Teneo
The Global CEO Advisory Firm

Changes to ATOL protection

How might the CAA's proposed changes to the ATOL funding model affect the industry and wider stakeholders involved?

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Introduction

As British holidaymakers have been returning to take package holidays with flights, the Air Travel Organisers' Licence ("ATOL") scheme provides consumers with two simple protections:

1. Should their holiday provider fail prior to departure, ATOL will refund the full value of the holiday purchased.
2. Should their holiday provider fail whilst the consumer is physically on holiday, ATOL will repatriate the consumer and provide compensation as necessary.

Currently, tour operators pay a flat rate of £2.50 per customer under the ATOL Protection Contribution. However, this does not reflect the risk individual ATOL holders pose to consumers as those businesses facing increased risk of failure pay the same contribution as those who are financially more secure.

COVID-19 has highlighted the dependency of some tour operators on the use of customer deposits for working capital. Tour operators often commit and prepay for hotel and other service capacity for a given holiday season in advance of a customer booking, thereby creating long working capital cycles which increase liquidity risk should a shock event occur.

After COVID-19 hit, the near immediate stop in operation and reduction in future bookings left many travel businesses struggling to provide customer refunds within the legal timeframe of 14 days. This led to several investigations by the Competition and Markets Authority ("CMA"). It is partially as a result of these failings that the Civil Aviation Authority ("CAA") who operate and regulate the scheme have proposed a range of reforms.

Proposed ATOL Reform

The CAA's first round consultation paper (published April 2021) outlines measures that could give additional protection to consumers through the restriction of the use of customer monies until the completion of a holiday. These measures include:

A. Full or partial segregation of customer funds through use of trust, escrow or separate bank accounts;

B. Mandatory provision of bonds (cash deposits) for all ATOL license holders;

C. Adjustment of the ATOL Protection Contributions ("APC") rate to be both risk based and proportionate to holiday value; and

D. Equivalent consumer financial protection to be taken out from an insurer in order to provide protection to an equivalent standard that the consumer currently receives through the ATOL scheme.

Once initial comments have been received, a second consultation period is due to commence in 2022.

Varying approaches to customer deposits

At present, there are a wide range of working capital approaches within the industry. Historically, Jet2 have held cash reserves greater than their customer monies held, whereas TUI have been heavily dependent on the investment of customer funds. On The Beach PLC, however, do not utilise customer monies, instead holding all amounts received in trust.

Top 5 ATOL License Holders by passengers licenced – 2019

#	Name	Passengers Licensed (2019)	Cash on Balance Sheet	Customer Deposits* (2019 statutory accounts)
1	TUI UK Ltd	5,555,145	£436m	£1,066m
2	Jet2holidays Ltd	3,915,000	£1,388m	£745m
3	On the Beach Travel Limited	1,646,800	£55m	£44m**
4	We Love Holidays Ltd***	1,374,812	£62m	£128m
5	British Airways Holidays Ltd****	1,010,148	£0m	£0.1m

*Figures presented are 2019 year ends for all companies to show pre-COVID customer deposit levels. **On The Beach PLC hold all customer monies as restricted cash in trust. *** The £128m shown represents the trade payables balance. No customer deposits are disclosed. This balance comprises amounts owed to hotel and flight operators and therefore relates to the use of customer monies. **** The amount shown specifically relates to the ATOL licensed company within the wider British Airways Group. The 2019 consolidated accounts (which also include non-ATOL protected amounts) include £1.3bn of cash and £2.9bn of customer deposits.

Source: UK Civil Aviation Authority & Company Statutory Accounts

Teneo's view of the proposed measures

Businesses within the sector are dynamic and diverse and will be impacted by the proposals to varying degrees. Some will prefer trust accounts, others will favour providing bonds and guarantees and some will prefer an insurance solution directly linked to turnover, which will smooth any financial impact. However, taking each proposal in turn:

A. Segregation of customer funds

Customer deposits currently are, in effect, being used by many as short term interest free loans from consumers. With travel slowly recovering, many bookings are being made with vouchers issued during the last 18 months rather than cash and operators are managing cash flows carefully should there be a further wave of COVID-19 cancellations, postponements and refunds.

Full or partial segregation of customer funds into a trust account or escrow will reduce available liquidity for those that do not currently operate in this manner. In addition, it may also require a review or reset of their leverage covenant position.

Where new trust or escrow accounts are required, careful planning will be required to manage the operational complexity of moving funds between protected and operational accounts.

B. Increase in bonding

The level of bond required by ATOL would primarily be based upon the financial strength of the applicant and, in theory, it should cover the highest liability point of the year.

The latest ATT accounts showed that many failures did not have adequate bonding in place and this is potentially not the most appropriate solution given its cost and lack of flexibility.

However, some tour operators suggest a more dynamic approach to bonding may result in lower costs.

C. Increase in the APC rate

Moving the APC rate to a more variable arrangement based upon the overall holiday price or using a risk based approach should ideally take into account how any other changes implemented may affect the risk profile of any business.

Given the current pricing at £2.50 per holiday, the changes proposed here will need to be significant to make a material impact to operators and it is likely that any increase in the APC rate would be passed directly onto consumers through an increase in the price of holidays.

D. Insurance

On the assumption that an adequate financial product exists that provides equivalent consumer financial protection, this approach could transfer all or part of the liability away from the CAA.

Careful management and oversight may be required to ensure that tour operators maintain an adequate level of cover whilst avoiding large excesses and premiums.

How might other stakeholders react?

The measures proposed by ATOL, specifically the withholding of customer monies or holding of deposits, are comparable to the risk management strategies adopted by merchant acquirers where travel companies are showing signs of distress.

Merchant acquirers will therefore likely be closely monitoring the usual renewal process in September and March each year as well as taking a view on the potential impact of these reforms on each operator.

They will therefore remain an important stakeholder to be managed proactively through any upcoming changes by each operator.

How Teneo can help

Teneo has a team of experts who can support all stakeholders with the implications of the proposed changes.

Given the second consultation is not due until 2022, our view is that formal impacts may not be felt for some time. However, with typical renewals in September and March, some elements of the proposals may start to be introduced by stealth.

With the ever-changing travel restrictions, many businesses have found financial forecasting a significant challenge during COVID-19, combined with increased scrutiny on such forecasts from wider stakeholders such as the CMA, lenders and card acquirers amongst others.

We have a wealth of experience supporting all stakeholders in delivering consensual and non-consensual restructurings, as well as a suite of other services including performance improvement and management consulting, to support operators navigate their way through to recovery and growth.

Sandy Duncan
Senior Managing Director

07968 903014
Sandy.Duncan@teneo.com

David Gard
Senior Managing Director

07913 695608
David.Gard@teneo.com

Ben Davies
Senior Managing Director

07768 294502
Ben.Davies@teneo.com

Simon Hanks
Associate Director

07825 831928
Simon.Hanks@teneo.com

Jennifer Currie
Associate Director

07493 046997
Jennifer.Currie@teneo.com

Matt Powney
Manager

07986 899133
Matt.Powney@teneo.com

The Global CEO Advisory Firm

London
5th Floor,
6 More London Place
SE1 2DA