REPUBLIC OF ESTONIA
MINISTRY OF ECONOMIC AFFAIRS AND COMMUNICATIONS

Analysis of Travel Guarantee Requirements and The Travel Guarantee System in Estonia

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Summary

Summary of the report is compiled into a comprehensive overview in this chapter, including summaries of research topics collectively, incorporating key observations and recommendations for the future.

Impact of PTD Changes on Advance Payments

During the analysis, current key practices of collecting advance payments by travel companies were mapped based on the main payment terms, which were compared with the proposals from the Package Travel Directive (PTD) regarding the maximum fee for booking a trip (25% of the package travel cost) and the deadline for paying the main part (up to 28 days before the start of the trip). The final text of the PTD Amendments did not initially address the limitation of advance payments for related travel service organizers. The approach, including assumptions and impact calculations, is discussed in more detail in chapters 4.1; 4.2; 4.3; 4.4; 4.5; and 4.6.

According to the latest version of the directive draft, the upper limit for the booking fee is set at 25% of the travel cost. Since this equals today's estimated average booking fee, this limitation does not actually restrict costs (i.e., it is not practically restrictive). The real impact on cost growth is only affected by the deadline limitation set for the main payment. The increase in costs is mitigated by the decrease in the amount of the guarantee and thus the cost of the guarantee (expense).

In summary, the change is expected to have a two-way impact on the cost change of travel companies, the detailed assumptions and calculations of which are provided in chapter 4.2. Currently, the change in costs was considered as a ratio of turnover covered by guarantees, which, based on current knowledge and main practices, would not result in significant additional expenses sector-wide – specifically, the net effect on turnover covered by guarantees would be 0.002%, which would reduce companies' business profit margin by a similar magnitude (see Table 7). However, it is quite likely that increased costs would be added to service prices, which, in summary, would not lead to a significant increase in costs for travelers.

This means that while the limitation on advance payments does have some impact on companies' profitability, overall, the change would not significantly increase the companies' cost base.

Regardless of the results of the impact calculations presented – which are based on averaged assumptions – there may be special cases where the planned limitations do not correspond to the interests of travel companies, their clients, or the service providers to travel companies. In a market with intense competition, it is advisable to leave the aspect of payment terms to market regulation and allow flexibility in setting conditions, which ultimately may also be in the interest of clients. Therefore, we recommend to the Ministry of Economic Affairs and Communications, as the policy maker, to not enforce the limitation of advance payments if possible or to do so to a minimal extent based on PTD requirements, while leaving unaffected the companies providing package travel services.

Initial Assessment of PTD Amendments Regarding the Establishment of Back-up and Crisis Funds and Stakeholder Views

During the analysis, various aspects of possible back-up and crisis fund solutions were addressed comprehensively. Firstly, potential prerequisites for the establishment of funds were outlined, including setting initial volumes and fulfillment periods based on both initial understanding and the yet-to-be-confirmed final text of the PTD. Additionally, the potential benefits of the funds were considered based on previous insolvency cases, current system challenges, and stakeholder perspectives. Calculations and assessments related to the funds were discussed in more detail in chapters 4.7; 4.8; 4.9; 4.10; 4.13; 5.4; and 6.2.

The purpose of the back-up fund is to provide additional protection for travellers' economic interests in situations where the guarantee taken by the travel company – in the form of insurance or a bank guarantee, for example – is depleted or proven inadequate in satisfying travellers' claims. The existence of a crisis fund is a preventive measure, considered by the EU narrowly for crisis situations – such as global travel disruptions – to potentially compensate travellers for the cost of cancelled trips and prevent the insolvency of travel companies. The aim of the crisis fund is to ensure that travel organizers have sufficient liquidity to make timely refunds to package travel customers in cases of mass cancellations due to unavoidable and exceptional circumstances. It should be noted that the initial version of the crisis fund is no longer addressed in the final text of the PTD.

Initially, the implementation of the back-up fund was examined through two scenarios: in Scenario 1, the management of the fund would be entrusted to the Consumer Protection and Technical Regulatory Authority (TTJA), with the additional cost to TTJA only arising from the addition of the function of collecting and managing payments from travel companies – in other words, the management costs would be borne by the state (TTJA), not by travel companies. In Scenario 2, a separate entity or institution would be created for the fund, with the TTJA transferring the insolvency processing function to the fund, while oversight of the system remains with TTJA.

Of these two approaches, Scenario 2, where functions currently located in the TTJA (except oversight) are transferred to the fund, was found to be more costly for travel companies. Under this scenario, annual costs for the government (public sector) would be less than €50,000, while estimated annual costs for travel companies would increase by approximately €116,000, or a

0.07% ratio to turnover covered by guarantees. In Scenario 2, additional costs for travel companies would amount to 0.12% of turnover covered by guarantees, equating to an annual increase in costs of €199,000 across the sector. Overall, the expected impact of the back-up fund system can be considered relatively small.

We strongly recommend that the Ministry of Economic Affairs and Communications seriously consider establishing a back-up fund to help address challenges related to both insolvency cases and repatriation of travellers from abroad. During the analysis, possible perspectives were clarified, and the analysis team concluded that instead of a back-up fund, it would be advisable to create a reserve funded by payments collected from travel companies, for example, from the state budget allocation, similar to what has been done in Finland. The annual cost of establishing a back-up fund for travel companies depends directly on the size of the fund and its fulfillment period. In the initial proposal, the fund size was set at €300,000, to be collected over three years, after which contributions would be suspended (see also Table 23). However, considering feedback from stakeholders and previous insolvency cases, it may be prudent to consider a reserve fund instead, with a smaller size, perhaps around €100,000. With a reserve of €100,000 to be filled within a year, the additional cost to travel companies would be 0.06% of turnover covered by guarantees. This would allow for the creation of an additional protective barrier at low cost, which could help address challenges related to insolvencies and potential repatriations of travellers. The replenishment of the reserve would be ensured proportionally through a payment obligation based on companies' turnover covered by guarantees, which they would pay annually.

It should be noted that collective guarantee solutions are not popular among travel companies. Based on interviews, survey results among travel companies, and the findings of the last workshop, it can be stated that a large portion of travel companies do not support the idea of additional collective protection mechanisms such as a back-up fund (see Chapter 4.13). Therefore, we recommend that both the Ministry of Economic Affairs and Communications and the TTJA, if the recommendation is implemented, engage in outreach efforts (information sessions, email newsletters, etc.) aimed at travel companies to explain the purpose and benefits of the fund and the slight increase in payment obligations.

Current Overview of Guarantee Service Provision, Situation Assessment, and Recommendations for the Future

Regarding the provision of guarantee services, the analysis team conducted a detailed market mapping, which has been comprehensively addressed in chapters 1 and 2.

Currently, there are 19 companies in the Estonian market offering guarantee services, with a total of 226 guarantee agreements concluded with travel companies. The analysis team did not identify market failures in the provision of guarantee services; however, it was noted that the availability of the service has deteriorated in recent years due to both macroeconomic changes and the COVID-19 crisis. Consequently, the risk appetite of guarantee providers has decreased, and additional guarantees, mainly in the form of deposits and real estate, are now more frequently required when issuing guarantees to companies. It is worth noting that insurance companies have also adjusted their approach, making it generally impossible to obtain small guarantees without additional collateral. It is important to recognize that the changed economic environment affects not only travel companies but also other sectors, including guarantee services.

This situation primarily complicates the situation for small and startup travel companies, where, in addition to higher costs, it is necessary to provide additional guarantees, which not all companies may be capable of. Consequently, the most restrictive conditions apply to them proportionally. The continuation of a similar situation and the increase in requirements may lead to the consolidation of service provision in the hands of more established companies with longer histories, which can more easily meet the requirements for complete protection of travellers (see also Chapter 2.6).

Therefore, we recommend that the Ministry of Economic Affairs and Communications create additional opportunities for travel companies to access guarantee services, thereby increasing competition and facilitating the entry of new companies into the market – primarily by examining the possibility of extending the KredEx entrepreneur guarantee to insurance companies' guarantee services. Additionally, we recommend that the Ministry of Economic Affairs and Communications and the TTJA increase awareness among travel companies of the loan guarantee offered by KredEx, which, in essence, can help startup travel companies facilitate access to guarantees.

The effects of Russia's military aggression have had a minimal impact on the guarantee market as a whole – significantly affected have been the business models of companies primarily organizing trips to Russia, Ukraine, or Belarus, but the proportion of such companies in the total population is small.

Examples of Guarantee Service Solutions from Other European Countries

Various options and alternative approaches derived from foreign practices for providing guarantee services have been discussed in detail in Chapter 3. While there are several mapped variations and alternative perspectives, the analysis team recommends adopting the approach of creating a back-up fund/reserve based on the Finnish practice, along with the possibility of an insolvency fee, as described, among other observations, in the back-up fund section. This would entail creating a second line of defense measure that takes into account the conditions and size of the Estonian market, as well as its specific characteristics, rather than adopting a foreign practice instrument in its unmodified form.

On the other hand, we believe that the use of a trust account instrument, as exemplified by the United Kingdom, could also be suitable for Estonian conditions, offering flexibility in enhancing the protection of travellers. Incorporating the trust account approach into the current system as an additional option could provide greater protection for the interests of travellers without necessarily replacing existing practices.

However, implementing the trust account model would not replace existing practices in Estonian conditions. Based on the UK solution, where trust accounts are used for making advance payments and, if necessary, for conveniently refunding them, this principle seems applicable to Estonian conditions as well. The success of using this instrument in Estonia depends on the interest of Estonian financial institutions (which is currently relatively low) in expanding their service offering. It is also possible to consider creating trust accounts across different sectors (not just for travel companies), which could increase the overall volume and be more attractive to providers of guarantees. This would thus be an additional measure that does not replace current solutions. However, it does not provide the same level of protection currently offered in Estonia (including covering the repatriation of travellers with trust

accounts), so the issues related to repatriation of travellers must be separately addressed, which is also a risk point for this solution.

We recommend that the Ministry of Economic Affairs and Communications and the TTJA, together with guarantee service providers, map out the potential interest and capability for providing this service, including acquiring knowledge about the precise costs of the service in the Estonian context, which will allow for an assessment of its attractiveness and sustainability for consumers.

Analysis and Recommendations on Minimum Guarantee Amounts

The current minimum guarantee amounts specified in the Tourism Act are no longer up to date to ensure complete protection for travelers, both in terms of fixed minimum amounts and percentage rates. This is due to the fact that these rates have remained unchanged since 2010, despite a significant increase in the cost of travel services in Estonia over the past decade. Therefore, it is necessary to establish new minimum guarantee amounts that take into account both the actual need for guarantees and the potential rise in entry barriers for companies.

Minimum guarantee amounts are essentially minimum levels set by policymakers that companies must adhere to when providing services in the sector, effectively setting entry barriers. It is important to understand the dual impact of higher minimum guarantee amounts: while they increase the protection of travelers, excessively high minimum amounts may make guarantee services inaccessible to some travel companies, potentially negatively affecting their business sustainability. Although the cost of travel services in Estonia has increased by approximately 90% between 2013 and 2022, the current rates have remained unchanged since 2010.

We recommend that the Ministry of Economic Affairs and Communications (MKM) and the Estonian Competition Authority (TTJA) adjust both the minimum guarantee amounts and the list of activities covered by the Tourism Act, but not in one change as large as the increase in service prices might indicate. We propose revising the minimum rates and activity list based on the specifics of the Estonian market, considering the potential impact on the sector. The possible new list of activities and associated minimum rates are provided in Chapter 5.2.

In Chapter 5.3, we have examined in detail the effects of changes on the guarantee amount, cost, and price increase for three main activity areas: activities in Finland, Sweden, and Latvia (previously partially covered under activities 3 and 4); activities in other countries not included in the previous category (previously partially covered under activities 3 and 4); and activities outside Estonia, including charter flights (previously activity 2).

As the changes assessed by PwC in terms of percentage changes do not have an impact on the guarantee cost due to the lack of current data, the analysis must focus on the impact of changes in fixed minimum rates. As a result, the total guarantee requirement for companies would increase by €1,942,500, resulting in an additional annual cost of €77,700 based on the average cost of guarantees. This would represent an increase of 0.04% annually from total sales covered by guarantees across all three activity areas. However, changes within each group vary, with the largest increase expected in the new activity area 3, ranging from 0.12% to 0.14% of sales covered by guarantees, while activity area 2 would see an increase ranging from 0.02% to 0.03%, and activity area 4 would experience less than 0.01% from total sales covered by guarantees.

It is important to consider that implementing the recommended adjustments may make it even more difficult for some travel companies to access guarantees, potentially reducing the number of active companies in the sector. However, adjusting the rates is advisable from the perspective of protecting travelers' interests. The proposed changes primarily affect companies operating under fixed minimum guarantee requirements (i.e., guarantee requirements of €13,000 and €32,000).

As one option, we recommend considering a special provision for new companies when implementing the new rates, allowing them to meet a lower guarantee requirement in their first year of operation. While this may reduce the protection of travelers' interests, it allows new companies to build a customer base and sustainable revenue, potentially reaching the minimum guarantee amount in terms of sales in subsequent years. The size of any potential deviation mainly depends on the policymakers' market awareness and capabilities but could, for example, allow new companies to meet 50% of the minimum guarantee requirement in their first year of operation.

Proposal for Repatriation or Continuation of Travel for Passengers

As with Estonia, the practice of repatriation in foreign countries was also found to be limited (i.e., isolated cases), making it difficult to propose adopting specific countries' practices in situations where there has been no need to deal with passenger repatriation in Estonia since the new Package Travel Directive (PTD) came into force in 2018. Themes related to the possible continuation of travel and repatriation are mainly addressed in Chapter 5.4.

The limited practical need has created a situation where not all travel companies actively consider the costs associated with repatriation in their guarantee requirements – including a lack of knowledge about the size of these costs. This is somewhat understandable because the costs associated with repatriation are often unclear and uncertain, only becoming apparent when the need arises. Since there isn't much precedent for this practice, companies currently lack a justified understanding of the precise magnitude of these costs. Since both the PTD and the Tourism Act stipulate that the company must consider all obligations when calculating the guarantee, we recommend that the supervisory authority, the Estonian Competition Authority (TTJA), together with representatives from the travel sector, conduct joint discussions to update the principles and guidance material (including how to assess and calculate the adequacy of the guarantee for meeting all obligations) and disseminate this knowledge to companies more widely.

The current repatriation system in Estonia is organized in the most cost-effective manner, but we believe that the system should also ensure flexibility. We recommend adopting a more flexible solution, whereby repatriation can be organized centrally/nationally (as is the case today) or in a way where the traveler can arrange their repatriation independently (similar to the combined approach in Ireland). A case-based approach allows for the most accurate understanding of passengers' needs, including the role of the Estonian Competition Authority in future repatriation arrangements.

Furthermore, it is worth considering the possibility of creating a second-level protection mechanism that would allow the use of accumulated funds for organizing passenger repatriation. In the current situation, where the costs associated with repatriation are not

generally considered, this would be a clearly justified measure to address an important challenge.

Assessment of the Current Guarantee System and Oversight in Estonia

The current guarantee system for travel companies in Estonia is generally understandable to market participants. However, a significant challenge lies in the fulfillment of due diligence obligations by companies, correct calculation of their guarantees, and consideration of potential repatriation costs.

Activities conducted within this analysis confirm that, overall, the current guarantee system is understandable and functional for market participants. However, there are certain challenges and issues that require additional attention. Interviews conducted, analysis of guarantee data, and broader document analysis (including the Estonian Competition Authority's [TTJA] separate adequacy check of guarantees) indicate that the guarantees obtained by companies are not always in line with the required guarantees at all times. In TTJA's controls conducted in 2023, inadequacy of guarantees was identified in 27 out of 41 checked companies, or nearly 66% of cases, resulting in an increase in guarantees by over 8 million euros in total.

One complicating factor is the knowledge that companies do not assess their guarantee needs on a daily basis but rather once per quarter or after significant bookings by clients. This means that not all travel companies monitor their required guarantee size on a daily basis. One main reason for this is the consideration of advance payments and its cash-based nature, meaning many companies do not have an automatic overview of their advance payment-covered sales revenue but often perform these extracts manually.

There are also discrepancies in advance payment reporting – primarily, TTJA has found that travel organizers account for advance payments only until the start of the package trip, resulting in insufficient guarantees. This approach is incorrect and does not provide a true overview of advance payments and the need for guarantees, as advance payments can only be deducted from the total amount after the package trip has taken place, i.e., after the safe return of passengers home.

Companies primarily assess the sufficiency of guarantees based on received advance payments, without taking into account potential additional costs that would arise during passenger repatriation. This challenge indicates a systemic issue, as passenger repatriation has not been a common practice, resulting in companies lacking knowledge of the extent to which repatriation costs should be considered. In this regard, the establishment of a back-up fund, as previously recommended, could be a helpful measure.

TTJA aims to increase awareness among entrepreneurs and enhance passenger protection, and therefore has the authority to impose fines to ensure that guarantees are adjusted according to actual needs. Increasing awareness among travel companies helps reduce the share of companies that do not fulfill their due diligence obligations sufficiently due to lack of knowledge – methods such as email newsletters with reminders, information sessions, etc. However, the effectiveness of restrictive or punitive measures should also be considered.

We recommend that TTJA conduct regular meetings or roundtable discussions with representatives of the travel sector to gain early insights into market trends and allow for the creation of a direct platform through which to inform companies of major planned changes to

Estonian or EU regulations. This ensures stronger communication between TTJA and service providers. Since the Estonian travel company market is composed of a large number of micro and small businesses, where a few larger companies account for a significant portion of total sector revenue (including revenue covered by guarantees), we recommend that TTJA regularly monitor changes, especially in the financial status of dominant companies.

Closer cooperation formats may make travel companies more receptive to the introduction of collective protection instruments, which is also addressed for the protection of passengers in the PTD.

We want to emphasize that, in our assessment, the main challenges in the field of travel company guarantees stem from companies' insufficient fulfillment of due diligence obligations, rather than from the fundamental structure of the current system. Therefore, we recommend considering the effectiveness of restrictive or punitive measures for repeat offenders, for whom existing guidelines and additional counseling have not had the desired effect.

A significant challenge lies in oversight (from both the reporting and oversight perspectives), largely conducted manually. Today, it is not possible to obtain the necessary data for assessing guarantee sufficiency (e.g., advance payments, sales reports) automatically and easily based on companies' annual reports for two main reasons: on the one hand, annual reports reflect the company's overall sales revenue but not sales revenue covered by guarantees, and secondly, the submission of annual reports does not adhere to the principle of quarterly reporting. Therefore, reporting-related activities and oversight, in general, are labor-intensive. As an additional measure, we recommend that TTJA consider implementing automated control based on companies' annual reports and consider the possibility of conducting inspections through third-party service providers.

Automated control of annual reports could provide valuable input to TTJA for conducting future inspections. Guarantees are set up to protect passengers in the event of a company's insolvency. Although guarantee sufficiency checks provide an indication of compliance with obligations, the final situation only becomes clear when insolvency occurs and the guarantee is invoked. However, signs of insolvency can be detected earlier.

In certain cases, the risk of insolvency is something that could be automatically assessed – for example, by downloading annual reports of desired activities/companies from the Business Register as open data and then conducting a kind of sustainability health check on companies' main financial indicators, using indicators such as those addressed by the Entrepreneur's Viability Index tool (formerly the Early Warning Service) for important economic indicators, and easily creating automated assessments of companies' financial health (based on balance sheet and income statement figures – e.g., assets, debt/EBITDA ratio, total debt/equity ratio, etc.). TTJA could be responsible for consolidating this automated analysis, for example, by involving the Ministry of Economic Affairs and Communications and Statistics Estonia or some other third-party service provider.

Based on the results, companies can be classified into different risk categories, providing an indication of which companies' fortunes it would be advisable to take more interest in. If a company has not submitted its annual report on time, it could be classified as a high-risk company. Even one insolvency case of a large-volume travel company and inadequate guarantees would significantly increase the average losses of the previous period. Therefore, it

would be necessary to regularly analyze travel companies based on profit margins to gain early indications of potential deterioration in the situation.

As the resources of TTJA specialists as supervisors are limited, it is worth considering the possibility of outsourcing control activities of companies through a trusted service provider, which could be, for example, accounting firms or audit offices.

Optimal Organization of the Guarantee Sector

Based on the activities conducted during the analysis, the recommendations described above, and the final chapter 6 of the analysis, we summarize the recommendations of the analysis team for the optimal organization of the guarantee sector as follows:

Maintain the current system based on individual guarantees by companies as the baseline.

In addition to the current individual guarantee system, recommend establishing a second-level protection in the form of a back-up fund or reserve. This would help address challenges related to handling insolvency cases and repatriating passengers.

Recommend updating and adjusting both the list of travel company activities and the minimum rates applicable to those activities. This ensures that the regulatory framework remains relevant and reflects the current industry landscape.

Propose creating an exception for the initial guarantee amount for starting companies (for new activity categories 2 and 3), facilitating access to guarantees. Additionally, if possible, consider expanding the current KredEx guarantee for guarantees offered by insurance companies.

Advocate for the adoption of an additional supervisory mechanism to automatically analyze companies' annual reports to assess their financial condition and identify indications of insolvency. This would provide early warnings of potential financial difficulties.

Recommend that TTJA consider outsourcing guarantee sufficiency checks to third parties, such as auditing or accounting firms, as a service. This could streamline the oversight process and utilize external expertise.

Encourage the Ministry of Economic Affairs and Communications (MKM) and TTJA to continue their awareness-raising efforts within the sector regarding the adoption of real-time economic solutions in travel companies' reporting. This aims to reduce sectoral concerns and increase participation in potential pilot programs.