basis make clear to consumers the implications of this approach for insolvency protection. There may be costs arising from to the businesses concerned, for example from changing websites, terms & conditions and other material available to ensure consumers are aware that holidays transacted on an agent for the consumer basis are not covered by ATOL.
107. There would be benefits to consumers from having this information so they could take better informed decisions about the holiday they intended to book and make alternative arrangements for insolvency protection, if desired, in light of the information provided.
108. Information to quantify and value these costs and benefits is not available at present, but will be sought in the consultation planned for Spring 2011. However, it represents an important element of the reforms as it seeks to addresses, in the short term, a potential way to avoid the ATOL scheme. A fuller solution to bring holidays sold in this way into ATOL would require new primary legislation.
109. The Other benefits and costs form the preferred option are summarised in table 5 below.

Table 6 Option 1 Non-monetised benefits and costs summary

		Quantification where possible
Non-monetised benefits	<i>Protection of Government guarantee</i>	£42m in 2010/11
	<i>Protection of CAA liability for ATTF debt</i>	£10's of million
	<i>Reduction in demand for FCO consular assistance</i>	
	<i>Consumers aware of implications and risks of holidays organised on an 'a4c' basis</i>	
Non-monetised costs	<i>Costs to businesses selling holidays on an 'a4c' basis of informing consumers</i>	

Option 2 - option 1 and removing 'flight only' sales from ATOL

110. This option is the same as option 1 - so comprising creating a new 'flight plus' category in ATOL and the ATOL certificate - but in addition removes all 'flight only' sales from ATOL. At present there are an estimated 4 million such sales in ATOL each year, where tickets are sold by 3rd parties, such as travel agents, and there is a period of at least 24 hours between a ticket being paid for and it actually being received by the consumer. Around 3 million of these 'flight only' sales are combined with other holiday elements to form 'flight plus' holidays, which until the proposed reforms are in place are not fully ATOL protected. A further 1 million 'flight only' sales are not combined with other travel elements. Under this option, all 4 million 'flight only' sales are removed from ATOL protection.
111. Table 7 below presents the costs and benefits of this option. The differences between this and table 4 setting out monetised costs and benefits for option 1 are set out in the paragraphs below.

Table 7: Option 2 Monetised costs and benefits summary, 10 year NPV, £m

Costs			£m
- Transitional	<i>Licence application</i>	<i>See table 2 above</i>	-0.7
	<i>Bonding</i>	<i>See annex 3</i>	-10.6
- Recurring	<i>Licence renewal</i>		-3.5
	<i>APC payments comprising:</i>	<i>£2.50 throughout</i>	-29.9
	<i>APC payments - 'flight plus'</i>		-113.1
	<i>APC payments - 'flight onlys' excluded</i>		83.2
	<i>Supplier failure insurance cover</i>	<i>£3 per 'flight plus' holiday</i>	-135.7
	<i>Refund and repatriation costs from additional failures</i>	<i>Based on past trends</i>	-12.0
Total			192.4
Benefits			
Recurring	<i>Benefits of increased passenger protection for flight plus holidays, net of loss from removing 'flight only' seats</i>	<i>£2.15 or £4.30 per passenger</i>	61.5 to 87.2
	<i>APC receipts to ATTF</i>	<i>£2.50</i>	29.9
	<i>Supplier failure insurance payouts, net of administration costs</i>	<i>Admin costs 30% of premiums</i>	95.0
	<i>Licensing renewal savings</i>		4.8
Total			191.1 to 216.9
Net Benefits			-1.2 to 24.5

Recurring costs - APC payments

112. Under option 2, APC payments in relation to 'flight plus' holidays would be £113.1m. This would be offset by no APC payments being made on 'flight only' sales, a saving of £83.2m, leaving a net cost of £29.0m. The removal of 'flight plus' holidays significantly reduces payments of the APC by ATOL businesses in the first 4 years of the assessment period compared to option 1. This means that the ATTF would only return to financial sustainability at a much slower rate under this option. Because of this, the APC remains at £2.50 throughout the assessment period, no reduction to £2 or £1.50 after 4 years has been assumed. There may be a risk under option 2 that the APC would need to be increased to help the ATTF's finances, although this has not been modelled.

Recurring costs - supplier failure insurance premiums

113. A greater number of 'flight plus' holidays under this option would need to be protected by commercially available supplier failure insurance. This is because the option for 'flight plus' sellers to purchase ATOL protected 'flight onlys' as a means of protecting the flight element of a 'flight plus' holiday would no longer exist. All 'flight

plus' holidays are assumed therefore to be protected by supplier failure insurance, leading to an increase in costs to £135.7m (although this will be partly offset by increased payouts under the policies, see below) There is a risk that the market for this type of insurance, which has a small number of participants, may not be able to meet such demand without substantially increasing premiums.

Recurring cost - additional travel company failures from expanding ATOL

114. The removal of 'flight only' sales would to an extent offset the expected increase in travel company failures from bringing 'flight plus' sales into ATOL, reducing this cost to £12m over the assessment period.

Recurring benefits - passenger benefits.

115. Removing 'flight only' sales would withdraw ATOL protection previously available for consumers who purchased this type of product. This is assumed to apply to the 1 million passengers who purchased 'flight only' tickets that are not combined with other elements to form 'flight plus' holidays. As under option 1, both high and low estimates of consumer benefit are used. As noted above, the range of values for passenger benefits are averages, so some consumers may place either a higher or lower valuation on them..

Recurring benefits: licensing renewal savings.

116. Under option 1, bringing businesses selling 'flight plus' holidays into ATOL leads to additional costs from annual ATOL licence and consortium membership renewals. Under this option, by removing 'flight only' sales, some businesses whose only ATOL activity is selling 'flight only's' would no longer be required to be in the scheme. It has been assumed that this would apply to half the 700 IATA registered airline ticket agents that have currently have an ATOL licence. This leads to a saving of £4.8m.

Recurring benefits: APC receipts to ATTF and supplier failure insurance payouts

117. As under option 1, these benefits are closely linked to the recurring costs of APC payments and supplier failure premiums. APC receipts to the ATTF (a benefit) are equivalent to APC payments (a cost), while supplier failure insurance payouts are the same as premiums paid for this insurance, net of a 30% administration cost.

118. In overall terms, this option has total monetised net benefits of -£1.2m (a cost) to £24.5m (a benefit), with a mid-point of £11.7m, somewhat less than option 1.

119. Option 2 would also deliver the net benefits arising from the ATOL certificate described above and summarised in table 5. However, option 2 would not deliver all the non-monetised benefits and costs for option 1 as summarised in table 4 above. In particular, the financial position of the Fund would be unlikely to have improved sufficiently after 4 years to provide the same level of protection to the Government Guarantee allowing for its withdrawal. Significant risks would also remain to the CAA's financial position. It seems unlikely therefore that the objectives of the reforms in relation to these issues would be met.

Option 3 - ATOL certificate only

120. Option 3 is a 'light touch' regulatory option that would simply comprise the ATOL certificate, measure ii) in option 1. The costs and benefits would be as set out in table 5 above and described in paragraphs 95 to 98. These are mainly in relation to the objective of providing greater clarity to consumers about whether their holiday is ATOL protected or not. The ATOL certificate would be expected to deliver this both to those who had a certificate and, over a period of time, to those that did not have one. Such consumers would have clearer information that they should consider making alternative arrangements for the protection against the insolvency of the holiday supplier, or to take an informed decision not to arrange this type of protection.

121. The benefits in achieving this objective would be lower than under option 1 however, as the current difficulty for consumers and the travel trade in determining what holidays are ATOL protected arising from the legal framework would remain, at least until a revised PTD is put in place. As at present, 'flight plus' holidays would not

be subject to ATOL protection. As noted above, more information about the monetised costs and benefits of option 3 will be sought in the planned consultation.

122. It seems unlikely that many of the Other benefits summarised in table 5 would occur under this option. Much clearer information about which holidays are ATOL protected may mean that some holidaymakers purchase ATOL protected holidays when they would have bought not protected ones. This may lead to an increase in ATOL protected holidays, so increasing the Fund's income to what it otherwise would have been. It is hard to quantify any such effect, but it seems likely that this would be very small and would not materially improve the financial sustainability of the Fund. The outcome in chart 2 above would therefore be likely, with the Government guarantee remaining in place beyond 2013 and the Fund unlikely to operate in surplus in the foreseeable future. As such, it would not be possible to consider a reduction in the APC from the current £2.50. An increase to £3 or greater may be more probable, significantly adding to costs for businesses.

RISKS AND ASSUMPTIONS

ATOL Protection Contribution

123. There is considerable uncertainty in the long term rate of the APC. This has been £2.50 per booking since September 2009, but was £1 prior to that. The CAA plan to review the arrangements for funding ATOL protection in 2011, which may lead to changes in the way ATOL is funded, including the level of the APC. This would potentially have most impact on the costs to businesses under options 2 and 3 where 'flight plus' holidays are brought into ATOL. The APC is assumed to be £2.50 per passenger for the first 5 years of the assessment after which, as a result of the reforms it reduces to £2 or £1.50, reflecting the fact that the reforms should permit the ATTF to return to financial sustainability opening the possibility of the APC being reduced. As noted above, this is an assumption for the purposes of this IA, and not a commitment to reduce the APC at any future point.

Forecasts of passengers

124. There is uncertainty about the number for ATOL protected passengers in the base case, as well as those brought back into the scheme under 'the 'flight plus' proposal. The latter is because of the inherent uncertainty in estimating activity that is currently outside the regulatory framework. While information from the consultation responses has been helpful, uncertainty still remains. In the base case, the number of ATOL protected sales is assumed to decline by 500,000 p.a. for the first 4 years of the assessment period, and then remain at the same level. A further risk is large scale move to avoid ATOL protection by businesses changing the way they sell holidays so they fall outside the scheme, even once it is reformed.

Bonding and insurance costs

125. Bonding and insurance costs are determined by the market at the time the bond or insurance policy is entered into. The pricing and/or availability of such products may therefore be subject to volatility, which is not reflected in the cost estimates above.

Passenger benefit from financial protection

126. As noted above, there is uncertainty about the value of ATOL protection to passenger, with estimates ranging from £1.00 to £6.97. Two values have been used in the assessment £4.30 and £2.15.

Review of Package Travel Directive

127. The European Commission is reviewing the PTD, and a proposal to revise it is expected in late 2011. The Commission are looking at a number of similar issues to those addressed by ATOL reform proposals. As a consequence, the PTD may be revised along the lines proposed above, or it may take a different approach. The ATOL scheme will need to be consistent with the revised PTD when this is finally agreed, which may mean changes to the reform proposals. The timing of a revised PTD becoming law is uncertain, but is unlikely to be in place for at least 4 years. Given this the Department has decided to press ahead with ATOL reform, but recognises that it may only be a temporary arrangement.

Failure of a large ATOL business

128. A failure of a large ATOL company with a significant cost to the ATTF would pose an increased risk to the viability of the fund and the current system for funding ATOL. It may necessitate an increase in the APC or alternative funding arrangements. To mitigate this risk, as part of its role as ATOL regulator the CAA closely monitors the finances of ATOL businesses it believes present a particular risk to the ATTF.

WIDER IMPACTS

129. Due to the nature of the reforms proposed for the ATOL scheme, we do not believe there will be any direct environmental or social impacts as a result of these regulatory changes. For example, these changes will not directly impact the volume of holidays purchased or the balance between long and short haul destinations but will improve consumers' ability to make informed choices. Businesses will seek to pass the additional costs on to consumers through higher holiday prices, but the additional cost as a percentage of total holiday cost is expected to be small, at around 1%.

SUMMARY OF PREFERRED OPTION

130. The table below summarises the net benefits and costs to business of the 3 options considered above:

Table 8 Summary of costs and benefits of options

Option	Net monetised net benefits	Key non-monetised benefits and costs	Annuitised net cost to business
1: Flight plus and ATOL certificate	£2.7m to £40.9m - mid point £19.1m	Better information and clarity to consumers Protects Government guarantee and CAA finances, leading to reduced risks Restores ATTF finances	£5.5m to £11.5m - mid point £8.5m
2: Flight plus and ATOL certificate with 'flight only' removed.	£1.2m to £24.5m - mid point £11.6m	Better information and clarity to consumers Does not restore ATTF finances, Government guarantee and CAA remain at risk	£9.4m
3: ATOL certificate only	TBC through consultation	Better information and clarity to consumers Does not restore ATTF finances, Government guarantee and CAA remain at risk	TBC through consultation

131. Option 1 would best meet all the policy objectives, would have the greatest mid point monetised net benefits and also result in the lowest mid point annuitised cost to businesses.
132. Option 2 would help achieve greater clarity for consumers, both by creating a 'flight plus' option and also by removing 'flight only' sales, creating a much clearer demarcation about what is and what isn't ATOL protected. However, it would do little to address the financial issues faced by the ATTF, certainly less so than in option 1. The net monetised benefits and annuitised cost to businesses are both less favourable than under option 1, although the difference for annuitised cost to business is not that great.
133. Although it would be a low cost approach, Option 3 above would not meet the objectives of the reforms, principally as it would do little or nothing to restore the Fund to financial sustainability. The benefits in terms of consumer clarity would also be lower as the uncertainty for consumers arising from the current legal framework would remain.
134. Given the above, there seems a strong case to reform ATOL by implementing option 1. This comprises:
- Ensuring that 'mix and match' holidays as well as traditional packages are financially protected by creating a new category of "flight plus" holidays in the ATOL scheme.
 - Taking action to ensure consumers are aware of the implications of holidays being sold on an 'agent for the consumer' basis.

- Introducing a standardised ATOL Certificate to replace existing information requirements, so that consumers know when they have booked an ATOL protected holiday.

135. These reforms should:

- Improve clarity for all consumers about insolvency protection for holidays including a flight.
- Provide greater clarity to the travel trade and CAA as regulator about which holidays are ATOL protected.
- Safeguard the finances of the ATOL scheme, including safeguarding the Government's guarantee and allowing for its eventual withdrawal so ending taxpayer support, placing responsibility for financing the ATOL scheme back to holiday makers and the travel trade.
- Put the finances of the ATOL scheme back on a sustainable basis, so allowing the option of the APC to be reduced from its current level of £2.50 to be considered, alleviating the regulatory cost to travel trade businesses.

136. The two values of consumer benefits used give 2 estimates of the monetised net benefits for the preferred option:

Table 6 Net benefit estimates for preferred option

Consumer benefit	Net benefit £m NPV
Low (£2.15 per passenger)	-2.7
High (£4.30 per passenger)	40.9
Mid-point	19.1

Net costs are expressed as negative numbers, net benefits as positive

137. In addition to the monetised net benefits and costs are the significant non-monetised benefits, as well as some costs. These comprise:

- Protecting the Government's guarantee supporting the ATTF's borrowing - currently £42m - from being called and allowing it to be reduced and withdrawn in the medium term.
- Protecting and reducing CAA's exposure to the ATTF's non-guaranteed borrowing, currently £10's of millions.
- The benefits of clearer information about their holiday protection to ATOL passengers from the ATOL certificate, including prompter refunds, set against the cost of developing, producing and distributing the certificate.
- Reducing the burdens on the FCO consular service.
- Benefits to consumers of knowing about the implications of holidays arranged on an 'agent for the consumer' for insolvency protection, net of any costs to businesses from delivering this.

138. The Department's view is that the monetised net benefits taken with the non-monetised net benefits cost of the options and present a good case for option 1 to be the preferred option, particularly in light of the potential financial liabilities for the Government and CAA that the preferred option should substantially mitigate.

139. There are risks and uncertainties surrounding the cost and benefits estimates, but not taking action to reform ATOL now carries a higher probability of a number of the

risks occurring, not least the impact on the Government's and CAA's financial exposure to the ATTF, as well as continuing uncertainty and confusion for consumers. The base case assumes an APC of £2.50 throughout the assessment period, but there is a risk that this might have to be increased to £3 or more if holidays continue to be moved from being sold with ATOL protection to outside the scheme. The reforms when implemented will help restore the ATOL scheme to its original intention of providing protection to consumers of flight inclusive holidays. Implementing the reforms should also put the Government in a good position to influence the European Commission's thinking in its current review of the PTD so that any new legislative proposal is proportionate to the risks and inline with the ATOL scheme.

140. These reforms should also be seen as an important initial step towards a more holistic review of how the ATOL scheme works and consumer protection for holiday makers more widely. The phases in such a review can be described as follows:

- The reforms outlined above, which through secondary legislation and use of existing powers will improve clarity for consumers and restore financial sustainability to the scheme, allowing taxpayer support to be withdrawn.
- Restoring financial sustainability will allow options for management of ATOL finances and the ATTF to be considered, which CAA expect to consult on in late 2011 or early 2012. This might include using alternative market based approaches, such as insurance, to fund some of the refund and repatriation obligations now met by the APC and the ATTF. Options for changes to the ATTF's governance can also be considered.
- Considering further changes to the ATOL scheme to reinforce clarity for consumers and financial sustainability, with measures that require primary legislation. This could include bringing 'flight plus' holidays sold by airlines and/or 'agent for the consumer' sales into ATOL, which would require primary legislation.
- Drawing on the steps above, input to the Commission's review of the Package Travel Directive, which is the forum where more fundamental changes to consumer protection could be considered, including options involving a greater role for consumer purchased insurance.

Impacts on businesses

141. In terms of impacts on businesses, the reforms represent an equivalent annual net benefit of -£11.9m to -£5.7m, that is an overall cost. The cost mainly arises from the APC being charged on flight plus holidays. The range is depended on the assumption about whether the APC is reduced to £1.50 or £2 after 4 years, once the Fund has returned to financial sustainability. The cost of supplier failure cover noted is the administration cost of the scheme – total premia paid and pay outs under the policy are otherwise assumed to cancel each other out over the assessment period.

Table 7: Summary of costs and benefits to businesses, £m NPV over 10 years

	£m NPV
APC payments	-99.1 to - 85.2
Licensing and bonding	-14.8
Supplier failure insurance net cost	-22.0
APC reduction	37.1-74.3
Information requirement	TBC
Total net benefit/cost	-47.7 to -98.8
Equivalent annual net benefit £m	-11.5 to -5.5

142. Further information on costs marked 'TBC' will be sought through consultation.

143. There may also be un-quantified benefits to businesses if the reforms boost consumer's confidence in the market for holidays including a flight by providing greater certainty about the protection available. The travel company failures in the last few years have raised awareness of insolvency protection in consumers' minds, which the reforms should help combat.
144. It seems probable that businesses will be able to pass on a significant share of the additional costs to consumers through higher holiday prices. The evidence used in the IA suggest that consumers place considerable value on financial protection for their holidays and should, in theory, be willing to pay extra for this.
145. Businesses selling 'flight plus' holidays will face the largest share of the costs, in particular from APC payments. At the same time however, consumers buying 'flight plus' holidays might be expected to value the benefits most from including 'flight plus' in ATOL. Businesses may therefore be able to pass through the additional costs. A number of ATOL businesses already show the £2.50 APC as a separate item on holiday invoices.
146. The additional cost to businesses selling flight plus holidays, ignoring any benefits, represent around £3 per ATOL booking, using an average of 5.5 million annual bookings p.a (6 million additional bookings are reached after 4 years, 5.5 million is the average over the 10 year assessment period). The average price of an ATOL booking is estimated to be between £400 and £500. An increased cost of £3 would therefore be 0.6% or 0.8% of this. 'Flight plus' holidays may be less expensive than the average given they tend to be aimed more at the value end of the holiday market. If 'flight plus' holidays were typically £250 per booking, the additional cost of the reforms would be some 1.2% of this. The increased cost per booking from the reforms is under the high estimate of consumer benefits of £4.30 per booking, although above the low estimate of £2.15.
147. All travel trade businesses selling package holidays with a flight and 'flight plus' holidays would be required to get ATOL protection and so would face broadly similar costs of compliance once the reforms were in place. This would ensure a more comparable regulatory regime for all businesses in this market. Some in the travel trade remain concerned that flight plus holidays sold by airlines would not be in the ATOL scheme under the reforms, which they see as an unfair competitive advantage to airlines. The Department is considering the case for the new primary legislation that would be needed to address this issue.

Implications for 'One In One Out' (OIOO) regulatory policy

148. The proposed reforms would result in an estimated net cost to businesses of £5.5 m to £11.5 m p.a., albeit one that is offset by substantial benefits to consumers and a significant reduction in financial risks to Government and the CAA.
149. The cost to business represents an 'In' in the terms of the OIOO policy.

IMPLEMENTATION PLAN

150. The reforms will be implemented mainly by new secondary legislation, but also by using existing powers, including changes to ATOL standard licence conditions. CAA has already announced its intention to develop the ATOL certificate, in consultation with the travel trade. The Department expects to consult stakeholders on new secondary legislation to introduce 'flight plus' in the first half of 2011, with the legislation coming into force by the end of 2011 or in early 2012. The intention is for the reforms to start to take effect in time for the peak holiday booking period for summer 2012, in January or February 2012. Further details of implementation process will be set out in the proposed consultation on 'flight plus' draft regulations.
151. The new draft regulations will include a sunset clause and/or provision for a review clause as appropriate in line with Government's latest policy on reviews and sunset clauses. This will need to take account of the fact that the ATOL scheme helps implement the PTD as far as package holidays including a flight are concerned.

152. The timing of any review may need to be flexible in light of the ongoing review of the PTD and the possibility of a revised PTD being in place as early as 3 years after the new regulations come into force. Further details will be in the planned consultation.

Annexes

Annex 1: Post Implementation Review (PIR) Plan

<p>Basis of the review:</p> <p>The regulations putting in place the reforms will include a review and/or sunset clause as necessary in accordance with Government regulatory policy. A sunset clause may not be appropriate as, in addition to implementing the reforms, the planned regulations also help implement EU obligations. The timing and precise nature of the review will in part depend on external events, in particular proposals to review the EU PTD or provide airline insolvency protection. These may mean that it makes sense to carry out the review within 5 years of the regulations coming into force, which will need to be reflected in the regulations.</p>
<p>Review objective:</p> <p>The review will consider the success of the policy in meeting its objectives. These are:</p> <p>providing greater clarity for consumers about insolvency protection for holidays including flights</p> <ul style="list-style-type: none">• providing greater clarity for the travel trade and the CAA as regulator• The ATTF is on a sustainable financial basis and can continue to protect holidaymakers• No ongoing support from taxpayers for the ATOL scheme through a guarantee• Lower burdens on business through a reduced APC
<p>Review approach and rationale:</p> <p>The review would include looking at data provided by ATOL licence holders and how trends have changed since the reforms. It would also include views from stakeholders, including ATOL holders and representative bodies as well as consumer bodies.</p>
<p>Baseline:</p> <p>The baseline is the current position as outlined in the Impact Assessment, revised as appropriate to reflect the position when the reforms come into effect</p>
<p>Success criteria:</p> <p>Greater clarity for consumers, no significantly greater regulatory burden on businesses than expected, easier to regulate ATOL scheme which is on a sound financial basis going forward, without Government support. The APC reduced from £2.50 and speedier claims handling for consumers when ATOL companies fail.</p>
<p>Monitoring information arrangements</p> <p>ATOL licence holders are required as a condition of their licence to provide CAA with various information about their activity which could be a basis for the review, subject to confidentiality considerations. CAA also has good information about the industry from its regulatory role.</p>
<p>Reasons for not planning a PIR</p> <p>N/A</p>

SPECIFIC IMPACT TESTS

Equality assessment test

A1 In line with DfT's Guidance on Equalities, the various filters on Religion or Beliefs / Age / Disability / Ethnicity and Race / Sexual Orientation / Gender equality have been applied to assess whether the implementation of this policy warrants a full Equalities Assessment. The proposed reform affects all passengers, so we do not anticipate any negative impacts on any of the equalities groups.

Competition assessment test

- B.1 The ATOL reforms directly affect the market for holidays including a flight - both traditional package holidays and also 'flight plus' holidays. The latter will comprise a flight and accommodation or car hire purchased within a short specified timescale in a way that means they do not fall within the legal definition of a 'package' in the PTD.
- B.2 Under the ATOL scheme there were an estimated 21 million package holidays and 'flight only' tickets sold in the UK in 2009/10. There are an estimated 4 million 'flight plus' holidays sold by tour operators and travel agents, many of which will use ATOL protected flight only seats. There is a wider market for leisure travel by air which is used for independent travel or Visiting Friends and Relatives (VFR), estimated to be 20 million passengers in 2009.
- B.3 The two largest tour operators, Thomas Cook and TUI, sell some 8 million package holidays between them. In addition to a number of medium sized businesses, there are some 2,000 businesses licensed to sell less than 500 package holidays per year. There are two large businesses selling 'flight plus' holidays that would be brought into ATOL as a result of the reforms. It is understood that there are also several hundred smaller companies selling this type of holiday, principally travel agents. Many businesses sell both 'flight plus' holidays and also package holidays. In all 600 businesses are believed to be brought into the ATOL scheme as a result of the proposed reforms. Airlines are the main participants in the leisure travel by air market for independent travel and VFR.
- B.4 Businesses active in the market sell a large variety of holidays to numerous destinations with a wide range of quality at different price levels. Accordingly, prices for a holiday can vary considerably, but are typically from a few hundred pounds per person to over a thousand pounds or more. There are also a number of substitutes to holidays including a flight, such as package holidays not including a flight or making independent arrangements for flights and accommodation.
- B.5 Businesses compete on both price of a holiday and also on 'quality' for example the standard of the hotel. Competition on price may be more prevalent at the lower end of the market where products may be more standardised and consumers may be less sensitive to the quality of the hotel above minimum acceptable standards. The market is an active and developing one. The increased use of the internet to sell holidays has opened a new route to market for suppliers, and one which allows greater flexibility for consumers to specify the various elements of the holiday desired.
- B.6 The market for package holidays including a flight is subject to regulation, both under the ATOL scheme and PTD, as outlined above (the PTD covers all package holidays, including those without a flight). The requirement to hold an ATOL licence imposes costs on new entrants to the market, but CAA has put in place mechanisms to reduce this cost for small businesses, such as the Small Business ATOL. This has a lower cost and reduced monitoring requirements compared to a 'full' ATOL licence. Typically hundreds of businesses enter the market each year, mostly of a smaller size. Currently there are no ATOL licensing or PTD obligations in relation to flight-plus holidays, including for new entrants to that market (although many businesses sell both ATOL protected packages and un-protected flight plus holidays at

present). The proposed reforms would bring regulatory requirements for 'flight plus' holidays more closely in to line with those for package holidays.

B.7 The Office of Fair Trading have prepared 4 filter questions as an initial means of assessing the impact of a policy on competition, which are discussed below in relation to ATOL reform.

1 Does the policy directly limit the number or range of suppliers?

B.8 The reforms do not fix any limit on the number or range of suppliers or create any exclusive rights to supply. They do extend the scope of an existing licensing scheme which has cost implications for businesses currently selling 'flight plus' holidays, as discussed further below.

2 Does the policy indirectly limit the number or range of suppliers?

B.9 The reforms will require an estimated 600 sellers of 'flight plus' holidays to obtain an ATOL licence - with associated costs. These, and businesses which already have an ATOL licence for the sale of traditional package holidays, would be required to pay the APC in relation to flight plus bookings and also incur other costs such as providing supplier failure insurance. Businesses selling package holidays already face these costs. The reforms will therefore raise the costs to businesses selling 'flight plus' holidays brought into the ATOL scheme. These costs are highest in the first year, as this is when bonding requirements are likely to be largest. For the very large to medium 'flight plus' businesses, these additional costs are estimated to represent around 1.6 to 1.8% of annual turnover in the first year, before reducing to 1.1% to 1.0% after 4 years when bonding is no longer required. Smaller 'flight plus' businesses face slightly higher relative costs, representing around 2.3% of first year annual turnover for businesses selling 500 holidays per year and obtaining an SBA. This partly reflects the flat rate bond that all small businesses (500 or less sales per year) must provide to CAA in the first 4 years of being a licence holder for use in the event of their insolvency. Costs reduce to 1.2% once bonding is no longer required, usually after 4 years. Costs for businesses choosing to join a consortium will be lower than this.

B.10 There are reasons to think that these costs may overstate the net position faced by businesses: as noted above a share of the additional costs is likely to be passed on to consumers through higher holiday prices. CAA have said they will adopt a flexible approach, where appropriate, when considering the bond requirements of businesses acquiring an ATOL licence for the first time, particularly for those that have been trading successfully for a number of years.

B.11 It is also arguable that the current position of ATOL licensed and non-licensed companies selling very similar products with different consumer protection arrangements distorts competition: the complexity of insolvency protection arrangements means consumers are often unaware that their current 'flight plus' holiday is not fully ATOL protected and so choose a holiday on the basis of incomplete information. The proposed reforms seek to address this so consumers would have greater clarity about the insolvency protection provided.

3 Does the policy limit the ability of suppliers to compete?

B.12 The purpose of the reforms is to establish a common regulatory framework for consumer protection of package holidays and 'flight plus' holidays, restoring the initial intention of consumer protection legislation in this area. They are supported by a range of travel trade businesses and representative organisations. The reforms are not expected to limit suppliers ability to compete with each other, although a segment of the market, flight plus holidays sold by airlines, may be outside the framework. Some in the travel trade argue that this is a competitive disadvantage to them. The Government is considering the case for primary legislation that would be needed so such holidays could include ATOL protection.

4 Do the reforms reduce supplier's incentives to compete vigorously?

B.13 This outcome is not anticipated for the reasons outlined above.

SMALL FIRMS IMPACT TEST

Introduction

C.1 This IA was prepared before the announcement of the Government's moratorium on new regulations affecting micro businesses - those with less than 10 employees - and start ups from April 2011 until 2014. The Small Firms Impact Test includes the best current information about micro businesses currently in the ATOL scheme as well as those that would potentially be brought in to it under the proposed reforms and estimates the potential impacts of the moratorium. Further information about micro businesses and the affect of a moratorium is expected be sought as part of the planned consultation on the ATOL reforms. Following the consultation, Ministers will decide if the moratorium should be implemented or whether an exemption should be sought.

Cost savings for micro businesses from moratorium

C.2 CAA estimate that a significant proportion of existing ATOL licensed businesses - between 500 to 700 out of the total of 2,500 - are micro businesses. For the purposes of the ATOL scheme they are licensed to sell up to 500 or 1,000 holidays or flights per year. All will hold Small Business ATOLs (SBAs) or be franchise members, arrangements which have been specifically designed for small businesses to reduce the regulatory burden of the ATOL scheme (see discussion below).

C.3 Although these micro businesses represent 20 to 30% of all ATOL licensed businesses, the share of total ATOL protected bookings (and hence APC income) they account for is far smaller. A number of these businesses currently sell 'flight plus' holidays (as well as package holidays of flight onlys) and, if the moratorium applied, they would not need to protect these under the ATOL scheme. This would lead to a saving to these businesses of around £3.40 per flight plus booking while the moratorium was in place, from not having to pay the APC or provide supplier failure protection. The total number of flight plus bookings this would affect is currently being assessed. Information may be sought as part of the consultation.

C.4 Although no firm information is available, it is estimated that 400 to 550 of the 600 businesses expected to be brought into ATOL under the 'flight plus' proposal will be micro businesses. As above, these businesses will account for a much smaller proportion of the up to 6 million p.a. flight plus holidays expected to be brought fully into the ATOL scheme, although no estimate is yet available. These micro businesses would also save around £3.25 per flight plus booking if the moratorium were applied.

C.5 In addition, the businesses that would have been brought into ATOL would not have to obtain an SBA or become a member of a franchise or consortium until the moratorium ended, expected to be April 2014, a delay of some 2 years from the date the reforms are planned to come into force, of January 2012. The cost saving varies according to which option is chosen, but is estimated to be around £20k in total in NPV terms (the difference between paying licence application costs in 2014 as opposed to 2012).

C.6 Businesses that would otherwise have applied for a SBA will also see cost savings from not having to provide a bond until 2014, when the moratorium ends, as opposed to 2012. This is estimated to be worth around £32,000 in total in NPV terms

C.7 In addition, two year's licence renewal costs would also be saved, between £530,000 to £730,000 in total. These are recurring costs that are avoided completely during the assessment period, rather than transitional costs relating to licence applications and bonding that are just delayed for a year or two.

C.8 The cost savings described above are summarised in table C1

Table C1: Initial estimate of cost savings from moratorium for micro business applying to ATOL reform.

	£ '000s NPV
Reduced APC and supplier failure protection costs	TBC
Licence application saving	20
Licence renewal saving	530-730
SBA bonding saving	32
Total	582-782

Other effects

C.9 Although there would be cost savings to micro businesses as a result of the moratorium, there would be potentially adverse effects on consumers, who would lose benefits from not being fully ATOL protected when they purchased 'flight plus' holidays.

C.10 It can also be argued that it would not be consistent with the objectives of the reforms to exempt micro businesses from the requirement to protect 'flight plus' holidays. To do so would remove insolvency protection from consumers who purchased holidays from these businesses, which conflicts with the aim of providing greater clarity about whether a holiday is ATOL protected or not. This would now partly depend on the number of employees in a business. Consumers could purchase very similar 'flight plus' holidays from a micro business that would not be protected or from a small business, with say 15 employees, that would be protected. As well as lacking clarity for consumers, this may also act to the detriment of micro businesses if the uncertainty about ATOL protection led to consumers buying holidays from larger businesses that they new were protected.

C.11 Many small businesses use ATOL protection as part of their marketing material to reassure consumers that the money paid for their holiday is financially protected. For example, the Association of Independent Tour Operators (AITO) has on its home webpage:

The Association of Independent Tour Operators offers an unrivalled collection of financially protected quality holidays from award-winning specialist independent tour operators.

While AITO members do sell non-air package holidays, the majority of sales are ATOL protected. Exempting small businesses from the scheme could therefore drive some consumers to larger businesses that were ATOL protected, with effects on micro business profitability.

C.12 In addition, without being ATOL members, micro businesses may find it more costly, or impossible, to obtain credit card merchant facilities, as in the absence of ATOL the merchant facility providers would face higher calls for refunds from consumers if the business became insolvent.

C.13 Once estimates of the number of flight plus holidays sold by micro businesses are made, the impact on APC income received by the ATTF and the Fund's financial sustainability can be assessed.

Measures to reduce ATOL scheme costs for small businesses, including micro businesses

C.14 CAA already has in place arrangements to reduce the regulatory burden of the ATOL scheme for small businesses (those selling up to 500 or 1,000 ATOL protected holidays or flights p.a), which would also be available for businesses brought into ATOL as a result of the reforms. These arrangements include:

- Small Business ATOL (SBA) This is currently available to businesses selling up to 500 holidays and/or flights per year. SBA applicants and holders are not subject to financial fitness checks and only have annual reporting requirements. The 500 p.a booking limit provides flexibility to businesses

to adjust plans without amending the licence. Licence application and renewal costs are accordingly lower for SBA businesses. New licence holders are required to provide a bond starting at £40,000, before reducing to zero, typically after the first 4 years of trading as an ATOL licensed business.

- Franchise arrangements are available for those selling up to 1,000 holidays per year. Businesses can join a franchise, which essentially is a 3rd party consumer protection scheme that has been approved by CAA. There are no financial fitness checks and no bonds required, - the franchise holder takes on part of the risk of ATOL obligations if one of its member business becomes insolvent. In some schemes a licence fee is still payable to CAA, and businesses pay for membership of the franchise. The APC is still payable on each booking.
- Specifically for the introduction of 'flight plus' holidays, the CAA has developed 'consortium' or 'approved body' arrangements as a way of reducing the burden of the ATOL scheme. The intention is that small businesses will be able to join a consortium led by an approved body. This body will hold an ATOL licence, which will act as an umbrella ATOL for consortium members to use when selling flight plus holidays. The CAA will approve the financial arrangements of the approved body, including how it would monitor its members. Consortium members would not need to have their own ATOL, and would not need to provide a bond. They would be expected to pay for membership of the approved body, and the APC would still be payable.

C.15 Evidence has shown that new ATOL licensed businesses, many of which are small firms, are most likely to become insolvent in the first few years of being established. It is for this reason that CAA requires additional protection against insolvency in the early years of a business, generally through the provision of a bond or other similar arrangements. While this does represent an additional cost of entry into the market, its purpose is to protect the ATTF, including the Government guarantee that underpins it.

C.16 A further benefit to small businesses of the ATOL scheme is the implicit cross subsidy in the APC, which is fixed at £2.50 for all businesses, regardless of the risk of insolvency. Under the previous ATOL funding arrangements based predominantly on bonds, small businesses would have been likely to pay considerably more than this on a per passenger basis to procure a bond.