

## Airline Insolvency Review: Call for evidence

### UK Finance response

14 May 2018

#### INTRODUCTION

UK Finance is the trade association which was formed on 1 July 2017 to represent the finance and banking industry operating in the UK. It represents around 300 of the leading firms providing finance, banking, markets and payments-related services in or from the UK. UK Finance has been created by combining most of the activities of the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association.

Our objective is to work with our members to build a more customer-focused and innovative finance and banking sector, cementing the UK's role as a global leader in financial services for the benefit of the wider economy. The interests of our members' customers are at the heart of this work.

#### INTRODUCTORY COMMENTS

We welcome the opportunity to provide feedback on the Airline Insolvency Review Call for Evidence. Improving the situation around airline insolvencies is vitally important and it is clear that there are a number of gaps in the current system. Over the past few years it has become clear that the statutory protections in place for card payments have led to the industry being treated as the de facto consumer protection scheme of last resort in instances of airline failure/insolvency. We are therefore keen to support the government in resolving some of the issues highlighted in the Call for Evidence.

We agree that one of the core aims of the Review should be to provide consumers with a clear and consistent level of protection irrespective of the way in which they have paid for their airline travel. We note that the chief beneficiaries of a clearer and more comprehensive consumer protection scheme would of course be consumers and the travel industry itself (given increase in consumer confidence that would arise). This needs to be factored in to consideration of the solution and who should pay for it.

In addition to responding to the Call for Evidence, we hope to participate in bilateral and/or group sessions with the Review team as appropriate.

#### COMMENTS ON THE CALL FOR EVIDENCE

The Call for Evidence lays out the main components/tasks of the review as follows:

- What practical arrangements are needed to get passengers home if sufficient capacity does not exist in the market?;
- How can passengers and the taxpayer be protected from the financial impacts of an airline failure?; and
- What changes need to be made to the current arrangements in the light of the answers to the above, and to put them on a more commercial basis?

It also notes that the Review will be assessing options against the following principles:

- The beneficiary pays for protection. This will require a careful balancing of the level of risk covered and the affordability of protection. The corollary of this principle is that the taxpayer's exposure should be minimised or removed.
- Efficient allocation of risk. The risks for passengers should be allocated to those best placed to manage and control them, whilst avoiding duplication where possible.
- Minimisation of market distortions. Constraints on the competitiveness and size of the UK aviation market should be minimised and UK registered airlines should not be put at a competitive disadvantage vis-à-vis international competitors.
- Simplicity for passengers. Passengers should understand the protection available and be able to identify which risks are covered, and to what level. In addition, passengers should be compensated in a timely and efficient manner: being brought home and compensated quickly.

We agree that these principles are an appropriate lens through which to view these issues, though it is interesting to note that the current card protections do not meet these principles. For example, from the Monarch incident there is currently a burden on the credit card issuers, yet they cannot directly manage the risk.

We also note that in terms of the efficient allocation of risk, it is important that the risks are not only allocated to those best placed to manage and control them, but also to those able to respond in practical terms once the risk crystallises – i.e. whoever shoulders the risk needs to be able to take practical steps to repatriate stranded customers, by sourcing capacity on flights.

We agree that the financial risks for consumers arising out of airline failure should be borne by the ultimate user of the service (i.e. the consumer) and not the taxpayer. However, we need to exercise caution around passing this risk onto creditors (i.e. through a special administration regime) as it could lead to significant market distortion.

We also think that it might be useful to include a principle / aim for the Review that for future Airline Insolvencies there will always be a clear and understood process, known to all the primary parties (e.g. airlines, CAA, ATOL, payments services) about what the process will be for dealing with the issue. While of course each failure is different, with different requirements, we believe that it is important to have a centrally documented procedure that can broadly be followed. This would have the benefit of ensuring that all parties are acting along similar lines to a similar time frame. It would also help to provide greater clarity about how and when to communicate with customers, and what will be expected of each party. We go on in this response to discuss our favoured option (the Denmark model option) and would expect that were a scheme of this kind in place, this would be this objective.

## COMMENTS ON SPECIFIC SECTIONS OF THE CALL FOR EVIDENCE

3.15: We would be interested in hearing views on who would be best placed to administer such schemes [The UK's ATOL scheme and the Danish Rejsegarantifonden are examples here, where companies pay a levy on travel products which feeds a fund used to pay refunds and ensure repatriation], and the extent to which capacity exists in current insurance and financial markets to provide equivalent protection on a commercial basis. We would also like to hear from those with views on how to create such capacity should none exist.

- A mandatory protection scheme applicable only to UK based companies (or holidays/ flights purchased through those companies), is likely to leave significant numbers of UK consumers exposed, with no protection, where purchases are made throughout non-UK companies; however
- A mandatory scheme which attaches to outbound UK flights and/or companies offering outbound UK flights would provide the most comprehensive cover for UK consumers. There seem to be two sensible options to achieve this:
  - A Danish style levy on all outbound flights, which is paid into a common fund to cater for airline failure. The fund should be administered by a body capable of arranging repatriation/ creating capacity; or
  - A fund contributed to by all airlines that fly UK consumers from the UK (regardless of head office location), with contributions dictated by reference to size/ type of airline (using a similar model to

the Financial Services Compensation Scheme). Again, the fund would have to be administered by a body capable of arranging repatriation.

- In either event, to ensure consumers are adequately protected, the fund should cater for refund and repatriation costs (to include consequential losses, including additional hotel stays etc).
- The Denmark model (scheme in which passengers pay a small 'departure fee' towards a rescue fund which inter alia, would meet creditor obligations so as to maintain flight operations and repatriate customers) appears to be equitable and consistent with the aims. Its administration could come within existing entities such as the CAA. This is the best way of ensuring that those users of the service are the population that contribute to the cost whereas other models would create a burden on the state or other people who do not use the service. Issuers/acquirers would be supportive of a clear and simple levy which would pay out in the event of insolvency. Of course, it would need to be carefully managed in terms of how it is communicated to customers so that they are clear what it is paying for.
- One member queried whether, in terms of ease and speed of solution, the current Air Fare Duty could be increased by a few pence to cover the cost of a levy.
- To avoid consumers who purchased holidays or flights turning to chargeback or s75, regardless of any alternative mechanism for protection (which could result in delays in consumers being refunded or repatriated) some form of limit to card issuers and/or acquirers liability could have to be introduced such that firms could reject or at least suspend otherwise valid claims where a consumer has not exhausted their statutory rights (this could be achieved, for instance, through a future statutory instrument introduced alongside a new scheme).
- It is worth noting that s75 protections still remain in force for credit card purchases despite significant reductions in interchange income as a result of the Interchange Fee Regulation cap – meaning the credit card companies are already suffering a relative loss from when s75 was first drawn up and will continue to do so until this is reviewed. If a mandatory levy/charge for consumer protection was to be brought in, then the potential to have airline tickets removed from S75 cover would be a logical step (for flight purchases that are covered by the mandatory charge).
- Mandatory Travel Insurance for airline travel is another option to consider. It would be low-cost and payable on all flights departing the UK at point of purchase. Its administration and enforcement would likely need to be centralised.
- We would urge caution in considering the introduction of a Special Administration (SA) regime for the airline industry. SA regimes are likely to reduce considerably amounts which would ordinarily be recoverable by creditors on an insolvency, which in turn would reduce creditors' appetite to continue to provide funding in the airline sector, resulting in market contraction.
- At present card acquirers and issuers can find themselves facing an unfair level of cost but pushing that cost back to financier through special administration schemes does not feel like the right solution.
- A range of other options for funding airline passenger protection or supporting the logistics of repatriation in the event of carrier's insolvency should be considered that would support appropriate behaviours across the industry (e.g. increased capital reserves, deferral of settlement until flight complete, leasing conditions etc).
- Very careful consideration should be given to the transition from present arrangements to any new model so that the risk is not shifted to unfairly impact existing funding arrangements.
- While the Review does seem to consider that all options are on the table, the cards industry is of the strong view that the responsibility and solution should lie with the airlines themselves. Whilst the consumer would be the beneficiary of any protection, the risk is created by the commercial activities of the airline (from which they profit) and their own fiscal management (for which they are responsible). Financial services firms are all required to provide and arrange for the possibility of their own demise and ensure that any failure they suffer is orderly. This should apply to airlines too.
- Ultimately, we believe that a commercial product solution or levy is the most favourable solution. Section 75 should be the last resort, and not the procedural norm. We also believe that the solutions should sit primarily with the airline industry. There is often a temptation in policy making to look at the payments system, which does indeed underlie all customer interactions and transactions, as the obvious home for

solutions to industry problems. But it is simply not feasible or sensible to make the central transaction 'pipes' responsible for solving social or financial problems for every industry.

- We also note that as with any project where solutions are proposed that will transfer risk from one party to another, there needs to be a transition period built in to ensure that industry stakeholders have time to account for the changes.

3.26: "Changes could also be made to the legal framework surrounding the insolvency of airlines to ensure there is access to the data and airline systems needed to run these operations effectively and efficiently in administration. Changes could also be made to place the emphasis on those administering an insolvent airline to ensure passengers' welfare".

- On the welfare point in 3.26, we agree that consideration of passengers welfare is important, although we recommend that this should not amend creditors' rights from what they would be in a standard administration as this could damage creditors' appetite to lend and so result in market distortion). Again, these could act to both improve the ability of passengers to find replacement flights and to lessen the financial impact of the failure.
- We agree that some changes are required to the legal framework around access to data following an insolvency. As the DfT is aware, following the Monarch collapse, the cards industry (facilitated by UK Finance) undertook a great deal of data analysis to try to determine what passengers were covered by S75 etc. This process was significantly delayed and hampered by delays in the provision of the data, but more importantly, by the poor quality of the airline data. Accepting limitations imposed by recent data protection laws etc, there is no reason in today's data-rich age that there should not be a comprehensive and complete data set of passengers, flight/holiday types, payment type/detail, and travel dates. This data set would be a core part of the procedure required to be in place following this Review. We anticipate that one of the aims of the Review could be to define the required components of the data set and to ensure that all airlines' internal data records are maintaining the appropriate data history and content and that this is stored in a way that can be captured and shared in case of an insolvency

## GENERAL CARDS INDUSTRY INPUT

Following engagement with the Review team, we understand the key issues requiring cards industry input to be:

- how the industry views its responsibilities
- how acquirers price for risk (in a general sense)
- how much change is required to materially change acquirers approach. If the risk profile changes (e.g. the acquirer takes the first, or last, or no hit) how does that change the cost/approach from acquirers to airlines.
- Future payments ecosystem and how those changes may impact customers (e.g. more bank-to-bank payments, different customer protections on those payments).
- What the hidden costs are for card firms when they act as a 'backstop'.

How the industry views its responsibilities

- The industry takes its responsibilities to protect customers seriously, and a lot of time and resource is spent by firms and schemes to ensure that procedurally and practically, customers experience as little detriment as feasible where they are not at fault.
- However, the industry does support any measures of harmonisation where the consumer is provided with clarity around what steps they need to take in the event of things going wrong as opposed to the position of "contact your card issuer" in all cases.
- The implications of airline failures are almost unique in terms of the impact they have on consumers, given the volume of people potentially impacted at the same time, and the immediacy of their needs for support in terms of returning home.
- This is important for two reasons:

- Firstly, the priority for stranded customers impacted by airline failure is to return home without additional cost. While s75 may provide some financial protection, card issuers (or acquirers for that matter) do not have the capabilities to assist with the practical challenges associated with repatriation.
- Secondly, card issuers' potential liability for s75 claims arising following an airline failure can well exceed the value of the underlying transactions – particularly where repatriation is necessary. This is because:
  - While the initial transaction will have included the costs of a flight ticket, that would have been paid in advance. Any claim for the costs of repatriation is likely to be based around the cost of a ticket required at short notice, at a time when the costs would be significant inflated by the increased demand for flights caused by the inevitable volume of stranded passengers (particularly where flights have not been specifically sourced for stranded passengers); and
  - Claims are likely to include consequential losses, such as extra transport or accommodation costs.
- Given the above, any scheme resulting from this inquiry which could lead to an additional burden on card issuers, will not only fail to offer the practical assistance consumers require, but may also run the risk of card issuers being forced to make risks based decision to decline travel/ airline ticket purchases to mitigate their exposure (being the only way issuers could effectively mitigate the associated risks).

How acquirers price for risk (in a general sense)

- *Unfortunately we have not been able to get input on this in the time period, but we can continue to liaise with the Review team on this issue.*

How much change is required to materially change acquirers' approach. If the risk profile changes (e.g. the acquirer takes the first, or last, or no hit) how does that change the cost/approach from acquirers to airlines.

- *Unfortunately we have not been able to get input on this in the time period, but we can continue to liaise with the Review team on this issue.*

Future payments ecosystem and how those changes may impact customers (e.g. more bank-to-bank payments, different customer protections on those payments).

- This is a very important aspect to consider. Reliance on consumer chargeback or s75 rights ignores the fact that payments in future may become more complicated. Any future solution which relies on the consumer protections currently available alongside 'traditional' payment methods are unlikely to be future proof, given the fast-developing payment eco-system.
- The introduction of the Revised Payment Services Directive (PSD2), as well as Open Banking in the UK (and similar initiatives in other EU countries) will radically change the payments landscape over time. PSD2 introduced new categories of regulated players, including Payment Initiation Service Providers (PISPs). PISPs are able, with the customers consent, to initiate payments on the customer's behalf from their bank account directly to merchant's bank account. This type of bank-to-bank payment does not go on the cards rails and therefore is not subject to the same protections. While there are of course some high-level protections in place for bank-to-bank payments, in a scenario where, for example, an airline collapses, if the customer had used a bank-to-bank payment to pay for their ticket, they would probably not be able to claim back for the loss of the service.
- While volumes of this kind of payment are currently low, we expect them to grow (and indeed it was the intention of the European Commission that these legislative changes should introduce greater competition into the cards payment market). With these kinds of changes underway it is more important than ever that the solution arrived at through this Review does not seek to rely on the cards protections afforded now, given that in the future many customers may have paid through different means.

- As an example, we have recently seen an announcement of “a challenge to credit card companies being launched by the global airline industry and Deutsche Bank with a new electronic real-time payment system for plane tickets...The new system for web-based ticket sales to individual passengers, which does not have a brand name yet, is scheduled to be rolled out across Europe from the end of 2018, with Germany as the first market.” This kind of venture is clearly designed to take large volumes of ticket sales away from traditional card payments and therefore emphasises the need not to rely on the cards payment system as a backstop.

What the hidden costs are for card firms when they act as a ‘backstop’.

- In terms of hidden costs outside of the actual chargeback are the operational costs incurred to handle both the original raising of the chargeback and any resulting queries that arise on the back of that. In terms of remit, card firms’ responsibilities are governed by both the CCA & the payments Scheme. Payments made outside of the scheme/card eco system may offer different protections.
- As a general point, we note that card firms are not in a position to immediately respond to an unexpected crisis impacting large numbers of customers at once – such that reliance on firms in this situation would be both unrealistic and result in significant additional costs.

Other comments:

- Issuer members have noted that there are mechanisms designed to help to prevent customers being compensated twice. For example, there is a MasterCard mandate which prevents chargeback where there is evidence of sufficient bond/or insurance. This prevents the cost being passed onto the acquirer and the customer being compensated twice. Nevertheless, the processes are time and resource intensive for firms and a situation where customers of airline failures are known to be protected by another scheme would be far simpler.
- In addition to repatriation and refunds, the work should consider consequential loss as this is important in achieving good outcomes for customers.
- ATOL protections seem to work well most of the time for travel agents and thus could be a model for airlines.
- Although we haven’t had the time to consider this in more detail for the call for input we think that there is merit in exploring the absolute cost to the airline industry of imposing risks on parties not able to efficiently manage the risk.
- In the case of chargeback exposure, we believe that the asymmetry between the risk management information available to the acquirer is most likely to result in the acquirer retaining more collateral than may be strictly required if the risks were readily identifiable. There is good evidence that the exposure to risk typically discourages acquirers from recruiting airline businesses, which we expect would impact the competitiveness of the pricing in this market. These factors in themselves can be a contributing factor to airline failure in certain circumstances. A better allocation of risk may materially reduce the risk of specific airline failure.
- The position in relation to S75 is even more extreme. The issuer has absolutely no way of quantifying or managing any risk and has no direct contractual relationship within the airline at all. It is also worth noting that as a result of the exposure to consequential losses, credit card issuers are effectively exposed to a higher degree of risk than parties in contractual relationships with the airline. There seems little logical justification for this. The sole remedy for the issuer is to prohibit use of the credit card for a purchase, which in itself undermines the central utility of the product from a consumer’s perspective.
- It is interesting to note that recently a number of our members have responded to identified risks, both to consumers and lenders by prohibiting the purchase of virtual currencies etc by credit card. Were this to become prevalent in relation to airline ticket sales it would no doubt have an adverse impact on the market generally.