National Audit Office

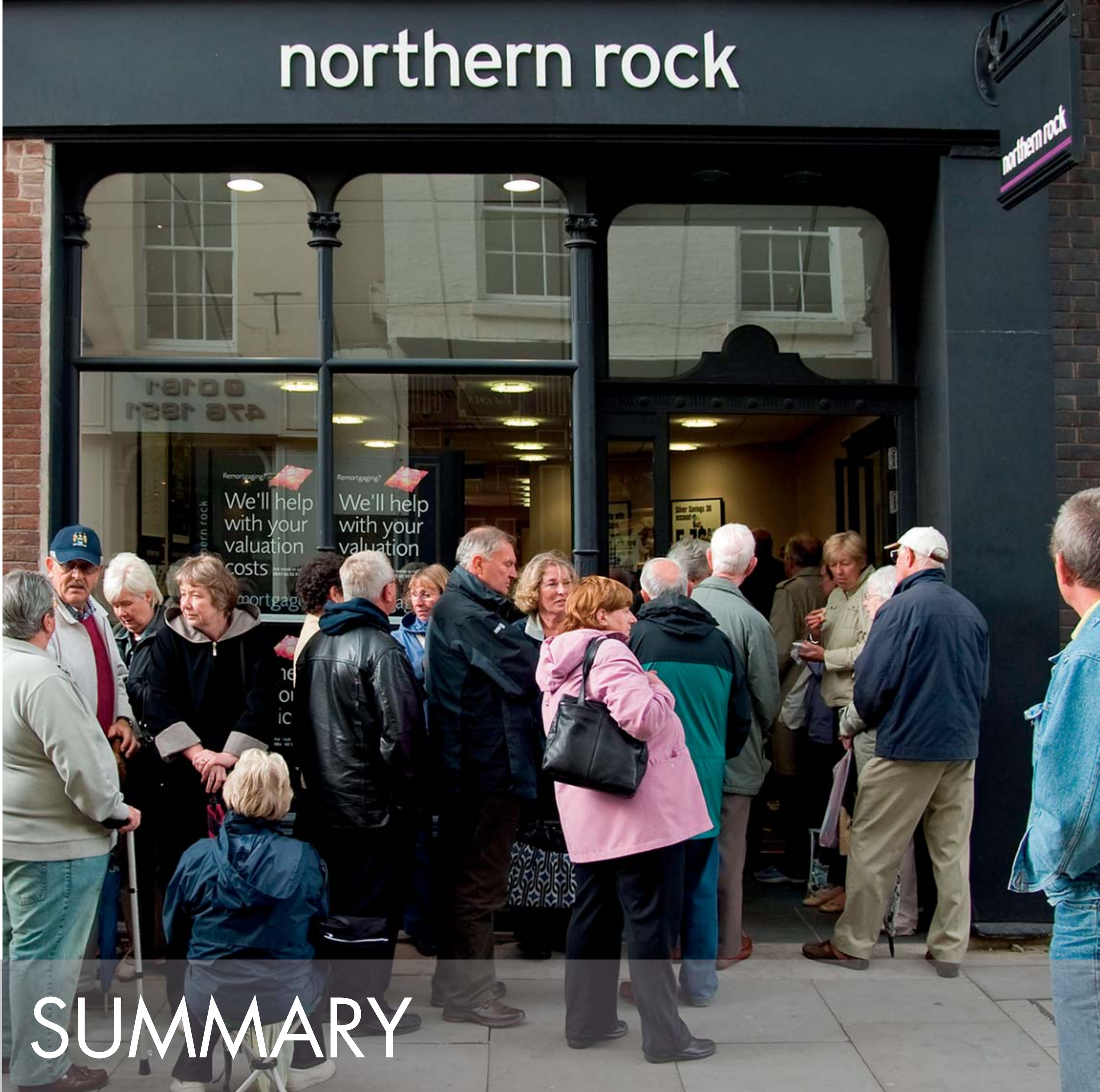
HM TREASURY

The nationalisation of Northern Rock

LONDON: The Stationery Office
£14.35

Ordered by the
House of Commons
to be printed on 18 March 2009

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 298 Session 2008-2009 | 20 March 2009



SUMMARY

1 Over the ten years to 2007, Northern Rock (the company) had become a stock market listed bank and grown rapidly to become the fifth largest provider of mortgages in the UK, with assets in excess of £100 billion. The company's growth was based on making competitively priced mortgages easily available. To maintain its competitiveness, Northern Rock required access to relatively low cost sources of funds, beyond what could be raised through retail deposits alone.

2 To raise the funds it needed, Northern Rock became reliant on wholesale lenders such as other banks and on selling, rather than retaining, the mortgages it had already issued. In August 2007, credit concerns stemming from bad debts in the US mortgage market caused banks to curb their lending to each other. As a result, Northern Rock began to experience problems in raising short term funds and rolling over existing loans from wholesale lenders. As the market worsened, the company became increasingly concerned that it would not be able to repay its wholesale borrowings as they became due, and asked the Bank of England (the Bank) for financial support in its role of lender of last resort.

3 The failure of a major bank would leave individuals and businesses unable to access savings or meet ongoing payment obligations. A single bank failure has the potential to destabilise other parts of the financial system and the economy generally, through its wider impact on consumer confidence. As banks are pivotal to the financial stability of the UK economy, successive governments have sought to regulate their activities.

4 The Financial Services and Markets Act 2000 created a single regulator for UK financial services, the Financial Services Authority (FSA). Alongside this, the Government also introduced a framework for the protection of financial stability, which set out the roles of the Treasury, the FSA, and the Bank of England (the Tripartite Authorities). In exceptional circumstances such as a major bank in severe financial difficulty, responsibility for the authorisation of a support operation and the use of public funds rests with the Treasury.

5 On 14 September 2007, Northern Rock announced that the Treasury had authorised the Bank to provide emergency support to Northern Rock, in the form of a loan secured against the company's highest quality assets. When Northern Rock's customers became aware of the existence of the support, queues formed outside the company's branches and, over a few days, just over £4.6 billion was withdrawn from depositors' accounts. The Treasury considered that the run on deposits could have an adverse effect on other banks. In response, the Treasury announced on 17 September 2007 that it would put in place arrangements to guarantee retail deposits. These arrangements were subsequently extended to certain wholesale funding and to further emergency support provided by the Bank. The guarantee arrangements covered up to £51 billion of the company's liabilities and allowed Northern Rock time to seek a longer term solution to its difficulties. The search culminated in the company being taken into public ownership in February 2008 **(Figure 1)**. A more detailed chronology of events is at Appendix 1.

1 Summary of key phases in the search for a solution

September – December 2007 | **January – March 2008** | **April 2008**

Stabilisation: In September 2007, the Treasury put in place arrangements to guarantee retail customer deposits and many of the company's wholesale deposits and borrowings. In October, the Bank, indeminfied by the Treasury, made additional support available to Northern Rock and over the course of the following two months the Treasury increased the coverage and scale of its guarantee arrangements.

Search for a long term solution: Following the failure of attempts by Northern Rock to find a buyer, a number of further private sector proposals for the whole or parts of the company were considered, but no private bidder was able to raise the necessary finance to proceed on either basis. In January 2008, the Treasury announced that it would guarantee an issue of bonds by the company to allow a private sector buyer to raise funds and repay the emergency support. Two private sector proposals were received but would have required the Treasury to risk large sums of publc money over an extended period and offered little benefit to the taxpayer in return. In February 2008, the Treasury concluded that the company should be brought into public ownership.

In **public ownership** during 2008 Northern Rock made progress against a three-year plan to repay the emergency support and release the Treasury guarantee arrangements by 2011-12. This was to be achieved primarily by encouraging the early redemption of mortgages, with the aim of a return to private ownership thereafter. In early 2009, to provide support to the wider economy, the Government announced that Northern Rock would increase its mortgage lending activity.

6 The actions taken by the Treasury, working with the other members of the Tripartite, were aimed at:

- **reducing the risk of a serious loss of confidence in the UK banking system, which would have caused wider economic disruption**. The Treasury needed to ensure that Northern Rock's depositors remained confident that their savings would be safe, and that customers of other banks were not prompted to withdraw their savings;
- **minimising the financial risk to the taxpayer** that substantial, taxpayer-backed support to a bank in difficulty would be called or not be repaid.

Scope of this report

7 This report examines:

- actions taken by the Treasury to stabilise Northern Rock and avoid any wider impacts on the financial system (Part 1);
- the search for a longer term solution to Northern Rock's difficulties that protected the interests of the taxpayer (Part 2);
- the oversight of Northern Rock in public ownership (Part 3);
- the capacity of the Treasury to handle a company restructuring which was unusual and highly complex (Part 4).

8 Our methodology is summarised at Appendix 2. This report does not consider:

- the causes of Northern Rock's problems and the implications for the regulatory regime operated by the Financial Services Authority, both of which are outside our statutory audit responsibilities and have been examined in detail by the House of Commons Treasury Committee (see Appendix 3); or
- the consequences for the Bank of England's oversight of stability in the financial system, which is also outside our statutory audit and, along with changes to the framework for handling banks in difficulty, are the subject of the Banking Act 2009.

Key findings

On the actions taken to stabilise the company

9 **The Treasury had no choice but to put in place guarantee arrangements for retail depositors, once the run on deposits was underway. This support avoided the immediate risk of instability spreading to other banks**. Following media reporting and the company's announcement of the emergency loan from the Bank, retail depositors withdrew around one fifth of their deposits over three days, the share price fell by more than half, and the cost of insuring against default by the company increased. The run on deposits was widely reported, including images of queues of retail customers outside branches. The Treasury decided that there was an increased risk of contagion in the financial markets and that further measures were necessary to maintain stability. The guarantee arrangements put in place removed the queues outside branches, reduced media coverage and avoided immediate potential problems at other banks.

10 **Although the initial guarantee arrangements prevented wider financial instability, they did not completely stem the outflow of funds from Northern Rock**. From 18 September 2007 to the end of that month, a further £4.4 billion of retail deposits was withdrawn. These outflows necessitated additional borrowing from the Bank and required further guarantee arrangements for deposits and certain wholesale borrowing to be made over subsequent months, all backed by the taxpayer. With each decision to extend public support, the Treasury's intention was to put taxpayers' money at risk only to the extent necessary to stabilise the situation. While the situation did eventually stabilise, the company's finances remained vulnerable.

11 Under the terms of the loans provided by the Bank, Northern Rock was required to put in place a plan to stabilise its business by conserving cash, primarily by reducing the number of mortgages written. The company also required the Bank's approval before entering into any corporate restructuring, making substantial changes to the general nature of its business and paying dividends. The Bank put in place arrangements to monitor compliance with the stabilisation plan and had wide ranging rights to information on Northern Rock's business. **Given the extent of the financial assistance provided from October 2007, the Treasury could have sought to introduce further conditions to limit the company's activities, for example on the risk profile of lending undertaken**.

12 Northern Rock continued to write Together mortgages of up to 125 per cent of a property's value throughout the period that it was receiving emergency support, albeit at a reduced volume. Between September 2007 and February 2008, over £1.8 billion of Together loans were written, around 30 per cent of total mortgage lending, compared with just under £5 billion (26 per cent of total mortgage lending) in the preceding eight months of 2007. Around £1 billion of these new mortgages reflected commitments made by the company to potential borrowers prior to September 2007. As part of the company's stabilisation plan, the terms for Together loans were tightened by the company in October and November 2007. At 31 December 2008, Together mortgages represented around 30 per cent of the mortgage book but about 50 per cent of overall arrears and 75 per cent of repossessions. The Treasury judged that mortgage transactions were necessary to maintain the business while a longer term solution was sought.

13 Indefinite and unlimited public support for Northern Rock was not an option that was available or desirable. Under the European Union rules on state aid, the emergency support provided to Northern Rock had to be notified to the European Commission. The Commission considered that the guarantee arrangements provided by the Treasury were permissible but could not remain in place for more than six months, unless the Treasury submitted a restructuring or liquidation plan by March 2008. In any event, it would not have been in the taxpayers' interest to continue to fund and bear the commercial risks of a private company over which the Treasury had limited control. The Treasury therefore had to find a longer term solution by March 2008.

On the search for a longer term solution

14 The Treasury set itself objectives at an early stage: to protect the taxpayers' interest; keep the company stable to protect depositors; and maintain wider financial stability. The Treasury had to operate under a number of constraints: it needed to be aware of how its actions might be interpreted by volatile financial markets; not put itself in the position of controlling the actions of the company as a shadow director; remain aware of shareholders' rights; and find a solution that would be consistent with European Union state aid rules.

15 In late September 2007, the Treasury identified through a systematic assessment of the available options essentially three choices:

- allowing Northern Rock to fall into administration;
- stopping it taking deposits and writing new mortgages and beginning a process of winding down the company; or
- allowing it to continue to take deposits and write new mortgages while putting in place a longer term recovery plan which would keep the company in business.

A wind-down or a continuation of business could be taken forward with Northern Rock remaining in the private sector, probably under new ownership, or by taking the business into public ownership.

16 Allowing Northern Rock to fall into administration would have prevented depositors from accessing their money and entailed potential taxpayer losses of between £2 billion and £10 billion. There were no special procedures under UK law that would allow depositors in a bank to be treated any differently from the creditors of another private sector business in difficulty. Allowing Northern Rock to enter an insolvency procedure would therefore have resulted in depositors not having access to their savings for a period of months, thereby risking a loss of confidence at other banks and hardship for individuals. The Treasury was also concerned that a rapid sale of the company's assets at reduced prices might mean that part of the emergency support was not repaid. The Treasury and its advisers estimated a potential loss of between £2 billion and £10 billion, the wide range reflecting the uncertainties in estimating the prices that might be obtained for the company's assets.

17 The option of winding down the business was considered, but inadequate IT systems at Northern Rock meant that depositors would have had to wait for their money, risking another major run and potential hardship for those reliant on access to their funds. A wind-down of the business would have involved a sale of the branches, deposits and some of the mortgages to another bank, followed by longer term disposals of the remaining assets to repay creditors. If the sale of the deposits and branches proved impossible, the alternative would have been to implement a scheme for rapid repayment of retail and wholesale deposit accounts. Northern Rock was not, however, able to return depositors' cash quickly. The company operated a manual account closure process and estimated that it would have taken up to 10 to 12 weeks to repay depositors with a likely error rate of 25 per cent. The scope for securing better prices through a more controlled and longer term series of asset sales would have depended on financial market conditions not deteriorating further. The Treasury therefore ruled out an immediate wind-down on practical grounds, although work was put in hand to update the IT systems to enable quicker repayment of depositors if needed at a later stage.

18 In September 2007, the Treasury took a timely decision to commission a team of officials to work on proposals for public ownership, as a contingency measure. While the Treasury considered that public ownership would provide the control over the company necessary to protect the interests of the taxpayer, it did not see it as an immediate response as other options were preferable and should be considered. Public ownership might introduce uncertainty for investors in the UK banking system, as well as risking reputational damage to the UK's standing as a leading international provider of other financial services. There was, at that time, no legislation on the statute book or available in draft form that would allow the Government to take the company into public ownership should it be required at a future date.

19 The Treasury's preferred option was to support the company's search for a private sector solution. Before and after approaching the Bank for emergency support, Northern Rock had searched for a private sector buyer, initially of the entire business and later for parts of it as well. The Treasury considered that the search for a solution was a matter for the Board of Northern Rock which remained in place and was accountable to shareholders. As this initial search failed to find a suitable purchaser, the Treasury asked Goldman Sachs to liaise with the company as it took the process forward. Following legal advice received in September 2007, the Treasury considered that it should avoid taking any actions that were properly a matter for the directors of Northern Rock. The Treasury judged that it could not directly intervene in the process run by the company to find a potential buyer. Bidders reported that the sale process to December 2007 had been frustrating and confused, partly as a result of challenges arising as a consequence of the company employing three sets of financial advisers.

20 During this period depositors continued to withdraw money, despite the guarantee arrangements, with the pace quickening again in November when a total of £1 billion was withdrawn during a week. Amid media reports that the bidding process was in difficulty, Northern Rock, with agreement from the Treasury, announced on 26 November 2007 that discussions would be taken forward with one of the bidders, the Virgin Consortium. The announcement reduced deposit outflows. **But competitive tension in the bidding process was interrupted on the basis of a non-binding bid, which in the event could not be taken forward because of difficulties in obtaining financing**.

21 As financial market conditions worsened the prospect of a sale to a sufficiently well capitalised buyer, who could repay the publicly financed element in due course, became increasingly remote. The Treasury announced in November 2007 that it would consider financing bids on a matched basis with the private sector. Potential buyers, however, were not in a position to arrange private funding for a bid and further public support would be needed if the process was to be taken forward. The Treasury therefore began to take a more active role in finding a solution and announced in January 2008 proposals to replace the emergency support from the Bank with a guarantee covering a bond issue worth up to £27 billion, secured over the company's assets. A new invitation to bid was therefore issued in January. Only two detailed bids were received, from Virgin and from Northern Rock's management team. Across a wide range of criteria, the Treasury considered that these proposals did not meet the test of protecting the taxpayers' interest, and would carry considerable uncertainties over their deliverability as the financing plan was put in place and State Aid clearance sought.

22 The Treasury estimated in February 2008 that if Northern Rock was taken into public ownership for three years it was likely to require a net subsidy of £1.3 billion. On a base case scenario, the subsidy to Northern Rock in public ownership was below the estimate of £1.9 billion to £2.2 billion if one of the two final private sector bids had been chosen.

23 The estimate of public support to Northern Rock was, however, highly dependent on the forecast price of £1.2 billion the Treasury might obtain if the company was restructured and returned to the private sector when market conditions had stabilised. Such an estimate would always be uncertain given its dependence on the economic climate, changes in the housing market and on potential buyers' perceived confidence in the Northern Rock brand. As there were material uncertainties around the deliverability of the private sector bids, the Treasury considered that in all the circumstances the best option to protect the taxpayer interest was a period of public ownership.

24 Northern Rock was therefore placed into public ownership on 22 February 2008 using powers provided by the newly enacted Banking (Special Provisions) Act 2008.

On the oversight of Northern Rock in public ownership

25 Following public ownership the Treasury has maintained oversight of Northern Rock's progress against a new business plan. On entering public ownership, the Treasury appointed two directors to the company's board and soon afterwards a Shareholder Relationship Framework was agreed. The Treasury receives regular updates on the company's performance and holds regular meetings with the management team to review progress.

26 By 31 December 2008, the company had repaid some £3 billion more than planned for that year. One of the key objectives for the company was to encourage existing mortgage customers to move to other lenders, with the resultant repayments used to repay the loans from the Bank. The business plan envisaged full repayment of the loans from the Bank by 2010. As part of the government's financial intervention to support lending in the economy, Northern Rock announced in January 2009 that it would reduce the rate of mortgage redemptions and that repayments of the Bank's loans (which were transferred to the Treasury in 2008) would continue at a slower rate.

27 The Treasury did not challenge with sufficient rigour the company's forecasts of future trading conditions, before approving its initial business plan under public ownership. The timetable for approving an initial business plan for the company was driven by the need to submit an approved plan to the European Commission by the end of March 2008, less than six weeks after it was taken into public ownership. When scrutinising the plan, the Treasury's focus was on the period over which the emergency support would be repaid and the factors that might directly impinge on that objective. It paid less attention to the robustness of the broader business plan. The plan, which had been under development during the last few months of 2007 and early 2008, for example, assumed a five per cent fall in house prices between 2008 and 2011. These assumptions were not updated as the housing market began to turn downwards in early 2008.

28 In the lead up to public ownership, the Treasury did not commission its own due diligence on the company's operations, for example, on the quality of the loan book. The Treasury judged that it could rely on the work of the Bank, supported by its accounting advisers, and the Financial Services Authority as respectively lender to and regulator of the company. The company had capitalised arrears on its mortgage book at a much earlier stage than other lenders which, when changed in May 2008, increased the reported rate of arrears significantly and brought it into line with that reported by other lenders.

29 The company's reported loss at 30 June 2008 of £585 million was £314 million greater than the base case and worse than the recession case used in the plan approved three months earlier. In response to continued volatility and increasing weakness in the financial markets, some banks began to take steps to strengthen their regulatory capital positions. The Treasury announced in August 2008 that, subject to approval by the European Commission for State Aid purposes, some of the outstanding emergency loans to Northern Rock would be converted into an equity investment to bolster Northern Rock's regulatory capital and that the company had estimated that up to £3 billion of debt might need to be converted for this purpose. In March 2009, the company announced a loss of £1.4 billion for the year to 31 December 2008.

On the capacity of the Treasury

30 The Treasury worked with the Bank of England and Financial Services Authority to find a solution and benefited from their advice, but it alone had responsibility for determining what action was in the best interests of taxpayers. UK-based banks have collapsed before, for example BCCI in 1991 and Barings in 1995, but these crises did not involve a run on a significant high street financial institution. The crisis at Northern Rock therefore presented a new situation for the Treasury.

31 The Treasury had been aware of potential shortcomings in the arrangements for dealing with a financial institution in difficulty prior to the crisis at Northern Rock. From 2004 the Tripartite Authorities had undertaken exercises to test their response to a range of scenarios. These exercises had identified the need for further work on how the resolution of an insolvent firm with systemic repercussions would be handled and by whom. As a result, scoping work was done to identify the key issues the UK would face in winding up a financial institution, the practical processes available and therefore the gaps and options to fill them. Prior to 2007, work on improving the existing arrangements was not, however, judged by the Treasury to be a priority in a benign economic environment, compared with other financial crisis response planning. The Treasury started a project in early 2007 to produce a consultation document by Autumn 2007 on how the Tripartite Authorities would deal with a bank in difficulty. Following consultation, new legislation was put before Parliament in December 2008 and received royal assent in February 2009.

32 **Once the scale of the crisis was recognised, the appointment of the second Permanent Secretary to lead the Treasury team was crucial to providing clear leadership at official level**. The early appointment of a senior responsible owner for the project provided a clear focus for other members of the Tripartite, private sector bidders and others seeking an informed view of the Treasury's likely position.

33 **Following the initial guarantee arrangements for depositors, the Treasury brought together a team drawn from across the Department but struggled to maintain continuity in its staffing**. The maintenance of financial stability had not, in terms of staff resources, been a major part of the Treasury's work. In dealing with Northern Rock, the Treasury had to respond very quickly to events as they developed. As a result, decision making had to take place largely outside of normal risk management procedures for major departmental projects and made limited reference to the Treasury board, although the board did receive briefing on two occasions over the five months prior to public ownership. The availability of people with relevant skills and experience was severely stretched and resulted in two changes of team leader along with changes to the composition of the team. The Treasury was therefore very reliant on key officials and its advisers for the expertise it needed. In the event, some stakeholders found it difficult to work with the rapid turnover of staff within the Treasury team.

34 The Treasury made extensive use of professional advice for support during the bidding process and preparing the financial analyses of the various options. Professional fees for the Tripartite Authorities have amounted to just under £27 million, including over £9 million on legal advice. Separately from this advice, Northern Rock spent £39 million on advisers to review its strategic options and search for a private sector solution. In addition, the company paid bidders' costs totalling £13 million. With the company in public ownership since February 2008, all the advisory and bidding costs have ultimately been borne by the taxpayer.

35 **The Treasury worked closely with its advisers to understand the assumptions underlying the options available but there were weaknesses in the initial contract negotiated by the Treasury with its financial adviser, Goldman Sachs**. These weaknesses included, for example:

- An initial agreement by the Treasury that a large part of the firm's remuneration would consist of a success fee, but no clear definition of what success might look like in a complex and evolving situation. Once the decision was reached to take Northern Rock into public ownership, agreement was reached that it would be inappropriate for a success fee to form part of the final sum to be paid.
- Although the Treasury discussed the options analyses prepared by Goldman Sachs and tested the assumptions used, it did not request access to the underlying financial models developed by its advisers, which were regarded as proprietary information. This limited its ability to validate estimates of the costs and benefits of each option.

36 **There were also weaknesses in the management of electronic records**. Following the decision to take Northern Rock into public ownership, the Treasury had to expend significant time and resources to collate relevant records in an accessible form for litigation and audit purposes.

37 **The Treasury applied lessons from its experience of Northern Rock to the handling of Bradford & Bingley**. In September 2008, Bradford & Bingley experienced difficulties that necessitated Treasury action. Although there were differences to the Northern Rock case, the Tripartite Authorities were better prepared, having kept a watch on the company before market conditions made action necessary. The scale of the problems in the financial markets and the prospect of prolonged difficulties were by this point apparent. At a practical level, the availability of suitable powers on the statute book proved crucial to the Treasury's ability to take action quickly. The Banking (Special Provisions) Act 2008 allowed the Treasury to take into public ownership or transfer to another owner a bank or building society judged to be a threat to financial stability. The Tripartite Authorities' experience in considering the options for Northern Rock allowed the Treasury to take a course of action to protect financial stability, without having to put large sums of taxpayers' money at stake in a company it did not own and therefore did not directly control, although it now has to manage the risks associated with public ownership.

Conclusion on value for money

38 The crisis at Northern Rock presented the Treasury, and other members of the Tripartite, with a situation that had not been experienced in recent times in the UK. The failure of Northern Rock could have had adverse consequences for the economy through its wider impact on consumer confidence. Once the initial run had started, the announcement of the initial guarantee arrangements slowed the outflow of retail deposits. It took several extensions to the scope of taxpayer support to stabilise the company. The public support protected customers and prevented the liquidity problems experienced by Northern Rock at the time causing wider disruption to financial stability.

39 The Treasury undertook a comprehensive review of a range of options for the longer term resolution of Northern Rock's difficulties. The search for a solution to Northern Rock's problems took place against a backdrop of deteriorating conditions in the financial markets. Public ownership was eventually chosen because it offered the best prospect of protecting the taxpayer from the risk that over £50 billion of public support that had already been provided to Northern Rock would be called upon or not be repaid. The analysis of options that resulted in Northern Rock being brought into public ownership was sufficiently robust. Nevertheless, the action needed to resolve Northern Rock's difficulties stretched the capacity of the Treasury to handle the complex issues involved.

40 Following public ownership, the Treasury put in place adequate systems to monitor the progress of Northern Rock in repaying the public support provided. But the Treasury did not carry out sufficient testing of the company's initial business plan. In light of an increasingly difficult economic context, additional public support has had to be provided to the company. Under the original business plan, the Treasury had expected the emergency loans to be repaid by 2010 and then to be in a position to return the company to the private sector when market conditions stabilised. Any sale and the eventual cost to the taxpayer are dependent on the company's performance in managing its existing mortgage portfolio, its future lending activities, as well as the performance of the UK housing market.

Recommendations

a **Once the initial guarantee arrangements were announced the taxpayer was exposed to risk. As a condition of receiving public support, the volume of mortgage business written by the company was reduced significantly. Throughout the period of that support, however, Northern Rock continued to write together loans of up to 125 per cent of a property's value.** Where it decides to provide support to a company in difficulty, the Treasury should assess systematically the risks to the taxpayer, as distinct from the risks relevant to the responsibilities of the other Tripartite Authorities acting as lender or regulator. It should also identify what information will be needed to monitor those risks and decide how they should be mitigated.

b **Scenario tests conducted by the Tripartite Authorities prior to the collapse of Northern Rock had identified potential weaknesses in the arrangements for dealing with a bank in difficulty**. When reviewing the lessons to be learned from future scenario tests, the Tripartite Authorities, having identified the lessons learned and agreed an action plan with target dates, should take forward the necessary work with vigour. The Tripartite Authorities should review progress against these targets at suitable intervals.

c **The need to revise Northern Rock's business plan so soon in the light of tougher economic conditions illustrates the importance of developing sufficiently robust business plans from the start**. The Treasury should vigorously challenge the assumptions underlying any future business plans presented by Northern Rock. Any financial forecasts should be tested under a sufficiently wide range of economic assumptions, both positive and negative.

d **At the time it took Northern Rock into public ownership, the Treasury had not conducted due diligence on the company, for example on the quality of the entire loan book**. Although the Treasury worked with the Bank of England and Financial Services Authority to find a solution and benefited from their advice, it alone had responsibility for determining what action was in the best interests of taxpayers. The Treasury should use future scenario testing exercises to trial the actions that would be needed in the time available to it to properly assess and validate the information it receives on the quality of the underlying business of a financial institution in difficulty. This assessment can then inform the Treasury's scrutiny of any proposed business plan should an individual institution require public support.

e **In deciding to take Northern Rock into public ownership, the Treasury considered the outcome of its financial analysis to be uncertain and gave due weight to the deliverability of private sector bids.** In any comparable situations in the future, the Treasury should follow the practice adopted here of looking beyond financial estimates to consider the deliverability of the options open to it and the likelihood of protecting the taxpayers' interest.

f **Once the scale of the crisis became clear, the Treasury benefited from assigning responsibility to a senior official for managing its response.** In future crisis situations, the appointed officials, as in this case, should have sufficient seniority to marshal the necessary resources, make clear the Treasury's position to third parties and act as a focus for overseeing the response at official level. The arrangements put in place should also spell out the role of the Treasury board in helping to manage the risks. The Treasury should also examine the training and development it provides its officials to handle such situations, for example drawing on the experiences in other parts of the public sector, for instance in civil and military contingency planning, where preparation for handling a crisis is a key part of staff development.

g **The Treasury required extensive professional advice and was necessarily dependent on its advisers for support in evaluating the available options.** Although the Treasury challenged the underlying assumptions used by external advisers, it should be in a position to validate the analyses prepared for it, particularly in fast moving situations where crucial decisions have to be taken quickly. To this end, it should draw where appropriate on expertise from within the Treasury or from expertise available elsewhere in the public sector, such as in Partnerships UK.

h **The contract with Goldman Sachs included a discretionary "success" fee, which the Treasury and Goldman Sachs ultimately agreed was not appropriate in the circumstances.** Where consultants are appointed at short notice to help with a crisis situation, a robust contract should be put in place at the earliest opportunity. Where a "success" fee is provided for, Departments should agree the criteria by which success is to be determined. If the objectives cannot be adequately specified at that stage, the Department should as in this case stipulate that the payment of such a fee will be at its discretion.

i **There were weaknesses in the Treasury's management of electronic records.** The Treasury should put in place adequate arrangements for filing, storing and accessing the electronic and paper records generated. The Treasury should consider whether its working processes and IT infrastructure is capable of supporting the demands of such a project and take action to address any shortcomings.