Motability Operations | Group plc

City Gate House
22 Southwark Bridge Road
London SE1 9HB

motabilityoperations.co.uk

Rt Hon Esther McVey MP
Secretary of State for Work and Pensions
Department for Work and Pensions
Caxton House
Tothill Street
London SW1H 9NA

15 February 2018

Dear Secretary of State

**Comments on the Urgent Question raised by John Mann MP regarding the Motability Scheme**

As outlined in the separate letter to you from Lord Sterling, Chairman of Motability, we are writing in relation to the Parliamentary debate regarding the Motability Scheme (the "**Scheme**") that took place following an urgent question from Mr John Mann MP on 8 February 2018.

As you will no doubt appreciate, Motability Operations Group plc (the "**Company**"), as the commercial entity responsible for the delivery of the Scheme on the ground pursuant to a contract entered into with the Motability Charity (the "**Charity**"), observed the debate with interest. In this regard, it is important to note at the outset that the Company warmly welcomes scrutiny of the Scheme and the opportunity to explain its role in the Scheme's delivery.

We regret that many false statements were made about how the Scheme actually works and the Company's role in delivering it. In view of the vital importance of the Scheme to the lives of some 629,000 disabled people, any debate and discussion of these topics must be based on sound facts and proceed on a properly informed basis.

We have enclosed with this letter a short briefing paper, which explains how the Scheme works and which addresses certain of the issues that have been misunderstood in the debate. We would be grateful if you would kindly distribute that paper within your Department.

Given that the Parliamentary statements betraying Members' misconceptions about the Scheme are in Hansard, we are placing a copy of this letter, and its enclosure, in the libraries of both Houses. We understand Lord Sterling is making a similar arrangement. We also intend to send copies of this letter to those who participated in the Parliamentary debate as well as other significant parties and to make a copy of this letter available on our website. In this letter, we seek to address the inaccuracies and misunderstandings apparent in the Parliamentary debate under the following headings:

1. The Role of the Company;
2. Funding;
3. The Reserves of the Company; and,
4. Executive Remuneration.

*The Role of the Company*

During the course of the debate, it became clear that there is a fundamental misunderstanding regarding the separate roles played by the Charity and the Company. Indeed, a number of the comments demonstrated that certain Members have confused the roles of the two entities.

The Charity and the Company are separate entities. The Charity is responsible for the oversight of the Scheme and the Company, which is a plc and not a charity, is responsible for delivering it under the terms of a contract entered into with the Charity, which was most recently amended in 2008. In that role, the Company buys and sells over 200,000 cars a year and represents approximately 10% of all new car sales in the UK.

*Funding*

It was stated that the *"Charity...is funded by the taxpayer through a direct grant from Government"*. That statement is incorrect.

The Scheme is operated and delivered by the Company, whose revenues are derived from vehicle lease payments from its customers (who voluntarily assign some or all of their benefits to the Company to make those lease payments) and from sales of used, end-of-lease cars in the market. Indeed, the Company is the largest seller of used cars in the UK market. On average, the Company sells 650 used cars per day, seven days a week. In 2017, this generated over £2 billion of revenue.

Therefore, while the Company does, for administrative convenience, have funds transferred to it by the Department of Work and Pensions, that is only because individual participants in the Scheme have freely chosen to assign some or all of their benefits to the Company to meet their vehicle lease payments. If they had not done so, those funds would not revert to the Government (as seems to have been suggested), but would be the property of the individual benefit recipients to spend as they see fit. That fact seems to have been completely lost in the debate.

## *The Reserves of the Company*

The suggestion was made during the course of the Parliamentary debate that the Charity "*is carrying cash reserves of £2.4 billion*". That is also incorrect.

In its most recent set of accounts, the Company records "restricted reserves" of £2.4 billion on its balance sheet. Contrary to what was suggested during the debate, this sum is not held as idle cash, but is invested in the Company's fleet of 629,000 vehicles. That fleet is worth approximately £6.5 billion and, therefore, the Company holds capital equivalent to approximately a third of the value (i.e. £2.4 billion) of its vehicles currently under lease. This is a prudent commercial position for the Company and, indeed as a reference point, is in line with Bank of England stress-test guidance for other financial institutions.

As an inevitable consequence of what is said above, it is not the case that the £2.4 billion of reserves held by the Company is capable of distribution (either to the Government or otherwise). Such a fund of idle cash simply does not exist, as we have explained above. Even if that were not the case and even if the Government were entitled to expropriate these funds (which it is not), that would be to the detriment of the Scheme's customers and would undermine the Company's strong capital base that is essential to its sustainability against the myriad of commercial risks it faces and its ability to obtain debt funding on competitive terms.

As noted during the course of the debate, the Company achieved a post-tax profit of approximately £200m in 2017. However, that does not demonstrate that the Charity has been underspending its budget. First, and as already noted, these are funds of the Company rather than the Charity. Secondly, all of the profits of the Company are reinvested into the Scheme for the benefit of its customers. For example, in addition to directly investing £113 million into the customer proposition (including the provision of free adaptations to customer vehicles and subsidising wheelchair accessible vehicles), the successful and efficient management of the Company has allowed it to donate over £265 million to the Charity over the course of the last 3 years. In doing so, the Company has assisted the Charity in supporting disabled people who, for example, no longer receive disability benefits due to reassessment by the Department for Work and Pensions. In fact, £175 million of the £265 million donated by the Company during the last three years has been used to support customers who, due to benefits reassessment by the Department for Work and Pensions, are no longer eligible to be members of the Scheme.

It is also important to correct the suggestion that the shareholders of the Company (Barclays, HSBC, Lloyds and the Royal Bank of Scotland) have profited significantly as a result of the Scheme. They have not. They received an aggregate of £1.5 million between them in 2017, which includes the coupon required to be paid on the preference shares allocated to them in return for their initial capital contributions to the Company at its inception. In addition, the banks may receive fees in respect of arrangement and transactional services that they may provide to the Company when it issues debt securities. Any such fees are benchmarked against prevailing market rates.

*Executive Remuneration*

During the exchanges, it was suggested that the CEO of the Charity was paid £1.7 million. That is not correct. However, the CEO of the Company did receive a total remuneration package of this value in 2017; this included remuneration for in-year performance and the award of deferred compensation under a long term incentive plan (LTIP) which is now in run-off. Subject to meeting performance criteria, the final payment under this LTIP will be made in 2018.

The CEO's remuneration, and the remuneration of the other directors, was approved by the Board acting on the recommendations of the Company's remuneration committee, which in turn makes its recommendations with reference to, among other things, appropriate market benchmarks and having taken advice from its remuneration advisers. In that context, it is important to note that the Scheme has grown over time, undergoing a structural transformation which included the assumption of a broad range of commercial risks by the Company that were previously borne by insurers, vehicle manufacturers and others. As a result, the Company has become a significant and increasingly complex operation, regulated by the FCA, generating revenue of £4.2 billion annually. An enterprise of this scale requires an experienced and professional leadership team capable of managing the risks associated with a complex business owning and operating a fleet of vehicles worth £6.5 billion. The levels of executive remuneration are set in order to attract and retain the best possible management team and recognise that we must be competitive in the market for such executive talent. The quality of the current management team has been demonstrated by the Company's excellent customer satisfaction rating (recently independently measured at 98%), robust financial sustainability and customer affordability.

*Conclusion*

Given the pressures on the Secretary of State's time, we have sought in this letter to deal with what seem to us to have been the most important misunderstandings concerning the Scheme, and we know that Lord Sterling's separate letter also tackles several key issues raised in the exchanges.

The quality, value and sustainability of the service provided to Scheme customers is the guiding principle of everything that we do at the Company.

**Neil Johnson**

**Chairman**

**Motability Operations Group plc**

Cc Lord Sterling of Plaistow

# MOTABILITY OPERATIONS GROUP PLC (THE "COMPANY"): FACT SHEET

## Background to the Motability Scheme (the "Scheme") and the role of the Company

- The Scheme was founded in 1977. The Motability Charity (the **"Charity"**) was and is responsible for overseeing the Scheme.
- In its initial stages, the Scheme was financed and operated by a partnership formed by the UK's four major clearing banks – Barclays, HSBC, Lloyds and the Royal Bank of Scotland. At that stage, the intention was that the Scheme would provide up to 20,000 vehicles for disabled individuals. In 2008, the partnership between the banks was superseded by the Company (with those same banks as its shareholders), which now delivers the operational aspects of the Scheme, under contract to, and supervised by, the Charity.
- The shareholder banks have exhibited exceptional support for the Scheme. This support has been particularly crucial during the periods of financial instability experienced by the Scheme in the past. It is important to note that the support provided by the banks has not resulted in any significant financial gain to them (contrary to what has been suggested in the media and in Parliament). In 2017, the shareholder banks received between them payments of £1.5m in aggregate, as they did for the two years prior to that (including the 7% coupon on their preference shares).
- As a result of the banks' support and the credibility that the Company has built in the investor community, the Scheme has, over the course of the last forty years, gone from strength to strength, and the mission and scope of the Scheme have evolved dramatically.
- The Scheme has provided 4.5 million cars to disabled people since its inception and the Company currently serves approximately 629,000 customers with a fleet of vehicles worth £6.5bn. Last year, purchases by the Company accounted for approximately 10% of new car purchases in the UK. Given the significant scale on which the Company acquires vehicles, and the buying power associated with that scale, the Company can offer its customers exceptional value and choice.
- The Company has always been, and continues to be, focussed on its number one priority: providing exceptional customer service and delivering the Scheme in a manner that works best for its valued customers and their specific needs.

## Structure of the Scheme

- As noted above, the Charity is responsible for overseeing the Scheme and setting its policy. The Company is responsible for operational delivery and is accountable to the Charity for the service it provides.
- The Charity and the Company are therefore separate entities, and the relationship between them is regulated by contract. This contract requires the Company to meet Key Performance Indicators and allows the Charity to exercise effective oversight of the Scheme. The Charity also has the option to terminate the contract on notice if the Company underperforms.

## Funding of the Scheme

- The Scheme is not funded either by the Government or taxpayers.
- The Scheme's customers are the recipients of certain disability benefits. It remains up to the customer how to spend those benefits. If the customer would like to spend some or all of that benefit to acquire a vehicle, one of the options available to them is to become a member of the Scheme.
- Once a customer chooses to become a member of the Scheme, that customer will, instead of arranging and making vehicle lease payments him/herself, assign to the Company some or all of the benefit due to him/her from the Department for Work and Pensions. Accordingly, all or part of a customer's benefit may be paid directly to the Company on that customer's behalf. The sums paid by the Government to the Company therefore do not constitute Government or taxpayers' money, but rather the private funds of individuals who have chosen to join the Scheme.
- Furthermore, while a certain proportion of the Company's revenue is made up of customers' lease payments, over half of the £4.2bn of revenue generated by the Company is derived from the sale of used, end-of-lease cars into the highly competitive used car market.
- The £6.5bn of vehicles owned by the Company is also part funded by competitively sourced bond financing with 12 bonds issued in the debt capital markets since 2008.

## The Reserves of the Company

- The Company does not hold cash reserves of £2.4bn.
- As set out in the Company's annual report, this figure represents the Company's "restricted reserves", which is the accounting entry that records the Company's accumulated trading profits over time. These restricted reserves do not exist as idle cash in a bank account: the

£2.4bn comprising the Company's restricted reserves is invested into the fleet of vehicles which are provided to customers under the Scheme.

- The existence of these restricted reserves provides the Company with a strong capital base to meet the dual objectives of ensuring:
    - o a stable and sustainable Scheme that can withstand adverse economic forces, such as fluctuations in the used car market, insurance costs, fuel costs and currency fluctuations; and
    - o that the Company can obtain debt finance for its operations on the best possible terms.
- In that context, it is clear that the Company cannot pay the sum of £2.4bn to the Government as has been suggested: such a cash fund simply does not exist. If it did, it would not be open to the Government to unlawfully expropriate it to the clear detriment of the Scheme's disabled customers.
- The Company makes a trading profit of approximately £200m a year. That sum is not distributed to investors, but it is instead added to the Company's reserves for reinvestment in the Scheme and to underpin the financial stability of the Company. It cannot therefore be described as an "*underspend*". The fact that a profit is made reflects the prudence of the Company's directors in managing the Company and the risks it faces to ensure that the Scheme can be sustained and can grow in the future.
- One example of the way in which profit generated by the Company has been used in order to benefit its customers is through the provision of transitional support provided to individuals who have been re-assessed for, and subsequently lost, their disability benefits and therefore are no longer able to acquire a car under the Scheme. This involved the Company committing to the provision of up to £500m to support those losing vehicles as a result of policy changes made by the Department for Work and Pensions.
- The maintenance of a strong capital position and the reinvestment of trading profits are critical to the Scheme's stability and to ensuring that the Scheme can help as many customers as possible.

**<u>Market Position</u>**

- The Company does not have a monopoly on providing vehicles to recipients of disability benefits. Those on disability benefits are entirely at liberty to decide how to spend the sums paid to them by the Department for Work and Pensions. Indeed, over two-thirds of recipients of the Higher Rate Mobility Component of the Disability Living Allowance, the Enhanced Rate of the Mobility Component of Personal Independence

Payment, the War Pensioners' Mobility Supplement, or the Armed Forces Independence Payment choose not to join the Scheme.

- Recipients of disability benefits are of course free to purchase or hire a car in the traditional manner without participating in the Scheme. However, the Scheme undeniably offers customers exceptional value for money. According to the National Audit Office Report relating to the Scheme published in 1996, the average cost of hiring a vehicle through the Scheme was, back then, 30% lower than comparable contract hire offerings. This percentage now stands at 45% (both of these figures include a VAT concession that flows directly to the customer). These figures demonstrate that the Company continues to strive to provide value for money to its customers.
- The Company is fully accountable for its operational activities, which are overseen by the Charity. The Company is held to certain standards under the terms of its contract with the Charity and, should those standards not be met (or should the Charity identify a better means of delivering the Scheme), the contract may be terminated.
- To date, the delivery of the Scheme by the Company has been extremely successful. Indeed, customer satisfaction has been independently measured at 98%. Further, the Scheme has an excellent customer renewal rate of over 91%.

## Executive Remuneration

- The CEO of the Company (not the CEO of the Charity, as has been suggested) was paid £1.7m in the last financial year, including remuneration for in-year performance and the award of deferred compensation under a long term incentive plan. The amount of the CEO's remuneration, and that of the other directors, was approved by the Board acting on the recommendations of the Company's remuneration committee, which in turn makes its recommendations with reference, inter alia, to appropriate market benchmarks and having taken advice from its remuneration advisers.
- While this level of remuneration has been questioned, it is important to note that as the Scheme has developed and expanded over time, so the Company has become a significant and complex operation that turns over £4.2bn annually. That requires a very experienced and professional leadership team to effectively and efficiently manage the business and the significant commercial risks associated with it.
- In those circumstances, and given the fact that the Scheme is relied on by 629,000 disabled people, it is essential that the Company can attract and retain the best possible executive talent.

- It is important to note also that the remuneration committee is careful to ensure in its decisions that both the levels and the component parts of executive remuneration are aligned with market best practice. It is for this reason that, based on the remuneration committee's recommendation, the Board determined to cease awarding any new units under the directors' long term incentive plan ("**LTIP**") with effect from December 2015. The impact of these changes to the LTIP will result in a decrease of approximately 20% on a like-for-like basis in the CEO's remuneration starting in the next financial year.