

Consumer Protection Group
Air Travel Organisers' Licensing



Consultation on proposal to increase the rate of ATOL Protection Contribution

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Consultation on proposal to increase the rate of ATOL Protection Contribution

1 Purpose of Consultation

- 1.1 This is a consultation seeking views on a proposal to increase the rate of ATOL Protection Contribution ("APC").
- 1.2 Currently, each Licence holder must contribute £1 for every passenger booked under its ATOL into a protection fund called the Air Travel Trust Fund ("ATTF" or "the Fund"). The objective of the ATTF is to use Trust monies to repatriate and meet claims for losses incurred by customers of a failed Licence holder¹. The Fund's liquidity is enhanced through an insurance policy designed specifically for this purpose and a credit facility, which is partly backed by a Government Guarantee for a transitional period.
- 1.3 A reduced number of bookings, partly due to difficult economic circumstances, and the failure of XL Leisure Group² ("XL") are putting significant pressure on the liquidity available to the ATTF. Based on updated projections of the ATTF, the Civil Aviation Authority ("CAA") expects the deficit of the Fund to exceed the current facility by October 2009. The CAA's analysis suggests that in order to secure an additional long-term facility, to eliminate the deficit and to build a self-sustaining Fund, the rate of APC will have to be increased.
- 1.4 On the basis of the renewed forecasts, and having reviewed a number of options for rate increases, the CAA proposes that the rate of APC is increased to £3 from 1 October 2009 i.e. on bookings taken from that date. The CAA considers this will allow the deficit of the Fund to be removed in a reasonable timeframe and will provide a sufficient degree of resilience in view of the current economic uncertainty.
- 1.5 As set out in the Spring 2007 consultation³, the CAA remains committed to reviewing the financial arrangements of the ATTF once the deficit of the Fund has been eliminated. This would include a review of the rate of APC in the context of ensuring the longer-term sustainability of the Fund.
- 1.6 The deadline for responses to this consultation is Friday, 12 June 2009. Details of how to respond are set out in paragraph 11.5.

2 Rationale for the introduction of APC

- 2.1 In Spring 2007 the Department for Transport ("DfT") and the CAA conducted a joint consultation (the "Spring 2007 consultation") seeking views on the establishment of a mechanism for removing the deficit of the ATTF⁴ and on whether bonding should be replaced with a per-passenger charge.
- 2.2 Taking into consideration the Government's 'Better Regulation' agenda, the principal policy objectives were to:

1. As set out in the Air Travel Trust Fund Payment Policy (http://www.caa.co.uk/docs/33/ATTF_Policy_Statement.pdf).

2. Comprising of ATOL Holders: The Really Great Holiday Company PLC, Kosmar Villa Holidays PLC, Freedom Flights Limited and Aspire Holidays Limited.

3. 'Consultation on Reform of ATOL Bonding Arrangements and the Replenishment of the Air Travel Trust Fund', which is available at http://www.caa.co.uk/docs/33/Consultation_ATOL_Reform_2007.pdf.

4. At the beginning of 2007 the deficit of the ATTF was £18.4m.

- a) ensure that ATOL holders (also referred to as “Licence holders” or “the Trade”) met the full cost of providing consumer protection rather than the taxpayer. At that time, the Government provided a guarantee for the deficit of the Fund and whilst this remained the case, the cost of providing consumer protection could ultimately be borne by the taxpayer;
- b) simplify the ATOL scheme, by reducing the financial and administrative burden on the Trade; and
- c) address concerns that the requirement for each ATOL holder to provide a bond for its potential failure was disproportionate to the risk addressed (on average between 1-2% of firms who hold an ATOL fail in any one-year).

2.3 The options identified in the Spring 2007 consultation were:

Option 1. do nothing; or

Option 2. maintain bonding for all ATOL holders and introduce a per-passenger charge until the deficit of the ATTF was removed and a surplus built-up to meet future calls on the Fund; or

Option 3. remove bonding for the majority of ATOL holders and introduce a per-passenger charge to remove the deficit and subsequently build-up a self-sustaining Fund, able to meet future failure costs.

2.4 The option to ‘Do nothing’ provided no scope for meeting the policy objectives, particularly as there would have been no mechanism for the Trade to eliminate the deficit and allow the Government to withdraw its Guarantee.

2.5 There was overwhelming support from the Trade for Option 3⁵. This was implemented with effect from 1 April 2008, with a per-passenger charge (rate of APC) of £1.

3 Benefits of APC

3.1 By adopting Option 3, the Trade largely avoided the direct costs of bonding in addition to an APC of £1 per passenger.

3.2 Further benefits of the APC included:

- a) reducing the value of bank bonds from £1.5 billion (of a total value of bonds of £2.1 billion) to approximately £75 million thereby freeing up credit lines, which has:
 - i) provided ATOL holders with access to additional liquidity ahead of a difficult trading environment; and
 - ii) aided the consolidation that has taken place within the industry, including the mergers amongst the Top 4⁶. It is thought that the Top 2 would have had difficulty in securing the required level of bonding from banks for the enlarged operations, without severely limiting their lines of credit.
- b) aligning the cost of providing consumer protection to actual bookings. Revenue forecasts, on which bond amounts were calculated, were typically between 7-11%⁷ above the level of actual revenue achieved;

5. A summary of responses to the joint consultation is available on the DfT website:

<http://www.dft.gov.uk/consultations/archive/2007/atol/summary>

6. The ‘Top 4’ consisting of TUI, Thomas Cook, First Choice and My Travel merged into a ‘Top 2’ of TUI Travel and Thomas Cook

7. Source: ATOL Business 2006, Issue 27

- c) avoiding upfront payment of protection costs. Under the APC, collection is related directly to bookings taken and is paid in arrears. This has substantial cash flow benefits for the Trade; and
- d) reducing the dependence of Licence holders on the willingness of obligors (banks or insurance companies) to provide bonds. If a bonding scheme was still in place for all ATOL holders, a large number would probably find it difficult in the current credit crisis to either obtain a bond or to obtain a bond at an acceptable price. Some credit insurers appear reluctant to provide cover at all in the current economic environment and banks appear to be seeking increased levels of security.

4 Current ATTF funding arrangements

- 4.1 The ATTF is principally funded by APC income. An insurance policy and a credit facility have been arranged to provide additional liquidity until the Fund becomes self-sustaining. In some failures the ATTF may also receive recoveries, such as bond monies.
- 4.2 A £300 million insurance policy underwritten by AIG (UK) Ltd and Axis Specialty Ltd provides the ATTF with access to funds in the event of the failure of an ATOL holder(s) where costs arising from refunds and repatriation exceed £50 million in a year.
- 4.3 To cover the excess of the insurance policy the ATTF arranged a credit facility with Barclays Bank plc (see Table A below). The Government exceptionally agreed to guarantee a proportion of the facilities but in line with its policy to have the full costs of protection borne by the Trade, expected this to be removed by April 2011:

Table A: ATTF Credit Facility (£ millions)

	01-Apr-08	01-Apr-09	01-Apr-10	01-Apr-11
Total Facility	60	50	50	50
Government Guarantee	31	25	15	Nil

- 4.4 The ATTF's financial year-end is 31 March.

5 ATTF Historic Forecasts

- 5.1 This section sets out the assumptions used for the forecasts included in the Spring 2007 consultation and a subsequent update in March 2008.

March 2007 projections

- 5.2 In developing the cash flow projections for the ATTF for the Spring 2007 consultation, the CAA used:
 - a) booking forecasts provided by the Trade, which indicated a potential income of £27 million in the first year of the scheme, with small increases in the following years. These were compared against actual passenger carryings reported by Licence holders (see Table B). The forecasts appeared reasonable at the time, particularly in the light of industry estimates that bookings (on which APC is based) are typically 5-10% above actual carryings:

Table B: Actual passengers carried by all ATOL holders (millions)

FY01/02	FY02/03	FY03/04	FY04/05	FY05/06
27.8	27.6	27.8	28.3	26.7

Source: Licence holders' Returns submitted to CAA

- b) failure cost assumptions based on a statistical analysis of historical data, conducted by a professional services firm. This suggested a 95% likelihood that the average total annual payout for a failure outside of the 'Top 4', would be £6.5 million over a ten year period; and
- c) preliminary terms for a credit facility and an insurance policy.

5.3 The professional services firm was also appointed to review the methodology of the CAA's financial model, its fitness for purpose and assumptions used.

5.4 The projections indicated that a £1 rate of APC would remove the deficit by the end of FY09/10, assuming failure costs under normal trading conditions, insurance cover of £200 million and a credit facility of £50 million. A stress test, assuming a recession starting in FY09/10 and its effects lasting for three years, indicated that the Fund would be able to withstand a 'Top 4' tour operator failure by FY12/13.

March 2008 projections

5.5 The CAA updated its liquidity forecasts for the ATTF in the run up to the introduction of APC. These were made available to potential lenders and insurers to support the CAA in obtaining the credit facility and insurance cover. The update:

- a) reduced the anticipated income from £27 million to £24 million in the first year, with moderate increases in the following years, to reflect:
 - i) likely lower capacity in the market following the merger of the 'Top 4' into the 'Top 2'; and
 - ii) a more cautious approach by the CAA to the booking forecasts provided by the Trade. Some of the original estimates appeared too optimistic in the light of ATOL authorisations applied for during the September 2007 and March 2008 renewal periods; and
- b) increased the anticipated cost of insurance premiums due to:
 - i) a rise of the policy cover by 50% to £300 million, as a result of the mergers amongst the 'Top 4'; and
 - ii) the adverse impact of the emerging global financial crisis on the insurance market; and
- c) increased the credit facility to £60 million in the first year to maintain an acceptable level of liquidity in view of the lower forecast bookings.

5.6 The updated forecasts demonstrated that APC could still be introduced at a rate of £1. Under normal trading conditions the removal of the deficit would be delayed by less than a year and under a recession scenario until FY12/13.

5.7 Potential lenders to the ATTF accepted these updated forecasts as a basis for providing the credit facility.

6 ATTF Current Forecasts

6.1 Since the introduction of the APC, the financial outlook of the ATTF has been adversely affected by the costs of the failure of XL in September 2008 and by the recession, which is likely to result in lower bookings and an increase in failure costs.

6.2 In the light of this, the CAA has reforecast the liquidity position of the ATTF. The detailed assumptions behind the revised forecasts are discussed in Appendix 1.

6.3 Chart 1 indicates that if the rate of APC remains at £1 the current bank facility is expected to be exhausted by October 2009 and the deficit of the ATTF will not be removed:

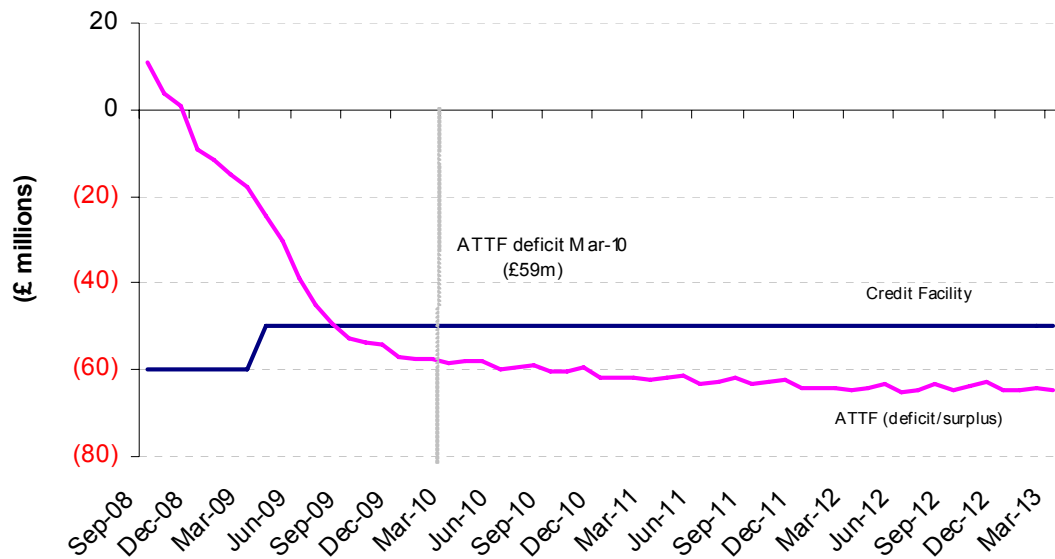


Chart 1 ATTF Liquidity Position (APC at £1)

6.4 The positive position at the end of September 2008 includes bond monies received in respect of the XL failure. The full impact of the XL failure is not seen until FY09/10, as bond monies met the majority of costs incurred during FY08/09.

6.5 Chart 2 (below) provides a breakdown of the factors which are contributing to the deterioration of the forecast deficit at the end of 31 March 2010, from £9 million to £59 million:

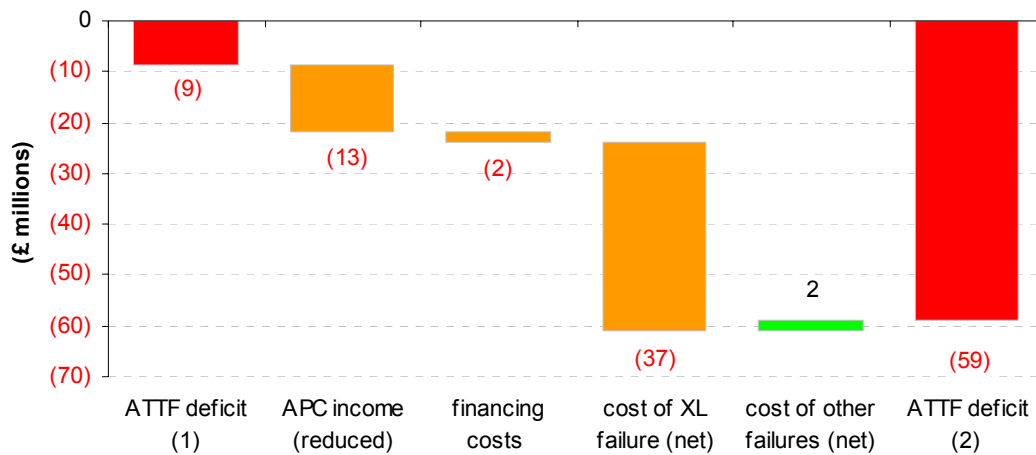


Chart 2 Comparison of forecast deficit to 31 March 2010

(1) deficit projected in March 2008 for end of FY09/10 under a recession scenario
 (2) deficit projected in March 2009

6.6 It should be noted that:

- a) the £13 million reduction in income comprises:
 - i) a forecast reduction in passenger bookings (£10 million); and

- ii) the timing difference between when bookings are taken and income being received by the ATTF (£2 million); and
 - iii) transitional arrangements, which saw some Licence holders opting to delay paying APC until 1 October 2008 as they had already incurred bonding costs until that date (£1 million); and
- b) the full cost of the XL failure is expected to be £89 million, with the net cost to the Fund estimated at £37 million. The balance will be met primarily through bond monies of £42 million and credit card companies of £10 million. For details on the XL failure, see Appendix 1.

6.7 To provide the Fund with sufficient liquidity to meet future costs, the existing credit facility would have to increase to a minimum of £80 million.

7 Options to eliminate the deficit of the Fund

7.1 Maintaining the APC at a rate of £1 is an untenable position. Lenders would not be able to provide the additional facility required to meet costs and provide the Fund with sufficient liquidity. The deficit would not be removed, and the only source of funds would be Government who have stated previously that the costs of providing consumer protection should be met by the Trade and not the taxpayer. As a result, a 'Do nothing' scenario is unacceptable to the CAA, the potential lenders to the ATTF and the Government.

7.2 Accordingly the income to the Fund will have to increase through a rise in the rate of APC in order to secure an additional credit facility in the short-term, and move the Fund into surplus within a reasonable timeframe. This would also allow the travelling public to remain confident in the robustness of the financing arrangements that will underpin ATOL.

7.3 In order to identify an appropriate level of increase the CAA has explored the impact of different rates of APC on the future liquidity of the Fund and its stakeholders (Chart 3), using the assumptions detailed in Appendix 1:

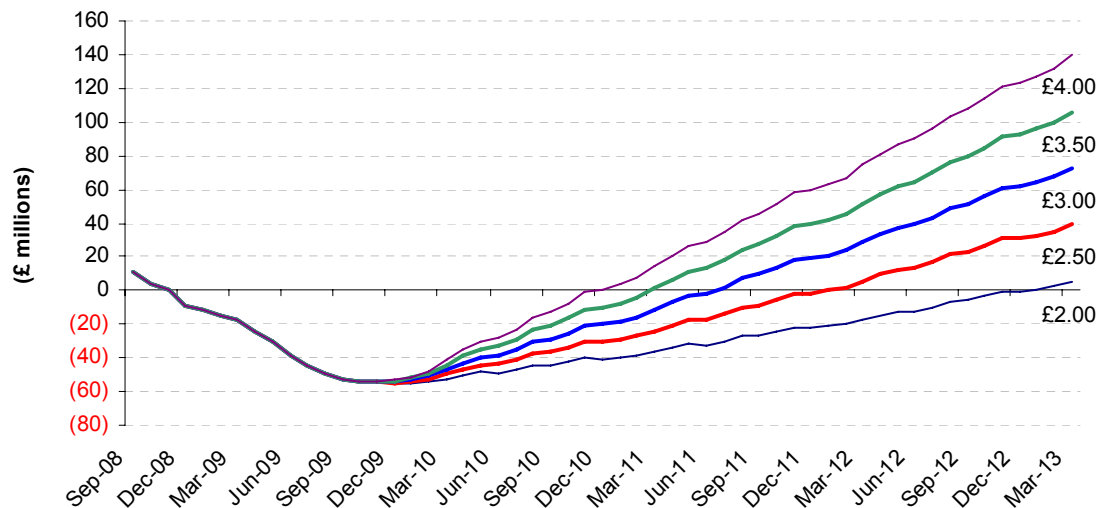


Chart 3 ATTF – Forecast Cash Position

- 7.4 Table C below analyses the effects of different rates in further detail. It shows:
- a) the month in which the Fund would move into surplus under a range of different APC rates (Column A); and
 - b) the expected date that the Fund would be able to absorb the failure of a Licence holder costing £30 million (Column B).

The table also shows the impact of a sensitivity scenario (“Pessimistic Case”) that considers the effect of a 10% drop in the volume of bookings and a 10% rise in failure costs to ‘base case’ figures (Columns C and D are equivalent to Columns A and B).

Table C: Effects of different rates of APC (see paragraph 7.4)

Rate of APC	Base Case		Pessimistic Case	
	Column A	Column B	Column C	Column D
£2.00	Jan-13	Jun-12	n/k*	n/k*
£2.50	Feb-12	Mar-11	Aug-12	Feb-12
£3.00	Jul-11	Jun-10	Nov-11	Feb-11
£3.50	Mar-11	Apr-10	Jul-11	Jun-10
£4.00	Dec-10	Mar-10	Mar-11	Apr-10

* n/k = not known as beyond the forecast period to end of FY12/13.

Proposals

- 7.5 In light of the above analysis, the CAA does not regard an increase in the rate of APC to £2 or £4 to be realistic options to consider as part of this consultation:
- a) £2 – this rate is unlikely to eliminate the deficit within a reasonable timeframe and allow the Government Guarantee to be released. This would therefore be unacceptable to the potential lenders to the ATTF and the Government. A rate of £2 also provides very little resilience to a large Licence holder failure and so raises the likelihood of an increase in the rate of APC, were this to happen;
 - b) £4 – whilst this rate is likely to move the Fund into surplus quickly and should allow the Fund to absorb a large failure in early 2010, the CAA is aware of the burden it may place on the Trade particularly at a time of economic uncertainty. Therefore, the CAA does not propose an increase in the rate of APC to £4.
- 7.6 The CAA proposes that any increase should be to a rate of between £2.50 and £3.50, with the rationale for each outlined in the following three paragraphs.
- 7.7 An APC rate of £2.50 would allow the credit facility to be increased to £80 million. However, it will take longer to repay the Fund and there will be a greater likelihood for the need to increase the rate of APC further, should a large failure occur at an early stage or the pessimistic scenario turns out worse than assumed.
- 7.8 An APC rate of £3.50 will move the Fund into surplus more quickly, thus providing an earlier opportunity to review the rate of APC and the Fund’s financial arrangements.
- 7.9 The CAA considers that a rate of £3 offers a reasonable balance between setting the rate as low as possible, whilst also providing a degree of resilience in the current period of economic uncertainty, and still meeting the objectives for introducing the APC. It should also allow for consideration to be given to reducing the credit facility and removing the Government Guarantee within a reasonable timeframe.

- 7.10 The CAA cannot rule out the possible need to increase the rate of APC further if circumstances turn out to be considerably worse than assumed, although the likelihood of a need to do so will reduce as the resilience of the Fund improves.
- 7.11 As set out in the Spring 2007 consultation, the intention remains for the CAA to consult on the future structure of the ATTF, once the deficit has been eliminated. It is envisaged that this consultation would consider whether it is appropriate for liquidity to be provided through a mix of funds, credit facility and a single insurance policy e.g. it may be appropriate to consider separate but comparable cover, designed specifically for the Top 2 tour operators, particularly as the scale of ATOL business they conduct is significantly larger than other Licence holders.

Implementation of proposed increase to the rate of APC

- 7.12 The CAA's proposal is to implement a change of rate to £3 on 1 October 2009. This will:
- a) delay the impact on Licence holders' costs until after the Summer 2009 season;
 - b) meet requirements to secure an additional facility, which potential lenders have indicated will not be made available unless an increase to the rate of APC is confirmed; and
 - c) meet potential lenders' expectations for the facilities to be repaid within a reasonable timeframe.
- 7.13 In addition, the structure of having licence holders pay monthly, quarterly and annually depending on licence size and type, means that administratively the implementation of any rate change is best suited to coincide with a quarter end and the commencement of a licensing period. The proposed date of 1 October fits with this.

8 Potential Regulatory Change

- 8.1 The failure of the XL Leisure Group highlighted the problems that can occur when passengers are using the same services, or have purchased similar products, but are entitled to different levels of assistance because of how they booked their holiday. The DfT, working with CAA and industry, undertook a 'lessons learned' exercise to review the failure of XL. This found that the arrangements were difficult for consumers and indeed for the trade to understand because:
- the legal framework for ATOL and other financial protection is very complex;
 - it also predates the rise of the internet and developments in the air travel industry which have had a significant effect on how consumers purchase holidays.
- 8.2 Improvements to communications and information to consumers will provide greater clarity in the short term. This is in hand through measures to improve the information available when a consumer is choosing a holiday, using the www.direct.gov.uk website; on the documentation received after the booking is completed; and in resort in the unlikely event that the airline or tour operator fails. For the longer term, DfT, working with CAA and other Government departments, is also exploring whether financial protection can be simplified and clarified for consumers by extending it to all sales of flights with another holiday component.
- 8.3 Depending on conclusions reached, some changes may require amendments to primary legislation or could be achieved through revisions to secondary legislation. DfT is grateful for the work the industry has done to produce its own proposals in this area and is also considering these.

- 8.4 The changes the DfT, CAA and other Government departments are considering include:
- extending financial protection to all flights sold with another holiday component;
 - allowing airlines to protect flights sold with another holiday component through the ATOL scheme;
 - allowing ATOL holders' non-air packages to be financially protected through ATOL or parallel arrangements.
- 8.5 Depending on the outcome of its work, the DfT expects to consult on options for reform, including any legislative changes required, later in 2009.

9 Impact on Licence holders of a change to the rate of APC

- 9.1 It is proposed that all Licence holders will pay the same rate of APC from the same effective date.

Licence holders with a passenger limit of more than 500

- 9.2 For licence holders with a passenger limit above 500, the new rate would apply to all bookings taken from 1 October 2009 with the first payments falling due in December 2009, from those licence holders required to pay on a monthly basis. For those who are required to pay on a quarterly basis, the first payment based upon the proposed new rate would be in February 2010.

Small Business Licence holders ("Small Business ATOL" or "SBA")

- 9.3 A change to the APC rate impacts on the particular regulatory arrangements that apply to SBAs:
- a) firms applying for a SBA for the first time are required to pay £500 into the ATTF, which is equivalent to 500 bookings at £1, before the grant of a licence; and
 - b) SBAs renewing their licences pay for all bookings taken during the previous licence period at the rate in force at the commencement of the new licence period.
- 9.4 Existing regulatory arrangements on SBAs mean that a change to the APC would have a disproportionate effect on SBAs. To maintain entry costs for SBAs at the existing level (which includes an upfront payment of £500 and the provision of a bond for the first four years) it is proposed that SBAs are exempted from Regulation 8 of the ATT Regulations⁸. This would be on conditions being set that ensure SBAs pay APC into the ATTF in line with the amount of business booked, the same as other Licence holders. The introduction of such an exemption is subject to consultation with, and a decision by, the Secretary of State.

8. The Civil Aviation (Contributions to the Air Travel Trust) Regulations 2007

10 Changes to Official Record Series 3 (“ORS3”)⁹

10.1 Consequential changes to the ORS3 will be necessary should the Secretary of State approve a change in the rate of APC. These amendments are summarised in paragraphs 10.2-10.4 below.

Section 2 – Confirmation Invoices and ATOL Receipts (Information to be included)

10.2 This section of the ORS3 details the requirements for an ATOL Confirmation Invoice and an ATOL Receipt. An administrative change is proposed whereby the existing reference to “£1” will be changed to, for example, “£X*” (*as published by the CAA in its Official Record Series 3).

Section 4 – Payment Periods and Rate of Contribution for the APC

10.3 The ATT Regulations require the CAA to publish the rate of contribution and the date on which that rate comes into force. This information is published within Section 4 of the ORS3. Should the Secretary of State decide to increase the rate of APC as a result of this consultation, Section 4 will be amended accordingly.

10.4 It is also proposed that Section 4, paragraph 4.5, is amended to accurately reflect the ATT Regulations whereby SBAs are required to make contributions relevant to bookings taken during the previous licence period, and not annually as specified.

11 Consultation Process

11.1 The ATT Regulations contain provisions for the rate of contribution to be amended:

- a) following consultation with ATOL holders, the Trustees of the Air Travel Trust and other persons appearing to represent ATOL holders; and
- b) with the approval of the Secretary of State.

Timeline

11.2 The proposed consultation timeframe is outlined below:

Action	Timeline
Consultation period	27 April 2009 – 12 June 2009
Review of responses	mid-July 2009
Decision from Secretary of State	end of July 2009
Publication of new rate and effective date	end of July 2009
Implementation of new rate	1 October 2009

9. <http://www.caa.co.uk/ORS3>

Questions

11.3 The CAA is seeking a response to the following questions. When responding, please provide as much detail of your reasoning as possible.

		Paragraphs
1	<p>The CAA has set out its assumptions behind the revised cash flow projections for the ATTF in Appendix 1 of this consultation.</p> <p>Do you agree that the assumptions used are reasonable? In particular those relating to:</p> <p>a) booking forecasts?</p> <p>b) failure costs? and</p> <p>c) the pessimistic scenario?</p>	<p>Appendix 1, 1 – 22</p> <p>Appendix 1, 2 – 5</p> <p>Appendix 1, 16 – 22</p> <p>7.4</p>
2	<p>Three options have been set out in Section 7, outlining the benefits and risks of each. Do you think that the rate of APC should increase to:</p> <p>a) £2.50</p> <p>b) £3.00 (the CAA's recommendation) or</p> <p>c) £3.50?</p>	7.7 – 7.9
3	<p>The CAA will consult with the Secretary of State on a proposal to exempt SBAs from Regulation 8 of the ATT Regulations, but with conditions which mean that they will pay the same as other Licence holders. Do you have any specific comments that you would like us to consider in this respect?</p>	9.4

Consultation Responses

11.4 This consultation document has been sent to the consultees listed in Appendix 2. The CAA invites responses on this document from any source. If a response is provided on behalf of a representative body, the response should summarise the parties that body represents. If consultees consider the view of a stakeholder not listed at Appendix 2 should be sought, please notify the CAA at the address in the following paragraph.

11.5 Please send all responses by Friday 12 June 2009 to consultations@caa.co.uk or write to:

Mark Rayner
 Consumer Protection Group
 K3, CAA House
 45-59 Kingsway
 London WC2B 6TE

11.6 If you have any queries on this consultation please contact Mark Rayner at the above address.

11.7 The CAA will review all of the responses received and a summary of the replies to the questions will be published on its website (www.atol.org.uk), within three weeks of the consultation closing date.

Freedom of Information

- 11.8 Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).
- 11.9 If you would like the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence.
- 11.10 In view of this it would be helpful if you could explain why you regard the information you have provided as being confidential. If a request for disclosure of the information is received, your explanation will be taken into account, but the CAA cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the CAA.
- 11.11 The CAA will process your personal data in accordance with the DPA and, in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

Government Code of Practice

- 11.12 This consultation document draws on version 3 of the Government Code of Practice on Consultation¹⁰ (the "Code"), which was published in July 2008 and became effective on 1 November 2008. The Code contains seven criteria. These criteria are listed and, where applicable, detail is provided on how they have been taken into account, below:

- i) Formal consultation should take place at a stage when there is scope to influence the policy outcome.*
- ii) Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.*

The Code suggests that consultations should last for a minimum 12 weeks and that this should be factored into project plans for policy development work.

Having given careful consideration to the Code's guidelines the CAA believes a six-week consultation period is appropriate:

- This consultation covers a single issue, seeking views on a proposal to increase the APC rate. The consultees are also narrowly defined (e.g. ATOL holders).
- There is no change to the structure of the ATTF proposed in this consultation. The CAA's obligation to consult on the policy for introducing APC was fulfilled in the DfT and the CAA's 'Reform of ATOL Bonding Arrangements and the Replenishment of the Air Travel Trust Fund' consultation (referred to in this document as the Spring 2007 consultation).
- The proposal to increase the rate of APC has been the subject of pre-consultation discussions between the Trade and the CAA. A proposed change has also been widely reported in the trade press.

10. <http://www.berr.gov.uk/files/file47158.pdf>

iii) Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.

An Impact Assessment has not been conducted since the consultation does not propose an amendment to (or introduction of) legislation or policy.

iv) Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.

v) Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.

vi) Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.

vii) Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

11.13 If you have any queries or comments on the consultation process itself, as opposed to responses to the consultation, please contact David Bourne of the CAA at apcconsultationqueries@caa.co.uk.

April 2009

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Appendix 1 Assumptions made in March 2009 for the cash flow projections of the ATTF

1 This section sets out the main assumptions behind the current forecasts for the ATTF.

APC Income

2 The number of bookings during the first six months of FY08/09 were in line with expectations but dropped notably as the UK economy moved into recession in the second half of 2008. Economic forecasters are suggesting the economy will contract (between 2.8%-3.3%¹¹) during 2009 and the CAA anticipates that bookings will therefore continue to decline in the current financial year. This assumption is supported by the projected booking figures provided by ATOL holders as part of their March 2009 renewal applications, some of which are 15%-20% down year-on-year.

3 After FY09/10 the CAA anticipates that demand for package holidays will recover slowly as economic forecasters predict only moderate signs of recovery e.g. BCC and CBI predict that there will be 0.8% or zero growth in 2010 respectively. The BCC also predicts that growth after 2010 will be weaker than in the periods leading up to the recession.

4 Table 1 compares the revised forecast bookings with the projections in March 2008.

Table 1 Estimated number of bookings covered by ATOL

	Estimate	Forecast	Forecast	Forecast	Forecast
Bookings (pax '000)	FY08/09	FY09/10	FY10/11	FY11/12	FY12/13
Forecast – March 2008	23,990	25,542	25,625	25,715	25,809
Forecast – March 2009	20,268	19,049	19,527	20,211	20,869

5 As a result of the reduced level of bookings, forecasts for income of the Fund based on £1 APC are £27 million less than originally anticipated for the five-year period to FY12/13.

Financing costs

6 The market for credit insurance has seen significant rises in premiums since the introduction of APC, however this does not affect the ATTF as the CAA negotiated a fixed rate premium for three years (to 31 March 2011). For forecasting purposes it is assumed that the Insurance Policy will be extended in due course at a similar premium level.

7 The CAA forecasts an increase in the interest costs as the level of the current bank facility has to be increased and the terms and conditions of the new financing arrangements are likely to be more onerous than those previously negotiated.

8 Potential lenders have advised the CAA that any additional facility will have to be secured by an additional Government Guarantee and will only be available if it is confirmed that the rate of APC will be increased.

9 The DfT has indicated that in line with emerging Government practice, it will apply a charge for providing a Guarantee for the additional facility. As previously stated, Government expects industry to bear the costs of consumer protection and will continue to look for the Guarantee to be removed as soon as possible.

11. Source: Confederation of British Industries ("CBI") and British Chambers of Commerce ("BCC")

XL failure

- 10 XL failed on 12 September 2008. Historically, the probability of a failure amongst the largest licensed tour operators is low (prior to XL there has only been 1 failure of a Top 5 operator in the last 20 years). XL was the UK’s third largest tour operating group and its failure was the largest since International Leisure Group in March 1991.
- 11 In reaching its decision to renew the licences in March 2008, the CAA took into account that the management and advisors of XL provided:
- a) evidence that the refinancing of the Group was at an advanced stage and due for completion in mid-May 2008; and
 - b) a credible business plan, based upon reducing capacity and cutting costs and a sufficient level of liquidity available within the Group. As part of the plan XL was to eliminate its previous years’ loss making ventures and refocus on its profitable core operations.
- 12 Despite the above the CAA required a significant bond of £42 million, representing approximately 15% of licensable revenue, in the then unlikely event that the Group was unable to achieve the refinancing.
- 13 As cash was expected to be sufficient during the summer season, the bond was designed to cover passenger liabilities in the event of a failure during October-January, when cash was predicted to be at its lowest.
- 14 Although not a key consideration in reaching a decision, the CAA was also conscious that a number of ATOL holders had already contracted with XL for their Summer 2008 programmes.
- 15 By the end of August 2008, XL’s cash resources had dropped to the low point forecast for November 2008. This was primarily due to:
- a) the inability of Landsbanki, its major lender, to provide additional liquidity as the bank was affected by the collapse of the Icelandic banking market. To minimise its exposure, a bank would normally ensure that a tour operator trades through to a seasonal low point but in this instance this was not an option;
 - b) an inability to continue using cash of overseas subsidiaries to support UK operations; and
 - c) a collapse in fuel prices. The Group hedged against rising fuel prices when fuel costs were already at elevated levels. As a result, when fuel prices fell XL was subject to substantial margin calls that took cash out of the business.

Failure costs

Cost of XL failure

- 16 Following extensive review of XL’s databases, the CAA estimates that costs arising from the failure will be in the region of £89 million.

Table 2 Breakdown of XL costs

	£ million
Repatriation Costs*	21
Refund Costs	65
Administrative costs	3
Total	89

* net of recoveries from passengers who were not ATOL protected and ATOL holders.

17 The ATTF will meet approximately £37 million with the remainder being covered by a combination of bond monies (£42 million) and credit card companies (£10 million).

Costs of failures (excluding XL)

18 Forecasts in March 2008 included a recession scenario assuming an economic downturn during FY09/10, with the impact lasting three years. In addition, it was forecast that bond monies would meet just 10% of failure costs.

19 Apart from XL, there were 45 ATOL failures in the year to 31 March 2009. The majority of these failures occurred within the last six months as the UK economy moved into recession. To date there has been a higher number of failures amongst firms who provided bonds than anticipated.

20 The CAA assumes that failure costs during this recession and the immediate period afterwards will be higher than originally predicted.

Table 3 Estimated gross failure costs excluding XL (£ millions)

	Estimate	Forecast	Forecast	Forecast	Forecast
	FY08/09	FY09/10	FY10/11	FY11/12	FY12/13
March 08					
recession case	7	10	15	12	8
March 09					
base case*	13	16	13	12	10

*base case reflects current recession environment

21 The figures in Table 3 are estimates of the failure costs before any recoveries from bonds or other sources. The CAA is assuming that 15% of total failure costs will be met from such recoveries.

22 The average gross failure costs for the five years to FY07/08 was £8 million per annum and for the ten years to FY07/08, was £5 million per annum. The ATTF met around 20% of these failure costs. Since the majority of Licence holders no longer provide bonds, this percentage is forecast to increase to 85%, with the remainder being met by either bond monies or a charge held by the Trustees of the ATTF over a failed company's fixed cash deposit(s).

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Appendix 2 List of Consultees

All Licence holders
All Trustees of the Air Travel Trust
AB Law
ABTA – The Travel Association
Advantage Travel Centres Ltd
Air Travel Consultancy
Air Travel Insolvency Protection Advisory Committee
Association of Chartered Certified Accountants
Association of ATOL Companies
Association of Greek and Cypriot Travel Agents
Association of Independent Tour Operators
Barclays Bank plc
Bird & Bird LLP
British Bankers Association
Confederation of Passenger Transport
Deloitte & Touche LLP
Elman Wall
Ernst & Young Global Ltd
Eventia
Federation of Small Businesses
Field Fisher Waterhouse
Gates & Partners
Guild of Travel Management Companies
Haines Watts
Institute of Chartered Accountants for England and Wales
Kirkpatrick and Lockhart Preston Ellis Gates LLP
KPMG
Longi Associates
MacIntyre Hudson LLP
Passenger Shipping Association
PricewaterhouseCoopers
Sam McKee Ltd
Scottish Passenger Agents Association
Sharman Associates
Smith & Williamson Ltd
Trading Standards Institute
Travel and General Management Services
Travel Trade Consultancy
Travel Trade Management
Travel Trust Association

Vantis PLC
White Hart Associates Ltd
Worldchoice