Regulatory Policy Committee

Implementation of revised ATOL measures to improve system resilience

Department for Transport – Civil Aviation Authority (CAA)

RPC rating: validated

Description of proposal

The assessment covers four measures aimed at increasing the robustness of the Air Travel Organisers Licensing (ATOL) system. The ATOL scheme is a statutory financial protection scheme that protects purchasers of package holidays from the insolvency of an ATOL licensed travel company.

All businesses that sell air holiday packages and some third party flight sellers in the UK are legally obliged to hold an ATOL. Under the licence, travel companies are required to contribute to the Air Travel Trust (ATT) - a public trust fund that pays for compensation to travellers if an ATOL operator becomes insolvent and is unable to meet its obligations to them.

The CAA reviews each business failure where payments from the ATT are required, and has noted a consistent pattern of inadequate financial assurance, especially among small business ATOL (SBA) licence holders. It is concerned that if this is not addressed the rate at which the ATT's funds are used up will increase and an increase in ATT contributions will be needed.

The regulator has therefore made the following changes to ATOL:

1) An amended financial test that small and medium-sized ATOL holders were required to pass in order to hold an ATOL licence;
2) Introduction of the ATOL Reporting Accountant (ARA) scheme, which requires firms' regulatory returns to be signed off by an ATOL certified accountant;
3) A change to the classification of a SBA, meaning businesses with licensable turnover in excess of £1 million can no longer be an SBA; and
4) An obligation for all new ATOL applicants to have at least £30,000 in paid-up share capital.

It had considered the option of removing the SBA licensing option altogether, but decided, based on feedback from industry stakeholders, that a more proportionate approach was preferable.

Impacts of proposal

The CAA considers each of the four changes in turn:

Revised financial test: The assessment states that this change affected 1,000 SBAs and 600 medium-sized ATOL holders. The regulator routinely collects data on the cash injection required to meet the test, and based on this concludes that the net cash injection required has not changed materially relative to previous years. It therefore concludes that the net ongoing impact of the change has been negligible.

ATOL reporting accountant scheme

This change affected 1,774 ATOL holders. The CAA expects that ATOL holders will experience an increase in their annual audit fees as a result of this change, which it estimates at £600 per annum (based on advice from an audit firm with relevant experience). This results in a total estimated cost to business across the industry of £1 million per annum.

Restrictions on who may be an SBA

This change has two different elements. The first is that the CAA's test for eligibility for an SBA licence is based on turnover rather than numbers of bookings. This change means three firms are no longer eligible for an SBA licence. They will be required to meet the requirements of a standard ATOL financial test and will pay a higher licence fee, which will cost each firm approximately £533 per annum, giving a total of,£1,600 per annum. There will also be some additional reporting requirements for these firms, which the CAA assumes are included in its estimates of costs for the reporting accountant scheme.

The second element of this measure is that all SBAs (around 1,000) must now meet a financial test when they renew their ATOL licence. The new test will require some SBAs to set aside additional capital as a condition of being granted a new licence. There are two opportunities for ATOL holders to renew their licences each year – March and September, and the CAA has data on the capital injections required as a result of this test for September renewals. Assuming that the March renewals are similarly affected, it estimates a total one-off capital injection of £3 million, affecting around 457 SBAs. As the capital injected is still available to those businesses, the actual cost to business is better estimated as "*the cost of capital of the additional capital bound into the business*." The CAA has estimated this using a weighted average cost of capital for the travel and tourism sectors of 6.7%, giving a final cost estimate of £199,463 per annum.

Increase in paid-up share capital for new ATOL applicants

The assessment states that the increase in paid-up share capital (the amount of money a company has received from shareholders in exchange for shares of stock) will only increase for new ATOL applicants. The CAA estimates the number of new ATOL applicants in each year based on administrative data, and has used a sample of cases to estimate the additional cost of capital imposed by this requirement, over and above the costs imposed by the financial test. On this basis, it estimates the cumulative impact of this measure in year N as £13,381 x N.

Using standard assumptions about reading speeds and wage data from a previous IA, the CAA estimates one-off costs to businesses due to familiarisation with the test guidance at £7.25 per SBA holder and £10.96 per medium-sized ATOL holder, giving a total of £13,800.

Benefits

The CAA argues that the benefits of these measures are difficult to quantify as the amount paid out from the ATT – in repatriation and refunds to customers – changes regularly and is largely driven by a small number of large incidents. It describes two key benefits:

(a) A closer balance between licence holders' (especially SBAs') contributions to the ATT and their demands upon it, so that more financially stable firms are not required to subsidise riskier ones;

(b) A reduced experience of insolvency for customers of ATOL firms and in particular of SBAs.

It plans to monitor the impact of the changes over the next 3-5 years, to test whether the package has met its objectives.

Quality of submission

The assessment provides appropriate and proportionate evidence to support the cost estimates presented; we were especially pleased to see a brief description of the rejected options and of future plans for monitoring and evaluation. As the measure is especially targeted on small businesses, an explicit discussion of any possible mitigation for, or benefit to, these businesses would have been helpful, but is not required. Similarly, a clearer explanation in support of the CAA's assumption that the size of the relevant market is unlikely to change over time would have improved the quality of the submission.

Departmental assessment

Classification	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£1.2 million
Business net present value	-£11.5 million

RPC assessment

Classification	Qualifying regulatory provision (IN)
EANDCB – RPC validated[1]	£1.2 million
Business Impact Target (BIT) Score[1]	£6.0 million

Michael Gibbons CBE, Chairman

[1] For reporting purposes, the RPC validates EANDCB and BIT score figures to the nearest £100,000.