National Audit Office

HM Treasury

The creation and sale of Northern Rock plc

Appendix Three

MAY 2012

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Benchmarking the sale of Northern Rock plc against NAO good practice criteria for asset sales

The NAO has produced over 40 reports on asset sales since the start of the 1980s privatisations. Many of the lessons from our previous work remain relevant today. We therefore benchmarked the sale of Northern Rock plc against the criteria set out below.

Establishing the objectives	
Has the Department clearly set out the policy aims it wishes the sale to enhance?	Four objectives were set: • maintaining financial stability; • promoting competition; • value for money; and • not leaving government a permanent shareholder.
Has the Department clearly set out its aims for the business and the sale's impact on the market?	The bids were considered in the context of financial stability and competition, but financial value was the overriding criterion for the sale.
Has the Department set out a prioritised list of all its objectives?	State aid requirements meant maximising financial value was the only criterion that could be considered. An analysis was conducted on the effect of a sale on financial stability and competition. In practice, the market share of Northern Rock plc was so small that none of the bids were regarded as having a significant effect on the market or financial stability.
Options appraisal	
Has the Department undertaken a robust options appraisal that proves that the chosen sale method represents best value for money?	On behalf of UKFI, Deutsche Bank evaluated a range of options for Northern Rock plc and concluded that sale was the best way to realise value.
Has the Department revisited the options appraisal throughout the sales process to update it with relevant information and ensure that the sale represents value for money?	Options were updated several times during the process, including immediately before accepting the final offer from Virgin Money.

Establishing the team and proper governance

Has the Department maintained sensible and effective governance arrangements and assigned responsibility for the sale to a suitably qualified senior responsible owner?	The sale was run by UKFI who were set a mandate to maximise value, with Treasury retaining approval and responsibility for the wider objectives of the sale.
Has the Department acted throughout the sale as an intelligent client, managing its agents and advisers, understanding the advice it is given, and taking responsibility for the achievement of the overall objectives?	UKFI managed its advisers well. Significant decisions were approved first by the UKFI board and then by Treasury. Advisers were appointed jointly with Northern Rock plc, with UKFI maintaining overall control of the process. Weekly meetings were held to discuss issues emerging from the bidders and significant decisions were approved by the UKFI board.
Has the Department ensured that it has an appropriately qualified team (including centrally, within its arm length bodies and its advisers)? Did the Department engage with centres of sales expertise including the Treasury and Shareholder Executive?	Treasury delegated the day to day management of the sale to UKFI, while retaining overall responsibility.
Were appropriate advisers used?	Appropriate advisers were appointed. The main advisers were: • Deutsche Bank for corporate finance advice and to run the process; • Freshfields for legal advice (joint appointment with Northern Rock); • Deloitte for accounting and tax advice; • KPMG to review the Virgin Money business plan. Total cost of advisers was £3.2 million.
Is there evidence that the initial budget was prepared at a sufficiently early stage and costed with sufficient detail? Was spend on consultancy monitored throughout the project and the budget revised accordingly?	Initial estimate for financial advice was £5 million to £8 million. Final fees were negotiated down to £1.8 million.
Did the Department manage its advisers effectively during the sales process?	The main advisers on the sale told us that UKFI set clear objectives. Bidders also commented that the team was well managed.
Was the engagement of advisers on a competitive basis?	Competitive tender used for the main advisers which resulted in fees below market level.
Were criteria for any success fees established during competitive tendering and designed solely to align incentives?	Success fee for Deutsche Bank was based on UKFI's evaluation of performance.

Managing longer term outcomes

Was a structured approach taken to assessing, monitoring, and managing the impact of the sale on risks to taxpayers throughout the planning and conduct of the sale?	Evaluation of the wider impacts of the sale was performed by the Treasury and revealed no issues.
Has the Department identified all the remaining residual interests, liabilities and risks to which the taxpayer is exposed after the sale, and established mechanisms to monitor and control them where possible?	Residual interest remains in the Tier one notes and clawback clauses arising from sale. UKFI commissioned due diligence to confirm that value could be realised from these interests. Some contingent liabilities arise from warranties and indemnities given on sale, although these were in line with, or better than, standard commercial practice.
Has the Department established mechanisms to regulate, protect and control aspects of the business where there is a specific public interest?	Northern Rock plc will continue to be regulated by the FSA (and successor regulators). The FSA was a key stakeholder in the sales process and completion was contingent on its approval.
Have claw-back provisions been used to ensure the taxpayer is compensated for a poor sales price arising from uncertainty?	A clawback provision was included to provide further proceeds for the taxpayer if Virgin Money is sold or floated on the stock exchange in, or before, 2016.

Preparing the business for sale

Did the Department provide due diligence materials to purchasers? Was the dissemination of materials efficient and effective?	Comprehensive data on Northern Rock plc was provided to bidders.
Did the Department use a robust valuation of the business in public and private ownership to assess the value for money of selling and the lowest acceptable price?	The initial Deutsche Bank report used a range of techniques to estimate the value of Northern Rock plc in public ownership and on sale to different types of purchasers.
Were these valuations sound, based on appropriate valuation methods, appropriate and reasonable assumptions, accepted principles of valuation and were they arrived at independently of the buyer and the management of the asset?	Valuations conducted by Deutsche Bank on behalf of UKFI, based on assumptions made by Northern Rock plc management. A range of standard methods for valuing banks was used.
Was the final price paid within the range expected by the valuations?	Yes, although towards the lower end.
Were staff incentive schemes proportionate to the benefit to the taxpayer of enhanced motivation?	The remuneration scheme was renegotiated downwards after the creation of Northern Rock plc.
Did non-executive directors retain their independence?	The head of the wholly-owned banks section of UKFI was a non-executive director of Northern Rock plc, which enabled UKFI to obtain a better understanding of the business before sale.
Did the Department restructure the business to maximize the attractiveness to bidders? Were the costs and benefits of different restructuring options appraised?	The business had been restructured in 2010 when Northern Rock plc was created. Further restructuring at the time of sale was considered, but the evaluation showed this to be lower value.

Did the Department extract all surplus component assets, such as cash, prior to the sale? If not were the value for money reasons for not doing so clearly set out?	Although Northern Rock plc held substantial cash reserves, FSA requirements and trading losses while in public ownership prevented cash being extracted before a sale. The potential to extract capital was highlighted in the sales documentation as a potential benefit to purchasers.
Conducting the sale	
Did the Department manage the timing of the sale to get the best price and chance of achieving the objectives?	Delaying a sale was considered. UKFI concluded that a sale in 2011 offered the best value.
Did the Department carry out an options appraisal to assess the risks and benefits of the potential sales methods?	A range of sale methods was considered before a straight sale was selected as the preferred option.
Was the Department's decision maker given sufficient information to decide on the most appropriate method of sale?	The decision to select a sale was approved by the UKFI board, Treasury and Ministers, based on advice from UKFI.
Is there clear evidence that the chosen method would maximise the Department's sales objectives?	A sale was considered to be the highest value. However, other options were re-evaluated before committing to a sale.
Was the asset marketed to a wide range of potential investors?	Deutsche Bank had initial contact with over 50 interested parties and provided information to 26 potential bidders.
Did the Department give due consideration to the risks specific to the chosen sales method?	Risks of all methods were considered carefully before committing to a sale. A further risk analysis was performed before approving the final decision to sell.
Did the Department seek to apply the lessons learnt from previous sales of public assets?	Clawback provisions were added to the sale agreement in line with previous PAC recommendations.

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