



A future for the travel sector?

CAA requirements

The economic slowdown following from the banking sector crisis, coupled with the weakness of sterling against the major tourist currencies, is demonstrably influencing consumer behaviour, with the short break sector being markedly hit, but this is not the only challenge operators are having to grapple with in these uncertain times. Relatively recent changes to the regulatory regime are resulting in, no doubt, unintentional additional pressures on operators.

The Air Travel Trust Fund (ATTF) is now the core source of funding for consumer repayment and repatriation costs when an ATOL holder fails. By 31 March 2008, when the system was last revised, the ATTF was in deficit to the tune of some £22m.

The ATOL Protection Contribution (APC), a sum payable by ATOL holders and set at the level of £1 per passenger each time a person books a package holiday that involves air travel, was introduced from 1 April 2008 with a view to addressing this deficit over a period of three years, allowing the government to recover its guarantee of this overdraft and building up a reserve. Additionally it served to replace the CAA's bonding requirements for the bulk of operators, excepting those deemed to represent a relatively high risk of failure.

The September 2008 administration of the XL Leisure Group, the UK's third-largest tour operator, generated claims from customers unable to travel and costs of repatriating stranded holidaymakers of around £90m. Despite XL being one of the few tour operators to be protected under the old bonding system (there were £42m of bonds in place at the time of failure) this case still represents a body blow to the ATTF of around £37m, putting the new deficit at around £59m. The talk of the banks' refusal to increase the £60m overdraft facility and the mathematics surrounding where the ATTF would have been left had the XL bonds been released under the new system certainly fuel speculation, that has been rife since the demise of XL, that not only will the ATTF require to be bailed out by the Treasury but also that the APC will require to be substantially increased.

Increasing costs

The APC now looks to be heading towards £3 per person (as now proposed by the CAA, which operates the ATOL scheme) and assuming operators will look to pass this on, it is hardly going to encourage consumer demand nor enhance operator performance. Additionally the polarisation of the bonding requirement towards those with the weakest balance sheets has inevitably influenced insurer appetite to provide CAA bonds and has increased the cost to operators who, by definition, are least well placed to absorb it.

Credit card acquirers and cashflow

Whereas traditionally bond obligors paid out first when an operator failed, credit card acquirers are now in the front line and, perhaps, not surprisingly are managing their exposures more conservatively, particularly as they reach peak periods. The CAA's position on XL, in not paying out on claims that involved part payment on credit cards, has no doubt exacerbated concerns, not to mention the cause of some rather lengthy delays in refunding XL customers that were unable to travel. There is evidence that the response of the credit card acquirers has been to slow down payments to operators, payment periods moving out from 10 towards 15-20 days, as they seek to build cash backing for contingent exposure to charge backs. This is starving operators of cashflow, magnifying financial risk and in the worst case precipitating the very circumstances which the credit card acquirers are attempting to protect themselves from.

Licence renewals

The CAA are clearly aware of those operators with potential problems and, if the run up to 31 March licence renewals was anything to go by, are maintaining a, perhaps understandable, hard line on capital and bonding requirements in order to protect the ATTF but, less understandably, appeared to have been prepared to let negotiations run to the wire. This had the inevitable effect of

truncating the underwriting process for insurers and made it harder for directors to arrange for the introduction of additional subordinated funding via the traditional route of borrowing against personal assets, as if that were not already hard enough these days.

Again, as a consequence, stakeholder actions are potentially precipitating failure, the end result of which could well be the undermining of consumer confidence in the sector and the loss of jobs, presumably the exact opposite of the government's intention.

How can MCR help you?

In the light of developing credit card acquirer and CCA patterns of behaviour, MCR's business consultancy team stands ready to advise bond obligors, banks and operators, not only in terms of relationships between each other and with those external stakeholders mentioned but also in respect of business performance and cashflow management, as required. We can point to our specialist experience in the sector. For example, in December 2007 we were appointed administrators to Travelscope Holidays Ltd, an £80m turnover travel business, and successfully facilitated a sale of the trading businesses after an intensive period of involvement and management of all stakeholder relationships.

Judging by the end of March licence renewal round we believe many of the issues discussed are likely to be played out again over the period to the end of September and we would welcome the opportunity for an early discussion.



Steve Manwaring,
director, MCR.
Contact him via:

smanwaring@mcr.uk.com
T +44 (0) 20 7487 7260
M +44 (0) 7827 290056