National Audit Office

Report
by the Comptroller
and Auditor General

The Motability scheme

HC 1681 SESSION 2017–2019 7 DECEMBER 2018

Key facts

614,000	1.72m	£888m
Motability car scheme customers in September 2017	people eligible to be customers of the Motability scheme	our estimate of the maximum annual value of tax concessions from which the scheme benefited in 2017

99%	customer satisfaction in 2017-18, compared with a target of 92%.
£2.62 billion	Motability Operations' level of reserves as at March 2018.
£2.19 billion	total profits made by Motability Operations between 2007-08 and 2016-17, compared with total forecast profits of £1.14 billion in that period.
£400 million	charitable donation from Motability Operations to Motability, from Motability Operations' profits in 2017-18.
18 years	average tenure of Motability's governors prior to appointments in September 2018, compared with the Charity Governance Code's recommended limit of nine years.
£1.70 million	total value of remuneration package for Motability Operations' chief executive, including salary, bonuses and other benefits, in 2016-17.
£1.86 million	total value in September 2018 of additional long-term bonus scheme owed to Motability Operations' chief executive, but not yet paid, of which only the initial allocations of £258,000 have previously been disclosed.

Summary

1 The Motability scheme (the scheme) enables eligible disabled people to choose to exchange certain mobility allowances paid by the Department for Work & Pensions and Ministry of Defence for the lease of a new car, powered wheelchair or scooter. In early 2018, just over 1.7 million people were eligible for the scheme.

2 Two organisations provide the scheme:

- Motability, a charity, is responsible for the strategic direction and oversight of the scheme. Its charitable purpose is to “facilitate the relief and assistance of disabled persons… in connection with the provision to the beneficiaries of personal or other transportation”.
- Motability Operations Limited, a public limited company, operates the scheme through an exclusive rolling seven-year contract with Motability, known as the scheme agreement. Motability Operations Limited is ultimately owned by four shareholder banks.

3 Another charity, the Motability Tenth Anniversary Trust, was established in 1989 to invest funds to provide Motability with income to support its charitable objectives.

4 The core Motability scheme product provides a ‘worry-free’ car lease package, including: maintenance; servicing and repairs; breakdown assistance; comprehensive insurance; and a range of adaptations available to the customer at no additional cost. In addition, Motability Operations is responsible for selling vehicles returned by customers at the end of the lease agreement. In the year ending 30 September 2017, it had 614,000 lease agreements in place and sold nearly 240,000 cars into the used car market. In 2017, Motability Operations’ sales represented 21% of total UK sales of 3-year-old vehicles.

5 In May 2018, a report by the House of Commons Work and Pensions and Treasury select committees raised questions about: the structures and governance of the scheme; government support for the scheme; the levels of reserves in Motability Operations; the remuneration of its senior staff; and the relationship between Motability and the Department for Work & Pensions. Along with the Secretary of State for Work and Pensions, the Committees recommended that the National Audit Office (NAO) should carry out a review of the scheme.

6 The NAO is not ordinarily the statutory auditor of Motability, nor of any of its related entities. Motability does not currently receive public funding, but the scheme does benefit from government support, including through tax concessions.

7 On 23 May 2018, the Chief Secretary to the Treasury reached an agreement with the Motability entities providing, for a three-year period, the Comptroller and Auditor General with a statutory power to conduct examinations into the "economy, efficiency and effectiveness with which the Motability parties have used their resources in discharging their functions".

Focus of our review

8 This report considers:

- the Motability scheme's customer offer and performance;
- the scheme's financial model, its impact and profitability; and
- the governance of the scheme and remuneration of Motability Operations' senior management.

9 Given the significance of the car scheme in terms of its scale relative to the powered wheelchair and scooter scheme, this report focuses only on the car scheme. Fieldwork was carried out from July to October 2018. Our approach and methods are set out in Appendix Four.

Key findings

The Motability scheme's customer offer and performance

10 In 2017-18, overall customer satisfaction with the Motability scheme was 99%. Customer service standards are very high, with customer satisfaction having exceeded a target of 92% continuously for the last decade. This performance is impressive in the context of a customer base of people with disabilities, many of whom have complex needs. This followed a turnaround in overall scheme performance when a new management team at Motability Operations implemented a major change programme between 2002 and 2008. In March 2018, all 23 of the scheme's contractual key performance indicators exceeded targeted levels (Paragraphs 1.16 and 1.18).

11 The Motability scheme exclusively benefits from certain tax concessions associated with the direct transfer of the mobility components of qualifying allowances from the government, worth a maximum of £888 million in 2017. Based on May 2018 figures, the lease prices offered by Motability Operations are 44% cheaper on average than comparable leasing products in the wider market — nearly two-fifths of this discount arises directly from the tax concessions provided by government. Government also directly transfers customer allowances to Motability Operations, reducing the company's exposure to customer credit risk. This reduced exposure to risk supports a higher credit rating, enabling Motability Operations to access cheaper financing. Government support has also contributed to the scheme's scale, which enables Motability Operations to negotiate substantial discounts from manufacturers (Paragraphs 1.11–1.13 and 1.19).

12 The scheme's customers represent 36% of all eligible individuals. The 614,000 car scheme customers in September 2017 compare with around 1.7 million individuals who are eligible for the scheme. The percentage of customers as a proportion of eligible individuals compares with 29% in 2008. The scheme agreement makes Motability responsible for managing awareness of the scheme among eligible individuals who are not customers. Motability Operations has carried out limited research on eligible people who are not customers, to understand the reasons why they have not used the scheme, including any barriers to entry, but has not been able to draw any firm conclusions from this. Citing data protection concerns, the Department for Work & Pensions has not enabled Motability to access its database of eligible individuals for research purposes (Paragraphs 1.2, 1.8, 1.22 and 1.23).

Motability Operations' financial model

13 Motability Operations has generated £1.05 billion of unplanned profit since 2008. From 2008 to 2017, Motability Operations planned to make £1.14 billion of profit, but generated £2.19 billion of profit. The unplanned profit was driven by inaccuracy in Motability Operations' forecast value of vehicles, which is typically lower than the wider market average. This generated £826 million, or 79%, of the total unplanned profit. Underestimating the forecast value of cars means customers were charged £390 million more than was required in their lease agreements to cover the costs of depreciation. In reality, however, Motability Operations has benefited from the continued strong performance of the used car market over the past decade (Paragraphs 2.7, 2.9 and 2.10).

14 Motability Operations has chosen a more prudent risk management approach than other car leasing companies, despite its overall business risk being lower owing to the competitive advantages afforded through government support. Motability Operations has made various changes to its business model since 2002, for example taking responsibility for selling ex-lease vehicles and taking on the majority of its vehicle fleet insurance risk. Alongside a growing customer base, this has made scheme administration more complex and increased its risk exposure. Motability Operations is less able to manage its risk exposure through diversification compared with other car leasing companies and has chosen a considerably more risk-averse approach by adopting an intentionally conservative reserves target. However, government has provided the Motability scheme with a number of significant advantages that reduces the overall business risk being managed as part of the scheme when compared to other companies. We consider that the advantages of government support outweigh the disadvantages and while Motability Operations' prudent approach may have been appropriate while the business was changing, it is less justified given its ongoing success (Paragraphs 2.13, 2.15, 2.17–2.19).

15 **Motability Operations' prudent approach means it is holding more reserves than other car leasing companies. At 31 March 2018, Motability Operations held £2.62 billion in reserves**. 79% of the value of total assets that make up the reserves is vehicles. Holding reserves ensures Motability Operations can withstand economic downturns without raising lease prices, providing a sustainable and stable scheme for customers. If Motability Operations adopted an approach to risk management more in line with other car leasing companies, who are more exposed to worsening macro-economic conditions, it could hold a lower level of reserves. Reducing its target reserves level would increase the level of funds available to distribute, given that it is likely that Motability Operations will continue to generate significant surpluses unless an economic shock occurs. However, a less conservative finance policy could lead to a downgrade of Motability Operations' credit rating. This would increase its cost of financing, which would have to be funded through increased lease prices or operational efficiencies (Paragraphs 2.16, 2.17, 2.19, 2.21–2.24).

16 **Investment in the scheme has supressed the level of reserves that would be considered surplus to Motability Operations' requirements**. In addition to retaining profit as reserves, Motability Operations has invested £1.37 billion since 2008 in a range of initiatives that have increased costs into its business and are designed to improve its customer offer, such as free vehicle adaptations, payments to customers when they return their vehicles in a good condition and payments to dealers to incentivise excellent customer service. Motability Operations consults with customer groups and Motability to generate ideas to improve the customer offering. However, it is unable to demonstrate how effective this investment is in driving continued achievement of the scheme's strategic objectives given its already excellent performance relating to customer satisfaction and lease affordability. Given the size of investment, we think there should be a wider consideration of the value for money of customer investment that takes into account alternative uses of money beyond the scheme (Paragraphs 2.25–2.27).

Governance arrangements

17 **In addition to investments in the customer offer, Motability Operations donated £345 million to support Motability's grant activity between 2010 and 2017.** Motability has allocated half of this amount (£175 million) to fund transition support grants for scheme customers who have lost their eligibility for the scheme following their assessment for Personal Independence Payment (PIP), where previously they had been eligible through receipt of Disability Living Allowance (DLA). These grants enable these individuals to either continue their scheme leases for up to six months or receive up to £2,000. This was introduced following government's policy change to replace DLA with PIP, but will not require funding in the longer term. In the five-year period from 2013-14 to 2017-18, Motability spent £101 million on PIP transitional support grants. Motability expects that the Department for Work & Pensions will complete its programme of reassessments in 2019-20 (Paragraphs 1.9, 2.28 and 3.4).

18 **In September 2018, Motability Operations announced a further £400 million donation to Motability**. The £400 million it received in 2018 represents 14 times its total annual spending in 2017-18. In recent years, Motability Operations has advised Motability to expect ongoing sizeable donations of at least £100 million a year, in the absence of economic shocks. Motability does not have a long-term strategy and has only recently developed a structured framework for determining specific new purposes to which it will put high-value donations. In September 2018, Motability's board of governors approved funding for a range of new initiatives, which are expected to cost around £100 million a year by 2024-25. To ensure the sustainability of these initiatives, Motability expects to use the 2018 donation to contribute to holding surplus funds of between £500 million and £600 million in future years. The surplus funds are to be held within the charity, separate and additional to the reserves held by Motability Operations. Motability plans to draw on its surplus funds if there is any shortfall in expected future donations. It is not yet clear that Motability can absorb the scale of the donations it has received as a result of Motability Operations' unplanned profit in a way that can maximise its effectiveness (Paragraphs 3.5–3.7).

19 **Motability's governors have often exceeded recommended tenure limits, and there has been insufficient consideration of diversity in appointing them**. A review of Motability's governance in 2003 recommended planned and progressive refreshing of its board and the Charity Governance Code recommends a tenure limit for governors of nine years. However, before new appointments were made in September 2018, the average tenure of Motability's governors was 18 years. In September 2018, Motability announced the retirement of three governors and the appointment of five new governors. Following these changes, there are now four governors who continue to significantly exceed the recommended tenure limit of nine years, having each served for at least 16 years. While there is collective expertise in financial and automotive services, as well as personal and professional experience of disability, there are no black and minority ethnic governors, and only one female governor (Paragraphs 3.8 and 3.9).

20 **Motability has limited formal influence over Motability Operations' executive remuneration arrangements**. Motability Operations' Remuneration Committee is responsible for its remuneration policies, with the scheme agreement providing limited influence for Motability in this area. In recent years, the charity has become concerned about the reputational consequences of high levels of pay, even though the remuneration arrangements have functioned as Motability Operations' Remuneration Committee intended, following consultation with Motability. Correspondence in 2016 between Motability and Motability Operations shows that, following confirmation of new executive remuneration arrangements in 2015, Motability's chairman expressed concerns. The Motability Operations chairman conveyed that he had been under the impression that Motability's chairman supported the new arrangements. Motability's chairman, in his further reply, maintained his concerns about the level of variable pay. Motability has now recognised that it does not have sufficient formal mechanisms or influence to address this risk to the scheme's reputation but has not yet rectified the situation. A 2018 governance review recommended that Motability should seek to amend the scheme agreement to enable it to better control Motability Operations' executive remuneration (Paragraphs 3.10–3.12 and 3.26).

21 **Remuneration for Motability Operations' executive directors has been generous and linked to performance targets set at levels that have been easily exceeded since 2008**. Motability Operations made significant performance improvements between 2002 and 2008. After that, it set the thresholds for 'excellent' performance for all of its targets for its long-term incentive plan (LTIP) below levels it was already achieving when the plan was introduced. The targets were not made more stretching over time and all targets were exceeded for the period of this scheme, from 2008 to 2015. As a result, in the first seven years of the scheme, five executive directors received £15.3 million in total, a nearly four-fold increase in the value of units initially allocated to them. A review of remuneration commissioned by Motability Operations in 2015 found that these arrangements resulted in relatively high payments for delivering consistent performance (Paragraphs 3.14 and 3.15).

22 **Total remuneration for Motability Operations' executive directors is forecast to fall from 2019, but annual bonuses have continued at near maximum levels**. In 2015, the Remuneration Committee undertook a review of remuneration arrangements. It recognised that it could use a broader range of comparators as benchmarks, although this range still does not fully reflect the structural advantages from which Motability Operations benefits and does not include comparisons with public sector entities or large charitable trusts. As a result of the new arrangements, we forecast that total executive remuneration will fall after the final LTIP payments are made in December 2018. For example, the chief executive's total remuneration is likely to reduce from £1.7 million to around £1.4 million in 2019-20. However, in the first two years of the arrangements introduced in 2015, annual bonuses have been paid on average at 93% of their maximum levels. Independent benchmarking reports provided to Motability Operations report that, on average, FTSE 250 firms have paid 70% to 75% of the maximum bonus available, with higher levels leading to investors exerting pressure to set tougher performance targets (Paragraphs 3.17–3.19).

23 **The full value of a separate incentive scheme for Motability Operations' chief executive has not been disclosed previously**. Between 2010 and 2015, the chief executive benefited from an additional five-year long-term incentive scheme (LTIS), designed to ensure his retention in post. Motability Operations has only disclosed the initial £258,000 to the public through its annual report and accounts. This complies with minimum financial reporting disclosure requirements. The full value of the scheme may be of interest to the Work and Pensions and Treasury select committees, given their previous interest in this matter. Payment of the scheme's value can be released at any time. The scheme was worth £1.86 million in September 2018 and is likely to be worth around £2.2 million by 2022 (Paragraphs 3.20–3.22).

24 **A recent governance review of Motability provides an opportunity to update aspects of governance to support the scheme's long-term effectiveness**. Motability commissioned a review of its governance from its solicitors, in response to a Charity Commission recommendation. The Charity Commission had previously carried out a review of Motability during 2017 in response to an unspecified complaint about Motability and the Motability Tenth Anniversary Trust. The July 2018 governance report made 44 recommendations, many of which touch upon issues that we have also identified in our review, for example the roles and terms of office for governors, and suggested updates to the scheme agreement, including clarification of the charity's role relating to Motability Operations' remuneration. Motability plans to provide a response to all recommendations by December 2019 (Paragraphs 3.25–3.27).

Concluding remarks

25 The Motability scheme provides an excellent service to eligible people who choose to lease a car. Motability Operations has successfully changed its business model over time, bringing aspects of the service, such as insurance, directly into the business. The management of Motability Operations turned the scheme around and built it into an increasingly profitable business and a force to be reckoned with in the UK used car market.

26 Motability Operations' management has performed well since 2002. However, we do think there is a difference between turning an underperforming business around and carrying out a series of important but not necessarily exceptional tasks to keep it on a road to successful operation. Motability acknowledges that the scheme benefits from structural advantages afforded to it through government support – for example, tax concessions, direct payment of mobility allowances and an effective monopoly. However, we do not see that Motability Operations reflects these advantages adequately in its consideration of risk when compared to other companies, how it assesses its performance, and how executives are rewarded. Its prudent view of risks and reserves tends to reinforce their 'exceptional' performance viewpoint, which we think leads to very high executive reward. While, following a review, total executive remuneration at Motability Operations will now fall, Motability has had difficulty over a long period of time influencing Motability Operations to set executive pay at the levels the charity considers appropriate. In the first two years following the introduction of new remuneration arrangements, annual performance bonuses have been paid at close to maximum levels.

27 Motability Operations has continued to benefit from upside risk such as strong performance in the used car market, and it has not brought its forecast value of vehicles into line with the wider market. While generating higher profits than expected means more money is available to support disabled people, we have not seen any evidence that Motability or Motability Operations have an effective framework to ensure their investments provide value for money. In the absence of an economic shock and unless it changes its business model, we think it likely that the company will continue to generate substantial cash surpluses. In light of all this, further consideration is needed of the executive reward structure and the issues relating to scheme governance and whether they are suitable to underpin the Motability scheme so that it can continue its excellent work for its customers. There is also a clear public interest in the government providing more clarity around its objectives for mobility allowances, given the favourable enabling conditions it provides for the scheme.

Recommendations

28 Motability should:

a Develop and publish a long-term strategy, based on broad and open consultation, that sets out how it can put the significant income it expects to continue to receive from Motability Operations to best use.

b Address all of the findings of its recent governance review and report transparently on the changes it makes as a result. It should publish an update on this in early 2020, once all changes have been implemented.

c Commission external benchmarking on the level of reserves held at Motability Operations based on comparable companies in similar industries on a global basis, both regulated and unregulated. Such benchmarking should go beyond establishing adequacy and should also assess how conservative the level is relative to that held by the company's peers.

d Carry out a review of the performance framework for the scheme, recognising that it is in a uniquely advantaged position, and that targets, including those linked to Motability Operations' executive directors' remuneration, have continuously been exceeded for many years.

29 Motability Operations should:

e Provide greater ongoing transparency through its annual report and accounts about the total value of the performance bonuses it pays to its executive directors, including the cumulative value of its long-term incentive plans, and the performance criteria used to determine these bonuses.

f Review its approach to forecasting to understand why it has consistently under-estimated profit over the last decade, so that it can better plan for future distributions of profit.

30 The government should:

g Review the value and impact of the support it provides for the scheme at an appropriate frequency, in light of its overarching objectives for mobility allowances.

h Work with Motability and Motability Operations to enhance promotion of the scheme, and support more extensive research into eligible people who do not use the scheme.