House of Commons

Committee of Public Accounts

The sale of former Northern Rock assets

Twenty-fourth Report of Session 2016–17

Report, together with formal minutes relating to the report

Ordered by the House of Commons to be printed 2 November 2016

HC 632
Published on 9 November 2016
by authority of the House of Commons

The Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine "the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit" (Standing Order No. 148).

Current membership

Meg Hillier (*Labour (Co-op), Hackney South and Shoreditch*) (Chair)

Mr Richard Bacon (*Conservative, South Norfolk*)

Philip Boswell (*Scottish National Party, Coatbridge, Chryston and Bellshill*)

Charlie Elphicke (*Conservative, Dover*)

Chris Evans (*Labour (Co-op), Islwyn*)

Caroline Flint (*Labour, Don Valley*)

Kevin Foster (*Conservative, Torbay*)

Simon Kirby (*Conservative, Brighton, Kemptown*)

Kwasi Kwarteng (*Conservative, Spelthorne*)

Nigel Mills (*Conservative, Amber Valley*)

Bridget Phillipson (*Labour, Houghton and Sunderland South*)

John Pugh (*Liberal Democrat, Southport*)

Karin Smyth (*Labour, Bristol South*)

Mrs Anne-Marie Trevelyan (*Conservative, Berwick-upon-Tweed*)

Powers

Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No. 148. These are available on the Internet via www.parliament.uk.

Publication

Committee reports are published on the Committee's website and in print by Order of the House.

Evidence relating to this report is published on the inquiry publications page of the Committee's website.

Committee staff

The current staff of the Committee are Dr Stephen McGinness (Clerk), Dr Mark Ewbank (Second Clerk), George James (Senior Committee Assistant), Sue Alexander and Ruby Radley (Committee Assistants), and Tim Bowden (Media Officer).

Contacts

All correspondence should be addressed to the Clerk of the Committee of Public Accounts, House of Commons, London SW1A 0AA. The telephone number for general enquiries is 020 7219 4099; the Committee's email address is pubaccom@parliament.uk.

Contents

Summary

UK Asset Resolution (UKAR) took advantage of good market conditions and strong investor demand to sell £13.3 billion of former Northern Rock loans in the UK Government's largest ever financial asset sale. The transaction was executed successfully within a tight timeframe. Competitive tension between bidders was achieved resulting in a final price that was slightly more that the outstanding value of the loans sold. While there are many positives from the sale there are also areas for improvement particularly during the preparation phase: there was no formal business case for the sale bringing together in one document all the information needed to make critical decisions; the potential value of alternative sale options was not quantified before the transaction began; and the financial adviser was selected without an open competition. HM Treasury should also have done more to consider the wider implications of the sale by scrutinising the impact on customers and tax revenues more thoroughly.

Introduction

In 2008 during the financial crisis Northern Rock was nationalised. The taxpayer took on all of the bank's assets and liabilities, including a special purpose securitisation vehicle called Granite. All of Northern Rock's legacy assets are managed by UKAR, which is owned by HM Treasury and supervised by UK Financial Investments (UKFI). Since 2014, following UKAR's reclassification as a public body, HM Treasury and UKFI's primary objective for UKAR has been to shrink the size of its balance sheet as swiftly as possible, while demonstrating value for money. In March 2015, UKAR publicly launched a sale of £13 billion of former Northern Rock assets including Granite. In November 2015, following a competitive process UKAR announced that a consortium led by affiliates of Cerberus Capital Management LP (Cerberus) had purchased the assets. The sale, which achieved completion in May 2016, resulted in Cerberus paying a fraction more (0.6%) than the outstanding value of the loans. After discharging the liabilities and other adjustments the taxpayer received £5.5 billion in cash. Some 270,000 mortgages and loans were sold in the deal.

Conclusions and recommendations

1. **There are lessons to be learned from this successful sale.** This sale was over four times larger than any UK Asset Resolution (UKAR) has previously conducted and involved a financing structure which increased the complexity of the transaction. UKAR and its advisers overcame these difficulties and managed the sale well. The assets, most of which were mortgages yielding over 4.5% interest, were attractive to investors. As a result, bidders competed against each other for the assets which resulted in a sale price above the par value of the loans. The Government is planning to sell more financial assets, including student loans and other UKAR mortgages. These loans may be less attractive to investors which may make achieving a good price more challenging. Ensuring competitive tension in these future sales will be a key part in achieving value for the taxpayer.

   Recommendation: ***HM Treasury should conduct a post-sale review for this, and all other major sales, setting out lessons learned and ensure these are shared across government to increase corporate finance knowledge and skills.***

2. **There was no formal business case for the sale and alternative sale options were not valued until very late in the sale process.** While numerous documents were produced by UKAR, UK Financial Investments (UKFI) and HM Treasury regarding different aspects of the sale, information was not brought together in a single document, or business case, to provide a comprehensive overview of all aspects of the sale. Alternative sale options were considered prior to the sale launch (in November 2014), but these options were only valued near the end of sale process (in September 2015) after bids had been received. Documents produced by HM Treasury and UKFI noted that holding the assets to maturity would have been positive for the public finances in the long term, but a hold valuation was not produced. We consider that the production of a rigorous business case for the sale would have made the omission of a timely valuation of alternative sale options (including the hold valuation) less likely.

   Recommendation: ***HM Treasury should ensure that formal business cases are produced for every asset sale. These should include a timely valuation of all potential sale options, and be updated throughout the sale process. HM Treasury should develop business case guidance and a template specifically for asset disposals.***

3. **The valuations of the assets sold erred on the side of caution and the assumptions on which they were based were not well evidenced, creating a risk that UKAR could have sold the asset for less than its inherent worth.** Valuations are important as they set a reserve price which has to be bettered for the asset to be sold—if the bar is set too low and there is insufficient competitive tension or there are poor market conditions, there is a risk of accepting an offer which does not reflect the true worth of the asset. In this case a well run sale meant that this risk did not materialise. Nevertheless we are still concerned that some of UKAR's assumptions had a conservative bias—for example, the assumed cost of equity that bidders would require was higher than in previous transactions. In addition, the documentation of the evidence used to inform and support UKAR and UKFI's judgement in selecting the valuation assumptions was not transparent.

Recommendation: ***HM Treasury should ensure that hold and sell valuations are produced for all asset sales. The sell valuation should be from the perspective of a potential buyer, informed by market data on the cost and mix of finance that a buyer would use; if there are different buyer types it may be appropriate to produce more than one sell valuation. HM Treasury should consider setting up an independent panel of valuation experts for all major sales to review and challenge valuations in advance of all significant asset sales.***

4. **The process used by UKAR to appoint Credit Suisse as its financial adviser for the sale did not follow good practice.** Credit Suisse's fee more than doubled and there was a potential conflict of interest. Credit Suisse, which had previously advised UKAR on another sale, was selected to be UKAR's financial adviser after a limited competition with two other firms. After Credit Suisse was appointed, when it became clear that the sale size would be larger than had been originally anticipated, UKAR agreed to increase the transaction fee from £2 million to £4.5 million without any competition. UKAR told us that it would not appoint an adviser in this way again, but considered that retendering would have delayed the transaction by at least six weeks which would have risked value for money. The large size of the sale meant that some of the bidders would need to borrow significant sums from banks to finance their bids. In order to maximise the pool of banks able to lend to bidders, UKAR allowed Credit Suisse to provide financing for potential bidders despite prohibiting this in an earlier sale due to the potential conflict of interest. Credit Suisse Asset Management, a separate legal entity within Credit Suisse, was also part of a bidding consortia which made the highest bid in the first round but subsequently pulled out due to a perceived conflict of interest.

Recommendation: ***HM Treasury should ensure that departments and arm's-length bodies have an open competition to select a financial adviser. Sale advisers must be independent and not conflicted through involvement in other roles on the sale (such as financing or bidding). However, if there are exceptional circumstances where conflicts are unavoidable, there must be a clear rationale and plan in place to mitigate risks.***

5. **Ex-Northern Rock customers whose mortgages were sold to Cerberus are paying more for their mortgages than those whose mortgages remain with UKAR.** The 0.25% Bank of England base rate cut in August 2016 was passed on in full from 1 September 2016 by UKAR to its ex-Northern Rock customers with Standard Variable Rate (SVR) mortgages. However, customers whose SVR mortgages were sold to Cerberus only received a reduction of 0.15%, from 1 October 2016. Cerberus told us that its funding model meant that it did not benefit from the base rate cut to the same extent as banks did and that as a result it could not pass on the rate cut in full to its customers. UKAR and UKFI structured the sale to give some protection to customers whose mortgages were included in the sale in the short term from interest rate rises, but they had not contemplated a rate cut so did not require purchasers to pass this on. Customers are able to switch mortgage provider, but some customers, particular those with an imperfect payment record, may find this difficult.

Recommendation: ***UKAR and UKFI should consider what measures should be put in place to protect customers from being disadvantaged by such sales. They should attempt to quantify the potential impact on the sales price of placing more comprehensive restrictions on future interest rate movements. The Financial Conduct Authority should consider whether consumers would benefit from understanding how different types of mortgage lender set interest rates, and what this could mean for borrowers should the owner of their mortgage change.***

6. **HM Treasury did not consider the tax domicile and its impact on expected tax payments of bidders during the sale even though these could have an effect on the overall taxpayer value of a transaction.** The winning bidder Cerberus has a complicated company structure with companies based in the Netherlands and the Cayman Islands. Cerberus said that if it had bid using a UK domiciled company it was likely that it would have paid more in tax but also less upfront for the assets. HM Treasury told us that it does not consider the tax domicile of potential bidders primarily because it would be open to legal challenge. Therefore no information was requested or calculated by HM Treasury on the expected UK tax impact of the sale. We are concerned that this put UK domiciled companies at a disadvantage. We note that in response to a previous report of this Committee, HM Treasury formally agreed that it was legitimate to prevent offshore arrangements used in a transaction.

Recommendation: ***When an asset is sold HM Treasury should require departments as far as possible to discount gains from tax avoidance that may be factored into bids. HM Treasury should also produce unambiguous guidance, for both selling departments and potential bidders on if, and how, tax will be taken into consideration as part of a sale or a contract award.***

1 Sale of loans

1. On the basis of a report by the Comptroller and Auditor General, we took evidence from HM Treasury, UK Financial Investments (UKFI) and UK Asset Resolution (UKAR) on the £13 billion sale of former Northern Rock assets.[1] We also took evidence from: Credit Suisse, UKAR's financial adviser for this sale; Cerberus, who led a consortium which purchased the assets: and the Financial Conduct Authority (FCA), the financial regulator.

2. In 2008 during the financial crisis Northern Rock was nationalised. The taxpayer acquired all of the bank's assets and liabilities, including a special purpose securitisation vehicle called Granite. All of Northern Rock's legacy assets are managed by UKAR. HM Treasury's shareholding in UKAR is managed by UKFI.[2]

3. In 2013 UKAR was reclassified as a central government public sector body. This gave HM Treasury's permanent secretary the responsibility for overseeing UKAR and also resulted in the chief executive of UKAR becoming an accounting officer directly accountable to Parliament. Since 2014, following an HM Treasury strategic review of UKAR, HM Treasury and UKFI's primary objective for UKAR has been to shrink the size of its balance sheet as swiftly as possible, while demonstrating value for money.[3]

4. In March 2015 UKAR publicly launched a sale of £13.3 billion of former Northern Rock assets including Granite. This sale was over four times larger than any of UKAR's previous loan sales—the largest before this had been a sale of £2.7 billion of mortgages in 2014. In November 2015, following a competitive process, UKAR announced that a consortium led by affiliates of Cerberus Capital Management LP (Cerberus) had purchased the assets. TSB Bank (TSB), the UK retail and commercial bank, was a junior partner in the consortium and received a quarter of the loans as part of the deal. Cerberus told us that including TSB in the deal helped achieved best value from the transaction. The sale, which achieved final close in May 2016, resulted in the consortium led by Cerberus paying £74 million (0.6%) more than the outstanding value of the loans. After discharging the liabilities and other adjustments the taxpayer received £5.5 billion in cash. Some 270,000 mortgages and loans were sold in the deal.[4]

5. HM Treasury told us it considered that there were a number of elements behind the successful sale. It noted that a key part of this was a competitive process with multiple bidders. It felt that the sale process had been professionally managed; it said that the advisers were good value and that it could draw on expertise from within UKAR and UKFI.[5]

6. We agree with HM Treasury that a key part of ensuring a successful sale is the presence of competitive tension between bidders. In this case the large size of the sale and the complexity of the financing structure might have limited the number of potential bidders. However the assets being sold were attractive to bidders (85% of the mortgages were paying more than 4.5% interest and 97% of the loans were performing) resulting in there being multiple bidders in the final round competing to buy the assets.[6]

1 C&AG's Report, *The £13 billion sale of former Northern Rock assets*, Session 2016–17, HC 513, 19 July 2016.
2 C&AG's Report, paras 1–2
3 C&AG's Report, paras 3, 1.7–1.9
4 Q 2; C&AG's Report, Key facts, paras 4-5, 1.7–1.9, 2.12, 3.14
5 Qq 62, 97
6 Qq 19, 87; C&AG's Report, paras 1.14, 2.8–2.11

2 Making the case for the sale

Considering the options

7. HM Treasury did not require UK Asset Resolution (UKAR) or UK Financial Investments (UKFI) to produce a formal business case for this transaction to bring together all the crucial information on the sale in one document. This is inconsistent with the approach HM Treasury usually requires of other government departments and organisations. For example, in preparation for the sale of shares in Eurostar, which was a much smaller transaction than this sale, the Shareholder Executive produced a business case and also asked for an internal gateway review. UKAR and UKFI told the National Audit Office that preparing a business case would have taken up valuable time and resources. HM Treasury considered that the business rationale for the sale was well documented. However, it did agree that bringing all the numerous documents together in a single business case was a recommendation that it would take on board.[7]

8. In September 2014, following feedback from investors, UKAR and UKFI began to explore a possibility of a large sale of mortgages which included the Granite securitisation vehicle. UKAR's financial adviser, Credit Suisse, provided some initial advice in November 2014. This noted that the larger sales which included Granite would score highly for speed of balance sheet reduction, a key priority for UKAR, but might be more challenging and provide lower taxpayer value than smaller sales. At that stage there was no attempt to value the different options, instead, UKFI, UKAR and its adviser started work on exploring the feasibility of this large transaction. HM Treasury told us that the speed of balance sheet reduction was important but it was "never the case" that this mattered more than value for money.[8]

9. A comprehensive sale business case would quantify different sale options at an early stage, allowing decision makers to pursue in further detail the options most likely to yield the best value for the taxpayer. This was not done for this sale. UKAR did analyse the potential value of different options, but this was only done near the end of the sales process in September 2015 after the initial bids and towards the end of the final bidding round. That analysis suggested that alternative options, such as breaking up the Granite structure and selling the assets in smaller parcels targeted to particular investors, could have increased the valuation by up to £307 million.[9] However, UKAR and UKFI considered that a single large transaction was advantageous. For example, it accelerated the run-down of UKAR's assets, reducing its exposure to market risk. UKFI told us that it had believed that the risks of waiting were very much skewed to the downside as it considered that the probability that the exceptionally good market conditions at the time of the sale would deteriorate was higher than the probability that they would improve further.[10]

10. The assets sold were yielding significantly more than the government cost of borrowing meaning that more government debt could have been paid off in the long-term by holding them. The National Audit Office reported that while both UKFI and HM Treasury had considered that short-term fiscal gains from a sale would be outweighed by the long-term

7 Qq 62, 96, 113; C&AG's Report, paras 2.14–2.15
8 Qq 64, 67; C&AG's Report, para 2.4, Figure 7
9 Qq 67–71; C&AG's Report, para 4.10–4.11
10 Qq 70–71; C&AG's Report, para 4.11–4.13

gains from holding the assets to maturity, they had not calculated a "hold" valuation. The National Audit Office's calculations showed that in theory £2.5 billion more debt could have been paid off if HM Treasury had held the assets to maturity. UKFI told us that it agreed that the maths of the calculation were correct but emphasised that UKFI's mandate was to engage in an orderly disposal of these assets and therefore it had been focussed on selling them.[11]

Valuations

11. In our report on the sale of Eurostar we expressed our concern that there had been a pattern of undervaluing publicly owned assets prior to sale. These valuations are important as they in effect set a reserve price above which the Government will be willing to sell the asset. If the bar is set too low and there are problems during the sale process, such as volatile market conditions or very few bidders, there is a risk that the Government accepts an offer which undervalues the asset. While this risk did not materialise in this case as the sale was competitive, we asked UKAR, UKFI and their advisors how they had derived their valuations.[12]

12. UKFI accepted that their reserve price was quite a bit lower than the actual consideration. UKFI explained that it had assumed that a buyer would require a mid-teens annual equity return over the lifetime of the investment. However, the sale competition had resulted in a significantly lower return for the buyer and therefore a higher price being achieved. UKFI noted that it had produced a valuation range and that it did not believe that the difference between this range and the sale price had been wide enough to threaten the integrity of the sale decision.[13] UKAR's valuation was lower. UKAR had assumed that the buyer would require a 20% annual return on investment, higher than the return implied by the price paid in a previous sale it had conducted. UKAR told us that it had another higher valuation in mind but that it had chosen not to document it. The National Audit Office report noted that the documented evidence for the valuation assumptions could have been improved.[14]

13. We also asked Credit Suisse about its valuation. It explained that it had a wide range but that the top of its range was the closest of all the valuations to the actual price. The financial adviser had, unlike UKAR and UKFI, calculated distinct valuations from the perspective of private equity type and bank type buyers. UKFI told us that it was prudent for financial advisers to put a wide range to accommodate all possible outcomes.[15]

Financial adviser procurement

14. In September 2014 UKAR appointed Credit Suisse as its financial adviser on the sale or outsourcing of its mortgage servicing platform (the part of UKAR's business which administers mortgages and provides customer services) alongside a small sale of assets. UKAR had asked Credit Suisse, alongside two other potential advisers, to pitch to become its financial adviser rather than running an open competition for the appointment. Credit

11 Qq 63, 89; C&AG's Report, para 1.19, 1.20

12 Qq 33, 73, 87; Committee of Public Accounts, *The sale of Eurostar*, Sixteenth Report of Session 2015–16, HC 564, January 2016.

13 Qq 88–89; C&AG's report, para 4.6

14 Qq 74–75, C&AG's report, paras 4.4, 4.8

15 Qq 33, 85, C&AG's report, paras 4.4–4.6

Suisse had advised UKAR on a previous transaction and had provided pro bono advice on UKAR's strategy earlier in the year so knew the business well.[16] After the appointment it became apparent that the sale of assets would be significantly greater than originally envisaged. In February 2015, following discussions with Credit Suisse, UKAR agreed to increase the transaction success fee from £2 million to £4.5 million in recognition of the larger scope of the sale. When combined with their monthly retainer, which over the sale period amounted to £0.9 million, the total fee came to £5.4 million. Credit Suisse told us that the fee, which amounted to 0.04% of the total assets sold, was lower than it and others banks would normally charge other government institutions and much lower than the fee it would charge to the private sector. UKAR told us that although it had agreed this fee without competition it had looked back at the scorecard used to initially select the financial adviser and believed the same decision would have been made.[17]

15. UKAR told us that it would not procure a financial adviser in this way again although it said the circumstances of this sale, running two sale processes (the mortgage servicing platform and the assets) in parallel, were unlikely to be repeated. UKAR considered that re-opening the procurement process, following the scope and fee changes, would have delayed the sale by between six weeks and two months. It said that given deteriorating market conditions during the time of the sale, it could be seen with hindsight that any delay could have cost the taxpayer a lot of money.[18]

16. In previous sales UKAR had not allowed its advisers to provide any financing for bidders as doing so would create a potential conflict of interest as the adviser would stand to receive fees from financing of bidders which could affect the impartiality of its advice to UKAR. However, due to the large size of the sale, which meant that some of the bidders would need to borrow significant sums from banks to finance their bids, UKAR agreed to allow Credit Suisse to provide finance to bidders. Credit Suisse told us that it had provided financing to two of the three final round bidders. Credit Suisse noted that it was common for this type of transaction. UKAR had asked for, and been supplied with, information documenting the separation between the team advising on the sale and the part of Credit Suisse that provided the financing.[19]

17. Credit Suisse Asset Management (CSAM), a separate legal entity within Credit Suisse, was also involved in a consortium which made the highest bid for the assets in the first round. Credit Suisse told us that that CSAM dealt with third party money and was managed separately with a different governance structure. The bid by CSAM also received financing from Credit Suisse. This financing had to be approved by a committee at Credit Suisse who considered there was a potential perceived conflict as other bidders might consider that the consortium that included CSAM might receive preferential financing terms. CSAM subsequently withdrew from the consortium. Credit Suisse agreed that it was unusual to have been involved, at one stage, in three different areas of the sale (sale adviser, provision of finance to bidders, and bidder consortium member).[20]

16 Qq 33–34, 94; C&AG's report paras 2.3
17 Qq 34–42, 94; C&AG's report, Figure 9
18 Q 94
19 Qq 31, 46–48; C&AG's report, paras 2.18
20 Qq 32, 48–51

3 Wider implications of the sale

Customer treatment

18. In August 2016 the Bank of England cut the Bank Rate from 0.5% to 0.25%. Cerberus told us that following this cut its Landmark Mortgage customers on the Standard Variable Rate (SVR) would receive a 0.15% reduction in their rate on 1 October 2016. This is less than the 0.25% rate cut given by UK Asset Resolution (UKAR) to its SVR customers which took effect for the majority of customers from 1 September 2016. Cerberus told us that as it was funded from the wholesale markets it did not receive a reduction in its funding costs in the same way that a retail bank would. It also noted that many other wholesale lenders had not reduced their SVR at all.[21]

19. The Financial Conduct Authority (FCA) told us that it was concerned to ensure that customers were treated fairly and emphasised that it had the ability to take enforcement action if required. It said it had spoken to Cerberus as well as other firms which make up 90% of the mortgage market, and that all of these firms had reduced their rate to some extent. The FCA said that it was important to remember that in many cases the customer had choices and could switch to another mortgage provider. However, its concern was for those "trapped customers" who were not eligible to move to other providers. It said that at the moment its regulation, which prevented unfair treatment, was in place to protect these customers.[22]

20. We asked UKAR and UK Financial Investments (UKFI) why the conditions of the sale had provided some short-term protection for interest rate rises but had not ensured that cuts in interest rates were passed on in full to customers. They told us that given that rates were already at historic lows they had not contemplated them going down further. UKAR considered that if it had required a buyer to reduce rates in step with the Bank Rate then it would have been highly unlikely to have reduced the price as the market was not considering a rate cut as a possibility at the time of the sale. However UKFI considered that although it would not have affected the price of this particular sale it may have affected future sales as the negative impact on the buyer would be remembered by prospective buyers involved in future sales.[23]

Tax

21. The Cerberus company that purchased the assets from UKAR had a complicated holding structure which included companies in the Netherlands and in the Cayman Islands. Cerberus told us that the use of the Cayman Islands companies did not serve a tax planning purpose and was tax neutral. It noted that some US multi-national companies had used the Cayman Islands to accumulate income outside of the United States but that this should not be conflated with Cerberus' use of the Cayman Islands companies.[24]

22. Cerberus explained that it would be subject to tax in the Netherlands on the taxable income related to its investment in the former Northern Rock assets. It said that it had had a presence in the Netherlands since 1998 and that this business owned in excess of

21 Qq 1–2; NRAM website, 'Bank of England Base Rate reduction'
22 Qq 5, 11, 45
23 Qq 115–121
24 Q 16; Cerberus Capital Management (GNR0001)

$14 billon of assets. Cerberus did not give any detail about the rates of corporation tax it would be paying on its profits in the Netherlands. However, it did state that if the company purchasing the assets had been a UK registered company that it "would imagine that those taxes would be greater" but that "the up-front price to taxpayers would have been less". Cerberus also maintained that it had been completely transparent with UKAR, UKFI and their advisors throughout the process about its investment and ownership structure and that none of the parties, nor any other party on the sell side, had raised any concerns about the use of a Dutch holding company during the sale.[25]

23. Over 10 years ago this Committee examined the Mapeley STEPS PFI deal under which the then HM Customs & Excise, and the Inland Revenue transferred the ownership and management of most of their estates to Mapeley, a private sector consortium, in a 20-year deal. On signing the contract with the departments, Mapeley transferred the freehold and long-leasehold properties to a company based in Bermuda. Having examined the deal this Committee concluded that the departments knew that Mapeley was owned by shareholders based outside the UK, but did not clarify the company's tax plans, or find out that it intended to hold the properties offshore until late in the procurement process. The Committee recommended that departments should as far as possible discount gains from tax avoidance that may be factored into a PFI bid, since any price advantage to the Exchequer is likely to be offset by lower tax revenue.[26] HM Treasury accepted the Committee's recommendation that it should have sought to prevent offshore arrangements in the contract. The Treasury also noted that it had issued guidelines to all departments, which indicated that it is possible for departments to make it a contract condition (notified in advance when advertising the contract) that the successful bidder will be prohibited from using particular tax arrangements, including offshore tax havens, provided such a restriction would not in fact be directly or indirectly discriminatory between European Community bidders.[27]

24. We asked HM Treasury why it had not done more to consider the tax implications of this sale. It told us that its approach was that it does not discriminate against bidders based on their tax domicile for three reasons: firstly, that it would be open to legal challenge: in this case the bidder was based in the Netherlands, another EU member state; secondly, from a practical point of view it was difficult to work out the tax rate bidders would pay with any certainty and it could change after the sale; thirdly, even if it could discriminate on a tax basis then if this resulted in fewer bidders it would reduce competitive tension.[28]

25 Qq 17, 24; Cerberus Capital Management (GNR0001)

26 Committee of Public Accounts, *PFI: The STEPS deal*, Twentieth Report of Session 2004–05, HC 553, June 2005

27 HM Treasury, *Treasury Minutes on the Fifteenth, Twentieth to Twenty-second and Twenty-fourth Reports from the Committee of Public Accounts*, Session 2004–2005, Cm 6667, October 2005

28 Q 109

Formal Minutes

Wednesday 2 November 2016

Members present:

Meg Hillier, in the Chair

Richard Bacon
Philip Boswell
Charlie Elphicke
Chris Evans
Kwasi Kwarteng

Draft Report (*The sale of former Northern Rock assets*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 24 read and agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Twenty-fourth of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Monday 7 November 2016 at 3.30pm

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Monday 12 September 2016

Question number

David J. Teitelbaum, Head of European Advisory Offices and Senior Managing Director, Cerberus European Capital Advisors LLP, **Jerome Henrion**, Head, Financial Institutions Solutions Group, Global Markets, Credit Suisse, and **Jonathan Davidson**, Director of Supervision, Retail and Authorisations, Financial Conduct Authority — Q1–61

Charles Roxburgh, Second Permanent Secretary, HM Treasury, **James Leigh-Pemberton**, Chairman, UK Financial Investments, and **Ian Hares**, Chief Executive, UK Asset Resolution Limited — Q62–121

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

GNR numbers are generated by the evidence processing system and so may not be complete.

1 Cerberus Capital Management (GNR0001)

List of Reports from the Committee during the current session

All publications from the Committee are available on the publications page of the Committee's website. The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2016–17

First Report	Efficiency in the criminal justice system	HC 72
Second Report	Personal budgets in social care	HC 74
Third Report	Training new teachers	HC 73
Fourth Report	Entitlement to free early education and childcare	HC 224
Fifth Report	Capital investment in science projects	HC 126
Sixth Report	Cities and local growth	HC 296
Seventh Report	Confiscations orders: progress review	HC 124
Eighth Report	BBC critical projects	HC 75
Ninth Report	Service Family Accommodation	HC 77
Tenth Report	NHS specialised services	HC 387
Eleventh Report	Household energy efficiency measures	HC 125
Twelfth Report	Discharging older people from acute hospitals	HC 76
Thirteenth Report	Quality of service to personal taxpayers and replacing the Aspire contract	HC 78
Fourteenth Report	Progress with preparations for High Speed 2	HC 486
Fifteenth Report	BBC World Service	HC 298
Sixteenth Report	Improving access to mental health services	HC 80
Seventeenth Report	Transforming rehabilitation	HC 484
Eighteenth Report	Better Regulation	HC 487
Nineteenth Report	The Government Balance Sheet	HC 485
Twentieth Report	Shared service centres	HC 297
Twenty-first Report	Departments' oversight of arm's-length bodies	HC 488
Twenty-second Report	Progress with the disposal of public land for new homes	HC 634
Twenty-third Report	Universal Credit and fraud and error: progress review	HC 489

HOUSE OF COMMONS

Public Accounts Committee

Oral evidence: Granite and Northern Rock, HC 632

Monday 12 September 2016

Ordered by the House of Commons to be published on 12 September 2016.

Watch the meeting

Members present: Meg Hillier (Chair); Mr Richard Bacon; Deidre Brock; Kevin Foster; Nigel Mills; Stephen Phillips; Karin Smyth.

Sir Amyas Morse, Comptroller and Auditor General, Adrian Jenner, Director of Parliamentary Relations, National Audit Office, Stephen Smith, Executive Leader, NAO, and Richard Brown, Treasury Officer of Accounts, HM Treasury, were in attendance.

Questions 1-121

Witnesses

I: David J. Teitelbaum, Head of European Advisory Offices and Senior Managing Director, Cerberus European Capital Advisors LLP, Jerome Henrion, Head, Financial Institutions Solutions Group, Global Markets, Credit Suisse, and Jonathan Davidson, Director of Supervision, Retail and Authorisations, Financial Conduct Authority.

II: Charles Roxburgh, Second Permanent Secretary, HM Treasury, James Leigh-Pemberton, Chairman, UK Financial Investments, and Ian Hares, Chief Executive, UK Asset Resolution Limited.

HOUSE OF COMMONS

Report by the Comptroller and Auditor General

The £13 billion sale of former Northern Rock assets (HC 513)

Examination of witnesses

Witnesses: David J. Teitelbaum, Jerome Henrion and Jonathan Davidson.

Chair: Good afternoon everyone and welcome to the Public Accounts Committee on Monday 12 September 2016. Today we are looking at the Government sale of some of the assets bought when the banks were bought up by the Government after the 2008 crash, particularly those relating to Northern Rock. We have two panels today and our hashtag for anyone following on Twitter is #northernrock.

Our first panel is made up of Jerome Henrion, who is Head of the Financial Institutions Solutions Group, Global Markets at Credit Suisse. I hope I got your title right, Mr Henrion, and that I pronounced your name correctly.

Jerome Henrion: Yes, absolutely. Thank you.

Chair: And Mr David Teitelbaum—is that how it is pronounced?

David J. Teitelbaum: Teitelbaum, thank you.

Q1 **Chair:** Sorry. I pronounced it the German way—I keep doing that. Mr Teitelbaum is Senior Managing Director of Cerberus European Capital Advisors. Then, in a slightly different role but a very big different role, we have Jonathan Davidson from the Financial Conduct Authority—the FCA—which, of course, oversees how customers are treated by financial institutions.

It was a very big sale—£13 billion of assets sold by Government—so we are very interested in how this worked from a sales point of view, what the deal was for consumers and how well they are going to be treated now and on an ongoing basis, and what lessons can be learned for the future asset sales the Government are planning over the next four years. I want first to ask Mr Teitelbaum: on Friday, you announced that you would be reducing the rate of interest for Cerberus customers—the holders of these mortgages. Why did you announce that only on Friday and why have you set 1 October as the date when it will be introduced?

David J. Teitelbaum: First of all, good afternoon. The SVR was set by the board of directors of Landmark, which is a board that is independent of Cerberus. Only one member of that board of directors is an employee of Cerberus. Landmark is, like other wholesale funded institutions, not a direct beneficiary of the 0.25% reduction in the base rate. Landmark funds from the wholesale markets and so the Landmark board has been spending time over the past several weeks, since that announcement, evaluating the markets and ultimately the various factors that go into their cost of funding, including the three-month LIBOR.

The determination in the interest of the customers of Landmark, while at the same time, of course, balancing the interests as an entity regulated by the FCA, was to reduce the rate. The LIBOR on Friday, for example, reduced by approximately 0.143% and the board of directors decided to reduce the rate by 0.15%. So what they are doing is putting into effect a reduction in the interest rate for their borrowers that is more than the likely reduction in interest rate that they themselves will benefit from.

Chair: Okay.

David J. Teitelbaum: That's No. 1, and perhaps I might just make point No. 2 on the second part of your question, which is the timing of it. They are putting that into effect as of 1 October and the benefit of the reduced rate will not come into effect until 20 October for Landmark, because that is the date when the cost of funding resets. It resets every three months. So they are passing on more than the benefit they see as a wholesale funded institution and giving that benefit to customers before they see the benefit themselves.

Q2 **Chair:** When you bought this asset, a chunk of it was then sold off quite quickly to TSB, which cut its rate earlier and sharper than Landmark Cerberus did. The difference for customers is quite stark.

David J. Teitelbaum: That is true. TSB came into the transaction at the same time that we did, and of course with full disclosure to sellers. We made that choice in order to ultimately deliver best value, so we think the taxpayer ultimately benefited from that decision. The loans within that portfolio were randomly selected in terms of which loans went to TSB and which loans went to Landmark. TSB, like other retail funded institutions, has a benefit from the reduction in base rate, whereas, as a wholesale funded institution, the benefit is not directly seen by Landmark.

I would point out that we are looking at just one short discrete point in time. Of course, these are mortgage loans with a long life to them, so, if I properly understand where your question is coming from, you would have to ultimately look at this in the totality over time, rather than perhaps one discrete point in time. Among wholesale lenders, I would note that, to my knowledge, many of them have not reduced their standard variable rate, or SVR, at all.

Q3 **Chair:** We are just a bunch of MPs who are not financial experts. Our constituents who have got mortgages are concerned about their rates. The bank rate was cut to provide some support to constituents, to the public, to mortgagees. Mr Davidson, what about the FCA's point of view? We have had a good explanation of the difference between the wholesale and the retail market, which is the bread and butter for the FCA. Do you have any concerns about your powers in relation to supporting consumers, the mortgagees, in this sort of circumstance?

Jonathan Davidson: No, we don't. In terms of the effect of the transaction on our powers to regulate, they are the same now as they were before the transaction took place. So we have all of our powers and the rules still apply.

Q4 **Chair:** By random allocation, some people have a lower interest rate as of now. I take Mr Teitelbaum's point that it is a point in time. Nevertheless, that is as of now, compared with those who—

Jonathan Davidson: Yes, so we are very interested in making sure that the rates that any mortgage consumer is charged are fair. We are in the process of writing to all providers of standard variable rate mortgages asking them to explain what decisions they have made and what their rationale is, so that we can then consider whether we consider that rationale to be fair or not.

Q5 **Chair:** What teeth do you have if you consider it not to be fair for this or for any other mortgage lender?

Jonathan Davidson: If it is not fair, we can bring enforcement action to correct that.

Q6 **Chair:** Can you explain in simple terms? If I was watching this and I had a mortgage with Cerberus, and you found that a mortgage was not fair, what would be the actual difference to the consumer of your action?

Jonathan Davidson: We would look to make sure that the systems and controls that had led to a breach of the rules were corrected, and we would also seek to make sure that consumers received redress and were put back in the position that they should have been.

Q7 **Chair:** Well, Mr Teitelbaum has given a very clear explanation of the difference between the wholesale and retail markets, so there is therefore a difference inbuilt there. To be clear, the FCA has no ability to say, "They must all be the same because their mortgages were sold by the Government."

Jonathan Davidson: No; on the standard variable rate mortgage, there are a number of factors that depend on the nature of the specific contract of the standard variable rate, although the standard varies. Typically, they will have something about the cost of funds in there among other factors that determine how the interest rate will be set.

Q8 **Chair:** This is my final question on this, but I think it's important. When you get your mortgage, probably most people are not thinking, "Is my lender in the wholesale market or in the retail market?" They are probably just looking at the rate at the time. What is the FCA doing to make sure that people going for mortgages are prepared and understand the difference and the potential risks to their interest rate, the SVR, from different parts of the market?

Jonathan Davidson: The most important thing we do is to require that any lender, when they are making a mortgage loan, makes an assessment of the affordability for the consumer of that loan. As part of the assessment of affordability, they obviously have to take into account the consumer's ability to pay. We also require the lenders to make an assessment of whether it will still be affordable with a change in interest rates by having regard to the Monetary Policy Committee guidance on what that should be. I believe at the moment that it is a 200 basis point increase.

Q9 **Chair:** But I think the ordinary consumer probably doesn't appreciate the difference. That is my point. Are you providing any guidance? If I wanted to look online, do you have any guidance about the difference between the type of lender and the impact on my SVR?

Jonathan Davidson: On whether a consumer should go for a variable rate or a fixed rate, no, but we expect whoever is selling them to provide impartial advice on what would be the best mortgage for them.

Q10 **Chair:** One last point. We will be putting this to the Government. A criteria was set that mortgage interest rates would not go up on sale, but there was no requirement that, as interest rates went down, there would be a requirement by the purchaser to drop interest rates. Is that something that you think is a concern? Would you like to see that done differently?

Jonathan Davidson: From our point of view, it is regulated, and if there was no movement down we would look to understand whether that was unfair to consumers. We would also be looking at the extent to which, if there is a variation term in the contract, that is fair to consumers.

Q11 **Chair:** So if Cerberus hadn't reduced it on Friday, you would perhaps be looking into it? Is that what you are saying?

Jonathan Davidson: We did, in fact, talk to Cerberus about this. As I said, we are also talking to many of the other firms in the market—not just Cerberus. We have spoken to firms that account for about a 90% share of the mortgage market already, and all the firms we have spoken to have reduced their rate. Nevertheless, as I said before, we are writing out more broadly to the whole market to understand what is going on, because we take it very seriously, and to make sure the rationale people are using for making those decisions is fair.

Q12 **Chair:** Thank you. Can I go back to you, Mr Teitelbaum, about corporation tax? Will Cerberus be paying corporation tax on income from the loans that you have taken on from the Government?

David J. Teitelbaum: There were taxes paid for the year ending April 2016 of over £170 million, and I think £53 million related specifically to this transaction. The amount of taxes to be paid in the future will depend upon the performance of the portfolio and, in the case of Landmark, the development of other business activities, which may include, but do not include today, new loan origination.

Q13 **Chair:** I understand that Cerberus European Residential Holdings is based in the Netherlands. Is that right?

David J. Teitelbaum: That is correct.

Q14 **Chair:** And owned by companies registered in the Netherlands and the Cayman Islands.

David J. Teitelbaum: Correct.

Q15 **Chair:** So which element of it are you paying tax on in the UK, and what taxes are you paying elsewhere on this portfolio?

David J. Teitelbaum: So, there will be taxes paid on the portfolio. Let me begin by saying that Cerberus, its portfolio companies and its affiliated activities pay their taxes due. I am unaware of any circumstance where somebody has come to a view otherwise. First, it is a firm that takes payment of taxes very seriously. Secondly, there will be taxes paid by CERH in the future in connection with this portfolio. CERH, as you noted, is a Dutch company. I don't know what amount of taxes will be paid in the Netherlands as a foreign holder; nor do I know, for the reasons I previously mentioned, what the tax profile will be for Landmark here in the UK in the future.

Q16 **Nigel Mills:** I guess that just begs the question: if you take paying taxes so seriously, why have the Cayman Island-resident bits in your structure? There would seem to be no reason.

David J. Teitelbaum: For a firm like Cerberus, and of course there are many out there, the Cayman Islands is not part of the structure in order to reduce taxes. To my knowledge, there is—to be clear—no tax benefit associated with being in the Caymans. What it is, however, is a location through which funds can be aggregated for foreign investors of Cerberus. So Cerberus, as an investment manager, has well over a thousand investors; many of those are non-US investors. Those investors have a high degree of comfort—in fact, I would argue it is somewhat convention that the Caymans is one of the locations through which those investors invest. But the fact that that location is the Cayman Islands versus another location—at least to my knowledge and granted, I'm not a tax expert, but my understanding is that there is no benefit associated with it. It is very much standard practice.

If I may add to that the presence of the Netherlands—this is a country through which Cerberus has significant capabilities. Its international investing activities have been let out of the Netherlands for 18 years, so since 1998.

Q17 **Chair:** Do you have any idea what you would be paying if Cerberus was an entirely UK-registered entity?

David J. Teitelbaum: I don't know the answer to that. I would imagine that those taxes would be greater and if they were greater, then the up-front price to the taxpayers would have been less.

Q18 **Mr Bacon:** Can I just clarify something? When you said that there is no benefit, what you meant, I think, was that there was no benefit to Cerberus. Presumably, there is a benefit to the investors—the thousand different investors in Cerberus—and that's why they do it.

David J. Teitelbaum: Forgive me, but my understanding is that when I use the word "benefit" in the context of—these investors are familiar with and comfortable with the Caymans. That is the motivation, rather than there being another motivation. I must say that there are areas of the transaction where I hope I can be helpful in the discussion today, but that is not an area where I have particular expertise.

Q19 **Nigel Mills:** Shall we move on to a slightly different subject? I suppose the question that first springs to mind, Mr Teitelbaum, is this: you paid more than par for these assets. How do you make money doing that unless you're trying to milk the poor mortgage borrowers for more than perhaps they ought to be paying?

David J. Teitelbaum: Well, the terms of the mortgage are set. I think approximately 97% of the portfolio is performing. One of the agreements that we had in the transaction was that you could not charge for a period of time a penalty for an early pre-payment of the mortgage. In fact, as I mentioned earlier, one of the additional uncertainties relative to the performance of the taxable income and performance of the investment is how the portfolio behaves.

We—I say that broadly speaking, around Cerberus—have no financial incentive in seeing the borrowers repay the loans sooner. So, when you have a portfolio where you're paying a premium to par, in fact it's the reverse; your incentive, if there is one, is to see the borrowers continue to service.

So, I think that the experience for the borrowers who originally borrowed from Northern Rock will now be a very similar experience. Again, to the comments you made, Landmark is an FCA-regulated entity. Computershare, which is the servicer of the portfolio, is FCA-regulated. The borrower experience will benefit from that, together with, I think, a spirit on the part of Cerberus, which is a very borrower-centric spirit and mode of business activity.

Q20 **Chair:** I just wanted to bring in the Comptroller and Auditor General, Sir Amyas Morse.

Sir Amyas Morse: Forgive me for coming back to the tax point, but I was encouraged by what you had to say about the Cayman Islands. I just want to make sure I understood you. I think you were making a statement about your group policy. So, is it right that the group holding company is in the Cayman Islands? Is that right? It's tax-resident in the Cayman Islands—is that right?

David J. Teitelbaum: There are certain entities which I believe effectively aggregate funds by foreign investors, but I have to—

Sir Amyas Morse: Okay. I got that bit. I'm just trying to be clear about something. So, as far as you know, are there group dividends being paid up into the Cayman Islands? Are they or aren't they?

David J. Teitelbaum: I apologise, but I do not have the answer to that question. If it—

Sir Amyas Morse: So your statement earlier about how it definitely isn't for tax reasons needs to be revised a little bit, because you actually do not know the answer to that, do you, from what you have just said? You don't know if there is a reason for accumulating—because you have just told me you do not know whether they do it or not. Is that right? Pardon me, but the extraordinary idea that people would have a Cayman Islands holding company that does not normally have any tax benefits is a little bit of a new one, as far as I am concerned. That is the only reason that I am asking you these questions. I am aware of tax havens, and it is generally known as a tax haven—it is one of the tax havens—and a lot of companies have a holding company there, and accumulate profits by paying out dividends. It is not an evil thing, but you seem to be saying that that is not the purpose.

David J. Teitelbaum: What I was trying to communicate—I might have done a poor job of doing it—is that my understanding is that the use of Cayman entities is motivated based on the familiarity that international investors have—

Sir Amyas Morse: In the case of your company.

David J. Teitelbaum: Familiarity and comfort was the motivation behind it. That was really the extent to which I was referencing that.

Sir Amyas Morse: Okay.

Q21 **Stephen Phillips:** Mr Teitelbaum, international investors have quite a degree of confidence in and, indeed, familiarity with London, which is a major financial centre, so why pick the Caymans over, for example, London?

David J. Teitelbaum: I think what you have is a fund managing many different limited partners and a need—as it relates to certain activities—to aggregate. Rather than reinvent the wheel, if you will, every time you make an investment in a new jurisdiction, having some level of continuity is, I believe, the rationale. Having said that, if there are questions relative to this, I am more than happy, if the Committee deems it relevant, to put you in contact with the people who can give you a more educated view on this. The reality is—

Q22 **Stephen Phillips:** You have been very clear. You said that the decision to place these vehicles in the Caymans had nothing whatever to do with tax benefits, at least from the perspective of Cerberus. That is your evidence, isn't it?

David J. Teitelbaum: It is my understanding that the rationale behind it was not to create a tax benefit, but—

Q23 **Stephen Phillips:** You have also been very clear—at least as I understood your evidence—that had these vehicles been placed in the

United Kingdom, the tax that would have had to have been paid would have been greater than it is with the vehicles being domiciled in the Caymans. Is that right?

David J. Teitelbaum: I think that is a bit—I may be mistaken—

Q24 **Stephen Phillips:** We can go back and look at what you said earlier, but that was my understanding of what you said.

David J. Teitelbaum: If I understood the question you posed, as you just asked it, if the ownership was in the UK, then I imagine that that would increase the tax profile and therefore reduce the proceeds to the taxpayer, but—

Q25 **Stephen Phillips:** From which it follows that there is less tax being paid as a result of these vehicles being domiciled in the Cayman Islands than if they had been domiciled in London. Would you say that that was not one of the incentives behind the tax domicile of these vehicles? Is that right?

David J. Teitelbaum: I was talking about the Cayman entities specifically. If I understand your question correctly, I also have to juxtapose that against my reading of the NAO Report, which talks about the fact—

Q26 **Stephen Phillips:** Sorry, could you answer my question, rather than floundering around with a lot of words that I do not really understand?

David J. Teitelbaum: Okay. My understanding of the NAO Report is that it would be against EU regulation to require the bidder—or to prohibit a bidder, because it would be discriminatory, if you will, according to EU regulation—to be from one member state of the EU, versus another. So, first, that is my understanding. Secondly, I would restate, as it relates to your questions, I would be happy to facilitate a discussion with people who would have more expertise than myself—

Q27 **Stephen Phillips:** I think someone from Cerberus had better write us a letter explaining the precise circumstances of the tax domicile of these various entities and the reasons why it is said—we may or may not choose to accept this—that a decision was made to domicile these vehicles for tax purposes in the Cayman Islands. So will you write us that letter?

David J. Teitelbaum: I will certainly—at a minimum, I will relay the request to my colleagues—

Q28 **Chair:** No, we are asking your company to write to explain what you tell us you cannot explain.

David J. Teitelbaum: We would be very happy to address the questions of the Committee, including that question.

Chair: We will be writing to you then.

Q29 **Mr Bacon:** While you are about it, I did not feel that I had a clear answer to my question on this point. I understood you to have said that there was no benefit, and my question was about whether that meant that there was no benefit to Cerberus, as opposed to no benefit to the investors, because I took it as read that there must have been a benefit to the investors for them to have done it. Can you clarify that?

David J. Teitelbaum: My reference in that comment was to Cerberus.

Chair: I think Mr Bacon's point is clear. We will make sure that we go back over this and write to you, although I am sure that someone behind you will be taking notes as well.

Q30 **Nigel Mills:** Shall we move on to Mr Henrion? You have not had a chance to speak in this session, and we don't want you to have wasted your time. Can you explain Credit Suisse's role in this transaction? You appear to have not one, not two, but three different angles in it, which might cause a few alarm bells.

Jerome Henrion: My role, and that of the advisory team, was to help UKAR to devise and execute a transaction that would help UKAR to meet its objective of reducing the size of its portfolio in a way that would represent value for the taxpayer. There is another part of Credit Suisse that had been discussing the transaction with market participants, with regards to potentially financing them on their purchase. You referred to a third part, which is Credit Suisse Asset Management, which was part of a consortium that expressed interest in buying the portfolio in the first round.

Q31 **Nigel Mills:** As an organisation, are you happy to be advising the seller, advising potential buyers and trying to make a bid? That situation seems a little conflicted.

Jerome Henrion: We would never advise a buyer and a seller at the same time, and that is not what happened here. We advised the seller, and another part of the organisation provided financing to some of the buyers—two of the final three buyers—as is quite common in these types of transaction.

Q32 **Nigel Mills:** But your organisation was advising the seller, financing a potential buyer and made a bid. Did that not make your organisation's ethics team think, "It looks a bit suspicious that we have three hands in this pie"?

Jerome Henrion: There's an advisory role, which is completely separate from the financing part, and then there is Credit Suisse Asset Management, which deals with third-party money and is managed separately, with a different governance structure. UKAR was made fully aware of the various roles that Credit Suisse was going to play in the transaction and was comfortable with the clear separation of the three roles that you described.

Q33 **Nigel Mills:** Figure 11 in the NAO Report shows the various valuations of the holdings that were done. It appears that your valuation was something of an outlier. It had the lowest bottom end of the range, at

94% of par, compared with what was eventually a deal sold at more than par. You can see why we are getting a bit nervous about the adviser creating a bit of a low valuation and then another part of it trying to buy it afterwards. It is not a great situation to get into.

Jerome Henrion: Well, you have chosen to focus on the lower end of the valuation. On the upper end of the valuation, we were actually the closest to the final bid. In fact, two of the final three bidders were within our range; only one bid was outside our range, and only just outside, by 0.2%. I don't think it is fair to say that our valuation was low or the lowest. It is true that the lower end was, but the upper end was closest to the mark.

Q34 **Nigel Mills:** Okay. Can we talk through how you got appointed to this process? It looks slightly abnormal. It seemed to start with you doing some pro bono work for the seller, and you then won a limited tender to do some sort of work. What you ended up doing was a far bigger project for a far bigger fee. Is that a fair summary of how the appointment process worked?

Jerome Henrion: We introduced UKAR to a few independent servicers to give them the chance to speak to institutions that have an independent servicing company, as they were thinking about whether or not to sell the servicing operation. That is a service we provide to all our clients. We are an intermediary. We help different market participants to get in contact with others and we never charge any fee for it. It is part of the service we provide.

With regard to the appointment, we responded to an RFP and we put our best foot forward. As I understand it from the NAO Report, they considered nine institutions and invited some of them. It seems that we had the best proposal, and we won on that basis.

Q35 **Nigel Mills:** What we didn't really get was a competitive tender of your success fee for a £13 billion transaction, which was, as we heard, the largest transaction of this type that the UK Government has ever done. Are you going to reassure us that the fee you ended up charging was not a little higher because you managed to avoid a competitive tendering process?

Jerome Henrion: I certainly believe that it was good value for money. We charged a 0.04% fee for the transaction, which is very low. It is much lower than what we and others would charge other Government institutions, which tends to be between 0.15% and 0.25%, and certainly a lot lower still than what we would charge the private sector. A 0.04% fee is very low for this kind of—

Q36 **Chair:** Why did you do that, Mr Henrion? Did you do that out of the goodness of your heart, or was the Government a hardball negotiator?

Jerome Henrion: No, we were negotiated down hard. A cap was imposed on us, so any size sold above £5 billion effectively attracts no fee. We ended up at this level.

Chair: But it can't have done Credit Suisse any harm to have been involved in this. As I say, you didn't do it out of the goodness of your heart. You were prepared to take that cap. It is interesting, because we look at high fees for advisers quite a lot in this Committee. It is something that Mr Phillips, in particular, has raised a number of times. We are interested in knowing how you agreed to do it for less than what you could have done it for.

Q37 **Stephen Phillips:** Well, you didn't, did you? Your original fee was £2 million, and you increased it to £4.5 million.

Jerome Henrion: Yes. I failed to answer that part of the question; I apologise.

Chair: Sorry, I interrupted you.

Jerome Henrion: The initial scope of the transaction was to sell the servicing operation with perhaps a small amount of assets attached to it—probably non-performing loans. The scope of that transaction changed significantly—

Q38 **Chair:** So that was the sale to Computershare.

Jerome Henrion: Project Phoenix, which ended up being sold to Computershare—absolutely. The scope of that mandate changed quite significantly. Rather than having a small amount of assets, it ended up having a large amount of assets in a complicated and structured way, because it required the sale of a company to be able to sell the assets that were in it. The amount of work, the number of man hours, the complexity and the time spent on the transaction evolved over time, and our fee had to evolve at the same time.

Q39 **Stephen Phillips:** I think Mr Mills's point is that the agreement to pay £4.5 million was done without a proper procurement process. The concern of this Committee might be, when we meet to discuss it, that had there been a proper procurement—particularly where you weren't wearing several hats, as it were—a fee may have been charged that was less than £4.5 million.

Jerome Henrion: I think that is a question better addressed to UKAR. We were invited to respond to an RFP, and we put our best—

Q40 **Stephen Phillips:** Well, you said there was push-back from the Government. How much did you ask for when the scope of the work you were being asked to do increased? You were originally being paid £2 million and you pushed it up to £4.5 million. How much did you ask for?

Jerome Henrion: Ten basis points on the amount of assets sold.

Q41 **Stephen Phillips:** Sorry, you will have to say that again.

Jerome Henrion: It was 0.1% of the amount of assets sold. We ended up at effectively the same number but capped at the £4.5 million fee, which equates to 0.04%.

Q42 **Stephen Phillips:** So in fact you asked for 0.1%, and the Government's negotiating strategy was to agree that and then to impose a cap. Is that right?

Jerome Henrion: That's right.

Q43 **Nigel Mills:** Can I just ask you one question, Mr Davidson? We ended up with a whole chunk of these mortgages being sold on to the TSB. I think those poor customers ended up not on the TSB standard rates; they ended up on slightly higher inherited Northern Rock rates. How can you be happy that I've become a TSB customer not on TSB rates but on something slightly higher? It just feels slightly wrong, doesn't it?

Jonathan Davidson: The rates that are charged are determined by the actual contracts, not by the institution, in the sense that each consumer has signed up to a contract. From that point of view, we wouldn't necessarily expect different books of mortgages, with different contracts formed at different times and with different segmentation, if you like, of customers, to always be on the same rate.

Q44 **Nigel Mills:** But don't you get slightly nervous when you see huge amounts of people's mortgages being sold for profit, and then you see lots of media coverage, not least from TSB, saying that this transaction will aid their profitability? Don't you get a little nervous that perhaps, somehow, what is being charged is more than what it ought to be?

Jonathan Davidson: If you're asking whether we are very interested in making sure that customers are not treated unfairly, we are extremely interested in that. We took a great deal of interest in the transaction and in how our regulations and powers would continue to apply. We satisfied ourselves that they would be the same afterwards as they were before. So the answer is yes, we will continue looking at it. As I said before, we are also very interested in how more generally across the market interest rates are being determined on the standard variable rate, especially with the cuts that we have seen. I wouldn't say I am uncomfortable, but I feel we are very interested in it, we are on it, and we will use the powers we have, if we need to.

Q45 **Chair:** I think Mr Mills was just highlighting one of our concerns when we were looking at this, which is that the hapless mortgagee is sold on. There are lots of machinations about how that is done by, in this case, a Government sale, and there is your role at the FCA, but the mortgagee really has no say over it. Although there is a contract in place, once they have their loan, there are some uncertainties when it is sold on. I think that is what Mr Mills was driving at. The individual has no control over that, except for once they can relinquish that mortgage.

Jonathan Davidson: Yes. As I said, in terms of our regulation, we are very concerned about that. Obviously, if the decision making about interest rates is transferred to a new legal entity, there is a requirement that the customers are actually notified, but in this case, the decision making about the interest rates came across and stayed with NRAM, which has been renamed Landmark, so that notification was not required. In a sense, the customers did not receive notification.

In terms of the hapless customer, one aspect of determining fairness has to be that customers have choices. To some extent, if a customer is able to cancel their mortgage contract, if you like, and go to another firm if they are being charged more, that is one factor we would take into account when assessing whether it is fair. Our concern with some of these customers is that in some circumstances they may not fit the criteria for other lenders, in which case they are what we would call trapped customers. In those circumstances, that is where we are very concerned to make sure that our regulation, which prevents them from being treated unfairly, is in place. At the moment, it is in place.

Q46 **Kevin Foster:** I want to go back slightly to one of the points made earlier about Credit Suisse's role. You said that you don't advise at the same time. How did you put in place the walls to ensure that your advice on the sale didn't end up benefiting the actual purchase bids? The fear would always be, of course, that even if you are not advising at the same time, if you have advised on the sale then when you come to bid you may well fundamentally have a benefit, having had information that others might not have had.

Jerome Henrion: There is a clear separation, as I mentioned. Anybody on the advisory team had no knowledge of what the other financing team was doing or who they were advising.

Q47 **Kevin Foster:** How separated are they? Same office? Different locations? Or just Chinese walls in the company?

Jerome Henrion: It is a Chinese wall; it is the same office. There is a Chinese wall. There is a procedure put in place by Credit Suisse. I should also mention that UKAR asked to review that separation. The person in charge of compliance walked them through these procedures, internally, to get them comfortable—

Q48 **Kevin Foster:** You mentioned UKAR asked for a thing. What sort of information did they ask for to satisfy themselves that there was appropriate division?

Jerome Henrion: They asked the compliance department to describe the separations and how they work. I asked it to write a letter to that effect, and I asked a person to walk UKAR through how these separations work.

Chair: Mr Smith from the NAO.

Stephen Smith: You said earlier that Credit Suisse would not act as the lead adviser on both sides. I wonder if you could talk to the Committee about the distinction you therefore make where Credit Suisse is acting as the lead adviser for UKAR, but Credit Suisse Asset Management is on the other side as a principal, making a bid.

Jerome Henrion: I am sorry, I did not hear the last part—

Stephen Smith: Sorry. You said that Credit Suisse would not act as an adviser on both sides—

Jerome Henrion: That's right.

Stephen Smith: Why then is it okay for Credit Suisse to act as the lead financial adviser for UKAR, and for Credit Suisse Asset Management to be one of the bidders?

Jerome Henrion: Because Credit Suisse Asset Management manages money for third-party clients—no Credit Suisse money is managed in those funds. It is a separate division, managed separately, with different governance and no Credit Suisse interest in the funds.

Stephen Phillips: It is in the interests of Credit Suisse Asset Management, obviously, to maximise the income for its clients and, indeed, its remuneration would in part be based on that. So it is a perfectly legitimate question. There is no point saying, "Oh, it's managing someone else's money, so it has no skin in the game"—plainly, it does.

Q49 **Chair:** I think our concern, Mr Henrion, is that you are twin-hatted—and you bid, so you were tri-hatted at one point, but then you withdrew. Was that because you recognised this concern, or was there another reason behind that? For the average person looking at this, to see one company with three pawns in the game, if you like, in different parts, whatever the Chinese walls, it does look extraordinary. We are obviously going to be asking the Government about this. So why did you bid, and why did you withdraw?

Jerome Henrion: When you say "you", it is not—

Chair: You were in a consortium, you were advising—

Jerome Henrion: We, the advisory team, had nothing to do with, and Credit Suisse itself had no role in, the bidding. It was Credit Suisse Asset Management—its fund, separate clients. It is not Credit Suisse; it is the funds managed by Credit Suisse who are bidding on it. I have forgotten your question now—

Q50 **Chair:** Funds that you advised bid—

Jerome Henrion: That we managed.

Chair: That you managed, yes. How did you decide, or who decided to withdraw? Was it you, or was it your clients, or Government?

Jerome Henrion: So, when the financing part of Credit Suisse went through their internal approval processes, as they do in any transaction, it went through a committee. The committee saw that there were several funds, or several bidders, financed by Credit Suisse, including one of the consortia in which Credit Suisse Asset Management was a minority participant. The committee decided, rightly so, that there was a potential perception of conflict between some of the other bidders and the bidder that included Credit Suisse Asset Management. The concern was that the other bidders might feel that the consortium in which Credit Suisse Asset Management is might receive preferential financing terms from the financing part of Credit Suisse. It is a bidder-bidder potential conflict, not an adviser-bidder conflict.

So the decision was then made: Credit Suisse financing would withdraw its financing from any consortium that included Credit Suisse Asset Management, or Credit Suisse Asset Management had to withdraw from the consortium. It was a minority participant, therefore it withdrew from the process, and subsequently the lead investor withdrew as well.

Q51 **Chair:** Does this happen often when you are bidding? Was this an unusual set of circumstances, that you had three pawns in the game, effectively?

Jerome Henrion: I don't know, but I would say so, yes.

Q52 **Mr Bacon:** Mr Davidson, is there any aspect of the sale of the loans portfolio that is the subject of an investigation by the National Crime Agency?

Jonathan Davidson: Not to my knowledge.

Q53 **Mr Bacon:** Not to your knowledge. The Republic of Ireland National Asset Management Agency was involved in a sale with a potential purchase by PIMCO, which withdrew because of concerns about fee arrangements. Is that not correct?

Jonathan Davidson: Yes, that is my understanding.

Q54 **Mr Bacon:** Right. What happened in the end?

Jonathan Davidson: I don't know.

Q55 **Mr Bacon:** You don't know. What about the US Department of Justice—are they examining it?

Jonathan Davidson: I don't know.

Q56 **Mr Bacon:** You don't know. And who bought the loans that PIMCO withdrew from and did not buy in the end?

Jonathan Davidson: I don't know.

Q57 **Mr Bacon:** Wasn't it Cerberus, Mr Teitelbaum?

David J. Teitelbaum: Yes.

Q58 **Mr Bacon:** It was. And it is correct, isn't it, that PIMCO was a potential buyer but then withdrew?

David J. Teitelbaum: I have read that before but I don't know from first-hand knowledge that that is the case.

Q59 **Mr Bacon:** You weren't worried about that.

David J. Teitelbaum: I have read about it, but I don't know anything more than that.

Q60 **Mr Bacon:** You didn't know about it at the time.

David J. Teitelbaum: I personally did not know.

Q61 **Mr Bacon:** Did Cerberus know at the time that PIMCO had been a bidder and then withdrawn because of concerns about hidden fee arrangements involving its own lawyers that it did not know about? It then withdrew and Cerberus came along and bought the portfolio that PIMCO had previously been bidding for. There was no one in Cerberus who knew that.

David J. Teitelbaum: No.

Mr Bacon: Okay, that is fine. That is your evidence.

Chair: Okay. If there is no one else, we will say thank you to our first panel. Thank you for your time. You are very welcome to stay and listen to the second panel. Our transcript of this hearing will be published in the next couple of days and you will obviously be sent a copy. It will be published on the website uncorrected, so, if you have any corrections, get them in quickly. We do not correct matters of substance; just little factual points that may have been lost in transcription.

Examination of witnesses

Witnesses: Charles Roxburgh, James Leigh-Pemberton and Ian Hares.

Chair: Welcome to our second panel this afternoon. This is in essence the panel representing the Government side of the deal. I am delighted to welcome Charles Roxburgh, the second permanent secretary at the Treasury, James Leigh-Pemberton, the chairman of UK Financial Investments, and Ian Hares, the chief executive of UKAR, the body that was holding these assets before the sale. Again, to remind anyone who is following us on Twitter, our hashtag is #northernrock. I will hand straight over to Mr Nigel Mills to kick off.

Q62 **Nigel Mills:** Okay. Mr Roxburgh, can you give us your assessment of how you think this transaction went and whether you learnt any lessons from it?

Charles Roxburgh: We were very pleased with how it went and I think the NAO Report sets out that it was a very professionally managed transaction that, in realising £13.3 billion of value for these assets, did deliver value for money for the taxpayer. There are always lessons to be learnt. I think some of the lessons to be learnt are that there were things that went right in this transaction that we should make sure we replicate in future transactions. The NAO Report sets those out helpfully: having a very professionally managed process; having a competitive process; and having a good grasp of the valuation ranges to make sure we did get good value for money. The NAO also makes some helpful suggestions around bringing out the documentation all in one place, which we think is useful and helpful. We will certainly take that on board.

Q63 **Nigel Mills:** Perhaps a good place to start is the good valuation ranges that you referred to. The first question on that is when and how well did you do the sell versus hold calculation? We accept that Government policy was to sell but it does not look like very early in this process that you did much of an assessment to see whether the taxpayer was better off holding or selling in that situation. Do you accept that?

Charles Roxburgh: No. Government policy is to hold assets when there is a good policy reason to hold those assets. In this case, the policy reason was that, because of the financial crisis, it made sense to acquire these institutions and associated assets, so the actual policy reason for holding the assets had passed.

The policy is that once that policy reason has passed, if there is a good opportunity to sell them at good value for money, the Government is open to selling them. In this case, UKFI spotted the opportunity and brought that to the Treasury's and Chancellor's attention and so the process started.

So the starting point is that we only hold assets where there is a policy reason to. If there's not and we can secure value for money then we will sell them.

Q64 **Nigel Mills:** I thought that once all this came on the Government's balance sheet a policy decision was taken that we should be divesting these as quickly as possible. I thought that was where this started.

Charles Roxburgh: As quickly as possible would suggest that speed mattered more than value for money, and that was never the case. What matters is to sell them when we can do so at a price that realises value for the taxpayer.

Q65 **Nigel Mills:** But I thought this sale was key to meeting the Budget promise of national debt falling as a percentage of GDP, so there seems to have been quite a timeframe on this.

Charles Roxburgh: There have been other asset sales that have been included in those projections. For the OBR those projections do include assumptions about future asset sales but those are only assumptions. If there is not an opportunity to sell the assets and realise value for money the sale would not proceed. Those projections were an outcome of the process not the driver of the process.

Q66 **Nigel Mills:** So, presumably at the start of this process you do a calculation that says: if we hold these assets for the next five or 10 years or whatever, we will get this amount of income, compared with this level of cost, and if we realise the asset, we can get this value. You then equate the two and see if that is in the interests of the taxpayer. Is that how it works?

Charles Roxburgh: There is an analysis like that in here but that does not allow for the risk of holding the assets, so you have to ask if there is a risk of holding those assets. Clearly, in any financial asset there is a risk but I come back to the overriding policy. The Government does not have a policy of holding financial assets for profit. We hold them where there is a policy reason to do so and, where there is not, we will sell them if we can realise value for money.

Q67 **Nigel Mills:** I sense from the NAO Report that some of these quite important calculations were done later in the process rather than at the start. I might have thought that at the start of the process you would do the hold versus sell calculation and then perhaps you would look at breaking up the parcels and see what structure of a deal would get the best consideration. The sense is that someone said, "I'll give you £13 billion for the whole lot," and you thought, "Great," and went down that and then at the end thought, "Perhaps we'll look at something different."

Charles Roxburgh: I think that is rather an oversimplification of what was a very complicated and professionally managed process. James, my colleague for UKFI, could you explain a bit more of the process?

James Leigh-Pemberton: The process began immediately after a preceding and smaller sale, Project Slate, which raised about £2.7 billion—again another sale of mortgages. As that process was coming to completion, we began to get some feedback from investors suggesting that there was a lot more appetite to buy performing residential mortgages than the size of that transaction suggested.

That was in the beginning of autumn—September 2014—so together with UKAR we went through a process of trying to substantiate whether that was true. We put a paper to our board in December 2014, which presented the findings of that process. Very early in 2015, together with Treasury colleagues, we wrote some advice to Ministers setting out our preliminary view that, subject to verification through a market-testing process and then a two-round sale process, a sale of this scale appeared to be feasible at prices that would deliver value for the taxpayer. Subsequent to our delivery of that advice, we were asked to provide an opinion to the OBR, and indeed to the Chancellor, setting out what we thought was feasible.

As Charles has said, the sequence of events was: smaller sale; identification of an opportunity that appeared to be possible; identification of the means by which that possibility could be verified into a feasible transaction that would deliver value; and then some consequential correspondence setting out what our conclusions were.

Q68 **Chair:** Mr Mills's point is an important one for future transactions. That was our concern in looking at this. You have highlighted what happened, Mr Leigh-Pemberton, but if the Government do this in future, would it not be advisable to look at those options a bit earlier on? We were concerned that it seemed a bit of an afterthought. I think that is really where Mr Mills is driving.

James Leigh-Pemberton: I see, yes. We did that process that I just described against the backdrop of what is set out in UKFI's framework document, which really says three things: it is not the intention of the Government to be a permanent investor in these financial assets; it is the task of UKFI to undertake the orderly disposal of those assets when we can deliver value for the taxpayer and preserve competition and financial stability. So our activity was informed by the mandate that we have to carry out those tasks.

Q69 **Chair:** And it was a good offer, in a sense.

James Leigh-Pemberton: Sorry?

Chair: When you had the suggestion that someone wanted to buy—

James Leigh-Pemberton: Absolutely.

Chair: We can understand the rationale, but it is that concern that there might have been a rush to do that. We were concerned about precedent.

Q70 **Nigel Mills:** I suppose where I was trying to get to was—I might have thought that you would look at the process and think, "Actually, do we get the best return from selling everything in one big £13 billion transaction, or do we get a better return by parcelling it up?" and you might do that at the start of the transaction and think, "Actually, if we just sell a clean mortgage book, that might attract high street lenders who can perhaps pay a bit more and might not exclude everyone who can't raise £13 billion." I just sense from paragraphs 4.10 and 4.11 of the NAO Report that you did that analysis a year into the transaction, when you had gone through a couple of rounds of bidding; you did not do it at the start and come to a planned conclusion that a £13 billion sale was the right thing. That is perhaps what surprised me in that situation.

James Leigh-Pemberton: As I said, our activity was informed by what our mandate tells us to do, but it was also informed, importantly, by the fact that certainly at UKFI, we had a view that the market conditions that were prevailing, particularly in the period from January 2015 through to the end of round 1—to June—provided a combination of market conditions that were exceptionally favourable to sellers, which therefore also informed the view that the risks of waiting were very much skewed to the downside. By that, I mean the probability that market conditions would deteriorate from those exceptionally good ones was higher than the probability that they would improve further.

Q71 **Nigel Mills:** It is just that when you do that analysis in September 2015, it is suggested that a single sale, or multiple sales could have increased the reserve price by between £48 million and £307 million. I accept that this is a £13 billion transaction, so they are not huge percentages, but I suspect most of my constituents would think that a chance to get £307 million more for the taxpayer might have been worth thinking about.

James Leigh-Pemberton: They are very substantial numbers, and we did take it into account. Probably the easiest way to illustrate the point is that in figure 17 in the National Audit Office Report, there is a sensitivity analysis showing what the value of this portfolio is at various different costs of debt and costs of equity. In the footnote it says that for every 25 basis points of rise in debt spread, it costs £100 million. So for every 50 basis point move, it is £200 million up or down. The NAO Report also points out the Towd Point securitisation by which Cerberus refinanced. They did it at 200 basis points per annum over LIBOR. In the sensitivity table, you will see that the 200 basis point line—obviously, because it is 50 basis points wider than the assumptions that we made—would result in a £200 million cost. So that is a long and complicated way of saying that market conditions were deteriorating, as evidenced by the fact that Towd Point refinanced Cerberus at a higher cost than had been imputed in the value assessment at the time that we made the sale to them.

Q72 **Nigel Mills:** I accept the NAO Report says that we got a good deal here and we got good value for the taxpayer, but, if you were being completely honest, wouldn't you say you would rather, at the start of the process, have done the analysis about whether selling the whole thing or breaking it up got the better return, rather than doing it towards the end and hoping you were in the right position?

James Leigh-Pemberton: We certainly accept the recommendation of the NAO that there should be a business case with all elements of these considerations assembled at the outset and then, as and when it is amended for market conditions, that it should be amended as we go through a process. That we absolutely understand. We had just completed a £2.7 billion sale of performing residential mortgages and we knew at that time, therefore, that we had empirical evidence that we could do more of those. The question that we posed for ourselves against the backdrop of the feedback that we had from investors was: should we have been contemplating doing something larger? In view of our mandate, the answer to that question was: if we can substantiate; if it is feasible; if it delivers value; and if it is proper and regular, the answer was yes.

Q73 **Nigel Mills:** We are in danger of going around in a circle. One of the bits of information you need in that is to work out what structure of the sale got the highest price. I am not entirely clear that you did that until you had decided what the structure of the sale was, and then a year later you decided to have a look and see whether a different structure might have been better.

I suppose we could move slightly on to the initial valuations that you started down this road on. I am looking at figure 11 in the NAO Report. The UKAR valuation probably did not turn out to be your finest hour, Mr Hares.

Ian Hares: I think you need to understand this valuation in context. What we chose to do was to estimate where the bottom of the range was. This isn't a range; this is the bottom of the range. The bottom of our range is not a great deal different from the bottom of the UKAR range. What we did not do but will do in future is to articulate a wider range. Within our papers there was a range. We just declared the one number.

Q74 **Nigel Mills:** Is that not a slightly strange thing to do when you are thinking, "Shall we sell this asset or not?"—to think what the bottom end of the range might be?

Ian Hares: Ultimately, when you approach an asset class such as this, the first thing you have to do is to estimate the cashflows, because cashflows depend very much on borrower behaviour, which in turn depends on the economy. So there is an uncertainty around there. Then it comes down to the assumptions you make around the discount value. Within the work that we did, there would have been a higher number and we just didn't choose to write that number down in the same way as others did.

Q75 **Nigel Mills:** Do you think that is acceptable? You just did not choose to write the number down?

Ian Hares: I do not think it made any difference to the outcome. It is worth bearing in mind we are not advertising what these prices are to Cerberus and everybody else who was interested in the beginning. This is an internal price for our consumption. The way we approach whether we will achieve value for money for the taxpayer—it is in the Report—is first and foremost: do we believe this is a good time to sell? Secondly, do we believe that the process we go through will drive our competitive process? That is underpinned by, when we have got through that process, do we believe that the price of the process that is thrown out gives a number that we feel is value for money? It is not the start of the process; it is the end. It is the underpinning, rather than the process itself.

Q76 **Nigel Mills:** If you do not have a figure in mind for what you think the top end of the range might be or what a good price might be, how do you evaluate during your process whether you are achieving the value you want to achieve?

Ian Hares: What we come back to is that we are looking at the bids we are offered. We received three bids, all of which were pretty close together. The Cerberus bid was the best bid. They were well above the bottom of the range that we calculated, and they were at the top end of our expectations.

Q77 **Chair:** Mr Hares, you have a lot of experience in different bits of the financial sector. We often ask the Treasury and other bits of Government about the commercial expertise available. Was it just the commercial expertise of people like you—those of you who were brought in to run UKAR—that was put into practice? Obviously, at a later stage Credit Suisse and others came in. Did you call on outside advisers as well?

Ian Hares: From our perspective, you are absolutely right. We have a team of people with relevant private-sector expertise that looks at these opportunities and weighs them up in terms of, "Does that make sense? Are we likely to achieve value for money?" That is exactly what we have got.

Q78 **Chair:** Okay. So you feel that you had the requisite commercial expertise, and that it was still up-to-date enough.

Ian Hares: Absolutely.

Q79 **Chair:** The danger is that as you come into the semi-public sector—

Ian Hares: That is absolutely right. That is the role that advisers play: they are close to the market all the time in a way that we cannot be.

Q80 **Chair:** So do you think, because you had expertise—you and others in UKAR—that you saved the taxpayer any money by having to have fewer external advisers? Do you think you got it a bit further along the line?

Ian Hares: To me, it is pretty inconceivable that you could run a transaction this big and complicated without external advice. I think that would be a very dangerous thing to do. We bring the ability to challenge the advisers, to understand what the advisers are saying and not to be in the position of relying blindly, if that is not too strong a word, on the advisers' advice. We can look at the advisers' advice and say, "Are you sure?" We did not get to the stage where we had to do this, but we could potentially ignore it.

Q81 **Chair:** You look at the advisers' advice, but did you look and the fees they were charging as well?

Ian Hares: Very much, we did.

Q82 **Chair:** Did you challenge them on that?

Ian Hares: Yes.

Q83 **Chair:** Mr Leigh-Pemberton, did you want to come in on this?

James Leigh-Pemberton: No.

Chair: You were nodding in agreement. For the record, Mr Leigh-Pemberton agrees.

Q84 **Nigel Mills:** I suppose I am starting from the presumption that you were working out whether to go ahead with the transaction with some idea of what you thought the asset was worth before you started so you could compare it to the bids; that might be quite useful. Mr Leigh-Pemberton, I think your organisation did a second valuation after UKAR's. Again, you made a few assumptions that turned out to be quite different from what the market was doing. Is there any learning point that you have from that?

James Leigh-Pemberton: Again, we made some assumptions about the cost of debt and the cost of equity. The high end of our valuation range, which you can see here, was spot on where the third-place person came and was 0.8 of a percentage point beneath the winner. We were conservative to the tune of 0.8 of one percentage point. I think it is fair to say that when we produced this valuation we were not expecting that we would get quite such a competitive process as finally emerged. The cost of equity and the cost of debt assumed by the bidders, as set out in the NAO Report, were indeed at historic lows for transactions of this sort. We thought we could get to new lows, in terms of cost of equity and cost of debt, but those new lows were actually lower than we thought we would be able to achieve.

Q85 **Nigel Mills:** Were you a bit surprised when the Credit Suisse valuation that the company paid money to get had quite such a large range and started quite a bit lower than yours got to?

James Leigh-Pemberton: I think if you look at the mid-point and, indeed, the top end, Ian has made the point that it is very important to have advice and to make sure that your work is being looked at, guided and checked by outside resource, but that it is also very important to have your own internal expertise. I am not at all trying to trivialise this, but it is prudent for financial advisers to put a wide range, because it can accommodate all possible outcomes.

Q86 **Nigel Mills:** Yes, it is much easier as an adviser to give a big range—

James Leigh-Pemberton: That is true, but it also comes back to Ian's point, which I think is important, which is that having the capability then to see that, to get what is valuable from the advice and to make the most of it, is part of the role of UKAR and of the UKFI.

Q87 **Nigel Mills:** We know this turned out okay. You had a very competitive transaction, which presumably made sure we got the right market price, but it looks like there was a bit of a risk, heading into the single largest transaction—a very unusual transaction—that you perhaps did not really know what the price was going to be. If you had not had quite so many interested parties, perhaps someone could have come along and got this undervalued, because your process did not quite start in the right place.

James Leigh-Pemberton: This is not reflected in the Report—perhaps because it is taken for granted—but I think that our process always accommodated the fact that, if at any point there was a change in market conditions or in the facts as they emerged contradicting our original assessment of what might be possible, with the result that we would not achieve value for money and decently beat the reserve price, we would then simply not proceed with the transaction. That was always contemplated. It is part and parcel of the way, historically, that we have done things in UKFI, which is that we have to be cognisant that market conditions can change. We have to be cognisant, also, of the possibility that our own assessment of them may not be completely accurate. Therefore, we have to give ourselves, in the way in which we design these processes, the opportunity to stop them if they will not deliver value for the taxpayer. That applied in the case of this transaction as well.

Q88 **Nigel Mills:** Your reserve price was quite a bit lower than the actual consideration, wasn't it?

James Leigh-Pemberton: Yes, it was. It was so, because we had worked on the assumption that a normal, mid-teens cost of equity would be applied here by the buyers. It turned out, I think through competition, that a significantly lower cost of equity was ultimately achieved.

Q89 **Nigel Mills:** I suppose that means—I think the NAO quotes £2.5 billion—

the taxpayer would have been better off just holding these assets, in theory, because we know the Government's borrowing rate is so low, compared with the 4.7% yield on these mortgages. I suppose it makes us a little nervous when we are making these hold and sell decisions that they might be a little bit out on the valuations that we start with, so we end up with a reserve price that is really quite a bit lower than what the market provides. Do you not perhaps feel that there is a risk that you might get the initial hold/sell decision wrong if you cannot get these valuations a bit closer to being right at the start?

James Leigh-Pemberton: Again, I enter a plea that may be self-serving. First of all, we came up with a valuation range that was in a tight range—97.3% to 99.8%—and I do not think, certainly from my previous experience, that the variation between that price range and the final outcome was so wide as to threaten the integrity of the original decision. In so far as the original decision of sell versus hold is concerned, I absolutely see the maths associated with the cash-flow curve that the NAO set out in the Report, but as Charles said earlier, our activity is fundamentally informed by what our mandate says, which is that we should engage in the orderly disposal and it is not the intention of the Government to hold these assets through to term.

Q90 **Nigel Mills:** Mr Roxburgh, how do you get comfortable that the mandate that you have been given is getting best value for the taxpayer in that situation? Don't you look at that and think, "Two and a half billion—we would have been better off as a taxpayer if we'd kept this"?

Charles Roxburgh: I would make a number of points on that. First of all, that is the UKAR central case, and there could well be downside from that.

Q91 **Nigel Mills:** Or upsides, presumably.

Charles Roxburgh: Well, the nature of these assets is it is more skewed to the downside than the upside, because you could lose all of the money or you could have a default, and the way interest rates move, most gets passed through the consumers. So there is more downside than upside—so it is the central case. Secondly, that is discounted at the gilts rate, and that is not how you evaluate holding assets. Businesses don't evaluate financial transactions using the marginal cost of debt; they use the weighted average costs of capital. In the Government, we use the Green Book methodology, which is not the marginal cost of debt; we use a discount rate, which is 3.5% real.

On holding these assets to term, you look at holding risk assets with downside using the marginal costs of debt rather than the discount rate we are meant to use, so we wouldn't accept that we should hold these assets to term. Now that's my other point, which is that the Government is not in the business of holding financial assets and funding them with gilts. That is not what we do in government. We hold assets where there is a policy reason to do it, and when there isn't we return them to the private sector at value for money.

Q92 **Nigel Mills:** I thought the Government was quite keen on supporting mortgages and home ownership and home buying, and was guaranteeing deposits and all manner of stuff. I guess I sensed that maybe holding some well-performing mortgages that were making a good bit of money was not perhaps that non-core to that activity now.

Charles Roxburgh: Policies like Help to Buy and the Help to Buy ISA are very explicit Government policies and the Treasury's job is to help implement those policies.

Q93 **Nigel Mills:** I do not want to labour it too much, but it does look like a big number, doesn't it? You think that the Government cost of borrowing is very low; these mortgages were all quite stable and well performing. Weren't you just quite tempted to keep taking the money and have it reduce the deficit, rather than reduce the debt in one go?

Charles Roxburgh: No, again, that is not our policy. Our policy is not to issue gilts and buy financial assets and make a spread on them. That is absolutely not what we do. We hold them when there is a policy reason and return them—

Chair: We are straying slightly.

Mr Bacon: We are going into policy.

Nigel Mills: I was just testing how Mr Roxburgh got happy with the decision that was being taken.

Chair: No, they are fair points to ask, but we are straying into policies, and Mr Roxburgh is not the one who makes the decision; it is the Minister sitting in the hot seat.

Q94 **Nigel Mills:** Presumably, if he thought it wasn't good value he would have to do something about it. Perhaps we could, before we have an internal spat, touch on a couple of issues we did with the pre-panel. I suppose the first one is the way Credit Suisse were appointed was a little, perhaps, less than perfect. How did that happen? Do you think that you have overpaid the advisor in that situation?

Ian Hares: I think it is important to put in context the journey we went through in 2014. As you heard earlier, we were engaged in a process which actually ran parallel to this transaction for the divestment of our mortgage servicing operation.

Chair: Could you speak up, Mr Hares? This is a bad acoustic, in a room designed for speaking.

Ian Hares: We were engaged in a process—we started early in 2014—to consider the divestment along with the servicing operation, which ultimately we did earlier this year, when we transferred that to Computershare. That was the focus through the summer of 2014 and we envisaged that, as part of that process, there may have been a small asset sale, probably around non-performing loans rather than performing loans. We identified a panel—a group of nine investment banks that we had thought it might make sense to help us with that. We reduced that to three on a desktop basis internally, using the expertise within the team, and put that out to RFP in September 2014, if I remember correctly. Out of that process Credit Suisse was selected, so that was a competitive process with three people.

In parallel to that, the genesis of this transaction started to appear, and we started to get into a situation where it looked like something much bigger than we had originally anticipated may be possible. At that stage it was maybe possible. I think I was probably one of the sceptics at that point, it is fair to say. Nevertheless, it was sufficiently important for us to look at. During that process, Credit Suisse said, "Hang on. This is not what we signed up for. The quote that we made was on the basis of a small transaction. We don't believe we are comfortable supporting a broader one."

We thought about that and talked about it with the board and UKFI. We agreed to press on with the market-testing work to work out what we actually would do, and then we would consider whether to continue with Credit Suisse and what fee we would pay them, once it was clear exactly what that transaction was going to be.

Credit Suisse probably weren't that comfortable with that but they agreed to go along with us. We carried on and did the market testing in December and January and provided advice to our board, the UKFI board and Ministers. We got to the stage where we actually believed that this transaction had the potential to deliver value for money and was feasible.

At that point, we got involved in negotiation with Credit Suisse, which resulted in them being prepared to do this for a £4.5 million success fee. At that stage, we went back to the scorecard that we had used to select them in the first place back in September or October and asked ourselves: had we known then what we know now, would we still have selected them? They still won on that scorecard. In fact, the success fee that they quoted—or that we agreed with them as part of that renegotiation in February 2015, if I have my dates right—was still lower than the second alternative we would have had with the requisite expertise out of the previous process.

Would I do it that way again? Almost certainly not, but I don't think we will be in a situation again where we are trying to run two processes in parallel in the way that we did. What would have happened if we had stopped and gone through a retendering exercise? I think it would have cost us six weeks to two months and delayed the transaction by that time. As we have already talked about, as does the NAO Report, as market conditions were deteriorating in the second half of 2015, that would have cost the taxpayer quite a lot of money. We didn't know that at the time, but that was the judgment we made.

Q95 **Chair:** What you have described is quite interesting. I have let you speak at length because it is fascinating to hear someone with commercial expertise in Government talking about this. Often we have found, and even Mr Roxburgh may agree, that sometimes Government can be a bit clunky because it can take time to go through various channels—you have to go through political approval and so on.

You were obviously able to be fleet of foot in this case. We can make an assessment about whether it was the right decision. Was there any challenge within Government or something that could have slowed down the decision you took when you went back to that scorecard and said, "We still would have gone with Credit Suisse."? Were you challenged within Government about that? Was there any problem?

Ian Hares: Our mandate requires us quite clearly—our framework agreement with UKFI is that whenever we appoint external advisers, we are required to get that signed off by UKFI. Further, my mandate from my board does not allow me to appoint advisers without board input. That is a board with independent experience of non-executive directors. There is a challenge process that comes from my board and UKFI, but it is actually a process that also allows us to move pragmatically and quickly when we need to.

Q96 **Chair:** Mr Leigh-Pemberton, do you want to comment on that from UKFI's point of view? How fleet of foot? These are quite challenging financial transactions that are a bit outwith what you might call the comfort zone of Government. Do you feel that there is that ability to be fleet of foot? Does that put the taxpayer at risk or is there a benefit?

James Leigh-Pemberton: I think there is the ability to be fleet of foot. I will say that perhaps one of the reasons why UKFI is there—dare I say it—is that actually ensuring that this process of sign-off is properly co-ordinated and planned to maintain the momentum in these transactions is extremely important. It happens to have been very clearly illustrated in this case, where, as we moved into round 2, you could feel markets becoming softer—admittedly from what were exceptionally buoyant conditions, but you could feel them becoming softer. The fact that each one of these decisions, including the decision to appoint Credit Suisse—the fact that the approvals associated with each one of the staging posts in this transaction had been pre-planned by the team at UKFI, working closely with Treasury and UKAR colleagues, meant that we could keep that momentum going.

That is a very long way of saying that I do think that between UKAR and UKFI and the Treasury team that we have worked with, there is an understanding of the importance of being fleet of foot and the capability of actually doing it as well.

Q97 **Chair:** That brings me to you, Mr Roxburgh. What lessons has the Treasury learned from this sale that would apply to future sales? We are going to be looking at these over the next Parliament. We have heard quite a good description from the two gentlemen either side of you. Do you concur with that, and what lessons are you going to take forward?

Charles Roxburgh: I do, and as I said to Mr Mills earlier, I think that learning from this what went well and making sure we repeat it is important: to have a competitive process; to make sure that where we use external advice, as I am sure we will, we get good value for money for that advice and we use advisers where they can add real value; and to learn from some of the process improvement suggestions that the NAO has made about pulling it all together into a single, documented business case. That is a helpful addition. But at the same time, we have excellent professionals, in both UKAR and UKFI, who have an understanding of markets, and it is really important that we draw on that professional expertise to time these transactions and execute them rigorously to get the best value for the taxpayer.

Q98 **Chair:** UKFI has a role in future sales, but UKAR—well, UKAR has its own area. Are you convinced that within the Treasury there is enough commercial expertise to make sure that these lessons are learned? I do not want to be rude about career civil servants. I have no problem with career civil servants. Well, we do from time to time, but—

Mr Bacon: Why are you looking at me?

Chair: Mr Bacon has written a book.

Mr Bacon: Mr Roxburgh was extremely helpful to me with a constituent—

Chair: Okay, but my point is that the longer you are in the public sector, the further you are from the commercial realities of what will make these difficult sales work well for the taxpayer, and there is a danger that that disconnection means that something could be sold at a lower value, or with less value for money for the taxpayer. How are you going to guard against that?

Charles Roxburgh: We do have people in the civil service in the Treasury who have private sector experience. I spent 30 years in the private sector before I joined the Treasury, and some of the people who work on the team have also had private sector experience. But that is one of the rationales for forming UKFI. Part of UKGI is to attract to work in the Government people who have that expertise, and I have been struck since joining the civil service by the general quality of staff—career civil servants and those who have worked outside and now work in the civil service. I am confident that the set-up we have, with the core civil servants in the Treasury drawing on UKFI and UKGI colleagues on these sales, gives us a very good basis to execute them well.

Q99 **Chair:** One of the challenges, of course, which we have touched on many times here, is what salaries you can pay people who come from the private sector. The Treasury has a high turnover anyway of people who go to the private sector. Perhaps I could start with Mr Hares. You are in a sense in a commercial sector within the Government, so it is slightly different, but what would make you want to go and work in the civil service compared with working in the commercial sector—and would you stay? That is one of the challenges as well: the turnover means we end up with this endless circle—revolving door—of people coming in and out.

Ian Hares: It is a very difficult—

Chair: If you do not want to go and work in the public sector, that is fine; you can say that too. It is just a constant theme of ours.

Ian Hares: From my sense—why did I come and do this job? It was because it fitted with my expertise and experience. Managing UKAR as we wind it down is unique, but—

Q100 **Chair:** But you are paid as though you were in the commercial sector, aren't you? You are paid at commercial rates.

Ian Hares: That was a proposition that I found attractive and have enjoyed—and I'm still enjoying. I have never really thought about it from a Treasury perspective.

James Leigh-Pemberton: I speak for myself, and I hope for my colleagues who have come from the private sector to work at UKFI. This is a job which is uniquely interesting and engaging if you are interested in financial markets and the financial sector as a whole. Having said that, we are also acutely conscious of the fact that UKFI is an organisation today of 15 people. Every single one of those people has to be of very high quality because the smaller the organisation, the more important it is that the chain should have no weak link in it. So it is extremely important for us to be able to ensure that we can offer an opportunity that would not otherwise exist to the potential candidates to come and join us.

I think we have to accept the proposition that people will move on. In our case, if they have been seconded from HM Treasury, they may return to HM Treasury, or they may return to another role in the private sector if they joined us from the private sector. It is a key corporate objective of UKFI to ensure that, first of all, we know where the target people we would like to come and work in the organisation are and who they are; and, secondly, we should be able to offer them a range of experience which is simply not available to them if they were to stay in their current job. But we do also have to accept that in due course they will go back. UKFI is a company which is designed to make itself redundant.

Q101 **Mr Bacon:** That was going to be my question. It was set up in an enormous hurry—obviously for very good reasons. Without signing your name in blood and knowing that there are still several tens of billions of assets to be disposed of over the coming years, what would be a reasonable guess for when you have a closing-down party—hopefully in a little less of a rush than the way in which you were set up?

James Leigh-Pemberton: Crikey. We are at the mercy of the markets, to answer that question. It is an impossibly difficult question to answer, because, if markets are unkind to us, we could go through very long periods of waiting until we can realise good value for the taxpayer in the way that Ian described.

Q102 **Mr Bacon:** You must have sketched out a central case.

James Leigh-Pemberton: Yes, we do have some kind of central case.

Mr Bacon: You do a map of time and some things go wrong but mostly it goes okay—

James Leigh-Pemberton: My own view—this is an entirely personal view—is that it is sort of five years-plus. It is not two; it is five years-plus.

Mr Bacon: I was expecting at least that, if not more.

Ian Hares: James has got a wider brief, obviously, but I am thinking about the same question from UKAR's perspective, because that is exactly the thought process that we go through. Part of the logic for outsourcing our mortgage service operations to Computershare was exactly that—we are the ultimate turkeys voting for Christmas. To put it in perspective, even after this sale, UKAR has £34 billion of mortgage assets. It is still the seventh biggest mortgage lender in the UK and we have not lent a penny for seven years. Apart from the big six, who are significantly bigger, we are still big. So there is still a big job to do.

Q103 **Mr Bacon:** While you say the big six, there are actually seven systemically important institutions because one of them is a mutual building society, which, unfortunately, is bigger than all the other mutual building societies put together. My next question is: once you have had your closure party and wound it all down, given the failure to introduce a properly competitive regime where instead of having six or seven major banks that do nearly all the personal lending, mortgages and business banking it was divided between 40, 50 or 60 institutions as it might be in a healthy competitive situation, how long do you think it is going to be before you have to do it all over again?

James Leigh-Pemberton: I have no idea.

Q104 **Mr Bacon:** But you accept that you probably will have to.

James Leigh-Pemberton: I do not think you should take it as inevitable. We see it from the other way around. All the regulation and legislation associated with the elimination of "too big to fail" has had a material impact on the financial performance and structure of two of the banks in which UKFI has a sizeable shareholding. I think that means there has been real impact in terms of the regulation and legislation.

Q105 **Mr Bacon:** It is not nothing, but we have not gone from six banks to 60 or six banks to 38, have we?

James Leigh-Pemberton: I think the determinant of whether we have to do it all again is whether the "too big to fail" legislation and regulation is successful.

Charles Roxburgh: I want to come in on two points there. On whether we will need to do it again, the whole point of all the massive re-regulation, the higher capital standards, the tougher regulation from the PRA and the macro-prudential oversight from the Financial Policy Committee is to ensure that the lenders have enough capital. They are stress-tested every year. The stress tests that they go through have been extremely rigorous about testing stress in the mortgage market. All of that is designed to give as good an answer as possible to your question of, "Will we need to do it again?"

On your point about competition, while we fully accept that there have been issues with competition in the retail, current account and small business market—that is what the Competition and Markets Authority has been looking at and has made recommendations on—the mortgage market is quite competitive. It is a highly intermediated market and people can get quite good prices. It has therefore not been such a focus of competition concern as current accounts and small business.

Q106 **Mr Bacon:** Yes. The Chair has said that this is my last question. I did not think I was going to be able to get my favourite subject of self-build into this session, but you have just raised the topic. You will probably be aware that there are regulatory proposals afoot that will cut the maximum exposure that an institution can have to self-build mortgages from around 25% to 5%, even though if you take into account both the size of the average claim and the instance of claims, they are about half as risky as conventional mortgages and therefore we should be having more of them, rather than fewer. Are you across that? The Building Societies Association and the chairman of Nationwide certainly are, because I talked to them about it just the other day.

Charles Roxburgh: In this new regulatory structure, the decisions on the right capital ratios for certain types of lending and the right levels of concentration are matters for our independent regulators, not for the Treasury. The details of those regimes are for the regulators.

Q107 **Mr Bacon:** Unfortunately, their evidence base appears to be not listening to people who know about the subject, but instead watching "Grand Designs". I am not making that up. The fear is that regulators do not have a sufficient grasp of the issues.

Charles Roxburgh: The structure is that it is critical to get the right leadership for the independent regulators. The Chancellor appoints the leaders of the independent regulators, but we have to trust their judgment on these detailed regulatory matters.

Q108 **Mr Bacon:** And if their judgment is looked very flawed? This is a serious matter. Government policy is to introduce more of this.

Chair: We could have—there are a lot of issues around regulation and mortgages, and not just what you are talking about, Mr Bacon.

Mr Bacon: But none of them are as important.

Chair: I am sure Mr Bacon's next book is going to be on self-build—

Mr Bacon: It is, actually.

Q109 **Chair:** There we go. I recommend you buy a copy, and that might cut short these conversations.

Can I move on? We have talked a lot about Government policy in relation to the sale, and we recognise, Mr Roxburgh, that as a civil servant your job is to implement that policy. Government policy is also, thanks to Ms Flint with the support of many members of this Committee—even more so since the Finance Bill was passed—to have more tax transparency. Why, therefore, was it deemed acceptable to sell these loans on to a company—Cerberus—that had tax arrangements involving 10 different companies working in at least three different countries, including the Cayman Islands? Was that a consideration at all?

Charles Roxburgh: Our approach is that we do not discriminate between bidders on the basis of their tax domicile. There are three reasons for that.

First, it would be open to legal challenge. In this case, the bidder was from the Netherlands, another EU member state. Our legal advice is that discriminating on tax domicile would be open to legal challenge.

Secondly, there is a practical point in these complex transactions that are dependent on market timing. To try to work out from the outside what tax rate the bidders would pay—you heard earlier that these arrangements are extremely complex, so to work it out from the outside is difficult and things can change. Someone could be UK-domiciled at the time of the bid and then change. That is a practical point.

Thirdly, it is important to get the competitive tension. Even if we could discriminate on a tax basis, it would reduce the competitive tension if there were fewer bidders. Those are the three reasons why we do not discriminate on the basis of tax domicile.

Q110 **Chair:** What about now, with Brexit looming? "Brexit means Brexit", the Prime Minister says; there are different views on the Committee about that. She says that, so would that have meant that the first consideration about taking account of other EU member states would not be a factor in future?

Charles Roxburgh: Until we actually leave the European Union, we are bound by all that EU law. Once we have left, it will depend on the terms of how we have left. Once we know those terms, then it may be possible to give you a fuller answer to your question, but at this stage I can't speculate, because those terms are still to be negotiated.

Q111 **Chair:** But you would agree, wouldn't you, that on the one hand the Government are saying, "We want to clamp down on people or companies aggressively avoiding tax", and they now have a tool to publish that information in future, presumably when circumstances are right, and yet we have a company domiciled in the Cayman Islands—well, in the Netherlands with Cayman Islands funding—that now owns the mortgages of a large number of the British public, and it's a bit of a tension?

Charles Roxburgh: As I say, our view is that it would neither be practical nor get the best price, and could be open to legal challenge, if we did it a different way.

Q112 **Chair:** But did you look at all at—I mean, you say you can't analyse or assess from outside what the tax revenues will be, but was that ever a factor in any of the discussions that you were having internally about the tax that would be paid? No, Mr Leigh-Pemberton is shaking his head. Are you shaking your head?

Charles Roxburgh: As I say, we don't look at it and in this case we didn't look at it.

Q113 **Chair:** Okay—well, not okay, but there we go. Also, Mr Roxburgh, on the business case point, we often look at this in our hearings. Would you be happy if other Departments came to you with an asset sale without a business case, as the Treasury did?

Charles Roxburgh: Well, there was a strong business rationale for it. The point, I think, in the NAO is that we hadn't pulled that all together into a single document. So, we take that on board as—yes, pulling it into a single document would be helpful. What we would say was that there was a strong business rationale and that was in all the documentation that we did prepare—that the teams prepared—and it was shared with Ministers and signed off by the accounting officer. We just pull it together into a single document—

Q114 **Chair:** I think we acknowledge that. Actually, though, part of the point here is that the Minister has got to defend this to the House of Commons—to Parliament. Without that information pulled together, it's harder to prove perhaps, though in this case the proof was, in the end result, the reasonable deal that was struck.

Mr Mills, did you have any other points that you wanted to raise?

Q115 **Nigel Mills:** There is the consumer protection, and—I suppose the question is this: how much did you balance protecting the mortgage borrowers with not wanting to reduce the value of the transaction in this situation? How did you equate those two competing things?

James Leigh-Pemberton: It's very difficult to be able to find an analytical framework which will provide you with evidence that you've struck that balance correctly, because actually the counterfactual doesn't exist. In other words, we did not go through an exercise which said to the bidders, "In the case of this sale, had the arrangements which we put in place not been put in place, what difference to the price would there have been?" We have not done that analysis, I'm afraid, so it's very, very hard to know a precise answer to your question.

I think the only way that, from a UKFI point of view, we have answered the question is to say we made a judgment based on the following: one, there is no precedent, to the best of our knowledge, for the protections against increases in excess of base rate increases that we put in place to protect against upside increases. There is no precedent for it. So it was different and it was exceptional. But two, during all the process where we worked with these three bidders in the second round, we never encountered a moment where we were told by any of them, "If you were to remove that constraint, we'd be able to bid a lot more aggressively."

So that's the only evidence that I've got to shed light on the question of how that balance existed.

Q116 **Chair:** There was a cap on how much interest could go up, but you did not include in the criteria a requirement that interest rates would drop if the base rate dropped. In retrospect, was that a mistake, because it didn't give consumers the protection they could have had?

James Leigh-Pemberton: I think, in retrospect, two things. I will speak from UKFI's point of view, and then Ian will probably want to say something from UKAR's point of view. First, at the time when we were completing this transaction, all of the commentary was about when base rates would go up. We did not contemplate, I am afraid to say, that we would need to protect against the possibility of a base rate drop.

Q117 **Chair:** I find that a bit extraordinary. I re-mortgaged because I thought interest rates were going to go up; I have since learned that it does not always happen, and they go down. If I, as an ordinary idiot consumer—I describe myself that way—could work that one out, I am surprised that all the brains we just talked about, with that great commercial expertise, could not contemplate that it might go the other way. As we have seen in the past, the markets don't always go the way you envisage.

James Leigh-Pemberton: That is absolutely right, although, with base rates at 50 basis points, if you think about it in a historical context, first, and secondly, with all the economic data that were prevalent—they were one of the reasons the markets were as they were in the period from January through to September 2015; stock markets were strong, and there were lots of encouraging economic data—it was not a likelihood that we thought we would have to address.

Q118 **Mr Bacon:** So you would agree that the Governor was over-egging it, then, would you?

James Leigh-Pemberton: I have no view on that topic. Monetary policy, thank goodness, is not a responsibility of UKFI.

Q119 **Chair:** Mr Hares, did UKAR not think about protection of the consumer?

Ian Hares: From our perspective, there are two aspects to this. One is the balance we talked about earlier, to add to what James said. The second is that we were clear that at the point we sell the portfolio, we don't expect there to be an immediate change in interest rates. The things consumers worry about most are rates going up or down, hence restriction No. 1 that we put in is that you can't move the rate for 12 months unless there is a base rate increase. No. 2 is that if there is a base rate increase, you can't go more than that base rate increase in that first 12 months, regardless of your cost of funds and those very valid arguments that we heard earlier. The last point around rates going down is exactly the one that James made.

Q120 **Chair:** It would have made it potentially less attractive to business had you put that in as a requirement. Was that at all a consideration?

Ian Hares: No, that was not a consideration at all. Actually, my sense is—this is jumping backwards with 20/20 hindsight—that had we put that in, we would probably have got it for free, because—

Chair: Sorry?

Ian Hares: Had we put that restriction in, it would not necessarily have impacted the value badly, because they wouldn't have believed it either.

James Leigh-Pemberton: I think that's absolutely right, although—

Chair: Unbelievable. That makes me reassured about my approach to things like my tax return. Clearly I'm as good at maths as the rest of you.

James Leigh-Pemberton: But I will add that I do believe that in the long run, we might have paid a price for it, because had we imposed that requirement and then this differential between the fall in base rate and the fall in LIBOR had materialised, it would have had a negative impact on the returns achieved via the buyer, and that would be remembered for the future by prospective buyers. That is all with the benefit of hindsight, but I think that in the end, it could have had an impact on the overall value achieved in the sale of UKAR's portfolio as a whole.

Q121 **Chair:** The concern is, of course, that customers who cannot re-mortgage easily, or at all, are the ones who get caught in this trap without any say. Mr Roxburgh, policy ultimately rests with Government, and you are a representative of Government today. In terms of Treasury sales in future, will you be looking at that consumer interest, or will you be concerned with what Mr Leigh-Pemberton said about the future impact on sales? Which is first—the consumer, the sale and the wider value to the taxpayer?

Charles Roxburgh: Certainly we will take the lessons from this into account for future sales—absolutely. On this sale, it is clear that we did want to make sure the purchasers were properly regulated, so that the people making the decisions remain regulated. We will take that into account. Whatever terms we put on future sales, we will consider at the time. I cannot preclude whether we will put caps, collars or whatever on those, but we will certainly take into account the lessons from this sale.

Chair: Can I thank you very much indeed for your time? As you may have picked up earlier, the transcript will be available in the next couple of days on the website. It goes up uncorrected, so get in quick if we have got any factual points wrong; otherwise, it remains as it is. Our report will not be out until October-November, at this rate, because our recess is coming. Can I thank you for your time and congratulate you on getting the sale through? Obviously you have picked up on our concerns, particularly for the future, and we will be coming back to this. I am sure we will see you again, Mr Roxburgh, and probably Mr Leigh-Pemberton, as we look at future sales, on mortgages and other things.