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|---|---|--|-------------------|
| <b>Title:</b><br>ATOL REFORMS USING PRIMARY LEGISLATION<br><b>IA No:</b> DFT00160<br><br><b>Lead department or agency:</b><br>DEPARTMENT FOR TRANSPORT<br><br><b>Other departments or agencies:</b> | <b>Impact Assessment (IA)</b>               |  |                   |
|   | <b>Date:</b> 06/02/2013                     |  |                   |
|   | <b>Stage:</b> Enactment                     |  |                   |
|   | <b>Source of intervention:</b> Domestic     |  |                   |
|   | <b>Type of measure:</b> Primary legislation |  |                   |
| <b>Contact for enquiries:</b> Tom Oscroft<br>020 7944 5488<br>tom.oscroft@dft.gsi.gov.uk  |   |  |                   |
| <b>Summary: Intervention and Options</b>  |   |  | <b>RPC:</b> 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, Two-Out? Measure qualifies as |
| £26m to £120m                             | £51m to £78m               | £6m to £9m   | No NA   |

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

The statutory Air Travel Organisers' Licensing (ATOL) scheme protects consumers when their package tour operator or travel agent becomes insolvent. It is being reformed through new regulations to make it clearer to consumers when their holiday is protected due to changes in the way holidays are sold, and also to address the scheme's finances (see IA DFT 00092). But those reforms are only partial and will leave significant potential uncertainty and confusion for consumers about the coverage of the scheme and a regulatory framework that is less than coherent for businesses. Further intervention requiring new primary legislation would be needed to address these issues, which non-regulatory measures could not achieve.

**What are the policy objectives and the intended effects?**

The objectives are to give the Secretary of State powers to enable future ATOL regulations to i) provide further clarity to consumers about what holidays are ATOL protected and to ii) help ensure coherence in the regulatory requirement to provide ATOL protection across all types of businesses that sell or arrange holidays including a flight. The intended effects would arise only when (and if) regulations under the new powers were made. They would be for consumers and the travel trade to have greater certainty about what holidays are ATOL protected and for there to be more coherence across businesses selling similar products about the requirement to provide ATOL protection.

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

Non-regulatory options have been considered, for example an approach based on better information to consumers. However these would be unable to meet the objectives. The regulatory option requires new primary legislation to change the current powers used to make ATOL regulations. The preferred option is to take new regulation making powers that would allow:

- 1 - package and Flight-Plus holiday sales by airlines to be covered by the ATOL scheme
- 2 - holidays including a flight procured under an 'agent for the consumer' model to be covered by the ATOL scheme,
- 3- other potential avoidance approaches to the scheme to be addressed.

The preferred option has positive net benefits and would meet the policy objectives better than non-regulatory options.

**Will the policy be reviewed? It will be reviewed. If applicable, set review date: 01/2018**

|  |                     |                       |                       |                      |                           |
|--|---------------------|-----------------------|-----------------------|----------------------|---------------------------|
| 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.                       | <b>Micro</b><br>Yes | <b>&lt; 20</b><br>Yes | <b>Small</b><br>Yes   | <b>Medium</b><br>Yes | <b>Large</b><br>Yes       |
| What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent) |                     |                       | <b>Traded:</b><br>Nil |                      | <b>Non-traded:</b><br>Nil |

**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:  Date: 7 2. 13

# Summary: Analysis & Evidence

# Policy Option 1

**Description:** Primary legislation to enable holidays sold by airlines and those procured on an agent for the consumer basis to be brought within the ATOL scheme

## FULL ECONOMIC ASSESSMENT

| Price Base<br>Year 2011 | PV Base<br>Year 2014 | Time Period<br>Years 10 | Net Benefit (Present Value (PV)) (£m) |             |                     |
|-------------------------|----------------------|-------------------------|---------------------------------------|-------------|---------------------|
|                         |                      |                         | Low: 26.6                             | High: 120.1 | Best Estimate: 73.3 |

| COSTS (£m)    | Total Transition<br>(Constant Price) Years | Average Annual<br>(excl. Transition) (Constant Price) | Total Cost<br>(Present Value) |
|---------------|--|---|-------------------------------|
| Low           | 0.0  | 10.7  | 89.7                          |
| High          | 0.1  | 16.5  | 138.5                         |
| Best Estimate | 0.0  | 13.6  | 114.1                         |

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

Airlines and travel businesses selling holidays covered by the scheme would face additional costs from paying a per passenger protection charge (£66.1m to £44.6m), supplier failure insurance premiums (£39.9m to £23.3m) and, for a small number of airlines, licensing costs (£0.1m to £0.0m). There would be additional costs from meeting refund and repatriation claims from passengers whose airline or travel company became insolvent (£32.1m to £21.7m)

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

Airlines and travel businesses may face additional cost from producing and distributing ATOL certificates

| BENEFITS (£m) | Total Transition<br>(Constant Price) Years | Average Annual<br>(excl. Transition) (Constant Price) | Total Benefit<br>(Present Value) |
|---------------|--|---|----------------------------------|
| Low           | 0  | 13.9  | 116.3                            |
| High          | 0  | 31.0  | 258.6                            |
| Best Estimate | 0  | 22.5  | 187.4                            |

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

Passengers would benefit from the extension of protection to holidays previously uncovered, estimated to be between £165m and £55m  
Airlines and travel businesses would benefit from payouts under supplier failure insurance policies, estimated to be between £27.9m and £16.3m.  
Per passenger protection payments would represent income of £66.1m to £44.6m

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

All consumers purchasing ATOL protected holidays would benefit from greater clarity about whether their holiday is ATOL protected  
Consumers may benefit if the more consistent and coherent regulatory framework for businesses facilitates improved competition and transparency

|  |                          |      |
|--|--------------------------|------|
| <b>Key assumptions/sensitivities/risks</b> | <b>Discount rate (%)</b> | 3.5% |
|--|--------------------------|------|

Key assumptions are in relation to the number of holidays that would be brought into the scheme, where a range of 3.2m to 4.7m has been used, but there is still considerable uncertainty.  
A further important assumption is the per passenger cost of protection, assumed to be £2.50 for two years before falling to £1.50 which may change following a review of options in 2012.  
A range of values for benefits per passenger has also been used, £4.30 or £2.15.

## BUSINESS ASSESSMENT (Option 1)

|  |                       |                     |                          |                             |
|--|-----------------------|---------------------|--------------------------|-----------------------------|
| <b>Direct impact on business (Equivalent Annual) £m:</b> |                       |                     | <b>In scope of OITO?</b> | <b>Measure qualifies as</b> |
| <b>Costs:</b> 7.9 - 12.4                                 | <b>Bens:</b> 1.9- 3.2 | <b>Net:</b> 6.0-9.1 | No                       | NA                          |

# Evidence Base

## Introduction

This Impact Assessment is concerned with further reforms to the Air Travel Organiser's Licensing (ATOL) scheme, additional to those set out in the other recent IA on this subject (IA no. DfT 00092 available at <http://www.dft.gov.uk/publications/dft-ia-00092/>). The reforms in that IA can be implemented through secondary legislation, namely new ATOL reform regulations. The reforms outlined in this IA would require new primary legislation to broaden the scope of the Secretary of State's powers to make regulations about the ATOL scheme. Such powers are included in the Civil Aviation Act that was introduced to Parliament in January 2012 and has now received Royal Assent. New regulations would need to be made under the powers in the Act to actually give effect to the reforms if the Government took the decision to proceed with this approach.

This IA has been prepared to accompany the section in the Civil Aviation Act that expands the Secretary of State's regulation making powers in relation to the ATOL scheme. In itself, a revised power to make regulations has no costs and benefits on businesses, consumers, the public sector or charities. This IA is therefore based on an assessment of what the costs and benefits would be if regulations under the proposed new power were made to implement two proposed reforms. The estimates are necessarily at a high level with a significant degree of uncertainty. A further, more detailed IA will be prepared to accompany consultation on new draft regulations under the power in the Act, should it become law. This consultation is expected to be in 2013.

A glossary of terms and acronyms used in relation to the ATOL scheme is at annex 2.

## Background to ATOL

1. The Air Travel Organisers' Licensing (ATOL) scheme is run by the Civil Aviation Authority (CAA). It provides financial protection for consumers who purchase holidays including a flight - and some flight only sales - from the insolvency of their tour operator or travel agent.
2. Unless exempt, all businesses selling flight-inclusive package holidays or Flight-Plus holidays (see below) are required to hold an ATOL licence and pay £2.50 per booking ATOL Protection Contribution into the pooled Air Travel Trust Fund (ATTF). If an ATOL licensed business becomes insolvent, the ATTF meets the costs of providing consumers yet to travel with a full refund and repatriating those already on holiday. The CAA, on behalf of the ATTF, assists or organises repatriation. In the year ending 31 March 2012, 17.3 million holidays and flights were ATOL protected. Around 67,475 consumers received a refund and a further 14,330 were repatriated.
3. The ATOL scheme protects consumers against the risk of being stranded abroad if their tour operator fails. In the absence of the scheme, consumers might face considerable detriment from having to make their own arrangements to return home and organise accommodation until then. This would be particularly acute in the event of the failure of a large tour operator in high season where available capacity on return flights and in accommodation might be scarce.
4. The scheme also protects consumers against the risk of tour operator or travel agent becoming insolvent between payment for a holiday and departure, which can often be a period of many months (although some travel agents pass customer payments to suppliers shortly after receiving them. While this risk arises for other goods and services, such as large items of furniture, the scale of potential risk is likely to be greatest in the travel sector, given the number of holidays protected each year under the scheme.
5. 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, further increasing premia. The ATOL scheme addresses this risk by requiring all tour operators to provide insolvency protection.
6. The ATOL scheme was introduced in the 1970s. In 1990 the EU Package Travel Directive (PTD) became law, which is implemented in the UK by the Package Travel Regulations (PTRs) 1992. The

PTD means that businesses selling package holidays must provide protection for consumers against their insolvency. It also requires a number of other protections for those buying package holidays. . Having an ATOL licence is the way in which businesses selling package holidays including a flight in the UK must comply with the requirements in the PTDs.

7. Airlines are currently excluded by law from the requirement to hold an ATOL licence. This is because airlines are subject to a separate licensing regime to allow them to carry fare paying passengers, previously in UK legislation but now set out in EU law. Airlines are not exempt from PTR obligations. Some UK airlines have chosen to protect their package holiday sales under the ATOL scheme by setting up subsidiary companies that can hold an ATOL licence. Other airlines protect their package holidays using other methods approved under the PTRs.

## Recent issues

### Lack of Clarity for consumers

8. In recent years there have been significant changes to the way that holidays are sold. This has been partly caused by the increased demand for independent travel, facilitated by the rise of the low cost airlines, but also by the ability of the internet to allow travel agents to provide customers with the opportunity to 'mix and match' or 'dynamically package' their own holidays. Some travel agents also claim to have adopted an 'agent for the consumer' approach to procuring holidays. Acting in this way takes the transaction outside the scope of the ATOL scheme.
9. It can often be unclear for consumers and travel companies to understand whether such 'mix and match' holidays are packages, and so should be ATOL-protected, or should be considered as individual holiday components purchased separately which are not protected. This confusion has led to significant consumer detriment, particularly when passengers only realise that they are not protected once their travel company has failed. There have also been delays to passenger refund payments whilst the CAA has tried to establish whether an individual was protected or not.
10. This is shown by the fall in the share of UK residents overseas leisure trips by air accounted for by ATOL protected holidays and flights. In 2000, there were 28.0 million ATOL protected flights (including package holidays), 84% of the total of 33.5 million leisure trips by air by UK residents. In 2011, there were an estimated 17.3million ATOL protected flights, out of a total of 38.0 million leisure trips by air by UK residents, a share of just 45% for ATOL protected flights.

### ATTF deficit

11. For historic reasons, the ATTF has operated at a deficit since the mid-1990s. Until the ATOL Protection Contribution (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, currently £20m. The Fund's deficit stood at £18m in March 2012, down from £42m a year earlier. The taxpayer is therefore exposed to financial risk of the ATOL scheme, rather than this risk being wholly with travel companies and holidaymakers who are the scheme's users and beneficiaries, where the Government believes it should lie.

### ATOL reform consultation

12. To address these issues, a consultation was launched on 23 June 2011 to seek views from stakeholders about proposed changes to the ATOL regulations that would:
  - Create a new Flight-Plus category in the ATOL scheme, requiring holidays consisting of a flight, plus accommodation or car hire when requested within two days of each other to be ATOL protected. (This applies to Flight-Plus holidays sold by tour operators and travel agents, not airlines).
  - Create a new ATOL Certificate that would be provided with each ATOL-protected holiday or flight sold, so that consumers had clear information about the protection that comes with their holiday.
13. The consultation also set out steps to help ensure that when travel agents operate on an 'agent for the consumer' model and so arrange holidays that are not ATOL protected, their customers are

made fully aware of the implications of this for insolvency protection. This is based on existing regulations.

14. Together, the above measures should address the two areas of concern: over time, the Flight-Plus proposal is expected to mean that up to an additional 6 million consumers p.a. are protected fully under the ATOL scheme, leading to greater clarity as well as increased APC income to the ATTF. The ATOL certificate further improves clarity about the flights and holidays covered by the scheme.
15. The consultation also asked for views on further potential reforms to the ATOL scheme for the medium to longer term. These included whether holiday sales by airlines and 'agent for the consumer' arrangements should be brought into the ATOL scheme.
16. Finally, it sought initial views on how the management and funding of the ATOL scheme might be amended once the deficit had been repaid, including providing a greater choice of compliance options for businesses.
17. The consultation on the proposals ended on 15 September 2011. After carefully considering the responses, on 9 February 2012 the Government announced its intention to put in place new ATOL regulations with effect from 30 April 2012 to give effect to the Flight-Plus and ATOL certificate measures outlined above. A summary of consultation responses and decisions is available at <http://assets.dft.gov.uk/consultations/dft-2011-17/dft-2011-17-responses-and-decisions.doc>

## Problem under consideration

18. However these measures will not be able to achieve fully the aim of providing greater clarity to consumers. Even after the changes, airlines will still be exempt from the requirement to provide ATOL protection for their holiday sales, including any Flight-Plus holidays. Businesses could still be able to avoid providing ATOL protection by acting on an 'agent for the consumer' basis, a potentially significant way for businesses to circumvent the scheme. There are also potential further ways in which the ATOL scheme might be avoided, including business claiming that they are 'facilitating' making available flight accommodation and so outside the scope of the scheme. Also, the regulatory framework for businesses selling holidays including a flight will not be coherent and consistent for businesses operating in that market. It is not possible to address these issues through new ATOL regulations, as they are outside the scope of the Secretary of State's powers as set down in the Civil Aviation Act 1982. New primary legislation would be needed to amend these powers so that future ATOL regulations could deal with them.

## Airline holiday sales

19. As discussed above, currently airlines are excluded from the ATOL scheme, as set out in the Civil Aviation Act 1982. This Act contains a licensing regime for UK airlines which was superseded in 1992 by an EU airline licensing scheme. Airlines need an EU operating licence in order to carry fare paying passengers.
20. Many major UK airlines have established subsidiary businesses to hold an ATOL licence through which to sell package holidays as a way of complying with the PTRs, although other airlines protect their packages in different ways. But with the ATOL reform regulations in place, airlines will not be obliged to provide financial protection for Flight-Plus holiday sales, only those that are package holidays as legally defined.
21. Many travel agents and tour operators argue that they are at a significant commercial disadvantage, as they are required to meet the obligations and costs (licence fees and APC payments) of ATOL protection whilst airlines can avoid such costs and offer cheaper holidays, in what is a very competitive price-driven market. There is therefore a lack of consistency in the regulatory framework for businesses selling holidays including a flight.
22. This inconsistency has the potential to lead to confusion for consumers, where exactly the same holiday can be purchased from a travel agent with ATOL protection and airline with no financial protection. This issue has become more relevant over the past decade or so as airlines have increasingly started to sell, or facilitate the sale of, hotel or villa accommodation, car hire and other holiday elements alongside flights. The traditional distinction between an airline on one hand and a tour operator or travel agent on the other has become blurred, with all these types of businesses selling very similar holidays.

## Agent for the consumer sales

23. Currently travel companies are legally required to provide ATOL protection only when they are 'making available' flight accommodation, including as part of a package holiday. This stems from the Civil Aviation Act 1982. 'Making available' means having a right to dispose of or sell a flight, and can be seen as the traditional model used by travel agents and travel businesses. Travel agents act for travel company 'principals' in selling travel services to consumers.
24. Some agents however argue that they act as an 'agent for the consumer', so rather than selling a holiday or flight to a customer, they buy the holiday on behalf of the customer acting as their agent. This takes the transaction outside the scope of the ATOL scheme as the business is not 'making available' flight accommodation.
25. It can often be unclear to consumers whether their travel agent is acting as an agent for the consumer, as this depends on the subtleties of how the transaction is completed. And yet this has significant implications for the level of financial protection that is provided with a holiday purchase.
26. Although acting as an agent for the consumer is legal, businesses might be contravening the Consumer Protection from Unfair Trading Regulations 1992 (the CPRs) if they do not make their customers aware that they will not be receiving the ATOL protection that they might expect. CAA has been working with the Office of Fair Trading to ensure that where businesses are acting as agent for the consumer, passengers are made aware of the implications for the provision of financial protection, so that they can make an informed decision whether to buy the holiday or not.
27. However this approach may still fall short of the aim to provide a clear position on financial protection for flight-inclusive holidays purchased in the UK. It could still be difficult for consumers to tell which holidays are covered by the ATOL scheme, while it provides a way for businesses to avoid the ATOL scheme entirely.

## Other avoidance approaches

28. After the Civil Aviation Act was introduced in Parliament two additional areas of concern were identified which might lead to further lack of clarity for consumers by allowing businesses to avoid the ATOL scheme. These are i) businesses potentially claiming that are merely 'facilitating' making available flight accommodation, and so outside the scope of the ATOL scheme and the Secretary of State's Powers to make ATOL regulations and ii) businesses arguing that goods and services sold alongside flights (such as hotel accommodation or car hire) are not in the scope of the scheme as they are not provided 'in connection' with the contract for flight accommodation, as the Secretary of State's current regulation making power requires.

## Initial consultation

29. The ATOL reform consultation carried out between June and September 2011 sought views on whether holidays sold by airlines and those arranged on an agent for the consumer basis should be brought into the ATOL scheme.
30. In relation to including airline holidays in the scheme, 40 responses received were in favour, 2 were neither fully for nor against and 8 were opposed. Those in favour included travel trade businesses and their representative organisations, consumer bodies, regulators and other public sector bodies. Those opposed were all airlines and their representative organisations.
31. Many responses from the travel trade strongly agreed with the proposal as a means of providing greater clarity for consumers as well as providing a 'level playing field' in relation to the regulatory requirements for airlines and tour operators selling very similar products. A number of these responses saw the different treatment of airlines and the travel trade in relation to the ATOL scheme as unfair. They argued that it would also be important to ensure airline holidays sold on a 'click through' basis were covered. Some called for prompt action for this reform to be implemented.
32. Several of the responses that did not support the proposal pointed to the fact that package tours sold by airlines were already protected, either under the ATOL scheme or other approaches allowed under the PTRs. CAA's existing financial monitoring of UK airlines also meant that requiring airlines to be ATOL licence holders would be disproportionate and un-necessarily costly. Some responses argued that sufficient protection mechanisms already existed. Others said that airlines should not be covered by the ATOL scheme where they only provided links to customers to purchase

accommodation, car hire and other holiday services from other website. Another response called for further consultation with airlines once an impact assessment had been produced.

33. There was near unanimous support for including holidays procured on an agent for the consumer basis in the scheme. Of the 28 responses that addressed the question, 26 were in favour and two were neither fully for nor against. The respondents in favour could see both the benefit to consumers of protecting such holidays as these were likely to resemble Flight-Plus or package holidays, as well as the need to close a potential loophole in the ATOL scheme.

### **Rationale for intervention**

34. Although the changes to the ATOL regulations that came into effect on 30 April 2012 went a long way to realising the aims of improving clarity around the provision of ATOL protection for holidays, without further action to bring airline and agent for the consumer flight-inclusive holiday sales into ATOL these aims cannot be achieved more fully. There would still be inconsistency around the provision of ATOL protection for package and Flight-Plus holidays, and there would still be a lack of clarity for consumers, the travel trade and the CAA.
35. For these reasons and taking account of consultation responses, the Department considers that the Secretary of State should have the powers in primary legislation to intervene to provide greater clarity for consumers and coherence in the regulatory framework for businesses, with the aim of ensuring that the ATOL scheme can continue to protect effectively consumers.

### **Policy objectives**

36. In order to address the above issues, we have set the following policy objectives for the further reforms to the ATOL scheme to be facilitated by new primary legislation:
- Provide greater clarity for consumers, so that it is easier to know which holidays are protected by the ATOL scheme.
  - Provide greater consistency and coherence in the regulatory framework for all businesses selling holidays including a flight
37. As discussed above, these objectives could be achieved by including holiday sales by airlines in the ATOL scheme and also those where the business acts 'an agent for the consumer'. Dealing with the potential avoidance approaches of 'facilitating' making available flight accommodation and clarifying when goods and services sold alongside flights are protected under the scheme would also help secure these objectives. Other options are also considered below.

### **Description of options considered (including do nothing)**

38. As noted above, the Civil Aviation Act 1982 means that the Secretary of State's powers to make ATOL regulations do not cover holidays sold by airlines or those procured on an agent for the consumer basis, nor the avoidance approaches mentioned in paragraph 28 above. In order to achieve the reform objectives and address the problems outlined above, new primary legislation is required to broaden the Secretary of State's powers. This would then allow the ATOL regulations to be further revised to include holidays sold by airlines and agent for the consumer sales. A new power to enable this is included in the Civil Aviation Act.
39. There are no immediate benefits or costs from broadening the Secretary of State's power to make ATOL regulations under the Civil Aviation Act 1982. These would arise if and when the ATOL regulations were further revised using the newly broadened powers, when a further impact assessment will be produced.

### **Base case (do nothing)**

40. The base case is the continuation of the ATOL scheme after the implementation of the reforms creating Flight-Plus and the ATOL Certificate, announced on 9 February. The Flight-Plus reform was implemented on 30 April 2012 and the ATOL Certificate came into force on 1 October 2012. It is essentially the same as the preferred option in the IA for ATOL reforms using regulations (IA DfT

00092). (A base case without financial protection for package holidays is not an option, given that this is a requirement of the EU PTD)

41. It is estimated there will be a total of around 19 million ATOL protected Flight-Plus, package holiday and flight only sales per annum. This is assumed to be constant throughout the ten year assessment period, from April 2014 to April 2024. Around 4,400 tour operators and travel agents are assumed to have an ATOL licence or meet their obligations under the ATOL regulations by being members of an 'Accredited Body'.
42. It is also assumed that including Flight-Plus holidays in the ATOL scheme from 30 April 2012 has put the scheme's finances back on a self-sustaining basis allowing the deficit in the ATTF to be paid off and the Government Guarantee to be withdrawn. This facilitates changes in the way the scheme is managed and financed so that the cost per booking is £1.50 on average, starting in April 2016. This cost could either be paid through a single rate APC levied on all bookings, as at present, or alternative financial arrangements where the cost varies, perhaps according to the risk or size of a business, but where the average per booking cost over all ATOL licensed business is £1.50. The CAA and Department intend to launch a call for evidence in early 2013 on the management and financing of the ATOL scheme. Our intention is to seek views from a wide variety of stakeholders. The outcome of this work should become clear later in 2013 and could be used in IAs accompanying a consultation on draft regulations that might be made under the new powers.
43. The introduction of a Flight-Plus category provides greater clarity for consumers and the travel industry about which holidays are ATOL protected, as does the ATOL Certificate. But the base case will not fully achieve the aim of clarity for consumers: there will be no obligation for airlines to provide ATOL protection for their holiday sales, or for businesses operating as agents for the consumer to protect their holiday sales, which would remain a way for the ATOL scheme to be avoided. This leaves a large sector of the market which provides holidays without ATOL protection, which consumers may expect to be protected.
44. There would also still be an inconsistent approach to regulating businesses, with different rules about the provision of ATOL protection for different sectors of the market, who are all selling the same type of products.

### **Preferred Option: measure 1 - Bringing airline holiday sales into ATOL**

45. Primary legislation would be used to broaden the Secretary of State's existing regulation-making power, and the ATOL regulations would then be revised to require airlines to protect their package and Flight-Plus holiday sales under the ATOL scheme. The Civil Aviation Act contains powers which allow this. A consultation on draft ATOL regulations accompanied by an IA will be published in the first half of 2013. Taking account of this, it is assumed here that this measure would not be implemented through the necessary revised ATOL regulations in place until April 2014.
46. As already discussed, some major airlines already sell package holidays through ATOL licence-holding subsidiaries, and other airlines protect their package holiday sales through alternative mechanisms allowed by the PTRs. Under this measure all airlines would have to protect their package and Flight-Plus holidays through the ATOL scheme. However, under the EU Services Directive, it would not be possible to require airlines established in other EU member states but not in the UK to protect Flight-Plus holidays they sell under the ATOL scheme.

### **Preferred Option: measure 2 - Requiring holidays including a flight procured on an agent for consumer model to be included in the ATOL scheme**

47. This measure would require those sales that are currently made on an agent for the consumer basis to be protected by the ATOL scheme. It would require primary legislation to provide the Secretary of State with the necessary powers to make regulations to do this, which are contained in the Civil Aviation Act. As under measure 1, it is assumed that new regulations to give effect to the policy are put in place from April 2014.
48. This measure would provide ATOL protection to a greater number of passengers per annum who currently do not receive it. However, under the EU Services Directive, it would not be possible to require airlines established in other EU member states but not in the UK to protect Flight-Plus holidays they sell under the ATOL scheme.



## **Preferred Option: measure 3 - closing avoidance approaches from 'facilitating' making available flight accommodation and in relation to goods and services provided alongside a flight**

49. This measure would enable potential avoidance approaches to be addressed, helping ensure that the objectives of the reforms in measures 1 and 2, as well as those in the ATOL regulations that came into effect in April 2012, can be secured. It requires changes to the Secretary of State's regulation making powers in relation to the ATOL scheme as set out in the Civil Aviation Act 1982.
50. Given this, it is not anticipated that this measure would have any costs and benefits that are not already accounted for in the IA for the ATOL reform regulations (IA no. DfT 00092) or in those set out below for measures 1 and 2.

### **Other option considered: All flights protection**

51. Under this option, ATOL protection would be extended to all flights departing UK airports where a ticket was purchased in the UK, regardless of whether they formed part of a holiday. This was not an option included in the ATOL reform consultation, but has previously been proposed by a number of stakeholders as a means of ensuring complete clarity about what flights are protected under the scheme. However the EU airline operating licence provisions (in the EC Air Services Regulation) mean that it would not be possible for such a scheme to be introduced just in the UK. An EU operating licence gives an airline the right to carry fare-paying passengers between any EU destinations without the need for any additional approval. It would not therefore be possible to impose the need for an ATOL licence in addition to this for EU airlines' 'flight only' sales. When developing regulations that may be made under the proposed powers in the Civil Aviation Act we will take into account developments from the Commission's review of the PTD.

### **Other option considered: non-regulatory measures**

52. There are other alternatives to the reforms that may not need new regulation. These options include: i) relying on better information to ensure consumers are aware which holidays are and aren't ATOL protected; ii) switching to a system whereby the onus is on consumers to purchase insolvency protection insurance; or iii) relying on the protection afforded when purchases are made by credit cards.
53. These options were discussed in the ATOL reform regulations IA. Relying on better information alone (option i) is not seen as a viable option, given that the underlying legal framework of the ATOL scheme is an important source of lack of clarity. Without changes to this, it would still be difficult for consumers, and the travel trade, to know if a holiday was ATOL protected or not. The creation of Flight-Plus and the requirement for an ATOL certificate are designed to address this for sales by tour operators and travel agents. The further reforms proposed under the option in this IA would extend this to other types of holiday, including those procured on an agent for the consumer basis.
54. Moving to a system where it is the responsibility of consumers to take out insurance against the failure of their travel company (option ii) is not possible for package holidays, as the PTD requires travel companies to provide this protection. Given this, and as the ATOL reform regulations will require businesses to protect Flight-Plus holidays, such an approach does not seem appropriate for airline Flight-Plus and agent for the consumer holidays alone.
55. The use of consumer insurance based approach may be one of the options to consider in the review of the PTD. At present many travel insurance policies exclude travel company insolvency protection while those that cover it may not provide repatriation assistance. But it may be a potential method of dealing with refund claims from travellers who have yet to fly. It may be less suitable for travellers already on holiday when their travel company fails and there was a need for a repatriation exercise to be co-ordinated. It is not clear if insurance companies could fulfil this role in the effective way that CAA currently does.
56. Turning to option iii, under the Consumer Credit Act 1974, credit card providers are jointly liable with businesses for the goods and services purchased with the card. So if a travel business became insolvent between a holiday being paid for and completed, the credit card company would be liable to return the money paid, where purchases were above £100. However, similar issues regarding the co-ordination of repatriation arise as under option ii). Credit card providers may also not meet any

costs above the original purchase price where consumers have to be repatriated. Costs to businesses may also increase if credit card companies were expected to meet some of the costs that are currently borne by the ATOL scheme. These companies would seek to recover any increase in cost arising from the businesses they provide services to, including by requiring greater additional financial security from them. This could in theory lead to higher overall costs to businesses, however this has not been quantified for this IA as such an approach would not be possible under the current requirements in the PTD.

## **Costs and benefits of the Preferred Option (including administrative burden);**

57. Unless otherwise stated, all costs and benefits in this section are expressed as NPVs over the 10 year assessment period, using a discount rate of 3.5%. The price base year is 2011. The approach to assessing costs and benefits below follows that used for the IA for ATOL reform regulations, as do a number of the specific assumptions.

### ***Measure 1: bringing airline holiday sales into ATOL - costs***

#### **Transitional costs**

58. Airlines who would now be required to protect their holidays under the ATOL scheme would face the following types of transitional costs:

- obtaining an ATOL licence, including management time
- developing systems to identify when Flight-Plus holidays are sold

#### *Licensing.*

59. Following discussion with CAA, it is assumed that up to an additional 10 to 20 airlines would need to obtain an ATOL licence under this measure. This does not include airlines that have a subsidiary company that holds an ATOL licence, where there would be no additional cost. Each airline would be required to obtain an ATOL licence at a cost of £1,890 (2012). There are also resource costs associated with applying for an ATOL licence, assumed to take 50 hours of senior manager's time, costed at £25.01 per hour<sup>1</sup> equalling £1,251 per licence application. This gives a total cost in NPV terms of £30,000 (10 airlines) or £61,000 (20 airlines)

60. Businesses obtaining an ATOL licence for the first time are normally required to provide a bond to the CAA for the first 4 years of their operation, as further security in the event of their failure. However, as EU airline operating licences already include financial requirements and monitoring arrangements, it is assumed that CAA waives its bonding requirements for the airlines brought into the scheme under this measure.

#### *Developing systems*

61. Airlines may need to develop booking systems to identify when a Flight-Plus holiday is requested, particularly if requests are made on different days (within the definition allowed) and also to produce the ATOL certificate. It is difficult to assess how much this will cost, so no monetised estimate has been included. Airlines may be expected to benefit from work done in preparation for the ATOL reforms requiring tour operators and travel agents to protect Flight-Plus holidays if this develops systems to identify this type of purchase. Further information will be sought when consulting on whether to make new regulations under the proposed powers.

#### **Recurring costs**

62. Recurring costs are mainly driven by the number of airline package and Flight-Plus holidays that would be protected under the ATOL scheme in this measure.

#### *Package holidays sold by airlines*

63. There are currently some 1 million package holidays sold by 7 airlines through an ATOL licensed subsidiary (excluding those sold by integrated tour operators with their own airlines). It is difficult to estimate precisely how many more additional package holidays would be brought into ATOL under this measure. For this reason a range of assumptions has been chosen with a lower estimate of

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<sup>1</sup> Annual Survey of Hours and Earnings 2011. table 14.5a, mean hourly pay for corporate managers and directors.

50,000 - i.e. 5% of the current total and an upper estimate of 100,000 - i.e. 10%. This assumption has been discussed with the CAA.

#### *Flight-Plus holidays sold by airlines*

64. There is little concrete information about the number of Flight-Plus holidays sold by airlines that would be brought into the scheme under this measure. Flight-Plus is a new concept, and airlines are not currently required to monitor sales made in this way. To address this, two scenarios have been developed for use in this IA, a low scenario whereby 2.6 million Flight-Plus holidays sold by airlines are brought into the scheme and a high scenario where 3.6 million holidays are. How these scenarios were arrived at is set out in annex 1. These assumptions have been discussed with CAA.
65. In preparing an IA to accompany draft regulations that would be needed to give effect to this measure, it will be important to develop a better evidence base for these assumptions so a more robust figure can be used. It should be noted that the assumptions about the number of Flight Plus holidays to be sold by airlines could be revised either up or down in subsequent IAs as further information becomes available.
66. Any new regulations made under the powers in the Civil Aviation Act to include holidays sold by airlines in the ATOL scheme would be expected to increase costs to businesses. Businesses would in turn seek to pass these extra costs on to consumers through higher prices for holidays including a flight which could affect demand for these holidays, depending on the price elasticity of demand.
67. The additional cost per holiday would include the per passenger protection charge, supplier failure insurance premiums (net of payouts) as well as other costs, which are detailed below. These are expected to be less than £5 per passenger, or less than 1% of the typical benchmark average cost of a holiday including a flight of £500. DfT's Aviation Forecasts published in August 2011 estimate an elasticity of demand with respect to air fares for UK leisure passengers of -0.7, which seems an appropriate proxy to use for elasticity for flight inclusive holidays. Any reduction in demand from an increase in the price of holidays is therefore expected to be small, at less than 0.7%. Given this, no allowance has been made for changes in demand in the assumptions for holidays expected to be brought into the scheme under this measure (and also measure 2).

#### *Protection cost per booking*

68. Under the base case the cost per ATOL protected booking (either the APC or alternative) is assumed to be £2.50 for the initial two years before falling to £1.50 on average for all ATOL bookings. These are the same assumptions as used in the preferred option in the ATOL reform regulations IA.
69. As noted above, how the ATOL scheme will be funded and managed in the assessment period may well differ from now. This would depend on the outcome of work by DfT and CAA looking at options for the management and funding of the scheme planned to begin early in 2013. For the purposes of this IA, it has been assumed that the new arrangements are structured so that there is no increase in this cost for airline package holidays that will be brought into the scheme (these are already protected under PTR approved arrangements). As regards airline Flight Plus holidays, per passenger costs might be lower than in the base case if the charge is based on the likely risk of an ATOL licensed business failing and airlines were thought to be a lower risk on average than other ATOL businesses.
70. However, this will only become clearer once the additional work mentioned above has reached initial conclusions. For this IA for airline Flight-Plus the per passenger cost is assumed to be the same as in the base case, with an APC (or alternative per booking cost) of £2.50 for the initial two years followed by £1.50. This is assumed to apply to 2.6m or 3.6m holidays per annum in the low and high scenarios respectively. The total cost of these payments is £37.4m (low scenario) and £51.7m (high scenario).

#### *Supplier failure insurance premiums*

71. Under the ATOL reform regulations introduced in April 2012, businesses selling Flight-Plus holidays are required to provide consumers with alternative holiday elements or a full refund if a supplier of one of the Flight-Plus elements becomes insolvent. This is also assumed to apply to airline Flight-Plus holidays under this measure. While not required to, airlines are thought likely to take out insurance to cover this risk. However, it is assumed that all airline Flight-Plus holidays use an airline's own flights, so supplier failure insurance for this element of the holiday isn't relevant. The

insurance would therefore only cover living accommodation and/or car hire. In the IA for the ATOL reforms regulations, an insurance provider estimated the cost of supplier failure insurance to be £3.00 per booking. Following discussion with the CAA, this has been reduced to £0.50 per booking for airlines selling Flight-Plus holidays in this IA, as the insurance will not need to cover airline insolvency- for the reason set out above, - as this is a greater risk than insolvency of other holiday element providers. The 50p premium applies to 2.6m or 3.6m holidays per annum in the low and high scenarios respectively, a total cost of £10.8m (low scenario) or £15.0m (high scenario).

#### *Increased refund and repatriation costs*

72. Extending the scope of ATOL scheme to cover holidays sold by airlines means it also has potentially greater liabilities from the possibility of the failure of an ATOL licensed airline. Over the past 7 years, the average expenditure on refunds and repatriation per ATOL protected passenger has been £0.84 (84p) taken from the ATTF's accounts and information from CAA about total ATOL protected passengers. Assuming this figure applies for passengers purchasing Flight-Plus holidays sold by airlines under this measure gives a total cost of £18.2m (low scenario) or £25.1m (high scenario). This could be an overestimate if airlines are less likely to fail than previous ATOL licensed businesses.

#### *Licensing renewal*

73. The 10 to 20 new ATOL licences under this measure would have to be renewed annually, at a fee of £1,185 per licence. There would also be associated management costs to airlines from licence renewal, estimated to be half those of applying for a new licence (see paragraph 56 above). The total cost is estimated to be £135,000 (low scenario with 10 additional airlines licensed) or £271,000 (high scenario with 20 airlines).

#### *ATOL certificate*

74. Airlines would need to produce and distribute the ATOL Certificate for all package and Flight-Plus holidays they sell. This can be done electronically, and airlines should be able to benefit from the technology and other approaches developed by travel trade businesses in respect of this.

#### *Familiarisation costs*

75. Familiarisation costs are not likely to be significant given that Flight-Plus sold by tour operators and travel agents have been part of the ATOL scheme since April 2012 and as the potential inclusion of Flight-Plus sold by airlines has been announced well in advance of its possible implementation.

#### *Regulatory/enforcement costs*

76. Additional regulatory and enforcement costs faced by CAA are not anticipated to be significant given the increase in ATOL licensed businesses and Flight-Plus holidays brought into the scheme is relatively small compared to its total size. Any additional costs would be expected to be covered by licensing fees.

### **Measure 1: bringing airline holiday sales into ATOL - benefits**

77. No transitional benefits are envisaged.

#### **Recurring benefits**

##### *Consumer benefits*

78. An important beneficiary would be consumers purchasing Flight-Plus holidays from airlines who will now benefit from ATOL protection, where under the base case they would not have. The IA for ATOL reform regulations used two values for consumer benefits from ATOL protection of £4.30 and £2.15 per passenger. These estimates are based on studies carried out for the European Commission and are also used in this IA. The benefit per passenger figure implicitly includes refund and repatriation payments by the ATTF to consumers directly affected by airline insolvency, as discussed above.
79. Combining the two per passenger benefit figures with high and low Flight-Plus scenarios described above in point 59 gives the following estimates of passenger benefits.

**Table 1: Estimates of consumer benefits, £m NPV over 10 years**

|                           | High Flight-Plus | Low Flight-Plus |
|---------------------------|------------------|-----------------|
| High pax benefits (£4.50) | 128.7            | 92.9            |
| Low pax benefits (£2.15)  | 64.4             | 46.5            |

80. No additional benefits are assumed for passengers buying package holidays from airlines that were previously protected under PTR approved approaches. Arguably this may underestimate benefits, as the ATOL scheme may provide better protection for consumers requiring repatriation given the CAA's expertise in organising this that would not be available under the available PTR approaches.

*Income from per passenger protection (or equivalent)*

81. Payments of the APC (or alternative) by airlines under this measure are a clear cost to those businesses. However, the APC also represents income (a benefit) to the ATTF, or what ever alternative arrangements might be in place in the assessment period. Assuming that the payments are made to the ATTF, part of government, the per passenger protection cost is therefore matched by an offsetting benefit of exactly the same value, £37.4m (low scenario) and £51.7m (high scenario).

*Payouts from supplier failure insurance premiums paid, net of admin costs*

82. Payments of supplier failure insurance premia are a cost to airlines under this measure. But airlines will also benefit from payouts under the policy when suppliers of living accommodation and other tourist services that make up a Flight-Plus become insolvent. It is assumed that all premiums received by insurance companies are paid out to airlines, with the exception of 30% for commission and expenses for the insurance company based on data from other property and motor insurance markets available on the Association of British Insurers website<sup>2</sup>. This gives a benefit of £7.6m (low scenario) or £10.5m (high scenario).

**Measure 1: Summary of monetised costs and benefits**

83. The table below summarises the costs, and benefits of this measure and also provides the estimate of net benefits.

**Table 2: Costs and benefits for measure 1, airline holidays, £m NPV**

|   | Measure 1            |              |
|---|----------------------|--------------|
|   | Airline holidays     |              |
| Costs                                       | High                 | Lo w         |
| <u>Transitional costs</u>                   |                      |              |
| New licences and associated costs           | -0.1                 | 0.0          |
| <u>Recurring costs</u>                      |                      |              |
| APC/protection cost per booking             | -51.7                | -37.4        |
| Supplier failure insurance premiums         | -15.0                | -10.8        |
| Increased refund and repatriation costs     | -25.1                | -18.2        |
| Ongoing licensing renewal                   | -0.3                 | -0.1         |
| <b>Total Costs</b>                          | <b>-92.1</b>         | <b>-66.5</b> |
| <b>Benefits</b>                             |                      |              |
| <u>Recurring benefits</u>                   |                      |              |
| Consumer benefits                           | <i>High estimate</i> | 92.9         |
|   | <i>Low estimate</i>  | 46.5         |
| Income from APC/protection cost per booking | 51.7                 | 37.4         |
| Supplier failure insurance payouts          | 10.5                 | 7.6          |

<sup>2</sup> [http://www.abi.org.uk/Facts\\_and\\_Figures/Facts\\_Figures.aspx](http://www.abi.org.uk/Facts_and_Figures/Facts_Figures.aspx) Annual General Insurance Overview Statistics

|                           |                      |              |              |
|---------------------------|----------------------|--------------|--------------|
| <b>Total Benefits</b>     | <i>High estimate</i> | <b>190.9</b> | <b>137.9</b> |
|                           | <i>Low estimate</i>  | <b>126.6</b> | <b>91.4</b>  |
|                           |                      |              |              |
| <b>Net costs/benefits</b> | <i>High Benefits</i> | <b>98.8</b>  | <b>71.4</b>  |
|                           | <i>Low Benefits</i>  | <b>34.4</b>  | <b>24.9</b>  |

84. All the combinations of Flight-Plus passenger scenarios and passenger benefits produce a net overall benefit, ranging from £24.9m in the low passenger and low demand scenario to £98.8m for high passenger scenario with high passenger benefits.

## **Measure 2: Requiring holidays including a flight procured on an agent for consumer model to be included in the ATOL scheme - costs**

85. The types of costs incurred under this measure are similar to those under measure 1, as they arise from bringing in to the ATOL scheme holidays that are currently outside it. However, there are some differences, which are discussed below. It is also assumed that holidays currently purchased on an agent for the consumer basis are Flight-Plus holidays, and that the businesses procuring them will have the same obligations as for other Flight-Plus holidays.

### **Measure 2: Transitional costs**

86. The ATOL reform regulations introduced in April 2012 are expected to lead to a substantial increase in the number of tour operators and travel agents required to have an ATOL licence as they sell Flight-Plus holidays - an estimated additional 1,900 businesses. These tour operators and travel agents, as well as those licensed before April 2012, may also procure holidays on an agent for the consumer basis. Given the large number of businesses brought into the scheme by these reforms, it seems reasonable to assume, at this stage, that there would be no other tour operators or travel agents brought into the scheme under this measure. As a result there are no transitional costs from new licensing or developing systems to identify where Flight-Plus are sold, as the relevant businesses would already have an ATOL license and may also be already selling Flight-Plus holidays.

### **Measure 2: Recurring costs**

87. As for measure 1, recurring costs are driven by the number of agent for the consumer holidays brought into the ATOL scheme. There is little information about the number of holidays organised on an agent for the consumer basis, or what this would be in 2014 when this measure is assumed to come into effect. Two scenarios have been assumed, discussed with the CAA, of 500,000 p.a. and twice that, 1 million p.a. As noted above (paragraphs 63 and 64) no allowance has been made for any change in demand for holidays arising from increased costs to businesses under this measure feeding through to higher holiday prices for consumers.

88. There is uncertainty around these estimates as agent for the consumer sales are outside the ATOL scheme and no data on their number is collected. However, some businesses already state that they operate on this basis and CAA's discussion with the travel trade indicate that other businesses are aware of the measure and that it is a potential way to avoid the ATOL scheme. The low scenario may arise if businesses realise that agent for the consumer sales will be included in the ATOL scheme under the powers in the Civil Aviation Act and decide to move away from this model in advance of this. The high scenario may arise if fewer businesses decided to do this, or if agent for the consumer was seen as an increasingly attractive way to avoid the ATOL scheme.

### *Protection cost per booking*

89. One protection payment cost per booking has been assumed under this measure, payable by the business acting as agent for the consumer. In principle, this type of transaction may involve more than one protection cost payment, if for example as part of arranging a holiday, the business procured a flight that was already ATOL protected. How this type of transaction would be handled has not yet been considered in any detail, but will be in preparing the regulations that would be needed to implement this measure. It is expected that the outcome of this would be included in a

subsequent IA accompanying consultation on draft regulations that may be made under the proposed powers in the Act.

90. The protection cost per booking is assumed to be the same as the base case of £2.50 per booking for the initial two years then £1.50 per booking. This gives a total cost over 10 years of £7.2m (low scenario) or £14.4m (high scenario).

#### *Supplier failure insurance*

91. As noted above, agent for the consumer procured holidays are assumed to be Flight-Plus holidays. Those arranging them will have the same obligations as Flight-Plus arrangers under the ATOL reform regulations including to provide consumers with an alternative or a refund if a holiday component supplier becomes insolvent. It is assumed that supplier failure insurance will be taken out to cover this risk. This premium is assumed to be £3.00 per booking, based on information from an insurance company provided for the ATOL reform regulations IA. It would cover the failure of an airline or a living accommodation provider or car hire supplier. The cost is £12.5m (low scenario) or £24.9m (high scenario).

#### *Increased refund and repatriation costs*

92. As under measure 1, increasing the number of holiday protected under the ATOL scheme means potentially greater liabilities from the possibility of the failure of an ATOL licensed business. Using the same assumptions about the likelihood and cost of an ATOL protected passenger being affected by failure as under measure 1 and the additional 500,000 or 1m passengers brought into the scheme under this measure, additional refund and repatriation costs are £3.5m (low scenario) or £7.0m (high scenario).

#### *Licensing renewal*

93. No businesses are assumed to be brought into the scheme under this measure, as all those procuring agent for the consumer Flight-Plus are thought to already be ATOL licensed. License renewal costs are therefore as in the base case.

#### *ATOL Certificate*

94. The ATOL Certificate would need to be produced and distributed for agent for the consumer arranged holidays. Businesses that arrange holidays on this basis are assumed to already have arrangements in place for doing this for the packages, flights and Flight-Plus holidays they sell under the ATOL scheme. The marginal cost of producing additional certificates for agent for the consumer holidays should be small.

#### *Familiarisation costs*

95. Familiarisation costs are not likely to be significant given that Flight-Plus sold by tour operators and travel agents have been part of the ATOL scheme since April 2012

#### *Regulatory/enforcement costs*

96. Additional regulatory and enforcement costs faced by CAA are not anticipated to be significant given the increase number of additional holidays brought into the scheme under this measure is relatively small compared to its total size.

### **Measure 2: benefits**

97. No transitional benefits are expected

#### *Recurring benefits*

98. The same categories of recurring benefits are expected under this measure as under measure 1 - consumer benefits, income from the APC, and supplier failure insurance payouts. The same input assumptions have been used to calculate the benefits as in measure 1, including the high and low estimates of benefit per consumer, apart from the number of passengers that will be affected, which in this measure is 500,000 or 1 million Flight-Plus holidays p.a respectively in the low and high scenarios.

99. The magnitude of these benefits is set out below in table 3.

## Measure 2: summary of monetised costs and benefits

100. Table 3 below summarises the costs and benefits of the two measures.

**Table 3: Costs and benefits for measure 2, agent for the consumer, £m NPV**

|  | <b>Measure 2</b>              |              |
|--|-------------------------------|--------------|
|  | <b>Agent for the consumer</b> |              |
| <b>Costs</b>                                   | High                          | Low          |
| <u>Recurring costs</u>                         |                               |              |
| APC/protection cost per booking                | -14.4                         | -7.2         |
| Supplier failure insurance premiums            | -24.9                         | -12.5        |
| Increased refund and repatriation costs        | -7.0                          | -3.5         |
| Ongoing licensing renewal                      |                               | 0            |
| <b>Total Costs</b>                             | <b>-46.3</b>                  | <b>-23.2</b> |
| <b>Benefits</b>                                |                               |              |
| <u>Recurring benefits</u>                      |                               |              |
| Consumer benefits <i>High estimate</i>         | 35.8                          | 17.9         |
| <i>Low estimate</i>                            | 17.9                          | 8.9          |
| Income from APC/protection cost per booking    | 14.4                          | 7.2          |
| Supplier failure insurance payouts             | 17.4                          | 8.8          |
| <b>Total benefits</b> <i>High estimate</i>     | <b>67.6</b>                   | <b>33.8</b>  |
| <i>Low estimate</i>                            | <b>49.7</b>                   | <b>24.9</b>  |
|  |                               |              |
| <b>Net costs/benefits</b> <i>High benefits</i> | <b>21.3</b>                   | <b>10.6</b>  |
| <i>Low benefits</i>                            | <b>3.4</b>                    | <b>1.7</b>   |

101. All the combinations of agent for consumer passenger scenarios and passenger benefit estimates produce a net overall benefit, ranging from £21.3m for high passenger scenario with high passenger benefits to just £1.7m in the low passenger and low demand scenario.

## Measure 3: closing avoidance approaches from 'facilitating' making available flight accommodation and in relation to goods and services provided alongside a flight

102. As noted above, as this measure is concerned with closing off potential avoidance approaches to the ATOL scheme, it is not believed there are any additional costs and benefits to those set out above from measures 1 and 2 as well as in the IA for the ATOL regulations 2012 (IA no. DfT 00092).

## Rationale and evidence that justify the level of analysis used in the IA

103. The approach to assessing the costs and benefits of ATOL reforms facilitated by proposed powers in the Civil Aviation Act follows that used for the IA on ATOL reform regulations. This is a relatively detailed assessment of the numerous costs and benefits arising. Many of the input assumptions used in the ATOL reform IA have also been used in this one, given that they are relatively recent and seem appropriate. This approach seems appropriate given that the ATOL reform regulations IA was only completed late in 2011.

104. The approach to assessing costs and benefits as well as the input assumptions will be reviewed and developed as policy development continues on measures 1 and 2. This work will be reflected in



an IA accompanying the consultation on regulations that would implement the measures planned for 2013, subject to the parliamentary process.

## Risks and assumptions

105. The assumptions used in estimating the costs and benefits are outline above. The key risks surrounding these are outlined below.

### *Estimates of package holidays and Flight-Plus brought into the ATOL scheme*

106. There is considerable uncertainty about the number of additional holidays that would be brought under the scheme on both measures 1 and 2. Little firm information is available about the current number of airline Flight-Plus and agent for the consumer procured holidays. A number of assumptions have had to be used in reaching the range of estimates, which have been discussed with the CAA. Further information will be incorporated into the estimates when it becomes available.

### *ATOL Protection Contribution/per passenger protection cost*

107. The Department and CAA intend to start work on a review of the funding and management arrangements for the ATTF in 2012. This is to identify and consider how the current arrangements might change once the ATTF's deficit has been paid off. The base case and the measures assume that the APC is reduced from £2.50 to £1.50 after two years. The review will consider the level of the APC as well as what alternative funding arrangements might be available to provide a choice of compliance measures for ATOL licensed businesses. This might include bonding or insurance measures, as well as having different funding arrangements for refunds and repatriations. The nature and level of the per passenger protection cost may well therefore change as a result of this review, which will be included in the IA accompanying consultation on draft regulations that may be made under the powers in the Act.

### *Consumer benefits*

108. The studies from which estimates of consumer benefits are taken were not specifically on the benefits from the ATOL reform measures, but appear to be the best evidence currently available. The uncertainty is reflected in the range of benefits per passenger used.

### *European Commission proposals*

109. The European Commission is considering revising the Package Travel Directive. It is expected to announce proposals for a revised PTD in Spring 2013. DfT will need to consider the content of the announcement and any implications for ATOL reform proposals in this IA.

### *Failure of a major tour operator*

110. The failure of a large ATOL licensed business, or a number of medium sized failures, with a significant cost to the ATTF is a potential risk to the scheme's finances. Should this occur, it may also have implications for the reforms in the IA, partly depending on the timing and cost of the failure or failures.

## Direct costs and benefits to businesses calculations following 'One in Two Out' (OITO) methodology

111. This IA assesses the likely impact of new primary legislation that includes new, broader powers for the Secretary of State to make regulations in relation to the ATOL scheme. The primary legislation itself has no impact on businesses, but regulations made under the new powers would be expected to. Because it has no impact on businesses, the primary legislation is outside the scope of OITO.

112. The costs to businesses would score in terms of OITO if and when regulations under the revised powers are made. These will be included in the Impact Assessments that will accompany drafts of those regulations, expected to be consulted on in 2013.

113. As an indication, the table below sets out the costs to business of the two measures that give rise to costs and benefits.

**Table 4 Cost to business, measures 1 and 2, £m NPV except where stated.**

|  | <b>Measure 1</b>        |            | <b>Measure 2</b>              |            | <b>Both</b> |            |
|--|-------------------------|------------|-------------------------------|------------|-------------|------------|
|  | <b>Airline Holidays</b> |            | <b>Agent for the consumer</b> |            |             |            |
|  | <i>High</i>             | <i>Low</i> | <i>High</i>                   | <i>Low</i> | <i>High</i> | <i>Low</i> |
| <b>New licences</b>                        | -0.1                    | -0.0       | NA                            | NA         | -0.1        | 0.0        |
| <b>APC/protection cost per booking</b>     | -51.7                   | -34.4      | -14.4                         | -7.2       | -66.1       | -44.6      |
| <b>Supplier failure insurance premiums</b> | -15.0                   | -10.8      | -24.9                         | -12.5      | -39.9       | -23.3      |
| <b>Ongoing licensing renewal</b>           | -0.3                    | -0.1       | NA                            | NA         | -0.3        | -0.1       |
| <b>Supplier failure insurance payouts</b>  | 10.5                    | 7.6        | 17.5                          | 8.8        | 27.9        | 16.3       |
| <b>Total net cost to business</b>          | -56.6                   | -40.8      | -21.9                         | -10.9      | -78.4       | -51.7      |
| <b>Equivalent Annuitised Cost, £m</b>      | -6.6                    | -4.7       | -2.5                          | -1.5       | -9.1        | -6.0       |
| <b>Cost for OITO purposes</b>              | Zero                    |            | Zero                          |            | Zero        |            |

## Sunset and review

114. The ATOL reform provisions in the Civil Aviation Act do not include sunset and review elements, as in themselves they have no impact on businesses given that they change an existing regulation making power. However, any regulations made under the revised powers would be expected to have an impact on business and so would include a review clause and sunset clause as appropriate. If new regulations were to be made in 2013, they would therefore be reviewed no later than 2018.

## Wider impacts

115. The main wider impacts likely to arise are in relation to small businesses, including micro businesses and on competition. Other impacts are also discussed.

### *Impact on small firms including micro-businesses*

116. Measure 1, bringing holiday sales by airlines into the ATOL scheme, is not expected to have any impact on small firms or micro-businesses as airlines are very unlikely to fall into either of these categories.

117. Measure 2 would affect small and micro-businesses that procure holidays on an agent for the consumer basis. Many travel agents are in these categories. A substantial number are expected to be brought into the ATOL scheme through the ATOL reform regulations that came into effect on 30 April 2012, as they sell Flight-Plus holidays. The Government decided that the requirement for a micro-business moratorium should be waived for these regulations, given that a moratorium would undermine the objective of improving consumer clarity if ATOL protection was dependent on the number of employees in a business. It may also affect micro-businesses commercially if they were selling holidays that did not have insolvency protection whereas their larger competitors did provide

this, particularly in the current economic circumstances. The moratorium was also not supported by many consultation responses.

118. For measure 2, it has been assumed that no new businesses, including small or micro-businesses, will be brought into the ATOL scheme. This is because all businesses arranging holidays on an agent for the consumer basis are assumed to already be in the scheme as they also sell package holidays, Flight-Plus or Flight Onlys. This assumption would be tested in consultation on draft regulations to implement the measure.
119. If there were any small businesses or micro businesses that operated on an 'agent for the consumer' model not already in the ATOL scheme, under measure 2 it would face additional costs. These would arise from paying the per passenger charge, supplier failure insurance premiums as well as license application & renewal costs. In order to reduce the burden of compliance on small businesses, the CAA has developed the 'approved body' approach. Businesses can become members of an approved body which means they do not have to obtain their own ATOL licence, a significant reduction in cost. A number of approved bodies have been established, mainly existing travel agent consortia which also provide commercial services to their members.

### *Competition*

120. A potential competition issue arises in measure 1 as it is not possible to require airlines established in other EU countries but not the UK to have an ATOL licence to protect their sales of Flight-Plus holidays. This arises from the EU Services Directive, which aims to promote the single market in services by placing restrictions on the requirements one Member State can place on a business established in another Member State that wants to trade in its territory.
121. There could therefore be competition effects if UK airlines are required to protect Flight-Plus holidays under the ATOL scheme but their competitors based elsewhere in the EU are not. This depends on whether airlines based in other EU countries are also established in the UK. If they are not, it is not possible to require them to have an ATOL licence. This would need to be assessed more fully in the IA accompanying a stakeholder consultation on whether to implement this measure.
122. A further aspect to competition is whether measure 1 affects competition between airlines and the travel trade in relation to the sale of Flight-Plus holidays. Many in the travel trade argue strongly that airlines face an unfair competitive advantage in this respect as under the current ATOL regulations they are not required to protect holidays they sell under the ATOL scheme and face the costs that this entails (although a number of UK airlines have chosen to protect their package holidays under the ATOL scheme). Measure 1 should address this issue and create a fairer competitive environment particularly as regards Flight-Plus holidays. This may give rise to benefits to consumers if it allows the market for holidays including a flight to function better and be more competitive.
123. However the extent to which this may be achieved partly depends on the number of airlines based in other EU countries that sell Flight-Plus and so cannot be subject to the ATOL scheme (as discussed above). There would continue to be a different regulatory framework for holidays sold by these airlines compared to those sold by tour operators & travel agents and UK airlines. This would be addressed if the PTD was revised to require Flight Plus type holidays to be protected throughout the EU.
124. A potential competition issue for measure 2 is in relation to businesses that might have considered entering the market for procuring holidays on an agent for the consumer basis under the base case, but as a result of this measure and the new requirement to comply with ATOL regulations decide not to do so. It is not clear if many businesses would actually be established specifically to sell holidays on an agent for the consumer basis, rather than a mix of holidays some of which would fall under the ATOL scheme.
125. If there were any such businesses, CAA has developed a number of lower cost options for smaller businesses needing to comply with the ATOL scheme, helping reduce any barriers for new entrants. These include the Accredited Body scheme, Small Business ATOL and ATOL franchise arrangements.

### *Wider environmental impacts*

126. Wider environmental impacts are not considered likely to arise from any regulations that may be made under the revised powers. This is because neither the total number of holidays by air nor the

mix of holiday arrival and destination points is expected to change. So, for example, there would be no impact on CO<sub>2</sub> emissions or those affected by noise living in the vicinity of UK airports.

### Equalities

127. An Equalities Impact Assessment initial screening has been carried out on the ATOL reforms the subject of this IA, and on the basis of the result of this, a full Equalities Impact Assessment has not been prepared.
128. The reforms should affect all consumers who purchase holidays including a flight from an airline or from a business operating on an agent for the consumer basis in the same way, including those across all equalities groupings.
129. One possible issue identified from the screening is in relation to the ATOL certificate, a document to be provided to all consumers purchasing an ATOL protected flight or holiday to clarify their rights under the ATOL scheme (This requirement came into effect in October 2012 under the ATOL reform regulations). Consumers who are visually impaired or those whose first language isn't English may be less able to benefit from the clarity provided by the Certificate than others (although their rights to ATOL protection are identical). The extent of this issue and, if relevant, potential means to address it are to be considered further - they apply to the ATOL reform regulations as well as the measures in this IA, if implemented.

### Justice impact

130. Any impacts on the justice system arising from the measures will be considered in preparing IAs for the draft regulations that would be needed to implement the measures once the powers in the Act have become law.

## Summary and preferred option

131. The preferred option is for the Secretary of State to have new powers in the Civil Aviation Act that would allow him to make future ATOL regulations that would include holidays sold by airlines in the scheme as well as those procured on an agent for the consumer basis. They would also allow potential avoidance approaches to be closed off. These powers could be used to meet the objectives outlined above of:
- Providing greater clarity for consumers, so that it is easier to know which holidays are protected by the ATOL scheme; and
  - Provide greater consistency and coherence in the regulatory framework for businesses selling holidays including a flight.
132. The table below summarises the costs and benefits of the preferred option, by adding together those for the two measures. The best estimate has been assumed to be the mid-point of the range as both scenarios and consumer estimates and benefits are considered equally likely to occur.

**Table 5 Monetised costs and benefits of preferred option, £m NPV over assessment period**

|   | High  | Low   |
|---|-------|-------|
| <b>Costs</b>                            |       |       |
| <u>Transitional costs</u>               |       |       |
| New licences and associated costs       | -0.1  | 0.0   |
| <u>Recurring costs</u>                  |       |       |
| APC/protection cost per booking         | -66.1 | -44.6 |
| Supplier failure insurance premiums     | -39.9 | -23.3 |
| Increased refund and repatriation costs | -32.1 | -21.7 |
| Ongoing licensing renewal               | -0.3  | -0.1  |

|   |                      |        |       |
|---|----------------------|--------|-------|
| <b>Total Costs</b>                          |                      | -138.5 | -89.7 |
| <b>Benefits</b>                             |                      |        |       |
| <u>Recurring benefits</u>                   |                      |        |       |
| Consumer benefits                           | <i>High estimate</i> | 164.5  | 110.9 |
|   | <i>Low estimate</i>  | 82.3   | 55.4  |
| Income from APC/protection cost per booking |                      | 66.1   | 44.6  |
| Supplier failure insurance payouts          |                      | 27.9   | 16.3  |
| <b>Total Benefits</b>                       | <i>High estimate</i> | 258.6  | 171.7 |
|   | <i>Low estimate</i>  | 176.3  | 116.3 |
|   |                      |        |       |
| <b>Net costs/benefits</b>                   | <i>High benefits</i> | 120.1  | 82.1  |
|   | <i>Low benefits</i>  | 37.8   | 26.6  |

As reported in table 4, measures 1 and 2 together would have a net cost to business of £51.7m to £78.4m, or on an annuitized basis £6.0m to £9.1m.

133. Now that the relevant power in the Act has become law; decisions to implement the reform measures will be taken on the basis of a further IA, accompanying a consultation on draft regulations that would be needed to implement them. The analysis in this IA suggests the measures would meet the objectives of the reforms and deliver positive net benefits overall, but with a significant cost to businesses.
134. The further IAs may be able to reflect the outcome, or emerging outcomes, of the work DfT and CAA intend to do later in 2013 on future financing and management options for the ATTF, which could result in changes to the cost estimates above. Better information about the number of airline Flight-Plus and agent for the consumer holidays should also then be available brought into the scheme.
135. The intention is to consult stakeholders on the draft regulations to implement the measures and revised IA in 2013. Should the outcome of this process be to proceed with the reform measures, and regulatory and other conditions satisfied, they might be expected to come into effect in 2013 or 2014.

## Estimate of additional holidays included in the ATOL scheme under measures 1 and 2

1. In the absence of detailed 'bottom up' information from businesses about the number of Flight-Plus and package holidays that would be brought into the reforms a 'top down' approach was used based on aggregate statistics and a number of assumptions. These estimates will be refined and developed for future IAs that will be part of any consultation on draft regulations needed to implement the measures, which is expected to take place in 2013.
2. In 2010, the Office for National Statistics reports there were 37.2 million leisure trips abroad by air (those for holiday and Visiting Friends & Relatives) made by UK residents. Over a similar period, there were 18.5 million ATOL protected flights and holidays, just under 50% of the total. (NB Figures for 2011 published by ONS in April 2012 show 38.0m leisure trips abroad by air. ATOL protected flights and holiday are estimated to be 17.1m in the same period around 45% of the total. These figures have not been used for this analysis as they became available after it had been completed and the results incorporated into the IA. A future IA to support the consultation on new regulations that may be made under the powers in the Act will be based on the latest available data.)
3. For the basis of this IA, there were therefore 18.7 million trips for leisure purposes by that were not ATOL protected in 2010. These comprise:
  - a. package holidays sold by airlines that are protected under PTR measures
  - b. Flight-Plus sales by tour operators and travel agents that have been brought into the scheme from 30 April 2012 as a result of the ATOL reform regulations
  - c. Flights procured on an 'agent for the consumer' basis to be included as part of a holiday
  - d. Flights as part of independent holidays where the components are purchased entirely separately
  - e. Flights for visiting friends and relatives (VFR)
  - f. Flight-Plus sales by airlines

The number of trips under item c) is relevant for measure 2 and the trips under f) for measure 1.

4. The number of package holidays protected by other PTR options, a), is assumed to be 50,000 to 100,000 (see main IA).
5. The number of Flight-Plus holidays sold by tour operators and travel agents fully brought under ATOL protection as set out in the ATOL reform regulations IA is 6 million p.a. However 3 million of these are assumed to include an ATOL protected Flight Only and so are already included in the 18.5 million ATOL protected holidays and flights. This leaves 3 million Flight-Plus sold by tour operators and travel agents under b).
6. It has been assumed that 1 million trips are organised on an agent for the consumer basis (see main IA). Taking account of the above, deducting categories a), b) and c) from the total of 18.7 million non-protected trips for leisure purposes leaves 14.6 million.
7. In the absence of further information, an equal split has been assumed between the three remaining categories, d) e) and f), which gives 4.9 million airline Flight-Plus.
8. As discussed above Flight-Plus sold by EU airlines not established in the UK cannot be included in the ATOL scheme because of the EU Services Directive. Data from the CAA airport passenger surveys suggests that foreign airlines carry about 52% of UK resident passengers who fly for leisure purposes (including VFR) other than on a package holiday.
9. So of the estimated 4.9 million potential airline Flight-Plus, 2.3 million are assumed to be on UK airlines that would be required to hold an ATOL licence. Of the remaining 2.5 million Flight-Plus on foreign airlines, airlines established outside the EU will be required to protect Flight-Plus holidays under the ATOL scheme. It is also possible that airlines established in other EU countries will also be established in the UK and so would protect Flight-Plus that they sell.
10. To reflect this, two scenarios have been used: i) that 10% of Flight-Plus sold by foreign airlines are ATOL protected and that ii) that 50 % are protected. This gives two scenarios for the total

number of airline Flight-Plus under measure 1, a 'low' scenario of 2.6 million p.a. and a 'high' scenario of 3.6 million p.a

Table A1: Low and High scenarios for airline Flight-Plus holidays, measure 1

|  | <b>Million pax p.a.</b> |
|--|-------------------------|
| UK resident trips abroad by air for leisure  | 37.2                    |
| <i>less</i>  |                         |
| <i>ATOL protected holidays and flights</i>   | 18.5                    |
| Non-protected UK resident trips abroad by air for leisure                                      | 18.7                    |
| <i>less</i>  |                         |
| <i>a) airline package holidays protected by PTRs</i>   | 0.1                     |
| <i>b) Flight-Plus sold by travel trade</i>   | 3.0                     |
| <i>c) Agent for consumer</i>   | 1.0                     |
| Independent holidays, visiting friends & relatives and Flight-Plus sold by airlines            | 14.6                    |
| <i>Assume</i>  |                         |
| Flight-Plus sold by airlines share = 33%   | 4.9m                    |
| UK airlines' share = 48%   | 2.3m                    |
| Foreign airlines' share = 52%  | 2.5m                    |
| <i>10% of Foreign airlines FP protected</i>  | 0.3m                    |
| <i>50% of foreign airlines FP protected</i>  | 1.3m                    |
| <b>Low scenario</b> (2.3m Flight-Plus sold by UK airlines plus 0.3m sold by foreign airlines)  | <b>2.6m</b>             |
| <b>High scenario</b> (2.3m Flight-Plus sold by UK airlines plus 1.3m sold by foreign airlines) | <b>3.6m</b>             |

## Glossary

|                                |  |
|--------------------------------|--|
|                                |  |
| <b>APC</b>                     | ATOL Protection Contribution - per booking charge paid to ATTF by ATOL licensed businesses, currently £2.50.   |
| <b>ATOL</b>                    | Air Travel Organisers' Licensing scheme  |
| <b>ATOL certificate</b>        | Document provided to all consumers purchasing an ATOL protected holiday or flight confirming their rights to protection.                               |
| <b>ATOL reform regulations</b> | The Civil Aviation (Air Travel Organisers' Licensing ) Regulations 2012 (SI2012/1017), implementing the reforms set out in Impact Assessment DfT 00092 |
| <b>ATTF</b>                    | Air Travel Trust Fund - funding mechanism for the ATOL scheme  |
| <b>CAA</b>                     | Civil Aviation Authority - regulator of the ATOL scheme  |
| <b>PTD</b>                     | EU Package Travel Directive  |
| <b>PTR</b>                     | Package Travel Regulations 1992, which implement the PTD in the UK   |
|                                |  |
|                                |  |
|                                |  |