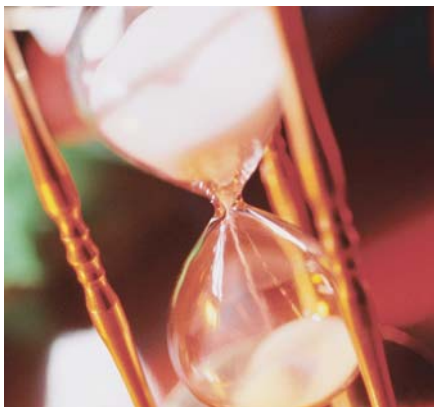


CBS perspective

ECO Sustainability

The automotive finance market seems somewhat divided over the popularity of Employee Car Ownership (ECO) schemes. On one hand, there are those who seem consumed with the desire to regularly vocalise their concerns about the potential longevity of such arrangements when compared with traditional company cars, whilst the opposing view promotes this increasingly popular structure as a viable long-term proposition. In order to make an informed opinion on the issue, it is important to consider the pertinent aspects that give rise to healthy debate amongst the fleet and finance communities.



One issue is awareness by employers of the type of arrangements available to them and to be able to distinguish between these. With the plethora of offerings currently in the market, many providers seem keen to position the ECO

label against what is effectively a basic Personal Contract Purchase (PCP) offering, making it very much a case of 'buyer beware', with many clients now asking uncomfortable retrospective questions of their selected provider.

The ability of ECO arrangements to deliver financial savings is another high profile discussion topic. In the opinion of CBS, such schemes are not a panacea guaranteed to reduce cost. Prospective employers will require careful due diligence of the business case for change before a recommendation to proceed is proposed. In our experience, only by deploying a thorough investigation of current and predicted future costs including key sensitivities and scenario exploration can the employer have confidence in any set of financial projections.

Similarly, the criticality of business mileage and the tax shelter this provides under the Inland Revenue's Approved Mileage Allowance Payments (AMAP) facility had lead many to believe that a threshold of minimum acceptable business mileage is singularly attributable to the viability of an ECO offering, with the corresponding opinion that it simply does not work for 'Perk' drivers. This premise wrongly dismisses a fundamental design opportunity that exists from being able to identify this sub-population of eligible employees. Where this scenario is evidenced, it is possible to construct different contract parameters for these drivers to facilitate inclusion.

Having said this, levels of business mileage are an important contributor to ECO viability but not singularly so. Similarly key to the potential attainment of financial economies are the presence of manufacturer discounts leading to low vehicle operating costs, employee attrition rates, fleet demographics, fuel policies and the concentration of higher rate tax payers. The combination of these additional factors will, in most cases, outweigh the impact of business mileage as a variable in the economic model.

There was lots of speculation in the lead up to the last budget regarding the potential revision to the aforementioned AMAP rates.

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Managing Directors Viewpoint



Martin Maguire
Managing Director

In my experience, companies implement ECOs to meet a variety of objectives ranging from maximising savings to protecting employees from increasing tax and NIC costs associated with company cars. In addition, companies also have varied constraints within which they must operate, e.g. balance sheet reporting criteria, banking covenants and corporate risk policies. To meet these objectives whilst staying within the required constraints, bespoke innovative solutions are required to maximise the benefit to the company of implementing a structured ECO.

These solutions often require unique funding arrangements to support them. Many banks and finance houses, which provide funding to the providers of ECO arrangements, often do not have the flexibility in their systems and internal corporate governance to embrace innovative funding solutions that sit outside their standard portfolio of products. To meet this challenge CBS has specifically designed flexible systems to support such solutions and also has its own internal finance house to provide funding for schemes implemented by ourselves.

Topical Issues *in Focus*



How efficient is your scheme?

Many employers who operate an ECO will currently be preparing their 2004/05 PAYE Settlement Agreements ("PSA") for submission to the Inland Revenue. With the payment of the tax and National Insurance calculated on the PSA due to be paid by 19th October, it is only now that some employers are realising how much they have to pay in "gross up costs" under their ECO.

However, many employers may be paying significantly more tax and National Insurance than is necessary, simply because of the inefficiencies inherent in the

structure of their ECO. Conversely, CBS continues to save its existing client base nearly £3 million each year over and above the core savings generated by the ECO, through the implementation of effective ECO structures, all of which have Inland Revenue clearance obtained on an individual client basis.

The development of these tax efficient structures by CBS, which do not impose an additional administrative burden on the employer nor have any detriment to the benefit received by the employee, has opened up ECOs to a new group of

employers who previously thought that the low business mileage that featured in their fleet profile meant that an ECO would be unsuitable for both themselves and their employees.

An equally important point is that the ability to use a PSA as a means of settling tax and National Insurance on ECO allowances is gradually being removed from most employers by the Inland Revenue. CBS has therefore developed alternative, administration friendly, mechanisms that allow employers and employees to continue to enjoy the benefits of an ECO without relying on a PSA. ■■■

CBS Poll

In each issue of the CBS Perspective we will be posing a topical question and asking for your opinion. This issue's question...

Which of the following potential additional services from your provider would you value most?

Proactive review of your company car benefit

Tax and legal compliance advice and management

Health and Safety compliance

Insurance advice and solutions

Flexible funding arrangements

Results from previous CBS Perspective's topical question

In the last edition of CBS Perspective, the Poll question asked fleet and benefit makers, "if you were reviewing the method of delivering a car benefit which of the following would you select?" The options were Company Car, Structured ECO, Private Contact Purchase (PCP), Gross Cash and Hire Cars.

Currently, the company car is still by far the most popular form of delivering car benefit to employees. As a result, most of the responses to changing the method of funding were for options other than company cars.

The most popular choices, totalling 62% of all responses, were changes to either a Structured ECO or a PCP. This reflects the ongoing search by employers to deliver a car benefit to employees in the most cost efficient manner and with the flexibility to meet other benefit objectives such as protecting employees from increased tax and NIC costs. This response also possibly reflects the confusion by employers of the difference

between Structured ECO and PCP schemes. CBS has recently discovered that some large corporations have not investigated implementing an ECO as they believed that by doing so they would lose control over the benefit and that their employees risk position would change for the worse. As illustrated in previous Perspective articles, this is not the case.

A significant number of respondents (28%) said that they would consider a move to gross cash. These were typically organisations with foreign parent companies. It is not always clear if companies moving to gross cash have considered all the implications of doing so. In CBS's experience, gross cash allowances are often overstated. Employers no longer have to take direct risks such as early termination and excess mileage but employees can easily become dissatisfied with this arrangement. Furthermore, opting for gross cash does not absolve employers of their obligations under health and safety legislation and could actually increase their risk due to the reduced control they have over employee choice and ensuring ongoing compliance with Road Traffic Act requirements.

There were a small number of responses for moving to company cars. This reflects CBS's recent experience of companies finding that employees have responded adversely to the introduction of gross cash or that the introduction of an ECO or PCP has not met the implementation objectives. In the latter case this is often due to an inappropriate scheme structure being implemented rather than an ECO arrangement not being suitable for that business. ■■■

Register your opinion by submitting your vote on our website
www.carbenefitsolutions.co.uk.

The results of this poll will feature in the next edition of CBS Perspective. Remember, your opinion counts!

Health Check

Over recent years, many employers faced with the need to either hold employees harmless to company car tax increases or in the search of financial efficiencies (or both) have implemented ECOs. However some of these schemes are now proving to be problematic or are giving rise to concerns over compliance issues.

In CBS's experience the primary reason for the issues these employers are facing is that they have implemented a "one size fits all" ECO offered by many providers, which does not take into account the unique characteristics of their own business.

CBS firmly believe that an ECO should be designed around the client and not the other way around and as a result we only offer tailored schemes. It is important to understand that CBS's product offering does not result in a scheme that involves

over complex structures that require a significant increase in additional administration. In fact quite the opposite is true.

In order to identify problems, and provide the necessary solutions, CBS has developed a "Health Check" programme which has been rolled out to a number of businesses, who prior to CBS's involvement, were unsure how best to address their concerns. The programme also focuses on opportunities to increase both the financial and operational efficiencies of the ECO whilst at all times ensuring tax and legal compliance.

By providing this Health-Check service, CBS has already presented the opportunity for clients to save hundreds of thousands of pounds. ■■■

current policy and the mix of marginal rate tax payers (22% or 40%) within the eligible employee population.

Some providers will insist on a minimum fleet size (typically several hundred units) in order to realise their pre-sale costs over time. At CBS, assuming the proposition makes sound financial sense for the employer, we look to accommodate fleets in excess of 100 units.

Increasing Company Car Tax is eroding our employees' car benefit. How could we compensate employees without increasing the cost to the company?

Ander an ECO an employee no longer pays Company Car Tax, providing the scheme is structured correctly. Instead of paying tax, the employee pays a contribution to their employer towards the cost of running their car. This contribution can be set at a level which is lower than the Company Car Tax on the equivalent car.

In this scenario the employee is financially advantaged and the company may also achieve cost savings through the introduction of the ECO, a "win-win" situation. ■■■



If you have a question you would like to ask our experts, please send your questions to:- mail@carbenefitsolutions.co.uk, alternatively visit our website.

This issues questions include;

I've heard that there is a minimum fleet size before an Employee Car Ownership (ECO) scheme proposition becomes economically viable. Please could you advise the minimum criteria?

As a general rule, fleet size is one of a number of factors for consideration. Additional considerations include business mileage, attrition rates, the

ECO Longevity... Cont.

This method of reimbursing employees using private vehicles for business purposes with free-of-tax payments has been labelled by some fleet commentators as 'over generous' and as such a veritable financial prop for ECO stability. What this opinion fails to recognise is that AMAP rates are supposed to reflect the operating costs of vehicles, something the fleet sector is similarly keen to register its concerns on regarding consistent downward movement in vehicle residual values and increasing fuel costs almost in the same breath. No reduction in AMAP rates was proposed in the budget but it is worthwhile stating that had it been the case (assuming all other things remaining equal), the impact would have been a revised set of projections with reduced savings potential and not the catastrophic demise of ECO some had speculated would ensue.

To the neutral observer, it seemed slightly peculiar by comparison that the removal of the 3% Euro-4 subsidy on diesel company cars registered after 1st January 2006 didn't receive anywhere near as much exposure from the same individuals in terms of what it meant for company car driver's tax liabilities and the resultant link with their employers Class 1A National Insurance costs. It would appear the growth in demand of diesel powered vehicles in the company car environment and the corresponding potential to swell the tax take from a subtle change in the assessment rules did not escape the Chancellor's notice.

With most employers keen to minimise their associated administration arising from workplace car provision, ECO schemes have been somewhat stigmatised for not meeting this requirement. However, with the latest generation of ECO scheme purposely designed to remove the need for payroll transactions and mileage reported from the employer's domain, this view is somewhat dated. When compared with the increasing workload on employers who provide traditional company cars resulting from the need to comply with high profile corporate responsibilities resulting from changing Health and Safety legislation and P11d / P46 reporting, the balance of burden would appear neutral.

As the UK's leading provider of employer-sponsored structured ECO arrangements, CBS are ultimately committed to the promotion, development and ongoing longevity of structured car schemes for those UK employers for whom the business case for change meets with their stated financial and human resource objectives.

In concluding, one would have to offer the challenge to those keen to dismiss structured company car alternatives as a passing fad that if this is the case, why it is that these schemes remain the preferred benefit provision methodology of many of the UK's most dynamic and successful employers, several of whom pioneered their introduction over ten years ago? ■■■

The workplace automotive finance market in the UK is constantly evolving and in a cluttered supply arena, the cultural characteristics that differentiate between the mediocre and the magnificent offer no surprises.

Generally, company car alternative schemes can be categorised into three main types, specifically:

| 1 Employer Sponsored Schemes | 2 Arms Length Schemes / PCP | 3 All Employee / Affinity Schemes |
|--|---|---|
| Company car substitution designed to replicate the look and feel of traditional arrangements | Company car supplement with bespoke calculations and potential additional risk considerations for employees | Retail type discount offering not dependent on company car entitlement and void of any employer involvement |

The main differentiator is that participation within type one and two schemes is normally predicated on employees having had previous entitlement to company car benefit. This is not the case with type three schemes.

Employer-sponsored schemes are specifically designed to replicate the operational 'look-and-feel' of company cars and as such include access to vehicles and a package of associated services identical to previous arrangements. Additionally, eligible employees are not exposed to any risk considerations (e.g. Early Termination or Excess Mileage charges). All such costs are met by the employer with the objective of benefit parity for employees.

Arms length schemes (type 2) feature employees selecting specific term and mileage parameters for their chosen vehicle from a supplier introduced by the employer. Calculations on the quantum of cash available as compensation for the removal of the company car are normally specific to the individual and the employers responsibilities in respect of potential charges are passed to the participating employee.

The following table highlight the differences between the various categories of ECO in relation to the components that make up the scheme structures, implementation requirements and operational processes.

| ECO Classification | Scheme Type | | |
|--|-------------------------|-------------------|-------------------------|
| | 1 Employer Sponsored | Arms Length / PCP | All Employee / Affinity |
| Full disclosure Inland Revenue tax clearance. | | | |
| Consumer Credit Licence required. | | | |
| Credit Sale Agreement as contractual finance paper. | | | |
| Interest Free Loan used as deposit. | | | |
| Credit scoring of participating employees not required. | A | | |
| Standardised contract parameters applied, not bespoke to individual drivers. | | | |
| Cash allowances paid to employees. | | | |
| Tax efficient mechanism used to deliver allowances. | | | |
| Use of Approved Mileage Allowance Payments (AMAP) | | | |
| Full corporate discounts applied. | | | |
| Maintenance (including breakdown recovery and road tax) included. | | | |
| Motor Insurance included. | | | |
| Early Termination costs paid by employer. | | | |
| Excess Mileage costs paid by employer. | | | |
| PAYE Settlement Agreement. | | | |
| Private Fuel option retained. | | B | |
| No more risk than a company car for employees. | | | |

Notes:

- A Credit normally granted on an 'auto-accept' basis within BoE minimal guidelines.
- B Normally 'bought out' as part of transition from traditional company car arrangements.

Legend

- Not a standard feature.
- Feature is normally optional.
- Standard feature.

Our extensive portfolio of services allows us to develop bespoke solutions that aligned to your business objectives. CBS have advised, designed, implemented, gained tax approval and operated ECO schemes for some of the largest companies in the world. Our services include:

- Employee Car Ownership (ECO) Consultancy
- ECO Scheme Management
- ECO Fleet Management
- ECO Implementation
- ECO Funding
- ECO Health Check
- Project Management
- Inland Revenue Tax Clearance
- Compliance Audit
- ITT Management
- Bespoke funding solutions

If you are interested in any of these services, contact CBS's Consultancy team on 0870 751 9872 for further information. ■■■

Sign up for emails

If you would like to receive email alerts direct to your computer please email mail@carbenefitsolutions.co.uk and put 'Alert' in the subject box. As and when important technical information is released or CBS has some news we will send you an alert. This service will allow you to keep up-to-date with industry news and also take part in any CBS industry related activities.

Next Edition

The next edition of the CBS Perspective will be available in October 2005.

If you would like to submit a question or discussion topic please send them to us at mail@carbenefitsolutions.co.uk.

You will find the result of our CBS Poll in the next edition and on our website at www.carbenefitsolutions.co.uk.

If you would like to receive the next CBS Perspective via email please contact ssopala@carbenefitsolutions.co.uk.