Consumer Protection Group

Civil Aviation Authority

CAP 765

Consultation on the Replenishment of the Air Travel Trust Fund and Proposed Reform of ATOL Bonding

www.caa.co.uk

ISBN 0 11790 598 4

31 March 2006

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Published by TSO (The Stationery Office) on behalf of the UK Civil Aviation Authority.

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1 Introduction

1.1 This informal consultation seeks the views of licence holders[1] and other consultees on proposals to:

- replenish the Air Travel Trust Fund (the "ATTF"[2]); and
- reform ATOL bonding.

1.2 Once the views of consultees have been assessed, a proposal for reform will be developed with Government and a formal three month consultation held (with a Regulatory Impact Assessment) on the secondary legislation required to give effect to any reform. The CAA will also consult on the changes to licence terms necessary to give effect to the reforms. A provisional timetable for these changes is set out in Section 11 of this document.

2 Executive Summary

2.1 The CAA has been asked by Government to consult with licence holders and other interested parties on proposals to replenish the ATTF and to reform ATOL bonding. The Civil Aviation Bill, which is expected to become law this summer will, subject to secondary implementing legislation, enable contributions to be made by licence holders into the ATTF.

2.2 The CAA's view is that under both proposals the contribution should be set at as low a level as possible, given the continuing market distortion that leads to licence holders bearing greater regulatory costs than their airline competitors. It proposes that the level should be set at a flat rate of £1 per passenger and refers to this passenger charge as the Consumer Protection Charge ("CPC") in the consultation document.

2.3 The ATTF must be replenished irrespective of whether or not there is a reform of ATOL bonding. The CAA does not consider it viable to maintain the current arrangements where, if bonds are insufficient, customer refund and repatriation costs are met from an overdrawn fund, in deficit by £15.5m and backed by a Government guarantee. If bonding remains, the CAA has estimated that a CPC would need to be collected for between three and four years to build up a sufficient fund to meet refund and repatriation costs arising from future failures of licence holders. The practical effect would be that each licence holder would need to continue to provide a bond to the CAA and at the same time collect a CPC from passengers.

2.4 However, in the CAA's view the introduction of a CPC provides an opportunity to remove bonding, while maintaining the current level of financial protection provided to consumers. The industry estimated last summer that the potential savings from removing bonding were between £3 and £4 per passenger, comprising the direct cost

1. A licence holder is defined as a business that holds an Air Travel Organiser's Licence ("ATOL"). For more detail on the ATOL scheme please refer to www.atol.org.uk.
2. The term '"ATTF" in this document has a different meaning dependent on the context in which it is used. If the term is used in the context of replenishing the ATTF it refers to the existing back-up fund used to meet claims when the bonds provided by a failed ATOL holder prove insufficient to meet the refund and repatriation costs. When used in any other context it refers to a new fund that replaces bonding, to be the primary method of meeting licence holder failure costs.

of bonding and associated compliance costs. The CAA's view is that the introduction of a £1 CPC to replace the current hidden bonding cost borne by licence holders would bring significant overall benefits to licence holders through a reduction in their costs and simplification of the regulatory environment.

2.5 While there is considerable scope to simplify ATOL, such a reform would inevitably impact on the way the CAA would in future need to assess and monitor the financial fitness of licence holders. The CAA considers that it would be important to ensure there are additional safeguards in place to prevent any disproportionate increase in the costs of the failure of licence holders borne by the ATTF. The CAA proposes to approach this issue in a targeted way, primarily through financial assessment and licence monitoring. The CAA would in particular expect new entrants to ATOL, whose passengers would have immediate access to the ATTF, to provide financial guarantees to the CAA until such time as they had demonstrated an ability to remain within the terms of their licence. The approach outlined to manage a reform of ATOL bonding is consistent with the principles set out in the Hampton review[3], in particular the concept of earned autonomy.

2.6 The principal aspects of the CAA proposal to reform ATOL bonding are as follows:

- Licence holders would collect, at the point of booking, a £1 non-refundable CPC from each passenger and remit funds collected to the CAA on at least a quarterly basis;
- A CPC would be a transparent charge identified separately on a customer's invoice (as opposed to the current hidden bonding charge);
- Funds collected through a CPC would be used to build up a fund of no more than £250m. External advice would be sought on how best to utilise funds collected to ensure access to liquidity to the level required;
- Directors of new entrants to ATOL (and where there has been a change of control) would provide financial guarantees to the CAA for the first four years, payable on demand in the event of failure. In the majority of cases the guarantee required from a new entrant would be for a fixed sum of £40,000, which would reduce over time if the business had demonstrated compliance with its licence terms;
- Directors' overtrading guarantees[4] would be removed. The CAA would introduce alternative monitoring methods to assess whether licence holders were accurately reporting and monitoring their ATOL business. These would include a change in the reporting basis for licence holders to one based on bookings taken (rather than departure date), minimum requirements for licence holder business systems, "audits" of those systems and the introduction of Accountable Managers;
- In-depth financial assessments would be introduced for a small number of licence holders, who would be required to provide more regular detailed forward-looking financial information to enable the CAA to have greater visibility on the future viability of those businesses. This would primarily impact licence holders over a certain size threshold where there was a pattern of high growth; or where the CAA had specific concerns on financial viability.
- The CPC would be introduced for all bookings taken after 30 September 2007 and bonds would no longer be required as a licence condition after that date.

3. The Hampton review refers to the document produced for HM Treasury "Reducing administrative burdens: effective inspection and enforcement", dated March 2005.
4. A director's overtrading guarantee can be called only if the relevant licence holder was overtrading at the time of failure (as defined in the guarantee document) and the ATTF had to pay out because the bond was insufficient. There is no limit to the liability but the maximum that in practice may be pursued under a guarantee will be the amount paid out by the ATTF.

3 Background

3.1 The ATTF has been in deficit since 1997 following a series of tour operator collapses during the 1990s (and because the CAA's power to require contributions lapsed in the 1980s). The Civil Aviation Bill, anticipated to become law this summer, contains clauses that will, subject to secondary implementing legislation, enable the CAA to require contributions to be made by licence holders to replenish the ATTF.

3.2 Following the Government's decision last year not to proceed with the CAA's recommendation to extend financial protection, travel industry trade associations continued to press the Government to replace ATOL bonding with a less burdensome means of compliance, to help address the fact that tour operators continued to bear greater regulatory costs than their airline competitors. Consequently, the Government asked the CAA to consider whether a per-passenger charge, whose original purpose was simply to replenish the ATTF, might be extended to enable a reform of ATOL bonding and establish a less onerous means of meeting licence holders' financial protection obligations to air travellers.

3.3 Terms of Reference for this work were agreed between the CAA and the Government in November 2005 and are attached at Appendix A. The scope is limited to reforming the ATOL bonding system through a transparent CPC, with particular emphasis on reducing the costs to licence holders that arise from the current bonding arrangements. The Civil Aviation (Air Travel Organisers' Licensing) Regulations 1995 (the "ATOL Regulations") will not be changed as a result of the work being undertaken and so it is not expected that the number of consumers protected under the ATOL scheme will be affected by this exercise.

3.4 In December, CAA contacted a number of key stakeholders (the main trade associations, the ten largest licence holders and representative bodies of bond obligors) to gather information on a range of issues central to a reform of ATOL bonding[5]. This early engagement with a representative cross-section of those impacted by the potential reforms has helped the CAA to establish the parameters for this consultation document. References to industry views in this document relate to comments made by stakeholders in that pre-consultation exercise, unless otherwise stated.

3.5 The Judicial Review decision in the High Court in January to quash Guidance Note 26 on the definition of a 'package', led to widely divergent interpretations of the judgment by industry. The CAA has therefore sought, and received, permission to appeal. The CAA has a date for a hearing in June, which it is anticipated will allow a judgment before the ATOL September renewal. The CAA believes that the preparatory work for a reform of bonding should proceed despite this continuing uncertainty.

3.6 It should also be noted that the European Commission is reviewing the Package Travel Directive ("PTD") as part of a review of all European consumer legislation. Although ATOL pre-dates the PTD, it is the main way in which the UK meets its financial obligations to air travellers under the Directive. The CAA considers it is currently unlikely that a review of PTD would affect any proposed reform of bonding itself. Consequently, the CAA sees no reason why the European Commission review should prevent it from proceeding now with a consultation on a reform of bonding.

5. A copy of the letter sent by the CAA to stakeholders is at Appendix B.

4 Replenishing the Air Travel Trust Fund ("ATTF")

4.1 The Civil Aviation Bill contains clauses that will, subject to secondary implementing legislation, enable the CAA to require contributions to be made by licence holders to replenish the ATTF. The ATTF is currently in deficit by £15.5m and is incurring annual interest costs of more than £0.7m. Licence holder failure costs have been met through a borrowing facility guaranteed by the Government. A CPC to replenish the ATTF needs to be introduced as a priority to place it on a firmer footing, irrespective of whether or not bonding is reformed through a CPC on passengers.

4.2 This Section outlines the CAA's preliminary views on the level to which the ATTF should be built if bonding continues and remains at broadly the same levels as today. The way in which a CPC might be collected to replenish the ATTF, and the issues connected with collection, are largely the same issues that need to be addressed if a CPC is also used to replace bonding. These issues are summarised in paragraphs 8.15 and 9.14 and are not duplicated here.

4.3 There are a number of potential ways of calculating an appropriate level for the ATTF if bonds remain, and three possible approaches are outlined below. An assumption has been made that on the failure of a licence holder the current division of liability between credit card companies, bond obligors and the Air Travel Trust ("ATT")[6] will remain unchanged, i.e. on failure, the bond meets all failure costs first and, if the bond is exhausted, remaining failure costs are divided according to agreements in place between the credit card companies, the CAA and the ATT (refer also to paragraphs 8.9 to 8.14).

Historical Build-up Basis

4.4 The Air Travel Reserve Fund, the precursor to the ATTF, was originally established in the mid-1970s to address concerns that bonds held by licence holders were insufficient to meet the costs of repatriation and refunds arising from failure. It was recognised that it would be prohibitively expensive for a licence holder to provide a bond that would cover its failure at all times of the year and a back-up fund was considered a more suitable approach to deal with this. Bonds, as now, were set at a level to meet the costs of a low season failure.

4.5 The Air Travel Reserve Fund was built up over a period of two and a half years through a levy on industry, calculated as a percentage of licence holders' licensed revenue. The charge was initially set at 1%, or £1.25 per passenger based on the average price of a holiday in 1975 of £125. In 1976 this was increased to 2%, or £2.50 per passenger, following concerns that the fund remained inadequate.

4.6 The annual licensed revenue of licence holders in 2005 was £14bn, with an average price per passenger of £514. Applying the historical contribution rates of 1% rising to 2%, over the same time period as in the initial build-up, the ATTF would be built up to more than £500m, based on a per passenger charge of £5 in the first year and £10 thereafter.

4.7 The principal argument against this approach is that the industry today bears little resemblance to the industry of the mid-1970s, when those rates of contribution were set. In addition, the CAA estimated in its advice to Government last year that the ATTF should be built up to £250m if bonding was removed. If bonding remains, the size of the ATTF should logically be significantly less than this figure.

6. The ATT is the legal instrument that appoints the Air Travel Trust Trustees as legal owners of the ATTF. Under the terms of the ATT the Trustees are appointed to receive and hold Trust Funds, and spend them in accordance with the discretion set out in the terms of the ATT.

Historic Maximum Basis

4.8 Table A outlines the size of the back-up fund each year for the ten year period to 1991. The failure of ILG Travel Group in March of that year, the second largest licence holder at the time, depleted the ATTF to such an extent that the fund size after that date is irrelevant for the purposes of this exercise. Data has therefore not been included after 1991. The ATTF was intended to be able to meet the costs (after bonds) arising from the failure of one of the largest tour operators, whilst meeting on-going annual calls. The demise of ILG in March 1991 demonstrated that the ATTF was able to meet the costs of such a failure but it fell into deficit by 1996 as a result of subsequent annual calls on it.

4.9 The CAA's view is that it remains appropriate for the ATTF to be built up to a level where it could meet claims from a failure of a major tour operator with a sufficient surplus to meet annual calls. One approach for calculating an appropriate level for the ATTF going forward would therefore be to use the historic maximum size of the fund as an indicator of an appropriate level for the ATTF in the future.

Table A: Historic data on ATTF

Year ended 31 March	ATTF (£m)	ATTF adjusted for inflation (£m)	ATTF as a % of licensed turnover	ATTF adjusted for industry growth and inflation (£m)
1982	15.64	37.22	1.05	170.11
1983	16.61	37.80	1.04	162.86
1984	19.44	42.14	1.03	161.63
1985	19.52	39.88	0.97	140.81
1986	22.10	43.67	1.04	153.50
1987	22.75	43.15	0.95	133.39
1988	23.18	41.91	0.74	101.29
1989	23.44	39.32	0.65	82.62
1990	23.71	36.34	0.64	79.13
1991	26.70	38.65	0.80	89.95

4.10 The maximum size of the ATTF, in real terms, was £50.4m in 1979, whilst its size fluctuated between £36m and £44m over the ten year period to 1991. The size of the industry in the 1980s and 1990s was, however, significantly smaller than today. The CAA has therefore adjusted the figures to reflect industry growth, shown in the final column of Table A. The declining trend reflects the fact that over the period shown in the table the volume of business under ATOL grew significantly, whilst at the same time annual payments from the ATTF arising from licence holder failures exceeded any income earned (contributions to the ATTF ceased in 1976).

4.11 On a historic maximum basis the ATTF should be built up to £170m. The adjustment for industry growth is, however, a relatively crude method of calculation and it may be more appropriate to use the range of figures over the period (i.e. £79m to £170m) as a better indicator of an appropriate size for the ATTF.

Historic Percentage of Licensed Turnover Basis

4.12 Table A illustrates that there has been a relatively consistent relationship between the size of the ATTF and the volume of licensed turnover for most of the period between inception and the failure of ILG. In the ten years to 1991, the percentage fluctuated between 0.64% and 1.05% of licensed turnover. Licensed turnover is currently £14bn, and if the ATTF is calculated on the basis of this historic relationship, the ATTF should be built up to between £90m and £147m.

Summary

4.13 The above analysis, summarised in Table B below, demonstrates that if bonding remains, a significant back-up fund is required to meet the potential financial protection needs of the industry in future years. The CAA does not however consider that the ATTF should be built up unnecessarily and our preliminary view is that the minimum target for the fund, if bonding remains, should be set at £90m. This is also broadly equivalent to the estimated maximum cost to the ATTF of a major tour operator failure during the low (winter) season if bonds remain at current levels. As the ATTF is currently in deficit by £15m the CAA estimates that total CPC contributions of at least £105m are required.

Table B: Summary of Options for the Basis of ATTF Build Up

	Target size of ATTF	**Estimated time to target (based on £1 CPC)**
Historic Build-up Basis Original charge collected as percentage of 'holiday' cost.	£500m	17 years
Historic Maximum Basis Original fund peak adjusted for inflation and size of current market.	£79m to £170m	3 - 6 years
Historic Percentage of Licensed Turnover Size of the fund as a percentage of licensed turnover. Percentage based on pattern of original fund.	£90m to £170m	3½ - 6 years

4.14 The CAA considers that a CPC should be set at £1 per passenger. It does not make sense, in the view of the CAA and industry, to attempt to collect less than £1 and given the continuing market distortion that leads to licence holders bearing greater regulatory costs than their airline competitors, the CAA considers that the CPC should be maintained at as low a level as possible.

4.15 The current annual ATOL passenger authorisation[7] is 28m. On the assumption that the volume of ATOL passengers will remain at the same level the CAA estimates that it would take between three and four years to build up the ATTF to the minimum level to meet future needs (identified in paragraph 4.13), based on the £1 per passenger charge.

4.16 The CAA invites responses on its preliminary view that **if bonding remains**:

- the ATTF should be built up to £90m and maintained at that level;
- the per-passenger charge should be set at £1.

7. Every licence contains an individual limit for the passengers and (in most cases) turnover authorised in each licence category, in each quarter. A licence holder is required to estimate annually the number of passengers it expects to carry during the next twelve months.

5 Proposed Reform of ATOL Bonding

5.1 The introduction of a Consumer Protection Charge ("CPC") provides licence holders with an opportunity for reform of ATOL bonding and the CAA considers that there is considerable scope to simplify the existing licensing arrangements by doing so. The CAA's preliminary view is that the replacement of bonding (a hidden cost borne by the consumer) with a transparent CPC to meet refund and repatriation costs would bring significant benefits to licence holders, through a reduction in compliance requirements and the removal of bonding costs, whilst at the same time maintaining the current level of protection provided to consumers.

5.2 The remainder of Section 5 sets out the CAA's understanding of the current regulatory burden of bonding. Subsequent sections of this document set out the principal issues, which (based on industry views) the CAA considers will need to be addressed if a change is to be made, and its preliminary views on how best to manage those issues in an environment without bonds. The emphasis throughout is on simplification.

Existing Regulatory Burden of Bonding

5.3 Industry estimated last summer that the potential savings from abolishing bonding were between £80m and £100m a year, equivalent to between £3 and £4 per passenger. This comprised the direct cost of bonding and the cost of compliance. The industry view suggests that the most significant benefits will apply to small and medium-sized operators whereas the position for the largest is less clear-cut.

5.4 The CAA's view is that there are significant potential benefits to industry overall from a reform of bonding. The CAA recognises, however, that the cost of obtaining a bond and maintaining an ATOL will vary between licence holders and consequently has outlined below some considerations to bear in mind when making an assessment on the potential impact to a licence holder of a reform of bonding.

5.5 The CAA recognises that bond obligors contribute to the regulation of the industry through their assessment of licence holders as part of the bonding renewal process. The CAA also recognises that certain insurance obligors have in the past provided temporary financial support to a small number of licence holders in financial difficulty. These ancillary benefits of the bonding system will be lost under the CPC scheme. The CAA believes these are outweighed by the benefits of simplification of ATOL and a reduction in the regulatory burden. The CAA explains in Section 6 the way in which it would propose to mitigate the loss of the obligors' role if bonds are removed, through the financial monitoring of licence holders.

Direct Costs

5.6 The CAA lists below a number of points to consider when reaching an assessment on the potential impact to licence holder costs of a reform of bonding:

- Industry estimated last summer that the total annual direct cost of securing bonding is between £50m and £60m, equivalent to an average of £2 per passenger. The CAA considers this to be a fair estimation. The insurance industry estimates that the average cost is lower, at close to £1 per passenger.
- The removal of bonding could provide licence holders with greater access to financial facilities and increase their ability to invest in their businesses. The requirement to provide bonds, currently totalling £2bn, utilises much of the debt capacity of licence holders' businesses and raises the cost of such debt.
- Banks normally request, in addition to an arrangement fee, security from licence holders as a condition of issuing a bond (both from the licence holder and the

directors). This is a further cost that may restrict a licence holder's ability to borrow and invest in their business.

- Bonding, and hence the cost paid by a licence holder, is based on passenger and turnover forecasts. Many licence holders find it difficult to forecast accurately in advance due to the uncertainty of the marketplace and the fast-changing nature of the travel sector. They argue that they are penalised through higher bonding costs for over-optimistic projections. CAA statistics suggest that the industry over-estimates the volume of business typically by around 10%.
- Bond premiums are paid upfront at renewal time. This has a negative impact on a licence holder's working capital.
- The availability and cost of insurance bonds tends to be cyclical and can vary greatly depending on the state of the travel industry as well as events unrelated to the sector. This volatility introduces additional business risk that licence holders currently have to manage that would not be present if a £1 CPC was introduced. The last significant restriction on insurance bonding capacity was in 2002; in recent years the cost of obtaining an insurance bond has been on a downward trend, but it is difficult to predict how long this will continue.

Compliance Costs

5.7 The industry estimated that compliance savings from the removal of bonding would be £22m. This refers to the cost of obtaining and maintaining an ATOL, including the application itself, as well as the monitoring and reporting of sales and authorisations. It is equivalent to management time of around 50 hours per year for each licence holder. A significant element of the compliance burden arises from the need to distinguish between different types of business. These business differentiations were introduced ten years ago in consultation with industry to minimise the bonding burden on licence holders, as the perceived risk varies between business types. The principal compliance savings that would arise from the removal of bonding include:

- The number of licence categories would be reduced from five to two, namely sales to the Public and sales to the Trade. This would significantly reduce the extent of reporting to the CAA – the CAA estimates that 25% (or more than 3,000) fewer returns will be required and hence the time spent complying with requirements would be reduced. In addition, licence holders' systems would no longer need to reflect this complexity.
- The annual renewal process with bond providers would no longer be required.
- There would be considerably less paperwork involved in managing changes to a licence holder's business. For example, under the existing arrangements, if a company that sells scheduled flights wishes to commence selling packages, it needs to add a new category of business to its licence, change its ATOL number and amend its documentation. The move to a single licensing category for all sales to the Public would remove this complexity.
- The current complexity in the ATOL numbering system would be removed i.e. the restrictions governing licence holders who make scheduled sales or agency sales only and whose ATOL numbers begin with "7" or "8" would disappear. There would instead be a single numbering system for licence holders that wish to sell to the Public.
- The renewal process would be streamlined with a shorter application form. The removal of bonding would also facilitate the introduction of a web-based form, which would bring benefits to licence holders in the longer term, by making it possible to renew a licence online.

- Reforming bonding would provide opportunities for a more flexible licensing regime. For instance, Small Business licence holders might be given an annual authorisation level, instead of quarterly authorisations, that would allow them to accept bookings up to that upper limit without the need to vary their licence (see paragraph 6.5).
- Airline Deeds, introduced as an alternative to bonds, would be removed (there are around 2,000 currently in force, provided by 90 airlines for almost 250 licence holders). Airlines currently bear a £2.1bn risk in providing these guarantees and the cost of providing that risk capital is passed on to licence holders. If Deeds are removed, a CPC would be collected from these passengers but the overall cost to industry would reduce.

Licensing Fees

5.8 The CAA envisages that in the short term, a move to CPC will be neutral on CAA's running costs. This is because the CAA would reallocate resources away from routine work, such as the collection and management of bonds, to a more targeted approach, assessing the financial and system arrangements of those licence holders identified as the most significant risk to the ATTF. A system without bonds does however lend itself more readily to automation, and the CAA will be aiming to introduce IT systems that would enable CAA running costs to be reduced over the medium term.

5.9 The CAA invites responses on its preliminary view that:

- a reform of ATOL bonding through a per-passenger CPC would bring a reduction in the regulatory burden, through the removal of bonding costs and a reduction in the compliance burden.

6 Financial requirements[8]

6.1 The CAA considers that a reform of bonding would inevitably impact on the way in which it assesses and monitors the financial fitness of licence holders. This section sets out the CAA's preliminary view on how it would approach such a change.

6.2 The travel industry is a "cash-for-promises" business. It is probably unique in the opportunities it provides a start-up business to enter a marketplace with a limited outlay of capital. The internet, which has been readily adopted by consumers to purchase travel products, has expanded those opportunities. The CAA is keen to encourage a competitive marketplace and has taken significant steps in recent years to reduce the regulatory cost on both new entrants and existing licence holders, in particular through the Small Business ATOL ("SBA") initiative. The ease of entry needs, however, to be balanced against the potential impact on the consumer and the ATTF of an increase in the number of failures.

New entrants (and existing licence holders where there has been a change of control)

6.3 Industry has expressed concern that if the CAA further reduces the cost of obtaining an ATOL, through the removal of bonding, this will enable entrants to enter the marketplace at minimal cost but with potential significant impact on the customers of that business and the ATTF in the event of failure. The CAA accepts that there is a danger that the integrity of the system will be undermined unless the CAA distinguishes between existing operators and new entrants who have not yet demonstrated an ability to manage their affairs within the Standard Terms of their licence. The approach set out below applies equally to licence holders where there has been a change of control, as the CAA considers they should be treated similarly to new entrants to ATOL.

6.4 The CAA proposes that the directors of a new entrant should provide a financial guarantee to the CAA. These financial guarantees would be based on the concept of a bond i.e. the funds would be payable (on demand) in the event of failure, to meet repatriation costs and refund claims before claims on the ATTF. The guarantees would normally remain in place for four years. During this period customers booking with new entrants would pay the CPC as normal.

6.5 80% of new entrants are licensed under the SBA arrangements and gain the benefit of being licensed without a financial assessment. If bonds are removed, the CAA proposes that an SBA licence applicant would no longer have quarterly authorisations but would instead be given an annual authorisation of 500 passengers. This would enable it to accept bookings up to that level without varying its licence. The CAA does *not* propose to re-introduce a financial test for SBAs.

6.6 The CAA proposes that the total value of financial guarantees required from the directors of a new entrant (licensed under SBA arrangements) be set at a flat rate of £40,000. This is equivalent to the level of bond that a licence holder authorised for 500 passengers is currently required to provide, based on the industry average price and the normal bond start rate of 15%. It is slightly above the average bond currently provided by businesses licensed under SBA arrangements. The CAA proposes that for individual firms this level would normally be reduced to nil over a four year period, dependent on the administrative record of the licence holder and its ability to comply with its licence terms.

8. The CAA's current financial criteria for grant of a licence are set out in detail in the CAA's Official Record Series 3: Air Travel Organisers' Licensing, a Guide for Applicants and Licence Holders at www.atol.org.uk.

6.7 The CAA proposes that directors' financial guarantees are calculated differently for the minority of new entrants that apply for more than 500 passengers, through a flat rate percentage of a licence holder's forecast annual authorised turnover, with a minimum bond amount of £40,000. The start rate of 15% would normally be reduced after two years to 7.5%.

6.8 The proposals are summarised as follows:

	Potential Options	
New entrant (or change of control)	***Financial Guarantee***	***Trust Account***
Small Business ATOL	£40,000 (normally reducing to nil within 4 years)	Demonstrate suitable Trust account arrangements are in place, approved by CAA
Standard ATOL	15% of licensed turnover, normally reduced to nil within 4 years	

6.9 Finally, if bonding is removed, there will be a number of existing licence holders who will have held a licence for less than four years and who are therefore effectively "new entrants". Each of these licence holders would need to be assessed on an individual basis to decide whether a financial guarantee should be provided in the short term and, if so, at what level (within the framework set out in the table above).

Existing operators

6.10 The removal of bonding places an additional potential liability on the ATTF built up through a CPC and the CAA would need to take steps to ensure that calls on it remain at an acceptable level. The CAA's view is that without bonds the CAA would need to introduce a more targeted approach to financial assessment, which includes forward analysis of the financial strength of certain licence holders and a more in-depth understanding of their business and the environment in which they operate. This suggests an acceleration away from the retrospective annual "free asset" test, which has limitations as an indicator of future financial performance.

6.11 A more in-depth approach is potentially resource intensive and the CAA proposes that it is targeted only at those businesses where both the likelihood and impact of failure is most significant. Our analysis suggests the CAA should use more in-depth analysis for licence holders:

- with a pattern of high passenger number growth, by organic growth, or through acquisition;
- who operate in specific high risk markets;
- where there has been, or is expected to be, a change of control;
- who have a licence authorisation of over 30,000 passengers, in particular those that take forward commitments on aircraft capacity.

6.12 This builds on the approach the CAA currently adopts and our intention would be to minimise the impact of any changes whilst ensuring that, at the same time, the CAA effectively manages the additional risks that arise from removing bonding.

6.13 The number of licence holders with a passenger authorisation of more than 30,000, who are not already subject to a more in-depth financial assessment, is relatively small (no more than 90 out of a total of 2,500). As each will be dealt with on a case-by-case basis it does not follow that the CAA would be analysing all of these companies to the same extent. The type of information the CAA is likely to request will be information that a well-managed business would be expected to produce routinely for internal purposes, such as an annual budget and cashflow forecast, analysed by month (including sensitivity analysis that assesses the impact of changes to key business drivers to those forecasts), and monthly or quarterly management accounts against which business performance can be measured.

6.14 The CAA invites responses on its preliminary view that if bonding is removed:

- Directors of new entrants (and licence holders where there has been a change of control) should be required to provide a financial guarantee to the CAA for four years, as outlined in paragraph 6.8;
- These guarantees should be reduced over a four year period, dependent on the administrative record of the licence holder and its ability to comply with its licence terms;
- In-depth financial assessments should be introduced for licence holders that meet the criteria specified in paragraph 6.11.

7 Licence Compliance

7.1 Licence monitoring has been a key part of the CAA's work for a number of years and has been achieved through a variety of different measures. If ATOL bonding is to be reformed as proposed, licence monitoring will become even more critical. The CAA considers that our approach would need to be updated and some proposed changes are outlined below. In addition, the CAA intends to build on its existing licence monitoring activities and tackle more actively the activities of suspected dishonest operators. It would do this by targeting their methods of distribution and by tightening up our procedures for vetting individuals at the new entrant stage or where there has been, or is expected to be, a change of control.

Overtrading

7.2 Over time the CAA has introduced measures, including directors' overtrading guarantees, to try to ensure that licence holders do not overtrade their authorisations and are adequately bonded, i.e. the bond properly reflects the level of turnover undertaken. The aim has been to protect the ATTF from unnecessary calls on it. If bonds are replaced with a CPC, the emphasis changes to ensuring that each licence holder collects the appropriate amount of CPC and reports this accurately and on time to the CAA. However, the CAA believes that a need to influence directors' behaviour to manage their businesses properly within the terms of the licence would remain.

7.3 Directors' overtrading guarantees were introduced in 1997 in response to a series of large calls on the ATTF arising from substantial overtrading. The CAA accepted at the time that it might not be straightforward to collect under the guarantees. However, it considered it important to introduce a new deterrent to help control a problem prevalent at the time, and to provide a mechanism for preventing a director that failed to honour their obligations under an overtrading guarantee from taking a position of control in a licence holder until those obligations had been satisfied. There was significant opposition to their introduction, but over time they have generally become the accepted norm and there is a perception amongst some in the industry that their introduction has acted as a deterrent to directors from acting dishonestly.

7.4 The CAA has carried out a review of directors' overtrading guarantees. This demonstrates that, as expected, the recovery of sums from guarantors has not been straightforward, although the CAA has pursued (and are currently pursuing) a number of individuals through the courts. The level of recoveries is not of course the only measure for assessing their success. We have made a comparison of a number of key indicators for the ten year period before overtrading guarantees were introduced with the period since introduction. There is some evidence that the introduction of these guarantees has led to a reduction in the number of calls on the ATTF and an increase in the percentage of cases where bonds were adequate to meet failure costs. There is, however, evidence that there has been a deterioration in these rates over the last year, as trading conditions have worsened and some licence holders struggle to adapt their businesses to an internet-driven environment.

7.5 Paragraphs 9.2 to 9.4 explain a proposed change in the basis of reporting to the CAA, moving from the departure date system to one based on bookings taken. In the CAA's view this change would significantly improve its ability to detect a licence holder that is overtrading its licence and is critical to a new approach.

Change of control

7.6 In the CAA's experience, a change in control of a licence holder is a significant potential risk to the ATTF and it is important that sufficient safeguards are in place to prevent dishonest operators entering the marketplace either as a new entrant or by purchasing an existing licence holder "off-the-shelf". Licence holders are currently required to inform the CAA about changes in shareholdings and directorships within

21 days of a change taking effect, i.e. after the event. The CAA is particularly concerned with the number of failures that have occurred shortly after a change in control, where the CAA had not been informed of the change in accordance with the 21 day time limit and therefore has been unable to take action in relation to the licence holder. In some cases there is evidence of fraud, whereas in others the cause of the failure may simply be mismanagement. In both cases, the CAA was denied the opportunity to assess the "fitness" of the new owners.

7.7 The CAA considers it important to tighten the rules in this area to help protect the ATTF from disproportionate calls on it. The CAA proposes that each licence holder should nominate two individuals, subject to CAA approval, who will be designated as "Accountable Managers" on the licence. They will be responsible for ensuring compliance with the terms of the licence. In most cases, the CAA expects these will be the individuals that currently provide overtrading guarantees to CAA, i.e. those in a position of control or influence in the business. If an "Accountable Manager" intends to leave the licence holder, the CAA should be given 21 days notice in advance of the intended change.

Business Systems

7.8 The CAA has discovered that the systems in place at a number of companies that have failed recently were inadequate to enable those running the business to manage the operation effectively; this has in some cases also hindered the CAA's ability to manage the failure effectively. The CAA considers it vital that both existing licence holders and new entrants have in place systems for effectively controlling, recording and monitoring the bookings taken. This need not necessarily be a sophisticated IT system, but the CAA proposes that, in future, minimum requirements are specified and met as a condition of licence grant or renewal. One option might be to specify that these requirements are met by all as a condition of granting an ATOL, or alternatively for established businesses that are above a certain size threshold. The CAA expects that the majority of businesses will already have in place such systems and so this will only be an additional burden on the few that do not.

7.9 This approach fits with a proposal to carry out a programme of system audits to help assess whether licence holders are reporting accurately the extent of bookings taken. It would be our intention to establish a dedicated team whose principal function would be to manage this programme and manage licence monitoring issues; the resources required would be available through a re-allocation of workload away from time-consuming administrative tasks, such as the collection and management of bonds.

Standard Terms

7.10 Each Licence currently contains up to 13 Standard Terms and, as already noted above, a reform of ATOL bonding would lead to a number of changes to those terms. Any amendments to the Standard Terms would be subject to a separate formal consultation exercise during the summer. This would give all licence holders a full opportunity to comment on any proposed changes.

7.11 The CAA invites responses on its preliminary view that:

- Directors' overtrading guarantees should be removed;
- A minimum standard specification should be set for licence holders' systems;
- There should be targeted "audits" of systems to ensure standards are met;
- Reporting should be on the basis of bookings taken, rather than departure date;
- There should be tighter requirements around change of control at a licence holder;
- Each licence holder nominates two "Accountable Managers", who are responsible for ensuring compliance with the terms of the Licence.

8 Air Travel Trust Fund principles

8.1 In paragraphs 4.2 to 4.16 the CAA set out its preliminary views on the appropriate size of the ATTF *if bonding remains* (a minimum target of £90m). In our advice to Government last summer, the CAA estimated that *if bonds were removed* a fund of £250m, or access to liquidity of this amount, would be required in order to meet the potential cost of a major tour operator failure in the low season. The CAA sees no reason to alter this figure at this stage. The CAA therefore estimates that the ATTF will need to build up to between £90m and £250m depending on whether or not bonding remains. The CAA intends to obtain specialist advice on the most efficient way to utilise the funds it collects, to try and minimise the period during which a CPC needs to be collected.

8.2 The current number of passengers carried annually under ATOL is 28m. There will therefore be a build-up period of several years. During this time there will need to be arrangements in place to ensure that there is access to short-term financing facilities in the event that the cost of licence holder failures cannot be met from funds collected during this period. The power to require contributions from licence holders should enable the ATTF to secure sufficient facilities from the financial markets, but these might be insufficient in the event of a failure of a major tour operator early in the build up phase of the ATTF. In these circumstances, the CAA assumes that the Government would provide a short term guarantee to enable the ATTF to continue to meet its obligations to customers. In such a situation it is probable that the amount of the CPC would be increased so the ATTF could return quickly to a position where it could again borrow in its own name, without the support of a Government guarantee.

8.3 The speed at which the ATTF builds up will depend on a number of factors, including the level set for the CPC, the timing of payments into the ATTF and the volume of business under ATOL. Responses from industry were consistent on a number of the underlying principles of the ATTF.

Should the CPC be fixed at one level for all passengers?

8.4 All the Trade Associations stated a preference in the pre-consultation discussions for a flat rate approach, irrespective of type or price of product purchased. The principal benefit of such an approach is simplicity, both from the licence holder’s and the CAA’s points of view; it is also difficult to see what alternative there might be that is both workable – licence holders would need to ensure their systems were capable of making any differentiation - and fairer to licence holders. Furthermore, it is important that the chosen approach is straightforward for the consumer to understand.

8.5 One alternative might be to distinguish between long and short haul products: although the cost of repatriation is not necessarily linked to the distance that the customer has flown from the UK. For instance, most passengers on long haul flights are on scheduled services where repatriation costs may well be minimal, as the customer holds a ticket that will be accepted for travel regardless of the failure of the licence holder. Conversely, the cost of repatriation of passengers from a Mediterranean resort, particularly in summer, can be disproportionately high when compared with the price paid for the product.

8.6 A suggestion made by one tour operator (at the pre-consultation stage) was that there might be a tiered CPC linked in some way to an assessment of the financial viability of each operator. The CAA has concerns about the potential confusion that such an approach might bring to the customer, and has outlined at paragraphs 6.1 to 6.13 the measures it considers might best be used to reflect the differing financial risks of licence holders. Furthermore, there is a danger that the complexity of bonding would be replaced with a new but equally complex CPC calculation.

8.7 The CAA proposes that *all* passengers who are booked to travel under an ATOL, irrespective of age, pay the CPC. This preserves the principle that each passenger who stands to benefit from the ATTF if their operator fails is charged for that financial protection guarantee. Furthermore, the CAA proposes that no refunds of the CPC are given for cancellations; the customer will be receiving the financial protection offered by ATTF from the moment they book and, if the licence holder was to fail at any point before they cancel, the customer benefits from that protection.

8.8 The CAA proposes that the CPC is set at £1 per passenger. The rationale for this approach is set out in paragraph 4.14.

What liabilities should the ATTF meet?

8.9 The size of the ATTF will be dependent on what liabilities it is intended to meet. On this point, a crucial issue is the extent to which liabilities should first be met by the ATTF, or whether other mechanisms should first meet them with the ATTF as a backstop.

8.10 Credit card issuers have a statutory obligation under Section 75 of the Consumer Credit Act 1974 to make repayments under certain circumstances to a customer that purchased a holiday from a company that subsequently failed and where that passenger did not receive the holiday to which they were entitled. The ATT currently has agreements in place with both credit card issuers and certain merchant acquirers that set down the basis under which the ATT, bond obligor or a third party meets customer liabilities on failure. These agreements have been entered into in order to benefit the consumer when a licence holder fails, to help smooth both the refund and repatriation exercise.

8.11 A small number of industry respondents stated in the pre-consultation exercise that, in the absence of bonds, they would like to see the ATTF as the first and only line of defence and pick up all customer liabilities on failure. They were attracted by the simplicity of this approach and the potential for a reduction in charges from the merchant acquirers (licence holders would presumably expect to have an undertaking from acquirers in advance that this would happen). There were however concerns expressed by others at the impact this might have on the size of the fund required and about the fact that the CPC would need to be set at a higher level.

8.12 It is clear that the extent of calls on the ATTF would be significantly higher if it is required to pick up all customer liabilities and this would almost inevitably lead to a higher CPC to reach the target fund size within a reasonable timescale. Furthermore, the CAA has no evidence to suggest that the cost to the consumer will necessarily reduce in overall terms if the ATTF meets all liabilities, as any reduced merchant acquirer security costs would be offset by a higher CPC.

8.13 Other factors need to be taken into account when assessing this issue. Industry has expressed concern about the need to ensure that there are sufficient checks and balances within the system if bonds are replaced by a CPC, to help ensure that dishonest operators are unable to take advantage of a new system without bonds; the CAA shares these concerns. It is increasingly difficult for a travel business to function without access to credit card facilities, and although there are a small number that rely entirely on a retail network to sell their product, they are a diminishing minority. Increased booking over the internet is driving higher usage of credit cards and facilities are increasingly seen as a vital requirement for all tour operators.

8.14 In the CAA's view, if the third party filter currently provided by merchant acquirers were to be removed, then the CAA would need to compensate for that reduction in financial oversight through an increase in financial assessment and monitoring in order to protect the ATTF from disproportionate calls on it. In any event, it would be difficult to justify over-riding the statutory obligations of credit card companies, through the ATTF meeting all claims on failure, unless there was an overwhelming argument that this would be in the consumer's interest.

8.15 The CAA welcomes responses on its preliminary view that the ATTF should be built up through a:

- non-refundable £1 CPC applied to all passengers, and that;
- the existing principles under which failure liabilities are apportioned between the credit card companies and the ATT, which are intended to be in the best interests of the consumer, are maintained as far as possible.

9 Collection of a Consumer Protection Charge

9.1 An effective approach to collection is key to the successful implementation of a CPC. The CAA does not consider that the additional costs of collection of a CPC by the ATTF should be met from ATOL licensing fees. It proposes instead that the running costs of the ATTF are met from funds collected through the CPC, i.e. borne by licence holders.

How should the CPC be collected?

9.2 Initial responses from industry show considerable support for an approach based around collecting the CPC directly from the customer at the point of booking, with payment into the ATTF on a monthly basis in arrears. The industry has indicated the necessary change to the basis for reporting to the CAA, from departures to bookings, should be straightforward to implement with a minimum of cost. Collection at the point of booking appears to the CAA to be a sensible approach.

9.3 One significant advantage of a reporting system based on the level of bookings accepted is that it provides the CAA with a more effective early warning system to enable it to more effectively target licence holders where there are concerns. This in turn should help to minimise the number and extent of calls on the ATTF.

9.4 A CPC paid in arrears brings benefits, as licence holders no longer need to pay for the cost of protection in advance out of working capital; this is likely to represent a substantial saving for larger licence holders.

Should all licence holders pay into the ATTF on the same basis?

9.5 The view of the industry is that the time elapsed between collection from the customer and payment into the ATTF should be as short as possible, with payments preferably made monthly. The CAA considers that the potential benefits of collecting the CPC each month from *all* licence holders are outweighed by the additional administrative burden it is likely to place on those businesses.

9.6 There are currently almost 1,200 businesses who benefit from being licensed under the SBA arrangements, as they carry a maximum of 500 passengers a year. The arrangements have worked well since their introduction in May 2003. CAA proposes that each SBA will no longer be given a variable quarterly authorisation but will instead be given an annual authorisation of 500 passengers. This will provide additional flexibility to an SBA holder as it will no longer need to vary its licence as long as it remains within the 500 threshold. If bonds are removed, these are the licence holders that are likely to gain the greatest benefits.

9.7 The CAA proposes that SBA licence holders pay the CPC contribution in advance. This will be £500 in the first year, whether as a new entrant or as an existing SBA holder in the first year of the CPC scheme, to reflect the level of authorised passengers. The CAA does not consider this to be an unreasonable sum to pay in advance (in relation to the administrative burden that would otherwise be placed on SBA holders) and, furthermore, if the licence holder does not utilise its 500 passenger authorisation during the year, the following year's payment will be reduced to reflect this.

9.8 The CAA proposes that those licence holders authorised for more than 500, but less than 30,000 passengers (refer paragraphs 6.10 to 6.13) report on a quarterly basis, as the amounts that would be collected on a monthly basis would not be material in the context of the additional administative burden. The proposals on collection are summarised as follows:

Licence Scale (passengers)	Up to 500	Between 501 and 30,000	Over 30,000
Payment into Fund	Annually in advance	Quarterly	Monthly

How could the CAA ensure that licence holders pay accurately and on time?

9.9 It is inevitable that a small number of licence holders will fail before they have paid over the total CPC amount relating to the number of passengers booked. However, the CAA considers that a scheme based around the approach above is manageable, as long as there would be an adequate penalty regime to tackle those licence holders that do not pay on time.

9.10 It is clear that there would need to be a strong CAA enforcement effort to ensure the accuracy of reporting and maintaining the integrity of the system; the CAA would propose to increase its resourcing in this area. The integrity of the system will be dependent to a considerable extent on ensuring that licence holders, through their internal systems, are able to distinguish between customers where a CPC is payable, and those where it is not. Likewise, the integrity of the approach would rely on accurate reporting to the CAA of those passengers where a CPC would be payable. The CAA therefore proposes that it would carry out selective "audits" of licence holders' systems to assess whether passenger numbers accurately reflect the business undertaken. These will be targeted at licence holders where the CAA has concerns over the accuracy of reporting and also on a random basis to monitor overall compliance by licensed firms.

9.11 In addition, the CAA proposes that where the CAA has identified particular concerns about a licence holder (over the accuracy or timing of its reporting), it should be able to require future CPC contributions to be paid more frequently, or in advance, until such time as those concerns have been allayed.

9.12 The CAA also considers it necessary to have in place a formal mechanism for the recovery of unpaid sums and interest on those sums. Finally, in extreme cases, action might need to be taken to suspend or revoke a licence for non-payment of the CPC using the statutory powers in the secondary implementing legislation.

Should the CPC be transparent to the consumer?

9.13 There has been considerable support from industry for the CPC to be a transparent sum shown separately on the customer's documentation. The CAA would expect that highlighting the financial protection offered by licence holders would be an effective tool in building awareness of ATOL and helping the customer make an informed decision when booking a flight or flight-based holiday.

9.14 Licence holders have argued in the past that it is difficult to market the concept of protection against insolvency to a consumer at the point of booking. A transparent CPC, where the cost of protection is separately identified to the consumer at the point of sale, provides licence holders with an opportunity not available under the current "hidden" bonding scheme.

9.15 The CAA invites responses on its preliminary view that the CPC should be:

- collected from the customer at the point of booking;
- transparent, disclosed on the customer's documentation;

that licence holders:

- pay into the ATTF at different times determined by the level of passengers they are authorised to accept;

and that a penalty regime is put in place which includes:

- comprehensive "audits" of licence holders' systems;
- an ability to obtain CPC payments more regularly, or in advance in cases of late reporting/payment;
- interest penalties for late payment; and
- in extreme cases, formal action to suspend or revoke an ATOL for non-payment.

10 Third party Agreements

10.1 These arrangements were introduced when the ATOL Regulations were amended in 2003 to give small businesses - those licensed for up to 500 passengers - alternative ways to provide financial protection under the ATOL scheme. There are currently two active agreements in place, with the Travel Trust Association and Barclays Bank plc; the number of businesses licensed under each scheme are 175 and 15 respectively. In both cases the potential costs of failure are underwritten, either in part or in full, by the third party.

Travel Trust Association ("TTA")

10.2 TTA members hold an ATOL in respect of the air packages they sell. Customer funds are protected through a combination of insurance and trust account arrangements. The flight is not, however, protected by the TTA as each member is required to sell the flight element of the package as the agent of a non-TTA licence holder, who in turn provides a bond to the CAA. If bonding is replaced with a CPC, a TTA member will act like any other agent by collecting the CPC and remitting to the non-TTA licence holder, who will have the responsibility of paying sums collected to the CAA.

10.3 The CAA does not therefore consider that the proposed bonding reform should lead to any material changes to the arrangements in place between the TTA, its members and the CAA.

Other Agreements

10.4 The Barclays scheme is operated by the trading division, Barclaycard Business. The 15 members licensed under the agreement do not currently provide a bond to the CAA, as all costs of failure are underwritten by Barclays.

10.5 Travel and General Management Services Ltd (TGMS) and the Confederation of Passenger Transport (CPT) recently signed agreements with the CAA. The CAA has to date received one application from each organisation and no businesses have yet been licensed under these agreements. In both cases the organisations undertake to fund all costs of failure.

10.6 The CAA's view is that if bonding is replaced with a CPC then all sales to the public under an ATOL should be subject to the CPC to avoid confusion and ensure transparency to the consumer. It follows that all customers that pay the CPC should have access to the ATTF in the event of failure of the licence holder they booked with. If a CPC is introduced, the CAA would therefore need to review the arrangements with Barclays, TGMS and CPT and work with those organisations on the future of their agreements.

11 Transitional arrangements

11.1 The table below outlines the timetable for change and steps that need to take place before a CPC can be introduced.

Task	Timeline
Informal consultation with industry on replenishing the ATTF and a reform of bonding	April – May
Review responses and make recommendations to Government	May - June
Formal consultation on CPC secondary legislation and revised Licence Standard Terms	July – September
Obtain specialist advice on ATTF	Autumn 2006
CPC Legislation comes into force	March 2007
Introduce passenger CPC and new Licence Standard Terms	September 2007

11.2 The industry has indicated that it would prefer any transitional period between bonds and a CPC kept as short as possible; a dual system of bonds and a CPC would add complexity and would not deliver the potential financial benefits to licence holders as quickly. There is a general consensus that a CPC should be introduced for all new bookings taken beyond a specified date, preferably tied into the normal bonding renewal cycle. The CAA agrees that this is a logical approach and points to a transition at either the end of March or September.

11.3 Once the Civil Aviation Bill becomes law, secondary legislation will need to be introduced that requires licence holders to contribute to the ATTF. This will require a formal consultation on the terms of the secondary legislation to be carried out over the summer and it is unlikely that the legislative timetable will enable new Regulations permitting the collection of a CPC to come into force by March 2007.

11.4 It is important that licence holders have adequate time to prepare for a change to a CPC. This should not be too onerous on licence holders (or agents acting on their behalf) but systems will nevertheless need to be put in place to manage the collection effectively and it will be vital for all concerned to have as smooth a changeover as possible. Our provisional view is that the transition should take place at the end of September 2007. It is also important to ensure that the changeover does not cause confusion to the consumer. For instance, if the transition took place over two renewal periods beginning next September, only licence holders that had just renewed their licences would be charging the CPC for the first six months This could impact on consumers' behaviour, to the detriment of some businesses, and the CAA therefore proposes that all licence holders move to a CPC on the same date.

11.5 One final point: it is important that the ATT makes the most efficient use of the funds that it receives from a CPC in the light of the potential future demands on it. It is therefore our intention to seek professional advice on how best to manage funds collected under a CPC. Confirmation is being sought from HM Revenue & Customs that the funds would not be subject to income tax. The CAA expects this to be a major piece of work and intends to put this out to tender during the summer once a decision has been reached on whether a CPC is used to simply replenish the ATTF or, in addition, replace bonds.

11.6 The CAA invites responses on its preliminary view that:

- bonds should be replaced at the point a CPC is introduced;
- all licence holders should begin collection of a CPC from customers at the same time;
- the changeover to a CPC should take place at the renewal in September 2007.

12 Consultation responses

12.1 This document has been sent to the consultees listed at Appendix C. The CAA invites responses from any source on the issues and proposals raised in this document, but particularly on its preliminary views, summarised in paragraphs 4.16, 5.9, 6.14, 7.11, 8.15, 9.14 and 11.6. If a consultee is responding on behalf of a representative body the response should summarise the parties that it represents. If consultees consider the views of a stakeholder not listed at Appendix C should be sought, please notify the CAA at the address in 12.2. The period for responses to this initial consultation will be six weeks. A formal consultation on the secondary legislation will be held during the summer, taking into account responses to this document, and will be accompanied by a Regulatory Impact Assessment.

12.2 Please send responses by 19 May 2006 to:

Helen Bennett
Consumer Protection Group
K3, CAA House
45-59 Kingsway
London WC2B 6TE

Or by e-mail to: consultations@cpg.org.uk

12.3 The CAA will review all the responses received, and based on that review, will make recommendations to the Department for Transport on how to proceed. A summary of the responses received will be published on our website www.atol.org.uk within a month of the consultation closing date. Consultees should be aware that in accordance with the CAA's obligations under the Freedom of Information Act 2000, all consultation responses sent to us will be subject to publication or disclosure. The CAA can consider individual requests that consultation responses be kept confidential. However, the circumstances in which the CAA can agree to ensuring that confidentiality are limited and determined by the terms of the Freedom of Information Act 2000.

12.4 This consultation document has been drafted in accordance with the principles in the Code of Practice on Consultation published by the Cabinet Office (www.cabinetoffice.gov.uk). That code contains six criteria that are:

1) Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2) Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.
3) Ensure that your consultation is clear, concise and widely accessible.
4) Give feedback regarding the responses received and how the consultation process influenced the policy.
5) Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6) Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

12.5 If you have a comment or complaint about the consultation process please contact:

David Bourne
Consumer Protection Group
K3, CAA House
45-59 Kingsway
London WC2B 6TE

Consumer Protection Group
March 2006

Appendix A Review of ATOL Bonding – Terms of Reference

Objective

To assess the options for reforming ATOL bonding within the constraints of the existing legislative framework and make recommendations on the way forward to Government.

Scope of review

To focus on reforming the bonding system (rather than wider aspects of ATOL licensing) with a particular emphasis on reducing the costs to ATOL holders that arise from the current bonding arrangements.

To consider moving from bonds to a single per-customer transparent levy to build up a fund, encompassing the Air Travel Trust Fund, for meeting ATOL holders' refund and repatriation obligations.

Components

The principal areas to consider are:

- an enforceable collection mechanism;
- the size of the fund and the period of build-up;
- transitional arrangements;
- whether in the absence of bonding, changes to CAA's financial monitoring of the industry are required.

Timing and consultation

The review should aim to identify a solution as soon as possible, and in any event within 6 months, and subject to that proceed swiftly to implementation. The CAA will need to consult the industry during this period.

November 2005

Appendix B Letter sent to stakeholders at pre-consultation stage

December 2005

Dear

1 We announced earlier this month that the Government had asked us to assess the options for reforming ATOL bonding. We consider this a positive opportunity for change and are looking to find a solution that brings de-regulatory benefits to licence holders as early as possible. To help us in that process we would appreciate your initial views on the issues raised in this letter prior to the CAA commencing a wider formal consultation exercise early next year.

2 The Air Travel Trust Fund (the "Fund") has been in deficit since 1997 and the industry has campaigned for some time for legislation to put the fund on a firmer footing. The Civil Aviation Bill, which we expect to become law early next year, gives the Secretary of State the ability to make Regulations that require contributions into the Fund. This will enable it to be replenished and at the same time provides an opportunity to look at the options for replacing bonds with a fund based on a levy. The Government sees this as a means of achieving a reduction in the ATOL burden.

3 On wider consumer issues, we understand that during 2006 the European Commission will be looking at the issue of insolvency in relation to air travel and the European consumer legislation in general. The Government's Terms of Reference for a review of ATOL bonding do not include these issues. We will nevertheless continue to monitor the situation and take into account relevant developments.

4 Bonding brings complexity to ATOL, as the need to distinguish between different types of business for bonding purposes adds considerably to the compliance burden. We will be looking for ways to reduce that complexity and replace it with a straightforward mechanism for meeting tour operator obligations on failure, whilst at the same time ensuring that there are sufficient checks and balances in place to prevent disproportionate calls on the Fund. There remains a continuing need to strike a reasonable balance between the extent of regulatory oversight and the need to protect a fund raised through a levy on the travelling public. The emphasis, we believe, should be on simplification whilst retaining the current level of protection for the public.

Levy collection

5 A major criticism of bonding is that the cost is incurred upfront and so impacts on working capital. Our current thinking is therefore that a levy should be collected in arrears. We expect however there to be concerns with a levy paid in arrears, namely that a tour operator may fail before it has paid over the total levy amount relating to the number of passengers booked. The Government has asked that we consider moving from bonds to a single per-customer transparent levy, which points to the tour operator collecting the levy when a customer books. The time elapsed between collection of the levy and payment into the Fund, as well as the way in which the levy is collected, are important issues that we expect licence holders will want to consider.

6 The ability of licence holders, through their internal systems, to distinguish between customers where a levy is payable, and those where it is not, is critical to a successful implementation. Likewise the integrity of the approach will rely on accurate reporting to the CAA of those passengers impacted. We will try to find an approach that is effective whilst straightforward to administer so ensuring that complexity, and hence overall cost (to industry

and CAA), is kept to a minimum. This points towards a flat per-passenger levy, and selective risk-based "audits" of licence holders' passenger numbers, although alternative options need to be considered.

7 We would like your views on:

- an appropriate mechanism for collecting a levy in arrears e.g. quarterly returns, bookings data, monthly APD return
- The length of time between collection and payment into the Fund
- The way in which the CAA might best ensure the accuracy of returns (or funds) received
- A per-passenger transparent levy

Size and shape of Fund

8 CAA intends to investigate ways to utilise, in as efficient manner as possible, funds it collects under a levy and will seek specialist advice as soon as it is practicable to do so. This is unlikely to be before Spring next year, by which time we aim to have identified a solution with industry on the way forward. Our recommendation to Government on an "all flights" levy was for a fund of £250m, representing our assessment of the cost of the failure of a major tour operator in low season. This remains our view although it may not be appropriate to build up the actual fund to meet the cost of such a catastrophic failure given that the underlying annual average payout (from bonds and the ATT) has been at a relatively low level in recent years; another approach may be more appropriate to meet those needs.

9 The speed at which a fund builds up will depend on a number of factors including the level set for the levy, the timing of payments into the Fund and the volume of business under ATOL. In addition, the size of the Fund will also be dependent on what liabilities it is intended to meet. On this point, a crucial issue is the extent to which liabilities should first be met by the Fund, or whether other means (e.g. credit card issuers) should first meet them with the Fund as a backstop.

10 There is currently a deficit on the Air Travel Trust Fund of £11m. Once the Civil Aviation Bill gets Royal Assent the CAA will, subject to the Secretary of State making Regulations, require licence holders to contribute to replenish the Fund. One approach would be to require licence holders to contribute on the same basis to remove both the deficit and build up a fund for the future. Alternatively, a different basis could be used but this would introduce additional complexity.

11 The principles that underlie the fund are critical. We would therefore like your views on:

- The extent to which a levy should be fixed at one level for all passengers
- Flexibility to vary the levy dependent on the annual costs of payout
- A continuous levy as opposed to an on/off mechanism
- One levy for clearing both the current deficit on the ATT and meeting future needs
- The extent to which the fund should meet liabilities before credit card issuers

Financial Monitoring

12 CAA needs to consider how best to manage the financial risks in a licensing environment where bonds no longer exist. We have for some time adopted different approaches to the financial assessment of licence holders dependent on key criteria such as scale of business, recognising that a one-size-fits-all approach is not an appropriate approach to regulation. Our view is that a reform of bonding should lead to an acceleration away from the retrospective annual "free asset" test to a more targeted approach which includes forward

analysis of the financial strength of licence holders. This is likely to primarily affect medium-sized tour operators, in particular where an assessment of the potential impact and likelihood of failure merits doing so. At the other end of the scale an extension to the existing Small Business ATOL approach needs to be considered.

13 Overtrading guarantees were introduced in 1997. They tackled issues prevalent at the time and it is for debate as to how effective those guarantees have been in recent years in terms of dissuading dishonest or poorly managed operators from overtrading their licences. We need to consider whether those risks might be better managed in other ways such as through improved monitoring e.g. the selective assessment of licence holders' reporting systems, wider use of reporting on the basis of bookings taken, and so on.

14 At the entry level we will seek to ensure that there are sufficient safeguards in place to dissuade dishonest operators from entering the marketplace where a licence holder can set up relatively easily without a significant upfront capital outlay. We are therefore considering whether personal bonds, backed by a bank or insurance guarantee, might still be provided at the entry level and where we have specific concerns about the way in which the scale of business is being managed. However, consideration also needs to be given to the extent to which additional requirements on new entrants constitute barriers to entry and hence inhibit competition.

15 We would like your views on:

- Enhanced targeted financial monitoring
- Directors' overtrading guarantees and their relevance going forward
- Control mechanisms for managing overtrading
- Personal bonds

Transitional arrangements

16 The CAA is keen to see benefits accrue to licence holders as early as possible whilst at the same time it needs to ensure that there is a means of meeting tour operator obligations if a failure occurs before sufficient funds have built up. If a solution is identified where bonds are to be replaced by a levy, we envisage an early transition away from the current system – an interim arrangement based around a combination of bonds and levy might add significant complexity - although this is unlikely to be practical before Spring 2007. We would like to understand better the potential constraints that you envisage on a timescale for implementation.

17 A move away from bonds provides an opportunity to simplify the licensing system through measures such as the removal of airline Deeds of Undertaking and a reduction in the number of licence categories and types of licence held (this will in turn enable the removal of certain existing restrictions on sales between licence holders). These changes will need to be managed carefully over an agreed period of time to ensure early benefits to licence holders but at the same time avoid unnecessary disruption.

Next steps

18 We are hoping to complete this initial information gathering stage within the month and are therefore keen to get preliminary views as soon as possible. We do not expect you to have a formal position on each issue raised in this letter, but we are looking for broad parameters to enable us to develop proposals for formal consultation early in the new year.

Yours sincerely,

Appendix C List of Consultees

1 All current ATOL holders

2 All businesses that have made an application for an ATOL at the consultation date

3 Trade Organisations and Official Bodies

Association of ATOL Companies
Association of British Insurers
Association of British Travel Agents
Association of Greek Travel Agents
Association of Independent Tour Operators
Air Travel Insolvency Protection Advisory Committee
African Travel and Tourism Association
Air Transport Users Council
Board of Airline Representatives UK
Baltic Air Charter Association
British Bankers Association
Confederation of Passenger Transport
Department for Transport
Department for Trade and Industry
European Low Fares Airline Association
European Tour Operators Association
Federation of Small Businesses
Federation of Tour Operators
Guild of Travel Management Companies
International Air Transport Association
International Passenger Protection Ltd
Eventia
Institute of Travel and Tourism
Local Authorities Coordinators of Regulatory Services
National Consumer Council
Office of Fair Trading
Pacific Asia Travel Association
Passenger Shipping Association
Scottish Passenger Agents Association
Truly Independent Professional Tour Operators
Trading Standards Institute
Travel Trust Association
Which?
Worldchoice

4 Bond Obligors

Bastion Surety
Coface SA
Gramercy Insurance Co
Lombard Insurance Co Ltd
[Association of British Insurers acting on behalf of 25 other insurance obligors]

5 Credit Card Companies and Representatives

Association for Payment Clearing Services
Barclays Merchant Services
The Royal Bank of Scotland

6 Airlines

Aer Lingus Group Plc
Aeroflot UK
Aerolineas Argentinas
Air Canada
Air China
Air France
Air India
Air Jamaica
Air Mauritius Ltd
Air Namibia
Air New Zealand
Air Seychelles
Alitalia
All Nippon Airways
American Airlines
Astraeus Ltd
Azerbaijan Airlines
Belavia Belarusian Airlines
British Airways Plc
British Mediterranean Airways Ltd
British Midland Airways Ltd
BWIA West Indies Airways Ltd
Cathay Pacific Airways Ltd
China Eastern Airlines
Continental Airlines Inc
Croatia Airlines
Delta Airlines Inc
Emirates
Ethiopian Airlines
EVA Airways Corporation
Futura International

GB Airways Ltd
Gulf Air
Helios Airways Ltd
Iberia Airlines
Icelandair
Iran Air
Japan Airlines
JAT-Loguslar Airlines
Jet Airways
Kenya Airways
Kirbris Turkish Airlines
KLM Royal Dutch Airlines & Northwest
Korean Air
Kuwait Air
LOT Polish Airlines
Lufthansa German Airlines
Malaysia Airlines System
MALEV Hungarian Airlines
Olympic Airlines S.A.
Pakistan International Airlines
Qantas Airways Ltd
Qatar Airways
Royal Air Maroc
Royal Brunei Airlines
Saudi Arabian Airlines
Scandinavian Airlines System
Singapore Airlines Ltd
Sri Lankan
South African Airways
Swiss International Airlines
Syrian Arab Airlines
TAP Air Portugal
Thai Airways International Public Co. Ltd
Transavia Airlines
Turkish Airlines
Turkmenistan Airlines
United Airlines Inc
US Airways
Uzbekistan Airways
Ukraine VARIG Brazilian Airlines
Virgin Atlantic Airways Ltd

7 Others

Air Travel Consultancy
Association of Certified Chartered Accountants
Deloitte

Eastcastle Management Group
Field Fisher Waterhouse
Haines Watts
Heath Lambert Group
Institute of Chartered Accountants for England and Wales
KPMG LLP
Lane & Partners
Ms Helen Simpson
NM Rothschild & Sons
Price Waterhouse Coopers
Sam McKee Ltd
Teletext
Travel Trade Consultancy
Travel Trade Gazette
Travel Weekly
White Hart Associates