

CAA response to “Review of Package Travel Directive and ATOL implementation and funding arrangement – call for evidence”

Introduction

1. CAA support this call for evidence and the review of ATOL implementation and funding that it forms part of. The Air Travel Trust's return to surplus and the EU Commission's recent publication of their proposal for a new Directive relating to package holidays and assisted travel arrangements means that this is the right time for the review to take place.
2. CAA’s intention in responding to this call for evidence is to offer independent advice, making use of the experience that we have gained in operating the ATOL scheme. ATOL has been in operation for over 40 years and in that time will have paid all valid claims, with no requirement for a contribution from Government or the taxpayer, against the backdrop of a rapidly evolving industry and variable market conditions. History suggests that any future arrangements will likely have to be in place for a minimum of 20-25 years and it will be important that they are similarly successful and adaptable.
3. Our response is organised around the main topic areas of the call for evidence. A summary of the part CAA plays in current implementation and funding arrangements is appended at Annex A.

Review principles

4. CAA believes that the principles contained in the call for evidence are the right ones, recognising that in practice some principles will conflict with others. Identifying the appropriate balance between the principles will be key to a successful review process, and the development of realistic and effective options for the future.

Package travel implementation

5. CAA sees the benefits of bringing arrangements for businesses to meet Package Travel Directive insolvency protection requirements for air and non-air packages together. Together with the direct costs of compliance with two different sets of arrangements, the administrative efforts required represent a significant burden on businesses; particularly for smaller operations.
6. As well as reducing these costs and burdens, potential benefits of having one set of arrangements include greater consumer clarity, the opportunity to develop an integrated package protection certificate, and reduction in insurance and bonding costs. Reduction in the costs and burdens that businesses face will depend, to a certain extent, on the compliance options available to businesses selling a mix of air and non-air

packages; there would be little point in unifying arrangements if options for protection of non-air business were confined to membership of one or other approved body, as businesses would still face having to meet two sets of requirements in order to trade.

7. Implementing a proposal to bring arrangements for air and non-air packages together could make ATOL's continued management by the CAA somewhat anomalous, given the fact that some companies we would be required to regulate would have no connection to aviation. At the moment, CAA and Government derive considerable benefits from ATOL being overseen by the CAA; it means that we can derive synergies from the simultaneous regulation of airlines and travel businesses, and CAA's relationships with airlines mean that managing the consequences of failures is simplified. Nevertheless, there is no necessary reason why ATOL must be managed by the CAA. An alternative solution, which preserved existing benefits and improved consumer clarity, might be for the CAA to take on a role to provide an electronic portal as a single point of entry for consumers in making claims and to provide them with information, irrespective of the type of holiday they bought.

8. The CAA has no data of its own on the size of the non-air package market. The following table reproduces survey data published by the ONS showing the number of passengers departing the UK who when asked responded that they were travelling on an inclusive tour. This might be suggestive of the relative scale of the package markets although respondents' perceptions are unlikely to map perfectly onto the legal definition of a package. It should be noted that travel businesses selling a mix of air and non-air packages hold ATOLs and some of these ATOL holders only have a relatively small amount of ATOL business. This means that the proportion of business not currently subject to regulatory oversight is considerably less than might be suggested by the proportion of non-air holidays taken.

2012	Air	Sea and tunnel	Total
Holiday	28.6	7.6	36.2
of which inclusive tour	12.1	2.4	14.5
Business	5.6	1.4	7.0
Visit friends or relatives	9.8	2.0	11.8
Miscellaneous	0.9	0.7	1.6
All visits	44.9	11.6	56.5

Control of market entry

9. The CAA believes that control of market entry is the best way to ensure the effective implementation of an insolvency protection scheme, and to best protect UK Government from potential liabilities arising from it; essentially because of the attractiveness of this cash-for-promises market to fraudulent or risky business models. Licensing is a practical way of administering entrance controls.
10. One of the reasons that the ATOL scheme was originally introduced was to prevent fraudulent charter market operators from taking money for non-existent flights, and failures in recent years have sometimes included fraud as contributing factors. Assessing fitness to operate forms a useful control against the risk of company fraud. Controlling market entry protects consumers from unfit operators and badly run businesses.
11. Existence of a licensing scheme and the ATOL brand has given CAA the flexibility to respond to industry developments. This has reduced the risk of UK taxpayers being exposed to potential claims were unprotected consumers to take their cases to European Courts.
12. CAA's view is that the Package Travel Directive requires businesses to fully protect customers' money and to be able to ensure their timely repatriation. Where businesses fail to do so, there is the potential for Member States to incur liabilities. A licensing scheme provides a very effective mechanism for monitoring whether businesses operating within the UK are protecting consumers as required, and a means of enforcing these requirements.
13. The option of using third-party arrangement to gain access to the market, outlined in further detail in Annex A, demonstrate that, even within a licensing regime, the function can be delivered in different ways to best suit a particular businesses' circumstances.

Overlapping protection

14. CAA recognises the potential for overlap between ATOL protection and merchant acquirers' liabilities under Section 75 of the Consumer Credit Act. This is why we developed agreements between the ATT and merchant acquirers following the introduction of ATOL protection contributions in 2008. At the time, the amount of security card issuers were requesting from businesses was unaffordable for some; particularly smaller businesses and new market entrants. The agreements were, therefore, a practical way of maintaining the competitiveness of the industry and increasing consumer choice.
15. The agreements reduce the potential costs to the ATT, merchant acquirers and businesses, but mean that, in some cases, consumers face being passed to another organisation before receiving refunds. Additionally, businesses have to meet two sets of

criteria in order to meet ATOL Regulations and obtain credit card facilities and are often required to provide two different sets of financial security. Rationalising these arrangements further would provide a benefit for consumers and could reduce the administrative and cost burdens that businesses face.

16. It would be possible for the future system to develop different agreements. One extreme policy could be that it passed all possible Section 75 claims to card issuers. Section 75 liability would still apply if future arrangements did not meet claims. That would reduce the system's need for income, although the card industry may then seek more security from travel businesses. Stranded travellers might need to make their own arrangements to return, or to obtain refunds. Additionally, because Section 75 protections only extend to personal losses, such an arrangement would not be adequate for consumers who buy holidays on behalf of a group.
17. The other extreme policy would be for the future system to completely indemnify the card industry from Section 75 claims for ATOL protected sales. That would considerably increase claims that the future system would face, and as such could be seen as being in opposition to the principle to reduce Government exposure. In addition, removing the involvement of card issuers would reduce the amount of risk pricing taking place in the system. On the other hand, it could be argued that the card industry would then have little or no need to seek security from the industry, at least in terms of its licensable business. If the card industry did not respond, there may be the potential to charge card issuers for taking on their liabilities. The major attraction is simplicity from the consumer perspective; having paid for their holiday and got their ATOL certificate they could then claim without the possibility of being pushed back to the card issuer.
18. Both of these scenarios would reduce the administrative burden to businesses and would represent an advance under Better Regulation principles.
19. Under existing Credit Card Agreements, refunds to customers who bought ATOL protected holidays and flights with credit cards from agents are all met by the ATT, but this is a matter of discretion rather than legal necessity and could be changed.
20. If the future system of insolvency protection were to adopt a policy of passing all claims to the card industry it could have material consequences. Clearly the extent of exposure to consumer claims would reduce. But it would be likely also to have indirect consequences. Merchant acquirers and travel agents, newly exposed to card payments on agency sales of ATOL protected products, would take that into consideration in their decisions. In theory, merchant acquirers will be likely to seek more security from agents and this would take liquidity out of the industry. Smaller businesses could find it difficult to meet security requirements and consumer choice would suffer.

21. There is a further likely outcome. At present if an ATOL holder collapses, agents are confident that the ATT will pay refunds on (among other things) credit card sales they have made. Take the case where a consumer paid a travel agent for a holiday with an ATOL holder using a credit card. A new policy would mean that if the ATOL holder failed, the CAA would direct the consumer to claim from the card issuer, which would reimburse them. Under scheme rules, the card issuer would recharge the refund to the merchant acquirer which issued the travel agent with card payment facilities, and the merchant acquirer would in turn recharge the travel agent which took the payment. The impact of this would be that agents would need to look critically at the creditworthiness of the ATOL holders whose product they were selling, because if the ATOL holder failed then they, the agent, would ultimately be liable for the refunds. This will be likely to lead agents to stop selling the product of financially troubled ATOL holders, thereby exacerbating their financial difficulties and possibly hastening a collapse. (Of course it is not the purpose of the ATOL scheme to stop companies from failing.)
22. One way of interpreting this is that the CAA and ATT have in effect been providing a credit reinsurance service for travel agents. Clearly this is not an intended function of the ATOL scheme, which is to protect consumers. It would be consistent with some of the intended direction of changes arising from the review of funding arrangements for the ATT to pass all card claims to the card industry, and in so doing oblige the travel and card sectors to manage this issue between them. It would, however, be inconsistent with improving matters for consumers.
23. Ultimately, decisions on these issues are political and will reflect the relative importance that Government places on review principles.
24. CAA does not believe that the overlap between holiday insurance and ATOL protection is a significant issue. Our understanding is that few or no available policies insure against tour operator or travel agent insolvency, leaving the main potential area of overlap as general travel insurance policies containing Scheduled Airline Failure Insurance and Flight-Only ATOL protection.

Learning from Europe

25. CAA's research shows that there is huge variation across Europe in the rules surrounding insolvency protection, and the extent of that protection.
26. Lessons can be learned from how other Member States have implemented Package Travel Directive requirements, but there are certain characteristics of the UK that may explain different approaches. These include the pre-existence of the ATOL scheme, the history of large companies failing, the greater need for organisation of repatriation exercises, the size of some businesses, and the extent of risk that Government is prepared to accept. For example, several other European bodies are conscious that their

arrangements would be insufficient to cope with the largest failures. It is also necessary to exercise caution where other checks and balances exist which are outside of Package Travel Directive implementation, but which contribute to the effectiveness and resilience of that Member State's arrangements.

How should financial protection system be organised?

27. CAA's view is that the current status of ATT as a Central Government Body, with abilities newly constrained by virtue of ONS's classification of its funding mechanism as a tax, is unsustainable.

Company-specific arrangements

28. Of the scenarios that the call for evidence outlines, CAA believes that the "company-specific" arrangements would pose the greatest risk to tax-payer finances. The lack of any requirement to licence, with enforcement carried out by trading standards means that there would be greater risk of fraud and of businesses selling unprotected holidays. If these risks materialised, the Government could be required to recompense consumers directly. The scenario described involves no central fund sitting behind arrangements. If the arrangements that a company put in place were to fail for any reason or the company committed fraud, this would leave consumers and Government unprotected. Absence of any backup funding arrangements would also make it more difficult to centrally coordinate large scale repatriations.

29. CAA does not think that easy parallels can be drawn between the "company-specific" scenario and German arrangements because of additional requirements that German businesses have to meet in order to trade.

30. While CAA can see that the "company specific" scenario described would increase the range of compliance options for some businesses, it is likely that others would struggle to protect their sales, or find such options too expensive. Unless companies are part of a cohort large enough for bond providers or insurers to look at as a population with predictable failure risks (including costs), the prices they set will be high. Losses will most probably be capped and the largest companies will be unable to join; particularly if they experience financial difficulty.

31. The advantages of "company specific" arrangements are that, for businesses protected in this way, the cost of providing protection would be internalised within each business, which would be efficient in the sense of avoiding any cross-subsidy between riskier and less risky businesses. It would also achieve most closely the Government's goal of making industry taking responsibility for its own affairs.

Central fund

32. When considering the existence of a central fund supporting future arrangements it is important to determine what that fund would be required to do. The fund could, as is now the case with the ATT, act as the primary source of funds to meet scheme obligations or could instead act as a reserve fund to arrangements put in place by individual businesses or to third party arrangements.
33. Any central fund should not be classified as a Central Government Body, as this imposes impractical restrictions on how the fund operates and may not retain the trust of industry. CAA recognises that this means that contributions to the fund would have to be made on a different basis to the current ATOL protection contribution.

Regulator-led central fund

34. If there is to be a central fund overseen by a regulator, CAA is neutral as to whether it has a continuing role. Our view is that any regulator would need a manageable and enforceable framework within which to operate and one that continued to evolve in ways to improve consumer clarity about their protection. The regulator would need the power to set the level of any contributions to the fund and all scheme members would need to contribute to the fund in some way. The regulator would also require the powers necessary to protect the Government from any claims that may result from businesses not complying with Package Travel Directive requirements.
35. Our experience has demonstrated that considerable benefits derive from the fact that a regulator is connected with scheme financing. The involvement of a regulator gives the banking and insurance markets the confidence to participate in the scheme's risk financing, increases buying capacity and reduces overall costs. We have been told by the ATT's insurers that the CAA's regulatory powers are decisive in enabling the current insurance policy as it is. It has meant that CAA has been able to reduce the risks to scheme financing through regulatory intervention. The relationships that we have with businesses by virtue of our regulatory role have meant that we are able to mobilise their support when other businesses fail, leaving us better able to manage the consequences of failures.

Industry-led central fund

36. CAA recognises some of the benefits that would come from a central fund overseen by industry. In order to be effective, the fund and lenders would need reasonable certainty on the security of future income streams. It would not be sustainable if the charging base, from which APCs were drawn, were not secure; for example, if ATOL holders could withdraw at little or low cost, perhaps by rearranging their sales so that business became not licensable. There would need to be some sort of complementary arrangements to protect against unlicensed trading and providing policy advice for legislative purposes.

37. CAA agrees that care would be needed in developing its governance and processes to avoid the risk of issues arising from industry representatives taking decisions affecting their competitors. Inability to tackle these issues was one of the main reasons CAA took over the management of bonds from ABTA and FTO in 1993. We also think that, given the different business models used by different sectors of the travel industry, it might be challenging to reach consensus positions on key policies.

38. Government would also need to think about how it would assure itself that the fund was sufficient to meet its liabilities and what it would do if the fund proved to lack the necessary resilience.

Central coordination of repatriation

39. CAA's view is that central coordination of repatriation is needed at regular points. In order to do this effectively, those doing the coordinating need access to funding.

40. The benefits that CAA has historically derived by virtue of the connection between centrally coordinated financing arrangements and repatriation lie in the fact that we have credibility and the trust of the industry, at home and abroad, when large scale repatriations are required.

41. An additional benefit derived from central coordination of repatriation is the ability it gives Government to act where unprotected consumers are stranded abroad with little opportunity to repatriate themselves. This was the case in the 2008 failure of XL, where the Government provided funding to CAA to repatriate large number of unprotected consumers in a timely fashion.

Financial mechanisms for a central reserve fund

42. The chart showing failure trend data in Annex A of the call for evidence shows that the largest scheme expenditure in any of the last ten years was less than £100 million and the greatest annual call on the ATT less than £50 million. This suggests that arranging central funding that will provide sufficient liquidity to cover the vast majority of possible failures can be easily achieved. For example, only current eight ATOL holders create an exposure of greater than £50 million over the Winter months and only in two ATOL holders would a low season failure exceed existing insurance limits.

Variable APC rates

43. CAA can see the benefits that might come from introducing variable rates of contributions including fairness and the ability to incentivise positive changes in behaviour. Set against this are the complexity of administering such arrangements both for the managers of the fund and the businesses that contribute to it.

44. At present APC is set at a flat rate of £2.50. Flat rates are the simplest to implement but mean that expensive packages cost the same to protect as inexpensive ones, and riskier businesses pay the same levy as more stable ones. They also represent the easiest model to communicate to consumers. It should also be noted, however, that the CAA currently imposes other measures on riskier businesses such as bonds and blocked cash, so the cost burden to them of obtaining protection is higher, though the cost is not transparent to others.
45. If a variable APC was to be introduced, there a number of potential bases for how it could be calculated each with different attractions.

Percentage of sale price

46. This is also easy to calculate, and improvements to the quality of the travel industry's booking systems since the introduction of APC may mean that most businesses could now implement this without excessive additional cost. It was also the approach recommended by the Transport Select Committee in their special report into ATOL reform, published in early 2012.
47. A levy based on a percentage of sale price would mean that expensive packages would cost more to protect than cheaper ones, pro rata, but would still involve travel businesses with different levels of risk paying the same levy. In addition the connection between holiday price and risks to scheme financing is very weak. There would also be challenges in developing ways to administer such an arrangement; the administrative costs of having a system based on actual price paid would likely be prohibitive; the costs of providing assurance that correct prices are being identified and reported would be high; and setting bands would create price points in a highly competitive market.

Risk based

48. One market feature over recent years has been the growth of less risky business models within ATOL; essentially, this is the increasing popularity of online business models. These models are lower risk for a variety of reasons: passing on tickets or other documents of value earlier; and being generally less reliant on customers' money. In 2010 about 14% of authorised ATOL seats were from such specialists, whereas in 2013 this had risen to 19%; about 4 million seats. (**Source:** CAA – Authorisations by market segment)
49. This data suggests setting contributions based on the exposure created by the travel seller's business model and protection arrangements could be a more equitable solution, albeit one that would be expensive to calculate. The charge would be set principally on the basis of an analysis of the amount of exposure to the central fund created by the business model.

50. For example, businesses A and B both sell 10,000 holidays per year at £700 per person. If business A takes payment two months before departure and business B is one month, then business A creates about twice the exposure to the central fund as business B and would pay about twice the contributions. Alternatively, if both took the money at the same time but business A ran a trust account which mitigated almost all the risk, it would pay a much lower contribution.
51. This would enable the creation of effective incentives for the travel industry to make its own arrangements: those travel sellers that created least consumer (and taxpayer) exposure would also face the lowest contribution burden. At present, in many cases this would impact traditional tour operators more heavily than businesses with an online model.
52. This would, however, make public debate on the cost of protection more opaque; consumers would have little or no ability to understand the how the cost of protection was reached.
53. Again, such an approach would not be without difficulties; the exposure created by companies is dependent on variables that are subject to marked change; it would be challenging to develop a means of estimating exposure that wasn't open to manipulation; and it would create an incentive for companies to attempt to game the system.

Based on the perceived failure risk

54. The cost of contributions would be higher for businesses that were less financially stable. This would address an issue of equity between travel businesses, in that well-financed businesses would no longer be effectively subsidizing those that were less well-financed.
55. It would, however, be expensive to estimate, as well as being controversial. It is unlikely that the CAA could set such prices effectively, because the likelihood of a high level of judicial challenges could make the system unworkable. It could be achieved to a certain extent by the imposition by the regulator of a requirement for, for example, bonds, which would themselves be priced by the guarantors.
56. Ultimately, the decision as to which contribution method would be best is a political one. From a regulatory perspective, the flat rate levy is simplest to administer and enforce, though other options would give any regulator greater leverage and would certainly be more equitable for some businesses.

Elements of a future protection system

57. CAA think that the different elements described under the "company specific" banner could provide, at least smaller, businesses with a greater range of options for companies to comply with requirements, but believes that they could play a part in any of the scenarios described. Indeed, we think that some sort of back up fund would be essential to protect Government from liabilities due to fraud, or if the arrangements companies put in place were to prove insufficient.

Insurance and bonds

58. CAA recognises the advantages of insurance and bonds as elements of a protection system in that payouts do not come out of the public purse and insurers can be expected to price their risk and premiums charged on an economic basis.

59. However, there are also disadvantages. The CAA's experience has been that the availability of capacity in the insurance bonding market is variable. This is a potential source of instability in a system based on bonding, in that a reduction in bonding capacity can leave businesses unable to meet the financial requirements without raising additional funding.

60. In the period before bonding ceased being the primary source of funding, bonds covered about 70% of failure expenditure, and the remainder was borne by the ATT. (**Source:** CAA – historical failure data)

61. Shortly before bonding was (broadly) abolished banks provided about 69% of ATOL bonds and insurers the remaining 31%. The total value of bonds issued was about £2 billion. (**Source:** 2007 Consultation on ATOL Reform p23)

62. Potential bonding costs also vary between companies. Estimates of bond costs for individual companies come out at about £2 per passenger with smaller companies paying more than larger ones. Before the introduction of the APC in 2008, total bonding costs were about £54 million. Industry's estimated compliance costs were £22 million per annum (**Source:** 2007 Consultation on ATOL Reform p19). Today, licensed seats are around 22 million so bonding costs would be about £44 million (assuming no change in rates and availability).

63. CAA, on behalf of the ATT, has arranged both insurance and banking facilities. Our experience in doing so shows that insurance availability is dependent on reinsurers' ability to obtain capacity, and pricing reliant on the ability of a regulator to influence outcomes, for example by using licensing conditions to reduce the likelihood and extent of failures. The availability of banking facilities has been a function of the cost of failures and our ability to raise the level of ATOL contributions; a factor which also means that we have been able to secure them at a reasonable price and without a Government

guarantee. It will be important to preserve these factors in future arrangements if these cost benefits are to be maintained.

64. In addition to availability and cost, in order for insurance policies to play a full part in future arrangements, certain of their limitations would have to be overcome, for example, by having exclusion clauses and including run-off periods during which if no other insurer can be found then the business must be closed and the insurer's risk crystallises.

Segregation of customer money

65. CAA believes that trust accounts can form a useful part of future protection arrangements for smaller companies. They offer the opportunity to insulate the taxpayer from potential liability and could provide an attractive compliance option for some companies. Potential downsides include the fact that large sums of money would be unavailable to businesses to use as working capital and that businesses may be required to incur significant costs in order to assure a regulator that the arrangements that they put in place are adequate. There is also an execution risk in that any arrangements would be subject to legal challenge and if, for whatever reason, they proved insufficiently robust, consumer claims would have to be funded from an alternative source.

Industry organisations

66. CAA's current strategy for ATOL includes the greater use of third party arrangements and franchises and we believe that these can form a valuable part of future arrangements. Such arrangements enable considerably more flexibility in how protection is actually organised, and businesses providing such membership services would be incentivised to make the most attractive offering to potential members. They also enable commercial disciplines to be embedded more deeply into the provision of protection services.
67. One question is what size of business such arrangements could work for. Another is how to ensure the taxpayer is protected by such arrangements internalising their risk. This latter point raises the question of timing for some companies who may take some time before they would be in a position to participate in arrangements that are adequately contained within the industry.
68. It is difficult to envisage a future where members of industry organisations would not also have to contribute in some other way to overall scheme financing, not least to pay for repatriation exercises. Unless this is the case, it is possible that such arrangements would take on those businesses posing less risk, leaving Government with a responsibility to provide a means for risky businesses to protect their sales.

The role of the CAA in ATOL arrangements

1. ATOL, managed by the CAA, has been at the centre of the provision of insolvency protection for air holidaymakers for several decades. During its history the organisational and funding arrangements for ATOL have evolved, with varying roles for the CAA and sometimes radical shifts in how funding for the scheme has been organised.
2. The CAA's current part in these arrangements is set out in this Annex.

Authorising businesses to sell travel

3. A central function of the ATOL system is determining the terms on which businesses sell air travel products and authorizing them to do that.
4. At present, the CAA determines the terms on which it will grant an ATOL licence; maybe a bond, maybe refinancing, and some requirement for monitoring information. Accredited Bodies and ATOL Franchise operations determine the terms on which they will permit businesses to join (subject to CAA approval).
5. The decision to permit businesses to sell air travel is typically made by the CAA and we adopt a risk-based approach to these decisions. We consider the fitness of persons controlling the business when considering all ATOL applications. For the smallest businesses, which create least financial exposure, there is the Small Business ATOL scheme. SBAs (c1,000 licences) are granted on the basis of no financial test. For the largest businesses (c350 licences), whose failures would most costly, the CAA employs a team of financial analysts who maintain a permanent watch on the businesses, assessing detailed financial monitoring information and assessing their financial health. Where businesses are identified as risky, the CAA seeks to reduce the risk to consumers and the ATT by imposing appropriate measures on them, such as a requirement for a bond, or a trust fund, or fresh capital: if the business cannot satisfy the CAA as to its financial position then the CAA may take action against the licence which usually closes the business down. The roughly 600 ATOL holders between these two extremes are subject to a less detailed financial test once per year, and again licensing action might be taken if the CAA is not satisfied with their finances.
6. Franchises, the CAA/ABTA agreement and Accredited Bodies provide alternative ways by which businesses can be authorized to trade. With franchises, although franchise members get their own ATOL granted by the CAA, the CAA relies largely on the arrangements and decisions made by the franchisee, because the franchisee is responsible for financing the failure of a member and ATT exposure is materially reduced. In practical terms the decision to permit the business to trade in this protected

market is made by the franchisee. The two current franchisees are the Travel Trust Association and Travel and General.

7. CAA has a joint administration agreement in place with ABTA under which ABTA processes applications on behalf of the CAA and provides a guarantee where a bond would normally be required, although the final decision and responsibility for financing member failure rests with the CAA.
8. With Accredited Bodies, members do not need an ATOL at all. Provided the CAA is content to appoint a business as an Accredited Body, it can then appoint members with no further reference to the CAA. The CAA takes its assurance from the systems and protection provided by the Accredited Body, as well as taking a view on the AB's own financial stability.
9. CAA's authorisation of companies to trade benefits consumers by protecting them from the risks of fraud and companies with the greatest risks of failure and benefits the taxpayer by insulating them from potential claims arising from inadequately protected holiday sales.

Regulating travel businesses

10. The CAA also acts to ensure that ATOL holders comply with the terms of their licences. We enforce non-compliance with ATOL regulations and use our regulatory powers to reduce financial risk in the system and to consumers.
11. This gives CAA the ability to intervene to protect the ATT from the risk of certain businesses failing, and to reduce the impact of potential failures on consumers and scheme financing.
12. The table below shows costs of failure as a percentage of protected revenue since 2005/6. It demonstrates that the impact of financial insolvencies on an industry with thin margins and which is still based on cash for promises has been well controlled.

	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12	2012/13
Total expenditure (millions)	£4.7	£3.3	£0.38	£36	£11.4	£48.2	£14.2	£1.1
ATOL departure revenue (millions)	£14,138	£13,664	£12,673	£12,419	£13,066	£12,929	£13,552	£13,705
%	0.033%	0.024%	0.003%	0.29%	0.087%	0.373%	0.105%	0.008%

Financing the system

13. The Air Travel Trust (ATT) is currently at the centre of financing the system, in that it provides most of the liquidity used to manage the consequences of failures. The key points about the ATT are as follows:

- It was created by the Secretary of State for Transport, who appoints the Trustees. The Trustees are always CAA Board Members or senior officials, and the CAA provides administrative services to it under contract. A third party representative also attends Trust meetings for items which do not include information that is commercially confidential to individual ATOL holders. Legally and financially it is separate from the CAA;
- Its funds come almost entirely from the APC; £2.50 per ATOL booking, collected from ATOL holders (including Accredited Bodies) by the CAA;
- Its liquidity comes from a borrowing facility and it also maintains a £300 million insurance policy against the insolvency of large travel organisers;
- Calls on the ATT are also mitigated by protection arrangements the CAA has put in place for particular licence holders, such as bonds and trust accounts.

14. The CAA supports the ATT to manage the system with a view to reaching a position where its access to liquid funds is sufficient to avoid taxpayer exposure in all but the most extreme scenarios. Under current arrangements, the reserves and insurance available would be adequate for all but the most extreme failures.

15. Franchises and Accredited Bodies also provide funding for managing the consequences of failures, which they manage themselves. The nature of the arrangements (typically trust accounts and/or insurance instruments) is for the Franchise holder or Accredited Body to determine, subject to the CAA being content that the arrangements are effective. These businesses generally also pay APCs to the CAA to account for the possibility of their own failure.

16. The Government supports the system by giving the banking and insurance markets the confidence to participate in the scheme's risk financing, by virtue of CAA's involvement.

Managing the consequences of failure

17. Managing the consequences of failures is typically done through CAA commissioning the services of others.

18. The CAA manages most failures. Repatriation is typically managed through obtaining the failed ATOL holder's booking records, and then liaising with airlines and hoteliers and so on as necessary. Queries are handled through a third party call centre kept on a retainer, and almost all claims (other than where legal issues make it complex) are outsourced to claims handling agencies. For some failures with a high proportion of

agency sales, the CAA works with the travel agents so the agents refund their customers and are reimbursed by the ATT.

19. Generally, franchises and Accredited Bodies manage the failures of their own members, using their own systems and arrangements. The CAA provides an assurance role, in that it ensures that these bodies perform their functions as required.
20. For repatriations, the CAA typically manages those exercises with its own dedicated team except in rare circumstances, such as occurred when the XL Group of companies collapsed, when travel industry professionals with appropriate expertise were commissioned to perform some of the key roles given the magnitude of the failure and its particular circumstances.

CAA's role in assuring third party arrangements

21. In some cases in current arrangements the In the case of existing Accredited Bodies and ATOL Franchises, organisations other than the CAA provide some or all of the necessary functions of the ATOL system. These organisations use different means to achieve their purposes; trust funds, centrally-provided booking systems, approved supplier lists are examples. The small businesses which are presently members of these organisations have a choice as to which they join and hence how they comply.
22. In this regard, the CAA's current role is to provide assurance. For example, the insolvency of an Accredited Body would be likely to cause its members to collapse as well; so the ATT remains at risk and the CAA assesses the risks associated with each Accredited Body. Because the Accredited Body is providing all of those functions (it determines who it will have as members, makes arrangements to fund insolvency management activities, and manages them) there remains a reputational and financial risk if it does not perform well. Rather than assessing each member, therefore, the CAA assesses the Accredited Body itself.
23. For businesses other than Accredited Body members and franchised licence holders (though including ABs themselves), the CAA currently determines the terms on which it will grant licences. For example, it determines fees, does not typically apply a financial test to SBAs, applies very detailed financial analysis to the major licence holders and may set demanding financial requirements for them as a condition of continuing to hold the licence. In general terms, the CAA has developed a set of structures and rules intended to be appropriate for businesses of different sizes. The only material third party input to those licensing decisions occurs for businesses large enough to be covered by the ATT's insurance policy, where the insurers will review the CAA's assessment of the riskiness of licence holders as part of their own work in determining how much insurance cover they will be willing to give them; though the final decision on the licence remains with the CAA.