Title:

Reforming the Air Travel Organisers' Licensing (ATOL) Scheme

IA No: **DfT 00092**

Lead department or agency:

Department for Transport

Other departments or agencies:

Impact Assessment (IA)

Date: 03/02/2012

Stage: Enactment

Source of intervention: Domestic

Type of measure: Secondary legislation

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Summary: Intervention and Options

RPC: GREEN

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£6.2m	-£55.6m	£6.5m	Yes	IN

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

The ATOL scheme protects consumers when their package holiday tour operator becomes insolvent. It needs updating to reflect how holidays are now sold. 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 £42m. 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is needed to put the scheme back on a sustainable basis, allowing the Government guarantee underpinning ATOL to be withdrawn and so that holidaymakers and travel firms fund the scheme rather than taxpayers.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and legal certainty about whether a holiday is ATOL protected ii) the Government's guarantee is safeguarded and can be withdrawn so that holidaymakers and travel trade meet the full cost of ATOL and iii) in the medium term once the scheme's finances are stable, to reduce the £2.50 per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 were considered in the consultation Impact Assessment: :
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 requiring an ATOL certificate 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, and following the consultation is the preferred option. The estimated monetised net benefits are in a range of -£24.0m to £36.4m. There are also important non-monetised benefits, as well as some non-monetised costs.

Will the policy be reviewed? **It** will **be reviewed.** If applicable, set review date: 04**/**2017

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes/No
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: [Signed by Theresa Villiers, Minister of State for Transport] Date: 06/02/12

Summary: Analysis & Evidence — Policy Option 1

Description: Including Flight Plus in ATOL and better information through the ATOL certificate

FULL ECONOMIC ASSESSMENT

Price Base Year 2010/11	PV Base Year 2011	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -24.0	**High: 36.4**	**Best Estimate: 6.2**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	**Optional**		**Optional**	Optional
High	**Optional**		**Optional**	Optional
Best Estimate	**19.2**		**14.6**	143.5

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

Businesses selling Flight-Plus holidays brought into ATOL face transitional costs including from obtaining licences and providing bonds to the Civil Aviation Authority (CAA) for 4 years (£18.2m NPV). The largest recurring cost is from supplier failure insurance premiums paid by Flight Plus arrangers (£72.2m), followed by additional costs to the ATOL scheme from providing refunds and repatriation to Flight Plus holidaymakers (£37.4m). Additional net APC payments are £8.5m and ongoing licensing costs £7.2m

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, expected to be very small on a unit cost basis.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	**Optional**		**13.9**	119.5
High	**Optional**		**21.4**	179.9
Best Estimate	**0**		**17.6**	149.7

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

There are no transitional benefits. Consumers on Flight-Plus holidays would benefit from full ATOL protection, estimated to be between £120.9m and £60.4m. Businesses would benefits from pay-outs under supplier failure insurance, estimated to be £50.6m. The scheme would benefit from additional net APC receipts of £8.5m.

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

All ATOL customers will benefit from greater clarity about whether their holiday is ATOL protected on not. The Government will benefit from the stronger position of ATOL finances, safeguarding its guarantee, which supports the scheme's borrowing, currently of £30m. The CAA will benefit from reduced exposure to the scheme's debts that are not supported by the guarantee. The increased clarity for consumers should mean the FCO's Consular Service benefits from reduced demands for assistance from holidaymakers.

Key assumptions/sensitivities/risks — Discount rate (%) **3.5**

i) The number of passengers fully protected by ATOL rises by 6 million p.a., although there is some uncertainty around this. ii) It is assumed that the APC falls from £2.50 to £1.50 per booking after 4 years, reflecting the improved state of ATOL finances iii) Benefits to passengers from full ATOL protection are valued at £4.30 per passenger (high) and £2.15 per passenger (low) based on a 2009 study by the European Commission.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 21.0	**Benefits:14.5**	**Net: 6.5 cost**	Yes	IN

Evidence Base (for summary sheets)

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
6. 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.
7. 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

8. 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.

9. 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. The Fund's deficit stood at £42m in March 2011.

10. 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.

11. 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 and £30m in August 2011. It is scheduled to fall to £20m in 2012 before being withdrawn in 2013.

ATOL numbers

12. ATOL protection is currently provided to approximately 18.5 million passengers in the year ending March 2011. 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 7 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
2011	18.5m	29	47,013	145,809	49,739

Source: Civil Aviation Authority

PROBLEM UNDER CONSIDERATION

Lack of clarity for consumers

13. 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.

14. 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 21 million.

15. 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.

16. 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.

17. 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 causes 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.

18. 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.

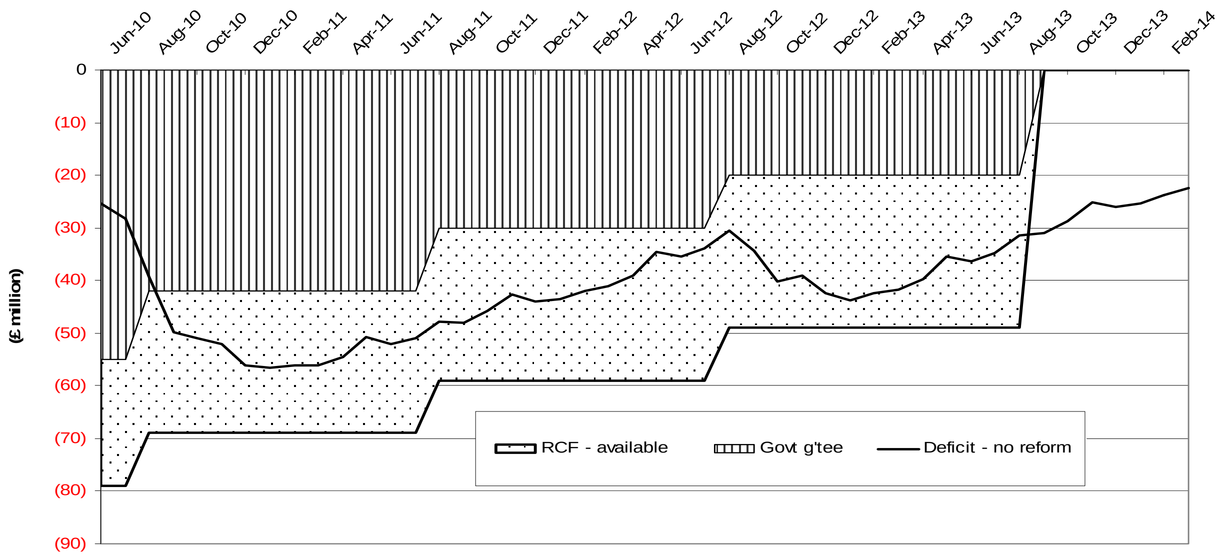
ATOL finances

19. 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.

20. Chart 1 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.

21. 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 1: ATTF projection, 2010 to 2014, base case



Source: CAA
RCF = Revolving Credit Facility

POLICY OBJECTIVES AND RATIONALE FOR INTERVENTION

22. 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.

23. 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.

24. 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.

25. 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

26. 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'.

27. 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 in the second half of 2012.

28. 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 it 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.

29. 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

30. 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

31. 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.

32. 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.

33. 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

34. 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.

35. 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

36. 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).

37. 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.

38. This approach would also require a change to the PTD, and could not be considered until the ATTF deficit had been repaid.

Consultation on reform options

39. Following an initial consultation on reforms to the ATOL scheme carried out between December 2009 and March 2010 as part of the wider “Regulating Air Transport” (RAT) consultation, an 'in principle' decision on the reforms to take forward was made in February 2011. The Department then consulted on detailed measures to reform the ATOL scheme, including draft new secondary legislation, between 23 June and 15 September 2011.

40. This consultation was in two parts. The first concerned measures that could be implemented through new secondary legislation or other existing mechanisms. The second part covered reforms for the medium and longer term, including some that would require new primary legislation.

41. The key elements of the reforms in new secondary legislation are the subject of this IA. They comprise:

- creating a new category of Flight-Plus holiday in the ATOL scheme to include holidays that resemble a package but are outside the legal definition of a package that determines eligibility for protection
- clearer, standardised information to consumers when any ATOL protected holiday (Flight Plus or package) or flight is purchased by means of a new ATOL certificate.

42. In addition, the consultation described steps to ensure that that where businesses arrange holidays on an 'agent for the customer' basis and so are not covered by the ATOL scheme, the businesses ensure that consumers are fully aware of this, so that they can make an informed decision about their purchase and whether to arrange alternative financial protection.

43. These proposals are aimed at meeting the objectives of improving clarity to consumers and the travel trade about what holidays are and aren't ATOL protected. The Flight Plus proposal should also help secure the scheme's finances by increasing the number of holidays covered by it and this APC income. Once the deficit has been paid off, it should be possible to reduce the APC and also to consider other options for how the ATOL scheme is managed and funded, see below.

44. The consultation also sought views on whether the moratorium on regulations affecting micro businesses should apply to ATOL reforms. It proposed that the reforms be implemented from 1 January 2012.

45. The medium to longer term reforms in the second part of the consultation were:

   - whether new primary legislation should be used so that a) Flight Plus and package holidays sold by airlines would be required to be protected under the ATOL scheme (airlines are currently exempted in the Civil Aviation Act 1982) and b) holidays arranged on an 'agent for the consumer' basis were brought within the scheme.
   - initial views on reforming the way refunds and repatriations are currently funded and organised under the ATOL scheme once the existing deficit has been repaid and the scheme is financially self-sustaining. This includes the governance of the ATTF

   The first bullet should further increase consumer clarity about the coverage of the scheme, and also provide a more coherent regulatory framework for businesses operating in the market for holidays including a flight. The second bullet is part of the preparation of looking at changes to how the ATOL scheme might be better run in future.

Consultation responses

46. Over 80 responses to the consultation were received, a summary of which can be found in a separate document. The responses broadly supported the proposed reforms to be implemented by secondary legislation, although many raised a number of significant points about the specifics of the proposals including their potential costs. These points are reflected in the assessment of costs and benefits below.

47. A significant number of respondents said that the proposed implementation date of 1 January 2012 would not give sufficient time for businesses to make the necessary changes required by the reforms. In recognition of these concerns, on 25 October 2011 Ministers announced that the implementation date would now be in April 2012.

48. Following the consultation, Ministers have decided, subject to necessary clearances, that the reforms requiring primary legislation should be taken forward, through the proposed Aviation Bill. It is proposed that the Bill is used to widen the Secretary of State's power to make ATOL regulations, so that holidays sold by airlines and those procured on an agent for the consumer basis can be included in the ATOL scheme. This should further increase clarity to consumers, and also ensure a consistent and coherent regulatory framework for businesses selling flight inclusive holidays.

49. The first step in these reforms will be to change the Secretary of State's powers to make ATOL regulations in the Civil Aviation Act 1982 through clauses in the Aviation Bill. Once this has been done, new regulations will need to be made to give effect to the reforms. Given this, it is unlikely these reforms will be in place before 2014, given the time needed for a Bill to go through the parliamentary process and then to prepare and consult on new regulations. An IA is not required for the change to the Secretary of State's regulation making power through the Aviation Bill, as there are no costs and benefits associated with this. An IA will be prepared for regulations made under the revised power as these would be expected to have costs and benefits arising from them. CAA plan to do further work on the reforms to how refunds and repatriations are managed & funded in 2012, taking account of consultation responses.

Do the proposed reforms constitute gold-plating?

50. The Department believes that the reforms using secondary legislation do not constitute 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.

51. 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.

52. 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

Base case

53. <u>The Base case</u> 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.

54. 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.

55. 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.

56. A lack of reform could also undermine the financial viability of the scheme. The ATTF was £42m in deficit in March 2011. 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 £30m, 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.

57. In the base case, the APC is assumed to remain at £2.50 throughout the 10 year assessment period.

The Preferred Option

58. The preferred option (Option 1 in the consultation IA) is a set of 2 measures to help meet the reform objectives, as consulted on between June and September 2011. The measures are:

Measure i): Closing loopholes by creating a new Flight-Plus category in the ATOL scheme through new secondary legislation

59. 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.

60. To help address this, a new category of ATOL protection would be created, Flight-Plus, which would cover flights requested with accommodation or car hire as well as other significant components for use in the same holiday. The requests for the flight and main holiday elements have to be made within two successive days, to a business that facilitates arranging the holiday.

61. As well as protection against the insolvency of the travel agent or tour operator, Flight- Plus also includes 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 would be required to provide an alternative or if this was not possible a refund.

62. In addition to improving clarity for consumers and the travel trade, by increasing the number of holidays in the ATOL scheme and so APC payments to the ATTF, the Flight Plus measure should help meet the objective of safeguarding the Government guarantee and helping the Fund return to financial self-sustainability.

Measure ii): ATOL Certificate for passengers

63. This measure would provide consumers with much clearer information that their holiday of flight 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. The CAA has had discussions with the travel trade about the detailed content and format of the certificate. As the CAA first announced its intention to develop an ATOL certificate in October 2010 this measure could be considered as part of the base case. However, it is included in the preferred option to provide a complete and transparent picture of the reforms, and as the Certificate will only be given full effect once the proposed new secondary legislation comes into force. This will require ATOL businesses to provide the certificate to consumers.

Other measures consulted on

64. The consultation stage IA also included two further options. One included measures 1 and 2 above, and also removing 4 million 'flight only' sales by 3rd parties from ATOL. This was 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. A final option was to rely solely on measure ii) above - the ATOL certificate - as a means of providing consumers with better information when their holiday is ATOL protected as a lighter touch alternative way of improving consumer clarity than including flight plus holidays in the ATOL scheme.

65. Neither of these options has been taken forward. The option of removing 'flight onlys' from the ATOL scheme attracted some support in consultation responses as a way of improving clarity. However other responses were concerned about the reduction in financial protection this would entail for consumers. By removing flight only sales from the scheme, there would also be substantially less income to the ATTF as a consequence, likely to delay the time when the Fund's deficit could be repaid.

66. Many responses supported the principal of protecting Flight-Plus holidays in the ATOL scheme. Relying solely on the ATOL certificate would only partially improve clarity for consumers as the

underlying legal framework would remain unchanged. There would also be no or very little effect on the ATTF's financial position, with little prospect of the Fund's deficit being repaid.

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Moratorium on regulations affecting micro businesses

67. The consultation sought views on whether the moratorium on new regulations for micro businesses and start ups should apply, as the ATOL reforms come within the moratorium's scope. A substantial number of businesses that sell Flight-Plus holidays are likely to be micro- businesses.

68. 39 responses out of a total of 82 answered on this point. 30 were against the moratorium applying, 3 were in favour and 6 more expressed views that were partially in support or partially against. Those not in favour argued that applying the moratorium would undermine a key objective of the reforms to improve clarity to consumers about when their holiday was ATOL protected. If the moratorium were to be in place, ATOL protection would in part depend on the number of employees in a business selling Flight-Plus which would be unlikely to be apparent to consumers. Others pointed to the Approved Body (AB) proposal in the consultation (see below) that was designed to reduce the costs of complying with the proposed ATOL regulations for smaller businesses selling Flight-Plus. Those that were in favour of the moratorium could see the benefits from reduced burden of regulation. One proposed that the moratorium should apply, but that businesses should be able to opt-out of it if they wanted.

69. The CAA already has in place two ways to reduce the burden of complying with the ATOL regulations for smaller businesses - a Small Business ATOL (SBA) and franchises. Both of these provide flexibility and reduced burdens for businesses selling less than 500 or 1,000 flights & packages per year respectively. The AB proposal adds a further model aimed at small businesses, many of them likely to be micro-businesses currently outside the ATOL scheme selling Flight-Plus. Under it, these businesses would not require a licence of their own but could operate as members of an AB. The AB would have an ATOL licence and also meet other specific requirements set down by CAA. The AB would need to be satisfied with the businesses systems and financial controls of a member. If it was, then the member business would effectively trade using the AB's ATOL licence. Member businesses would be required to pay a membership fee to the AB. It is expected that ABs will mainly be existing travel agent consortiums that already provide commercial services to member businesses. The AB proposals, along with SBAs and franchises, provide 3 options for smaller businesses to comply with the ATOL regulations.

70. In light of the consultation responses and AB proposal, Ministers have agreed to an exemption from the moratorium for the proposed ATOL regulations. The costs and benefit estimates below have been prepared on this basis. An 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. This suggests a range of net benefits from a cost of £19m to a benefit of £6m

COSTS AND BENEFITS OF THE PREFERRED OPTION

<u>Measure i</u> - Flight-Plus.

71. CAA estimate that 6 million holidays p.a. will, over time, be brought fully into ATOL as a result of this measure. This includes 3 million Flight Plus holidays that are currently sold with only partial ATOL protection (for the flight) and 1 million holidays that are currently outside the scheme entirely (for example as they are procured on an agent for the consumer basis). The 2 million reduction in ATOL holidays over the initial 4 years of the assessment period in the base case is also reversed.

72. After the first 4 years, the 6 million p,a remains constant, with no further growth. This is consistent with trends over the past 15 or so years where ATOL protected holidays have fallen as a share of a growing total market for UK residents leisure trips by air.

73. 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. The gross additional cost to businesses is expected to be £3.90 per holiday, less than 1% of the assumed average holiday cost of £500

74. In response to the consultation, ABTA estimate that 630 of their members - mainly travel agents- that would need to comply with the ATOL regulations under the reforms There are also an estimated 1,700 small travel agents that are existing members of travel agent consortiums, many of which will not be ABTA members. The travel agent consortiums are expected to become ABs under the reforms, as a means of allowing their members to comply with the ATOL regulations. Allowing for a substantial overlap between ABTA members and travel agent consortia members, it is estimated that and additional 1,900 businesses will be brought into the scheme. From discussions with the travel trade, CAA's view is that 5 Approved Bodies will be established.

Costs- Transitional

75. Businesses brought into ATOL for the first time may face 5 types of transitional costs:

- New Licence application: those associated with getting an ATOL licence, both the cost of the licence itself and the resources needed to apply for one;
- Bonding: the costs of providing a bond usually for an initial 4 years of trading;
- Familiarisation: changes to software to identify when a flight plus holiday has been sold and
- Agency Agreement: establishing agreements between ATOL licensed businesses and their agents selling package holidays and flight onlys.
- Software development costs for on-line agents

Transitional costs - new licence application

76. 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), an Approved Body (AB) licence. These costs and the estimated number applying for each type are set out in table 2 below.

77. The license costs are set by CAA., and are assumed not to increase in real terms. On advice from CAA, the administration cost is based on 50 hours work for senior corporate mangers to apply for a full ATOL licence. Twice that has been assumed for an Approved Body licence given it is a new option, and 25 hours for an SBA reflecting the lower inputs needed for that types of arrangement. Travel agents that become members of an Approved Body are assumed to pay an additional £100 p.a. as part of their existing membership of a travel consortium (see para 68 above). The mean salary for senior corporate managers is £49,163[1], or around £24 an hour. The total transitional cost relating to obtaining ATOL licences of all types is estimated to be £1.2m in the first year of the assessment.

Table 2 - Cost of new ATOL licences

Type of licence	Cost of 'licence' (£)	Associated administration cost (£)	Total per 'licence' (£)	Number of businesses	TOTAL £'000
Full	1,890	1,193	3,083	50	154
SBA	1,185	596	1,711	145	248
Approved Body (AB)	20,000	2,385	22,385	5	112
AB member	100	298	398	1,700	677
					1,191

Transitional costs - bonding

78. CAA require new ATOL holders 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

[1] 2009 Annual Survey of Hours and Earnings, Mean annual salary for senior corporate managers

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 are at annex 3, estimated to be £11.3m over the first 4 years of the assessment period (constant prices). .

Transitional costs - familiarisation

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

<u>Transitional costs - changes to software to identify when a Flight-Plus holiday has been arranged</u>

80. Consultation responses identified a transitional cost arising from changes to on-line and other booking systems to identify when a Flight-Plus has been requested, specifically when the flight and other holiday elements are requested at different times within the 2 successive days allowed for in the proposed secondary legislation. Three businesses estimated this to be £1m each, while one other identified the cost but did not quantify it. A representative body for on-line travel agents also identified this as a cost for its members.

81. The actual level of costs required will depend in part on how the requirements in the regulation are interpreted, in the first case by CAA as regulator, but ultimately by the courts. Previous discussions with the travel trade have suggested that a relatively low cost, pragmatic approach of asking customers if a related holiday element had been requested in the past day, followed by database searches, should be able to identify the great majority of Flight-Plus requested.

82. From the consultation responses received, it has been assumed that 6 businesses face this cost - at an average of £1 m per business, giving a total cost of £6m in the first year only.

Transitional costs - agency agreements

83. One of the proposals consulted on is to require agency agreements between all ATOL licensed businesses and the agents who sell package holidays or flights on their behalf. This is not directly linked to Flight Plus, but is part of improving clarity about the basis of relationships in the travel trade, which can be difficult to determine particularly when a business becomes insolvent. While a number of ATOL businesses may have these agreements in place a now, and it is certainly good business practice to do so, consultation responses showed that a number of businesses did not or that existing agreements would need to be renewed.

84. Following discussion with CAA, it has been assumed that 5,000 to 10,000 new agreements would be required, and that each would require on average 4 hours of senior management time to put in place, valued at £96. This reflects the fact that CAA has published a schedule of terms to be included in these arrangements, which should standardise and streamline the process. Using the top of the range of 10,000 new agreements, the total transitional cost for agency agreements is therefore £0.7m, incurred in the first year.

85. In total, all <u>transitional costs</u> amount to £19.2m in constant prices over 4 years (or £18.2m NPV).

86. The analysis focuses on business that will be brought into the ATOL scheme on the introduction of the reforms. There are also likely to be new entrant businesses in subsequent years of the assessment period that will be required to comply with the ATOL regulations in order to sell Flight Plus holidays. It has been assumed that the total number of businesses remains constant, with new entrant businesses replacing those that fall out of the scheme, either due to insolvency or from changing their business model. Many of the new entrant businesses are expected to become members of Approved Bodies with low transitional costs for licensing and bonding. Other transitional costs may be passed on to new entrants from businesses leaving the market so may already be captured in the above analysis.

Costs - recurring

87. Businesses brought into ATOL for the first time in order to sell Flight Plus holidays will face four types of recurring costs:

- Licence renewal
- ATOL Protection Contribution payments
- Supplier failure insurance premiums

88. Other recurring costs, either to the ATTF or CAA will be:
    - Additional travel company failures from expanding the ATOL scheme
    - Additional enforcement expenditure

These are discussed in turn below. All recurring costs arise in each year of the 10 years of the assessment period. All values are NPV over 10 years unless otherwise stated.

Recurring costs - licence renewal

89. In terms of annual recurring costs, businesses will need to renew their ATOL licence or AB membership each year which requires payment of a fee set by CAA. Associated resource costs are based on 25 hours work for a Full ATOL licence. It is assumed that most businesses that are AB members will already be part of a travel agent consortium that has become an AB for which they pay an annual fee. Following discussion with CAA, an additional £100 p.a. fee has been assumed for AB members to cover additional costs from the AB option. Licensing costs are assumed to remain constant in real terms throughout the assessment period.

Table 3 - Annual cost of ATOL licence and consortium membership annual renewal

Type of licence	Cost of 'licence' p.a. (£)	Associated administration cost p.a (£)	Total per 'licence' p.a (£)
Full	1,185	596	1,781
SBA	780	298	1,078
AB	10,000	596	10,596
AB members	100	298	398

90. Over the assessment period, total licence renewal and consortium membership renewal costs are.£7.2m.

Recurring costs - ATOL Protection Contribution

91. A significant annual recurring cost arises from the liability to pay the APC by for each Flight Plus holiday booked. This is currently £2.50 per person. In the consultation IA it was assumed to reduce to £2 or £1.50 after 4 years, reflecting the improvement in the position of the ATTF arising from the reforms. For this IA, only £1.50 per booking is used after 4 years. CAA has confirmed that the ATTF would be viable with this level of APC once the deficit has been repaid. While this is a plausible assumption for the purposes of this IA, it should not be taken as a commitment by the Secretary of State to agree to reduce the APC to £1.50. APC payments in respect of Flight Plus holidays total £82.8m.

92. The reduction in the APC to £1.50 after 4 years will apply to ATOL protected package holidays and flights, not just Flight Plus. The total benefit of reduced APC payments for these holidays and flights is £74.3m. The net cost of the APC changes to businesses is therefore £8.5m.

93. The level of the APC is approved by the Secretary of State in nominal terms. In this IA it is assumed to maintain a constant value in real terms. once approved.

Recurring costs - supplier failure insurance

94. As well as paying the APC to protect consumers against their own insolvency, businesses selling Flight Plus will have to provide consumers with alternative arrangements or a refund 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.

95. Many businesses selling flight plus holidays are expected to protect the flight element of a Flight-Plus 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 ATTF trustees have agreed to reimburse a proportion of the cost to the flight to the Flight-Plus arranger, reflecting the fact that an APC will have been paid for the flight as well as for the Flight-Plus holiday.

96. The Flight-Plus arranger can decide whether to purchase flights in this way or buy them from other sources. In the latter case, they would then be likely 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 has been assumed to cover the failure of non-airline suppliers. A further 3 million holidays are assumed to be covered by supplier failure insurance at a cost to businesses of £3.00 per passenger, following advice from a leading supplier of this type of insurance. The cost is assumed to remain constant in real terms for 10 years. In total, recurring costs for supplier failure insurance are £72.2m. .

97. 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. The benefit from pay-outs net of administration costs is £50.6m. The net cost of supplier failure insurance is therefore £21.6m.

Recurring cost - additional travel company failures from expanding ATOL

98. Including Flight-Plus in ATOL increases the number of businesses and holidays protected by the ATOL scheme, so the number of travel company failures each year is likely also to rise. The ATTF will meet the cost of repatriating holidaymakers already abroad and providing refunds, which represents a cost of this option.

99. It has been assumed that the additional 6 million Flight Plus p.a that will be fully ATOL protected under the option experience travel company failures in the same proportion as existing holidaymakers. Using data for the past 10 years, around 0.3% of ATOL protected passengers per annum are affected by a travel company failure. The average expenditure for each passenger refunded or repatriated is £302. Applying these figures to the additional 6m Flight Plus p.a given full ATOL protection under the scheme gives a total cost over 10 years of £37.4m

Recurring cost - additional enforcement expenditure

100. 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 number of such prosecutions is not expected to increase in this option relative to the base case, so there are therefore no additional costs to be incorporated.

101. In total, recurring costs amount to £125.3 m. (NPV over 10 years).

Benefits - transitional and recurring

102. There re no transitional benefits from this measure. There will be three types of recurring benefits

- Incerased passenger protection
- APC receipts to ATTF
- supplier failure insurance payouts

Recurring benefits - passenger protection

103. 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 10 years, the ATOL scheme has spent £211.2 million on refunds and repatriation, at an average of £302 per passenger. Some 250 million passenger have been protected by the scheme over the same period . This means that the expected avoided cost (benefit) is around £0.85 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 £4.30[2]. 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.

104. 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.

105. 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.

106. £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 are used the £4.30 from the European Commission survey, and half that amount, £2.15, both assumed to remain constant in real terms thoughout the assessment. No consultation responses commented on the values used for benefit from passenger protection. Therefore both estimates are used to provide a range. It should also be noted that this estimate is an average; some consumers may well value this protection more highly, others much less so. Using the two values gives an estimated benefit to consumers from ATOL protection for Flight-Plus holidays of £120.9 to £60.4m NPV over 10 years.

107. 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 £37m cost to the ATTF of meeting claims arising from ATOL failures, as mentioned in para 97. 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

108. The ATTF operates as a pooled fund. The additional APC payments outlined above 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, or they meet the costs of current travel company failures. While representing a

[2] 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

cost to businesses, the net additional APC payments are also an equal and offsetting benefit to the ATTF of £8.8m (NPV over 10 years).

109. As mentioned above, in addition to paying premiums for Supplier Failure Insurance, Flight Plus arrangers should also benefit from payouts under their policies when suppliers to do fail. this is assumed to be equivalent to premiums paid, net of net of administration costs of 30%, or £50.6m (NPV over 10 years).

110. In total, recurring benefits amount to £179.9m to £119.5m (NPV over 10 years)

111. All the costs and benefits from this measure are summarised in table 4 below. Overall, measure 1 produces monetised net benefits in the range of £36.4m (a benefit) to -£24.0m (a cost) (NPV over 10 years).

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

Costs			**£m**
- Transitional	*Licence application*	*See table 2 above*	***-1.2***
	Bonding	*See annex 3*	***-10.6***
	Software changes		***-5.8***
	Agency agreements		***-0.7***
- Recurring	*Licence renewal*	*See table 3 above*	***-7.2***
	Net APC payments comprising:	*£2.50 to year 4 then £2 or £1.50*	***-8.5***
	APC payments - Flight-Plus		*-82.8*
	APC payments - reductions for all		*74.3*
	Supplier failure insurance cover	*£3 per holiday where used*	***-72.2***
	Refund and repatriation costs from additional failures	*Based on past trends*	***-37.4***
Total Costs			**-143.5**
Benefits			
Recurring	*Benefits of increased passenger protection*	High - £4.30 per passenger	***120.9***
		Low - £2.15 per passenger	***60.4***
	Net APC receipts to ATTF	*£2.50 to year 4 then £1.50*	***8.5***
	Supplier failure insurance payouts, net of administration costs	*Admin costs 30% of premiums*	***50.6***
Total Benefits		**High**	**179.9**
		Low	**119.5**
Net Benefits		**High**	**36.4**
		Low	**-24.0**

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

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Measure ii): ATOL Certificate

112. 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 in the form of an ATOL certificate, making it much easier for consumers to recognise when a holiday or flight was ATOL protected. It would be a legal requirement for ATOL licensed businesses to provide consumers with a certificate.

113. The ATOL certificate proposal was included in the ATOL reform consultation. Many responses welcomed the concept of the Certificate and saw it as a useful way of providing clarity, but many others were concerned about how it would operate in practice, and also potential cost implications. CAA established a working group with the travel trade to discuss these issues, which has met a number of times since the Spring. This group has addressed a number of travel trade concerns about the practicality and potential costs of the Certificate. An initial draft of the Certificate was published by CAA in November 2011, with the final form and content expected to be agreed with the travel trade by the end of 2011.

Costs

114. There would be a transitional cost to businesses in adapting IT and other systems to produce and distribute the Certificate. All ATOL businesses would be likely to face such costs. Consultation responses provided limited evidence on what they might actually be, partly reflecting perhaps that final decisions on the form and content of the Certificate had yet been taken. In order to help businesses, particularly smaller ones, reduce these costs, CAA has developed a simple software solution to populate and produce Certificates.

115. 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, but on a per unit basis is likely to be very low , as the Certificate will take a standardised from and can be distributed electronically. Consultation responses pointed out that the Certificate would not be able to replace existing documents such as the ATOL confirmation invoice and ATOL receipt , as invoices and receipts would continue to be required as part of the normal course of business.

Benefits

116. The benefits would go to consumers who would be clearer that their holiday was ATOL protected. This would be of general benefit to up to 22 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,

Costs - transitional	*Changes to systems to produce it*	Un-quantified
Costs - recurring	*Production and distribution of certificate*	Very low per certificate
Benefits- recurring	*Clarity about ATOL protection*	18 million ATOL passengers p.a
	Quicker processing of refund claims	Thousands of passengers p.a.

Other benefits and costs

117. In addition to the costs and benefits from the two measures 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

118. By increasing income to the ATTF, the reforms should help safeguard the Government's guarantee supporting commercial borrowing by the ATTF, reducing the likelihood 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 be for those who benefit from the scheme, holidaymakers and the travel trade, to bear its full financial risk, not to share this with taxpayers.

119. 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.

120. 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

121. 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

122. As mentioned above, part of the set of reforms consulted on 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. This is an existing obligation of businesses under the Consumer Protection Regulations 2008, although some may not be aware of it.

123. There would be benefits to consumers from having better information about the insolvency protection provided with their holiday so they can take better informed decisions about the holiday they intended to book and make alternative arrangements for this protection, if desired.

124. This represents an important element of the reforms as it seeks to addresses, in the short term, the consequences for consumers of a way to avoid the ATOL scheme. A fuller solution to bring holidays procured on an agent for the consumer basis into the ATOL scheme would require new primary legislation.

125. The Other benefits and costs form the preferred option are summarised in table 3 below.

Table 6 Non-monetised benefits and costs summary

		Quantification where possible
Non-monetised benefits	*Protection of Government guarantee*	£30m in 2011/12
	Protection of CAA liability for ATTF debt	£10's of million
	Reduction in demand for FCO consular assistance	
	Consumers are aware of implications and risks of holidays organised on an 'a4c' basis	

PROPORTIONALITY OF ASSESSMENT

126. This IA contains a relatively detailed assessment of the costs, benefits and other impacts associated with the ATOL reform policy. This is appropriate given the nature of the reforms and their impact on businesses and consumers, as well as the fact that this is a final stage IA.

RISKS AND ASSUMPTIONS

ATOL Protection Contribution

127. 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. The APC is assumed to be £2.50 per passenger for the first 4 years of the assessment after which, as a result of the reforms it reduces to £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

128. 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

129. 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

130. As noted above, there is uncertainty about the value of ATOL protection to passenger, with estimates ranging from £0..85 to £6.97. Two values have been used in this assessment, £4.30 and £2.15 per passenger.

Review of Package Travel Directive

131. The European Commission is reviewing the PTD, and a proposal to revise it is expected in 2012. 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

132. 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.

IMPACTS ON BUSINESSES

133. In terms of impacts on businesses, the reforms represent an equivalent annual net cost of £6.5m. The cost mainly arises from those associated with licensing & bonding, along with net supplier failure insurance costs . APC costs are lower as although businesses selling Flight-Plus holidays will have to pay this, the reforms should allow the APC to be reduced for all other ATOL protected holidays and flights after 4 years. once the Fund has returned to financial sustainability. The net cost of supplier failure cover 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
Licensing and bonding	-18.9
IT changes and agency agreements	-6.5
APC payments for Flight Plus	-82.8
Supplier failure insurance premiums	-72.2
APC reductions for package and flight only	74.3
Supplier failure insurance payouts	50.6
Net benefit/cost	-55.6
Equivalent annual cost £m	-6.5

134. 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. Greater clarity over ATOL protection may also mean that some credit card merchant acquirers reduce their financial requirements for tour operators and travel agents.

135. 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.

136. 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. 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.

137. The additional gross cost to businesses selling Flight Plus holidays, ignoring all benefits to businesses, represent around £3.90 per ATOL booking, using an average of 5.4 million annual bookings p.a (6 million additional bookings are reached after 4 years, 5.4 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 £3.90 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 1.6% of this.

138. 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.

One In One Out policy

139. The proposed reforms would result in an estimated net cost to businesses of £6.5 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. The cost represents an 'In' for the purposes of the 'One In One Out' policy. The Department has identified the necessary offsetting 'Outs' as follows:

- Traffic Regulation Orders - Introducing a Flexible Approach to Publicity Requirements - £5.9m
- EU Directive on the Interoperability of Rail Systems -£2.08m

Both these measures are expected to be introduced in the Statement of New Regulations 3 period.

WIDER IMPACTS

140. 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 PREFERED OPTION

141. The table below summarises the net benefits and costs of the preferred option :

Table 8 Summary of costs and benefits of options

	Monetised net benefits (10 year NPV)	Key non-monetised benefits and costs	Annuitised net cost to business
Flight plus and ATOL certificate	NPV of -£24.0m to £36.4m	Better information and clarity to consumers Protects Government guarantee and CAA finances, leading to reduced risks Restores ATTF finances	£6.5m

142. 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 £30m - 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

143. 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 the preferred option, particularly in light of the potential financial liabilities for the Government and CAA that this option should substantially mitigate.

144. 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.

145. 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 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.

- Taking forward further changes to the ATOL scheme to reinforce clarity for consumers while improving the coherence of the regulatory regime for businesses, which would require primary legislation. This includes bringing Flight-Plus and all other holidays sold by airlines and 'agent for the consumer' sales into ATOL. .
- 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.

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IMPLEMENTATION PLAN

146. The reforms will be implemented mainly by new secondary legislation, but also by using existing powers, including changes to ATOL standard licence conditions. The consultation proposed that the reforms come into effect from 1 January 2012. However, a number of consultation responses from the travel trade argued that this would not allow enough time for the businesses to make the necessary changes. Taking account of this, Ministers announced in October 2011 that the implementation date would be in April 2012.

147. The draft regulations include a review clause in line with Government's latest policy on reviews and sunset clauses. An initial review must be carried out within 5 years of the regulations coming into force, and will need to take account of how the PTD is implemented in other Member States. In addition, provisions relating to Flight Plus will effectively be sunset after 7 years.

Annexes

Annex 1: Post Implementation Review (PIR) Plan

Basis of the review:

The regulations putting in place the reforms will include a review clause in accordance with Government regulatory policy. A sunset clause is 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.

Review objective:

The review will consider the success of the policy in meeting its objectives. These are:

providing greater clarity for consumers about insolvency protection for holidays including flights

- **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**

Review approach and rationale:

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.

Baseline:

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

Success criteria:

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.

Monitoring information arrangements

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.

Reasons for not planning a PIR

N/A

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 purchasing a package holiday or a Flight-Plus, so we do not anticipate any negative or significantly differential 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 . The latter will comprise a flight and accommodation or car hire purchased requested within a day of each other 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 one or two large businesses selling Flight-Plus holidays that would be brought into ATOL as a result of the reforms, and around 50 medium sized ones. It is understood that there are potentially some 1,850 smaller companies selling this type of holiday, principally travel agents. Many businesses sell both Flight-Plus holidays and also package holidays. In all 1,900 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 1,900 businesses selling Flight-Plus holidays to obtain an ATOL licence or be a member of an Approved Body - with associated costs. These businesses, as well as those 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 and other transitional costs are likely to be largest. For the very large to medium Flight-Plus businesses, these additional costs are estimated to represent around 1.2% to 1.3% of annual turnover in the first year, before reducing to 0.6% to 0.7% after 4 years when bonding is no longer required. Smaller Flight-Plus businesses face slightly higher relative costs, representing around 1.9% 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 0.8% once bonding is no longer required, usually after 4 years. Costs for businesses part of an AB scheme are expected to be substantially below this, depending on the additional membership fees changed by the AB. No restrictions of businesses joining ABs are expected, provided the business meets the terms of membership, which are likely to include appropriate financial monitoring and control, amongst others.

B.10 The cost estimates in the paragraph above are indicative only. As noted above at least 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 type 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.

B.13 In the course of the consultation, on-line travel agents identified additional costs of the reforms to their particular business model from changes to software needed to identify when a Flight-Plus had been sold where separate elements had been requested at different times. This was estimated at £1m for each business. The actual level of costs required will depend in part on how the requirements in the regulation are interpreted, in the first case by CAA as regulator, but ultimately by the courts. One pragmatic approach might be to include a question to the consumer at some point during the booking process to identify if an element of the same holiday had been booked that day or the previous one.

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

B.14 This outcome is not anticipated for the reasons outlined above.

SMALL FIRMS IMPACT TEST AND MICRO BUSINESS MORATORIUM

Introduction

C.1 In March 2011, the Government announced a moratorium on new regulations affecting micro businesses - those with less than 10 employees - and start ups from April 2011 until 2014. The consultation sought views on whether this should apply to the ATOL reforms, or whether a waiver from the moratorium should be sought. 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.

Costs and benefits arising if the micro businesses moratorium was put in place

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 they account for is far smaller,. While no firm evidence is available, it has been assumed that each would sells 250 or 500 Flight Plus holidays p.a., or 350,000 to 175,000 in total assuming 700 micro businesses.

C.4 Although no firm information is available, it is estimated that all but 50 of the 1,900 businesses expected to be brought into ATOL under the Flight-Plus proposal are likely to be micro businesses. However , these businesses are also expected to account for a relatively small proportion of the up to 6 million p.a Flight Plus brought into the scheme. Using the same assumption about the number of holidays sold by existing ATOL licensed micro-businesses gives a range of, 925,000 and 462,500 per year. The assumptions about the number of micro businesses and Flight-Plus holidays they may sell is set out below.

Table C 1: Micro businesses and Flight Plus sales assumptions

	Number of businesses	Number of Flight Plus holidays sold p.a		Total FP holidays sold	
		High	Low	High	Low
Existing ATOL licence holders	700	500	250	350,000	175,000
New to ATOL scheme	1,845[1]	500	250	925,000	462,500
Total				1,275,000	637,500

[1] 1,700 Approved Body Members and 145 SBAs

C.5 Following the analysis on the main IA, There would be a number of benefits to micro businesses from the moratorium being in place:

- those that would have been brought into the scheme will save costs of licensing and bonding or additional Approved Body fees
- no APC would be payable on Flight-Plus holidays sold
- No supplier failure insurance premium would be payable

C.6 There would also be costs. These comprise

- reduced consumer benefits, the High and Low estimates of £4.30 per passenger and £2.15 per passenger are used from the main IA
- reduced APC receipts to the ATTF
- supplier failure insurance payouts foregone

The costs and benefits are summarised in the table below, for both the Higher and Lower estimates of Flight- Plus holidays sold by micro businesses.

Table C2: costs and benefits of moratorium for micro business applying to ATOL reform regulations.

	£ million NPV	
	High sales	**Low Sales**
Benefits		
Reduced licensing costs	8.0	8.0
APC payments saved	20.6	10.3
Supplier failure insurance premiums saved	31.8	15.9
Lower ATTF payouts	8.9	4.5
Total	69.3	38.7
Costs		
Reduced passenger benefits[1]	-45.5/-22.8	-22.8/-11.4
APC income foregone for the ATTF	-20.6	-10.3
Supplier failure insurance payouts foregone	-22.2	-11.1
Total	-88.3/-65.5	-44.1/-32.8

Net benefits/costs	-19.0/3.7	-5.5/5.9

[1] The £4.30 and £2.15 values from the main IA have been used.

The results show a net benefit/cost of between -£19.0m (cost) and £5.9m benefit.

Other effects

C.7 Micro-businesses would also benefit from costs savings from not having to produce the ATOL certificate

C.8 A number of consultation responses also pointed out 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 as 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 knew were protected.

C.9 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. This is likely to be particularly relevant where the economic climate is uncertain with an increase risk, or perception, that travel businesses may become insolvent.

C.10 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.

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

C.11 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 the Approved Body (AB) arrangements as a way of reducing the burden of the ATOL scheme. The intention is that small businesses will be able to become a member of an AB 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.12 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, for the time being, the Government guarantee that underpins it.

C.13 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.

C.14 Finally, in the absence of the ATOL scheme, it is possible that there would be far fewer small businesses operating in the market for flights with holidays. Arguably, without the protection provided by ATOL, holidaymakers might be driven towards larger businesses as they may be perceived as being stronger financially and at less risk of insolvency than smaller ones.