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# Review of consumer protection in the travel and travel related services market

Prepared for the Department of the Treasury, on behalf of the Standing Committee of Officials of Consumer Affairs

November 2010



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# Key messages and recommendations

The following are PricewaterhouseCoopers' key observations and recommendations from our review of consumer protection in the travel and travel related services industry, separated according to the three components of the review's Terms of Reference.

## The need for consumer protection measures in the travel industry

- 1 For the most part, competitive markets underpinned by generic consumer protection rules, some voluntary accreditation and some private measures provide an adequate and appropriate level of consumer protection in the travel industry.
- 2 Historically, protecting the carriage of monies by travel agents and volatility in that market was the driving rationale for the existing travel agency regulatory scheme, the only industry specific consumer protection regulation in the travel industry. Subsequent developments suggest that there is no longer sufficient justification for industry-specific consumer protection regulation in this sector and that the existing scheme is now not fit for purpose.
- 3 Consumer protection concerns in the airline industry have been raised. These were acknowledged, and are being addressed, by recommendations in the Australian Government's Aviation White Paper.

## The relevance, effectiveness and viability of the current travel agency regulatory scheme

- 4 The travel agents licensing scheme is the only industry-specific consumer protection regulation in the travel industry, and includes training requirements, administration and disclosure rules, and a compulsory prudential oversight and compensation scheme.
- 5 The licensing framework provides little consumer benefit while imposing regulatory cost on business. Its state/territory basis imposes unnecessary cost and does not reflect the national nature of the market.
- 6 The compensation scheme administered by the Travel Compensation Fund (TCF) has performed well in improving consumer protection since its introduction in the 1980s. The industry has, however, changed radically over this time, and the risks to consumers associated with the collapse of a travel agent have significantly reduced.
  - More and more consumers are purchasing direct from travel suppliers or via credit cards; in which case their funds are not at risk from travel agent collapse.
  - Market consolidation and the declining market share of smaller agencies have improved the ability for consumers – through media coverage of large companies – to better assess the solvency of businesses in the industry.
  - Increasing consumer affluence and familiarity with travel, combined with the declining real cost of travel, make travel purchases a less significant household purchase.
  - The economic cost of the scheme is in the order of nine times greater than the average value of claims paid.
- 7 Consumers appear to value protection from travel agent insolvency, being willing to pay, at a minimum, \$30 on a \$1,000 fare for such protection. Consumers are however largely unaware of the current scheme and, therefore, this willingness to pay represents the value they place on avoiding the potential for loss (ie rather than the value of the current scheme per se). Accordingly, the question for this review is whether the current scheme is the optimal framework for this protection to be provided.
- 8 On the evidence, the compensation scheme appears unduly burdensome relative to the risk of consumer detriment from travel agent collapses and represents a disproportionate regulatory response relative to consumer protection regulation in other industries. On balance, there is insufficient justification to maintain the current scheme with its attendant costs.

## Regulatory and non regulatory options to address consumer protection issues

- 9 PwC believes that the industry-specific consumer protection regulations in the travel agents market are no longer fit for purpose, and that the scheme should be reformed to better meet the current and future needs of the sector.
- 10 PwC recommends that consumer protection in the travel industry, including travel agents, be centred on the generic provisions of the proposed Australian Consumer Law, supported by voluntary accreditation under the National Tourism Accreditation Framework.
- 11 PwC recommends that the existing travel agents licensing scheme be replaced with a mandatory registration scheme, that is administered by a single national body and imposes minimal 'character' entry requirements (such as a 'fit and proper person' test) and selected conduct requirements (such as disclosure obligations and a code of conduct).
- 12 PwC recommends that an accreditation scheme, licensed under the National Tourism Accreditation Framework, be established for travel agents and other travel intermediaries. PwC also recommends that the option of expanding the scope of the proposed Aviation Ombudsman and creating an enforceable industry code under the Australian Consumer Law be explored in line with the timing of these two initiatives.
- 13 PwC recommends that the insolvency protection functions of the Travel Compensation Fund (prudential oversight and compensation) be discontinued. The phased wind-up of the fund should be implemented in line with the implementation of other recommendations in this report.
- 14 PwC recommends that detailed consideration be had as to the appropriate mechanism for implementing these reforms. A detailed transition plan is outlined in the body of this report.
- 15 PwC acknowledges that reform decisions may be informed by other policy considerations beyond a pure cost-benefit analysis. Accordingly, PwC has also outlined recommendations for reform of the existing compensation scheme that improve the scheme's operation while retaining some consumer protection from travel agent insolvency.





## Abbreviations

ABS	Australian Bureau of Statistics
ACCC	Australian Consumer and Competition Commission
ACL	Australian Consumer Law
AFTA	Australian Federation of Travel Agents
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investment Commission
ASX	Australian Securities Exchange
ATEC	Australian Tourism Export Council
ATOL	Air Travel Organiser's Licence
BITRE	Bureau of Infrastructure, Transport and Regional Economics
BSP	Billing and Settlement Plan (IATA)
CATO	Council of Australian Tour Operators
COAG	Council of Australian Government
FCL	Flight Centre Limited
GDP	gross domestic product
ESOS	Education Services for Overseas Students
IATA	International Air Transport Association
NGF	National Guarantee Fund
NLS	National Licensing System
NTAF	National Tourism Accreditation Framework
OH&S	occupational health and safety
PDS	product disclosure document
PwC	PricewaterhouseCoopers
RBA	Reserve Bank of Australia
SCOCA	Standing Committee of Officials of Consumer Affairs
TAANZ	Travel Agents' Association of New Zealand
TCF	Travel Compensation Fund

## Glossary

External administration	Due to insolvency or other problems the company is being administered by an outside agency appointed by the company, a liquidator or a chargee.
National Scheme	The National Co-operative Scheme for the Uniform Regulation of Travel Agents, introduced in 1986 and subsequently adopted by all Australian states and territories.
PwC Consumer Survey	A survey of consumers on a range of issues relating to consumer protection in the travel industry and on their willingness to pay for such protection. The study was conducted on PwC's behalf by TNS Group and surveyed a random sample of over 800 travel consumers.
PwC Travel Agents Survey	A survey of Australian travel agents (distributed to all TCF members, 415 responses received) on a range of issues relating to consumer protection in the travel industry and the existing regulatory regime.
Travel agents	For the purposes of this report, <i>travel agents</i> refers to businesses required to be licensed as 'travel agents', in accordance with the provision of the various Travel Agents Acts of each Australian state and territory. This definition refers to persons or businesses carrying on a business of selling (or arranging, making available, purchasing for resale or advertising to sell) travel or travel and accommodation. See section 2.2 for more detail



# Executive summary

## Our task

PricewaterhouseCoopers (PwC) has been requested to conduct a review of consumer protection in the travel and travel related services market, and to:

- identify and review the effectiveness of, or need for, consumer protection measures in the travel and travel related services market, particularly in relation to consumer prepayments for services
- consider the relevance, effectiveness and viability of the current travel agency regulatory scheme, with a particular focus on the operation of the Travel Compensation Fund (TCF)
- identify and consider regulatory and non-regulatory options within a cost/benefit framework to address consumer protection issues at a Commonwealth and State/Territory level.

Our work is cognisant of previous other reviews in this sector including the National Competition Policy review in 2000.<sup>1</sup>

## Our approach

Our approach has been to consider the need for consumer protection measures in light of the nature and objectives of best practice consumer protection. This included considering the principles of best practice consumer protection, the approaches adopted in other industries and lessons learned from their experience and the broader consumer protection framework in Australia.

This approach was applied to the particulars of the Australian travel industry via an examination of the markets, segments, players and circumstances of the travel industry. Accordingly, our review included:

- a review of the existing regulatory and non regulatory consumer protection framework in the Australian travel industry and relevant and comparable international jurisdictions

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<sup>1</sup> See Centre for International Economics (2000) 'National Competition Policy review of the National Scheme for the Regulation of Travel Agents' and Working Party report to Ministers. This review can be obtained from the National Competition Policy website: <http://ncp.ncc.gov.au/>.

- soliciting contributions from interested parties, including:
  - the release of an Issues Paper
  - review of the submissions
  - face-to-face and telephone consultation with a comprehensive mix of consumer, industry and government stakeholders.
- surveys of industry and consumers
- an analysis of available data and other information.

## Our findings

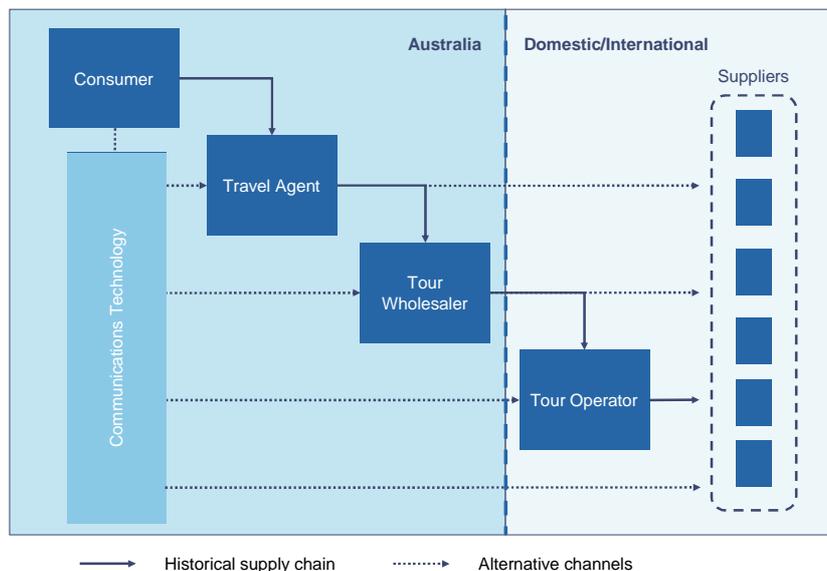
### The industry

The travel industry is diverse. It incorporates many different markets and segments, with nuanced characteristics, trends and circumstances in each. With some exceptions, travel markets are typically highly competitive and dominated (in number at least) by small businesses.

The travel industry has undergone major changes in its operation due to the advent and uptake of technology (most importantly the internet). In parallel with these changes, the industry has seen the growth of electronic payment methods. These changes have come during a period of increasing travel by Australians due to, amongst other things, the declining relative cost of travel.

There is also a broad trend towards consolidation in previously unconsolidated sectors of the market; most notably, travel intermediaries. These developments have had a profound effect on the industry, including changing the nature of the supply chain by which consumers have historically accessed travel products. This impact is demonstrated by Figure ES1, with technology increasing the number of transaction avenues available to the consumer.

Figure ES1 – Travel industry supply chain



These developments have improved the choice and information available to consumers, while reducing their vulnerability to consumer protection issues historically present in the market.

### The existing consumer protection framework

The centrepiece of consumer protection regulation in Australia is the generic provisions of Fair Trading Acts and the *Trade Practices Act*, applicable to all industries. These are being harmonised nationally under the Australian Consumer Law initiative, which is due to be fully effective and implemented by January 2011.

While primary reliance for consumer protection regulation should be placed on the generic rules applicable to all industries, there may be some limited circumstances in which industry-specific provisions are appropriate. Nevertheless, a clear need for additional consumer protection should be demonstrated; for example, a particularly great risk of consumer detriment and/or inadequate opportunities for prevention, redress or non regulatory protection.

In the travel industry, industry-specific consumer protection regulation is currently focussed on travel agents. A compulsory licensing regime and an insolvency protection scheme are in place. Together these measures attempt to achieve three key objectives.

- **Competency** – protecting consumers from inadequate service from travel agents, to the extent this is the result of incompetence on behalf of the travel agent.
- **Compensation** – providing compensation to consumers who lose funds in the event of a travel agency collapse, including prudential oversight to minimise such occasions.
- **Conduct** – improving business conduct in the industry via the disciplinary powers vested in the relevant licensing authority.

Other industry-specific measures are being developed, including a national accreditation framework for the tourism industry and an industry ombudsman for the aviation sector.

A range of non regulatory measures are also present. These include industry associations' codes of conduct, commercial arrangements and some private sector protection (credit card charge-back and travel insurance).

### The need for consumer protection

For the most part, competitive markets underpinned by generic consumer protection rules, some voluntary accreditation and some private measures provide an adequate and appropriate level of consumer protection in the travel industry.

Notwithstanding, legitimate concerns have been raised about two areas where the risk of consumer detriment, and the lack of opportunities for redress, are potentially unacceptable. These areas are:

- inadequate service (in a variety of markets)
- the loss of prepayments (particularly in relation to travel agents and air travel).

There is little evidence of substantial consumer protection issues relating to poor service in the travel industry. The area that was raised by stakeholders however, related to the air travel industry – cancellations, delays, service quality and travel insurance – rather than travel agents. Substantial measures to address these concerns have already been proposed by the Australian Government's Aviation White Paper. These measures should be explored.

A further initiative in relation to quality service is the National Tourism Accreditation Framework (NTAF). The NTAF aims to promote improved quality and better outcomes for consumers via an umbrella scheme that supports and empowers accreditation programs across a number of regions and industry sectors. This initiative appears sufficient to address other consumer protection concerns relating to inadequate service in the industry.

The risk of losing prepayments in the event of business insolvency was the driving rationale for the introduction of specific regulation of travel agents in the 1980s. Since that time, a number of developments have occurred which substantially reduced the risk of consumer detriment for agency collapses.

- Increasing household incomes and consumers' familiarity with travel, combined with the declining real cost of travel, make travel purchases a less significant household purchase.
- Consumers have greater access to information and the ability to contract direct with suppliers via electronic payments and the internet. More and more consumers are doing so, in which

case their funds are not at risk from travel agent collapse. The popularity of credit card usage also reduces the amount of funds exposed to this risk.

- Market consolidation and the declining market share (in terms of revenue) of smaller agencies have improved market oversight of the solvency of businesses in the industry.

At present, the available evidence suggests that the risk of consumer detriment is not sufficient to justify substantial regulatory intervention in this market. In addition, some private sector options are also available to consumers to protect themselves against these risks.

### The effectiveness of the current travel agents regime

While it is likely that the travel agents consumer protection framework has served a good purpose since its introduction in the 1980s, in many ways the measures in the regime are duplicative, obsolete, disproportionate and/or poorly targeted to achieve desired consumer protection outcomes.

Consumers value consumer protection in this sector, including being willing to pay a considerable component of their travel fare (at a minimum, \$30 of a \$1,000 fare) to obtain protection from travel agency bankruptcy. Estimates of the total willingness to pay for insolvency protection in this sector exceed the estimated cost of the regulatory scheme. For the most part however, consumers are unaware of the existing regime. The willingness to pay therefore is not a value of the current scheme, but rather a representation of their aversion to a loss and the value they place on protection.

Industry also value consumer protection in the sector, but are critical of a number of elements of the current framework.

The licensing framework could retain its beneficial components under a substantially less onerous scheme. In particular,

- in relation to competency, the training/experience requirements are poorly targeted and, in the most part, superseded by industry practice
- in relation to conduct, the enforcement powers largely duplicate the provisions of the generic consumer protection laws – key enforcement powers provided to licensing authorities can be achieved under the provisions of the proposed Australian Consumer Law.

In short, there are few grounds for departure from the generic consumer protection provisions in this industry. The regime also fails to reflect the national nature of the market. It remains a state based system and creates unnecessary duplication for businesses operating in multiple jurisdictions.

In relation to insolvency protection measures, the scheme represents an onerous and disproportionate measure, given:

- the approach taken in other comparable industries, including those that pose a similar or greater risk of consumer detriment or are of greater systemic importance to the Australian economy
- the annual regulatory burden of the scheme is significantly higher than the level of funds paid out
- improvements in the vulnerability of and choice available to consumers from the growing uptake of information technology and electronic payment options
- consolidation of the market and the growth of larger players, which gives greater capacity for consumers to observe indications of business solvency through media coverage of rating agencies statements or ASX disclosures.

Meanwhile, the licensing and insolvency protection regimes impose a significant financial and administrative cost on travel agent businesses.

In relation to licensing, the costs include:

- a financial cost to business (ie annual licensing fees) totalling, industry wide, approximately \$1.4 million per annum
- staff time to complete compliance tasks, costing businesses a total of \$270,000 per annum – these costs may be compounded by businesses who are licensed across multiple states
- the completion of required training courses, with an estimated financial cost of \$800 and staff time costs of \$1,200 – representing an estimated total cost to industry of \$4.3 million per annum.

In relation to the compensation scheme, the total cost is estimated at \$19.3 million per annum, including:

- the operating costs of the TCF (approximately \$2.8 million per annum)
- compliance activities of businesses (estimated at \$3.2 million per annum)
- the requirements to prepare audited financial accounts (\$4.8 million per annum)
- the provision of securities (\$2.5 million per annum)
- the retention of excess capital reserves (\$6.0 million per annum).

In total therefore the cost of the regulatory scheme – including licensing and compensation – is \$25.3 million per annum relative to the average pay-out to consumers of \$2.9 million (averaged over the

last 10 years). The regulatory costs are therefore around nine times the current value of consumer funds lost.

## Our recommendations

### Overarching framework for consumer protection

The consumer protection framework for the travel industry should be built on two key elements:

- voluntary accreditation under the NTAF for all travel businesses, supported by, in relation to travel agents, a national registration scheme
- the generic consumer protection provisions of the proposed Australian Consumer Law (ACL).

The majority of PwC's recommendations in this respect reflect the *status quo* or initiatives that are already in train (eg the development and implementation of the NTAF and ACL). Our recommendations however lend support for consideration of an extension to the mandate of the proposed Aviation Ombudsman, to include reference to the entire travel industry.

With respect to travel agents however, our recommendations represents substantial reform.

### Reform of the existing travel agents licensing regime

It is clear from all stakeholders and from the available evidence, that significant reform is necessary in this sector. Put simply, the *status quo* is not appropriate. Stakeholders differ in their opinions on the nature and scale of reform necessary.

With respect to the licensing regime, PwC recommends replacing the existing provisions with:

- a registration scheme that:
  - is a single nationally administered scheme
  - removes existing competency requirements, including the mandated training
  - retains basic disclosure and 'fit and proper person' character requirements
- an accreditation program, developed in conjunction with industry, for the sector consistent with the NTAF
- the option of an enforceable industry code of conduct under the ACL.

Having reviewed the need for insolvency protection of travel agents, a demonstrable case for regulatory protection was not found.

At the same time, the scheme imposes a substantial economic cost on the industry.

PwC recommends the removal of all insolvency protection from the current regulatory framework.

Should this option not be preferred by government, PwC also sees some merit in two alternatives: the development of an industry-led compensation scheme, or various enhancements to the regime in its current state.

Careful consideration should be had to the implementation of these recommendations. Accordingly, a phased implementation plan is recommended.

# Preface

On 8 May 2009, the Ministerial Council on Consumer Affairs directed the Standing Committee of Officials of Consumer Affairs (SCOCA) to commission a review of consumer protection in the travel and travel related services market. PricewaterhouseCoopers (PwC) was appointed by SCOCA to undertake this review.

## Background

Under the Terms of Reference in the Consultancy Contract between PwC and the Commonwealth Department of the Treasury (on behalf of SCOCA), the review is to:

- identify and review the effectiveness of, or need for, consumer protection measures in the travel and travel related services market, particularly in relation to consumer prepayments for services
- consider the relevance, effectiveness and viability of the current travel agency regulatory scheme, with a particular focus on the operation of the Travel Compensation Fund
- identify and consider regulatory and non-regulatory options within a cost/benefit framework to address the identified consumer protection issues at a Commonwealth and State/Territory level.

PwC has considered consumer protection issues in connection with the provision of travel and travel related services in the Australian market place, including services provided directly or indirectly by persons carrying on business in Australia to both inbound and outbound tourists as well as business travellers in connection with travel inside and outside Australia.

For the purposes of this review, travel services include air, sea and land transport, while travel related services include vehicle rental, accommodation, sightseeing tours, special events and other services associated with travel (such as finance and insurance). Suppliers of travel and travel related services include principals (those who directly provide the services) and intermediaries (those involved in making arrangements).

The consumer protection measures in this industry, in particular those concerning travel agents, have been the subject of several reviews, including a National Competition Policy review in 2000<sup>2</sup> and an unpublished TCF review of the TCF's capital adequacy and capital requirements in 2004 (driven by the collapse of Ansett/Traveland in 2001). This review is cognisant of the analysis and recommendations of these reviews and builds on them in light of more recent developments.

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<sup>2</sup> Centre for International Economics (2000) 'National Competition Policy review of the National Scheme for the Regulation of Travel Agents'.

## Review methodology

PwC's methodology for this review included the following activities.

- A review of the existing regulatory and non regulatory consumer protection framework in the travel industry.
- The release of an Issues Paper highlighting the key issues for our review and inviting submissions from interested parties.
- Review of the 32 submissions received in response to the Issues Paper. A list of submissions received is provided in Appendix A.
- Face-to-face and telephone consultation with a comprehensive mix of consumer, industry and government stakeholders. A full list of persons/organisations consulted is provided in Appendix B.
- A review of travel agent regulation in other international jurisdictions. A summary of our findings is provided in Appendix C.
- A review of business risk data prepared for this review by Dun and Bradstreet. Information on Dun and Bradstreet's data, including their approach to collecting data and the full results, is provided in Appendix D.
- A survey of over 800 consumers in relation to consumer protection in the travel industry. The survey is set out in Appendix E.
- A survey of all Australian travel agents participating in the TCF relating to the regulatory scheme for travel agents. The survey is set out in Appendix F.
- An analysis of available data relating to consumer complaints, business failures and other consumer protection matters.

## Acknowledgements

PwC is grateful for the assistance of many stakeholders and other interested parties throughout the conduct of this review. In particular we were greatly assisted by the following organisations:

- the Travel Compensation Fund, and in particular Mr Glen Wells
- the Australian Federation of Travel Agents, in particular Mr Jayson Westbury.

We would also like to thank the various industry representatives, government stakeholders and consumer groups that have assisted us throughout the course of this review. A full list of participating stakeholders is contained in Appendix B.

## Structure of this report

This report documents the analysis, findings and recommendations of our review. It is structured as follows.

- [Chapter 1](#) outlines the context of our review by defining consumer protection and discussing the nature, dynamics and recent developments in the travel industry.
- [Chapter 2](#) outlines the current regulatory and non regulatory consumer protection framework in the travel industry, including the industry-specific regulations applicable to travel agents.
- [Chapter 3](#) considers the need for consumer protection measures in the travel industry, based on observations from Chapter 1 and 2, available data and information and the stated concerns of stakeholders.
- [Chapter 4](#) reviews the effectiveness of the current regulatory regime in addressing key consumer protection concerns, in light of these concerns and broad policy objectives.
- [Chapter 5](#) outlines six options to reform the existing insolvency protection scheme relating to travel agents.
- [Chapter 6](#) outlines PwC's recommended reforms, including an overarching consumer protection framework for the travel industry and reforms to the existing travel agents' regime.
- [Chapter 7](#) outlines considerations regarding implementation of the proposed reforms.
- [Appendices](#) provide additional supporting materials.



# 1 Context of this review

## Key messages

Consumer protection refers to a range of regulatory and non regulatory measures that seek to address a failure in the private market that leaves consumers especially vulnerable to financial loss.

Primary reliance for consumer protection regulation should be placed on the generic rules applicable to all industries. In some limited circumstances industry-specific provisions may be appropriate.

The travel industry is diverse, incorporating many differing and nuanced segments. With some notable exceptions, travel markets are typically highly competitive and dominated (in number) by small businesses.

Recent developments in the industry, including developments in information technology, electronic payments and the declining relative cost of travel, appear to be reducing the vulnerability of consumers in this sector.

## 1.1 What is consumer protection?

There are a range of government regulations and policies that deal with consumer protection relating to the purchase and use of goods and services in Australia. They are intended to promote better outcomes for consumers by:

- protecting them from unfair, unjust or deceptive conduct and unsafe or somehow defective goods or services
- providing assistance when they suffer loss from such conduct or products
- assisting them in making better purchasing decisions (eg by providing certain information or mandating certain terms or conditions).<sup>3</sup>

Appropriate consumer protection measures attempt to redress failures in private markets that leave consumers particularly vulnerable to financial (or other) risk. Typical examples of such failures include information asymmetry (as between businesses and consumers) or disproportionate market power in the hands of businesses. Regulatory or non-regulatory consumer protection measures, properly designed, can remove or mitigate the risk to consumers from such circumstances.

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<sup>3</sup> Productivity Commission (2007), 'Review of Australia's Consumer Policy Framework'.

In this way, consumer protection regulation complements measures to address wider issues of concern, such as Occupational Health and Safety (OH&S), product/service safety and business conduct (eg competition policy). While it is important that measures to achieve consumer protection objectives are cognisant of these considerations, these wider regulatory obligations are not consumer protection issues *per se*. Accordingly, they are not the subject of this review.

### When is industry-specific consumer protection appropriate?

The centre-piece of Australia's consumer protection framework is the provisions of the Commonwealth's *Trade Practices Act 1974* and of the various state-based Fair Trading Acts. These Acts impose restrictions on the conduct of all businesses relating to competition, fair trading and consumer protection legislation.

In principle, a generic consumer protection framework applicable to all industries is desirable; it provides certainty to businesses and consumers as to their rights, expectations, responsibilities and obligations regardless of where and in which industry they operate. However, as the Productivity Commission recognised in its 2007 *Review of Australia's Consumer Policy Framework*, generic consumer protection laws will not always be sufficient to protect consumers, and provide appropriate obligations and responsibilities for businesses, in all industries. Consequently, industry-specific protection may sometimes be warranted.<sup>4</sup>

The Productivity Commission also acknowledged that divergence from the generic provisions is costly, both in administration and to business, and can restrict competition and innovation. Indeed, the Commission suggested that specific regulations are typically more prescriptive in nature and, consequently, likely to be more costly and restrictive to business.

In the Australian context, it was noted that specific consumer protection measures are common and cover most significant areas on consumer spending. However, serious deficiencies were noted in the basis for these provisions, including:

- the need for specific regulations to supplement the generic consumer law is not always demonstrated
- some specific provisions are introduced because of a reluctance, or lack of resources, to enforce the generic laws
- some specific provisions are overly prescriptive and do not allow businesses to adapt to changing consumer needs (therefore raising costs and prices)

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<sup>4</sup> Ibid (page 24).

- some regulations appear primarily designed to protect incumbent business from competition, rather than assisting consumers.<sup>5</sup>

Unwarranted industry-specific consumer protection regimes impose unnecessary costs on businesses and detract from good outcomes for consumers and the community. Accordingly, the generic consumer law should only be supplemented by specific provisions where a demonstrable need is established and the provision's appropriateness is assessed.

Such a need should be assessed with reference to the circumstances and nuances of each particular market or industry. However, such a need may be more likely to be observed where:

- the risk of consumer detriment is particularly high
- the potential detriment is significant and possibly irreparable – for example, medical services
- the suitability or quality of a service/product is difficult to ascertain prior to purchase.

These three considerations provide a useful framework from which to consider the need for consumer protection in the travel industry and, as such, form a framework of analysis that can be observed throughout this report.

### When is business licensing appropriate?

Where industry specific regulation can be justified on public policy grounds, there is a further question as to whether a licensing system is the most appropriate framework through which to regulate the sector in question.

Licensing occurs when a government or other regulatory authority (including self and co-regulatory schemes in some industries) grant permission to businesses or individuals to offer specific goods or services, or to undertake a defined set of activities in the marketplace. Licences generally come with clear conditions, outlining the manner in which the licensee must conduct their operations.

In practice, governments employ licensing as a regulatory tool in order to achieve a range of policy or administrative goals.

- Licenses can be used to **limit entry**, by restricting the amount of an activity which occurs. This is prevalent in natural resource management, such as the regulation of fisheries, where a licensing system helps to limit resource depletion. In these cases, licenses have a commercial value and are often tradeable.

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<sup>5</sup> Productivity Commission (2007), 'Review of Australia's Consumer Policy Framework'.

- Licensing can be used to restrict entry on the basis of **minimum competency** requirements. This is done in contexts such as the legal or medical professions where information asymmetries might be such as to render consumers unable to judge the quality of practitioners. The aim is not to limit entry to a specified level of activity, but rather to a specified level of quality. Although licenses in this context have a value to the individual licensee, they are generally not tradeable.
- Licensing can be used to limit entry on the basis of other **minimum attributes**. This could include the requirement to have certain levels of insurance or to satisfy a financial viability test. As with minimum competency requirements, these conditions impose some cost to entry, but to not limit entry to a specified number of operators or level of activity.
- Licensing can provide a framework for the **enforcement of conduct requirements** in a regulated industry. Examples include motor car traders or real estate agents, who are licensed in most jurisdictions and face a range of industry-specific rules concerning the way they undertake their activities. The potential loss of a business license poses a significant sanction in the event of a breach; and unlicensed trading is explicitly prohibited.
- Some licensing systems are instituted solely to **provide regulators and policy makers with information** which might become valuable in the context of a particular event. For example, the licensing of dairy farmers might be useful in the event of a food safety scare so that regulators can quickly target advice or testing to identify and quarantine identified sources of the problem.
- Licensing systems can allow **recovery of regulatory costs** through the imposition of a license fee. Industry specific regulation which does not involve licensing could impose costs on the regulator, which must be met by the taxpayer if they are unable to be recovered from the regulated industry.

Of these six licensing goals, the first three are associated with policy considerations while the latter three deal with administrative considerations. In practice, most licensing systems involve some combination of these functions.

Licensing based on the first three functions can address underlying market failures, such as the over-use of a common resource or an information asymmetry. They also have the potential to impose costs through limiting competition via barriers or costs to entry. Licensing based on the latter three functions is less likely to involve significant restrictions on competition, but can nonetheless impose administrative burdens on licensees. It is therefore important to be cognisant of the goals of licensing regimes, to drive the design of an appropriate scheme and avoid imposing unnecessary burdens on business.

In using licensing as a regulatory tool, it is important to ensure that:

- there is explicit acknowledgment as to which of the above six licensing goals or functions constitute the aims of the proposed licensing system
- any restriction on entry is justified by a clear policy rationale and is the least cost way in which to address the market failure
- the administrative advantages of licensing outweigh the administrative burden placed on licensees.

### Other relevant considerations

While consumer protection regulation has a unique set of objectives, targeting the improvement of outcomes for consumers, it should nonetheless be consistent with best practice regulation. In this respect, the Council of Australian Governments (COAG) has articulated eight principles as follows.

1. A case for action should be established before addressing a problem.
2. A range of feasible policy options must be considered (including self regulatory, co regulatory and non regulatory approaches) and their benefits and costs assessed.
3. The option that generates the greatest net benefit for the community should be adopted.
4. Legislation should not restrict competition unless it can be demonstrated that:
  - the benefits of the restrictions to the community as a whole outweigh the costs
  - the objectives of the regulation can only be achieved by restricting competition.
5. Effective guidance should be provided to relevant regulators and regulated parties in order to ensure that the policy intent and expected compliance requirements of the regulation are clear.
6. Governments should ensure regulation remains relevant and effective over time.
7. Affected key stakeholders should be consulted at all stages of the regulatory cycle.
8. Government action should be effective and proportional to the issue being addressed.<sup>6</sup>

In addition to these considerations, there are a number of important wider issues present in the travel industry, many of which are key issues to relevant stakeholders. While they are not the focus of our review, as they are not directly related to consumer protection, it is

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<sup>6</sup> Council of Australian Governments (2007), 'Best Practice Regulation' (page 4).

important that our review is cognisant of these issues. These issues are briefly described below.

- The nature of various commercial arrangements in the industry. Travel businesses, in particular travel agents, have important commercial arrangements with a variety of organisations and institutions. To some degree these arrangements deal with issues relevant to consumer protection issues, often protecting a third party from the same risks consumers might be vulnerable to. Examples of such arrangements include:
  - the International Air Transport Association’s (IATA’s) accreditation process – this process, described in more detail in 2.3, imposes a degree of prudential oversight on travel agents who are members of IATA in order to protect member airlines
  - bank or credit card company merchant arrangements – these arrangements govern the relationship between banks and businesses authorised to process sales and often include prudential measures (for the purposes of limiting the exposure of the banks).<sup>7</sup>
- Ensuring Australian businesses compete on a ‘level playing field’ with domestic and international competitors. Industry frequently cite the anomalies in the current regulatory framework (particularly the scope of businesses included) and the fact that international businesses can compete in the Australian market via the internet without being subject to Australian regulatory conditions. Similarly, Australian businesses competing internationally must comply with Australian regulatory conditions which competitors are not subject to.<sup>8</sup>
- Interplay with international jurisdictions. Operating in international jurisdictions may impose obligations on Australian businesses that duplicate Australia’s regulatory measures. Such circumstances are undesirable, as they impose additional cost on businesses without additional consumer benefit. For example, additional prudential oversight for United Kingdom Air Travel Organisers’ Licence (ATOL) holders or New Zealand Travel Agents Association of New Zealand (TAANZ) members (see Appendix C for details of international examples).

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<sup>7</sup> Concerns about the nature of these business-to-business relationships were raised by, for example, Pasla Air Travel in its submission to this review.

<sup>8</sup> Such concerns were raised in submissions by Mobile Travel Agents, the Australian Federation of Travel Agents and the Australian Tourism Export Council.

## 1.2 What is the travel and travel related services market?

The travel industry is an important component of the Australian economy, contributing over \$40 billion to Australia's gross domestic product (GDP) and employing almost half a million people.<sup>9</sup> The travel industry supports trade and business within and across Australia's states and territories, and internationally. The industry provides a broad range of products and services, including:

- travel services (flights, shipping/cruises, rail and road transport)
- accommodation (hotels, motels, resorts and hostels)
- travel intermediary services (travel agents, tour wholesalers)
- tourism services (tour operators, hospitality and entertainment, car hire)
- ancillary travel services such as travel insurance and finance.

Each service is provided by a different market within the travel industry, each differing in their structure, dynamics and market players.

On the whole, markets are generally highly competitive and dominated, at least in number (if not in revenue), by small businesses (which make up 93 per cent of Australia's tourism businesses).<sup>10</sup> Although some players generate a large proportion of industry revenue (ie major airlines), the majority of the industry consists of smaller businesses that are utilised by tourists and travellers.

There is a slight trend however towards consolidation across the travel industry.<sup>11</sup> Even in low concentrated areas such as hotel accommodation, consolidation is evident with the emergence of chains and a trend away from ownership towards leases and management agreements.<sup>12</sup>

From a consumer perspective, the travel industry consists of three aspects:

- international travel by Australians
- travel by overseas residents to Australia
- domestic travel by Australians.

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<sup>9</sup> Australian Bureau of Statistics (2009), 'Australian National Accounts: Tourism Satellite Account 2007-08 (5249.0)'.

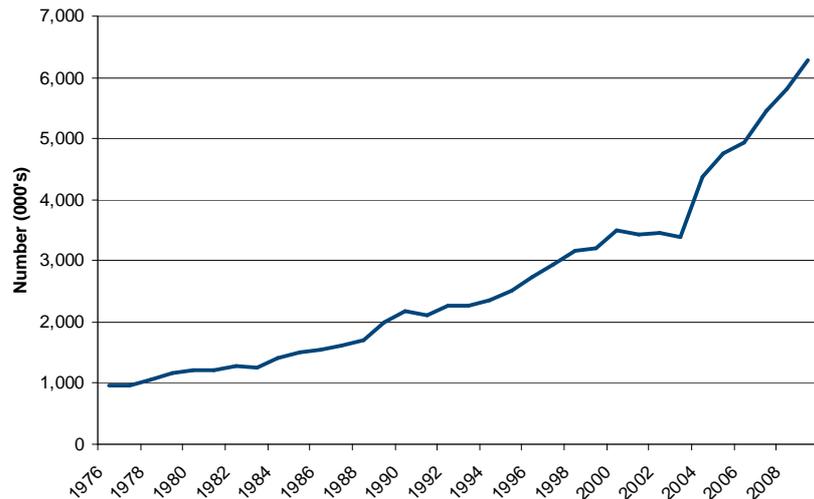
<sup>10</sup> The Jackson Report (2009), 'Informing the National Long-term Tourism Strategy' (page 10).

<sup>11</sup> IBISWorld (2009), 'Tourism in Australia: X0003', (page 12).

<sup>12</sup> IBISWorld (2009), 'Hotel Accommodation in Australia: H5711' (page 8).

Over the last couple of decades, international travel has become very popular. Australians are choosing more and more to spend their holidays overseas. Immigration to Australia has also grown over this period, with many Australians taking a number of trips to visit family in other countries. This strong upward trend in international travel by Australians is shown in Figure 1.1.

**Figure 1.1 – Short term (less than one year) overseas departures by Australian residents**<sup>13</sup>



Overseas travel has also been popular in other countries. The number of visitors to Australia from overseas has grown substantially over the last few decades. Whether visiting family or going on a holiday, effective marketing has contributed towards Australia becoming a popular tourist destination for overseas travellers. At the start of the 1980s, Australia received just under a million international visitors. By 2009, this had increased to over five and a half million, representing significant growth in the industry.<sup>14</sup> Figure 1.2 shows this trend over time.

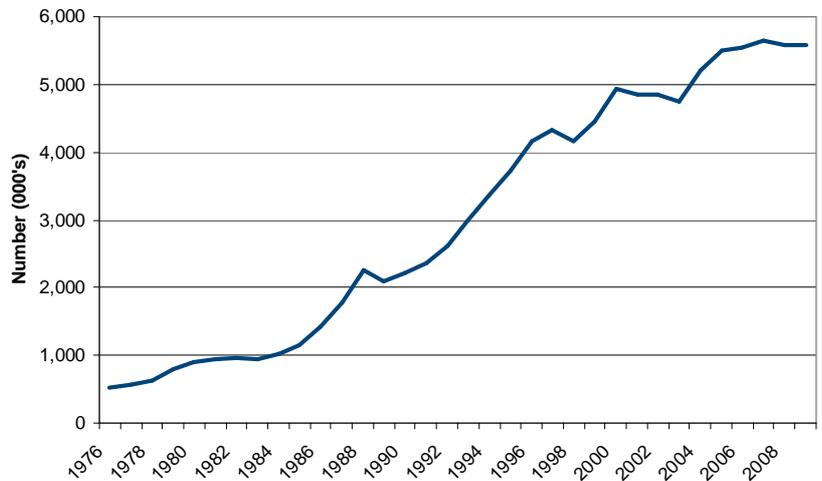
Although the trend over time is certainly increasing, Australia has not fared as well as other countries in recent years. Since 2005/2006, the number of overseas visitors has tapered off. Overseas travellers now perceive Australia as relatively expensive and believe our tourism infrastructure (eg public transport, telecommunications and technology) is under prioritised in the Australian economy.<sup>15</sup>

<sup>13</sup> ABS (2009), 'Overseas Departures and Arrivals, Australia (3401.0)'.

<sup>14</sup> Ibid.

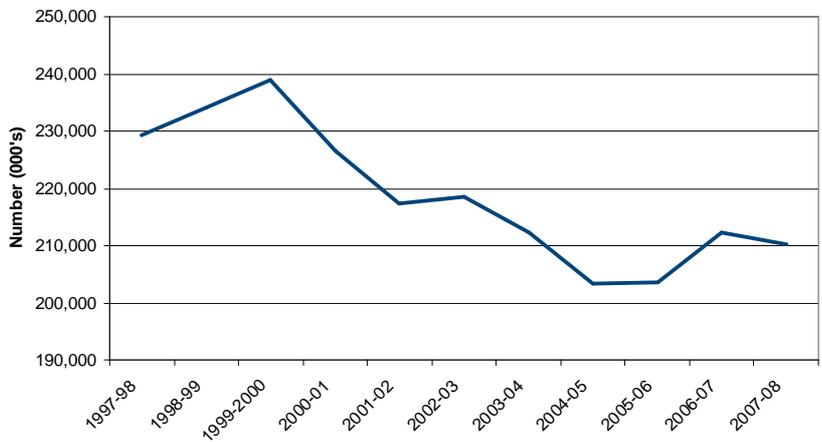
<sup>15</sup> The Jackson Report (2009), 'Informing the National Long-term Tourism Strategy'.

**Figure 1.2 – Short term (less than one year) overseas visitors arriving in Australia<sup>16</sup>**



To some extent, Australians are choosing international travel as an alternative to taking domestic trips. This means the domestic travel market has not shared in the strong historical growth. Over recent years domestic trips by Australians have actually been decreasing. Figure 1.3 demonstrates this, with the number of domestic trips falling by 8.3 per cent over the last decade to 2008.

**Figure 1.3 – Domestic tourism visits (overnight and same day) in Australia<sup>17</sup>**



The travel and travel related services industry is subject to a high level of global competition. Over the last decade and particularly the last few years, Australia’s travel industry has increasingly been driven by international travel. With a strong Australian dollar and a

<sup>16</sup> ABS (2009), ‘Overseas Departures and Arrivals, Australia (3401.0)’.

<sup>17</sup> ABS (2009), ‘Australian National Accounts: Tourism Satellite Account 2007-08 (5249.0)’.

40 per cent drop in international airfares due to the global recession, many Australian consumers are choosing to travel overseas rather than taking domestic trips.<sup>18</sup> This trend has a significant consequence for consumers. Once a consumer transacts with overseas suppliers, any Australian consumer protection regulation no longer applies as the transaction is outside the Australian legal jurisdiction.

The recent economic downturn has had an impact on both domestic and international travel by Australians. People are generally taking shorter trips and cutting their travel budgets. Although the number of travellers has been strong across the travel industry, revenue and consumption have been slow in recent years.

## Travel markets

There are a variety of diverse markets that make up the travel and travel related services market, each differing in their structure and dynamics.

## Intermediaries

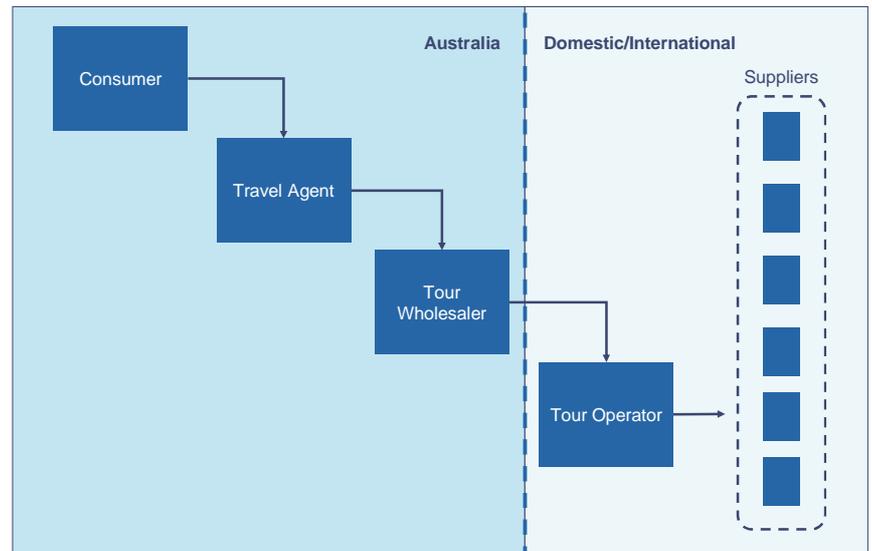
A variety of service providers are classed as travel intermediaries, including travel agents, tour wholesalers, tour desks and online booking agents. The role of an intermediary is to facilitate transactions between the consumer and travel service suppliers, in exchange for a commission or profit.

Travel agents are the main players in this segment of the travel industry. They provide a comprehensive service, with the ability to organise a customer's full travel experience. Traditionally, travel agents were considered the 'gatekeepers' to the travel industry; being an intermediary by which most consumers, particularly those travelling overseas, purchased travel products supplied by tour wholesalers, foreign or domestic tour operators and travel service suppliers (airlines, hotels, etc). Under this industry model, travel agents performed an important role, connecting travel consumers with other participants in the industry. This is represented by the historical supply chain diagram in Figure 1.4.

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<sup>18</sup> IBISWorld (2009), 'Tourism in Australia: X0003' (page 37).

Figure 1.4 – Representation of historical travel industry supply chain



While using a travel agent offers a number of advantages to consumers, including the ease of transacting with a single party and the expert knowledge and advice of the agent, the nature of the activities of these businesses may have historically given rise to consumer protection concerns:

- information asymmetry – consumers being at a substantial information disadvantage as to costs and other factors of travel, thereby leaving them vulnerable to exploitation by travel agents
- restrictions on choice – consumers being, to some degree, reliant on travel agents in order to purchase travel products
- carriage of monies – consumers paying large sums of money to travel agents, in order for them to be passed on to suppliers.

It is perceived by many that the combination of these circumstances leaves consumers vulnerable to financial loss, in particular from a travel agent collapse. This, and the presence of a number of high-profile agency collapses, is understood to have been the driving motivation for the introduction of the current national regulatory scheme discussed below.

In addition to travel agents, other travel intermediaries include the following:

- **Tour wholesalers.** Wholesalers put together travel packages that do not currently exist or compile current package modules to create a more comprehensive package. These packages can involve a full range of travel services and are sold either directly to consumers or through a travel agent.

- **Inbound tour operators.** These businesses also package together a range of travel experiences, which are sold to overseas travellers visiting Australia. Inbound tour operators generally provide additional ‘on the ground’ services such as local planning and advice, tour guides and interpreters.
- **Selective intermediaries.** These businesses only facilitate certain travel services, rather than the customer’s whole trip. Examples include accommodation booking agents (only selling accommodation) and tour desks (only selling particular tours provided by tour operators). Most importantly, if these providers do not sell flights, they are not required to be licensed under the current ‘travel agents’ licensing scheme.
- **Ticket consolidators.** Consolidators make contractual arrangements with several airlines to buy large amounts of airline tickets at discount prices. These are then distributed to travel agents. The market for consolidators generally comes from independent agents who are too small to make individual arrangements with several airlines. Consolidators give small travel agents additional buying power, enabling them to compete with larger operators and removing the need to join associations such as the International Air Transport Association (IATA). This essentially lowers the cost of entering the travel agent market and reduces the skills required to run a travel agency business.

### Market concentration

In contrast to the industry as a whole, travel intermediaries and inbound tour operators operate in a fairly consolidated market, with a trend towards further concentration. In terms of market share, 46 per cent of the market is captured by the top four players,<sup>19</sup> with the largest player (Flight Centre Limited) estimated to represent 30 per cent.<sup>20</sup> Mergers have also been occurring between top major players in the market. In 2008, Jetset merged with Qantas Holidays and Qantas Business, creating the third largest player in today’s market. More recently, a merger between Stella (second largest player) and Jetset is currently underway. If this merger is successful, market concentration could be significantly increased.

Nevertheless, at least by number the industry remains characterised by relatively small businesses. Over 65 per cent of businesses employ fewer than 10 persons<sup>21</sup> and 97 per cent have five or fewer locations.<sup>22</sup> According to data provided by the TCF, only 6 per cent of business generate turnover in excess of \$10 million.

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<sup>19</sup> IBISWorld (2009), ‘Travel Agency Services in Australia: I6641’ (page 11).

<sup>20</sup> IBISWorld (2009), ‘Travel Agency Services in Australia: I6641’ (page 26).

<sup>21</sup> Based on information provided to PwC by Travel Compensation Fund.

<sup>22</sup> PwC Travel Agents survey.

Although concentration is occurring, the intermediaries market exhibits several different business models, including large businesses, chains or franchises, and niche or independent operators. Across the sector there are approximately 3,000 businesses, approximately 40 per cent of which are part of a chain or franchise arrangement.<sup>23</sup> Although this is fairly high, it means that 60 per cent of the market is still represented by independent agents. While many of these may struggle to compete against larger operators and chain brands on factors such as price or marketing, some businesses cover niche markets that meet particular consumer needs. These businesses are expected to have a competitive edge from a loyal customer base that may be sustained despite concentration of the market, keeping competition relatively high.

Consolidation in the intermediary sector was also highlighted by stakeholders. The Australian Federation of Travel Agents (AFTA) commented that:

*Generally, numbers of single brand/premise businesses have declined while the number of franchise and company owned stores has increased.<sup>24</sup>*

With consolidation comes the emergence of large agencies with strong brands. In an effort to protect these brands, chains or franchises are likely to perform a degree of oversight and monitoring of their own members. In addition, large businesses or chains may be publicly listed companies, meaning information (including relating to their solvency) is readily available. With more accessible information, consumers can therefore make a more informed choice in choosing a travel agent.

## Trends

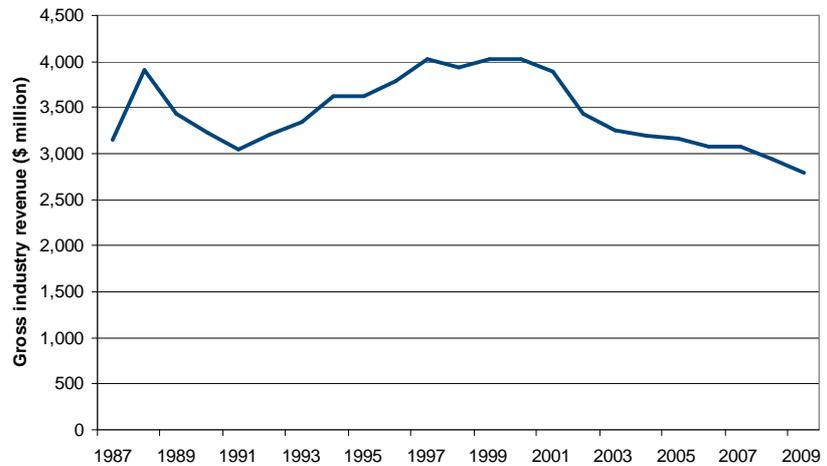
Intermediaries, particularly travel agents, typically generate revenue through commissions on the sale of travel products provided by suppliers. Accordingly, travel intermediaries represent a fairly small proportion of travel industry output, but have a higher percentage of travel sales passing through their hands. Figure 1.5 shows gross industry revenue for travel intermediaries over the last two decades.

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<sup>23</sup> Information provided to PwC by Travel Compensation Fund.

<sup>24</sup> Australian Federation of Travel Agents submission (page 15).

**Figure 1.5 – Gross industry revenue (Real 2009 dollars) – travel intermediaries<sup>25</sup>**



Although there has been some upward movement over time, when focusing on the last 10 years, revenue has been falling in real terms. There are several changes in the industry that can explain this, particularly in relation to travel agents.

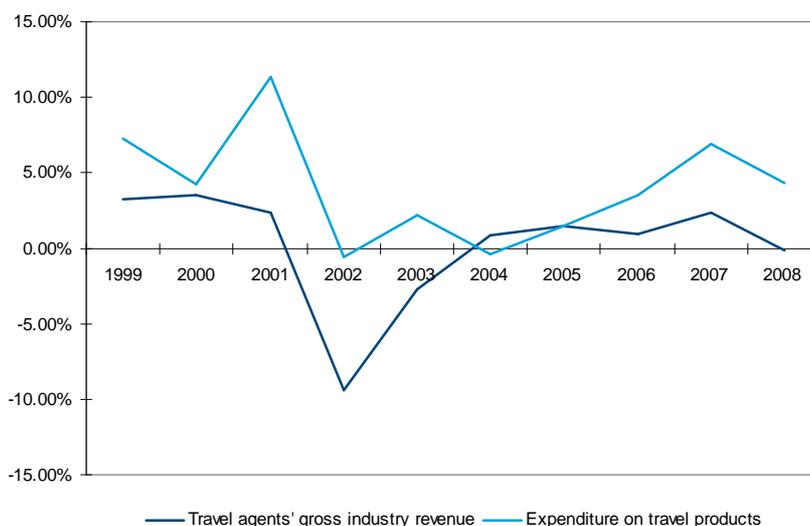
The ability of consumers to transact directly with suppliers, mostly online, is leading to lower demand for travel intermediaries. Online booking is encouraged by suppliers (ie hotels and airlines) and is becoming popular with consumers, essentially by-passing the services of a travel agent and/or wholesaler. The PwC Consumer Survey suggested that just 29 per cent of international travellers and 14 per cent of domestic travellers purchased their most recent trip via a travel agent. Direct purchases from suppliers were travel agents' chief competitor, accounting for almost 50 per cent of international purchases.

The global recession has also intensified price competition. This is particularly felt by travel agents, whose revenue from airline sales is declining as airlines are reducing or eliminating agent commissions and airfares are declining in price. Consumers can also save money by avoiding the commissions and profit margins of intermediaries with increased access to purchase tickets directly from the supplier.

These factors have led to the relative decline in the use of travel intermediaries, particularly travel agents. Over time, there has been dramatic growth in the travel industry, with growth in total expenditure remaining mostly positive and strong. Growth in the revenue of travel intermediaries has generally been lower than that of industry expenditure and experienced much greater downturns. This difference is demonstrated in Figure 1.6.

<sup>25</sup> IBISWorld (2009), 'Travel Agency Services in Australia: I6641' (page 42).

**Figure 1.6 – Annual growth in travel intermediaries’ gross industry revenue compared to total expenditure on travel products<sup>26</sup>**



Since 2008, revenue (in nominal terms) is estimated to have fallen to below 1998 levels. Furthermore, travel intermediaries represent only about 3 per cent of the travel industry output, a fall from around 4 per cent a decade before.<sup>27</sup> These trends demonstrate that intermediaries increasingly play a smaller role in a consumer’s travel experience.

### Airlines

Airline travel, both domestic and international, is the largest market segment in the travel industry.<sup>28</sup> One of the consumer protection issues highlighted in relation to airlines is the level of redress available to consumers when an airline delays or cancels a flight. Many airlines have time limits in their complaints procedures and may not provide sufficient compensation to consumers to cover all costs incurred due to flight changes.

### Market concentration

Similar to intermediaries, airlines operate in a consolidated market. The main players in the domestic market are Qantas Group (including Jetstar), Virgin Blue and Tiger. During 2009-10, the top four airlines are expected to hold over 90 per cent of market share.<sup>29</sup>

<sup>26</sup> ABS (2009), ‘Australian National Accounts: Tourism Satellite Account 2007-08 (5249.0)’; IBISWorld (2009) ‘Travel agency services in Australia: I6641’.

<sup>27</sup> ABS (2009), ‘Australian National Accounts: Tourism Satellite Account 2007-08 (5249.0)’.

<sup>28</sup> IBISWorld (2009), ‘Tourism in Australia: X0003’ (page 7).

<sup>29</sup> IBISWorld (2009), ‘Domestic Airlines in Australia: I6402’ (page 20).

Although most of the domestic airline industry is deregulated, several restrictions and controls are still in place. Only Victoria and South Australia have opted for 'open skies' agreements, allowing airlines to operate in a free market. Other states still regulate some interstate routes, restricting the number of providers and the level of consumer choice.<sup>30</sup> In some cases, restrictions are to encourage or ensure the provision of service on routes that may not otherwise be provided, thereby increasing consumer freedom. The general lack of strong competition in this area however, does raise the issue of a lack of consumer choice for some domestic routes.

The international market is less concentrated, but the top four players (Qantas, Singapore Airlines, the Emirates and Air New Zealand) are still estimated to represent 56 per cent of the market in 2009-10.<sup>31</sup> Access to this segment of the market is heavily regulated. Consumer choice can be quite restricted, depending on the agreements held between Australia and other countries.

Unlike many other travel related markets, the airline sector is becoming less concentrated, with the arrival of additional players. In the domestic market, greater competition is expected with the introduction of low cost carriers (most recently Tiger Airways) and the potential for further deregulation across states. The international market is also seeing the arrival of low cost carriers, as Tiger Airways, Air Asia and Jetstar are entering the market and/or adding additional routes to their schedules.

### Trends

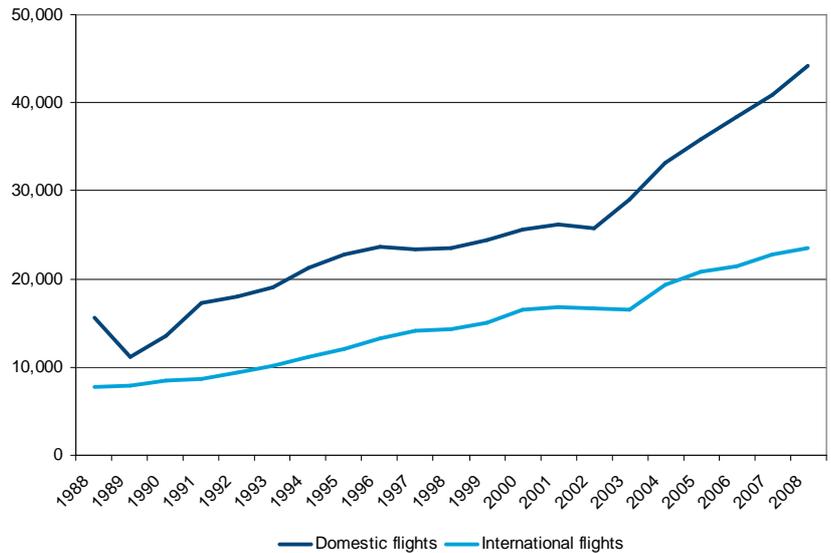
Total airline passenger traffic in Australia has nearly trebled over the last two decades.<sup>32</sup> Figure 1.7 shows the upwards trend in both the international and domestic markets over the two decades to 2008. While both sectors have contributed to the historical growth in the airline market, domestic flights have been slightly stronger. This may represent the contribution of business flights and family visits.

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<sup>30</sup> See Alan Johnston and Andrew Trembath (2005), 'Economic regulation of intrastate aviation and the National Competition Policy', Staff Discussion Paper, National Competition Council.

<sup>31</sup> IBISWorld (2009), 'International Airlines in Australia: I6401' (page 21).

<sup>32</sup> Australian Government (2009), 'Flight Path to the Future: National Aviation Policy White Paper', available at <http://www.infrastructure.gov.au/aviation/nap/>.

Figure 1.7 – Number ('000) of passengers on flights in and from Australia<sup>33</sup>

Despite the rise in airline passenger traffic, pressure on profits has been high. The global recession and the introduction of low cost carriers have led to much lower airfares. Additionally, high fuel prices, especially during 2007-08, increased costs for the industry. Although strong price competition and high costs means tight profitability for the industry, consumers are gaining from the cheaper airfares.

### Accommodation

This review takes a broad view of the accommodation market. Accommodation includes not only large providers such as hotels and resorts, but others such as bed and breakfasts, camp sites and house or apartment rentals.

### Market concentration

The accommodation market in Australia is highly fragmented, with low concentration. The main area of concern for consumers relates to service quality and whether it meets their expectations. This is dealt with by state fair trading bodies, where consumers can make official complaints and assistance can be given to resolve the issue.

There is strong competition in this market, as accommodation providers not only compete within their own market segment, but also against other types of accommodation. Word of mouth is an important source of demand, so market forces should encourage an appropriate quality of service.

<sup>33</sup> Bureau of Infrastructure, Transport and Resource Economics (2010), Aviation Statistics: International and Domestic Airline Activity, available at <http://www.btre.gov.au/info.aspx?NodId=49>.

## Other tourism suppliers

Finally, the travel industry also includes an array of other services, such as hospitality, entertainment, car hire, adventure, day tours and cruises. Although some of these services are also used by non travellers (eg hospitality and entertainment), they also constitute an important part of the travel/tourism industry. Given the wide array of services and businesses, it is not surprising that this segment represents over 50 per cent of travel/tourism industry revenue.

One increasingly popular segment of this market is cruise ships. Since 2005, the market for cruises in Australia has almost doubled, with Australians taking over 365,000 cruises in 2009.<sup>34</sup> The market is dominated by services around Australia, and to New Zealand and other islands in the South Pacific, with these destinations accounting for approximately two thirds of the market. The South Pacific is the largest segment, attracting 38 per cent of Australian cruise passengers. Local markets however are demonstrating strong growth, with passenger trips to New Zealand and Australia growing by 75 per cent and 52 per cent respectively in 2009. Around the world voyages, which only account for 3 per cent of passengers, are nonetheless also increasingly common, having grown by 68 per cent in 2009.

Cruises are often sold as a comprehensive holiday package and typically last for at least one week (over 90 per cent of cruise trips last for more than four days, two thirds for more than a week). They typically require bookings well in advance of departures, as well as significant prepayments, either direct to the cruise provider or to an intermediary.

## Recent developments

Changes in the economy, especially improvements in technology, have altered both the dynamics of the travel industry and the vulnerability of consumers.

## Technology and the internet

The development of information and communications technology, most importantly the internet, has been a key driver of change in the industry. The internet has given consumers access to a broad range of information and choices. Both travel suppliers and intermediaries have detailed information about their products and services online, allowing them to market directly to consumers. Coupled with the spread of credit card use, the internet has also given consumers the ability to purchase directly from suppliers online. In fact, this is increasingly being encouraged by suppliers, with special online deals by many airlines and accommodation providers that are often unavailable through other means (ie from a travel agent).

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<sup>34</sup> International Cruise Council Australasia (2009), 'Australian Cruise Industry Report'.

New technologies have also streamlined payment processes. When a credit card is used, some travel agents have agreements with suppliers (or other intermediaries) that facilitate the direct transfer of consumers' funds to the supplier. The transaction is facilitated by the supplier's merchant facility so that the agent is never in possession of the funds and therefore poses no insolvency risk to the consumer.

The consequence of this development was highlighted by AFTA:

*This effectively takes the travel agent out of the transaction and therefore the question of passing on of monies is irrelevant.<sup>35</sup>*

These developments have had a substantial impact on the vulnerability of consumers in the market. In particular, improvements in information and communications technology have:

- increased the availability of travel information and thereby significantly reduced the information asymmetry that travel agent businesses may have previously enjoyed
- improved the level of choice available to consumers, including whether or not to transact via travel agents or engage tour operators or travel service suppliers directly.

### Changes to historical travel industry supply chain

Technological developments have had a profound impact on the industry. The ability of consumers to access more information and contract directly with service suppliers is enabling components of the historical supply chain to be integrated or bypassed altogether. The Australian Tourism Export Council (ATEC), for example, noted:

*Over the last decade, the marketing and (to a degree) distribution of Australian tourism product has been changed significantly by the coming of the internet and its growing use for commercial transactions. The classic distribution model described above has been under siege as each player in the chain now has cost-effective tools to deal directly with each other, but most importantly tourism businesses (suppliers and informal aggregators) have been able to deal directly with customers.<sup>36</sup>*

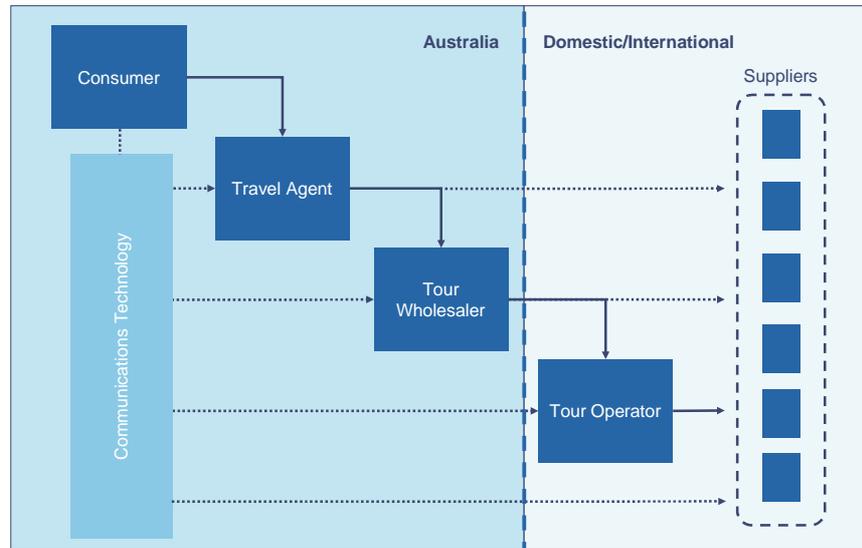
As a result of these changes, it is widely accepted that travel agents can no longer be considered 'gatekeepers' to the travel industry, particularly (but not solely) in relation to domestic travel. It is now common place for consumers to by-pass travel agents and contract directly with suppliers. These developments are represented in Figure 1.8.

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<sup>35</sup> AFTA submission (page 26).

<sup>36</sup> Australian Tourism Export Council (2010), submission (page 4).

**Figure 1.8 – Impact of communications technology on historical supply chain**



This trend is reflected in the results of the PwC Consumer Survey. Relatively few respondents report using a travel agent on their most recent purchase of various travel products, particularly for domestic travel. While a significant proportion of travellers still purchased international airline tickets (29 per cent) and accommodation (15 per cent) from a travel agent, only 14 per cent and 8 per cent respectively did so for their most recent domestic trip. In both cases, booking directly with the supplier was the favoured alternative mechanism, accounting for almost half of airline ticket purchases and two thirds of accommodation purchases not made via a travel agent.

The impact of electronic mediums was also clear in the survey results. Of those customers who purchased airline tickets direct from travel service suppliers, almost 95 per cent did so online. In relation to accommodation, online purchases accounted for over half of direct purchases while online booking agents (eg Wotif) also accounted for a significant portion (28 per cent) of non travel agent accommodation bookings.

### Relative cost of travel

The historical and recent growth in Australia's travel market reflects both an increase in household income, and the relative affordability of air travel. The level of annual disposable income available per capita in Australia has increased 50 per cent over the two decades to 2009.<sup>37</sup> With greater disposable income, consumers can afford to make more discretionary purchases, including expenditure on travel.

<sup>37</sup> ABS (2010), 'Australian National Accounts: National Income, Expenditure and Product'.

This increase in income has been coupled with favourable movements in the price of travel. Low cost carriers such as Tiger and Virgin have entered both the domestic and international airline market, increasing price competition for larger players such as Qantas. This has resulted in a significant fall in airfares. More recently, the global downturn has also impacted airline ticket prices, with discounted prices offered by many airlines to increase passenger numbers. Airfares can represent a large proportion of total travel expenditure for any one trip, especially for international travel, so reduced airfares has made travel much more affordable.

The decline in the relative cost of travel means travel no longer represents a major consumer purchase, like buying a car or house. Travel has become a discretionary expenditure that is accessible to a greater proportion of the population.

## Future directions

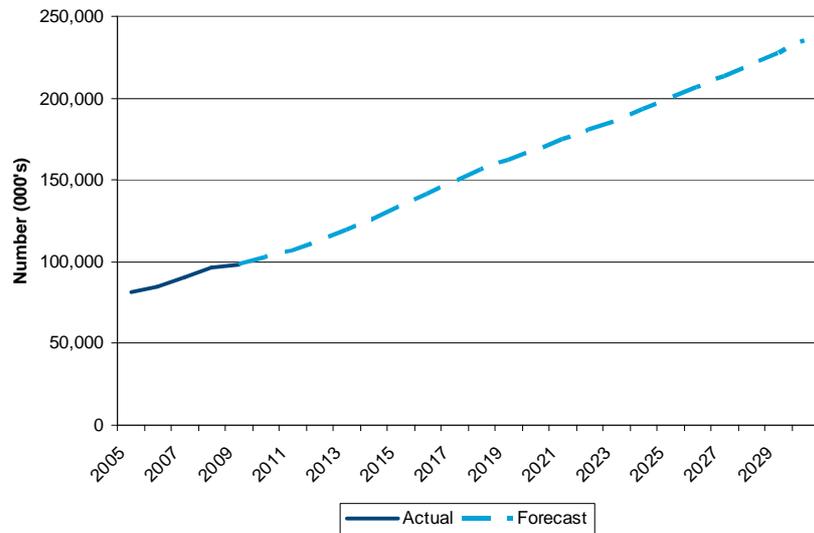
Given the major changes in the Australian travel and travel related services industry over the past two decades, it is important to consider its likely future directions in considering consumer protection risks in the industry.

## Travel by Australians

PwC expects that consumption of travel products by Australians will continue its strong growth over the coming decade, driven largely by an ever increasing use of air travel by Australians.

There is a broad consensus that Australia's aviation sector will continue to grow, despite forecasts of higher fuel prices and climate change concerns. Australia's Bureau of Infrastructure, Transport and Regional Economics (BITRE) has forecast the level of air passenger movement in Australia over the coming decades (see Figure 1.9). These forecasts suggest continued increases in passenger movements through Australian airports, including:

- an almost three-fold increase in international travel by 2030
- a 140 per cent increase in total passenger movements over the same period.

**Figure 1.9 – Air passenger movements through Australian capital cities<sup>38</sup>**

A large component of passenger traffic is overseas departures by Australians. Having nearly doubled over the past two decades, PwC forecasts short term (less than one year) international departures by Australians to continue to grow, driven by existing industry trends. These include:

- declining fares relative to inflation and household incomes
- increased competition including entry and growth from low cost carriers
- ever increasing sense of global connectedness via online and media technology
- greater familiarity with online purchasing.

Increasing long distance travel is reflected in forecasts of Australians' consumption of travel products more broadly. Australians' consumption of accommodation services, hospitality and entertainment products are also expected to increase over the coming decade.

### Industry profitability

From an industry perspective, these trends reflect strong demand for air travel and other tourism products. However, market trends suggest that travel businesses may not enjoy commensurate increases in revenue.

Firstly, strong competition in the international air travel market is expected to place downward pressure on international airfares and, accordingly, limit the potential growth in airline revenues. Similar

<sup>38</sup> BITRE (2009), 'Aircraft Movement Forecasts'.

dynamics are expected in the domestic travel industry, where the low margin, high volume business model of carriers is expected to continue; not least of all driven by increased market share of low cost entrant Tiger Airways.

The market for other travel products (accommodation, hospitality, tours) demonstrates similar supply growth over recent years and is also forecast to continue.

For travel agents (and other travel intermediaries) travel by Australians (both domestically and internationally) is a key driver of travel agents' industry revenue, accounting for approximately 70 per cent of their revenues.<sup>39</sup> The strong growth expected in these markets is likely to have a positive impact on activity in the travel agents sector.

However, the sector faces serious commercial challenges arising from:

- an increasing willingness of travellers to contract directly with travel service suppliers
- reduced commissions from transport operators to travel agents that do not meet certain sales volumes
- vertical integration – travel service suppliers or tour wholesalers/operators operating their own travel agency businesses
- a greater ability of consumers to research and accumulate information on the internet rather than relying on the agent's knowledge.

Accordingly, PwC expects that the industry is in a transitional period, moving away from businesses that have relied on the historical 'gate-keeper' model and towards businesses that can:

- offer cheaper (or at least price competitive) travel products – most importantly by obtaining bulk discounts by being a large player or a member of a chain or affiliated buying group
- retain a loyal customer base by offering quality and trustworthy service – for example, offering booking expertise to improve scheduling (eg more convenient flights), expert travel knowledge or on trip support.

Considering the above, affiliation or membership in a buying group, affiliate brand, chain or franchise is likely to be increasingly important for travel agents. Such membership offers improved buying power, lower marketing and promotional costs, improving branding and access to the latest booking and reservation technology. All of these,

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<sup>39</sup> IBISWorld (2009), 'Travel agency services in Australia: I6641' (page 9).

according to IBISWorld, are key success factors for travel agency business in the current market.<sup>40</sup>

At the same time, stakeholders also see an ongoing role in the industry for smaller 'niche' players, those specialising in particular destinations or travel options (eg cruises).

### Summary

While the Australian travel market continues to grow, recent developments continue to change the shape of the industry. Broad trends include increased consumption of, and familiarity with, travel services, a breakdown of the historical supply chain and consolidation in previously unconsolidated markets.

These developments have been generally positive for consumers, improving the choices available to them and reducing their vulnerability to consumer protection concerns.

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<sup>40</sup> IBISWorld (2009), 'Travel Agency Services in Australia: I6641' (page 23).

## 2 Current consumer protection measures in the travel industry

### Key messages

The centrepiece of consumer protection regulation in Australian is the generic provisions of Fair Trading Acts, applicable to all industries. These are being harmonised nationally under the Australian Consumer Law initiative. Other relevant regulations include company and criminal law.

Industry-specific consumer protection regulation is focussed on the travel agents market, with compulsory licensing and insolvency protection schemes in place. Other industry-specific measures are currently proposed, in the development of a national accreditation framework for the tourism industry and an industry ombudsman for the aviation sector.

A range of non regulatory measures are also present. These include industry associations' codes of conduct, commercial arrangements and some private sector protection (credit card chargeback and travel insurance).

### 2.1 Generic consumer protection regulation

Businesses in the travel industry are required to comply with the generic business and consumer protection rules that are applicable to all Australian businesses, many of which provide some measure of consumer protection. These include:

- business/trade conduct rules
- other relevant laws relating, for example, to the operation of companies and to crimes.

Of primary relevance to this review is the generic consumer protection measures incorporated in these provisions. Primarily these measures are contained in the Commonwealth's *Trade Practices Act 1974* and the Fair Trading Acts in each state and territory. However, other relevant provisions are also identified in this section.

#### Fair trading acts

Australia's State and Commonwealth jurisdictions provide protection to consumers under generic consumer protection rules that apply to all industries. These rules are incorporated in the Commonwealth's *Trade Practices Act* and the various state-based Fair Trading Acts.

### *Trade Practices Act*

The *Trade Practices Act* is the Commonwealth's primary competition, fair trading and consumer protection legislation. It covers the relationships between suppliers, retailers, wholesalers, customers and competitors, and covers a full range of consumer protection and competition matters, including:

- anti-competitive conduct
- unfair market practices
- industry codes of practice
- mergers and acquisitions
- product safety and labelling
- price monitoring
- the regulation of certain industries, including airports.

Under Australia's federal system, the *Trade Practices Act* applies only to businesses that operate as incorporated entities or across state jurisdictions and, as such, may not apply to some travel agents. However, many of its provisions are mirrored in state fair trading legislation (discussed below).

The provisions of the *Trade Practices Act* most relevant to the tourism and travel industries include the following.

- Unconscionable conduct provisions (Part IVA). Examples of these provisions include varying key terms of an agreement without notice, and failing to disclose the key terms in a contract to consumers.
- Consumer protection provisions (Parts V). These provisions relate to misleading or deceptive conduct, false or misleading representations, displaying the single price of packaged goods and services, 'bait advertising',<sup>41</sup> accepting payment for a good or service without intending or being able to supply as ordered, and harassment and coercion.

Part VC mirrors Part V and provides for criminal prosecution to be brought for breaches of Part V. Offences under Part VC can be given penalties (for each offence) of up to \$220,000 for individual traders and up to \$1.1 million for companies.

Importantly, Part IVB of the Act also allows for the establishment of industry codes of conduct. These codes regulate the conduct of participants in an industry towards other participants or consumers in the industry. Such codes can be voluntary or mandatory and

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<sup>41</sup> An example of bait advertising is when a travel agent advertises a travel package at a very low price, but when a consumer goes to purchase the product there are none available and the agent tries to sell the consumer a higher priced package. Under the *Trade Practices Act*, an advertised product must be available for a reasonable amount of time, to a reasonable number of consumers.

corporations are prohibited under the Act from contravening a mandatory code or a voluntary code to which they are bound. The Act provides for a number of enforcement measures for breaches of industry codes, including damages and injunctions. Currently, there are industry codes in place for franchises, and the horticulture and petroleum marketing industries.

The *Trade Practices Act* is administered by the Australian Competition and Consumer Commission (ACCC), an independent statutory authority charged with promoting compliance with competition, fair trading and consumer protection laws. Its role complements the activities of consumer affairs agencies in each state and territory, who administer their applicable fair trading legislation. The ACCC's activities include enforcing certain prohibitions in the *Trade Practices Act*, including those in Parts IVA and V.

#### Application to the travel industry

Utilising the generic provisions, the ACCC has been engaged in a number of guidance and enforcement activities in relation to the travel industry.

One of the primary areas of attention has been in relation to 'component pricing'. Component pricing refers to a practice of advertising the price of a component of a good or service only; for example, advertising the costs of airline flights in a flights and accommodation package deal. Historically, this practice was common in the travel industry, particularly in relation to tours or airline tickets.

In 2009 changes to the *Trade Practices Act* introduced component pricing rules.<sup>42</sup> These measures were introduced to ensure consumers are aware of the total cost they will incur in purchasing the product. The rules require businesses to advertise (in a prominent way) a single total price for the advertised good or service, including any booking charges, taxes, duties or other charges. In support of these changes, the ACCC published a pricing manual for the travel industry to provide practical guidance to travel agents and other travel businesses on the application of these provisions.

Other rules that have been the subject to ACCC investigations in the travel industry include:

- third line forcing – requiring purchasers of one product (eg flights) to purchase another product (eg travel insurance) from another party
- bait advertising – advertising a product at a low price with only a very small number of such products available (ie in order to sell the customer a higher priced product as an alternative).

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<sup>42</sup> *Trade Practices Act 1974* section 53C.

## Fair Trading Acts

Further consumer protection is provided by the Fair Trading Acts in each state and territory.<sup>43</sup> While their provisions are broadly equivalent to the measures of Part V of the Commonwealth's *Trade Practices Act*, the *Trade Practices Act* is limited by Australia's Constitution and therefore generally applies only to corporations and enterprises trading across state and international borders.<sup>44</sup> In this way, the state acts extend the operation of these provisions to all businesses in Australia.

The Fair Trading Acts impose restrictions on the conduct of all businesses intended to protect consumers from unconscionable conduct. Examples of behaviour that is prohibited by these acts relevant to the travel industry are:

- misleading or deceptive conduct
- unconscionable conduct
- false or misleading representations
- harassment and coercion
- bait advertising
- accepting payment without intending or being able to supply.

## Australian Consumer Law

Following the Productivity Commission's 2007 *Review of Australia's Consumer Policy Framework*, the Council of Australian Governments (COAG) agreed to implement a uniform national consumer law scheme.<sup>45</sup> This reform is currently underway and is intended to culminate in the introduction of a single national consumer law for Australia, called the Australian Consumer Law (ACL).

The purpose of the ACL is to harmonise Australia's existing generic consumer protection framework to provide consumers with the same protections, and businesses with the same responsibilities and obligations, wherever they are in Australia. The ACL will be a schedule in the *Trade Practices Act* (to be renamed the *Competition and Consumer Act 2010*), and will replace the Fair Trading Acts (and other related legislation) in all states and territories. It will be administered by the ACCC and the fair trading bodies in each state and territory.

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<sup>43</sup> *Fair Trading Act 1992* (ACT); *Fair Trading Act 1987* (NSW); *Consumer Affairs and Fair Trading Act 1990* (NT); *Fair Trading Act 1989* (Queensland); *Fair Trading Act 1987* (SA); *Fair Trading Act 1990* (Tasmania); *Fair Trading Act 1999* (Victoria); and *Fair Trading Act 1987* (WA).

<sup>44</sup> Productivity Commission (2007), 'Review of Australia's Consumer Policy Framework' (page 18).

<sup>45</sup> SCOCA (2009), 'An Australian Consumer Law: Fair Markets – Confident consumers'.

Broadly speaking, the ACL is intended to reflect best practice in each of the existing state and territory Fair Trading Acts. It will include the major provisions outlined above. The ACL will also introduce new provisions relating to:

- unfair contract terms
- a national product safety law and enforcement scheme
- new consumer rights law (replacing the existing conditions and warranties provisions).

#### Unfair contract terms

The ACL is to introduce new provisions to protect consumers from unfair contract terms in standard form contracts.

Under the new provisions, contracts will be considered 'unfair' where they:<sup>46</sup>

- cause significant imbalance in the parties' rights and obligations arising under the contract
- are not reasonably necessary to protect the legitimate interests of the supplier
- could cause financial or non-financial detriment to a party.

These proposed rules have some relevance to the travel industry, particularly given the prevalence of standard form contracts in, for example, airline ticketing and travel insurance.

#### Industry-specific consumer protection under the ACL

Importantly, while the ACL will replace Australia's existing generic consumer protection rules, it is not intended to replace all industry-specific measures. The Productivity Commission's review did however propose a review of industry-specific provisions.<sup>47</sup> The proposed review is an acknowledgment of the cost and uncertainty that unwarranted industry-specific provisions unnecessarily impose on business.

Specifically, the Commission recommended that COAG's Business Regulation and Competition Working Group instigate a review program that would:

- identify and repeal unnecessary specific consumer regulation, (with an initial focus on requirements that only apply in one or two jurisdictions)

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<sup>46</sup> Australian Government (2010), 'The Australian Consumer Law: An Introduction' (page 5).

<sup>47</sup> Productivity Commission (2007), 'Review of Australia's Consumer Policy Framework' (page 26).

- identify other areas of specific consumer regulation where unnecessary divergences in requirements or lack of policy responsiveness impose significant costs on consumers and/or businesses
- determine how these costs would be best reduced, whilst maintaining protection for consumers, with explicit consideration of:
  - the case for transferring policy and, where appropriate, enforcement responsibilities to the Australian Government
  - a process and timetable for harmonising and streamlining currently divergent specific regulation that remains the responsibility of the states and territories.

### Harmonisation of occupational licensing

As a response to the Commission's review, in July 2008, COAG agreed to develop a national trade licensing system for a range of occupations, effectively aiming for nationally uniform requirements for obtaining a licence. The aim of this initiative is to enhance the productivity of the Australian economy by reducing regulatory duplication and creating a more efficient, streamlined environment for business activity. As an important secondary outcome, it will further reduce barriers to the mobility of skilled labour between jurisdictions.

The system is proposed to apply to seven occupational areas:

- air conditioning and refrigeration mechanics
- building and building-related occupations
- electrical workers
- land transport (passenger vehicle drivers and dangerous goods)
- maritime occupations
- plumbers and gasfitters
- property agents (including conveyancers and valuers).

COAG has determined that a National Licensing System (NLS) will be established through cooperative national legislation, with national governance arrangements determining policy issues such as licence policy, standard setting and disciplinary arrangements.

This harmonisation represents an important reform. It reflects a government desire to improve the consistency of regulatory regimes across state and territory borders and recognises that, for many Australian sectors, their market is a national one. Australia's travel industry, particularly as it relates to long distance travel and travel intermediaries, is also arguably a national market. Accordingly, affording the same harmonisation approach to regulatory schemes in this sector is worthy of consideration.

## Other relevant provisions

In addition to specific consumer protection legislation, consumers are protected by measures incorporated in laws concerning other matters. Relevant rules and regulations include those relating to corporations or company law, and criminal law.

### Corporations law

Corporations play an increasingly important role in Australia's travel industry. While corporations have long provided travel services (airlines, rail transport, etc), they also play an increasingly important role in the travel agency market.

The regulation of companies in Australia is centred on the *Corporations Act 2001* and its associated regulations, which outlines rules governing the formation and operation of companies. Of most importance to consumer protection, the Act imposes fiduciary duties upon company directors. These duties govern the exercise of the director's office and civil or criminal penalties can be imposed on directors for breaches of these duties. These duties include the obligation:

- to act with reasonable care and diligence
- to act in good faith in the best interests of the company
- not to use their position or information obtained dishonestly to gain advantage for themselves
- to prevent insolvent trading by the company.

These obligations, and the associated penalties for breach, impose strict requirements on company directors to faithfully exercise the duties of their office. They therefore indirectly protect consumers, who may otherwise suffer loss as a result of misconduct by company directors.

Most importantly, directors who allow their company to trade while insolvent can be ordered to pay compensation for losses incurred by third parties due to the insolvent trading.<sup>48</sup>

### Australian Securities and Investment Commission

The Australian Securities and Investment Commission (ASIC) is Australia's corporate, markets and financial services regulator. Its primary function is to ensure Australia's financial markets are fair and transparent, and that investors and consumers are informed and are confident in the integrity of the financial system.

ASIC is responsible for administering the *Corporations Act*. Of primary importance to this discussion, ASIC is charged with ensuring

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<sup>48</sup> *Corporations Act 2001* section 588K.

that directors and officers of companies carry out their duties honestly and diligently. Accordingly, ASIC will from time to time take action against company directors and officers for breaches of these duties.

### Australian Securities Exchange

The Australian Securities Exchange (ASX) is Australia's primary stock exchange and lists securities in many Australian businesses, including in the travel industry. Publically listed travel and travel related services businesses include:

- airlines – Qantas Airways Limited and Virgin Blue Holdings Limited
- travel agents – including Flight Centre Limited, Jetset Travelworld Limited and Webjet Limited
- ancillary travel services – such as insurers QBE Insurance Group Limited and Suncorp-Metway Limited.

As listed entities, these businesses are subject not only to general company law but also to the listing rules of the ASX, which set standards of behaviour for listed entities. These rules are enforceable contractually, between the ASX and the listed entities, and under the Corporations Act. Amendments of the listing rules must be lodged by the ASX with ASIC, and may be disallowed by the relevant Minister.

Notably, the listing rules include periodic and continuous disclosure requirements. Periodic disclosure requirements outline the responsibility for entities to produce quarterly, half yearly and annual reports, and the minimum content for each. Continuous disclosure requirements oblige listed entities to immediately advise the ASX of any information that might reasonably be expected to have a material effect on the value of its securities. Examples of such information include:

- any change in financial forecasts or expectations
- any rating applied by a rating agency and any change to such rating
- any changes affecting the company's capital structure – such as making a takeover bid, share buy-back arrangements, capital raising and business restructuring
- changes to the company's registered details, including the company's officers and directors, registered address and auditors.

Consequently, in addition to oversight by regulators such as ASIC, which is typically focussed on business conduct, listed entities are also subject to significant market oversight and transparency – with particular attention to the health and profitability of the business.

## Criminal law

Australia's criminal law system prohibits a number of actions that might cause consumer detriment. These include:

- theft and related offences
- fraud and related offences
- obtaining property or financial advantage by deception.

These offences are enforced by the relevant police authority in each jurisdiction and have numerous and severe potential sanctions.

## 2.2 Industry-specific regulation

While all businesses in the travel industry are subject to the generic consumer protection measures (outlined above), industry-specific consumer protection regulation in the travel industry is primarily focussed on travel agents.

In addition to this regulatory regime, two important Australian Government initiatives, incorporating measures aimed at consumer protection, are presently being developed.

- Aviation White Paper – a recently published report by the Australian Government recommending a number of potentially important initiatives.
- National Tourism Accreditation Framework (NTAF) – a proposed umbrella scheme to promote voluntary accreditation programs in various facets of the Australia tourism industry.

These topics are discussed in turn.

## Travel agents

Travel agents are governed by the applicable regulatory regime in each Australian state and territory. These regimes are broadly aligned by the *National Co-operative Scheme for the Uniform Regulation of Travel Agents* (the National Scheme). The National Scheme was introduced in 1986 in order to promote nation-wide industry standards. Initially adopted by Victoria, New South Wales, Western Australia and South Australia, it now applies to all Australian states and territories, except the Northern Territory.<sup>49</sup>

Under the National Scheme, all participating states and territories are required to enact a series of uniform rules, including requiring that travel agents be licensed and members of the Travel

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<sup>49</sup> While the National Scheme has been adopted in the Northern Territory, businesses in this jurisdiction are exempted from participating in the Travel Compensation Fund.

Compensation Fund. It is suggested that the key objectives of the scheme are to protect consumers from:

- inadequate service from travel agents, perhaps as a result of incompetence on behalf of the travel agent
- financial loss arising from the failure of travel agencies to account for monies deposited with them.<sup>50</sup>

As a result of the scheme, the regulatory regime applicable to travel agents provides consumer protection in three broad categories:

- entry requirements, including requirements for licensing
- insolvency protection measures (including a compensation scheme administered by the Travel Compensation Fund (TCF))
- conduct requirements.

### Entry requirements

All persons carrying on business as a travel agent must be licensed by relevant state and territory regulatory bodies.<sup>51</sup> The licensing of travel agents is intended to improve industry standards (through a series of competency and conduct requirements) and ensure travel agents participate in the compensation scheme (discussed below).

### Scope of the regime

‘Carrying on business as a travel agent’ is defined in most states and territories as carrying on a business of selling (or arranging, making available, purchasing for resale or advertising to sell) travel or travel and accommodation.<sup>52</sup> Exemptions from licensing are available for persons who carry on such business:

- in the course of their employment
- in relation to travel services or travel services and accommodation that the person owns.

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<sup>50</sup> Centre for International Economics (2000), ‘National Competition Policy review of the National Scheme for the Regulation of Travel Agents’.

<sup>51</sup> The National Co-operative Scheme for the Uniform Regulation of Travel Agents – Participation Agreement (Schedule).

<sup>52</sup> The definition of ‘travel agent’ in the ACT includes businesses that only sell accommodation (*Agents Act 2003*, section 11).

Further exemptions are available in some states and territories, such as for:

- persons only arranging travel that begins and ends on the same day,<sup>53</sup> or
- persons only arranging domestic travel and their annual turnover being less than \$50,000.<sup>54</sup>

This definition of a 'travel agent' identifies relevant businesses by the functions they perform (eg selling tickets), rather than the nature or identity of the business. There is some suggestion that this definition, and the exemptions, have led to uncertain or incongruous outcomes. Certain businesses commonly understood to be travel intermediaries may be excluded from this definition; such as accommodation booking services, tour, cruise and coach operators and/or online agents that merely perform a brokerage service.<sup>55</sup> Alternatively, certain businesses that are not commonly considered travel intermediaries (eg airlines) may be required to be licensed as travel agents.

#### Licensing criteria

Under the National Scheme, certain persons are deemed ineligible for a travel agent licence. These include persons who:

- have not attained the age of 18 years
- are disqualified from holding a licence
- are not of good reputation or character
- are not likely to carry on business honestly and fairly
- are in any other way not a fit and proper person to be a licensee.

These restrictions have been adopted by each participating state and territory and, as such, the preconditions for licensing in each state are broadly similar.<sup>56</sup>

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<sup>53</sup> Such provisions are enacted in all states and territories except NT.

<sup>54</sup> Such provisions are enacted in NSW, Queensland, SA and Tasmania.

<sup>55</sup> AFTA (2009), 'Discussion Paper: Better Regulating Travel and Travel-Related Services' (page 23).

<sup>56</sup> The relevant instruments of each state are the following legislation, together with their associated regulations: *Travel Agents Act 1986* (NSW); *Travel Agents Act 1988* (Queensland); *Travel Agents Act 1986* (SA); *Travel Agents Act 1987* (Tasmania); *Travel Agents Act 1986* (Victoria); *Travel Agents Act 1985* (WA); *Agents Act 2003* (ACT); and *Consumer Affairs and Fair Trading Act* (NT).

In addition to these eligibility rules, all states and territories require that travel agents, or certain employees (eg day-to-day manager), have a specified level of experience and/or qualifications. These requirements require that person to:

- have completed a specified training course
- have worked in the industry for a specified period of time (typically one year).

In most states and territories these requirements are only imposed if the travel agent arranges international travel.

The required training, commonly referred to as the 'Construct Normal International Airfares' unit, must be provided or assessed by a nationally recognised organisation (of which there are many). Typically, the course can be completed in around 40 hours, and covers such topics as:

- the structure and workings of the international aviation industry
- international rules governing travel fares
- calculating fares
- international taxes and government charges
- the International Air Transport Association's ticketing system.

While the relevant qualifications/experience requirements are broadly equivalent across jurisdictions, there are differences. For example, in some states the licence holder is required to have personally met the requirements, while in others the requirements are imposed on the business' day-to-day manager. In the ACT, the day-to-day manager must be a licensed travel agent. In Victoria, the relevant person (manager) is required to have completed both the training and experience requirements.

### Insolvency protection

The second broad category of consumer protection measures are designed to compensate consumers for losses from the bankruptcy or insolvency of travel agents. These measures are primarily incorporated in and executed by the Travel Compensation Fund (TCF).

The TCF was set up in 1986 as part of the introduction of the National Scheme. It is the primary body by which consumers are protected against financial losses arising from the financial collapse of a registered travel agent.

The licensing rules in the National Scheme require participation in the TCF as a precondition for being licensed. The TCF's purposes are:

- to ensure that only persons who have sufficient financial resources may join, or continue to participate in, the fund and therefore may carry on business as a travel agent
- to provide compensation to eligible consumers who have suffered financial loss as a result of the bankruptcy of registered travel agent.<sup>57</sup>

### Prudential oversight

The TCF may impose a number of requirements in order to ensure that travel agents hold sufficient capital prior to joining, or continuing to participate in, the TCF.

A relevant person is eligible to participate in the TCF if the TCF's Board considers the person has, and is likely to continue to have, sufficient financial resources to enable the person to carry on business as a travel agent. In formulating its opinion, the TCF may consider a variety of factors, including any previous involvement of the person in the industry. However, the primary indicator is the person's financial position.

The TCF has developed guidelines by which it determines whether or not a participant's, or potential participant's, financial resources are sufficient. The guidelines include minimum capital requirements (based on gross annual turnover) and two financial ratio tests:

- net tangible assets relative to gross turnover
- net working capital relative to monthly overhead expenses.

The financial ratio tests are used as an indication of the adequacy of the business' financial resources by a points system. Businesses are awarded points, in a range from negative three (-3) to eight (+8), according to their individual ratios. In addition, an agent that maintains a fully funded trust or client account is awarded 4 points. Businesses must pass the TCF's minimum capital requirements and achieve a score of at least 10 for approval of the initial application and for renewal of participation.

In addition to allowing/refusing or furthering/cancelling participation in the fund on the basis of financial resources, the TCF may also impose financial requirements on participants, including:

- maintaining a client account for received monies
- increasing the capital/reducing the debt of the business
- providing security in favour of the Board

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<sup>57</sup> Travel Compensation Fund Trust Deed.

- obtaining insurance or a guarantee
- accounting requirements (eg audited financial accounts).

In practice, the TCF requires all participants to submit audited financial accounts annually and imposes a requirement of a bank guarantee and an insurance arrangement for some participants (namely those who do not, or cease to, meet the capital requirements outlined above).

### Compensation

In addition to prudential oversight, the TCF is also charged with compensating consumers who suffer loss from the collapse of a travel agent business in certain circumstances. The TCF pays compensation, up to \$25,000, to a person who:

- enters into travel or travel related arrangements with a fund participant (directly or indirectly)
- suffers direct pecuniary loss directly resulting from a failure to account by a fund participant, that arises from an act or omission of that participant (or its employee), for money paid by the person
- is not protected against loss by an insurance policy.

The TCF Board also has discretion to compensate a person:

- for other pecuniary loss resulting from the participant's failure to account
- for similar losses from a failure to account by someone who is not a participant
- beyond the \$25,000 limit.

A number of compensation payments have occurred in relation to the second dot point (ie travel related losses in relation to businesses that are not participants of the fund). TCF suggests this typically occurs in instances where a consumer believes they are dealing with a licensed travel agent.<sup>58</sup>

The claim history of the TCF over the past decade is outlined in Table 1.

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<sup>58</sup> Centre for International Economics (2000), 'NCP review of the National Scheme for the Regulation of Travel Agents' (page 20).

Table 1 – Claims paid out by the TCF (2000 – 2009)<sup>59</sup>

Year	Value of claims paid	Number of claimants	Number of travel agent failures	Average amount per claimant	Average amount per failure
2000	\$1,945,626	874	23	\$2,226	\$84,000
2001	\$956,597	20,760	24	\$46	\$39,000
2002	\$11,109,413	4,547	24	\$2,443	\$462,000
2003	\$2,412,388	1,283	22	\$1,880	\$109,000
2004	\$1,829,549	633	12	\$2,890	\$152,000
2005	\$483,130	2,170	10	\$223	\$48,000
2006	\$920,921	765	12	\$1,204	\$76,000
2007	\$4,060,490	6,485	18	\$626	\$225,000
2008	\$2,049,019	1,779	40	\$1,152	\$51,000
2009	\$2,953,053	2,742	31	\$1,077	\$95,000
5 year average	\$2,093,323	2,788	22	\$856	\$99,425
10 year average	\$2,872,019	4,203	22	\$1,377	\$134,658

As the table demonstrates, with the exception of 2002, which was dominated by the collapse of Ansett Airlines and its subsidiary travel agent Traveland, the TCF typically pays out between \$500,000 and \$4 million per annum at an average of approximately \$2 million. This equates to a typical claimant payout of between \$500 and \$2,000.

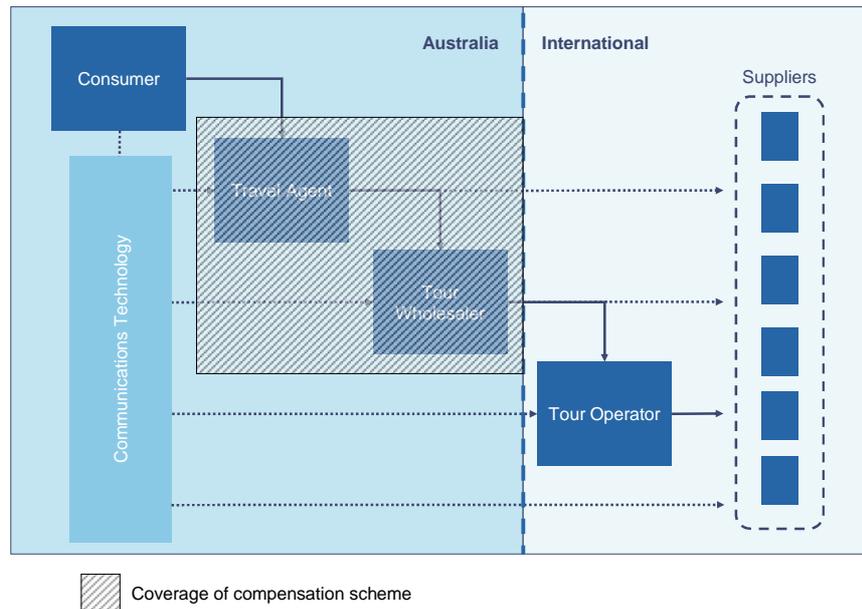
The data suggests an average of 22 travel agents fail each year resulting in compensation, with the above averages 40 and 31 occurring in 2008 and 2009 respectively. The average equates to failures of approximately 0.7 per cent of all TCF participants every year.

#### Scope of the compensation scheme

It is important to understand the scope of the travel agents compensation scheme, which stakeholders comment can be confusing and poorly known by consumers. It is represented, in relation to international travel by Australian travellers, in Figure 2.1.

<sup>59</sup> Compiled from Travel Compensation Fund Annual Reports.

Figure 2.1 – Scope of existing compensation scheme<sup>60</sup>



Importantly, the scheme is limited to monies due to failure to account by a licensed travel agent. Therefore, where monies have been appropriately forwarded to a travel service supplier (or other intermediary) or where the consumer has contracted directly with suppliers, the funds are not covered by the scheme.

Given the ongoing movement away from intermediaries (discussed in the previous chapter) increasingly travel purchases by Australians are not covered by the TCF. By way of indication, in 2009, \$9.2 billion was paid to retail travel agents who are TCF participants for travel products.<sup>61</sup> By comparison, in 2007-08 Australians spent \$28 billion annually on travel purchases (eg travel, accommodation, car hire and travel agency services).<sup>62</sup> Subsequently, the TCF coverage extends to less than one third of purchases of travel products and only provides protection for the period of time that it is held by the agent.<sup>63</sup>

### TCF funding and costs

The TCF's compensation payouts, and its operating expenses, are partly funded by income from the following sources:

- initial contributions by new participants of \$7,430, and \$5,000 for each additional location

<sup>60</sup> Tour operators located in Australia may also be included in the compensation scheme.

<sup>61</sup> Information provided to PwC by Travel Compensation Fund.

<sup>62</sup> ABS (2009), 'Australian National Accounts: Tourism Satellite Account 2007-08 (5249.0)'.

<sup>63</sup> AFTA has suggested that it extends to 45 per cent of travellers. See AFTA submission (page 34).

- initial administration fees by new participants of \$760 and \$470 for each additional location
- ongoing annual renewal fees of \$390 and \$290 for each additional location.<sup>64</sup>

In the most recent year (ending 31 December 2009) the TCF received \$1.8 million in contributions from new participants and \$1.6 million in renewal fees. The TCF's other major sources of income include claims against:

- bank guarantees and other securities (\$1.7 million)
- company directors or auditors (approximately \$0.1 million per annum)
- interest from funds invested (approximately \$1.2 million).<sup>65</sup>

Both initial contributions and annual fees are constant across all travel agents, regardless of size or other factors. The TCF is considering the introduction of 'risk-based' fees and charges, but as yet, such changes have not been implemented.

The administration cost (ie non claim expenses) of the TCF amounted to approximately \$2.8 million for the year ending 31 December 2009.<sup>66</sup>

Following a review of the TCF's capital adequacy and capital requirements in 2004, following the collapse of Ansett/Traveland in 2001, the TCF has made an effort to increase its funds on hand. At 31 December 2009 the TCF's reserves exceed \$25 million.<sup>67</sup>

## Conduct requirements

The National Scheme includes provisions that allow the relevant authority to institute disciplinary action against travel agents on various grounds. These include:

- a licence was improperly obtained
- a licensee has been convicted of an offence
- the business is being conducted in an unfair or dishonest manner
- a person involved in the management of the business is not a fit and proper person
- the licensee does not have, or is unlikely to continue to have, sufficient financial resources to carry on the business.

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<sup>64</sup> Information provided to PwC by Travel Compensation Fund.

<sup>65</sup> Travel Compensation Fund (2009) Annual Report.

<sup>66</sup> Ibid.

<sup>67</sup> Ibid.

Such disciplinary action may include:

- suspension of a travel agent's license for a period of up to twelve months
- imposing a condition on the licence
- disqualification of the licensee.<sup>68</sup>

In addition to these provisions, other states and territories have set out further behaviour requirements in their regulations. These rules cover a variety of areas of businesses' conduct and operations, including:

- 'unjust', 'deceptive' or 'misleading' conduct rules<sup>69</sup>
- advertisements – for example, requiring a business disclose its licence name and/or number on published advertisements<sup>70</sup>
- notices in premises – outlining prescribed particulars such as business name and/or licence number,<sup>71</sup> and
- online trading – including licence number and jurisdiction on the business' home page.<sup>72</sup>

To a certain extent, these powers (and the grounds on which they may be exercised) duplicate the provisions of the generic fair trading rules. In essence, they allow these rules to be enforced by the relevant licensing authority, in the form of disciplinary sanctions. In some respects however they are inconsistent with these rules, and may create additional cost or provide some uncertainty to businesses.

## National Tourism Accreditation Framework

In recognition of the role accreditation can play in promoting quality products and services, the Australian Government, in conjunction with the states and territories, has been working to develop a National Tourism Accreditation Framework (NTAF). The NTAF will be an umbrella framework, enabling and supporting independent accreditation programs that operate in the different segments and markets of the industry. The NTAF intends to improve industry quality and standards in two ways:

- providing consumers with a means of identifying quality tourism businesses

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<sup>68</sup> *Travel Agents Act 1986* (NSW), section 21.

<sup>69</sup> Such provisions are enacted in NSW, Victorian, WA, NT and the ACT.

<sup>70</sup> Such provisions are enacted in all states and territories.

<sup>71</sup> Such provisions are enacted in all states and territories except the ACT.

<sup>72</sup> *Travel Agents Regulation 2007* (Victoria), section 7.

- providing businesses with an incentive to improve the quality of their products/services, which will be recognised under the accreditation or ratings systems under the NTAF.

At present, over 20 independent programs are currently accrediting, rating or certifying products, services and/or providers in the tourism industry.<sup>73</sup> The NTAF seeks to strengthen these programs by allowing them to be co-branded with the NTAF. The NTAF will become a nationally and internationally recognised mark, providing accredited businesses with a symbol of quality assurance. While the accreditation programs participating in the NTAF are still to be determined, it is understood that at least one 'generic' tourism accreditation program (ie one available to all business in the tourism sector) will be developed.

In order to protect its brand and reputation and to ensure consistency of quality under the framework, the NTAF will make a number of requirements of participating programs. Firstly, programs must meet certain criteria in order to participate. Programs must also:

- provide details of the quality criteria used by the program for accrediting/rating participating businesses
- comply with general principles that must be addressed in the program's assessment process.

The NTAF will be administered by a body known as the Tourism Quality Council of Australia, with industry and government representatives appointed by the Minister for Tourism.

At the time of this report, preparation for the implementation of the NTAF is underway, with pilot implementation being conducted with several participating accreditation schemes. It is expected that the framework will become operational during 2011.

## Aviation White Paper

Over the past twenty years, Australia's aviation industry has seen growth in passenger numbers, as cheaper airfares make flying accessible to more and more people. Over this period, amongst other things, Australia has seen the arrival of low-cost airline businesses (the most recent of which was Tiger Airlines in 2007).

The airline industry has presented a number of consumer protection challenges. Cited examples include bait advertising, failing to display the single price of packaged goods and services, unfair contract terms in a ticket's standard form contract and inadequate handling of complaints.

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<sup>73</sup> Department of Resources, Energy and Tourism 'National Tourism Accreditation Framework' Fact Sheet, available at [http://www.ret.gov.au/tourism/policy/national\\_tourism\\_accreditation\\_framework/Pages/NationalTourismAccreditationFramework.aspx](http://www.ret.gov.au/tourism/policy/national_tourism_accreditation_framework/Pages/NationalTourismAccreditationFramework.aspx).

The Australian Government recently released the *National Aviation Policy White Paper*,<sup>75</sup> which outlines the Australian Government's intentions on a variety of issues relating to the industry, including consumer protection. In addition to the upcoming changes to generic consumer protection laws (discussed above), the White Paper suggests two consumer protection measures to be implemented by the industry to improve the handling of complaints:

- the development of a 'Corporate Charter' by each airline, setting out minimum standards of complaints handling such as response times and offering full refunds in certain circumstances
- establishing a mechanism for complaints to be examined by an independent third party or ombudsman.

Some action has taken place already in this respect, including Jetstar launching its Corporate Charter (named the Jetstar Customer Guarantee) in February 2010.

## 2.3 Non regulatory consumer protection

Outside the regulatory framework, a number of private sector organisations and arrangements have developed that offer a degree of consumer protection, albeit indirectly or at a direct cost to the consumer.

### Industry associations

The travel industry has a range of industry associations covering, amongst others, the aviation, travel agents (and other intermediaries), hotels and tour operator segments. Many of these organisations represent a large component of their relevant industry. For example, the Australian Federation of Travel Agents (AFTA) represents over 60 per cent of travel agents and 90 per cent of the industry by turnover.<sup>76</sup>

Membership in these organisations provides a degree of tacit assurance as to the *bona fide* nature of the business which, to the degree consumers are aware of and value such assurance, is likely to generate commercial advantage.

Accordingly, these industry associations will often maintain a Code of Ethics to which their members should comply in order to maintain and establish the reputation of the organisation. While such codes do not impose legally binding obligations on association members,

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<sup>75</sup> Australian Government (2009): 'Flight Path to the Future: National Aviation Policy White Paper'.

<sup>76</sup> AFTA (2009), 'Discussion Paper: Better Regulating Travel and Travel-Related Services' (page 1).

they impose some commercial or business incentive for meeting conduct requirements.

For example, AFTA requires its members to comply with its Code of Ethics. The code contains guidelines such as:<sup>77</sup>

- being factual and accurate when providing information about their services, and the services of any organisation that they represent
- treating every client confidentially
- using every effort to protect their clients against fraud, misrepresentation or unethical practices
- providing complete details about terms and conditions of any travel service, for example, cancellation fees, before accepting payment for a booking.

In addition, the Council of Australian Tour Operators (CATO) has a Code of Ethics which is made up of three parts.<sup>78</sup>

- Relations with the public – which closely mirrors AFTA's Code of Ethics.
- Relations with travel agents, carriers and other principals – for example, prohibiting false or misleading statements when giving opinions regarding another travel agent.
- Relations with fellow members – for example, conducting business in a way which avoids confrontation with other tour operators.

A further example is the Australian Tourism Export Council (ATEC), whose Member Code of Ethics and Business Practice also includes three parts.<sup>79</sup>

- Professional business standards – which include a statement requiring members to inform customers of all terms and conditions of a contract.
- Lawful business practices – which outlines the relevant legislation, for example, the *Trade Practices Act*.
- Compliance – which describes the disciplinary action that may be taken for a breach of the code, for example suspension from ATEC.

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<sup>77</sup> AFTA Code of Ethics.

<sup>78</sup> CATO Code of Ethics.

<sup>79</sup> ATEC Member Code of Ethics and Business Practice.

## Commercial arrangements

Although not directly targeted at improving consumer protection, certain commercial arrangements may do so indirectly by, for example:

- providing reasonable and appropriate barriers that may restrict the entry of so called 'fly-by-night' operators
- requiring standards of competency or conduct that lead to improved quality of service
- requiring standards of financial adequacy that reduce the risk of business failure.

There are several such arrangements in the travel industry, as discussed in the following sections.

### International Air Transport Association

The International Air Transport Association (IATA) is the representative body of the international airline industry. Its membership includes some 230 airlines that together account for 93 per cent of scheduled international air traffic. IATA represents the interests of its member airlines and, in doing so, imposes a number of requirements on affiliated travel agents to protect their interests.

One important component of IATA's role is administering the IATA Passenger Agency Program, a travel agent accreditation scheme. The program is designed to simplify the relationships between member airlines and travel agents by facilitating:

- authorisation for agents to sell tickets on behalf of the airlines
- a centralised invoicing and payments system between airlines and agents, known as the Billing and Settlement Plan (BSP).

For member airlines, the program provides a number of commercial benefits. The travel agent accreditation process provides the airlines with a global network of travel agents for the distribution of their products; all of whom meet minimum standards and financial criteria and have signed uniform agency agreements. The BSP facilitates a simple and reliable accounts management system. Accounts are typically settled every 7 to 14 days, with IATA boasting a 99 per cent collection rate.

Travel agents that meet certain industry standards and financial criteria can be accredited under the scheme. Accreditation allows the agent to issue tickets on an airline's behalf; non accredited agents are required to purchase via a ticket consolidator. IATA suggested that, at present, some 1,200 Australian travel agents are accredited with the organisation.

As mentioned, IATA accreditation requires participating travel agents to meet certain business standards and financial criteria. Business

standards relate to such matters as employing well trained and competent staff, security and confidentiality, and making honest and transparent statements.

Historically, the financial criteria imposed on accredited agents in Australia have mirrored those of the TCF, for example requiring businesses to achieve certain financial ratios and/or maintaining separate client accounts. This is reflective of the fact that the prudential oversight of IATA is essentially protecting against the same risk as the TCF (namely travel agent insolvency). The difference is that IATA provides such oversight in order to protect the interests of member airlines, rather than consumers. Nonetheless, the requirements are likely to reduce the risk of insolvency of IATA accredited agents, indirectly benefiting consumers.

Recently IATA has announced changes to its financial criteria that will apply from 1 July 2010.<sup>80</sup> The new criteria are understood to impose requirements on travel agents in excess of those imposed by the TCF. The new requirements removed the previous 'points based' system in favour of four separate requirements, being:

- holding minimum share capital and reserves
- maintaining a complying client travel account
- meeting a working capital to overheads test
- meeting a profitability test.

Accredited agents are required to meet all four tests or provide additional paid-up capital or financial security (insurance, bank guarantee) to IATA. Industry stakeholders have suggested these requirements represent more stringent obligations on businesses as compared to the TCF.

The presence of IATA accreditation offers some indirect protection to consumers in the following ways:

- requiring minimum business standards – which ensures the *bona fide* nature of businesses and limits the ability of 'rogue' businesses to operate in the market
- imposing prudential requirements – which reduces the risk of business collapse, to the benefit of both consumers and airlines
- provides a form of accreditation – allowing consumers who value a level of quality assurance to choose purchase only from IATA accredited agents.

It is important to note that, given IATA focuses on the interests of airlines, such requirements provide no guarantee that the interests of consumers are protected. Nonetheless, the IATA scheme is likely to

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<sup>80</sup> IATA Notice, 'Introduction of new financial criteria – update', 31 March 2010, available at [http://www.iata.org/worldwide/asia\\_pacific/australia/Documents/](http://www.iata.org/worldwide/asia_pacific/australia/Documents/).

play a significant role in promoting good conduct in the travel agents sector.

### Chains and franchises

Chains, franchises and other affiliate groups are becoming increasingly important in the travel industry, particularly in relation to travel agents. As mentioned, TCF data suggests that approximately 40 per cent of travel agent businesses are part of a chain or franchise arrangement.<sup>81</sup> The PwC Travel Agents Survey suggested this number was higher, with 68 per cent of respondents stating they were part of some form of co-operative or affiliate group. AFTA suggests estimates that non aligned agents account for only 20 per cent of businesses in the industry.<sup>82</sup>

Membership of an affiliate group provides a number of important advantages for a travel agent, including:

- cost efficient promotional and marketing expenditure
- strong brand awareness and reputation
- access to cheaper travel products via bulk buying power.

It is expected that, in the presence of the strong commercial pressures on travel agents discussed in section 1.2, these advantages will become increasingly important. For example, House of Travel, in its submission, states its expectation that the number of travel agents will reduce due to mergers, acquisitions and closures and expects more larger travel agencies and fewer small travel agencies.<sup>83</sup>

From a consumer perspective, large chains or affiliate groups provide the opportunity, to some degree, to benefit from the oversight of those chains over their own members. Given the importance of brand reputation, members are likely to perform a degree of self regulation and enforcement, knowing that poor conduct or service by one member will tarnish the reputation of the whole. While stopping short of guaranteeing the obligations of group members, this commercial imperative nonetheless provides some assurance of the *bona fide* nature of the member business.

The presence of large chains also draws into question the ongoing appropriateness of aspects of the regulatory regime in the travel agents industry. As Flight Centre Limited (FCL) notes:

*... there were no large multi-national travel agencies in Australia at the time the [TCF's financial] criteria were introduced. FCL estimates that independent operators*

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<sup>81</sup> Information provided to PwC by Travel Compensation Fund.

<sup>82</sup> AFTA (2009), 'Better Regulating Travel Related Services' (page 11).

<sup>83</sup> House of Travel submission (page 2).

*represented 80-90 per cent of the industry when the TCF's framework was developed. Today, national or international chains would represent 80 per cent of the industry.<sup>84</sup>*

Similar sentiments were also expressed in PwC's industry discussion forums and House of Travel's submission.<sup>85</sup>

## Bank merchant arrangements

Businesses wishing to offer electronic payment options (credit card, EFTPOS, etc) are required to enter into merchant arrangements with banks or other financial institutions. Such businesses impose a degree of risk on banks, as consumers may seek relief from the banks, via the chargeback mechanism (discussed below), if the relevant goods and services are not supplied. For example, if a business falls bankrupt, customers may seek chargeback from their bank for losses they incur.

In recognition of this risk, banks enter into merchant arrangements with these businesses to limit or be compensated for this risk. While these arrangements may differ from business to business, we understand that they may include risk related merchant fees and/or imposing financial adequacy requirements on businesses.

## Private protection options

Finally, in recognition of consumers' willingness to pay for protection against various risks, two important private sector protection options have developed which have specific application in the travel industry: credit card payments (including the chargeback mechanism) and travel insurance.

## Credit Cards

Credit cards are an increasingly frequent means of payment for consumers, particularly in the travel sector. Credit cards offer advantages, as compared to cash or other payments methods, including deferring cash payment, the ability to pay online or over the telephone, timely and convenient access to funds and security (eg reducing the amount of cash a consumer carries with them). For these reasons, over the past decade credit (and debit) card payments have become increasingly common.<sup>86</sup>

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<sup>84</sup> Flight Centre Limited submission (page 3).

<sup>85</sup> House of Travel submission (page 2).

<sup>86</sup> Reserve Bank of Australia (2009), 'Research discussion paper: Price incentives and consumer payment behaviour' (page 1).

### Prevalence of credit card transactions in the travel industry

In line with broader market trends, the use of credit cards is particularly common in the travel industry. The Reserve Bank of Australia (RBA) estimates that credit cards account for 42 per cent of payments in the holiday/travel sector. Debit cards (which may, in some circumstances, also benefit from the charge-back mechanism)<sup>87</sup> account for a further 20 per cent of payments.<sup>88</sup>

The RBA's survey also demonstrated that the choice of payment by consumers is related to both the transaction amount and the merchant environment. For purchases of \$200 to \$500, the survey found that credit cards were used 21 per cent of the time, whereas credit cards were used 30 per cent of the time for purchases above \$500. In relation to merchant categories, the travel industry had the highest credit card usage with 42 per cent of purchases; compared to an overall average of 13 per cent. According to the RBA, cash payments accounted for only 27 per cent of purchases.<sup>89</sup>

The PwC Consumer Survey suggests an even greater frequency of credit card use, particularly when consumers purchase direct from travel service suppliers. When purchased directly from suppliers, the overwhelming majority of purchases of airline tickets (87 per cent), accommodation (84 per cent), hire cars (90 per cent), travel insurance (89 per cent) and tours (77 per cent) were purchased via credit card. Credit cards were less common with cruise ship purchases (59 per cent); the dominant form of other payments being direct fund transfers (eg EFTPOS). The survey suggested that cash/cheque payments are rare when purchasing direct from travel service suppliers. Such payment methods account for no more than 5 per cent of direct purchases of airline tickets, accommodation and hire cars purchases, although they account for up to 10 per cent of tour and cruise ship transactions.

Payment methods are somewhat different when purchasing via a travel agent. While credit cards account for the majority of airline tickets (55 per cent), accommodation (53 per cent), hire care (50 per cent) and cruise ship (62 per cent) purchases from a travel agent, the majorities are substantially smaller. These numbers are consistent with the PwC Travel Agents Survey, which suggested that on the whole credit cards are used for 59 per cent of domestic travel purchases and for 56 per cent of international travel purchases.

In most cases, direct fund transfers (EFTPOS, BPAY) and cash/cheque payments make up the balance of payment types.

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<sup>87</sup> Consumers using some debit cards are able to select the 'credit' or 'debit' option on purchases. When 'credit' is selected, the payment is made via the 'scheme debit system' (this system is operated by Visa and MasterCard), which offers the same protection as people who use Visa or MasterCard credit cards; including, where available, access to the charge-back mechanism.

<sup>88</sup> RBA (2009), 'Research discussion paper: Price incentives and consumer payment behaviour' (page 13).

<sup>89</sup> Ibid (page 13).

Interestingly, cash/cheque payments still account for a substantial proportion (21 per cent) of purchases via a travel agent. This may be reflective of travellers who are less comfortable with electronic payments also preferring the additional service and comfort that comes from purchasing via a travel agent rather than direct from the supplier. It may also reflect a common practice of additional fees being charged on credit card transactions.

### Charge-back mechanism

One common security feature of credit cards is a process known as 'charge-back', by which consumers can request their financial institution to 'reverse' a transaction where the goods/services are not supplied, are defective or transactions are unauthorised.<sup>90</sup> In some instances therefore, consumers may be able to reverse the charge in the event that they did not receive the goods or services for which they had previously paid.<sup>91</sup> Where this mechanism is available, the consumers are protected from the risk of travel agency insolvency. Compensation (via reversal of the charge) can be obtained from the credit card provider, who may then recover outgoings from business owners, directors and/or auditors.

The charge-back mechanism therefore may substantially reduce the risks to consumers of supplier (including travel agent) insolvency. To cite a high profile example, when Ansett Airlines collapsed, customers who had booked flights on credit cards were able to apply for charge-back, under which the National Australia Bank reversed several million dollars worth of payments.<sup>92</sup> It is also understood to have reduced the number of compensation claims made on the TCF, as the TCF does not typically compensate a credit card payment unless a claimant can demonstrate that a charge-back application was made and denied.

Opinions were divided among travel agents regarding the level of reliance consumers should place on the credit card charge-back mechanism to protect against insolvency risk. On the one hand, some stakeholders appreciate that the charge-back mechanism reflects a relatively simple means by which consumers can protect themselves from this risk. Discussions with representatives of the Financial Services Ombudsman suggest that charge-back is not a particularly problematic mechanism, at least in the travel industry context. Most charge-back related disputes concern the limitation period for claims which, in other circumstances, can be unclear. It was suggested that this is not the case in relation to travel products, where the intended departure date is well established as the 'starting point' for time limits on claims.

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<sup>90</sup> Consumer Affairs Victoria (2004), 'Online shopping and consumer protection: Discussion paper' (page 15).

<sup>91</sup> Specific conditions vary depending on credit card supplier and product.

<sup>92</sup> John Kavanagh, 'Chargeback to the Rescue', *Business Day*, 29 April 2009.

Others however are less confident of the ability of consumers to rely on this mechanism. Choice, for example, writes:

*Chargeback cannot be relied on a (sic) a consumer protection mechanism because less and less consumers are making travel payments by credit card. In addition, the policies and practices of credit providers vary, preventing consumers in many instances from accessing chargebacks as was evidenced by the Ansett collapse. In addition chargeback is still not well known amongst consumers...*<sup>93</sup>

Ozcruising were also sceptical about consumers' awareness of this option:

*Most clients would not know the specific details for insurance coverage provided by the use of a Credit Card and understand the ramifications of insolvency.*<sup>94</sup>

Respondents to the PwC Travel Agents survey were also less positive about consumers' reliance on charge-back. Only 43 per cent thought consumers should rely somewhat or entirely on the mechanism for insolvency protection, compared to 42 per cent who thought not much or no reliance should be placed on it. This may reflect the likelihood that travel agents indirectly bear the cost of this mechanism, through higher merchant fees and/or having the burden of charge-back placed upon them, under merchant arrangements, for losses from the insolvency of other businesses.

PwC understands that under typical merchant arrangements the travel agent may bear the cost of a loss where a travel service supplier fails to deliver a service that was sold via the travel agent. Businesses have highlighted the cost this imposes on travel agents; being predominantly small businesses, such costs are considered a substantial cost burden.<sup>95</sup>

Finally, the PwC Consumer Survey highlights the point, raised by Choice and others, that consumers are largely unaware of the mechanism. While 53 per cent of consumers have heard of the charge-back function, only 31 per cent reported having some or a good understanding of what it entails.

## Travel insurance

The private market for travel insurance is well established in Australia. A number of policies, with a range of different premiums and coverage, are offered by established market players, including CoverMore, Vero/AAMI, QBE and others.

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<sup>93</sup> Choice submission (page 4).

<sup>94</sup> OzCruising, submission (page 2).

<sup>95</sup> These concerns were raised in PwC's industry discussion forums and by submissions, such as Wendy Mulry Travel.

More recently, the market has seen the advent of direct sales by insurers to travellers, bypassing the historical role of travel agents who typically sold the product on behalf of insurers (at a margin). Recent publications have drawn attention to the perceived high margins travel agents receive on such products,<sup>96</sup> and stakeholders expect that consumers are increasingly purchasing travel insurance directly from insurers.

The PwC Consumer Survey results show that 44 per cent of international travellers intend to purchase insurance through a travel agent, but only 15 per cent of domestic travellers intend to do so.

Travel insurance products differ in terms of risks covered. Broadly, the most important areas of coverage are:

- cancellations or amendments to your travel due to circumstances outside your control
- lost baggage or travel documents
- overseas medical expenses.

In addition, policies may also provide protection against loss from travel service supplier insolvency, personal liability, rental car excess and other financial risks. Notably however, no travel insurance product currently protects consumers against losses from travel agent insolvency; this coverage is automatically provided by the TCF.

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<sup>96</sup> For example, Choice's *Travel Insurance Buying Guide*, available from [www.choice.com.au](http://www.choice.com.au), suggests travel agents receive up to 50 per cent or more of the total premium.

### 3 The need for consumer protection in the travel industry

#### Key messages

For the most part, competitive markets underpinned by generic consumer protection rules, some voluntary accreditation and some private measures provide an adequate and appropriate level of consumer protection in the travel industry.

Notwithstanding, legitimate concerns have been raised about two areas where the risk of consumer detriment, and the lack of opportunities for redress, is potentially unacceptable: inadequate service (in a variety of markets) and the loss of prepayments (particularly in relation to travel agents and air travel).

The risk of inadequate service appears only to be of sufficient extent to justify regulatory intervention in the air travel industry. Such action has already been proposed by the Australian Government's Aviation White Paper, whose measures should be explored.

While the risk of losing prepayments was the driving rationale for the specific regulation of travel agents, the vulnerability of consumers in this respect has decreased due to recent and ongoing developments in the industry. Some private sector options are also available to consumers to protect themselves against these risks.

Within the context of the current regulatory structure discussed in Chapter 2, our review has identified two broad categories of consumer protection concerns in the travel industry.

- **Inadequate service.** These concerns relate to the failure of travel and travel related services businesses to deliver service of adequate standard, quality and reliability and/or the inability of consumers to obtain sufficient redress in such instances. In this respect, of particular interest are the domestic airline, travel agents, tour desks and travel insurance markets.

Current regulatory measures in this respect are the generic consumer protection rules (eg fair trading legislation), relevant industry ombudsman services and the entry requirements and disciplinary powers incorporated in the travel agent licensing regime.

- **Loss of prepayments.** These concerns relate to the risk of financial loss where payments are made by consumers in advance of a service that is not subsequently delivered, particularly in the case of business insolvency. The risk arises either from consumers making payments some time in advance of the service being delivered, or making payments via an intermediary. The travel agents sector is of particular

interest, given the historical practice of taking carriage of monies for payment to third parties.

Current regulatory measures in this respect are limited to the travel agents compensation scheme, administered by the Travel Compensation Fund (TCF).

### 3.1 Inadequate service

A consumer protection issue across all industries relates to the provision of services to an appropriate standard. When a consumer contracts with a service provider, they expect a certain level of quality based on the representations of the supplier. If this is not adequately provided, an appropriate avenue for redress should be available for consumers in order to gain sufficient compensation.

Stakeholders have raised concerns about inadequate service and the lack of sufficient redress in the following travel industry sectors:

- travel services (travel agents and airlines)
- tour desks
- travel insurance.

Consistent information and data on the adequacy of service is limited as it is very subjective and hard to quantify. PwC has attempted to provide some indication of service levels by using consumer complaints statistics. Currently, consumers can lodge complaints with the relevant state fair trading body or industry ombudsman. The level of complaints received by these bodies provides a rough indication of the extent of this problem across different industries. It is likely that the number of consumer complaints understates the issue, as some consumers may be reluctant to complain for a variety of reasons. Queensland Consumers Association made comment about this potential problem, stating that:

*(consumer complaint statistics) usually massively understate the actual extent and relative importance of consumer problems.<sup>97</sup>*

For this reason, these figures will only be used in a comparative sense, to understand the relative (as opposed to absolute) importance of consumer problems for each area of concern.

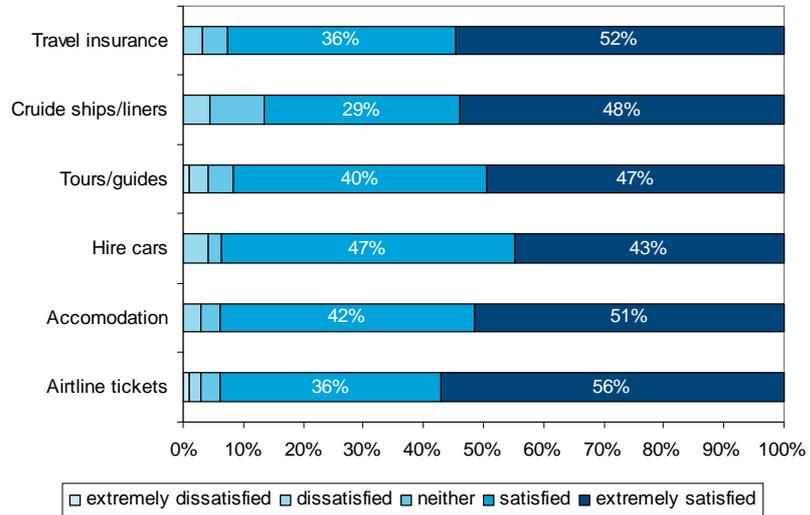
It should be noted at the outset that across the travel industry, there does not appear to be widespread concerns about inadequate service. An indication of the service quality provided by travel suppliers can be seen in the results of the PwC Consumer Survey, shown in Figure 3.1. The survey demonstrates that consumers are, on the whole, satisfied with the travel services they have received.

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<sup>97</sup> Queensland Consumer Association submission (page 2).

For each service shown, at least 89 per cent of consumers were satisfied or extremely satisfied with the service they received.

**Figure 3.1 – Consumer satisfaction with travel services purchased through channels other than a travel agent<sup>98</sup>**



These results are for services purchased through channels other than a travel agent. The results for product purchases via travel agents however are just as compelling, with 85 per cent of consumers being satisfied or extremely satisfied with their level of service.<sup>99</sup>

### Travel services

Statistics from fair trading bodies suggest that travel related complaints make up a relatively low proportion of fair trading and consumer issues, relative to other industries.

Total travel complaints account for between one and eleven per cent of complaints across Australia. Interestingly, travel only represents up to five per cent of complaints in most states, while in Queensland and Tasmania they are around 11 per cent of all complaints.

While travel is the subject of a noticeable portion of consumer complaints, other industries make up a greater proportion relative to their size (see Table 2). This suggests that service issues in the travel industry are no higher than those in other large sectors of the economy.

<sup>98</sup> PwC Consumer Survey.

<sup>99</sup> We would expect satisfaction between channels to be similar because if there is significant dissatisfaction in one channel consumers would migrate to another channel.

**Table 2 – Industry comparison of consumer complaints**

Industry	Proportion of complaints <sup>100</sup>	Australian Industry Revenue (billion) <sup>101</sup>
Building and Construction	6 to 20 per cent	\$29.5
Automotive	3 to 17 per cent	\$100.4
Estate agents	2 to 17 per cent	\$8.4
Travel	1 to 11 per cent	<sup>102</sup> \$78.6

Consumers' complaints about travel seem to be relatively evenly spread across travel agents, airlines and accommodation. Accordingly, there is no clear evidence that suggests that one segment of the market causes more (or fewer) issues for consumers than others.

Across Australia, travel agent related complaints account for between 6 and 36 per cent of all travel related complaints; accounting for 30 per cent in most states.<sup>103</sup> This represents up to four per cent of all consumer complaints, although in most states it amounts to less than one per cent of total complaints. On the other hand, the PwC Consumer Survey shows that consumer satisfaction with purchases of airline tickets through a travel agent is reasonably high, with 88 per cent satisfied or extremely satisfied with their service. Accommodation, hire cars, tours and cruise ships and travel insurance were also good with 89 per cent, 85 per cent, 80 per cent, 81 per cent and 88 per cent respectively. Notwithstanding, instances of poor service by travel agents may, and do, occur; one such instance is noted by Mrs Christine Napper in her submission to this review.<sup>104</sup>

In relation to airlines, the general area of concern for consumers relates to changes to, or cancellations of, scheduled flights. Many stakeholders have commented on the impacts this can have on consumers. Delays, cancellations and downgrades can not only result in financial loss, but also cause consumers significant inconvenience. Travel is typically for a particular purpose, which will be hindered by cancelled or delayed services. Across Australian jurisdictions, between six and 31 per cent of travel complaints relate to airlines, representing less than 1.5 per cent of all consumer complaints.<sup>105</sup>

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<sup>100</sup> Statistics provided by the relevant fair trading bodies in each Australian state and territory.

<sup>101</sup> IBISWorld industry reports.

<sup>102</sup> This figure includes air travel, accommodation, restaurants and cafes, tours, travel agents and motor vehicle hiring, sold to Australian residents and overseas visitors.

<sup>103</sup> Statistics provided by the relevant fair trading bodies in each Australian state and territory.

<sup>104</sup> Christine Napper submission (page 1).

<sup>105</sup> Statistics provided by the relevant fair trading bodies in each Australian state and territory.

Notwithstanding the relatively small number of complaints, the Australian Government has proposed a number of measures targeted at achieving better service quality outcomes and greater availability of redress in the airline industry. These policy measures were outlined in the Aviation White Paper (discussed in Chapter 2). In that paper, airlines are encouraged to develop corporate charters that outline complaint procedures and the establishment of an airline industry ombudsman was proposed. In principle, these measures seem to adequately deal with consumer concerns highlighted.

The other main area represented in consumer complaints is accommodation. Again, overall, the sector represents a small proportion of total consumer complaints. In addition, consumers are not particularly vulnerable in relation to this purchase. Payments are usually made after the service has been provided, allowing consumers a greater capacity to negotiate directly with suppliers and access sufficient redress for any shortcomings in their experience.

In conclusion therefore, there appears to be little case for additional consumer protection measures in relation to business conduct in this industry, beyond those measures proposed by the Aviation White Paper.

## Tour desks

Concerns have been raised by stakeholders about the lack of consumer protection measures in relation to tour desks. Most tour desks are not required to be licensed under the current travel agents licensing scheme, either because they do not sell flights or because their sales are below the relevant state threshold. Most comments have been focused on the Queensland market. The Queensland Tourism Industry Council made the following comment:

*This issue is particularly apparent in the Cairns region and has led to differing levels of quality customer service offered by some tour desks, limited protection for consumers when issues have arisen with unregistered tour desks and, consequently, negative visitor perceptions of some regional tour operators due to issues arising with these unregistered agents.<sup>106</sup>*

Although the level of consumer protection regulation is lower for tour desks than travel agents, there appears to be little evidence of significant consumer detriment arising from poor service by tour desks. It seems the issue raised is really focused on the existence of an unfair competitive advantage held by tour desks, as well as potential issues for suppliers and operators dealing with them, rather than consumer protection. As the focus of this review is consumer protection, protection for suppliers is beyond the scope of this review.

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<sup>106</sup> Queensland Tourism Industry Council submission (page 3).

Given the ability of consumers to access a wide array of information, especially online, consumers are not entirely reliant on tour desk recommendations when making travel choices. Moreover, these issues have not manifested themselves in a large body of consumer complaints. Accordingly, while commissions undoubtedly influence the recommendations of tour desks, consumers do not seem sufficiently vulnerable to warrant regulatory protection.

Accordingly, we see few grounds at this stage to support a recommendation of specific consumer protection measures in this area. However, it may be appropriate to flag this area as a subject for ongoing monitoring and investigation by consumer affairs agencies, particularly those in states where issues have been highlighted.

## Travel insurance

As with many insurance policies, travel insurance comes with its own exclusions and conditions. These terms, if not properly understood, may leave consumers with a lower level of cover than they expected to receive.

The financial ombudsman service (incorporating the insurance industry ombudsman) provides consumer support, including an external dispute resolution process, for the Australian insurance market. The ombudsman provides consumers with a place to complain and seek redress if an insurer fails to accept liability when a consumer makes a claim.

Consumer complaints on travel insurance are reasonably high. Since 2004, around 17 per cent of general insurance complaints<sup>107</sup> have been in relation to travel, despite the product accounting for less than eight per cent of the market.<sup>108</sup> By contrast, while motor vehicle insurance is the major source of complaints (accounting for 35 per cent) it also accounts for 30 per cent of the market and is therefore not grossly overrepresented. Home buildings (23 per cent) and contents (11 per cent) insurance are other major sources of complaints; being overrepresented in complaints data given that collectively they only account for 10 per cent of the general insurance market. Accordingly, it is fair to conclude that travel insurance is overrepresented in insurance complaints.

This conclusion was also supported by Choice, which noted that:

*travel insurance is a problematic product and data from the Financial Ombudsman indicates that it receives a greater number of complaints than any other general insurance product relative to its market share.*<sup>109</sup>

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<sup>107</sup> Annual reviews from the financial services ombudsman (2004-05 to 2008-09).

<sup>108</sup> IBISWorld (2009), 'General Insurance in Australia: K7422' (pages 17-18).

<sup>109</sup> CHOICE submission (page 7).

Given the high number of complaints, there appear to be consumer issues in this sector that need to be addressed.

Most insurance disputes tend to relate to consumers misunderstanding what their policy covers, with exclusions and conditions accounting for over 60 per cent of disputes.<sup>110</sup> This is common across all insurance products. It suggests that the expectations held by consumers at the time of purchase about their level of cover are not being met by travel insurance products.<sup>111</sup> Choice gave an explanation of why this might be the case:

*The terms and conditions under which general insurance policies (including travel insurance) are offered vary widely. However, there is basically no product that offers total and universal cover. All have limitations and exclusions and comparison of the relative features is difficult for consumers not only due to the length and complexity of PDS but also because insurers interpret and execute claims differently.*<sup>112</sup>

Although the product disclosure statements (PDS) should provide consumers with sufficient information to understand their insurance product, these results suggest it is ineffective in practice when it comes to increasing knowledge before a consumer commits to a particular policy. Choice commented on this, saying:

*Travel insurance terms and conditions are set out in policy documents and brochures which are long and complicated documents and which consumers simply do not and will not read or fully understand.*<sup>113</sup>

Interestingly, over 60 per cent of travel insurance complaints resolve in favour of the insurer.<sup>114</sup>

The issue of poorly understood coverage, conditions and exclusions appears common across most general insurance products. Accordingly, it seems that this is a general insurance issue and not specific to the travel industry. Moreover, travel agents are unlikely to be licensed insurance brokers. As a result, these problems are best addressed as part of a broader insurance discussion, rather than as a policy issue for the travel industry.

As mentioned, the industry ombudsman currently provides consumers with an avenue for redress in the event of insurance related disputes. Although complaints appear reasonably high, consumer issues of this kind are best handled by the industry ombudsman, under its general insurance mandate, rather than as part of broader travel industry consumer protection.

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<sup>110</sup> Annual reviews from the financial services ombudsman (2004-05 to 2007-08).

<sup>111</sup> Ibid.

<sup>112</sup> CHOICE submission (page 7).

<sup>113</sup> Ibid (page 7).

<sup>114</sup> Annual reviews from the financial services ombudsman (2004-05 to 2007-08).

Interestingly, some insurers commented that fraudulent claims by consumers are particularly common in the travel insurance market. Given the nature of the product, insurers may find policing and verifying fraudulent claims difficult. However, the data does not seem to support that claim. Of all consumer travel insurance complaints since 2003-04, only 0.21 per cent arose because insurers thought the claim was fraudulent.<sup>115</sup> It is possible that most fraudulent claims never result in a complaint, suggesting that fraud is effectively dealt with by the insurer.

### Summary

While some consumer protection concerns have been raised by stakeholders, there is little evidence that inadequate service presents a major consumer protection problem in the travel industry. Complaints on these issues represent only a small proportion of fair trading and consumer concerns.

Of the complaints that are recorded, many relate to airlines. The recommendations of the Aviation White Paper are expected to address these.

For the most part therefore, generic consumer protection measures (eg fair trading legislation), together with other existing measures in the industry (eg accreditation and rating schemes), appear to be achieving good consumer outcomes in this sector.

## 3.2 Loss of prepayments

A business exiting a market need not cause consumer detriment. In many cases, businesses are wound up in an orderly manner; business assets are sold, creditors are paid and any residual profits accrue to the owners. Orderly wind-ups are common – for example, while approximately 1,065 businesses exited Australia's general retail industry in 2009, only 238 (22 per cent) required external administration.<sup>116</sup>

Similarly, in the travel agents sector the majority of businesses who cease to be members of the TCF (and, hence, exit the industry) do so voluntarily (77 per cent), by reason of, for example, closure or sale of a business.<sup>117</sup> This implies an orderly wind-up in which creditors (including consumers) do not suffer financial loss. Approximately 6 per cent of exits result in claims on the TCF for loss of consumer funds.

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<sup>115</sup> Ibid.

<sup>116</sup> Dun and Bradstreet custom data.

<sup>117</sup> Based on a ten year average of data provided to PwC by Travel Compensation Fund.

In some cases however, businesses exiting a market impose losses on creditors (including prepaid customers). This may be due to a business becoming insolvent or declaring bankruptcy, or due to the misappropriation of a business' funds by an owner, director or employee.

While, in the case of bankruptcy, the assets of the business may be sold and the proceeds used to repay creditors (known as 'liquidation'), in many cases the business assets will be insufficient to fully compensate creditors. Bankruptcy and company law may also limit the ability of creditors to seek compensation from businesses owners. Furthermore, the process of liquidation can be costly and time-consuming.

As a result, there is a risk of consumer detriment from business insolvency. It should be noted that this risk is present, to some degree, in all industries. However, some stakeholders have suggested that the following factors may make this risk particularly significant in the travel agents' sector:

- the particular volatility of the sector
- the carriage of monies and/or significant prepayments.

These two peculiarities of the travel agents market are understood to give rise to a particularly high risk of consumer detriment. Choice, for example, suggests that:

*The most significant consumer risk in the travel sector is loss of prepayments for services which are not provided.<sup>118</sup>*

AFTA also acknowledges that practice of prepayments for travel services contributes to a need for at least some form of consumer protection.<sup>119</sup>

According to the PwC Travel Agents Survey, this risk appears to be acknowledged by travel agents. A majority of respondents believe that suffering financial loss from the bankruptcy of a travel agent (59 per cent) or travel service supplier (72 per cent) represents a somewhat significant or very significant risk to consumers.

Consumers are however less concerned with these risks, at least relative to other travel related risks. The PwC Consumer Survey scored consumer perceptions of various risks based on the proportion of respondents rating the risk level at 9 or 10 out of 10. While health/medical risk (52.5) and loss of luggage (50.1) were the most highly rated risks, travel supplier (41.3) and travel agent (40.5) insolvency were perceived as less of a risk.

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<sup>118</sup> CHOICE submission (page 2).

<sup>119</sup> AFTA submission (page 29).

What is clear is that this risk was the driving rationale for the existing travel agents compensation scheme and is understood by most stakeholders to have been a substantial consumer protection issue when the scheme was introduced in 1986. House of Travel, for example, submitted that:

*... the original reason consumer protection was introduced was because of the high number of inexperience/under capitalised travel agents that failed...*<sup>120</sup>

An important question for this review therefore is whether this risk remains sufficient to justify substantial regulatory intervention.

Conceptually, the scale and magnitude of this risk is dependent on three factors:

- the likelihood of financial collapse resulting in loss of consumer funds – that is, whether the industry is, as claimed, particularly volatile
- the extent of prepayments or carriages of monies, including the length of time monies are held for
- the extent of possible consumer detriment from such risks.

## Is the travel industry particularly volatile?

There are a number of *prime facie* reasons to suspect the travel agents market to represent a high risk of business collapse:

- barriers to entry (excluding regulations) are quite low<sup>121</sup> – the industry does not require much initial capital investment or extensive specialised training or qualifications, making it conducive to free entry and exit
- expenditure on travel is discretionary, meaning demand for travel agents may fluctuate more severely with changes in economic activity.

In addition, a history of 'rogue' or 'fly-by-night' businesses has been noted in this sector (see Box 1); this being a component of the rationale for the industry-specific regulation.<sup>122</sup>

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<sup>120</sup> House of Travel submission (page 1).

<sup>121</sup> See, for example, the Australian Competition and Consumer Commission's review of S8 Limited's proposed acquisition of Transonic Travel Limited and others available at <http://www.accc.gov.au/content/index.phtml/itemId/760812>

<sup>122</sup> Centre for International Economics (2000), 'National Competition Policy review of the National Scheme for the Regulation of Travel Agents' (page 23).

### Box 1: 'Fly-by-night' businesses

A commonly cited rationale for specific consumer protection regulation in relation to travel agents is a perceived history of, and tendency for, 'fly-by-night' or 'rogue' businesses entering the market. Indeed, it is understood that the proliferation of such businesses, together with some high profile collapses, was the impetus for the introduction of the National Scheme.<sup>123</sup>

A 'fly-by-night' or 'rogue' business typically refers to a business which presents a high risk to consumers, and their funds (eg prepayments), due to one of the following.

- **A lack of commitment to the long term health of the business.** Such businesses may be poorly capitalised and/or resourced, have poorly trained or managed staff, or have other operational problems due to the business owners having willingness to exit the market at any stage and being unwilling to invest in the long term health of the business. They therefore present a relative high risk of insolvency and, therefore, potential financial loss to consumers.
- **A willingness to engage in business misconduct.** Misconduct may include the misappropriation of funds, fraud or other unconscionable dealings.

It is important that a clear distinction is understood between these two 'types' of businesses. The former refers to legitimate (or, at least, legal) business dealings, albeit with a short term and arguably reckless and irresponsible business model. The latter refers to illegal and, in some instances, criminal conduct being perpetrated by a business.

Illegitimate or illegal business conduct can occur in any sector or industry. The general principle adopted by government is that these issues are dealt with by the overarching and generic business, corporation and criminal law. These provisions (detailed at 2.1) provide prohibitions against such conduct, criminal and civil penalties, and enforcement powers for the ACCC, ASIC, the police and other relevant authorities. As such, the presence or likelihood of such activity or such businesses in the travel industry is not, *prima facie*, grounds for industry-specific consumer protection regulation.

Therefore, it is important to consider whether, and to what extent, the likelihood of legitimate but short term and reckless businesses being set up in the travel agents industry (and the associated risk of consumer detriment) exceeds that of other comparable industries.

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<sup>123</sup> Ibid (page 23).

To assess the assertion of high volatility, several points of evidence can be used. PwC's analysis focuses on three sources of information:

- market entries and exits, noting that:
  - a relatively large number of businesses entering a market suggests that a market is growing
  - a relatively large number of exits suggests that a market is declining
  - a high number of both entries and exits, such that the size of a market stays relatively constant, suggesting that a market is volatile
- businesses entering external administration – meaning that due to insolvency or other problems, the business is administered by an outside agency
- the average distress probability – an estimate of the risk of financial distress.

These factors are considered on a relative basis, contrasting travel agents with comparable industries and other jurisdictions. Comparable industries were identified as those of similar size and importance in Australia, such as general contractors (for single family houses), hotels and motels, real estate agents and retail. Jurisdictions used for comparisons are the Northern Territory and New Zealand. The Northern Territory differs to other Australian states in that agents are not required to be members of the TCF. The main point of difference in New Zealand is that their scheme is self-regulatory, being run through voluntary membership to the Travel Agents Association of New Zealand (TAANZ). While imperfect, comparisons across jurisdictions give some indication of the effectiveness of the current regulatory scheme and how it affects the volatility of the industry.

To assist with our analysis, PwC engaged Dun and Bradstreet to assemble specifically compiled data on the three points of evidence listed above. While Dun and Bradstreet's data is gathered from a variety of industry information sources, they do not have access to the degree of market information that the TCF collects. Accordingly, the values cited in the following section are estimates and may not be consistent with information collected by the TCF. Given this, it is possible that Dun and Bradstreet may under (or over) estimate the number of industry players, failures, etc The purpose of this data is to compare the relative volatility of comparable industries, not the absolute number of business entries, exits and failures. We also note that the information provided by Dun and Bradstreet goes to the number of businesses collapsing in each sector, but not the size of these businesses, another factor driving the amount of loss to creditors (including consumers). For information on Dun and Bradstreet data and methodology, including their approach to collecting data and the full results, see Appendix D.

A further difficulty is assessing the volatility of the travel agents industry, for the purpose of assessing the risk of consumer detriment, is that current market information reflects an industry in the presence of the existing licensing and compensation scheme. This scheme represents a substantial regulatory intervention and is expected by many to have markedly reduced the volatility of the sector. In order to assess the impact of the scheme, PwC has compared market data from the Australian travel agents sector with the limited information available from travel agents industries where these measures are not imposed: the Northern Territory and New Zealand. While imperfect, these comparisons nonetheless provide an indication of the impact of the regulatory scheme on industry volatility.

### Entries, exits and external administrations

Information on entries, exits and external administrations suggests that the travel agents sector, including its current regulatory regime, does pose a particularly high risk to consumers as compared to other industries.

Over the last four years, approximately 12 per cent of travel agent businesses exit the industry each year, compared to just seven per cent of businesses entering. While neither figure is particularly high (relative to comparable industries), it implies a net market exit, suggesting an industry in decline or undergoing consolidation.<sup>124</sup> Suggestions of a declining travel agents industry are supported by our analysis in previous chapters, and are shared by industry commentators, including IBISWorld.<sup>125</sup>

Exits exceeding entries (net market exit) is also common in other similar industries such as general contractors, hotels and motels, real estate agents and retail. However, the percentage of exits in the travel agents industry is slightly higher than most of these other industries, whereas the level of entries is very similar (see Table 3).

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<sup>124</sup> Dun and Bradstreet custom data.

<sup>125</sup> IBISWorld (2009), 'Travel agency services in Australia' (page 17).

**Table 3 – Volatility factors for travel agents and other comparable industries in Australia, averages across 2006-2009<sup>126</sup>**

Industry	Average percentage of businesses entering the industry	Average percentage of businesses exiting the industry	Average percentage of businesses entering external administration	Average percentage of businesses leaving the industry that go into external administration
Travel agents <sup>127</sup>	6.8%	12.2%	1.8%	16.1%
General contractors	5.4%	8.7%	2.3%	28.0%
Hotels and motels	7.7%	11.5%	2.2%	19.4%
Real estate agents	5.1%	9.2%	2.1%	24.8%
Retail	8.2%	12.4%	2.6%	22.0%

While exits and entries for an industry may be more of a reflection of the nature of that industry, more significant is the percentage of businesses that enter into external administration. External administrations are a superior indicator as they count businesses where creditors have not been paid in full. If external administrations are common, it means more businesses in that industry are experiencing financial problems that cause creditors, potentially including consumers, to experience financial loss. Therefore, it gives a better indication of the risk of consumer detriment.

The number of external administrations provides little evidence of the travel agents industry presenting a high risk to consumers, particularly relative to other similar industries. Over the last four years, 1.8 per cent of travel agents entered external administration each year (being 16 per cent of all businesses exiting the industry). This is lower than other similar industries in the country and perhaps is to be expected given the role of the TCF. General contractors, hotels and motels, real estate agents and retail markets all experienced over two per cent of business entering external administration (see Table 3). The percentage of market exits that involved external administration over that period was also higher than the travel agents industry; ranging between 19.4 per cent and 28.0 per cent, compared to 16 per cent for travel agents (see Table 3).

These results suggest that the potential loss to consumers from the travel agents industry is no higher than other comparable industries in Australia. In fact, the percentage of businesses that leave the

<sup>126</sup> Estimates based on Dun and Bradstreet custom data. For further information on the nature of the data, please see Appendix D.

<sup>127</sup> According to data provided by the TCF, from 2006 to 2009 an average of 8.3 per cent of businesses exited the market each year, with an average of 9.5 per cent of these entering into administration or resulting in claims to the TCF.

industry at the detriment to creditors is lower than similar industries. Interestingly though, it is not dramatically lower than the other industries and given the oversight of the TCF, the data suggests a question as to how volatile the sector would be without the TCF – this is considered below.

### Distress Probability

A further indicator of industry volatility, particularly where it adversely affects consumers, is the likelihood of financial distress in an industry. The distress probability is Dun and Bradstreet’s estimate of the risk of financial distress, being a change of control or forced business closure, based on a set of significant predictive factors. The average distress probability across an industry is estimated from individual business distress scores.<sup>128</sup>

If the probability of distress across an industry is high, it is perceived that businesses are more likely to go into external administration, potentially leading to financial loss for consumers. Averaged across the last four years in Australia, the distress probability for the travel agents industry is 2.39 per cent.<sup>129</sup> This is classified by Dun and Bradstreet as an ‘average’ level of risk, this being a distress probability between 1.37 and 2.52 per cent. This probability is higher than most other comparable industries, including hotel and motels, real estate agents and retail (see Table 4). These industries however, are also classified as posing an ‘average’ level of risk. The average distress probability for general contractors on single family homes is higher than for travel agents, with an average across the same period of 2.68 per cent, being a moderate level of risk.

**Table 4 – Industry average distress probabilities in Australia<sup>130</sup>**

Industry	Average distress probability for the period of 2006 to 2009	Relative risk level deemed by Dun and Bradstreet
Travel agents	2.39%	average
General contractors	2.68%	moderate
Hotels and motels	1.45%	average
Real estate agents	2.21%	average
Retail	1.96%	average

In conclusion, Dun and Bradstreet estimate the level of risk for travel agents in Australia under the current regime is ‘average’.

<sup>128</sup> See Appendix G for more detailed information on how Dun and Bradstreet estimate these probabilities and how they are interpreted.

<sup>129</sup> Dun and Bradstreet custom data.

<sup>130</sup> Ibid.

## Summary

The available evidence suggests that, under the current circumstances (including the current regulatory regime) the travel agents market is not particularly volatile relative to other comparable industries.

## Effects of the current regulatory environment on volatility

The foregoing analysis of the travel agents industry reflects the market in the presence of the current regulatory framework. It is difficult to ascertain whether, or to what extent, the current level of volatility and risk is a function of the regulatory framework and high level of industry oversight (including the actions of the TCF) or merely the nature of the industry. On the one hand, all stakeholders agree that the industry has improved markedly since the introduction of the TCF in the 1980s. However, the extent to which this improvement is attributable to the TCF and other regulatory measures (as opposed to other market developments) and whether or not such standards would decline in the event the TCF was disbanded are subject to question.

Industry's perceptions are not clear. Some industry stakeholders (including AFTA<sup>131</sup> and Choice) note the success of the TCF in reducing industry volatility. Choice believes that the TCF's prudential role has been successful:

*The twin purposes of that part of the regulatory framework within which the TCF sits are to (sic):*

- *to compensate consumers who deal with travel agents for loss*
- *to ensure only persons with sufficient financial resources carry on business as a travel agent*

*For these purposes the TCF has performed well.*<sup>132</sup>

Respondents to the PwC Travel Agents Survey were less certain. Only 44 per cent of travel agents believe the TCF has been effective in reducing the risk to consumers from travel agent insolvency, as compared to 39 per cent who consider it ineffective. Opinions are equally divided as to the extent travel agency bankruptcies would increase in the absence of the TCF; with 44 per cent saying 'little' or 'not at all', compared to 42 per cent saying 'somewhat' or 'a lot'. A small majority of travel agents (51 per cent) do however acknowledge that consumers' funds would be exposed to greater risk in the absence of the TCF.

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<sup>131</sup> AFTA submission (page 31).

<sup>132</sup> CHOICE submission (page 2).

Perhaps the best indicator however, can be taken from the travel agent industry in two jurisdictions where travel agents are not subject to the same degree of prudential oversight.

- Northern Territory. Travel agents in the Northern Territory are required to be licensed under the national scheme, but are exempt from compulsory membership of the TCF.
- New Zealand. Travel agents are not subject to any industry specific regulation. Instead, a self-regulatory model has developed through the Travel Agents Association of New Zealand (TAANZ). Membership to TAANZ is entirely voluntary. Members must participate in the TAANZ bonding scheme, which involves prudential oversight, the provision of a bond and periodic payments to cover a compensation scheme.

Although data on the Northern Territory travel agent market is very limited, stakeholders have informed PwC that over the past five years there have been no travel agent collapses. This suggests that the Northern Territory has much lower volatility in their market compared to the rest of Australia, especially in relation to potential consumer loss. Admittedly, the Northern Territory market may not be representative of Australia as a whole; the market is small and can more easily be monitored by consumer protection bodies. The Northern Territory also benefits from larger chains that are regulated in other states. It also has a high proportion of government and corporate travellers. While far from conclusive, the Northern Territory experience indicates the likelihood that the presence of prudential oversight does not substantially affect consumer risk.

Data on New Zealand suggests that their voluntary scheme has not resulted in high levels of risk for consumers. According to Dun and Bradstreet, an average of only three per cent of businesses entered and left the New Zealand market each year between 2006 and 2009; compared to the average of 12.2 per cent that exited the Australian market.<sup>133</sup> The percentage of travel agent businesses in New Zealand that went into administration each year was also low at around 0.7 per cent over the same period; although this represents 25.5 per cent<sup>134</sup> of travel agent businesses leaving the industry, compared to 16.1 per cent in Australia.<sup>135</sup> Therefore, Australia's travel agent industry has greater volatility than that of New Zealand, particularly with respect to the percentage of exits and external administrations. However, of those that exit in Australia, a much smaller proportion required external administration than in New Zealand.

In terms of their distress probability, the New Zealand travel agents industry poses a similar level of risk to the travel agents industry in Australia. The average probability of distress for the New Zealand

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<sup>133</sup> Dun and Bradstreet custom data.

<sup>134</sup> This figure only relates to 2008. Dun and Bradstreet were not able to provide data for the years 2006, 07 and 09, as there was insufficient data to derive suitable estimates.

<sup>135</sup> Dun and Bradstreet custom data.

travel agents industry is 0.0243, being slightly above but very close to that of Australia (see Table 4). Specific information on the Northern Territory is not available.

It is estimated over the last four years that an average of just under 70 per cent of New Zealand travel agents are members of TAANZ,<sup>136</sup> leaving around 30 per cent with no oversight and no compensation for consumers if they were to fail. Although it is hard to determine the composition of the agents not covered by TAANZ, the lack of higher volatility and consumer risk in New Zealand suggests that a reduction in regulatory oversight in Australia – in the form of prudential oversight and compensation – is unlikely to significantly increase the level of distressed businesses.

If the level of volatility and risk in Australia's travel agent industry is a direct consequence of the existing prudential oversight, then the removal of the TCF would be expected to increase risk to consumers. While admittedly imperfect, comparisons of Australia to the Northern Territory and New Zealand suggest that without such oversight the level of risk and external administrations would not be substantially different.

Although we cannot expect there to be no collapses, the evidence suggests that the level of business failure would not be unduly higher than today. In short, it is not clear to PwC that the claims that prudential oversight continues to be of great value to the sector remain true.

## Summary

While it is difficult to ascertain the extent to which the current low level of volatility in the travel agents market is due to the presence of the regulatory regime, there is little evidence to suggest that business failure would dramatically increase in its absence.

## Consumer behaviour in the absence of the TCF

At present, consumers have little incentive to satisfy themselves about the solvency of the travel agent business with which they engage or undertake other measures to protect themselves (such as purchasing via credit card).

If the regulation were to change then this could see an increase in the use of credit cards and reliance on charge-back as an alternative means of protection, albeit with the direct cost to agents in merchant fees which agents will seek to pass through to consumers. To the extent competition allows for that pass through, the consumers would pay directly for this protection. While it is likely that credit

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<sup>136</sup> A combination of Dun and Bradstreet custom data and the TAANZ Annual Report 2009, available at <http://www.taanz.org.nz/assets/Documents/TAANZ-Annual-Report-2009.pdf>.

cards are not currently widely used for this purpose in the Travel sector, for travel agent purposes there is no incentive to do so given the current rules.

It could also see a 'flight to quality', with consumers using more trusted and reliable businesses to mitigate the risk of insolvency. While large businesses do collapse (eg Ansett), their level of financial stress can be more easily observed by consumers, for example via media coverage drawing on ASX statements, ratings agencies and/or other market information.

## Carriage of monies

In their role as an intermediary, certain businesses in the travel industry (namely travel agents and, in some instances, tour wholesalers or operators) may receive monies intended for another party (eg an airline or hotel).

As part of their role coordinating and arranging a trip, that may involve purchasing services from a number of transport, accommodation and other travel services providers, travel agents may take carriage of a customer's money. Customers benefit from the convenience of making a single payment (or series of progress payments), while the travel agent are charged with distribution of the monies to the various third party service providers.

Under this scenario, travel agents, as the name is said to imply, are understood to act as 'agents' of the travel consumer – negotiating and entering into arrangements on the travellers' behalf.

Likewise, travel agents are said to hold customers' monies (or the proportion of that which is not to be retained by the agent) 'on trust' to pay the supplier; that is, the agent is never entitled to the money in their own right, but is obligated to pass such money on to a third party supplier. This can be contrasted with principal suppliers. These businesses receive payment in their own right and, should they need to make payments to third parties to fulfil their obligations to their customer, do so out of their own working capital. As a result, monies received from customers are typically held in the business' day-to-day account and used to pay day-to-day operating expenses.

It is important to note that these two concepts, acting as 'agent' and holding monies 'on trust', have quite specific legal and accounting definitions and carry with them specified implications and obligations for the relevant parties.

- *Principal-agent.* A principal-agent relationship, at law, refers to circumstances where the principal delegates or authorises another party (the agent) to act on their behalf, particularly in relation to legal or contractual matters. Importantly, an agent can enter into contractual arrangements that are legally binding on the principal.
- *Trustee-beneficiary.* A trustee-beneficiary relationship is one in which a person's property (the beneficiary) is held by another

(the trustee) subject to certain fiduciary obligations and conditions. Importantly, at all times the original owner retains beneficial ownership of the property. The trustee is required to act in good faith and in the interests of the trust, and cannot receive any benefits of the trust property. Furthermore, in the event the trustee declares bankruptcy, creditors are not entitled to the funds in the trust as beneficial ownership remains with the beneficiary.

While the nature of the travel agent's business displays some resemblance to a principal-agent and/or trustee-beneficiary relationship, at law and in accounting terms travel agents do not act as 'agents' of the consumer and may not hold money 'on trust'. Accordingly, the implications and obligations of trustee-beneficiary and principal-agent relationships typically do not apply (at law or in accounting) to travel agents and their customers.

The perception of a 'principal-agent' relationship may represent the historical role of travel agents as 'gate-keepers' to the travel industry. Developments in the industry (greater familiarity with travel, improved consumer information via the internet, for example) have meant that travel agents no longer play that role.

Rather, payments received by travel agents may be more accurately described as a fee for a service – where that service relates to the agent matching the consumer with the purchase of travel services. Granted, the consumer will be adversely affected if the agent's business fails before the travel services are paid for and provided to the consumer, but care is needed to ensure the true commercial relationship between consumer and travel agent is not confused.

### Client accounts

A commonly proposed solution (or at least mitigation of risk) is the practice of a travel agent 'quarantining' client funds in a separate bank account (known as a 'client account'). This practice is understood to protect customer funds (particularly those that are to be on-paid to a third party) by separating them from the funds a business utilises in its day-to-day operations. Such accounts may be analogous to client trust accounts maintained by, for example, lawyers or real estate agents; albeit without the legal and professional standards provision that accompany them.

The maintenance of separate client accounts by travel agents is not currently mandated, either by the relevant regulations or by the TCF. Prior to 1986, NSW travel agent regulations did require such accounts to be maintained, however these requirements were not adopted by the introduction of the National Scheme.

Notwithstanding, maintaining separate client accounts is relatively common amongst travel agents – with 39 per cent of travel agents maintaining such accounts.<sup>137</sup> This popularity can be explained by:

- the TCF's capital adequacy rules (discussed at 2.2), under which maintaining a client account earns 'four points', contributing to a business satisfying the financial criteria
- the fact that many stakeholders consider the maintenance of client accounts to be good business practice.

In principle, a separate client account (properly maintained) mitigates, to some degree, the risk to consumers of financial loss in the case of business insolvency. Arguably, quarantining funds allows businesses to have better oversight of their financial situation and to ensure they retain sufficient funds to pay travel suppliers for travel booked with them. For this reason, some stakeholders consider compulsory client accounts to be a reliable consumer protection mechanism.<sup>138</sup>

It is important to note, however, that in most cases the presence of a separate client account does not give customers priority against other creditors in the case of a business becoming insolvent. As monies held in trust accounts are not held 'on trust', in the legal sense, such funds form part of the business' general asset pool from which all creditors are paid.

Furthermore, possessing separate accounts does not protect consumers against fraud or other misconduct by business owners or managers. It is unlikely that parties seeking to misappropriate funds will be prevented from doing so merely because such funds are in different accounts. It should also be noted that compliance with the TCF's client account rules by those who maintain them is not good. In 2009, approximately 70 per cent were not maintained in accordance with the TCF's requirements.<sup>139</sup> In addition, holding funds in a client account provides no guarantee that consumers' funds will not be lost. This is indicated by the fact that client accounts were being used by 30 per cent of travel agents that collapsed and resulted in claims to the TCF.<sup>140</sup>

Accordingly, maintenance of a client account without the ability to ensure 100 per cent compliance provides little assurance against the risks associated with the carriage of monies by travel agents.

## Prepayments

Another peculiarity of the travel industry, in particular in relation to international travel and/or complex travel products (such as tours), is

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<sup>137</sup> Information provided to PwC by Travel Compensation Fund.

<sup>138</sup> For example, see Goronwy Price's submission (page 2).

<sup>139</sup> Travel Compensation Fund (2009) Annual Report.

<sup>140</sup> Information provided to PwC by Travel Compensation Fund.

the prevalence of prepayments being required. Travellers are commonly required to book their trip some time in advance, often several months prior to the departure date. Bookings are commonly associated with payment of deposits, instalments and settlements prior to departure date. Consequently, monies may be held by travel agents or received suppliers well in advance of the services being delivered.

The length of time travel agents typically hold monies prior to the services being provided is not known with certainty. Industry stakeholders suggest that prepayment periods are becoming shorter, driven by the availability of electronic payment methods. For example, FarSight Travel commented:

*Gone are the days when you could travel now and pay later. With the advent of self-booking engines on the internet the industry in Australia is very much “pay now and travel tomorrow”.*<sup>141</sup>

These sentiments were shared by many participants in PwC’s industry discussion forums. Other stakeholders however, for example Choice,<sup>142</sup> expect that consumer funds are still held for substantial periods of time.

Respondents to the PwC Travel Agents Survey suggested that funds are held, on average, for approximately two weeks (14 days) prior to being used to pay suppliers. Consistent with these estimates, information provided by the Annual Financial Returns submitted to TCF report that for most participants (over 60 per cent) the client funds are held, on average, for less than 15 days. A considerable portion (30 per cent) do, however hold funds, on average, for more than 30 days.<sup>143</sup>

These figures may however disguise the possibility of funds being held for a substantial period of time in certain occasions. For example, payments relating to a minority of more complex or longer international travel may be held for substantial periods while simple transactions are paid for nearer to the departure date. TCF note that in more than 60 per cent of cases where it is required to compensate consumers, prepayments have been held by the insolvent businesses for more than 60 days.<sup>144</sup>

## Possible detriment to consumers

Historically, many stakeholders have perceived a travel purchase as being akin to buying a house or car; that is, the purchase represents a major, possibly ‘once in a lifetime’, expenditure. Such purchases,

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<sup>141</sup> FarSight Travel submission (page 1).

<sup>142</sup> Choice submission (page 5).

<sup>143</sup> Information provided to PwC by Travel Compensation Fund.

<sup>144</sup> Ibid.

so the argument goes, are of such an extraordinary nature to consumers that losses from business insolvency represent significant consumer detriment to the particular individual concerned. Accordingly, while the absolute quantum of total losses from this risk and/or the systemic importance of the industry may not be great, regulatory protection against such losses may nonetheless be warranted. However, given the declining relative prices of airlines and increased frequency of travel, such comparisons seem unfounded.

Governments have considered purchases of houses or motor vehicles from real estate agents or car dealerships to be unique purchases that warrant regulatory protection. Regulatory schemes have been imposed on these industries that, similar to the scheme applicable to travel agents, compensate consumers in the event their payment is lost, for example due to business failure. These schemes are described in Table 5.

**Table 5 – Compensation schemes in other industries**

**Real estate agents**

Estate agent indemnity funds provide financial compensation for people who lose money through the wrongful actions of a registered land agent or conveyancer (or their employees). Such schemes are typically state based, but operate in all Australian states.

Income for the fund comes primarily from interest generated from real estate agent and conveyancer trust accounts. These funds are required by law to be held on trust and, therefore, are held in designated accounts.

Compensation can be claimed by persons or companies who suffer monetary loss because of a fiduciary default of trust money. A fiduciary default can include when money is not accounted for properly, is wrongfully deficient owing to a breach of trust, stolen or misappropriated or when money is put to a different purpose than that which it is entrusted. In most cases, the full amount lost can usually be claimed from the fund.

Claims cannot be made simply because the estate agent or conveyance acted unprofessionally or gave bad advice. A breach of the agent's fiduciary duty, as a trustee, is required.

### Motor car traders

Motor car traders guarantee funds compensate a person (other than a trade owner) who suffers financial loss in connection with the purchase of a motor vehicle. The loss must arise from a licensed motor vehicle dealer failing to comply with the law, or from a licensed motor vehicle dealer failing to pass unencumbered title to the vehicle.

The funds are typically made up of money received from fees for licensing motor car traders and penalties paid for breaches of the law.

Examples which may give rise to claims covered by the funds include where a motor vehicle dealer:

- tampers with the odometer
- gives false and misleading information in a notice attached to a motor vehicle
- sells on consignment without written authority
- fails to repair a non exempt defect under warranty
- does not transfer good title to the motor vehicle
- does not deal with trust money in the prescribed way, such as not following the direction of the principal.

Purchases of real estate or new motor vehicles are substantial purchases. According to Australian Property Monitors, in December 2009 median house prices for Australian capital cities ranged from \$427,000 to almost \$600,000.<sup>145</sup> New motor vehicles, while less expensive, are nonetheless still major purchases; typically amounting to tens of thousands of dollars. Given the size of these purchases they are typically infrequent and, in some cases, 'once in a lifetime' events.

Some stakeholders consider the purchase of travel products to be akin to a home or motor vehicle purchase however most evidence suggests that this is not the case. Firstly, the perception could only be valid in relation to international travel products, as domestic travel rarely represents a household purchase of that magnitude. For more than 80 per cent of travel agents the average domestic travel product sold is less than \$2,000. This is likely to overstate the average domestic travel purchase, as travellers are less likely to use a travel agent for small purchases. Importantly, current consumer protection measures do not distinguish between domestic and international travel.

Even for international trips, the importance and unique nature of an international trip is diminishing. As outlined in the previous chapter, declining relative prices of international travel combined with the growing household income have made such travel increasingly accessible to Australian travellers. International travel by Australians has grown remarkably over the past two and a half decades. Australians today make four times as many short term overseas

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<sup>145</sup> Australian Property Monitors (2009) 'Home Price Guide'.

departures than they did 25 years ago, and almost 80 per cent more than they did 10 years ago.<sup>146</sup>

International travel purchases may still represent significant purchases for Australian consumers. For almost half of Australian travel agents, the average purchase is greater than \$4,000; for more than 80 per cent the average price exceeds \$2,000. Nonetheless, these values are not akin to new house or car purchases. Rather, such purchases represent more common and 'ordinary', albeit still significant, purchases.

It is important to note that there are many comparable purchases households may make for which government has chosen not to mandate a compensation scheme. An average purchase of a few thousand dollars makes travel purchases more similar to, say, home appliances (eg whitegoods), electronics (eg personal computers) or insurance. Indeed a number of recent collapses in these markets highlight government's decision not to intervene despite losses to consumers. These examples are summarised in Table 6.

**Table 6 – Financial collapses in other comparable industries**

**Kleenmaid Group – Whitegoods and appliances**

The Kleenmaid group, a large whitegoods and appliance manufacturer, went into voluntary administration in April 2009 and was subsequently wound up by creditors. The collapse affected thousands of customers who had paid deposits or the full cost of kitchen and laundry products that were never delivered.

Kleenmaid's cash-flow problems stretched back at least two years, with the group having a net asset deficiency of \$20 million in June 2007, according to a report by the liquidators. At the time of winding up, liquidators concluded that the group had a net debt of at least \$82 million.

Up to 6,000 customers were owed as much as \$27 million, with average outstanding claims of some \$4,500 per customer. These customers were ranked as unsecured creditors and therefore did not receive full refunds on their deposits. Customers who owned Kleenmaid goods were told warranties will not be honoured.

The Compass Capital Group has since acquired the Kleenmaid brand and Kleenmaid products are now sold by its subsidiary, Compass Capital Services Pty Limited (trading as Kleenmaid).

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<sup>146</sup> ABS (2010) 'Overseas Arrivals and Departures, Australia' (3401.0).

### **HIH Insurance Group – Insurance**

The HIH Insurance Group (HIH) was placed in provisional liquidation on 15 March 2001. The subsequent suspicions about a serious level of corporate mismanagement within HIH saw the appointment of a Royal Commission in August 2001.

HIH wrote many types of insurance in Australia, the USA, and the UK. In Australia, this included compulsory insurance (such as workers' compensation and compulsory third party motor vehicle) and non-compulsory insurance (such as home contents and travel insurance).

According to the HIH 2000 Annual Report the company had gross premium revenue of \$2.8 billion, total assets of \$8.0 billion, total liabilities of \$7.1 billion, with net assets of \$900 million.

The Royal Commission did not find fraud or embezzlement to be behind the collapse. The primary reason for the failure was mismanagement in the area of its core business activity. Adequate provision had not been made for insurance claims and past claims on policies had not been properly priced.

Overall, the Royal Commission referred 56 possible breaches of the Corporations Law and the NSW Crimes Act 1900 to the Australian Securities and Investments Commission (ASIC) and to the NSW Director of Public Prosecutions for consideration.

Interventions by Federal and State governments included:

- the New South Wales Government creating an emergency \$50 million package to compensate motor accident victims and home owners affected by the collapse
- the Commonwealth Government fast-tracking legislative changes to the general insurance industry to improve capital adequacy
- the Victorian Government creating a \$35 million rescue package for home-owners affected by the HIH collapse

the Commonwealth Government creating a package worth more than \$500 million to assist those people in hardship as a result of the collapse of HIH.

### **Clive Peeters – Whitegoods and appliances**

In May this year, whitegoods retailer Clive Peeters entered into voluntary administration having accumulated approximately \$160 million in debt. A publicly listed entity, Clive Peeters' shares were suspended from trading after the company revealed it was in discussions with its financiers. An external administrator has since been appointed.

Clive Peeters' financial report for the six months to December 31 2009 showed the company had total debt of \$160 million, while revenue fell 5.32 per cent during the period to \$252.5 million and the company posted a loss of \$424,000.

It is understood that the business suffered from a deteriorating retail market, due in part to rising interest rates and the fading impact of the Government's stimulus payments. It is expected the receiver will shut down unprofitable stores and attempt to sell the profitable ones, with Harvey Norman and JB Hi-Fi seen as the likely buyers.

### **Storm Financial – Financial planning**

Storm Financial, a Townsville-based financial planning group, was placed in voluntary administration in early 2009 after key lender Commonwealth Bank called in a \$10 million loan. Storm's collapse placed the savings of the company's 13,000 clients in doubt.

The company had grown quickly in recent years and claimed to have around \$4.5 billion in funds under advice. However, the crisis on financial markets hit the company hard, and in late 2008, fund manager Colonial First State (which is owned by CBA) terminated its four Storm-branded index funds and began hitting Storm clients with margin calls.

Many Storm clients lost the bulk of their life savings after following Storm's investment philosophy, which involved the use of margin loans to "amplify" investment returns. The massive fall in financial markets at the time meant that many Storm clients were heavily in debt due to the margin calls.

The Australian Securities and Investments Commission launched an investigation into Storm and the Financial Planning Association conducted its own inquiries into the collapse of the company. The investigation covers a range of issues, including investment home lending, margin lending and related advice. This investigation is still continuing.

Each of the examples above involved collapses of businesses resulting in financial loss to consumers. Importantly, despite government intervention of various kinds, for the most part governments did not see fit to compensate all consumers who suffered loss even though substantial individual outlays may have been involved. For example, the average consumer loss from the Kleenmaid collapse (\$4,500 per customer) is at least comparable to typical outlays on international travel purchases.

In addition, notwithstanding the ongoing review and policy considerations following the Storm Finance collapse, governments have also not seen fit to impose a compulsory industry compensation scheme or regulatory prudential oversight measures in the industry.

### Summary

While prepayments and the carriage of monies remains common in the travel agent market, these arrangements do not differ in their commercial nature from many similar arrangements in other industries.

While the loss of consumer funds can and does occur when businesses collapse, in most case the public sector does not intervene; either to specifically compensate consumers or to implement an overarching compensation or insolvency protection scheme.

The risk of consumer detriment in the travel agents market is not substantially greater than many industries where such substantial government intervention was not deemed appropriate.

## 4 The effectiveness of the existing travel agents regulatory regime

### Key messages

There is a broad perception that, on the whole, the National Scheme (including the licensing and compensation scheme arrangements) has succeeded in improving the standards and reliability of the travel agents sector.

The National Scheme has not, however, kept pace with important developments in the sector over the past 25 years and, accordingly, is outdated and no longer fit to achieve key consumer protection objectives in the current market environment.

The licensing scheme imposes some conditions on travel agents (eg mandatory training) that are costly yet without providing significant consumer benefit. The valuable elements could be retained by a less onerous scheme.

The compensation scheme is unduly burdensome relative to the risk of consumer detriment from travel agent collapses. It represents a disproportionate regulatory response considering the relative economic and systemic importance of the industry.

Whether the scheme is valuable from a cost-benefit perspective depends on the degree to which the risk of travel agent collapse would increase in the absence of the prudential oversight. There is little evidence to suggest this effect will be substantial and a six-fold increase in lost funds is required for the scheme to 'break even'.

Specific conduct requirements appear to offer little in addition to the generic consumer law provisions. Industry-specific enforcement measures are valued and could be retained under a less onerous registration scheme or under the Australian Consumer Law.

As discussed in the foregoing chapter, although not clearly defined in legislation, the key objectives of the regulatory regime for travel agents are understood to be to protect consumers from:

- inadequate service from travel agents (with a focus on incompetence on behalf of the travel agent) – primarily the focus of the licensing scheme and its entry and conduct requirements

- financial loss arising from the failure of travel agencies to account for monies deposited with them – the function of the compensation scheme and the TCF.<sup>147</sup>

The benefits of the scheme therefore relate to the ability of the existing measures to achieve these objectives and thereby improve consumer outcomes.

The costs of the scheme relate primarily to the regulatory burden placed on businesses to comply with the licensing and compensation schemes. These costs include:

- financial costs – licensing fees, membership fees and upfront contributions to the TCF
- administrative costs – employee time on completing forms and other compliance matters and fulfilling training requirements
- other compliance costs – preparing audited accounts or obtaining securities
- other imposts on business – holding certain capital reserves.

## 4.1 Licensing scheme

With some notable exceptions, industry is broadly supportive of some form of entry regulation in the travel agents sector, with few stakeholders suggesting the complete removal of entry restrictions. According to the PwC Travel Agents Survey, 80 per cent of travel agents considered the entry requirements to be somewhat or very important to protecting consumers from the major consumer protection risks in the travel industry.

Notwithstanding this support, industry representatives have criticised the scheme in its current form.<sup>148</sup> Only 37 per cent of travel agents thought the current arrangements were effective at achieving its consumer protection aims and some parties, such as AFTA<sup>149</sup> and ATEC,<sup>150</sup> have proposed reform to the scheme.

The current travel agents licensing regime is aimed at achieving four outcomes:

- ensuring participants fulfil certain minimum criteria related to establishing their *bona fide* nature (eg greater than 18 years of age, fit and proper person, not previously disqualified from holding a licence) and disclose certain business details

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<sup>147</sup> Centre for International Economics (2000), 'National Competition Policy review of the National Scheme for the Regulation of Travel Agents'.

<sup>148</sup> See, for example, the submissions of Flight Centre Limited, FarSight Travel, and Ms Goronwy Price.

<sup>149</sup> AFTA submission.

<sup>150</sup> ATEC submission.

- ensuring a minimal standard of competence via training and/or experience requirements
- collecting revenue to fund compliance and enforcement activities by the relevant authority
- mandating participation in the compensation scheme.

## Licensing criteria

Minimum criteria for licensing are a relatively inexpensive means of regulating entry into the travel agents market, imposing relatively minor administrative costs on business while enabling licensing authorities to easily and efficiently impose and enforce regulations.

The cost of these requirements relate to the time taken by a travel agent (or their employee) to complete the required paper work and other tasks to comply with the scheme. According to the PwC Travel Agents Survey, for the majority of businesses (60 per cent) complying with these matters takes four hours or less of staff time; implying a cost (in employee time) of no more than \$100 per annum. On the other hand however, a small but considerable proportion (15 per cent) spends more than 30 hours per annum, a cost of almost \$800 per annum per business. PwC estimates that compliance with licensing requirements (other than fees and training) costs the sector between \$250,000 and \$300,000 per annum.

These costs can, however, be compounded by the requirement to be licensed in each state and territory in which the business has a physical presence and other update requirements (for example, notifying the relevant authority of changes to key personnel or of short term changes in location). These additional costs provide little value in terms of consumer protection and, as such, should be minimised. However, the extent of these costs is not well known. Only nine per cent of respondents to the PwC Travel Agents Survey were licensed in more than one jurisdiction, only five per cent in more than two. However, it is the largest players who need to be licensed across jurisdictions, in a market where there is considerable consolidation. Larger players are also likely to have greater staff turnover; further exacerbating administrative costs.

A further issue with respect to these requirements is the potential duplication of these measures by the requirements of the TCF. The majority of travel agents (65 per cent) believe that licensing requirements are duplicated to some degree by the membership requirements of the TCF.

## Training requirements

Enforced training participation is arguably the most onerous on business. A typical training course that meets the training

requirements costs approximately \$800,<sup>151</sup> although travel agents report spending approximately \$2,000 per course.<sup>152</sup> According to travel agents, these courses require approximately 50 hours to complete (a cost of more than \$1,200 in staff time) and an average of 2.3 employees per business are required to have met these requirements. Using the more conservative cost estimate (\$800), PwC estimates the total economic cost at \$14.4 million.<sup>153</sup> Annually, staff turnover in the travel industry can be as much as 30 per cent;<sup>154</sup> suggesting an annual training cost of \$4.3 million.

Importantly, the training requirements seem poorly suited to achieve consumer protection outcomes. The nature of the training courses is essentially practical; dealing with the mechanics of booking and selling international flights. The courses merely ensure the licensed travel agent (or designated manager) is competent in the basic skills necessary to sell international travel.

These training requirements have not kept pace with the changing needs of industry which have rendered them obsolete or unnecessary, depending on the agent's business model. Travel agents who sell international travel may do so via two possible means:

- issuing tickets directly – for which accreditation with IATA and the licensing of ticketing software is required
- purchasing tickets from a ticket consolidator.

Under the first model, practical training (of the type provided by the required training units) is essential. Tickets simply cannot be issued without adequate skills and know-how. For this reason, most stakeholders consider it likely that these businesses will undergo (or require their staff to undergo) equivalent or superior training even in the absence of regulation. This is reflected in an average of three staff members completing the training where only an average of two are required to do so.<sup>155</sup> In addition, 60 per cent of respondents to the PwC Travel Agents survey said they would undertake similar training even if it were not formally required by regulations.

Under the later model, for those who purchase tickets via a consolidator, practical knowledge of international flight bookings is not necessary; these services are performed by the consolidator. In either case, there appears little risk of consumer detriment from business incompetence.

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<sup>151</sup> Advertised price for qualifying training course provided by Hayton College.

<sup>152</sup> PwC Travel Agents Survey.

<sup>153</sup> Please note, unlike many others this is not an ongoing annual cost. Training requirements need only be completed once by each employee and, hence, this cost is only incurred on the start-up of the business or due to staff turnover.

<sup>154</sup> Estimates provided by industry stakeholders during discussion forums.

<sup>155</sup> PwC Travel Agents Survey.

More importantly, the mandated training does not properly equip travel agents and address major consumer protection risks. While the majority of travel agents (54 per cent) acknowledge a significant risk to consumers of poor or incompetent service by a travel agent, most (53 per cent) believe the training requirements are somewhat or entirely ineffective in providing such protection. Only 18 per cent consider the training requirement somewhat or very effective at achieving consumer protection outcomes. This view is supported by many industry stakeholders.<sup>156</sup> It was also noted in the 2000 National Competition Policy Review.<sup>157</sup>

The compulsory training seems designed for the previously discussed 'gatekeeper' role of travel agents, ensuring travel agents are competent to book and schedule flights. Developments in the market, in particular the ability to transact direct with most suppliers, have changed the nature of the service consumers seek from travel agents and, accordingly, the necessary skills for the agent.

Relevant skills/services may include expert knowledge of locations and the ability to facilitate complex trips or provide travel support.

Finally, we note that poor service by travel agents does not constitute a major consumer protection concern as reflected in complaints to consumer affairs organisations. In most jurisdictions, travel agents account for less than one per cent of complaints received, and there is no evidence compulsory training is minimising these issues.

In conclusion, PwC considers there to be little value to consumers in mandating training requirements, which come at a significant cost to business.

## Revenue collection

Licensing authorities collect revenue from industry to finance the administration of the scheme and compliance and enforcement activities by the relevant body. Revenue collection via this mechanism is appropriate, as costs incurred by government in relation to a particular industry are funded by that industry and, therefore, reflected in the business' cost structure.

At present, licensing fees range between \$50 and \$750 for initial application and between \$55 and \$600 for annual renewal, depending on the state in which the business is licensed. Further costs are payable for additional branch locations, processing fees and penalties (eg late submission of forms). PwC estimates that

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<sup>156</sup> For example, see the submissions of Australian Travel Education Pty Ltd and Ms Goronwy Price.

<sup>157</sup> Centre for International Economics (2000), 'NCP review of the National Scheme for the Regulation of Travel Agents' (page 20).

annual licensing fees total \$1.4 million (broadly consistent with the TCF's estimate of \$1.6 million<sup>158</sup>).

Given our comments above, particularly in relation to the training requirements and the duplication of requirements across states and between the licensing bodies and the TCF, there appears scope for a reduction in these costs by consolidating the licensing regime (nationally) and incorporating it with the administration of any ongoing compensation scheme.

Some government stakeholders have voiced concerns about the loss of revenue (from licensing fees) that might occur if such reforms were adopted. It is understood that funds raised from fees may support other important activities of these agencies. In this respect, two matters should be considered:

- whether it is appropriate to collect revenue in this manner – rather than funding such activities out of consolidated revenue or specific fees or levies on other industries
- whether revenues can be collected from other sources – such as other targeted fees or increases in existing levies.

At the very least, alternative sources of funds may be needed if state regulations are to appropriately oversight the travel industry under their respective Fair Trading Acts.

### Mandating participation in a compensation scheme

The licensing scheme is also the mechanism by which the requirement to participation in the industry compensation scheme is imposed. It should be noted that this can be achieved without a licensing scheme, either through direct regulatory obligations or a less onerous registration scheme. Accordingly the benefits of achieving this objective are marginal.

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<sup>158</sup> Information provided to PwC by Travel Compensation Fund.

### Summary

The current travel agents licensing scheme generates little consumer benefit compared to the more significant costs imposed on businesses, and likely borne partly by consumers. The costs associated with licensing include:

- administrative compliance (between \$250,000 and \$300,000 per annum in staff time) – noting that this may be compounded by businesses who are licensed across multiple states
- mandated training courses (estimated total cost of \$4.3 million per annum)
- licensing fees (\$1.4 million per annum).

There is little consumer benefit from licensing other than ensuring participants are of a *bone fide* nature. Licensing can therefore be replaced by a less onerous scheme that removes training and competency requirements and retains minimal registration requirements, including a fit and proper person test.

## 4.2 Compensation scheme

Amongst stakeholders the effectiveness and appropriateness of the travel agents compensation scheme is the most contentious component of the regulatory framework.

On the one hand, both industry and consumers appear to value insolvency protection. The majority of travel agents (59 per cent) view travel agent insolvency as a significant risk to consumers. An even larger proportion (83 per cent) considers insolvency protection an important measure to protecting consumers from the major consumer protection risks in the travel industry. Consumers also place considerable value of the protection afforded by the compensation scheme. The PwC Consumer Survey estimates that consumers would be willing to pay up to \$60 on a \$1,000 purchase (6 per cent of purchase price) for this protection. This is reflected in more than 40 per cent of consumers viewing travel agent insolvency as a significant risk (see Box 2).

Consumers, for the most part, are unaware of the TCF's existence and therefore are unlikely to have strong opinions concerning its effectiveness, even if they do value 'being protected'. In fact the conclusion from the willingness to pay survey (see above) is that consumers value the protection afforded by the scheme (ie not losing their money). They do not necessarily however value the current regulatory regime, as the only consumers who indicated that they knew what the TCF does (three per cent) had either used or knew someone who used the TCF.

On the other hand, few stakeholders consider that the scheme, in its current form, is appropriate for the current market environment.

#### Box 2: Consumers' willingness to pay for insolvency protection

PwC conducted a willingness-to-pay study, with the assistance of TNS Australia, to estimate the value consumers place on the protection from financial loss from travel agent insolvency. The study was a discreet valuation exercise; that is, directly asking consumers how much they would be willing to pay. Details of the study, and the associated consumer survey, are provided in Appendix E.

The study used three approaches. Firstly, consumers were provided with no information as to the current level of risk. Secondly, consumers were provided with, in percentage terms, the proportion of funds paid to travel agents in Australia that are lost due to business insolvency.<sup>159</sup> The same question was then asked with this proportion steadily increasing, up to 15 times the current level. Finally, consumers were asked their willingness to pay extra for this coverage in the context of a typical travel insurance product that does not include this protection (estimated cost \$150).

In each case consumers were asked what amount they would pay in the context of a \$1,000 travel purchase. The results were as follows:

- Uninformed \$57.76 (5.8% of total fare)
- Informed \$29.81 (3.0%)
- Raised proportion \$33.50 (3.4%)
- Additional to travel insurance \$26.12 (2.6%)

The results suggest consumers place a relatively high value on this form of protection, given expected loss (based on retail travel agent gross revenue and the value of claims paid) is just \$0.30 in every \$1,000. Importantly, consumers' value drops markedly when informed of the level of risk and when asked in the context of the typical cost of a travel insurance policy.

These results are an indication of the value consumers place on avoiding financial loss in this context. They need however to be interpreted with care. The results reflect a point estimation for a potential loss of \$1,000. This value may differ for significantly larger or smaller purchases.

Travel agents appear generally willing for change, with only 45 per cent viewing the scheme as providing effective consumer protection and only 13 per cent thinking there should be no change

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<sup>159</sup> This value was estimated based on 2009 values for total retail travel agent gross revenue and the value of claims paid by the TCF. This information was provided by the TCF.

to its scope. Given the changes in the industry, FarSight Travel commented on the appropriateness of the TCF:

*the TCF had a role to play some years ago when there were any number of questionable schemes and companies operating in Australia's travel industry but that time had (sic) passed.<sup>160</sup>*

Similarly, the Queensland Tourism Industry Council made the following comment:

*QTIC acknowledges the flaws in the current Travel Compensation Fund (TCF) model, which was designed to deal with a situation where travel agents were more prevailing participants in the travel services industry. The current market place – where an increasing number of consumers are dealing directly with suppliers and paying for travel electronically – has made some aspects on the TCF model obsolete.<sup>161</sup>*

As outlined in the foregoing chapter, the scheme has two broad components: prudential oversight and consumer compensation. It is important to distinguish between the two functions as policy recommendations may differ if prudential oversight or compensation is considered more or less important than the other. It may also be possible to separate the two roles and/or maintain only one component, where appropriate.

## Prudential oversight

While in principle, under the terms of the TCF's trust deed, the prudential oversight function is incidental to the operation of the compensation (ie focussed on limiting the liability of the scheme by ensuring only businesses with sufficient resources are participants in the fund), this function has become increasingly important. Stakeholders, including the TCF, consider this function to be important in improving the stability of the industry and the solvency of its participants; it is not merely for the purposes of reducing the TCF's exposure but also for the well being and long term benefit of the industry.

Accordingly, the potential benefits of this function include:

- reducing the risk of travel agency insolvency – limiting the financial loss to consumers, and consequently, the TCF, and other creditors
- promoting consumer confidence in the travel agent market and the tourism industry more broadly

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<sup>160</sup> FarSight Travel submission (page 1).

<sup>161</sup> Queensland Tourism Industry Council submission (page 2).

- providing a form of accreditation – that is, membership in the TCF testifies, to some degree, to the business' solvency and *bona fide* nature.

### Reduced industry volatility

PwC's analysis of business data relating to market entries and exits, insolvencies and estimates of risk profiles is contained in the foregoing section (see 3.2). Our conclusion was that while there is a broad perception that the TCF's prudential oversight has improved the financial volatility of the industry as compared to prior to its introduction, there is little evidence to suggest that a dramatic increase in business failures would occur in the absence of the regime today. However, it is important to acknowledge this conclusion is based on imperfect comparisons and consideration of a possible situation that does not presently exist.

### Consumer confidence/accreditation

An important observation, acknowledged by the TCF, AFTA and other stakeholders, is that consumers are, for the most part, unaware of TCF or the protection it affords. The PwC Consumer Survey suggests that only 14 per cent have at least some awareness of the TCF, with only three per cent having a good understanding of the fund and its functions. This finding is supported by the perceptions of travel agents. Few travel agents (13 per cent) expect consumers to have any awareness of the TCF.

As a consequence, many stakeholders, including 67 per cent of travel agents, expect the TCF does little to improve consumers' confidence in the industry. This may understate the TCF's impact however; consumers may be unaware of the TCF but, similarly, are unaware of examples of consumers losing their funds due to travel agent bankruptcy.<sup>162</sup> Such examples are not commonly reported in popular press or current affairs programs, which might otherwise be the case if such persons were not compensated by the TCF. As a result, consumers' perception of the industry may be indirectly improved by the TCF's presence.

It is possible that this outcome of the scheme disproportionately benefits smaller businesses. Consumers are unlikely to value assurances of solvency for larger businesses, which are already subject to substantial market supervision.

In any event, this benefit does not, in itself, provide adequate justification for a scheme of this magnitude. A similar benefit of the scheme could be achieved by a less onerous accreditation scheme, similar to that envisaged by other parts of the tourism industry.

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<sup>162</sup> The PwC Consumer Survey found that only three per cent of consumers had personally, or knew someone who had, been compensated by the TCF.

## Costs

Industry consistently comments on the financial and administrative burden the TCF's prudential supervision function imposes on their business. These costs include:

- administrative compliance such as the completion of required paper work or other tasks
- financial cost of membership (discussed below)
- costs incurred in the preparation of audited financial accounts for the TCF (referred to as 'Annual Financial Review')
- costs provided requiring securities (such as bank guarantees)
- the opportunity cost of holding additional capital reserves.

Compliance with the TCF's administrative requirements is more time-consuming than the respective licensing obligations, taking an average of 41 staff hours annually (an estimated cost of over \$1,000). PwC estimates the total economic cost of these activities at approximately \$3.2 million per annum.

Preparing audited accounts typically involves a financial outlay to pay for the external auditor. In some cases, such as publicly listed companies, audited accounts may already be required of the business. For smaller businesses however this may represent an additional cost. According to the PwC Travel Agent Survey, 54 per cent of travel agents incur additional costs in relation to the preparation of accounts; that is, in addition to the auditing expenses they would otherwise have undertaken. The median quantum of this cost was \$3,000.<sup>163</sup> Accordingly, PwC estimates the total cost of this requirement at \$4.8 million per annum.

In addition to financial and administrative costs, the TCF also imposes financial adequacy obligations on businesses, intended to ensure businesses have sufficient capital to operate in the industry. The level of capital required depends on the level of activity (gross revenue, overheads, etc) of the business. Holding capital is not costless, having to be injected by business owners or raised on capital markets. Accordingly, 47 per cent of travel agents feel that the TCF's capital requirements restrain their business' operations. In this regard, Flight Centre made the following comment:

*When the financial criteria are applied to large entities the multiplier effect leads to some perverse results<sup>164</sup>*

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<sup>163</sup> The median result was chosen in this instance, due to a small number of high results. According, this estimate should be considered conservative.

<sup>164</sup> Flight Centre submission (page 3).

The TCF's financial adequacy rules apply a points system, described in the previous chapter. Under this system, businesses have two broad ways of satisfying the criteria:

- retaining sufficient working capital
- obtaining security, in the form of a bank guarantee or insurance.

Essentially therefore businesses can choose, either to increase their capital holdings to satisfy the capital adequacy tests or obtain a guarantee. Businesses are expected to choose their preferred option based on the relative cost of each.

According to the TCF, 852 travel agents businesses have been required to obtain securities worth a total of \$95.6 million.<sup>165</sup> While incurring these costs is a choice made by the business, they nonetheless reflect a cost of the scheme. Businesses choose to incur this cost rather than altering their capital structure; a measure which the business considers more costly. In the absence of the scheme, neither cost would be incurred. The TCF suggests these guarantees cost are approximately 2.6 per cent of the principal per annum.<sup>166</sup> Therefore PwC estimates the total cost of these measures at almost \$2.5 million per annum.

At the same time, the PwC Travel Agents Survey suggests that 32 per cent of travel agents altered their capital structure to comply with the TCF's financial requirements. Flight Centre suggested that, in the context of the travel industry:

*Financial criteria should not impede companies from adopting a capital structure appropriate for them.*<sup>167</sup>

Again, while these costs represent a choice of the business, they are nonetheless appropriately considered a cost of the scheme, being a cost that would not otherwise be incurred. Survey respondents suggested that they held an average of almost \$70,000 in additional capital and reserves to satisfy the TCF's financial criteria; that is, capital reserves in excess of what they would otherwise hold. Accordingly, based on a standard weighted average cost of capital of nine per cent, PwC estimates the annual cost of these restrictions (as measured in terms of opportunity cost to industry) at \$6.0 million.

Accordingly, PwC estimates the total cost of the prudential supervision arrangements under the scheme to be \$16.5 million annually.

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<sup>165</sup> Information provided to PwC by Travel Compensation Fund.

<sup>166</sup> Ibid.

<sup>167</sup> Flight Centre submission (page 4).

## Summary

The costs of prudential oversight are significant, including

- administrative compliance activities (estimated at \$3.2 million per annum)
- the provision of securities (estimated at \$2.5 million per annum)
- preparation of audited financial accounts (\$4.8 million per annum)
- the retention of excess capital reserves (\$6.0 million per annum).

Accordingly, PwC estimates the total cost to businesses at \$16.5 million annually. The benefits of prudential oversight are unclear, as there is little evidence that industry volatility would increase markedly in its absence.

## Compensation

The TCF's compensation function essentially acts as insolvency protection insurance for consumers, whereby financial compensation is provided in the event funds are lost. The chief benefit therefore is the compensation of consumers who would otherwise lose their prepayments for travel services.

The TCF has historically paid out between \$0.5 million and \$4 million per annum at an average of approximately \$2 million. A typical claimant receives between \$500 and \$2,000. Averaged over the last ten years, the TCF has paid out approximately \$2.9 million per annum to consumers; this is the directly observable benefit of the regulatory regime.

In addition to financial compensation, the TCF also provides additional benefits to affected consumers, including:

- a swift and costless resolution of claims – the average turn around time for claims on the TCF is between five and seven days<sup>168</sup>
- handling complaints that might otherwise be resolved by the relevant fair trading body.

Importantly, in the absence of the TCF, consumers will also need to take action to follow-up on credit card charge-back facilities and potentially take legal action if they believe there is scope to recover funds against the owners/directors/auditors of travel agents. Legal recourse is likely to be more expensive to consumers, compared to the economies of scale that can be generated by the TCF. In addition, the TCF might also pursue legal actions even where it is

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<sup>168</sup> Information provided to PwC by Travel Compensation Fund.

not likely to result in a net gain to the fund (ie the cost of legal action exceeds the funds recovered). While this incurs a net cost, it also provides a deterrent against similar future actions by businesses.

These benefits could be provided by other means. For example, the existing reserves or some portion of the reserves of the TCF could be dedicated (via a distribution back to and then recommitment by the participating jurisdictions) to a consumer fund to advocate and take collective action on behalf of consumers.

## Costs

The cost of the scheme relates primarily to its administration; namely, the costs incurred by the TCF (such as employee salaries). The TCF also incurs costs in the payment of claims. For the purposes of this analysis, those costs are best considered 'transfers' (ie a transfer of funds from one party (travel agents) to another (consumers, via the TCF)) rather than a net cost to society. Excluding claims therefore, the TCF's administration costs \$2.8 million per annum (based on the 2009 year). The TCF's costs are funded by participants' upfront contributions (currently \$7,430) and annual renewal fees (currently \$390),<sup>169</sup> which are also used to compensate eligible consumers.

It should be noted that the TCF's administrative costs do not relate entirely to administering the payment claims. The TCF is engaged in a number of other activities, including the prudential supervision activities discussed above.

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<sup>169</sup> Ibid.

**Box 3: Does the TCF represent a relatively low cost insurance product?**

The TCF is often described as a relatively inexpensive insurance provider; providing an insurance type service on a low cost basis, due to its 'not for profit' nature. Some stakeholders suggest that private insurers (were they to enter the market) would provide such cover at a higher price, owing to their incorporating a profit margin into their premiums.

An indication of the relative efficiency of the TCF in providing insurance-type cover, as compared to private insurers, can be made by comparing the funds received by each, relative to compensation claims paid out; that is, the monies received from customers (or, in the case of the TCF, businesses) relative to monies paid back to consumers in compensation.

In order to achieve this comparison, PwC calculated a ratio of:

- for the TCF, total fees received (including contributions, new application fees and renewal fees) to gross claims paid
- for private insurers, gross premium revenue to gross claims incurred.

According to data collected by the Australian Prudential Regulation Authority (APRA), for the five years ending June 2009, general insurance businesses received \$109.6 billion in gross revenue and paid out \$69.7 billion in gross claims; a ratio of 1.57. That is, private insurers received \$1.57 in gross premiums for every \$1 of gross claims paid.<sup>170</sup>

By comparison, for the five years ending 31 December 2009 the TCF received \$20.4 million in contributions, new application fees and renewals fees and paid out \$10.9 million in claims; a ratio of 1.87; suggesting a 19 per cent more expensive scheme.

While a crude comparison such as this should be carefully considered, there may be a number of reasons why the premiums to claims ratio might be different, including the following.

- **Non financial costs.** As outlined in this section, membership contribution and fees are not the only costs imposed on businesses by the TCF. Indeed more substantial costs relate to compliance with TCF's requirements (eg audit costs, guarantee fees and capital reserves). Such costs are not typically imposed by insurers and, hence, the above ratios understate the relative cost of the TCF.

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<sup>170</sup> Australian Prudential Regulation Authority (2009), 'Half Yearly General Insurance Bulletin (June 2009).

- **Industry characteristics.** General insurance provides for a number of insurance products across a range of industries. The particulars of each may limit the comparability of the relevant ratios.

Notwithstanding, the analysis does draw into question the claim that, relative to the private sector, the TCF represents an inexpensive form of insurance, noting again that this just compares cost to payouts and not additional compliance costs mentioned elsewhere in the report. A number of factors may give rise to the TCF being a more costly means of insurance, including:

- the ability of large insurers to generate economies of scale
- an implicit obligation on the TCF to pursue legal claims against owners or directors (eg to deter future misconduct)
- lack of incentive on the part of the TCF to minimise its costs, due to the absence of competition.

### Scope of the scheme

In addition to the relative costs and benefits of the scheme in its current form, stakeholders have also commented on whether the scope of the scheme (see Figure 2.1) is appropriate. Many considered the definition of what money is and is not to be compensated in the event of a business failure in the travel industry to be confusing and it is clearly not understood by consumers.

#### Existing scope

At present, the coverage of consumers' money is determined by whether or not money has been passed from the travel agent through to other businesses in the supply chain. This distinction however has limited connection back to any overarching consumer protection policy principle; that is, protecting consumers from financial risk associated with business insolvency. Rather, it appears to reflect the historical position of travel agents as 'gatekeeper' to the travel industry, including the perception that agents hold monies on trust for their customers. Travel agents are only a small component of the travel industry, and consumers' are not protected from insolvency of other travel businesses (such as airlines or hotels).

Few travel agents (13 per cent) consider the current scope appropriate. Many have commented on perceived anomalies in businesses that are or are not required to be members of the fund, and circumstances in which a consumer's money is or is not protected. It should be noted that these stakeholders are typically

more concerned with a 'level playing field' or equal treatment, rather than consumer protection.<sup>171</sup>

One of the matters raised relates to the potential of new, internet based businesses that sell to Australian consumers but are not licensed or a member of the TCF. For example, Expedia.com.au's website states:

*Expedia.com.au is operated by US-based Expedia, Inc. While, Expedia, Inc is not currently eligible for a travel agent's licence in Australia or to participate in the Travel Compensation Fund, our services are backed by the resources of the world's largest online travel company.*<sup>172</sup>

The other matter raised relates to a concern around whether the scope of the current scheme is well suited to protecting consumers from insolvency risk. Importantly, the scheme does not protect consumers from losses from the insolvency of travel service providers (eg airlines, tour companies, etc). With consumers increasingly contracting direct with suppliers, and given that travel agents only hold a consumer's monies for a certain period of time, the scheme covers only a small portion of the insolvency risk to consumers in the travel industry. For example, in the case of the Ansett/Traveland collapse, the losses to consumers contracting directly with the supplier are understood to be in the order of 50 times greater than losses (that were covered by the TCF) from travel agent collapses.<sup>173</sup> Accordingly, from a pure risk perspective, the scope of the scheme provides protection for only a small component of consumers' risk from insolvency.

Many stakeholders consider that these sectors pose greater financial risk to consumers than travel agents and, accordingly, the scope of the scheme should be expanded to include purchases in these sectors. Choice, for example, comments:

*The gaps in consumer protection lie in uncompensated loss for supplier collapse. To date there have been some very significant consumer losses arising from airline collapse as well as losses due to cruise ship company collapse. Given the highly competitive nature of the airline industry, the rise of low cost carriers, global events such as SARS and the GFC and volatility in fuel pricing mean that further collapses are inevitable.*<sup>174</sup>

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<sup>171</sup> The impact of the compensation scheme on the competitiveness of businesses was raised by, for example, AFTA, ATEC and Winners World Travel.

<sup>172</sup> Taken from <http://www.expedia.com.au/> (accessed on 10 June 2010).

<sup>173</sup> While precise estimates are not available, the loss to consumers from the Ansett collapse has been estimated at \$500 million, while claims on the TCF (for losses incurred from travel agent failure) were over \$10 million. (Source: Information provided to PwC by Travel Compensation Fund.)

<sup>174</sup> CHOICE submission (page 3).

On the other hand, some stakeholders argue for a reduction in the scope of the fund on the basis that, for example, the requirement for membership in the TCF is not directly related to the risk posed to consumers. ATEC, for example, notes that inbound tour operators are required to be members of the fund despite presenting limited or no insolvency related risk to consumers, as businesses are typically paid after the consumer has travelled.<sup>175</sup>

While travel agents are generally in favour of change, opinions are divided as to what form a change should take. While 47 per cent of agents are of the view that the scope should be extended to all travel service providers, 40 per cent think the scope should be reduced (ie that protection against travel agent insolvency should not be provided by the TCF). Importantly, 80 per cent of travel agents suggest that reliance should be placed on private insurance,<sup>176</sup> obtained by consumers, while 43 per cent support reliance on credit card charge-back;<sup>177</sup> this implies suggesting the scope should be reduced to remove this form of consumer protection.

#### Expansion of scope

In principle, the expansion of the scheme is appealing as it does away with any definitional issues (as to what monies are covered and when) and avoids any anomalies or perceived inconsistencies in compensation payouts. It also is most likely to reflect what consumers might expect when they become aware of the TCF. Expansion is supported by the House of Travel, who made the following comment:

*Any further consumer protection needs to encompass travel providers including airlines, shipping companies and hotels and cannot continue to be funded by just the travel agency and inbound tour operator segments of the industry.*<sup>178</sup>

From a cost-benefit perspective, an expanded scheme would come at a significant cost. Conceptually, the scheme would cover more funds (ie including those paid directly to suppliers) and for a greater period of time (ie beyond when funds are passed on to suppliers). In terms of funds covered, gross turnover by retail travel agents who are TCF participants was \$9.2 billion in 2009, compared to the \$28 billion Australians spend annually on travel purchases (ie travel,

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<sup>175</sup> ATEC submission (page 5).

<sup>176</sup> This may be partly explained by self interest, due to the relatively high margins that travel agents allegedly receive on travel insurance (see, for example, Choice's 'Travel insurance buying guide' which suggests travel agents can earn up to 50 per cent commissions on travel insurance products).

<sup>177</sup> Industry have commented that travel agents commonly bare the cost of chargeback under the typical merchant agreements. That is, if the agent acts as the seller of a travel product which is not subsequently delivered, chargeback claimed by a consumer from their bank/credit card provider is often claimed from the agent. While this would not be the case in the event of travel agent insolvency, it may colour travel agents' willingness to encourage reliance on credit card chargebacks.

<sup>178</sup> House of Travel submission (page 2).

accommodation, car hire and travel agency services). This represents a three-fold increase in the quantum of funds covered by the scheme, as well as those funds being covered at all points of the supply chain. Assuming a proportion increase in financial loss to consumers, this implies payouts increasing to over \$8 million per annum.

Covering the full travel industry supply chain also exposes the fund to the business insolvency risk in all travel-related markets (air transport, hotels, etc) and locations (ie domestic and international), not simply the travel agency market in Australia. As a result, the number of collapses for which the fund will be required to provide compensation is likely to increase substantially. Insurers who currently provide supplier insolvency may also be expected to exit this market, as consumers will not value such coverage where it is already provided by a compulsory public scheme.

It is also unlikely to be feasible, or in many cases possible, for the fund to provide the degree of prudential oversight to each market/location that it currently provides to the Australian travel agency industry. As such, the financial risk to the fund may not be mitigated, to the current extent, by prudential supervision. In addition, the benefits of such an expansion are a little unclear as there has not been a long list of monies lost in the past from all sectors of the travel industry (notwithstanding the Ansett collapse). Where it has been lost, this type of policy option has not been deemed necessary. In short, if this was not implemented after the Ansett collapse, it is hard to see its rationale now.

### Large players

When the existing compensation scheme was initially established, the industry was characterised by a large number of relatively small businesses. Accordingly, the failure of one business, or a number of businesses, was unlikely to challenge the financial health of the TCF itself. For most years of its operation this has proved to be the case; at present the average value of total claims paid (\$2 million) is small relative to the size of the funds reserves (currently \$25 million).

Consolidation however, has led to the presence of large travel agency businesses, including ASX200 publicly listed companies. The TCF is no longer able to guarantee to compensate consumers in the case of all travel agent collapses. This was made clear by the collapse of Ansett and consequently its subsidiary travel agent Traveland. This collapse cost consumers over \$13 million; given its capital reserves at the time, the TCF was unable to fully compensate these losses. Initially, the TCF paid only 40 per cent of each claim. Full payment of consumers' claims was then made once subsequent government funding was provided. These funds were recouped from remaining travel agent businesses via a special levy.<sup>179</sup>

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<sup>179</sup> Travel Compensation Fund (2002) Annual Report.

While the TCF's capital reserves have been built up since then, it remains unable to bear the cost of claims that would eventuate in the event one of the major travel agent businesses collapsed. As was the case in the Ansett/Traveland collapse, in the event of failure by a major travel agency business the TCF would be forced to:

- delay compensation
- impose an extraordinary charge on other travel agents
- rely on government assistance.

#### Comparison with other industries

Relative to the regulatory restrictions imposed on other industries, the travel agent market's compensation scheme represents an onerous burden on business, considering the systemic importance of the industry and the size, nature and importance of the relevant purchase of consumers.

Comparable schemes, while uncommon, can be found elsewhere in the Australian economy. These schemes involve regulatory bodies performing one of the TCF's two functions: prudential oversight and compensation. They include:

- prudential oversight:
  - banking
  - insurance
- compensation schemes:
  - securities trading
  - overseas student education
  - motor vehicle traders
  - residential builders.

In cases where prudential oversight is imposed, the sectors are typically of system-wide economic importance, such as the banking and insurance industry. Confidence in the viability and integrity of these sectors, as demonstrated by the recent global financial crisis, is crucially important to the operation of the economy as a whole. Accordingly, prudential oversight of these sectors appears, *prima facie*, appropriate.

Significantly however, even in industries where prudential oversight is industry-wide, there is no example of industry-wide mandatory compensation schemes. In the case of the global financial crisis, the Australian Government did step in to guarantee bank deposits and other investments. Nevertheless, no broad compensation scheme was imposed. In the case of the HIH collapse in 2001, the Australian Government did not intervene to compensate creditors (including policyholders) suffering a loss; in many cases, for commercial reasons, other insurers assumed and honoured existing policies. It appears that, even in these systemically important sectors,

minimising industry volatility via prudential supervision was deemed sufficient.

Where compensation schemes have been implemented, the sector in question is either systemically important (securities trading) or represents a significant and extraordinary household purchase (real estate agents and motor vehicle traders).

An example of the first type is the National Guarantee Fund (NGF), which guarantees funds in certain circumstances in relation to securities trading on the ASX. Broadly, the NGF guarantees funds for the period between the sale of a security and the completion and settlement of that trade. The issue at stake here however, as with the banking and insurance industries, is investor confidence in the integrity of Australia's share trading system. Again, given the systemic importance of this system to Australia's economy, the existence of such a scheme seems appropriate.

Examples of the latter type, significant and extraordinary household purchases, include schemes forming part of an occupational licensing regime, such as those of lawyers, real estate agents and motor car traders. These schemes perform a similar function to the TCF, compensating customers for loss in the case of businesses failing to account for their money, particularly in the case of prepayments.

Parallels are often drawn by stakeholders with these examples. Such comparisons however do not reflect the size of typical travel purchases today, nor the growing familiarity of Australians with travel. In addition, the commercial relationships of concern in these examples are also somewhat different to those of a travel agent. The relevant monies are meant and required to be held 'in trust', hence these schemes protect a specified deposit or an amount meant to be deposited, as well as the industry-wide trust in the system itself. Trust accounts have not been mandated for travel agents under the National Scheme,<sup>180</sup> which seems to be consistent with a view that monies paid to agents are not truly held 'in trust' but rather paid for a service (that service being the subsequent arrangement of travel bookings and accommodation).

Furthermore, these other schemes do not couple prudential oversight with compensation. While it is possible that these schemes are therefore required to pay a greater number of claims than would occur in the presence of prudential supervision, the relevant governing entity and businesses in the industry are not burdened with the cost of administering and comply with such supervision (which is estimated to cost the travel agent industry \$16.5 million annually).

Another comparable example of compensation arrangements relates to monies lost due to insolvency by overseas students studying at

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<sup>180</sup> Separate client accounts were mandated under previous NSW legislation prior to the introduction of the National Scheme.

international colleges under the Education Services for Overseas Students (ESOS) program. The difference with this program is that it is a provider of last resort, only in the event that students enrolled at an insolvent institution cannot be placed at other institutions.

### Would private insurers offer a similar product in the absence of the TCF?

At present, while private insurance is available to protect consumers against a number of travel associated risks, no provider of travel insurance currently offers protection on any policy against losses from the travel agent becoming insolvent. Opinions differ as to whether private insurers would offer this coverage were it not already provided by the TCF.

There appears good reason why no insurance product currently provides this coverage. The TCF, being a mandatory scheme covering all consumers, currently provides this protection at no direct cost.<sup>181</sup> In the presence of the current regulatory regime, consumers would receive no value from private insurance, which would come at a cost (an increase in premiums as compared to policies which exclude such protection). Accordingly, the market for this protection is effectively 'crowded out' by public provision.

Insurers have commented that, despite the presence of the TCF, such coverage was provided on some policies up until the collapse of Ansett/Traveland in 2001. Following this event, and driven by demands from reinsurers, insurers specifically excluded this coverage from their products. Typically travel service supplier insolvency was also excluded, although this cover has returned for some products.

Opinions differ concerning the willingness of insurers to offer travel agent insolvency protection in the future in the absence of the TCF. AFTA, for example, suggests:

*Initial discussions with representatives of the insurance industry regarding the willingness to provide this cover (travel agent insolvency protection) are very encouraging. Some large providers who already offer end supplier insolvency protection have indicated that they have no concerns in extending their policies to cover intermediary insolvency. They point out that the main reason they do not provide this at the moment is that it is offered by the TCF.<sup>182</sup>*

By contrast, other stakeholders express scepticism as to the ability of private insurers to this product. For example, Choice suggested:

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<sup>181</sup> Ultimately consumers will bear some of the cost of the TCF through higher prices, however this cost is automatic and implicit in prices.

<sup>182</sup> AFTA (2009) 'Discussion Paper: Better Regulating Travel and Travel-Related Services' (page 35).

*Travel insurance can neither be consistently nor affordably relied upon to provide last resort compensation to consumers. There is a vast amount of evidence from other sectors to support this view. There is also evidence that the costs to the community (and government who will be forced to resume responsibility when the private insurance markets fails) will dramatically outweigh the benefits.*

*... we fail to see how the TCF's compensation arrangements could ever be fully replicated by travel insurance.<sup>183</sup>*

Travel agents as a whole are divided in their expectations. While 68 per cent consider the insurance industry capable of providing such a product, only 48 per cent expect them to be willing to provide it and 44 per cent expect such coverage to be cost competitive to the TCF. A large proportion of respondents (approximately 35 per cent) stated that they did not know whether the private insurance market would provide this product.

Business insolvency protection for consumers is understood to be a particularly problematic insurance product, on the basis that consumers are typically less informed about the insolvency risks of businesses they contract with. The travel agents sector is understood to be particularly problematic, due to the following:

- supervision/oversight costs are expected to be high, owing to the relatively large number of small businesses in the sector
- removal of the TCF's prudential functions and/or regulatory barriers to entry is expected to result in a diminution of industry standards
- consumers' willingness to pay for such coverage is not known.

The Insurance Council of Australia, for example, is opposed to changes to the TCF and notes the challenges to insurers in developing a new insurance product:

*The development of a completely new product such as this (travel agent insolvency protection) would require significant evaluation and market research, including risk rating and pricing as well as reinsurance and set-up costs, to determine the feasibility of cover for a risk presently not addressed. The moral hazard issues presented by this risk are considerable and it is unlikely that they could be overcome without significant regulatory oversight of travel agents.<sup>184</sup>*

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<sup>183</sup> CHOICE submission (page 6).

<sup>184</sup> Insurance Council of Australia submission (page 1).

Similar sentiments were expressed by other industry stakeholders, including World Nomad Group in their submission.<sup>185</sup>

Insurers generally perceive that consumers are unlikely to be willing to pay significant premiums to protect themselves from these risks. This appears contrary to the results of the PwC Consumer Survey which suggested consumers would be willing to pay about \$26 on a \$1,000 travel product for the add on to existing travel insurance. Given that, at present, less than 0.05 per cent of funds paid through a travel agent loss are due to insolvency, it appears at least possible that a profitable market could emerge.

While it is not possible to comment definitely about the readiness of insurers to provide protection against travel agent insolvency, it appears unlikely that a strong appetite exists amongst general insurers to provide this product.

### Summary

Excluding claims, the TCF's administration costs are \$2.8 million per annum (based on the 2009 year). In total therefore, the cost of the regulatory scheme – including licensing, prudential oversight and compensation – is \$25.3 million per annum.

In contrast, the directly observable benefit (as measured in terms of the average pay-out to consumers) is \$2.9 million (averaged over the last 10 years). The regulatory costs are therefore around nine times the current value of consumer funds lost.

Other potential benefits relate to any reduction in costs from business failures resulting from the prudential oversight function of the TCF. There is little evidence to suggest a dramatic increase in business failure would occur in the absence of the scheme.

On balance therefore, the scheme represents a costly and disproportionate regulatory measure. There are no parallels to industries with comparable potential for consumer detriment.

## 4.3 Conduct

As previously outlined, the regulation of business conduct in relation to travel agents is governed by the generic consumer protection rules (of the *Trade Practices Act* and other fair trading acts) and the disciplinary powers provided to the relevant licensing authority under the licensing regimes in each state and territory.

The disciplinary powers under the travel agents licensing regime are largely duplicative of the generic consumer protection laws. Arguably however, the measures improve compliance in the industry, as the

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<sup>185</sup> World Nomad Group submission (page 1).

possible disciplinary measures (loss of licence, etc) provide a greater deterrent against misconduct than the threat of prosecution under the generic rules.

### Generic consumer protection

For the most part, stakeholders suggest that the generic consumer protection rules are sufficient to protect consumers from travel agent misconduct. This view is shared by the majority of travel agents (almost 60 per cent), most of whom also thought these provisions were adequately enforced by ACCC and state based fair trading offices. It is also shared by FarSight Travel:

*It would appear that Australian consumers are currently well protected by fairly stringent consumer protection legislation.<sup>186</sup>*

These views are consistent with the understanding that consumers are becoming less and less vulnerable to misconduct by travel agents, and travel agents, faced with a number of serious commercial pressures, have increasing incentives to ensure good service is provided to their customers. The changing nature of the industry and, most importantly, the loss of a significant information advantage, have contributed to this. There is also little evidence of a significant problem in business conduct in the industry. In most states the travel industry accounts for no more than five per cent of complaints to consumer protection bodies;<sup>187</sup> travel agents typically make up less than one third these.

It is likely therefore that the provisions of the generic rules provide adequate regulation of business conduct in the industry and there is no clear body of evidence suggesting a demonstrable need for industry-specific measures.

### Need for industry-specific enforcement powers

Notwithstanding the above, there is a body of opinion that considers the industry-specific disciplinary powers, currently incorporated into licence conditions, are important in ensuring good conduct in the industry. Most importantly, this view is shared by 65 per cent of travel agents, who are familiar with the scheme's operation and impact upon industry. This view is not however broadly shared by the state and territory fair trading bodies consulted over the course of this review.

In any event, it is not clear how effectively these powers are employed. Opinions differ amongst travel agents, who in relatively

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<sup>186</sup> FarSight Travel submission (page 2).

<sup>187</sup> Queensland and Tasmania are the exceptions, with the travel industry accounting for 11 per cent of complaints in these states.

equal numbers consider the licensing bodies effective (37 per cent) and ineffective (40 per cent) in enforcing licensing conditions.<sup>188</sup>

Given the key value of these powers relates to deterring businesses from breaching good conduct rules, it is important these provisions are understood by business. Given this, there may be some value in maintaining the ability for businesses to be easily barred from participating in the industry if they breach business conduct rules. This however can be achieved by less onerous measures, such as a negative licensing or a registration scheme. There are also mechanisms available under the *Trade Practices Act* (and the proposed ACL) for instituting enforceable codes of conduct for particular industries. Such an avenue could be explored if complaint levels are sufficient to warrant such measures.

#### Industry codes of conduct

There are several established codes of conduct relevant to travel agents, including those of AFTA, CATO and ATEC. Combined, these organisations have broad industry coverage; AFTA alone includes over 60 per cent of travel agents.<sup>189</sup> Their codes of conduct apply to all members and cover matters such as transparency and honest in business dealings. 54 per cent of travel agents believe these codes play an important role in ensuring good conduct in the industry.

To some degree, it is likely that the value to businesses of membership in such organisations is weakened by the presence of a compulsory licensing scheme. Mandatory participation in a licensing framework may provide implicit assurance of the *bona fide* nature of the licensed business in the eyes of consumers and other businesses; this assurance might otherwise be sort from membership in an industry association. Accordingly, the ability of associations to require and enforce a strict code of conduct may be weakened.

The proposed NTAF presents an opportunity to leverage the strength of existing industry associations and strengthen their membership system to provide voluntary industry accreditation. Under the NTAF, a participating industry accreditation scheme will be required to have certain minimum standards, such as an appropriate dispute resolution process. Such a system, supporting the generic consumer protection rules and enforcement bodies, appears to be a sufficient and proportionate scheme to promote good business conduct in this industry.

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<sup>188</sup> PwC Travel Agents Survey.

<sup>189</sup> AFTA (2009) 'Discussion Paper: Better Regulating Travel and Travel-Related Services' (page 1).

### Summary

The evidence suggests that generic provisions are sufficient to protect consumers from consumer protection risks in the travel industry. There is also scope under the *Trade Practices Act* and the ACL to provide prescribed codes of conduct for further protection.

## 5 Reform options for insolvency protection scheme

The previous chapter considered the effectiveness of the existing consumer protection framework in the travel industry, including the specific regime applicable to travel agents. It concluded that the existing insolvency protection scheme in the travel agents market is no longer fit for purpose, is unduly burdensome relative to the risk of consumer detriment it addresses and represents a disproportionate regulatory response relative to consumer protection regulation in other industries. Accordingly, there is insufficient justification to maintain the current scheme.

There are a suite of options to reform the existing insolvency protection scheme. These options differ with respect to impact on the existing regulatory regime, including:

- a shift in the burden of regulation
- a change in the cost of regulation
- a change in the level of consumer protection.

The nature of these options and their relative merits are discussed below. The discussion of the relative merits is based on the assumption that the overarching framework for consumer protection outlined in Chapter 6 (ie generic consumer protection rules supported by a registration scheme and voluntary accreditation under the NTAF) is implemented.

PwC's recommendations for a consumer protection framework that is better designed to meet the needs of the sector today and in the future are outlined in Chapter 6.

### Option 1: No insolvency protection

This option would see the generic provisions of the ACL, a national registration scheme and voluntary accreditation as the sole regulatory (or co regulatory) consumer protection measures relating to travel agents (discussed in Chapter 6). The entirety of the existing travel agents insolvency protection scheme would be disbanded and the burden of obtaining consumer protection in this respect shifted towards consumers.

While in some ways this option can be described as a 'deregulatory option', at least with respect to insolvency protection, a number of protection measures are (or may be) available to consumers. They include the provisions of the generic consumer law, as well as non-regulatory measures (credit card charge-back, private insurance).

The key reform elements of this option are as follows:

- The compensation scheme would be removed. Generic consumer protection provisions would remain, as would the potential for consumers to take out cover voluntarily (if insurers were willing to step into the market) or rely on other measures (such as purchasing with credit cards offering a charge-back mechanism) or their own efforts to satisfy themselves of the solvency of the agent.
- Prudential oversight would be removed. Some private sector oversight (bank merchant arrangements, IATA accreditation) would remain, albeit with these measures directly for a different purpose (the protection of banks'/airlines'/chains' commercial interests) than consumer protection.
- Several options for the use of the TCF's existing reserves. The existing resources held by the TCF could be dedicated towards a national body to undertake legal or commercial actions on behalf of consumers to recover funds in the event of a loss. It could also fund a transitional arrangement; potentially providing compensation in the case of demonstrated hardship or other appropriate circumstances. These options are discussed in Appendix G.

### Relative merits

Conceptually, this option is appealing as it brings the regulation of travel agents in line with:

- the remainder of the travel industry – therefore avoiding confusion, definitional issues and unfair differences in regulatory burdens
- the regulation of most other industries of comparable risk to consumers and systemic importance.

The key economic benefits of this option related to removing the cost burden of the current scheme (estimated at \$19.3 million annually). Where these costs are incurred by or passed on (eg via licence fees) to travel agent businesses, competition in the sector would ensure that the majority of these savings (in avoided costs) would be passed on to consumers. These costs include:

- the administration of the TCF (approximately \$2.8 million per annum)
- compliance activities (estimated at \$3.2 million per annum)
- the requirements to prepare audited financial accounts (\$4.8 million per annum)
- the provision of securities (\$2.5 million per annum)
- the retention of excess capital reserves (\$6.0 million per annum).

This option brings the regulation of travel agents into line with that of the rest of the travel industry; thereby removing definitional

anomalies present in the current system and providing a 'level playing field' for competition.<sup>190</sup> It also avoids confusion as to what monies are covered by the scheme, and when they are covered.

There would however be a diminution of consumer protection for individuals who book with an agent who subsequently fails. At the present rate, that would amount to over 4,000 consumers losing approximately \$2.9 million annually. While this number is small, relative to the economic cost of the scheme, the losses are concentrated on a small number of consumers and, accordingly, policy considerations other than pure aggregate economic efficiency may dictate the provision of protection for these individuals.

On top of the current rate of failures, there could also reasonably be expected to be an increase in those failures, to the extent that the TCF currently reduces business failures in the industry. Even if failures did increase, a six-fold increase in the current value of lost funds would be required before the value of lost funds exceeded the cost of the scheme. PwC's analysis found little evidence to support the view that such a dramatic increase in business failures would be likely in the absence of prudential oversight.

Importantly, consumers will still have a number of avenues available to them to obtain their own protection against the risk of travel agent insolvency. Their ability to do so has been discussed above, and may include:

- use of credit cards and the charge-back mechanism
- a 'flight to quality' – that is, with consumers using more trusted and reliable businesses to mitigate the risk of insolvency
- where available, obtaining private insurance.

In the absence of a compensation scheme, it is foreseeable that consumers will alter their practice to reduce the solvency risk of their purchases; having now an incentive to do so. Given the choice available to consumers, including an option of bypassing intermediaries all together, it is expected that the actions of consumers could reduce the riskiness of the industry.

It should also be noted that not all consumer protection measures will be removed. Consumers will still be able to pursue redress for monies lost due to fraud, misappropriation of funds and other misconduct under existing generic consumer and criminal laws.

Consumers will however need to take action to follow-up on credit card charge-back facilities and potentially take legal action if they believe there is scope to recover funds against the owners/directors/auditors of travel agents. Legal recourse is likely to be more expensive to consumers, compared to the economies of scale that can be generated by the TCF. These drawbacks could be

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<sup>190</sup> That is, where travel agents are competing with overseas domiciled businesses, accommodation only providers or other unlicensed intermediaries.

addressed by dedicating the current reserves or some portion of the reserves of the TCF (via a distribution back to and then recommitment by the National Scheme jurisdictions) to a consumer fund to advocate and take collective action on behalf of consumers (see Appendix G).

Removal of the industry-specific insolvency protection regime is PwC's recommended option. This option has the most merits, based on the following.

- Insolvency protection schemes of this nature are not imposed on other comparable industries, despite such industries posing a similar or greater risk of consumer detriment or being of greater systemic importance to the Australian economy.
- The annual economic cost of the scheme (\$25.3 million) is in the order of nine times greater than the average value of claims paid (\$2.9 million).
- The vulnerability of and choice available to consumers is improving by the growing uptake of information technology and electronic payment options.
- Consolidation of the market and the growth of larger players give greater capacity for consumers to observe indications of the solvency of businesses (eg market disclosures, ratings).
- The regulation crowds out the development of other consumer protection measures, such as private insurance and accreditation schemes.

## Option 2: Expanded compensation scheme

An approach suggested by a number of stakeholders is to expand the scope of the compensation scheme to include more or all of the travel industry. This option is driven by the perception that the current scope:

- is unclear and confusing
- excludes sectors where the risk of consumer detriment is greater
- discriminates between competitor businesses, for example between:
  - accommodation only and flights and accommodation agents
  - Australian and overseas domicile businesses
  - large and small businesses, particularly in the case of tour operators.

Under this option, the scope of the travel agents compensation scheme would be extended to include either:

- all businesses selling travel products to Australians
- all Australian businesses selling travel products
- a limited scope of additional businesses (most likely airlines, cruise companies and/or tour desks)

This option involves the following reform measures:

- changing the mandate of the TCF, under its trust deed, to require it to compensate consumers for financial loss resulting from the collapse of other travel businesses
- imposing an obligation, via a licensing or registration scheme or other regulatory instrument, on businesses in other parts of the travel industry to be members of the TCF
- development of appropriate practices, policies and guidelines relating to the TCF's prudential oversight of these additional sectors.

While this option has some merits, including providing superior consumer protection to travellers, the immensity and cost of the scheme appear excessive in the absence of a strong case for this form of consumer protection in the industry.

## Scope

The relative merits of the current scope of the compensation scheme are discussed at section 4.2. A key question for this option is which additional sectors would be included. There are three options:

- All businesses selling travel products to Australians. This option is appealing in that it removes any uncertainty, provides comprehensive consumer protection and does not discriminate between rival businesses. However, this option:
  - is prohibitively costly – covering the \$28 billion Australians spend annually on travel products for the entirety of the supply chain, rather than the \$9 billion per annum currently protected for only part of the supply chain
  - limits the ability for the TCF to offer prudential supervision – this is for two reasons: the sheer number of businesses and the inclusion of overseas businesses, in which Australia does not have regulatory jurisdiction.
- All Australian travel businesses. This option is more costly than the first, with the Australian travel industry generating approximately \$40 billion in revenues annually.<sup>191</sup> It also limits the coverage for purchases by Australian travels to domestic travel and international airline flights or cruises provided by

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<sup>191</sup> The Jackson Report (2009), 'Informing the National Long-term Tourism Strategy' (page 2).

Australian businesses. This potentially undermines the intention of the option; that is, providing comprehensive (or at least superior) consumer protection against insolvency.

- Selected industries. This option is potentially the most feasible, limiting the exposure of the TCF while extending protection to sectors of concern. Industries could be selected based on:
  - a demonstrable need for protection
  - the possibility and practicality of imposing prudential supervision.

The most obvious sector, particularly given the collapse of Ansett, is the airline industry. Arguably however, the airline industry does not meet the first criteria above, as (notwithstanding the Ansett collapse) there has not been a long list of monies lost by consumers in the past from all sectors of the travel industry. In addition, extending to this sector vastly extends the exposure of the fund and hence its cost. Qantas alone generates \$14.6 billion in revenue annually.<sup>192</sup>

### Benefits of an expanded scope

While an expanded scope is conceptually appealing, there are few in principle benefits of doing so. There is little evidence of consumers being at an unacceptable risk of losing funds from travel service supplier bankruptcy.

Many travel products, such as hotel accommodation or day tours, are paid for following or immediately prior to consumption of the services. In cases where prepayments are common, such as airlines and cruise ships, with the exception of the Ansett collapse, there is little evidence of consumers suffering substantial consumer detriment from supplier bankruptcy. In the case of Ansett, given the experience of the TCF, it is unlikely that, even if such a scheme was in place, it would be able to compensate all eligible consumers.

Furthermore, at present this coverage is available to consumers, albeit at a price, in the private insurance market including in policies of CoverMore, the largest provider of travel insurance.

With respect to prudential supervision, many large business (particularly in the airline industry) are publicly listed companies and subject to significant market oversight already. At the other end of the scale, imposing TCF-style requirements would be unduly onerous on the 93 per cent of tourism businesses that are small businesses.

There are some benefits to improving the clarity of the scheme's scope and removing anomalous treatment of similar businesses.

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<sup>192</sup> Based on Qantas' full year results for the year ending 30 June 2009.

These benefits however relate more to improving the competitive environment rather than protection of consumers.

## Costs

The costs of an expanded compensation scheme are difficult to estimate. A broad estimate can be made based on the following assumptions:

- the exposure to loss will be broadly proportional to the value of funds covered (although, at present, funds are only covered by the TCF for a limited period of time)
- the economic cost of prudential oversight will be broadly proportional to the number of businesses (acknowledging that the cost of oversight will most likely be a lot greater for large airlines).<sup>193</sup>

Based on these assumptions, the cost of an expanded scheme is estimated as follows.

- All businesses selling travel products to Australians.
  - Compensation in the order of three times greater, implying annual payouts in the order of \$8.4 million per annum.
  - Prudential supervision in the order of 200 times greater, implying economic costs in the order of \$3.3 billion.<sup>194</sup>
- All Australian travel businesses.
  - Compensation in the order of 4.5 times greater, implying annual payouts in the order of \$12.6 million per annum.
  - Prudential supervision in the order of 200 times greater, implying economic costs in the order of \$3.3 billion.
- Selected industries (for example, airlines),
  - Compensation in the order of two and a half times greater, implying annual payouts in the order of \$7 million per annum.<sup>195</sup>
  - Based purely on the additional number of businesses, prudential supervision should be relatively inexpensive as there are only a small number of airlines in the Australian market. However, being large businesses, it is likely that prudential oversight costs will be far greater for airlines than for a typical travel agent.

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<sup>193</sup> As noted earlier, the economic costs of prudential oversight include both financial and non financial costs, including auditor fees, obtaining securities, holding additional capital reserves and administrative costs (eg staff time).

<sup>194</sup> This calculation assumes that, due to jurisdictional limitations, only Australian businesses are subject to prudential oversight.

<sup>195</sup> Based on IBISWorld estimates of the gross revenue of the Australian domestic (\$11.9 billion) and international (\$11.0 billion) industries.

A further cost consideration, in addition to the expected average payout, is the inability of the fund to cover major collapses. The inability of the TCF to meet all claims from the Ansett/Traveland collapse, and its ongoing inability to payout all claims if a major travel agent business was to collapse, would be compounded many times over if exposed to losses from the collapse of, say, Qantas.

These rough estimates demonstrate the overwhelming cost of suggested scope expansions. Accordingly, the option of expanding the scope of the compensation scheme has little justification from a cost-benefit perspective.

Expanding the scope of the compensation scheme is not recommended on the basis that:

- doing so would be extremely costly, requiring:
  - as much as five fold increase in annual compensation
  - prudential supervision activities that are extraordinarily costly and, in many cases, not feasible
- there is little evidence of losses to consumers of sufficient scale to justify this form of protection
- private protection measures are available.

In the absence of a crisis it is hard to justify this approach. Indeed, if the Ansett collapse did not provide grounds for implementing such expansion, it is hard to see it ever being justified.

While this option has some benefits, in terms of improved clarity and the removal of differential regulatory obligations of competitor businesses, these benefits relate more to improving the competitive environment rather than consumer protection.

### Option 3: Prudential oversight without compensation

This option retains the TCF's prudential oversight function whilst removing its role of compensating consumers in the case of travel agency failure. In this respect, the two-fold prudential supervision would remain; that is:

- screening of travel agent applications with a view to weeding out unviable commercial applications
- ongoing prudential oversight over travel agents, in the same way that banks and insurance companies are overseen by the APRA.

In the event of a business failure, compensation would not be paid, but the emphasis would be on trying to prevent a failure in the first place. Regulatory effort and resources would be realigned to

address this concern, rather than spending money pursuing guarantees or other securities, or prosecuting owners, directors or auditors of failed businesses.

This option could incorporate improvements to the existing regulatory structure, including:

- a more proactive approach to oversight, based on active monitoring of compliance rather than reacting to historical information (in submitted financial statements)
- reforming the TCF's regulatory structure – for example, bringing the TCF under the auspice of the APRA and providing appropriate governance structure, accountability and review of decisions.

This option involves the following reform measures:

- reforming TCF's mandate to focus entirely on prudential supervision, including redirecting its activities accordingly
- ceasing the TCF's compensation function, including removing the obligation to pay upfront contributions
- distributing the TCF's capital reserves to other uses (see Appendix G for potential uses).

In many respects, this option has parallels with APRA's prudential regulation of Australia's banking and insurance sectors. Prudential supervision is undertaken to reduce the risk of business failure, however, as with the case with the collapse of insurer HIH, compensation is not provided to consumers in the event of business failure.

However, this comparison highlights this option's key weakness; it represents substantial regulatory intervention relative to the economic and systemic importance of the industry. While this option is likely to deliver a net economic benefit (relative to the current situation), there remains little in principle as a justification for this level of regulatory oversight in this industry.

## Benefits

The benefits of this option are that some of the costs of the existing regime are avoided, while still mitigating to some degree the risk to consumers from agent insolvency. Avoided costs include the administration of the compensation scheme (including costs incurred by the TCF in pursuing legal actions) and accumulation of capital reserves. The administration of claims on the compensation fund represents only a minor part of the TCF's activities and, accordingly, the savings from avoiding this function may not be great.<sup>196</sup> However, based on contributions by new participants alone, the

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<sup>196</sup> For example, AFTA's submission attributes less than \$900,000 of TCF's administrative expenses to administering claims.

benefit of not maintaining reserves for compensating consumers is approximately \$2.4 million per annum.

The cost of the prudential oversight function (compliance, audited accounts, securities and capital reserves) would of course remain. The existing capital reserves held by the TCF could be redistributed to the states and put to productive use.

## Costs

The option does amount to a diminution of protection to consumers, as they will not be compensated in the case of collapse. Given the ongoing prudential oversight, it is expected that total losses to consumers would not exceed the TCF's current annual payouts (approximately \$2 million per annum). Indeed, to the extent reform of the TCF improves its oversight function, losses would be reduced. It should be again noted that, from an economic perspective, payment of claims to consumers is a 'transfer' of funds from one party (travel agents) to another (consumers), rather than a net benefit to society.

It will be incumbent on consumers to protect themselves from these losses to the extent they are able and/or willing to do so. The absence of a compensation scheme provides consumers with an incentive to undertake measures, such as purchasing via credit cards, purchasing insurance (where available) and/or satisfying themselves of the agent's solvency, to reduce their risk of financial loss.

Finally, while it is uncertain as to whether private insurers will be willing to offer travel agent insolvency protection in the absence of the TCF's compensation function, conversations with insurers suggest they will be more likely to do so if prudential oversight is retained.

This option – prudential oversight without compensation – is not recommended on the basis that:

- it retains many of the costs of the current regime
- consumers will not be compensated for losses despite these costs
- the available evidence does not suggest this oversight is currently having a profound impact on the volatility of the industry.

Accordingly, this option is likely to retain significant costs on business for little consumer benefit.

## Option 4: Compensation scheme without prudential oversight

Under this option, the TCF would act more like a conventional insurer, compensating consumers in the case of a collapse but without exercising prudential oversight over the industry. Accordingly, the cost burden on business will be substantially reduced; in absence of prudential oversight however, the exposure of the fund (and hence the level of fees and upfront contributions) may increase.

The reform measures under this option include:

- reforming the mandate of the TCF to focus entirely on compensating consumers in the case of travel agent collapse
- removing the administrative, compliance and prudential standards requirements on travel agent businesses
- reducing the scope of the TCF's activities to focus primarily on collecting fees and contributions and processing claims – this would include ceasing to pursue legal actions on behalf of consumers.

While this scheme removes the majority of the economic cost of the regulatory scheme, the retention of the compensation scheme stills represents a significant regulatory burden relative to that of other comparable industries. It should be noted that this option retains a number of the shortcomings of the current scheme, including:

- a confusing and uncertain scope of what monies are covered by the scheme and when
- limited protection, considering other sources of insolvency risk in the industry that are not covered
- the inability of the scheme to handle the collapse of a major player.

### Benefits

As mentioned, the chief benefits relate to the removal of prudential standards requirements on businesses, including:

- the majority of compliance activities (estimated at \$3.2 million per annum)
- the requirements to prepare audited financial accounts (\$4.8 million per annum)
- the provision of securities (\$2.5 million per annum)
- the retention of excess capital reserves (\$6.0 million per annum).

Accordingly, PwC estimates the total benefit of removing this function at \$16.5 million annually.

## Costs

The key costs of this option relate to any deterioration in industry solvency due to ceasing the prudential oversight function. The effectiveness of the current scheme in reducing industry volatility is discussed at section 4.2. While it is difficult to ascertain what will eventuate in the absence of the TCF, the available evidence does not suggest a dramatic increase in travel agent bankruptcy will eventuate.

A further consideration is to what extent the various components of the insolvency protection scheme reduce the risk of travel agent collapse. Some stakeholders have commented that a key benefit of the scheme is a reduction in 'rogue traders' or 'fly-by-night' businesses, who take advantage of low barriers to entry and enter the market with a short term focus only. As this option retains a significant upfront contribution to the fund for market entrants (at present, over \$8,000), such businesses are likely to be deterred. Accordingly, despite the removal of prudential oversight, the increase in financial risk may not be as pronounced.

Based on existing losses (\$2.9 million per annum) and the cost of prudential oversight (\$16.5 million), a six fold increase in the loss of consumer funds is required to outweigh the benefits of reduced burden. This option is therefore likely to generate a net benefit. Under this option, the cost of increased collapses and loss of consumers' funds will be incurred by the TCF (through higher claims) and therefore industry (through higher fees and upfront contributions).

While this option – compensation without prudential oversight – represents an improvement on the *status quo*, it retains some key weaknesses of the current scheme:

- it represents an onerous measure relative to the risk of consumer detriment in the sector
- it imposes a mandatory scheme on all businesses despite the inability of the scheme to guarantee compensation in the event a large player collapsed.

It is therefore not recommended by this review.

## Option 5: Industry-led compensation scheme

To the extent that industry is willing, this option provides compensation for consumers in the case of travel agent collapse via an industry-led compensation scheme – perhaps administered by an existing or new industry peak body. Under such a scheme, industry would guarantee consumers against losses from travel agent insolvency.

The option closely mirrors the scheme presently in place in New Zealand and administered by TAANZ (the industry association). It allows industry to dictate the nature and form of any prudential oversight arrangements, as they assume the risk of agency collapses.

The option is predicated on the willingness of industry to participate in this scheme. This may be likely for two reasons:

- in the context of annual revenues in the order of \$3 billion, the cost guaranteed by industry (losses from failures in the industry) is small, being at present less than \$3 million (or 0.1 per cent of revenues).
- for industry, these costs are minimal compared to the administrative and compliance costs of the current regulatory regime (\$16.5 million per year) – this is consistent with their stated concerns.

The details of the scheme should be carefully considered, including further consultation with industry. The scheme could be voluntary, and therefore only cover participating businesses. Consumers wishing to protect themselves against travel agent insolvency risk can transact with participating businesses. In such a case, the system would need to be designed appropriately, and with government sign-off, to ensure no anti-competitive arrangements develop. Alternatively the scheme could be mandatory and include all travel agent businesses. A further option is allowing for businesses to 'opt-out' of the mandatory scheme if, for example, they are able to demonstrate that they satisfy market definitions of prudent capital structuring (eg the business is independently rated and maintains investment grade status).

There would also be some implementation issues for industry, and not merely membership and payment. It is envisaged that, under the scheme, industry may impose some requirements on participating businesses, including a degree of prudential supervision. It is likely that ACCC approval would also be required.

It is also envisaged that this scheme could draw on the current funds of the TCF to pay out compensation (if needed). This point is discussed further in Appendix G. It could still pursue charge-back and/or actions against the owners, directors or auditors of failed businesses. However, it is only likely to do so in the event this is likely to result in a net recovery of funds, considering legal costs.

### Relative merits

This option would remove a number of the costs to business of the current regime, including the cost of audited accounts, guarantees and other securities, and/or the opportunity cost of capital set aside to meet TCF financial criteria. As demonstrated in discussing the previous option, these costs far outweigh the current financial loss to consumers from agency failure (\$16.5 million as compared to \$2.9 million in claims).

Conceptually, the relative merits of this option, as compared to the current scheme, depend on whether industry is capable of delivering a compensation scheme at lower economic cost than the TCF. An industry-led scheme is likely to involve some of the requirements currently imposed by the TCF, including possibly some prudential oversight. However, lower overall cost might be achieved, for example, by:

- better targeting prudential requirements, based on superior knowledge of the industry
- better striking the balance between financial risk (reflected in expected losses) and prudential supervision (which is costly)
- no longer pursuing legal action where it is not likely to result in a net gain.

There is some reason to suggest this may be possible. The TCF, by virtue of its nature and mandate, has little incentive to reduce the compliance cost on business. Compliance measures reduce the exposure of the TCF without their incurring any cost. Industry therefore is likely to have clearer incentives to ensure the scheme is efficiently run, considering all costs (financial and non financial).

The experience of TAANZ in New Zealand also suggests this might be possible. TAANZ, which includes both a compensation scheme and prudential oversight, received a total of almost \$500,000 in membership and other fees from its 443 members; an average of \$1,124 per member. By comparison, the TCF received \$3.7 million in contributions and application/renewal fees for 2,857 participants; an average of approximately \$1,300 per business.<sup>197</sup> A number of the obligations imposed by the TCF are not imposed on TAANZ members, including:

- the preparation of audited financial accounts
- minimum shareholder equity rules only apply for the first two years of membership
- net tangible assets and working capital tests are not applied.

Membership for TAANZ is also separated into different categories, such that businesses with a low turnover have less rigorous requirements than those with high turnover and new members have slightly different requirements than existing ones.

All TAANZ members are however required to provide securities (minimum of \$50,000) and more onerous training requirements are imposed than those under the Australian licensing system.

It should be noted that this scheme may be unable to cover the loss to consumers in the event a major player collapses. However, as mentioned earlier, the current system is also unable to cope with

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<sup>197</sup> Based on figures from the most recent reporting year for each organisation.

such a collapse and, as such, consumers are not worse off under this scheme.

A further advantage of a voluntary scheme is the potential to promote the use of an 'accredited' travel agent (that is, one participating in the scheme). This empowers consumers to take responsibility for their choice whether or not to obtain solvency protection.

This option – an industry-led compensation scheme – is not recommended given, as outlined elsewhere, the onerous and disproportionate nature of an insolvency protection scheme relative to the demonstrable need for this protection. This option also relies on the participation of industry.

Nonetheless, this option has some merits. It has some significant advantages over the *status quo*, in that it:

- places the onus on industry to achieve the same level of consumer protection via the most efficient means – potentially allowing for a less costly and onerous regime
- is a voluntary scheme, requiring only those businesses who perceive a commercial advantage from this protection (based on the value consumers place on such a scheme) to be bound by the scheme.

This option has some implementation issues that should be considered, for example engagement with industry.

## Option 6: Enhance existing regulatory structure

This option involves reforming, at a relatively granular level, the existing regulatory scheme, while retaining its broad components. Reforms could include:

- limiting the coverage of the scheme to outbound travel only
- focussing the TCF's prudential functions on money at risk
- allowing exemptions from the scheme for businesses able to demonstrate alternative prudential oversight
- reform of the governance of the TCF.

Such reforms could be considered minor reforms, relative to the other options outlined in this report. The key features remain largely unchanged and, accordingly, the reforms mean minimal diminution of consumer protection.

To a large extent however this option retains the anomalous treatment of this industry and would continue to represent an onerous and disproportionate regulatory response.

Importantly, we do not propose amending the current definition of a travel agent. Most concerns in this respect relate to neutrality amongst competitors and seemingly anomalous outcomes, rather than consumer protection issues. There are few consumer protection grounds for including in the scheme businesses that are currently excluded by the definition (eg tour desks, accommodation only intermediaries).

### Limiting coverage

In relation to the key consumer detriment concern the compensation scheme aims to address (the loss of prepayments) international travel represents the bulk of the risk. International travel is far more likely than domestic travel to:

- involve substantial sums of money
- involve prepayments well in advance of the travel date.

This reform would avoid some (but not all) of the definitional issues/anti-competitive concerns of industry (ie in relation to domestic tour desks and accommodation only providers). Potentially it could also allow some businesses, such as inbound tour operators, to be excluded from the scheme.

In terms of scope, the majority of purchases through travel agents would still be covered, as international travel accounts for almost 80 per cent of travel agents' revenue.<sup>198</sup> However it represents a more targeted approach to the protection of consumers' funds.

### Focus on money at risk

At present, the TCF's approach has some characteristics that appear not to be well targeted at the risk being protected. These include:

- monitoring and assessing businesses based on their entire activities and financials, rather than monies at risk
- charging the same initial contribution and annual renewal fee to all members regardless of the size of the business and their impact on potential exposure of the fund.

Accordingly, the operation of the fund could be improved by redirecting the attention of the scheme towards the monies at risk and providing deferential and appropriate treatment of businesses according to the risk they pose to consumers' funds and therefore the TCF. Such measures would also give businesses an incentive to change their practices to reduce the risk to consumer funds; for example, by limiting prepayment periods.

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<sup>198</sup> PwC Travel Agents Survey.

A key element of this reform would be setting premiums (initial contributions and renewal fees) commensurate with the risk and exposure to the fund from the business (ie risk-based premiums). This reform has already had preliminary consideration by the TCF, who delayed further work until the completion of this review.<sup>199</sup>

## Exemptions

At present, the TCF and its current capital reserves could not fully compensate consumers in the event a major travel agency business collapsed. To be adequately capitalised for such an eventuality would require the TCF to maintain very large capital reserves and would be prohibitively costly.

In addition, a number of these major players are subject to additional prudential scrutiny by virtue of, for example, being publicly listed on the ASX. Such businesses are scrutinised on a daily basis by investors, creditors and ratings agencies – activities which duplicate the oversight of the TCF. These businesses also argue they bear excessive constraints on the operation of their business, with the capital adequacy rules imposing a greater burden on their business (eg capital restructuring, acquisitions) as compared to smaller businesses.

A reduction in the cost of prudential supervision with little associated consumer detriment could be achieved by allowing an exemption from the scheme if a business is able to demonstrate that it satisfies market definitions of prudent capital structuring; for example, if a business is publically listed, has independent rating of credit worthiness and satisfies an appropriate grade (eg investment grade or above). This exemption would allow the TCF to cover the risks that it was originally established to cover (and, indeed, presently has sufficient capital reserves to cover), namely, smaller agencies. Admittedly, large companies do fail. However, the fund is already unable to fully compensate in the case of such a collapse and hence this reform does not represent a diminution of consumer protection.

## Reform of governance arrangements

The TCF is currently governed by its trust deed, a document developed by agreement from the various states and territories. This document outlines the role, responsibilities, powers and functions of the fund.

This governance structure does not provide the accountability and review of decisions that would ordinarily be provided under a modern regulatory framework. Accordingly, consideration should be had to reforming the structure of the organisation to be more in line with best practice government organisation.

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<sup>199</sup> Travel Compensation Fund (2009) Annual Report.

The exact nature of the appropriate structure depends on the functions the body retains. It may be appropriate to separate the pure administration of the fund from the regulatory-like functions of prudential oversight. These functions could be performed by a constituent part of APRA, a regulatory body with other prudential responsibilities. Assuming the adoption of a national licensing/registration scheme, these functions should be incorporated into a single national body. In such a case, a regulatory agency or statutory authority may be a more appropriate structure.

Given the lack of clear evidence of the need for the existing regime, this option has no policy basis. It retains the disproportionate and onerous intervention in this sector.

Nevertheless, this option has some merits as it realises some of the benefits of reform and satisfies most of the major concerns raised by stakeholders. It also represents a marginal reform relative to the *status quo* and, accordingly, may be attractive in a practical sense.

## 6 Recommendations

### Key messages

PwC recommends that consumer protection in the travel industry be centred on the generic provisions of the proposed Australian Consumer Law, supported by voluntary accreditation under the National Tourism Accreditation Framework.

With respect to the travel agents market, this entails replacing the existing licensing regimes of each state and territory with a single national registration scheme. This scheme requires minimal entry criteria related to ensuring the *bona fide* nature of entrants.

Removing the compensation scheme has the most in principle merit and should be adopted as the preferred reform option for the travel agents compensation scheme.

Nevertheless, depending on the policy priority afforded to consumer protection and the appetite for policy change, an industry-led compensation scheme or reforms and enhancements to the existing regime have some merit. Accordingly, the shift in consumer protection and implementation issues should be carefully considered.

### Reform objectives

On the basis of our review of the need for consumer protection regulation in the travel industry and of the consumer protection framework in place (ie Chapters 1 to 4), PwC considers the following to be the appropriate objectives of regulatory reform in this sector.

1. To place primary reliance for consumer protection regulation on the generic consumer protection regulations of the Australian Consumer Law.
2. To endorse and support the adoption of the National Tourism Accreditation Framework (NTAF) throughout the travel industry as a driver of business quality assurance via voluntary accreditation.
3. To replace the existing travel agents licensing regime with a registration scheme that imposes less cost on business while maintaining elements of the existing scheme that provide consumer benefits.
4. To reform the existing travel agents compensation scheme to impose a burden more commensurate with the risk of consumer detriment, the vulnerability of consumers and the nature and systemic importance of the sector.

With these objectives in mind, our recommendations for reform of the consumer protection framework in the travel industry are structured in two parts.

- **Overarching framework.** PwC's recommendations for an overarching consumer protection policy framework for the travel industry are centred on:
  - voluntary accreditation under the proposed National Tourism Accreditation Framework
  - generic consumer protection regulation under the Australian Consumer Law.
- **Reform of the existing regulatory framework applicable to travel agents.** PwC's recommendations for the travel agents market include:
  - a national registration scheme
  - voluntary accreditation under the NTAF
  - the possibility of expanding the proposed Aviation Ombudsman and establishing an enforceable industry code of conduct under the ACL
  - discontinuing the insolvency protection regime administered by the TCF – with respect to this reform, two other options with some merit are also discussed.

We have also outlined in Appendix G possible alternative uses of the TCF's current capital reserves in the event a chosen reform made these funds available.

## 6.1 Overarching framework

The consumer protection framework for the travel industry should be built on two key elements:

- voluntary accreditation under the NTAF for all travel businesses, supported by, in relation to travel agents, a national registration scheme
- the generic consumer protection provisions of the proposed Australian Consumer Law (ACL).

The details of each, including their driving rationale, are discussed below.

### National registration and accreditation

In recognition of its important role in driving social, cultural and economic development across the country, Australia's travel industry is the subject of a proposed specific accreditation scheme, the NTAF. PwC's recommendation is that the entire travel industry, including (most significantly) travel agents, be included in this

scheme – providing voluntary accreditation to all businesses in the industry.

Further details of the NTAf, including current expectations of the timeframe for the framework's implementation, are outlined in Chapter 2.

## Australian Consumer Law

The proposed Australian Consumer Law (ACL) is to be the centrepiece of Australia's consumer protection framework once enacted. As discussed, the generic consumer law should only be supplemented by specific provisions where a demonstrable need is established and the provisions' appropriateness is assessed.

PwC considers that there is little evidence of a consumer protection problem relating to business conduct to justify a departure from the generic provisions. Importantly, the industry demonstrates few of the characteristics identified by the Productivity Commission that suggest industry specific protection might be necessary; for example, the risk of consumer detriment is not excessive or irremediable and consumers can, to some degree, ascertain the quality and reliability of a business prior to the transaction.

The proposed ACL (and the existing laws) provides a number of important consumer protection measures relevant to the travel industry, including:

- single unit pricing – displaying the single price of packaged goods and services (including all relevant taxes and charges)
- prohibition on 'bait advertising'
- rules against accepting payment for a good or service without intending or being able to supply as ordered.

The ACL will also maintain the ability to establish enforceable industry codes of conduct, to which all businesses in a particular industry are to comply. Under this mechanism, specific enforcement measures can be retained despite the absence of the disciplinary powers associated with licensing.

## 6.2 Reform of the regulatory regime for travel agents

It is clear to all stakeholders, and from the available evidence, that significant reform is necessary in this sector. Put simply, the *status quo* is not appropriate.

### Reform of the licensing regime

Applying the overarching framework outlined above to travel agents, PwC recommends that the sector be regulated by a national

registration scheme, supported by voluntary participation in an accreditation program consistent with the NTAF. This will include replacing the existing state and territory based licensing schemes and removing the associated training and competency requirements.

The key reform elements under this recommendation are as follows.

- Establishing voluntary accreditation schemes under the NTAF.
- Replacing licensing obligations for travel agents with a national registration scheme.
- Removal of training and experience obligations for travel agents.
- The *option* of expanding the scope of the proposed Aviation Ombudsman to include consumer protection relating to the travel industry more broadly.
- The *option* of an enforceable industry code of conduct under the ACL.

### Voluntary accreditation

The NTAF, described in detail in section 2.3, is an umbrella accreditation framework designed to promote standards, industry competency and dispute/problem resolution. As an umbrella framework, it supplements and supports a collection of accreditation schemes in the various travel and tourism related industries.

One of the more important components of the proposed NTAF is specifying minimum standards for dispute resolution processes. Under the scheme, qualifying accreditation programs will be required to develop and maintain appropriate mechanisms by which consumers can seek redress for inadequate or poor quality service.

Importantly, at present no industry accreditation scheme in relation to travel agents is identified for inclusion in the NTAF. This is not unexpected as it is likely that the presence of a compulsory licensing scheme reduces the value (in the eyes of consumers) of accreditation with an industry association. Accordingly, for travel agents to participate in this scheme, an appropriate accreditation scheme would need to be established.

Conditional on the removal of the existing licensing regime, PwC anticipates there would be an appetite amongst the existing industry associations (AFTA, ATEC, etc) to administer a qualifying accreditation scheme under the NTAF. These bodies already have a substantial membership base and enforce codes of ethics. In addition, as these organisations already perform the activities required to maintain a membership base (eg enforcement of codes, administration), such a scheme could potentially come at little additional cost to business.

## National registration scheme for travel agents

There appears to be little ongoing justification for requiring licensing of travel agents. While licensing can serve a variety of purposes (see 1.1), none of these provide compelling justification for retaining these requirements.

The key strengths of the existing licensing regime could be maintained via a less onerous regime, properly described as a registration scheme. The scheme would have the following elements:

- registration of all travel agent businesses to:
  - keep track of participants in the sector
  - if necessary, mandate participation in any ongoing compensation scheme
- screening for *bona fide* industry participants (ie 'fit and proper persons', over 18 years of age)
- registration fees, appropriate to fund compliance activities by state or territory fair trading bodies.

The scheme would be a national system, administered by a single national body. In the event a compensation scheme is retained (under several options below) it seems appropriate that this body is charged with administering the registration scheme also. Under the national scheme:

- administrative requirements for travel agents (ie registration, information disclosure) would be reduced by consolidating the administration of the registration (formerly licensing) and compensation schemes into a single national body
- businesses would be required to obtain a single national registration, which allows them to conduct business in all states and territories
- the differences between state/territory regimes would be removed by a single national scheme, which outlines which businesses must be registered, what *bona fide* requirements are mandated, etc.

Registration would place a small administrative cost on business (completing required forms, providing business information, etc). In addition, a small fee is envisaged to provide resources for:

- the registration body for processing and administration costs
- fair trading bodies for enforcement activities relating to the industry.

It is anticipated that this is likely to represent a reduction on current fees, given the relative decline in administrative requirements. While this approach may not remove any definitional issues around who is and who is not a travel agent, it would lower the cost to businesses

and hence the savings should result in reduced concern around industry demarcation. Furthermore, it would encourage participation and regulatory oversight and could be designed to capture internet based businesses domiciled outside of Australia.

Ideally, this reform would be implemented in conjunction with the harmonisation of licensing regimes under the proposed National Licensing System (NLS). Depending on the precise nature of the NLS, administration of the scheme could potentially be delegated to the new National Licensing Body. PwC understands that given the current state of national licensing reform, the licensing/registration of travel agents is not a priority. As such, the incorporation of travel agents into this reform may be inappropriate at the present time.

### Removal of training and experience requirements for travel agents

Mandating training requirements, on the whole, provides little consumer benefit; either being unnecessary or likely to be undertaken by business anyway.

The practical nature of the training means that many of the key aspects of travel agents' service are not covered by the training requirements. These include knowledge or experience with the travel destination, travel related advice (eg travel tips, insurance, etc) and trip planning/administration advice.

Meanwhile the requirements impose a cost to individuals and businesses including the cost of the course and completion time. PwC estimates the cost to industry of this requirement at \$4.3 million per annum.

PwC recommends that these requirements be removed. That is, under a proposed registration scheme entrants to the market would only be screened for particulars establishing their *bona fide* nature.

### Option: Expanded Aviation Ombudsman

The Aviation Industry Ombudsman, proposed by the Australian Government's Aviation White Paper, was noted earlier. It is intended to improve consumer protection in the Australian domestic and international travel sector by establishing an external mechanism for resolving disputes between carriers and consumers.

The establishment of an industry ombudsman in the aviation sector appears appropriate given:

- the concentration in Australia's domestic air travel industry
- the relatively high number of complaints received by consumer affairs bodies in relation to this sector.

PwC believes it would be desirable to expand the role of this body to provide a dispute resolution mechanism for the entire travel and

travel related services sector. This body could handle complaints relating to such issues as poor or incompetent service, failure to deliver a product, or the provision of misleading or insufficient information.

It should be noted that the development of this body is still in its infancy and significant work is still required to realise this proposal. Accordingly, including travel agents under the responsibility of an expanded Aviation Ombudsman may not be feasible in the short term.

### Option: Enforceable code of conduct

As noted earlier, the ACL will retain the current provisions in the *Trade Practices Act* that allow for the creation of an enforceable industry code of conduct. The advantage of this option is that it provides industry-specific enforcement powers to fair trading bodies, without the regulatory burden of a licensing regime.

PwC considers there may be some merit in developing an industry code of conduct for the travel industry to promote industry standards in lieu of licensing. In particular, this measure may be an appropriate alternative to voluntary accreditation under the NTAF if this initiative fails to generate sufficient industry participation. Accordingly, this option should be considered in line with the timing of the NTAF and ACL's implementation.

## Reform of the insolvency protection scheme

Having reviewed the need for consumer protection in this industry, a demonstrable case for regulatory protection against losses from travel agent insolvency was not found. This conclusion was based on:

- the relatively small risk of consumer detriment that currently presents itself in the market
- the regulatory approach taken in other comparable industries
- the relative size and systemic importance of the industry
- analysis suggesting the costs of most elements of the existing regime exceed their associated benefits
- a general presumption of allowing free and competitive markets to operate unrestrained unless a clear case for intervention can be demonstrated.

Therefore, PwC recommends the removal of all insolvency protection from the currently regulatory framework.

While the removal of all insolvency protection regulation is in principle the most appealing and best reflects of the need for consumer protection in this sector, PwC expects that the ultimate preferred policy option will also be informed by:

- the policy priority afforded to consumer protection
- practical considerations regarding implementation.

From the options outlined in Chapter 5, a further two were identified as being likely to achieve substantial positive net benefits. Each of these options has some merit and represents a substantial improvement on the *status quo*. They are:

- industry-led compensation scheme
- enhance existing regulatory structure.

To properly inform policy decision-making, the relative merits of each of these three options are outlined in this section.

### No insolvency protection

The deregulatory option, removing the regulatory protection against business insolvency, has the most in principle merits. As demonstrated in Chapter 3, our analysis of the need for consumer protection did not demonstrate a compelling case for government intervention in this market. This conclusion was based on:

- recent changes in the industry reducing the vulnerability of consumers – including the development of non regulatory protection options (eg credit cards) and the potential to bypass travel agents altogether via the internet and online purchasing options
- industry trends that have reduced the volatility of the industry and the exposure of consumer funds to potential loss
- the risk and magnitude of potential consumer detriment being:
  - comparable to many industries that government has not seen fit to regulate in a substantial and onerous way
  - not comparable to the few industries in which it has.

Given the above, PwC expects this option is likely to produce the greatest net benefit, driven by the removal of the majority of the existing regulatory burdens on business. Given the highly competitive nature of the travel agents' sector, it is likely that the majority of these savings will flow through to consumers in lower prices/margins on travel agent services.

Admittedly however, this option represents a major shift in the existing regulatory framework, including:

- placing increasing responsibility for consumer protection on consumers themselves
- substantial implementation measures.

Accordingly, careful consideration should be given to the implications of this change.

## Consumer protection

This reform places the primary burden for consumer protection in relation to business insolvency on consumers. This may be appropriate, assuming consumers are not especially vulnerable and sufficient non regulatory consumer protection options are available.

While this option clearly represents a diminution of consumer protection, the following is relevant.

- The diminution of protection relates to insolvency protection only. The valuable components of other consumer protection measures are retained by the overarching framework, with those that provide little consumer benefit (eg training) being removed.
- The regulatory regime still addresses fraud, misleading and deceptive conduct, breaches of officers'/directors' duties and other business misconduct under the generic consumer protection laws. These measures provide deterrence from such conduct and mechanisms to prosecute if it occurs.

In addition, the following measures will/may be available to consumers to protect themselves from these risks:

- the use of credit cards that offer the charge-back mechanism in the case of non delivery
- direct purchasing from travel service suppliers – while prepayments to travel service suppliers also involve insolvency risk they are not protected by the existing scheme and hence this option does not represent a diminution of protection for these purchases
- purchasing from well known, reputable or trusted businesses – it is noted in respect of purchases from large businesses, given the inability of the TCF to guarantee compensation in the case such businesses collapse, this does not amount to diminution of protection
- if available, private insurance.

## Practical considerations

This option represents a substantial regulatory change. Accordingly, careful consideration should be given to the reform steps necessary to achieve implementation, most notably winding up the TCF. These steps are outlined in more detail in the following chapter.

In addition, it is at least foreseeable that consumers may, at least initially, under-utilise the protection options available to them. Consumers have enjoyed, albeit tacitly, the protection of the TCF for over two decades. As a result, and given the resulting lack of media and other attention to travel agent collapses and the loss of consumer funds, consumers may not properly appreciate the risks to their funds from business insolvency. For example, consumers may erroneously expect their prepayments are held in isolated

accounts<sup>200</sup> or may fail to adequately assess the solvency of businesses before engaging with them.

Accordingly, there may be merit in conducting a phased winding up of the compensation scheme. This option gives a period of time for improved consumer awareness, potentially via an information campaign funded by the reserves of the TCF. One option is the immediate removal of the TCF's prudential oversight function while retaining the compensation scheme for a period of time, say three to five years.

This option has the further advantage of allowing time to observe the resulting increase in industry volatility. Expectations of the likely increase are necessarily imperfect. This option allows for monitoring of the change in the industry in the absence of the prudential oversight. Decisions can then be made as the necessity of the compensation scheme and/or whether consumer detriment is unacceptable in the absence of the scheme.

Options for the use of the TCF's current capital reserves are discussed in Appendix G.

### Industry-led compensation

In the event that, for whatever reasons, the removal of all insolvency protection regulation is not preferred by government, an alternative (or 'second best') option is to facilitate the establishment of an industry-led compensation scheme.

This option closely mirrors the existing regime in New Zealand, administered by TAANZ. The key advantage of the scheme relates to placing the onus on industry to provide the current level of consumer protection. To the extent they are able to do so at less cost, industry will enjoy the benefits of efficiency gains through lower membership fees and/or reduced restrictions or impositions on business operations. Based on the TAANZ example, efficiency gains may be possible.

As outlined, this scheme could take one of three forms.

- **Mandatory.** This has the advantage of competitive neutrality and, at least conceptually, providing the same protection to consumers regardless of who they purchase from. Importantly however, it is unlikely that the scheme could withstand the collapse of a major player; this is also the case with the TCF.
- **Mandatory with opt-out provisions.** This allows businesses that satisfy certain criteria (alternative oversight, independent rating, etc) to exit the scheme. The advantage is that the scheme would only regulate (and therefore impose costs on) those businesses that are not already monitored elsewhere.

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<sup>200</sup> The PwC Consumer Survey suggests that 71 per cent of consumers expect some or all of their money to be held by travel agents in a separate account.

Consumers would also be empowered to choose the value they place on such protection by choosing whether or not to purchase from a participating agent. Opt-out criteria could include:

- listing on an eligible exchange
- independent rating of investment grade or above
- certain business practices (eg maintenance of a dedicated trust account, minimum capital balances, etc).

It is expected that under this format large players would opt-out of the scheme. This has the advantage of removing the scheme's exposure to businesses it is unable to fully compensate for, and targeting protection at the type of businesses that the compensation scheme was initially designed for; that is, small 'corner store' businesses rather than large publicly listed entities.

- Voluntary scheme. This scheme is similar to the TAANZ scheme. Its advantage is that protection is limited to those businesses that see a commercial advantage from participation. As with the opt-out option, consumers are empowered to choose whether or not to purchase from participating agents, based on the value they place on this protection.

One suggested weakness of a voluntary scheme is the possibility that few businesses will opt in, presumably seeing no commercial advantage in doing so. The TAANZ experience suggests otherwise.<sup>201</sup> Such eventuality may also demonstrate the value (or lack thereof) consumers place on such protection, which draws into question the value of the scheme in any event.

A further issue to note with a voluntary scheme is ensuring it is carefully designed and its implementation monitored, to prevent its conditions or operation having an anti-competitive effect.

The mandatory scheme with opt-out provisions has some appeal. It removes some key cost elements of the scheme, in particular the compliance imposition on large players, while retaining the current level of consumer protection.

Nonetheless, this option has the conceptual issues noted above. That is, it amounts to a relatively substantial regulatory intervention in the absence of a clear and demonstrable need for this protection.

### Consumer protection

A key advantage of this scheme is that it retains the current level of protection for consumers. It places the onus for providing this

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<sup>201</sup> TAANZ suggests that its members include approximately 90 per cent of travel agencies in New Zealand.

protection on industry, who have an incentive to ensure the current level of protection is provided in the most efficient manner.

To the extent businesses are able to opt-out, the responsibility for consumer protection is shifted towards consumers. Nonetheless, assuming a mandatory scheme or a voluntary scheme with significant uptake, consumers will be able to choose to transact with participating businesses, in addition to utilising other non regulatory consumer protection options.

Furthermore, it is anticipated that businesses that opt-out will, for the most part, be large players. Given the limited ability of the current scheme to guarantee compensation in the event one of these players collapsed, this does not amount to a diminution of protection as compared to the *status quo*.

### Practical considerations

A key and substantial barrier to the implementation of the scheme is that it relies on the willingness of industry, and in particular an industry association (most probably, AFTA)<sup>202</sup> to facilitate the development of this scheme. While this has been achieved in New Zealand, significant industry buy-in is required.

A number of possible inducements may aid the uptake of this scheme, including the following.

- Predicating other reform measures recommended in this report on the uptake of such a scheme; for example, making the removal of licensing, training requirements and the TCF conditional upon the implementation of this scheme. Given the cost burden of these measures, it is in industry's interest to facilitate this scheme.
- Dedicating the TCF's capital reserves (currently over \$25 million) to a fund from which compensation is paid. As outlined elsewhere, this represents almost nine years' average compensation at the current rate of failure. Such a transfer reduces the cost of the scheme on participating businesses. In addition, given it was raised via industry fees, such a transfer may be appropriate.

A further consideration is the development of the structure, requirements and conditions of membership for a voluntary scheme. It is foreseeable that such a scheme could have an anti-competitive effect, if not carefully designed. The ACCC appears to be the appropriate body to oversight the development, implementation and operation of such a scheme. It may, in any event, already require ACCC approval under the *Trade Practices Act's* competition rules.

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<sup>202</sup> AFTA would seem the most logical body to implement this scheme, given its membership includes over 60 per cent of the industry.

As a first step, should this option be considered desirable, PwC recommends considerable engagement with industry stakeholders to gauge the appetite for such a measure.

### Enhance the existing regulatory structure

Finally, in the event that the deregulatory or industry-led approaches are not preferred by government, a third best approach could be the enhancement of the regulatory scheme while retaining its broad configuration.

Considerable improvement on the *status quo* could be achieved without wholesale structural reform of the regulatory regime. Important measures, highlighted earlier, are:

- limiting the coverage of the scheme to outbound travel only – focussing the scheme on funds most at risk and preventing some of the anomalies of the current scheme
- focussing the TCF's prudential functions on money at risk – limiting the impost on large companies operating in multiple markets
- allowing exemptions from the scheme for businesses able to demonstrate alternative prudential oversight – in particular, large publicly listed businesses
- reform of the governance of the TCF – including merging the licensing (or registration) and compensation functions into a single regulatory body with a modern regulatory structure.

These measures, combined with the removal of the licensing regime (including training and other requirements) and implementing a national scheme, remove many costs of the current regime and satisfy the wishes of many stakeholders.

While this option has the advantages of being 'the path of least resistance', having few significant implementation issues, and retaining the current level of consumer protection, it has little in principle or conceptual basis.

### Consumer protection

Responsibility for consumer protection under this option remains with the relevant regulatory body (eg the TCF), directly funded by industry. No reform measure under this option substantially alters the existing level of consumer protection.

### Practical considerations

Each measure under this option can be implemented independently of the other, with various issues and considerations for each.

Limiting the scheme to outbound travel involves two steps:

- altering the TCF's mandate under the trust deed – this is a reasonably simple measure for which there is precedent
- changing the terms of existing travel agents regulations to exclude businesses that sell domestic travel products only – this measure is more significant but can be incorporated in the changes required for a national registration scheme.

Refocusing the TCF's prudential oversight on 'funds at risk' is a relatively simple reform to implement and merely requires a change in the TCF's policies and practices. In practice, this involves the following.

- Charging premiums based on the risk and exposure caused by the entity. We understand that considerable work has already been performed by the TCF in this respect.
- Changing TCF's policies regarding the capital adequacy tests.

Provision for the exclusion of certain businesses could similarly be a relatively simple reform. The simplest means of achieving this reform would be to have businesses remain 'participants in the TCF' for the purposes of their licensing regimes, but being exempt from its prudential requirements, fees and other measures. This is also the most flexible means and allows for ongoing monitoring of the entities' compliance with the relevant opt-out conditions. Some consideration of the precise nature of the opt-out conditions would be required. Given the shape of the current industry, public listing and/or an independent rating of investment grade or above could be a good starting point.

Reforming the government structure of the regime is a more involved process that would preferably be incorporated with the reforms to the licensing scheme recommended by this report (discussed above).

## 7 Implementation

PwC's recommendation is that consumer protection in the travel and travel related services industry is based on the following:

- voluntary accreditation under the NTAF for all travel businesses, supported by, in relation to travel agents:
  - a national registration scheme
  - no insolvency protection regime.
- the generic consumer protection provisions of the proposed Australian Consumer Law.

With respect to the majority of the travel industry, these recommendations represent either the *status quo* or reforms that are already in train (eg the NTAF and Aviation Ombudsman). With respect to the travel agents industry however, these recommendations represent a substantial departure from the *status quo* and, accordingly, require significant reform measures to be put in place.

Careful consideration should be had to the mechanism for implementing these recommendations. This chapter comments on implementation by outlining:

- **the steps** required to achieve the desired 'end point'
- consideration of **the timing** of such measures, including certain interim reforms that can realise some of the benefits of the reform and can be implemented immediately.

Finally, this chapter outlines a suggested timeline for reform, based on reform milestones.

### 7.1 Implementation steps

Table 7 outlines the various components of the recommendations outlined in Chapter 6 and the reform measures required to achieve them.

Table 7 – Recommended reform and implementation steps

Reform component	Required steps
National registration scheme	Establish/designate a national registration body
	Development and enactment of governing Commonwealth legislation
	Repeal state and territory regulations
Australian Consumer Law	Development of industry code of conduct
National Tourism Accreditation Framework	Promotion of industry accreditation mechanism
Removal of compensation scheme	Amendment to Travel Agents regulations
	Termination of Travel Compensation Fund
	Distribution of fund reserves

## National registration scheme

Implementing a national scheme requires:

- the establishment of a national registration body
- the referral of regulatory powers from the states/territories to the Commonwealth
- development and enactment of governing Commonwealth legislation
- the repeal of state and territory regulations.

## National registration body

National licensing is currently an ongoing agenda for Australian Governments, in particular through the development of the National Licensing System (NLS). The NLS is to be established over the coming years to facilitate the coordination of national licensing for various occupations. Part of the initiative is the establishment of a national licensing body with responsibility for licence policy, standard setting and disciplinary arrangements. Under the NLS, while the states and territories will continue to process occupational licences, businesses will be issued national licences that allow them to conduct business in all Australian jurisdictions.

The NLS' National Licensing Body (NLB) appears the most appropriate body to administer the national travel agents registration scheme. Consistent with other industries, licences could be processed by existing state entities, with administrative costs being recovered from the national body (funded by licensing fees) under a service agreement.

An alternative structure (or interim measure, see below) could be an office or agency established under the Department of Resources, Energy and Tourism (DRET). While this has the advantage of locating the responsibility with the relevant portfolio department, the functions required (eg issue or cancellation of licences) appears more suited to the NLB rather than a policy-making department.

## Commonwealth legislation

Under the NLS, licensing remains essentially state based, with consistent provisions enacted by cooperative legislation by each jurisdiction. This mechanism reflected a desire for regulation of the relevant industries to remain firmly in the jurisdiction of the states; this was particularly important given the existence of a number of state regulatory agencies that were to remain operative. The regulation of travel agents does not seem to have the same imperative, particularly given the major existing regulatory body (the TCF) is a national one. Accordingly, a transfer of regulatory responsibility to the Commonwealth seems appropriate. Nevertheless, as with the NLS, a similar regime can be achieved through the implementation of 'mirroring' cooperation legislation.

Most notably, this may require a referral of powers from the states. At present, the Commonwealth heads of power under the Australian Constitution only allow for the regulation by the Commonwealth of corporate travel agents and those engaged in cross border trade. The referral of powers should be facilitated by MCCA and SCOCA.

The Commonwealth legislation should largely mirror the consistent elements of the state laws, as outlined in the National Scheme, save for the removal of:

- training and experience requirements for licence holders and/or store managers
- associated notification requirements (eg for a change of store manager, etc) – it is anticipated that ongoing notification requirements will only concern business particulars (eg locations, contact details, etc)
- the requirement to be a member of the TCF
- the disciplinary powers invested in the relevant licensing authority.

We do not propose amending the definition of a travel agent. Concerns in this respect primarily related to neutrality between competitors, concerns that should be largely minimised by substantially reducing the burden on business from the regime.

As discussed, the remaining requirements (relating to establishing 'fit and proper' persons) would be retained. In relation to some matters differences appear in the various state and territories acts. A nationally agreed set of 'fit and proper person' tests would need to be agreed, again facilitated by MCCA and SCOCA.

Importantly, some jurisdiction would be retained by the states in relation to the enforcement of an industry code of conduct established under the ACL. This function would be performed by the relevant fair trading/consumer affairs bodies. These activities would require funding that is appropriately sourced from registration fees. Therefore, provision would need to be made to redirect some of the registration fees received by the national body to the states.

## Repeal of state legislation

The final step in implementing a national scheme is the repeal of state regulations. Clearly this should occur in conjunction with the new national laws.

Some of the provisions that are not to be enacted by the Commonwealth laws (eg disciplinary powers for licensing authorities) are appropriate in the context of an industry code of conduct under the ACL. Accordingly, repeal of state laws should also be timed to occur after the establishment of these provisions. In this respect, the removal of state laws could be flexible, removing some of the burdensome requirements (eg notification rules) prior to a formal repeal of the legislation.

## Australian Consumer Law

The majority of the measures relevant to this industry are already either contained in the pre-existing fair trading legislation or proposed under the ACL. The ACL will shortly have effect and is expected to be fully implemented by January 2011.

An important reform recommended by this review is the establishment of an industry code of conduct under section 51AE of the *Trade Practices Act* (or the relevant provisions of the ACL). These codes provide enforceable industry codes that regulate the conduct of businesses in a particular industry. Accordingly, they provide a useful mechanism for industry-specific requirements consistent with the generic consumer law.

In order to effectively improve consumer protection outcomes without unduly burdening businesses, the code's condition should not replicate the provisions of the ACL. Rather the code should provide for specific application of the provisions to the industry and should specifically target identified problems in the industry. Possible provisions could include the following:

- disclosure requirements, such as the obligation to inform consumers of:
  - the period of time for which consumer's funds or deposits will be held prior to forwarding to the relevant supplier
  - whether or not the business retains these funds in a separate client account and in what circumstances monies are removed from that account
  - whether or not the business is a member of a chain, franchise or affiliate group (eg a cooperative buying group)
  - whether or not the business is accredited under the NTAF (or other scheme)
  - the availability of insurance, including (if available) policies that cover travel agency insolvency

- the availability of external dispute resolution
- business conduct requirements, for example:
  - fairness and accuracy in advertising
  - specific rules for online traders, such as disclosure of registration details and transparency concerning the flows of funds
- matters to address other issues that may arise in the industry.

The state and territory fair trading agencies, potentially coordinated through SCOCA, appear best placed to develop the code. It is important the industry code accurately reflects major consumer protection concerns in the industry and has a high degree of buy-in from stakeholders. Accordingly, the code should be developed with substantial participation from industry.

## National Tourism Accreditation Framework

Following the establishment of the NTAF, expected in 2011, an applicable accreditation for the travel agents sector should be developed. At present, the self-regulatory code administered by ATEC is the only program with specific application to licensed travel agents (in this case inbound tour operators) that has been identified for potential inclusion in the NTAF. There are also generic tourism accreditation programs in place in six states and territories (the exceptions being Queensland and New South Wales) that operate under the Tourism Accreditation Australia Limited (TAAL) framework; a precursor to the NTAF. In addition, other associations (eg AFTA, CATO) maintain codes of conduct and other requirements.

Establishing a voluntary accreditation program for the travel agents market will require significant buy-in from industry and, most likely, the existing industry association (AFTA). AFTA, in its submission to this review, has already flagged its support for such a development, stating:

*AFTA recommends the introduction of a travel services provider accreditation system to link with and re-enforce the licensing system to provide an additional mechanism to guarantee service standards for consumers.*

*AFTA recognises that the existence of service provider accreditation systems gives consumers more confidence in dealing with accredited suppliers, in that there is a set minimum service level standards backed by some 'policing' and control mechanism to ensure minimum standards are maintained.<sup>203</sup>*

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<sup>203</sup> Australian Federation of Travel Agents (2010) Submission (page 51).

Given its role in the development of the NTAF, DRET appears best placed to drive the development of a participating accreditation scheme for travel agents. The scheme should be developed with substantial input from industry and be consistent with the principles of the NTAF. It should address the following matters:

- customer service, relating to:
  - standards and quality of staff
  - disclosure of information
- overall business operations
- dispute resolution processes including, if available, possible recourse of an industry ombudsman (eg under an expanded Aviation Ombudsman).

## Removal of the compensation scheme

The final reform is unwinding the operation of the existing compensation scheme. This involves two steps: removing the requirement for travel agents to participate in the fund and terminating the fund itself.

The first step can be achieved as part of the establishment of Commonwealth governing legislation. Nonetheless, given the likely timeframe for this reform (discussed below) the same can be achieved by immediate (or, at least, more timely) amendments to state and territories acts, or by exempting all agents from participating in the fund; the latter is the current situation in the Northern Territory.

The TCF's trust deed currently outlines the legal mechanisms and implications for terminating the trust.<sup>204</sup> Termination can be effected by a unanimous decision of either the TCF's Board or MCCA. Upon termination, the balance of the fund's capital reserves (after the payment of outstanding liabilities) will revert to the states and territories in proportion to the number of TCF participations domicile in each state/territory at the time of termination. Funds are not returned to participants. Potential alternative uses for TCF's reserves are outlined in Appendix G.

## 7.2 Timing and interim measures

While our recommended framework contains several measures available for immediate implementation, it builds upon recent government initiatives that, as yet, have not been fully implemented. These are:

- the Australian Consumer Law, to be fully implemented by 1 January 2011

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<sup>204</sup> Travel Compensation Fund Trust Deed Clause 27.

- the National Tourism Accreditation Framework, expected to be operational in 2011
- the National Licensing System, expected to be operational from January 2011
- the Aviation Ombudsman – being proposed by the Aviation White Paper (published December 2009), this initiative, as at the time of this report, is yet to be developed.

Accordingly, consideration should be had to the timing in which various measures can be feasibly implemented, in particular with respect to the development of a national registration scheme and the removal of the compensation scheme. In addition, given such timing, certain interim measures should be considered that may realise some of the benefits of the reform in a timelier manner.

## National registration scheme

The key barrier to the implementation of the national registration scheme is the development of the NLS. Ultimately, travel agents should be regulated by a registration scheme administered nationally by the NLB. At present, the NLS is expected to be operational from January 2011 however discussions with relevant stakeholders have indicated that travel agents are not a priority sector for the reform. Accordingly, incorporation of the travel agents registration into this body does not appear feasible within the next, say, five years.

As interim measures, with more immediate prospects for implementation, the following could realise some of the benefits of the scheme.

- **Removal of competency requirements** (and associated administrative/notification requirements) from existing state and territory licensing regimes. This would include a change in legislation/regulation at the individual state level, potentially via amendment to the terms of the National Scheme. A further component of this could be developing and enacting an agreed set of 'fit and proper person' criteria in readiness for a national regime.
- Introduction of **automatic recognition provisions**, whereby a licence in one state allows businesses to operate in all other Australian states and territories (similar to motor vehicle driver licensing). Admittedly, this may lead to businesses choosing to licence in the lowest cost jurisdiction, depriving states of revenues to fund compliance monitoring and enforcement activities. This could be overcome by implementing uniform licensing fees. In any event, this is an interim measure prior to uniform licensing (including fees) under a single national scheme.
- Establishment of an **alternative national body**, with functions to be transferred to the NLB when appropriate. There are two possible options in this respect.

- The TCF. In its current form, or in a transitional state, the TCF could in theory administer the licensing scheme. This would also realise the benefits of minimising regulatory and administrative duplication between the two bodies. Its trust structure however does not provide the appropriate accountability and review of decisions that is expected of a modern regulatory body, notwithstanding its prudential governance for the past two decades.

In practice, given the concurrent reforms towards terminating the fund, it may not be feasible for the TCF to perform this function.

- A new body. Establishing a regulatory office under the relevant portfolio department (DRET) would allow for a modern regulatory structure with ties to under reform measures (eg the development of an accreditation scheme).

In either event, the intention is that the functions of this body can be easily transferred to the NLB when appropriate.

## Removal of compensation scheme

There may be some merit to the phased removal of the compensation scheme, namely the immediate removal of the prudential oversight function followed by disbanding the competency scheme and other functions. This may allow for the use of TCF reserve funds to assist with transition, for example funding an information campaign.

Accordingly, the phased removal could occur via the following steps.

- Removal of prudential oversight requirements. This includes administrative requirements (audited financial returns, other disclosures), compliance with capital adequacy rules and (where necessary) provision of securities. This reform could be achieved relatively quickly as it only requires a change to TCF's policies and practices.
- Removal of upfront contributions, membership fees and other revenue from industry. These fees could be retained initially to continue to provide some barriers to market entry, while observations can be made concerning the increase in industry volatility from the removal of prudential oversight. These could also, to some extent, retain the balance of the TCF's capital reserves.
- Information campaign. Some of the capital reserves could be used to advise consumers of the impending removal of the compensation scheme and other associated reforms to the regulation of this sector. The campaign could include brochures for distribution by agents, media releases and advertising via travel related media and internet sites.

- Removal of compensation function. Upon termination, the balance of funds would be returned to the states. As noted, these funds could be recommitted to the body administering the national licensing, for example to fund action on behalf of consumers or compensate consumers in cases of particular hardship.

While the TCF appears the logical body to implement the steps above, in practice it may not be feasible for the fund to retain only part of its functions in the short term. It may be appropriate for these functions to be transferred to the interim national body (eg under DRET). A logical progression is for this body to assume the compensation function (including collection of fees) upon the removal of the prudential oversight requirements. This body could also then fund and coordinate the information campaign. An alternative is for a state licensing (or fair trading) body to assume these functions on behalf of all states.

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## Appendix B Submissions received

PwC received 32 submissions to this review from stakeholders and interested parties. We are grateful for the time taken to contribute to our review. Some parties wished for their submissions to be confidential. Accordingly, while all submissions were considered and contributed to our review, confidential submissions have not been quoted in the body of this report.

Submissions were received from the following parties.

- 1 Australian Federation of Travel Agents (AFTA)
- 2 Anonymous tour operator
- 3 Australian Tourism Export Council (ATEC)
- 4 Australian Travel Education Pty Ltd
- 5 Bucks Australia Pty Ltd (Flinders Island Travel Centre)\*
- 6 Carlson Wagonlit Travel\*
- 7 Carnival Australia
- 8 CHOICE
- 9 Christine Napper
- 10 Department of Resources, Energy and Tourism (DRET)\*
- 11 Expedia\*
- 12 FarSight Travel
- 13 Flight Centre Limited
- 14 Goronwy Price
- 15 Harvey World Travel Manly, Masman, Wagga\*
- 16 House of Travel
- 17 Insurance Council of Australia
- 18 Intrepid Travel\*
- 19 Mobile Travel Agents (MTA)
- 20 OzCruising
- 21 Pasla Air Travel
- 22 Queensland Consumers Association
- 23 Queensland Tourism Industry Council
- 24 Quicksilver Connections\*
- 25 South Australian Tourism Commission
- 26 Tourism Queensland
- 27 Travel Associates Australia\*
- 28 Travel Compensation Fund\*

- 29 Wendy Mulry Travel
- 30 Winners World Travel
- 31 World Nomads Group
- 32 Wotif Group

\* confidential submission

## Appendix C Stakeholders consulted

PwC staff held numerous meetings with key stakeholders as part of our consultation process for this review. These stakeholders, and others, were encouraged to make formal submissions to our Issues Paper and contribute to appropriate surveys.

These meetings discussed the nature and process of our review and provided key stakeholders with an opportunity to discuss their concerns and provide comments on consumer protection in the travel industry. The meetings have been relatively informal and focussed on the key issues of concern for the relevant stakeholder.

Stakeholders with whom we consulted are identified below.

### Industry associations

- Australian Federation of Travel Agents (AFTA)
- Australian Tourism Export Council (ATEC)
- Council of Australian Tour Operators (CATO)
- Insurance Council of Australia
- International Air Transport Association (IATA)
- Queensland Tourism Industry Council
- South Australian Tourism Commission
- South Australian Tourism Industry Council
- Tourism NSW
- Tourism Tropical North Queensland
- Travel Agents Association of New Zealand (TAANZ)

### Government departments and agencies

- Commissioner for Consumer Affairs (NT)
- Commissioner for Consumer Protection (WA)
- Consumer Affairs and Fair Trading (Tasmania)
- Consumer Affairs Victoria
- Department of Education, Employment and Workplace Relations (Commonwealth)
- Department of Employment, Economic Development and Innovation (Queensland)
- Department of Industry and Investment (New South Wales)
- Department of Justice – Licensing, Regulation and Alcohol Strategy (NT)

- Department of Resources, Energy and Tourism (Commonwealth)
- Department of the Treasury (Commonwealth)
- Office of Best Practice Regulation (Commonwealth)
- Office of Consumer and Business Affairs (South Australia)
- Office of Fair Trading (NSW)
- Office of Fair Trading (Queensland)
- Office of Regulatory Services (ACT)
- Tourism Victoria

### Consumer Bodies

- CHOICE (Australian Consumer Association)
- Queensland Consumers Association

### Travel agents

- Carlson Wagonlit Travel (major corporate travel agent)
- Flight Centre
- Stella Travel Services (owner of Harvey World Travel)
- Traveller's Choice – Darwin
- Webjet
- Wotif Group
- various travel agents via state based discussion forums (see below)
- various tour wholesalers via a discussion forum (see below)

### Insurers

- Chartis Insurance
- CoverMore
- QBE Australia
- VERO (Suncorp Group)

### Others

- Financial Ombudsman Service – Banking Department
- Financial Ombudsman Service – General Insurance Department
- Intrepid Travel
- Qantas

- Travel Compensation Fund (TCF)

### Travel agents' discussion forums

PwC worked with AFTA to invite a representative sample of travel agents from each state to attend a series of discussion forums. These forums enabled travel agents to contribute further to our review and bring forward their views and experiences of the travel industry and its regulation. Almost all of the attendees were small travel agents, typically working as part of a chain under an umbrella arrangement.

PwC held the discussion forums in Melbourne, Adelaide, Brisbane, Sydney and Perth. PwC also contacted travel agents from the Northern Territory and held telephone discussion with them.

A forum of tour operators was also conducted, arranged by the Council of Australian Tour Operators (CATO) and with representatives of tour wholesaler businesses.

## Appendix D Travel agents regulation in other jurisdictions

This appendix provides a brief overview of the regulatory schemes applicable to travel agents in some other international jurisdictions. The market, regulatory and consumer protection circumstances of each jurisdiction are generally different to those in the Australian context, which limits the ability to make direct comparisons or parallels. Therefore, while our analysis of these regimes informed our review, we have not referred directly to these regimes throughout our analysis. Nevertheless, an understanding of these regimes provides a useful international context to the Australian regulatory framework.

### C1 European Union

The European Union (EU) Council sets out guidelines for consumer protection in the EU package travel industry in its Package Travel Directive: Package Holidays and Package Tours 1990 (PTD). It is expected that these guidelines be implemented as law by each EU member state. Under the PTD, organisers/retailers must follow a number of requirements, some of which include:

- not give misleading information concerning a travel package (Article 3)
- not change the contracted price during the twenty days before the departure date (Article 4)
- make alternative arrangements and compensate the consumer for the difference if a significant proportion of the services contracted are not able to be provided (Article 4)
- provide sufficient evidence of security for the refund of prepayments and repatriation of the consumer in the event of insolvency (Article 7).

Article 5 also stipulates that member states should ensure that organisers/retailers are liable to the consumer for the proper performance of contractual obligations. This is irrespective of whether the retailer/organiser is the supplier of the services or has the right to pursue the supplier of services, but does not apply where failure to perform is due to fault by neither the organiser/retailer or supplier. Compensation for non performance may be limited in the contract, but not unreasonably. There are also guidelines as to the information that must be provided to the consumer.

Many member states have adopted the PTD as law, but the specific regulations put in place vary across states. Some of these are outlined below.

The European Commission is currently reviewing the PTD. Given the introduction of the internet and low cost airlines, they believe it is no longer suitable to today's travel market. They are also concerned that many consumers are falling outside the current scope of protection provided. They are therefore considering extending the directive to provide protection for:

- dynamic packages where consumers make up their own packages, often online
- all airline tickets, including stand alone sales.

Priority areas for the review include:

- the scope of the directive – should it be extended to cover packages and other arrangements currently falling outside the scheme
- information to be provided to consumers
- liability for substandard service and assistance for consumers
- contract changes – particularly in relation to price changes
- insolvency – whether coverage should be extended to cover stand alone airline tickets due to high levels of airline insolvency
- a travel protection label – to indicate which products are protected under the legislation.<sup>205</sup>

## C2 United Kingdom

The United Kingdom (UK) has implemented the Directive through the Package Travel, Package Holidays and Package Tours Regulations 1992 (PTR). These regulations generally re-iterate the PTD. In relation to providing security, a minimum bond is required, which is based on turnover and the amount of prepayments held. The organiser/retailer must also have insurance where the insurer agrees to indemnify consumers in the event of insolvency for loss of money paid. For further consumer protection, the regulations stipulate that all prepayments be held in trust for the consumer.

In addition to the above regulations, the Civil Aviation (Air Travel Organisers' Licensing) Regulations 1995 cover packaged holidays by air and some 'flight only' sales. These regulations are administered by the Civil Aviation Authority (CAA). The Air Travel Organisers' Licensing (ATOL) scheme does not apply to airlines, but they still have obligations under the PTR. Likewise, ATOL licence holders are not required to provide security under the PTR, as they have other obligations under the ATOL scheme.

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<sup>205</sup> EUROPA (2009) 'Consumers: EU set to extend holiday travel protection', Brussels 26 Novemebr 2009, IP/09/1824.

A 'flight only' sale requires a licence if the seller does not provide a valid ticket at the time of purchase or (if booked online or by phone) send one by the end of the following day.

An ATOL licence must be held by all organisers/retailers that sell packaged holidays by air or sell 'flight only' sales as outlined above. However, if a travel agent sells a package constructed by a tour operator that holds an ATOL licence, the agent does not require their own licence.

The CAA has fitness and financial criteria for ATOL licence holders, and has the power to suspend a licence if these are not maintained. The CAA must be satisfied that the licence holder is a fit person to make available flight accommodation. A person's fitness is deemed to include their honesty, integrity, competency and capabilities.

### Financial Criteria

The CA must be satisfied that the licence holder's resources and financial arrangements are adequate to meet its actual and potential obligations. The degree of scrutiny increases with the size of the licence held and where the CAA perceives there is a higher likelihood of failure.

Standard licence holders (more than 500 airline seats sold annually) are subject to the free asset test. This is a basic solvency test that shows the relationship between assets and projected turnover, based on information from audited accounts. The CAA accepts non-audited accounts from small companies exempt from audit under company laws, and from sole traders and partnerships.

Licence holders must also have a minimum of £30,000 paid-up capital, and if there is a history of losses or the value of shareholders' funds is negative, this amount may be increased. Additionally, for licence holders with a high potential impact of failure or a higher likelihood of failure, an in-depth analysis of their financial position is conducted.

### Insolvency Protection

Under ATOL, the package provider (ie the agent) is contractually responsible for delivering the principle services. This means where a supplier fails (ie an airline), the agent is responsible for making alternative arrangements or reimbursing the consumer. In the event of supplier insolvency, consumers who have not yet departed must be offered a full refund or a replacement holiday from their package provider. Those who have begun their holiday must be offered repatriation at no cost.

If the package provider fails, the CAA takes on the responsibility for reimbursing and repatriating the consumer. This is financed by the ATOL Protection Contribution (APC). ATOL licence holders pay a contribution of £2.50 per air passenger booked and the funds are

pooled into the Air Travel Trust Fund (ATTF). Some licence holders may also be required to hold a bond for additional security.

## Review

Recent developments in the industry have led to concerns over the clarity and scope of the regulations. Given the rise in low cost airlines, internet usage and independent travel, there has been some uncertainty and confusion over whether consumers are covered. The Department of Transport are currently reforming the current regulatory framework to ensure that consumers can make informed decisions.

## C3 Denmark

In Denmark, the Travel Guarantee Fund Act provides for the protection of consumers who have bought a package tour. Travel providers and retailers (of package travel services) must register with the Travel Guarantee Fund to operate in Denmark. Registrants must pay a fee (to finance administration) and provide the fund with security, the level of which is based on turnover. Non-profit making associations are not required to provide security. Sanctions imposed for non-compliance include fines and prison sentences up to four months.

Consumers may claim reimbursement from the Fund for money paid for a travel service that was not performed if the travel provider/retailer is unable to compensate. Repatriation is also provided to the consumer when necessary. Where the travel provider is insolvent and the retailer compensates the consumer, the Fund may also reimburse the retailer. If a consumer claim is made, the Fund will seek full payment from the relevant travel provider's security.

## C4 Norway

Package travel organisers/retails in Norway must provide the Norwegian Travel Guarantee Fund with a guarantee provided by a bank or insurance company. This provides security for the potential claims of consumers. Additionally, a set annual fee must be paid to the Travel Guarantee Fund to cover administrative costs. The level of the guarantee is constant for all enterprises that exclusively offer travel destinations in Norway. However, if selling travel to destinations outside Norway, the guarantee is based on turnover.

## C5 New Zealand

New Zealand has no industry specific government regulations concerning consumer protection in the travel industry. The Travel Agents Association of New Zealand (TAANZ) is a self regulating trade organization representing travel agents and tour operators in New Zealand, and has voluntary membership.

TAANZ policy prescribes that full members must not engage in misleading conduct that may lead consumers to believe they are protected where they are not. Employees and other parties must also not be convicted of any offence of dishonesty or offence that carries a maximum penalty of three or more years.

Members are also subject to training requirements. One in every five staff members at a TAANZ member's office must be a full time selling staff member and pass prescribed qualifications.

The TAANZ imposes specific requirements as to the premises of its members. These cover areas such as clear identification of travel agent status, and secure and safe custody of monies and documents. Additionally, all TAANZ members are required to conduct their business in accordance with the TAANZ Code of Ethics and Practice.

### Insolvency Protection

All members must participate in the TAANZ Bonding Scheme. Under this scheme, all members must provide a bond in the form of a deed of indemnity. The level of indemnity required depends on the member's annual gross sales, which is reduced by commissions and credit card sales, but is set at a minimum of \$50,000. In addition, all members must use client accounts.

New Members (first two years) must provide the Bonding Authority with a minimum level of shareholders' equity and evidence that the company or business has adequate shareholders equity to meet reasonable commitments.

All members must provide annual financial reports to enable TAANZ to assess their financial adequacy.

The bonding scheme protects consumers where they did not receive the benefits for which they paid to a TAANZ member, however protection is only given against default of travel agents. If money has already been passed onto the supplier or intermediary, the consumer is not protected. The exception to this is when money is passed onto another TAANZ or International Air Transport Association (IATA) approved travel agent. In this case, the consumer is covered for the failure of the TAANZ/IATA approved agent if they fail to pass the money onto the principle. The TAANZ Bonding Fund sets a maximum for claims made as a result of the failure of any one TAANZ member. To date, no failure has occurred where consumers have not been compensated in full.

## C6 United States – California

California requires all sellers of travel to register with the California Office of the Attorney-General and display the registration number on all advertising. Registration must be renewed annually. A seller of travel is a seller who provides or arranges land and water vessel transportation services that exceed \$300 (including both retail and

wholesale). This applies to sellers whose place of business is in California and out-of-state sellers whose stock is sold in California.

All sellers of travel who receive payments from passengers must not use that money to buy travel on behalf of another passenger or for any business expenses or personal use. Additionally, prior to receiving payments, written disclosure of certain information regarding the seller and price is required.

The consumer is entitled to a full refund if there is a cancellation not in accordance with the contract or if any material misrepresentation is made by the seller.

### Insolvency Protection

All sellers of travel are required to register with the Travel Consumer Restitution Corporation (TCRC), which is a non-profit organization that administers the Travel Consumer Restitution Fund (TCRF). The TCRF refunds travel costs to consumers from California when a participating travel agent does not provide travel services due to business closure, bankruptcy, or default of a registered seller of travel. Consumers are not protected against the insolvency of air carriers or other registered sellers of travel to which funds have been forwarded.

Upon registering with the fund, sellers of travel must pay an initial assessment based on how long they have been selling travel. Thereafter, an annual assessment must be paid.

To protect consumer funds, sellers of travel must meet one of the following financial requirements:

- Use a trust account for all monies received from customers
- Purchase a surety bond to adequately cover consumers' monies
- Participate in a consumer protection deposit plan (deposit \$1 million)
- Participate in a consumer protection escrow plan

## C7 Canada – Ontario

The Travel Industry Council of Ontario (TICO) administers the Ontario Travel Industry Act 2002. Under this act, all travel retailers and wholesalers must be registered. Registration applicants must:

- have share capital if they are incorporated
- be financial responsible in the conduct of its business
- carry on their business in accordance with the law and with integrity and honesty.

TICO also has education standards that must be met by all persons selling travel services or providing travel advice to the public on behalf of an Ontario travel agency. The focus of the education is TICO matters rather than basic travel knowledge.

Under the Act, registrants must not falsify information or make representations that are false, misleading or deceptive. The Act also provides guidelines that must be followed regarding how prices are stated and the scope of information provided to consumers. Additionally, TICO strongly encourages all registrants to comply with their Code of Ethics.

### Insolvency Protection

Registrants must make contributions to the Travel Industry Compensation Fund. Payments are made twice a year and are based on Ontario gross sales.

The fund provides reimbursement to consumers who paid money to a registered travel agent for services not performed due to insolvency of that agent or the end supplier airline or cruise line (insolvency of other end suppliers is not covered). A consumer may still claim if the payment was made directly to the airline or cruise line via credit card. Note there is a maximum payment for each customer and restrictions on the total amount paid in claims arising from the one event.

Travel agents and wholesalers may also be compensated by the fund for money reimbursed to the customer or for provision of alternate travel services. This is the case if the travel services were not provided due to insolvency of a wholesaler, airline or cruise line.

As well as fund contributions, registrants must meet minimum working capital requirements. The required level of working capital is based on the registrant's level of sales in Ontario.

Upon first registering, security of \$10,000 must be provided to the administrative authority. This will be returned after two annual financial statements have been filed if no concerns are raised.

Also, they must maintain a trust account for all money received from customers for travel services. Alternatively, instead of using a trust account, businesses that have been registered for at least one year may instead provide security based on their sales in Ontario.

To provide TICO with the information they need to enforce the above regulations, registrants must file financial statements with TICO at least annually.

## Appendix E      Dun & Bradstreet business risk data

Dun and Bradstreet are a business information company that holds information on more than 2.8 million businesses in Australia. They also hold company records of more than 150 million companies worldwide. This information makes up a database that is constantly being updated by Dun and Bradstreet. The data provided to PwC is based on information held within that database.

To explain how the Dun and Bradstreet data was compiled, the following technical notes were provided by Dun and Bradstreet (D&B):

*Every entity in Australia operates in a specific industry. However, D&B does not necessarily have SIC available for every entity. Entities with a SIC on file may be defined as “commercially active”; that is they are actively seeking credit.*

*Before extending credit and/or selling on credit terms, creditors generally carry out due diligence to ensure the company applying for credit is “credit worthy”. Creditors conduct a commercial enquiry at D&B, who works on their behalf of the creditor to source general demographic information from the organisation applying for credit. It is through this interaction that information such as SIC is collected. D&B also updates records likely to be enquired upon.*

*Consequently, the raw counts per SIC extracted from the database require adjustment as they under represent the true number of entities. To achieve this adjustment, the survival distribution function was estimated. This involved examining the proportion of entities allocated a SIC code, given three frames of reference. The first frame of reference is start date. The second and third frames of reference are exiting the industry and entering external administration. The relative proportion of SIC codes present differs for those entering and exiting the various industries. Entities which entered external administration had significantly higher proportion of SIC codes present. This is due to the increased credit activity of these entities thereby increasing the likelihood of these entities having a file constructed. 95 per cent Confidence intervals were created using the standard errors of the proportions.*

Note that a Standard Industry Code (SIC) is a code used by Dun and Bradstreet to segregate and identify industry sectors.

## Distress probability

Financial distress is defined by Dun and Bradstreet as a:

- change of control (eg receiver manager, administrator or controller appointed)
- forced business closure (eg winding-up order, insolvency or liquidation).

Dun and Bradstreet use a 'Dynamic Risk Scoring System' to help identify the risk of financial distress for individual companies. To do this, they analyse historical company data and identify key attributes that are statistically significant for predicting financial distress. The model used to develop the dynamic risk score consists of over 100 predictive factors. Some of the data elements included in the model are:

- trade payment data
- D&B Collections data
- demographic data such as age, size and industry of company
- public record information, including court actions and registered charges
- financial accounts.

This system gives individual companies a dynamic risk score in the range of 1001 to 1560, with each score having an associated probability of financial distress within a 12 month period. Industry averages are then be calculated by using data from all the businesses in each particular industry.

Dun and Bradstreet assign a relative risk level to the full range of distress probabilities. This is shown in the table below.

Average probability of distress	Relative Risk
0 – 0.0044	Minimal
0.0044 – 0.0094	Very low
0.0094 – 0.0137	Low
0.0137 – 0.0252	Average
0.0252 – 0.0383	Moderate
0.0383 – 0.0738	High
0.0738 – 0.2201	Very high
> 0.2201	Severe

The full results of Dun and Bradstreet's analysis are provided in the table below.

Dun & Bradstreet business risk data

Sector	Year	Number entering industry			Number exiting industry			Number entering external administration			Total industry number at year end			Industry average distress probability
			+/-			+/-			+/-			+/-		
General contractors	2006	797	+/-	26	473	+/-	13	136	+/-	6	9188	+/-	39	0.0230
	2007	668	+/-	23	1250	+/-	21	243	+/-	10	8606	+/-	44	0.0273
	2008	334	+/-	14	559	+/-	15	144	+/-	8	8381	+/-	29	0.0290
	2009	105	+/-	7	650	+/-	19	248	+/-	14	7836	+/-	26	0.0277
Hotel and Motels	2006	548	+/-	18	408	+/-	11	82	+/-	4	4472	+/-	29	0.0140
	2007	406	+/-	14	641	+/-	11	96	+/-	4	4237	+/-	25	0.0139
	2008	314	+/-	13	468	+/-	13	87	+/-	5	4083	+/-	26	0.0143
	2009	53	+/-	4	382	+/-	12	91	+/-	6	3754	+/-	16	0.0158
Real estate agents	2006	335	+/-	11	270	+/-	7	97	+/-	4	5805	+/-	18	0.0200
	2007	244	+/-	9	790	+/-	14	164	+/-	7	5259	+/-	23	0.0209
	2008	415	+/-	18	461	+/-	13	83	+/-	5	5213	+/-	31	0.0239
	2009	105	+/-	7	402	+/-	12	98	+/-	6	4916	+/-	19	0.0237
Retail	2006	1273	+/-	42	996	+/-	26	282	+/-	12	12828	+/-	68	0.0181
	2007	1336	+/-	46	2384	+/-	40	392	+/-	15	11780	+/-	86	0.0199
	2008	758	+/-	32	1312	+/-	35	275	+/-	16	11226	+/-	67	0.0210
	2009	524	+/-	34	1065	+/-	31	238	+/-	14	10685	+/-	65	0.0194
Travel Agents (Aus)	2006	164	+/-	6	165	+/-	5	44	+/-	2	2567	+/-	11	0.0213
	2007	217	+/-	8	460	+/-	8	78	+/-	3	2324	+/-	16	0.0243
	2008	142	+/-	6	299	+/-	8	22	+/-	2	2167	+/-	14	0.0259
	2009	105	+/-	7	187	+/-	6	25	+/-	2	2085	+/-	13	0.0240
Travel Agents (NZ)	2006	30			28			C			572			0.0244
	2007	10			18			C			564			0.0251
	2008	28			16			4			576			0.0247
	2009	5			9			C			572			0.0229

# Appendix F PwC consumer survey

## Travel purchases

- 1 Have you purchased any of the following [various travel products] during the past two years?
- 2 Thinking about your most recent trip, was it for international or domestic travel?
- 3 Again thinking of your most recent trip, did you travel by yourself or with another person/other people?
- 4 On your most recent trip who did you travel with?
- 5 And how long was this trip for?
- 6 In the last two years, have you used a travel agent to purchase any of the following [various travel products] international or domestic travel products?
- 7 When you last purchased each of the following [various travel products] for international and domestic travel, did you use a travel agent?
- 8 For any of your purchases through a travel agent, how satisfied were you with the service you received from your travel agent?
- 9 If you did not make your purchase through a travel agent, what channel did you use to make your purchase?
- 10 Thinking about the product/s you have purchased through other channels, overall, how satisfied are you with the service you received?
- 11 When considering future international travel purchases, do you anticipate purchasing [travel products] the following through a travel agent to make your purchase?
- 12 When considering future domestic travel purchases, do you anticipate purchasing [travel products] the following through a travel agent to make your purchase?
- 13 For each of the travel products you purchased through a travel agent, please indicate your primary payment method.
- 14 For each of the travel products you purchased directly from the supplier, please indicate your primary payment method.

## Travel insurance

- 15 In relation to your most recent travel purchase, did you purchase any form of travel insurance?
- 16 Which [coverage options] were included in your policy?

- 17 When choosing a travel insurance policy, how important is it that [coverage options] are included in your policy?

## Willingness to pay

In the event a travel agent business becomes bankrupt, travel consumers who make their purchase through that agent may be at risk of financial loss. For example, if the consumer has paid for their travel in advance and that money had not be passed on to the supplier (eg airline or hotel) prior to business' bankruptcy.

While standard travel insurance policies may offer protection to travellers against financial loss from medical expenses, amendments or cancellations, lost luggage or travel service provider bankruptcy (eg airlines, hotels), standard insurance does not offer protection against travel agent bankruptcy.

Assume you are purchasing a \$1,000 travel product from a travel agent.

- 18 How much do you think it would cost to protect yourself from this risk (that is, to insure yourself, so that you would be compensated for any loss caused by the bankruptcy of your travel agent)?
- 19 How much would you be willing to pay to protect yourself from this risk?

Assume 0.03 per cent of the total monies spent on travel products via travel agents were lost due to travel agent bankruptcy (this equates to approximately 30 cents in every \$1,000).

- 20 How much would you be willing to pay to protect yourself from this risk, being 0.03 per cent?
- 21 How much would you be willing to pay to protect yourself from this risk if it was 0.1 per cent?
- 22 How much would you be willing to pay to protect yourself from this risk if it was 0.2 per cent?
- 23 How much would you be willing to pay to protect yourself from this risk if it was 0.5 per cent?

Assume that you are taking out travel insurance which costs approximately \$150 to protect yourself against financial loss from medical expenses, amendments or cancellations, lost luggage or travel service provider bankruptcy (eg airlines, hotels). This insurance does not offer protection against travel agent bankruptcy.

- 24 How much extra would you be willing to pay to protect yourself from this risk?

## Purchasing from a travel agent

- 25 Thinking about when you last purchased any product through a travel agent, how important was your perception of the financial viability of the travel agent in your decision to purchase a product from them?
- 26 When you purchase travel products from a travel agent, do you expect that travel agent to hold some or all of your payment in a separate account, from which to pay travel service suppliers (ie separate from the business' day-to-day business account)?
- 27 In your opinion, how significant are [various risks] when purchasing travel services?

## Travel compensation fund

- 28 Which of the following [options] best describes your level of awareness of the Travel Compensation Fund?
- 29 [If aware] You mentioned you are aware of the Travel Compensation Fund. How did you become aware of the Travel Compensation Fund?

The Travel Compensation Fund compensates consumers in the event they suffer financial loss as a result of a travel agent becoming bankrupt.

- 30 When you last travelled, were you aware of this coverage?
- 31 Have you, or anyone you know, made a claim from the Travel Compensation Fund?

Most credit cards offer a function known as a 'charge-back', by which consumers can request their financial institution to 'reverse' a transaction where the goods/services are not supplied, are defective or transactions are unauthorised.

- 32 Which of the following best describes your level of awareness of the 'charge-back' mechanism?

# Appendix G PwC travel agents survey

## Overall

- 1 In your opinion, in relation to the travel industry, how significant are the following risks [various options] for consumers?
- 2 In your opinion, how effective is the current consumer protection regime overall in the travel industry (including travel agents, airlines, accommodation, hire cars, tour operators, travel insurance etc)?
- 3 In your opinion, how important are the following to protecting consumer from the major consumer protection risks in the travel industry?
  - Entry requirements
  - Insolvency protection
  - Conduct requirements
- 4 How would you rate each of the following in relation to how well they protect consumers from major consumer protection risks in the travel industry?
  - Entry requirements
  - Insolvency protection
  - Conduct requirements

## Entry requirements

### Overall

- 5 To what extent do the current licensing arrangements limit entry into the market?
- 6 To what extent are the requirements to obtain a travel agents' licence duplicated by the membership requirements of the Travel Compensation Fund?

### Licence application

- 7 What amount do you pay annually in travel agent licence fees to state licensing authorities?
- 8 How many staff hours are required annually to comply with licensing requirements (eg completing forms)?

## Training

- 9 How many hours does it take on average for someone to complete the required training in your state?
- 10 How many of your staff are required, by the travel agent regulations in your state or the conditions of your travel agent licence, to complete training?
- 11 How many of staff (required or not required) complete such training?
- 12 What is the average cost of undertaking this training in your state (eg tuition fees, materials)?
- 13 In the states in which you are licensed, in your opinion, how effective are the training requirements at achieving consumer protection outcomes?
- 14 Would similar training be undertaken if not formally required by regulations?

## Experience

- 15 In your opinion, how effective are the work experience requirements in ensuring good industry standards?

## Insolvency protection

### Overall

- 16 In your opinion, what is the level of consumer awareness about the Travel Compensation Fund?
- 17 In your opinion, does the presence of the Travel Compensation Fund improve consumers' confidence in the industry?
- 18 In your opinion, how effective has the Travel Compensation Fund been in reducing the risk to consumers from travel agency insolvency?
- 19 If the Travel Compensation Fund was not undertaking its current role, to what extent do you expect travel agent bankruptcy to increase?
- 20 In your view, if the Travel Compensation Fund was not undertaking its current role, to what extent would consumers funds be exposed to increased risk?
- 21 Do you believe that the private insurance market is:
  - willing provide Travel Compensation Fund-type cover?
  - capable of providing Travel Compensation Fund-type cover?

- cost competitive to the Travel Compensation Fund (ie would you expect Travel Compensation Fund-type cover would cost less)?
- 22 To what extent should consumers rely on the following non-regulatory measures to protect themselves from losses due to insolvency?
- Credit card charge-back mechanism?
  - Private insurance?
- 23 The Travel Compensation Fund currently provides protection to consumers against losses from travel agent insolvency. Which of the following best describes your opinion of the scope of the scheme?
- The scope of the scheme should be extended to provide insolvency protection for all travel related services (eg airlines and hotels etc).
  - The scope of the scheme should be reduced (ie protection against travel agency insolvency should not be provided by the Travel Compensation Fund).
  - No change should be made to the scope of insolvency protection in the travel industry.
- 24 What percentage of your customers pay for their travel using a credit card? [Domestic/International]
- 25 What is the average number of days that you hold consumers funds before using it to pay to suppliers of travel (eg airlines, hotels, hire car companies etc)?

### Administration costs

- 26 How many staff hours are required annually to comply with the Travel Compensation Fund's requirements (eg completing forms)?
- 27 What (if any) is the additional cost on your business created by the requirement to provide audited financial accounts; for example, if you would not otherwise prepare audited financial statements or you are required to produce additional accounts to what you would otherwise produce?

### Capital requirements

- 28 To what extent do the Travel Compensation Fund's capital requirements restrain your business' operations?
- 29 What additional amount of capital and reserves are you required to hold due to the requirements of the Travel Compensation Fund? (ie beyond what you would otherwise hold)
- 30 What actions have you been required to undertake in order to meet the Travel Compensation Fund's capital requirements?

- Altering your capital structure (eg reduce debt, increase working capital)
  - Maintaining a trust or client account for received monies
  - Providing security, insurance or a guarantee
- 31 What do you perceive as the additional cost on your business annually in complying with the Travel Compensation Fund's capital requirements (other than the requirements to hold additional capital and reserves)?
- Additional account fees
  - Security, insurance or guarantee fees
  - Other

## Conduct requirements

- 32 Do the generic provisions of the Trade Practices Act (and state-based Fair Trading Acts) adequately protect consumers from travel agent misconduct?
- 33 Do the Australian Competition and Consumer Commission (ACCC) and state based fair trading offices adequately enforce these provisions?
- 34 How important are licensing authorities' disciplinary powers (eg the power to cancel your licence) in ensuring good conduct in the industry?
- 35 How effective is the licensing body in your state in enforcing the conditions of travel agent licences?
- 36 How important are the codes of conduct of industry associations (AFTA, CATO, ATEC) in ensuring good practice in the industry?
- 37 To what extent could consumers rely on industry associations (eg code of practice) rather than regulation to police travel agent conduct?
- 38 What mechanism is the most appropriate to ensure good conduct in the travel industry?
- travel agent licence conditions
  - mandatory accreditation
  - optional accreditation
  - industry association codes of conduct
  - market mechanisms
  - other, please specify

## General business information

39 Are you a members of a chain, co-operative, franchise organisation or other affiliation?

If yes, please specify the organisation/s

40 What percentage of your business' sales are made:

- via stores (shop fronts)
- via the internet (online sales)
- via other mechanisms

If via other mechanisms, please specify the mechanism

41 What states of Australia does your business have physical offices?

42 How many years has your business been operating in this sector?

43 What percentage of your business' revenue relates to:

- domestic travel
- international travel

44 What is your business' average annual turnover?

45 How many customers does your business make sales to every year?

46 What is the average amount that a customer will spend with you for one holiday/trip (on a per person basis)?

- for a domestic trip
- for an international trip

47 How many days in advance is the average holiday/trip booked by consumers?

48 How many staff does your business employ?

49 How many locations/branches does your business have?

50 Are you a member of the following organisations:

- Australian Federation of Travel Agents (AFTA)
- Council of Australian Tour Operators (CATO)
- Australian Tourism Export Council (ATEC)
- Other industry associations (please specify)

51 Is your business an International Air Transport Association (IATA) accredited travel agent?

52 Do you have a merchant agreement with a bank or credit card company?

## Appendix H Potential alternative uses of TCF reserves

As at 31 December 2009, the TCF has accumulated some \$25 million in financial reserves. Under the terms of the TCF trust deed, upon wind-up of the fund (a reform element of some of the options outlined above) these reserves will revert to the participating states and territory. Notwithstanding, rededication of these funds is possible and may be a simple and effectively means of raising capital to fund several different initiatives.

### Consumer advocacy

This function is currently performed by the TCF as part of its compensation function. The TCF will, as circumstances arise, pursue claims against the owners, directors or auditors of collapsed businesses to seek redress for lost monies. These actions performed two functions:

- recovering some or all of the lost monies (for example, in 2008 the TCF recovered almost \$590,000 from such parties),<sup>206</sup> and
- deterring other businesses, their officers and auditors from engaging in similar misconduct.

The TCF's existing capital reserves could fund these activities, potentially conducted (or at least administered) by a national registration body, with or without the presence of a compensation scheme.

From a cost-benefit perspective, the advantages of this option relate to the economies of scale that can be generated by a single body taking collective action on behalf of many individual consumers. Such action might be prohibitively costly if taken individually.

Importantly however, there appears to be few grounds for a scheme of this kind in the travel industry alone. In principle, the benefits of this option (collective action, deterrence) are the same for all industries and schemes of this kind are not the norm. There seems to be little reason why collective action/advocacy would be of such value to justify an extraordinary measure in this industry.

### Selective compensation

Either as a permanent measure, or a part of a transitional arrangements, in the absence of a uniform compensation scheme that capital reserves could be used to compensate selected persons

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<sup>206</sup> Travel Compensation Fund (2009) Annual Report.

only. Clear grounds for eligibility would need to be established, and may include cases where:

- the loss inflicted considerable hardship on the consumer – for example, particularly vulnerable consumers
- the consumer suffered severe detriment or loss – for example, being unable to attend an important family event
- the loss was caused by particularly unconscionable behaviour by the agent
- the consumer took significant measures to protect themselves from this risk.

It is expected that, without the inflow of funds from member contributions, the funds would diminish over time and be eventuated wound up. At the current rate of claims this would occur in approximately nine years, although the eligibility criteria would reduce this rate substantially. Depending on the strictness of this criteria (and hence the number and value of claims paid) it is possible this action could be funded by interest on the reserves, allowing for a perpetual fund. An interest rate of, say, 7 per cent would allow for compensation in the order of \$1.8 million annually; 60 per cent of the current average annual payout.

As per the above, we anticipate this function being administered by the national registration body.

### Information provision

The function could assist with the transitional arrangements in the event the government's preferred reform amounted to a shift in responsibility for consumer protection towards consumers themselves. It may be possible that consumers, having relied (unconsciously in most cases) on the TCF for insolvency protection, may not take adequate steps to protect themselves for a period; that is, until the presence of failures and uncompensated losses improves consumers' awareness of these risks.

In order to speed up this process, governments could take steps to improve awareness by providing material (in the form of brochures or booklets) informing travellers of:

- the risks associated with purchasing via a travel agent (or of prepayments more generally)
- recommended steps to mitigate such risks (for example, understanding how (and how long) prepaid funds are held, purchasing via credit card, assessing the solvency of businesses, etc).

Requirements could be imposed on travel agents, via the registration schemes, to provide or make this information available to travellers. Such a measure is not expected to be particularly costly and,

therefore, could also be funded by revenue raised on the registration scheme.

### Assistance for industry-led compensation scheme

As outlined in section 0, an option for ongoing protection of consumers against losses from travel agent insolvency is the establishment of an industry-led compensation scheme. The existing reserves of the TCF could be provided to the administrator of such a scheme, to provide an initial capital base. As mentioned, at the current rate the reserves alone could fund compensation for approximately nine years (more if interest income is considered).

Conceptually this option is appealing, as funds collected from industry for the purposes of compensating consumers are retained for that purpose. It is also likely that the rededication of these funds for this purpose would encourage industry to participate in such a scheme. Accordingly, this measure might be an appropriate inducement in the event this option is chosen.

### Returned to states

Finally the funds could be returned to the states and territories, as anticipated under the TCF trust deed, and included in consolidated revenue.

### Seed funding for NTAF accreditation scheme

Developing an accreditation scheme under the NTAF will require significant work from the relevant body, including developing policies and standards, establishing institutional and governance frameworks, and marketing and communications to industry. Existing funds could be provided to a new or existing body to cover the costs of establishing an accreditation scheme that complies with, and is licensed by, the NTAF.



