Monitor

Making the health sector work for patients

Consultation on our revised approach to risk assessing NHS foundation trust transactions

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About Monitor

Monitor is the sector regulator for health services in England. Our job is to protect and promote the interests of patients by ensuring that the whole sector works for their benefit.

For example, we make sure foundation trust hospitals, ambulance trusts and mental health and community care organisations are well led and are run efficiently, so they can continue delivering good quality services for patients in the future. To do this, we work particularly closely with the Care Quality Commission, the quality and safety regulator. When it establishes that a foundation trust is failing to provide good quality care, we take remedial action to ensure the problem is fixed.

We also set prices for NHS-funded services, tackle anti-competitive practices that are against the interests of patients, help commissioners ensure essential local services continue if providers get into serious difficulty, and enable better integration of care so services are less fragmented and easier to access.

Introduction

This document seeks to consult on our proposals to update Monitor's approach to assessing the risks of transactions undertaken by NHS foundation trusts. Following the consultation, we will publish an updated version of Appendix C of the *Risk Assessment Framework* (RAF) reflecting responses we receive.

This document also contains proposals for consultation on good practice guidance for transactions, which we expect to publish as part of a wider transactions guidance manual in spring 2014.

This consultation contains the following sections:

Section 1: What we are proposing

Section 2: Explanation of the proposed changes

Section 3: Full list of consultation questions for your consideration

Section 4: Proposed Appendix C of the *Risk Assessment Framework*

Consultation process and timing

We are very interested to hear any comments that you wish to make on our proposals and welcome your responses to this consultation. We have posed a number of questions in Section 2 of this document that we believe address important aspects of the proposals (these are repeated as a full list in Section 3). As well as responding to our specific questions, please provide any further comments you may wish to make.

Please submit your responses to the questions and any further comments **by 5pm on Friday 28 February 2014 using this online form: https://www.research.net/s/6V3ZLS9.** This is our preferred way of receiving your comments.

You can also email your response to consultation@monitor.gov.uk or send it to: Risk assessing transactions consultation, Monitor, Wellington House, 133-155 Waterloo Road, London, SE1 8UG.

Confidentiality

If you would like your name, or the name of your organisation, to be kept confidential and excluded from the published summary of responses or other published documents, you can request this on the online response form. If you send your response by email or post, please do not forget to tell us if you wish your name, or the name of your organisation, to be withheld from any published documents.

If you would like any part of your response – instead of or as well as your identity – to be kept confidential, please let us know and make it clear by marking in your response which parts we should keep confidential. An automatic computer-generated confidentiality statement will not count for this purpose. As we are a public body and subject to Freedom of Information legislation, we cannot guarantee that we will not be obliged to release your response or name even if you mark it as confidential.

What we will do next

We expect to receive a lot of responses to this consultation, so we do not intend to write back individually to everyone who contacts us. However we will read and consider all responses received. When we publish the amended Appendix C of the *Risk Assessment Framework* and the transactions guidance manual (which we aim to publish in spring 2014) we will explain how the comments and views we have received have influenced the final version of both.

You can sign up here to receive emails alerting you to the publication of new documents and engagement and consultation opportunities on our website.

Section 1: What we are proposing

Over the coming years, we expect that an increasing number of NHS foundation trusts may seek to reorganise either as part of a wider strategy of innovation and growth or in order to help resolve financial and clinical issues, given the significant pressures that they face. Many will want to plan acquisitions, mergers, investments and divestments. While transactions will help trusts reorganise, they will also involve some level of risk.

As sector regulator, Monitor must assess risks to the continued provision of NHS services and make sure higher level risks are appropriately mitigated, so that the high quality services patients need are protected.

Changes to our regulatory framework following the Health and Social Care Act 2012 have prompted us to re-examine our overall approach to transactions. We have looked at our rules for reporting and reviewing transactions to see how they could be improved to help trusts both identify and manage the risks involved in undertaking a transaction.

This document sets out our proposed changes to the current rules and how they would work in practice. In suggesting these changes, we do not want to discourage trusts from undertaking essential and/or innovative transactions, nor to unduly increase the regulatory burden. Rather, our aim is to help NHS foundation trusts adapt to the fast-changing NHS environment in ways that ensure long-term benefits to patients, while remaining proportionate in our approach to regulation.

1.1 Proposed changes in Monitor's approach to transactions

We are proposing to make a number of changes to how we work with NHS foundation trusts contemplating transactions and our approach to transactions generally.

Mergers and acquisitions

Alongside the proposed changes to the rules for reporting and reviewing transactions set out in this document, we are also separately seeking views (as explained in this letter of 24 January 2014 from David Bennett) on specific changes to our approach to engaging with NHS foundation trusts that are contemplating a merger or acquisition. A particularly important change is that Monitor intends to engage with trusts contemplating a merger or acquisition at an early stage to ensure any proposal works well for patients from both good governance and competition perspectives, including providing our view of the extent to which the transaction might raise competition issues and undertaking our assessment of relevant patient benefits.

This should make sure any merger or acquisition is based on a sound analysis of the clinical and other sources of patient benefit that should accrue from the transaction, and that there are robust plans in place to make sure those benefits are realised in practice.

As part of our preparations for introducing this approach we will consider your feedback and reflect the changes in our existing guidance. See [this letter] for further information on our proposals and how to send us your feedback.

All transactions (including mergers and acquisitions)

In this consultation document we are proposing five main changes to our approach to transactions as follows:

1. Adjusting the threshold for "significant" transactions that require a detailed review. We propose to consider risk factors in a transaction in addition to just its size relative to a trust's assets, income or capital (the current threshold). We propose to raise the relative size threshold that will, by itself, trigger the need for a more detailed review from 25% to 40%.

2. Introducing a clearer and more transparent scope for our detailed reviews, including guidance on best practice for transactions. This should help trusts to plan their transactions and know what to expect from detailed reviews.

3. Replacing the previous indicative continuity of services risk rating (CSRR) and governance risk rating for significant transactions with a single transaction risk rating.

4. Being more flexible in our approach to the timing of the submission of board governance statements on quality governance after the transaction has taken place.

5. Making minor changes to the certification on transactions reflecting the changes above.

We have proposed updates to Appendix C of the *Risk Assessment Framework* to reflect these changes; this updated version is set out in full in Section 4 of this consultation document.

To help us get our approach right, please review Section 2 of this document and send us your responses to the questions posed (for ease, the full list of questions is set out again in Section 3).

Section 2: Explanation of the proposed changes

2.1 The case for revising the threshold that triggers a detailed review

This section explains why we propose to change the reporting and reviewing thresholds, details of those changes and what they will mean in practice.

Why we are proposing changes

Monitor's current rules for reporting and reviewing major transactions – set out in Appendix C of the *Risk Assessment Framework* (RAF) – rely primarily on the relative size of any proposed transaction as a proxy for the level of risk inherent in its execution.

We currently require NHS foundation trusts to report all planned transactions to Monitor where the value of the transaction represents greater than 10% of the trust's assets, income or capital (as set out in the *Risk Assessment Framework's* definitions for major investments/divestments, shown in diagram 18). We are proposing to leave this reporting threshold unchanged.

Once a trust has reported a transaction to us, our current requirements are that, using the RAF definitions of relative size:

- all trusts proposing transactions of a relative size of more than 10% are currently asked to provide assurance to Monitor in the form of a certification;
- where the relative size of the transaction is between 10% and 25%, this is often the only requirement that we make. However, within this relative size range, a detailed review is triggered where the trust plans to diversify significantly or is in breach of its continuity of services or governance licence conditions; and
- any transactions of a relative size greater than 25% are automatically subject to a detailed review by Monitor.

Monitor's aim is to ensure that our regulatory response remains proportionate to the level of risk that the transaction presents. By analysing recent and planned transactions and listening to feedback from stakeholders, we have reached the view that the level of risk inherent in transactions is better measured across a range of factors including, but not limited to, relative size. Our analysis has shown that:

- some trusts have had quality issues after completing transactions that fell below the current 25% RAF definition threshold (for example, when they have acquired activities that they have not undertaken before, such as mental health trusts taking on community services); there are indicators that the risks to quality posed by transactions may become greater in the future due to ongoing pressures facing the sector;

- transactions in which NHS foundation trusts take on a significant amount of debt increase the financial risk of the enlarged organisation, but this risk is not captured by the existing measures of relative size; and
- some transactions have represented only a relatively low level of risk to the acquiring trust, even though their relative size triggered a detailed review (for example, some primary care trust asset transfers).

Details of the proposed changes

The proposed updated Appendix C of the RAF includes a number of additional factors which we believe we should consider in order to determine the overall level of risk that a proposed transaction represents, and therefore whether a detailed review by Monitor is necessary and proportionate.

The extent of the work we perform will depend on whether we classify a transaction as “small”, “material” or “significant”. The following table summarises the proposed level of review by Monitor for each transaction classification.

Classification	**Reportable**	**Review***
Small	Below reporting threshold	No review
Material	Reportable but not significant	Review of certification submission
Significant	Reportable and significant	Detailed review

*For statutory transactions approvals are always required, regardless of their classification (see section on ‘Statutory transactions’ in the proposed Appendix C of the RAF for details).

Monitor proposes to classify a transaction as significant, and therefore in need of a detailed review, if the transaction’s relative size (using existing RAF definitions) is:

- greater than 40%; or
- between 25% and 40% and Monitor has identified that the transaction is subject to any of the additional risk factors described in the table below; or
- between 10% and 25% and Monitor has identified at least one major risk or more than one other risk, as described in the table below.

The following non-exhaustive list of examples of additional risk factors aims to indicate to trusts what we may consider to be a major risk or otherwise.

Risk factor	Example of major risk	Example of other risk
Leverage	Capital servicing capacity of enlarged organisation is <1.75 (as defined in the *Risk Assessment Framework)*	Capital servicing capacity of enlarged organisation is <2.5 (as defined in the *Risk Assessment Framework)*
Experience of services provided by target	A significant change in scope of activity of acquirer	A minor change in scope of activity of acquirer
Acquirer quality	Governance is "red" or subject to "formal investigation" in the acquirer	Governance is subjective to "narrative" monitoring in the acquirer
Acquirer financial	CSRR ≤2 in the acquirer	CSRR of 2*/3 in the acquirer
Target quality	Target is rated "inadequate" by the CQC[1]	Target is rated "requires improvement" by the CQC[1]
Target financial	Target has significant current and/or historical deficits	Target has minor current and/or historical deficits

Monitor will look at each potential transaction on a case-by-case basis and may change our relative weighting of the risks outlined above, if we consider it appropriate. Trusts should keep us informed if there is any change to the risk profile of the transaction. We may change our classification of the transaction based on this information.

We recognise that under this proposed approach, trusts will normally engage with Monitor earlier than under the previous regime so they can find out whether Monitor is likely to require a detailed review of their transaction (ie, transactions with relative sizes of between 10% and 40% under RAF definitions). For these transactions, once we have completed our initial review of the risk factors, we propose to write to the trusts to confirm whether we will undertake a detailed review and set out our reasons for this.

We do not anticipate that adjusting how we calculate the threshold will mean we subject more transactions to a detailed review. While the adjustment means we may look at some transactions with a relative size of below 25%, it also means we may not carry out a detailed review of transactions with a relative size of up to 40%, if they are not subject to additional risks. Our aim is to help to raise awareness earlier

[1] Or equivalent rating from CQC following the conclusion of its consultation *A new start: consultation on changes to the way CQC regulates, inspects and monitors care*.

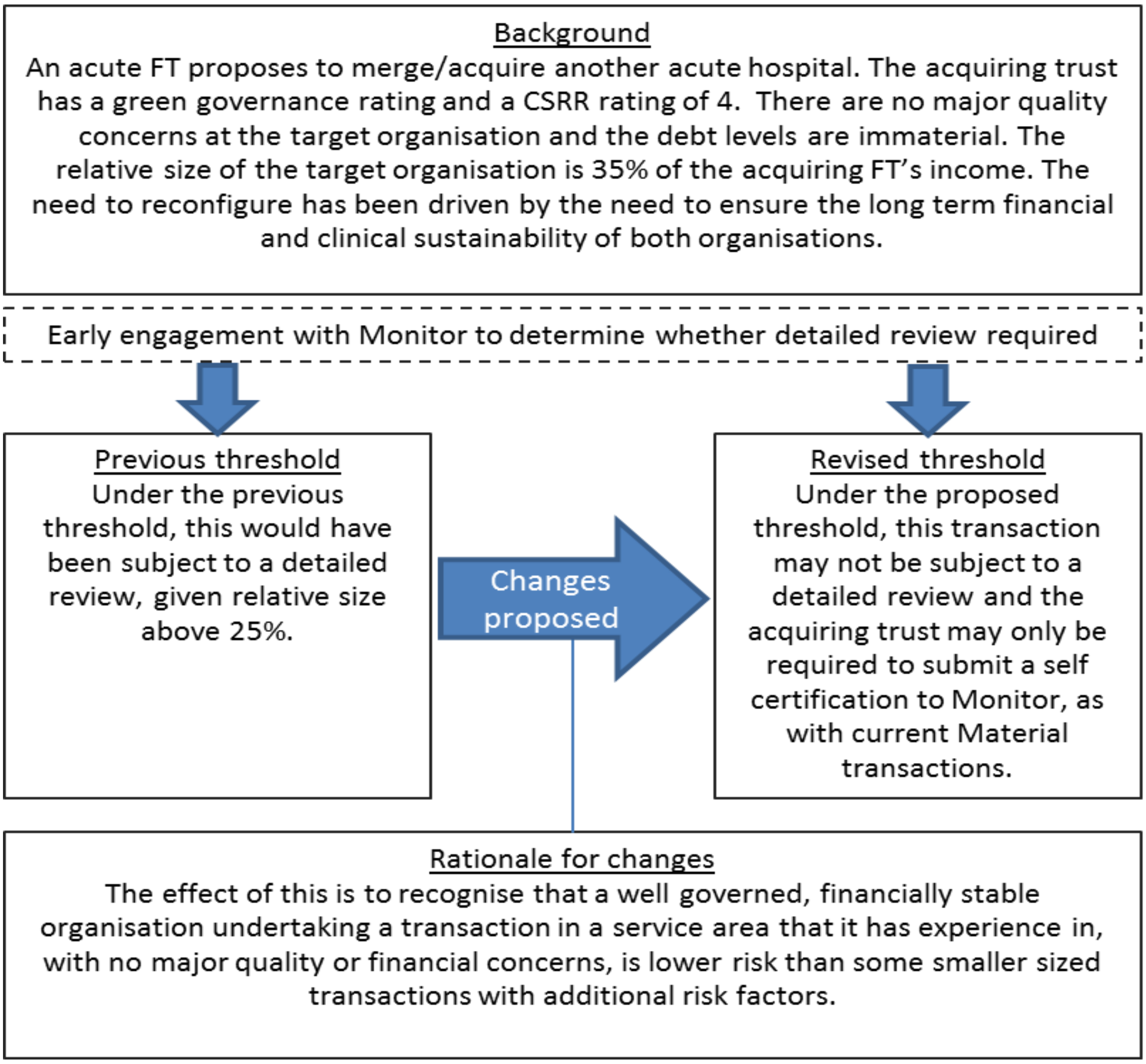
of potential risks in transactions, such as the risks of undertaking a new business activity, so that these can be effectively managed.

NHS foundation trusts planning a transaction should engage with Monitor at an early stage to see if it is likely to require a detailed review. If we initially decide not to review a transaction, we propose to reserve the right to reverse the decision should new risks become apparent at a later stage.

What the proposed changes will mean in practice

As noted above, the proposed approach to classifying transactions may lead to different types of transaction being either subject to or exempt from detailed review. We have provided the following case studies to help trusts understand the likely impact of the suggested new approach. We propose to keep the actual impact of changes we make after this consultation under review, and adjust the approach we take if necessary to make sure our regulatory response remains proportionate.

Case Study 1



Case study 2

<u>Background</u>

An acute FT proposes to merge/acquire a community services trust. The acquiring trust has a CSRR of 3, although the trust is subject to a narrative governance rating due to a Monitor investigation following concerns raised by a third party report. The target organisation is financially stable although it has just been subject to a CQC inspection with a resulting requires improvement rating*. The transaction is necessary to ensure the long term viability of both organisations. The relative size of the target trust is 20% of the acquiring FT's income.

Early engagement with Monitor to determine whether detailed review required

<u>Previous threshold</u>

Under the previous threshold, the acquiring trust would be required to provide Monitor with a self certification to provide us with assurance that appropriate risks had been sufficiently addressed.

Changes proposed

<u>Revised threshold</u>

Under the proposed threshold, this transaction would likely be subject to a detailed review.

<u>Rationale for changes</u>

This increases the level of regulatory scrutiny for this transaction recognising that the change in service scope, governance concerns at the FT and quality issues at the target may, if not dealt with effectively, have an adverse impact on patients. Having identified these factors as areas which can cause issues for trusts post-transaction, a more focussed review on these areas will aim to help the trust identify any possible risks as early as possible, allowing the trust to review and mitigate.

*Or equivalent rating from CQC following the conclusion of the CQC's consultation *A new start: consultation on changes to the way CQC regulates, inspects and monitors care.*

Case study 3

Background

An acute FT proposes to build a replacement unit which is currently located on a different site. The current building no longer fits the long term needs of the trust due to its age and re-locating to the replacement site will reduce estate maintenance costs. The trust will dispose of the land for a profit which will contribute to the cost of the new building. The remaining financing will be from cash reserves and a FTFF loan which will result in the trust having a capital service capacity (CSC) of greater than x1.75 on completion. The trust has a CSRR rating of 4 and a green governance rating. The replacement building provides high quality, tailored facilities. The replacement unit represents 30% of the trust's asset base.

Early engagement with Monitor to determine whether detailed review required

Previous threshold

Under the previous threshold, this would have been subject to a detailed review, given size threshold.

Changes proposed

Revised threshold

Under the proposed threshold, this transaction would likely be subject to a self certification by the Trust Board.

Rationale for changes

This may reduce the level of detailed review the trust will be subject to by Monitor. The effect of this is to recognise that a well governed, financially stable organisation undertaking a capital build which will improve the quality of service provision and not result in any significant debt being incurred, is lower risk than some smaller sized transactions with different risk factors.

Question 1: Do you agree with the proposal to amend the threshold triggering a detailed transaction review?
Question 2: Is the approach to identifying risks for the threshold clear?

2.2 Monitor's scope of work for a detailed review and proposed best practice guidance

Under the proposed update to Appendix C of the RAF (see Section 4), Monitor will undertake a detailed review of a transaction if we classify it to be "significant" by applying the framework set out in Section 1.1 above. This detailed review will be conducted at the final business case stage of the transaction process, as is currently the case. The purpose of the detailed review will continue to be to consider how the proposed transaction may affect the risk profile of the NHS foundation trust and, in particular, any risk of the enlarged organisation breaching its continuity of services or governance licence conditions.

We propose that the scope of work for a detailed review should cover up to four areas tailored to the type of transaction covering:

- strategy;
- transaction execution;
- quality; and
- finance.

In each area, we would pose a number of questions with which to assess the proposed transaction against good practice.

The questions, detailed in the tables below, are mostly a reframing of our current scope of work and do not materially alter what we would do. We acknowledge that not all elements of our scope of work would apply to every type of transaction, for example a detailed quality governance review is unlikely to apply to a significant capital investment. We would therefore tailor our work according to the nature and risks of the transaction.

To help NHS foundation trusts understand how we will score significant transactions against each of these questions, we intend to publish separately our definition of good practice as part of an updated transactions guidance document.

Concerning Monitor's good practice transaction guidance generally, we recognise that a number of publications are currently available to trusts, for example, *Risk Evaluation for Investment Decisions by NHS Foundation Trusts* and the merger guide[2], and that some of the material in them is out of date. To help trusts undertaking transactions, we are consolidating all this guidance into a single updated transaction guidance document, which we will publish in spring 2014. This document will include the good practice referred to in this document as well as guidance supporting our early stage reviews of mergers and acquisitions.

The questions and associated good practice under each of the four areas are set out below. We welcome your views on both.

[2] *Applying for a Merger involving an NHS Foundation Trust: Guide for Applicants*

Strategy: Is there a clear strategic rationale for the transaction and does the board have the capability, capacity and experience to deliver the strategy?

Key questions	Good practice (green risk indicators)
1. Is the trust's overall strategy well reasoned and can the board demonstrate how the transaction supports its delivery?	• The board can clearly articulate the trust's overall strategy and how the transaction supports its delivery; • The board can clearly articulate the financial and clinical synergies and benefits associated with the transaction, including the impact on workforce, and has undertaken sufficient analysis to demonstrate them; • The board can clearly articulate what challenges faced by the trust the transaction seeks to address; and • Where relevant, the board can clearly articulate what opportunity the transaction represents.
2. Has there been a detailed options appraisal and is there a clear rationale for the option that the trust has selected?	• The board has undertaken a detailed options appraisal covering a variety of alternatives, including the option of "doing nothing" or "a minimum"; and • The board can demonstrate how they have appraised the alternatives and chosen the option selected. Appraisals include financial and clinical assessments as well as impacts on patients, workforce and other stakeholders, where relevant.
3. Does this rationale set out why the transaction is the best option for patients, the trust and the local health economy?	• The board can clearly demonstrate why the transaction is the best option for patients, the trust and the local health economy; • Plans are supported by key stakeholders in the local health economy; and • The board has engaged with patients to gain their perspective and has reflected these in their plans.

4. Does the board have the capability, capacity and experience to deliver the trust's strategy?	• The board has (and/or has obtained) the necessary skills or experience to succeed in delivering its strategy, reflecting expected complexities where necessary.

Transaction execution: Does the trust have the ability to execute the transaction successfully?

Key questions	Good practice (green risk indicators)
1. Does the board have the appropriate capability and capacity to minimise execution risks?	• The board has (or has obtained) the necessary skills or experience to succeed in executing the transaction; and • There are no governance concerns in the acquirer/investing organisation.
2. Is the board able to identify and quantify transaction risks appropriately (including risks associated with the competition rules, if any)? Is its approach to due diligence robust, and is there evidence that key risks have been recorded?	• The board's approach has identified all key risks and has included, where relevant to the nature of the transaction: o clinical due diligence o financial due diligence o legal due diligence o operational due diligence, including HR, IT and estates matters o commercial due diligence o assessment of potential competition issues (where relevant) o understanding stakeholder perspectives • The board is able to articulate the key risks of the transaction.

3. Has the board effectively mitigated the key risks and established effective processes for the continued management of these risks, post transaction?	• The board is able to evidence an effective process for managing transaction risk; and • Key risks to the transaction are adequately mitigated – plans are in place to ensure a reasonable downside cash position for at least the first three years.
4. Is there a robust and comprehensive plan for delivery of the transaction, including integration and realisation of other benefits?	• A robust and comprehensive post-transaction implementation plan (PTIP) has been developed and clearly demonstrates: - benefits to be derived from the merger including synergies, cost reductions, and increases in revenue; - feasibility of the proposed organisational structure and changes from the current state; - plans for achieving cultural integration; - plans to deliver any transformation, or planned service changes; and - detailed plans to address any current non-achievement of national targets or core standards as well as plans to ensure ongoing compliance with national targets and core standards. • The plan has received an unqualified PTIP opinion (where relevant).
5. Is the integration plan sufficiently supported by clear lines of accountability, governance processes, delivery milestones and dedicated resource?	There is: • A feasible timeline for implementation; • A means of measuring success in delivering the integration plan; • A risk management strategy for all risks considered material by the current board and qualified professional advisor(s) to the integration;

	• Adequate capacity; and • Governance processes are in place to manage and implement the plan.
6. Has the trust met all regulatory and legal requirements (including Monitor certification), and is it planning the transaction with reference to good practice guidance?	• Unqualified and supported certification; • Transaction is planned in accordance with good practice guidance; and • Legal requirements are fully satisfied.

Quality: Is quality maintained or improved as a result of the transaction?

Key questions	Good practice (green risk indicators)
1. Has the trust received an unqualified quality governance opinion in relation to the transaction? (where relevant)	• Unqualified quality governance opinion
2. Has the medical director provided a certification to Monitor?	• Unqualified certification provided by medical director
3. What is the Care Quality Commission's (CQC) view of both trusts and the impact of the planned transaction?	• "Good" rating and no enforcement action in last 12 months for both acquirer and target
4. Would the enlarged organisation trigger any governance concerns under Appendix A of the *Risk Assessment Framework*?*	• No governance concerns triggered for the enlarged organisation under the RAF post transaction (after any agreed investment adjustments)

*Post investment adjustment

Finance: Does the transaction result in an entity that is financially viable?

Key questions	Good practice (green risk indicators)
1. Does the trust's plan demonstrate financial viability and sustainability, post transaction?*	• CSRR ≥ 4 in years 1 and 2 post transaction in the assessor case; AND • Cash position is sufficient at end of fifth year under an assessor case.
2. Has the trust received an unqualified financial reporting procedures (FRP) opinion? (where relevant)	• Unqualified FRP opinion (where relevant)

3. Has the trust received an unqualified working capital opinion? (where relevant)	• Unqualified working capital opinion (where relevant)

Note: The ability of the trust's board to manage downside financial risk will be assessed as part of question 3 under "transaction execution". The key question for consideration is: Can the board articulate future mitigation plans and demonstrate the capability to deliver these plans?	• Trust has demonstrated that it can maintain a sufficient cash position in a plausible downside case by year three of the plan. • Trust has plans to mitigate any downturn in performance and there is capability and capacity on the trust board to deliver these plans.

*Post investment adjustment as well as taking account of findings against strategic rationale and transaction execution criteria.

Question 3: Do you agree with the detailed scoping questions and good practice against which we will assess a transaction?

2.3 Proposing a single transaction rating

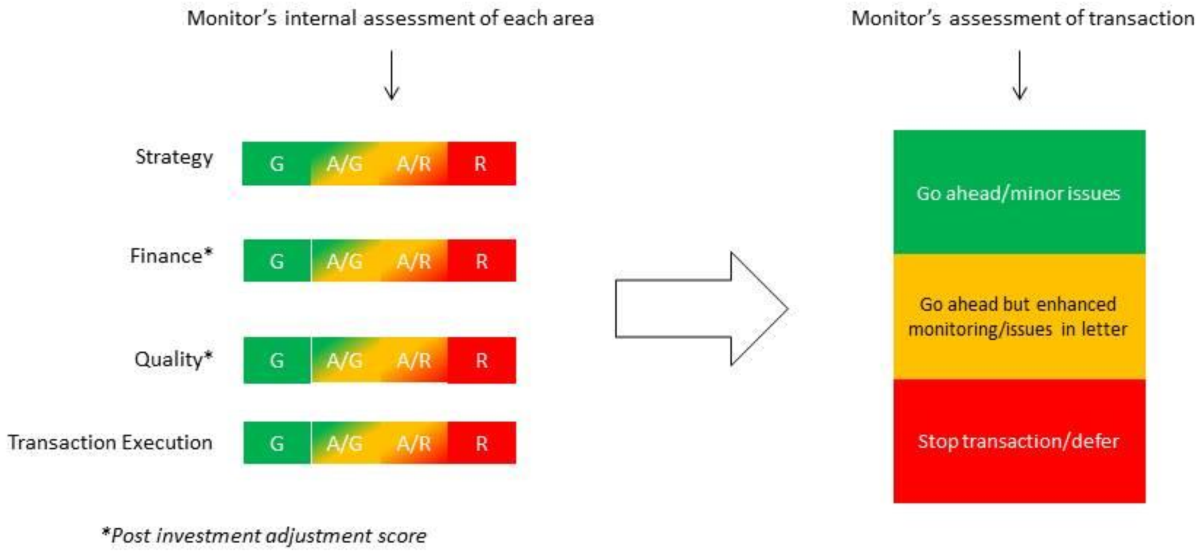
Currently, Monitor gives trusts a post-transaction indicative continuity of services risk rating and a post-transaction indicative governance risk rating. To simplify the transaction process, we propose to consolidate these two ratings into a single aggregate green, amber or red rating ("RAG rating") for each transaction. This rating will represent our overall view of the risk that the transaction could lead to a breach of the trust's continuity of services and governance licence conditions.

The transaction rating will be based on an aggregation of the risks identified under each of the four areas of review (strategy, transaction execution, quality, and finance), noting that some risks by themselves could be so significant that they drive the overall rating.

We will base our assessment of risk for each of the four areas of review on the trust's adherence to the good practice guidance, as detailed in the table below.

RAG	Definition	Evidence
	Meets or exceeds expectations.	Many elements of good practice and there are no major omissions.
	Partially meets expectations but confident in management's capacity to deliver green performance within a reasonable timeframe.	Some elements of good practice, with no major omissions and robust action plans to address perceived shortfalls. Proven track record of delivery.
	Partially meets expectations, but with some concerns on capacity to deliver them within a reasonable timeframe.	Some elements of good practice, with no major omissions. Action plans to address shortfalls are in early stage of development. Limited evidence of track record of delivery.
	Does not meet expectations.	Major omissions identified with concerns about management capacity to deliver.

These four ratings will then be aggregated into a single transaction risk rating, as summarised below.



The transaction risk rating definitions are:

- Green – no material concerns arising out of Monitor's detailed review.
- Amber – some significant issues arising that the trust will need to take action to address, and that may require ongoing regulatory monitoring. However, no issues arising that are sufficiently serious to stop or delay the transaction.
- Red – Monitor considers the issues to be sufficiently serious to delay the transaction to allow time for the trust to restructure the proposal if possible, addressing the risks involved. If this is not considered possible, Monitor would use its regulatory powers to stop the transaction if required.

The fourth case study, below, gives an example of how we might apply this new approach in practice.

Case Study 4

<u>Background</u>

An acute FT proposes to merge/acquire another acute hospital in order to ensure long term financial viability. The transaction was classified as Significant and during the course of the detailed review, a number of risks were identified which had not, in Monitor's view, been adequately mitigated by the Trust Board. These included risks around cultural differences between the two organisations which had not been adequately addressed by the acquiring FT, lack of management capacity to ensure the successful delivery of the integration plan and doubt as to the strength of some of the outer year downside mitigation plans. The Trust's assessor case demonstrated a CSRR of 3 in each year and a sustained cash position.

Monitor sends a letter to Trust outlining key risks and risk rating

<u>Previous approach</u>

<u>Rating – CSRR 3 and Governance – Amber/red</u>

Under the previous approach, Monitor would not expect the board to enter into a binding contract without having first satisfied itself that these risks can be mitigated

Changes proposed

<u>Revised approach</u>

<u>Rating - Amber</u>

Under the revised approach, Monitor may now require further actions to be completed before allowing the transaction to proceed. Post transaction this could also include specific milestones which must be completed, including enhanced monitoring with commitment from the Board

<u>Rationale for changes</u>

The effect of this is to award a single transaction rating assessing the overall transaction risk. The amber rating will be based on areas of risk and will likely include further measures that the acquiring FT are required to undertake. These may be in advance of the transaction completing, or subsequently through enhanced monitoring and reporting.

Question 4: Do you agree that, when a transaction is rated "amber", it may be appropriate to require some degree of enhanced monitoring by Monitor to ensure specific risks are addressed?

Question 5: Do you agree that a single transaction risk rating would be helpful to the sector?

2.4 Proposed changes to the timing of an updated corporate governance statement within the transaction process

Our proposed requirements for a trust's submissions for a detailed review remain largely unchanged. Material transactions over 10% by the RAF definitions, which do not require a detailed review, will still be subject to a certification, as will material transactions of a relative size of up to 40% by the RAF definitions with no additional risk factors. Trusts pursuing transactions that have been classified as significant, and therefore subject to a detailed review, will still be required to provide the certification as part of the review process, as they are now.

However, we propose to be more flexible about the deadline for submitting elements of the corporate governance statement that concern quality governance arrangements. We currently require an acquiring trust's board to provide Monitor with an updated corporate governance statement within six months of any transaction's completion. We recognise that in some circumstances trusts may need more than six months to implement their quality governance processes comprehensively across an acquired organisation. For instance, trusts may be taking on failing organisations that need more time to be turned around.

To be more flexible on the timing for this requirement, we propose to revise the wording in the RAF from "six months" to "an appropriate time frame", which will be agreed for each individual transaction. In assessing what time frame is appropriate for each transaction, we will need to understand the trust's plans and will focus on the capacity and capability of the board in question to deliver their plans.

As with our current transaction process, investment adjustments may still be allowed where trusts can demonstrate that a short-term negative impact on risk indicators, which could suggest a breach of their licence conditions, is a necessary consequence of fulfilling the long-term strategy. As is currently the case, we will consider investment adjustments on a case-by-case basis, following a written application and receipt of supporting information from the trust.

2.5 Proposed changes to certification requirements

Certification requirements as set out in Annex I of Appendix C of the RAF (see Section 4 of this document) largely remain unchanged, with the exception of the matters set out in 2.4 (above) and the following three additional requirements. In future, Monitor proposes to request evidence that the board has satisfied itself that it has:

- considered a detailed options appraisal before deciding that the transaction delivers benefits for patients and the trust in delivering its strategy;
- conducted an appropriate level of clinical due diligence relating to the proposed investment or divestment (to be included in the existing requirement

to certify that the trust has conducted an appropriate level of financial and market due diligence); and

- made provision for the transfer of all relevant assets and liabilities.

Question 6: Do you agree with the proposed changes to the certification requirements?

2.6 Preparatory steps for statutory transactions

Statutory transactions are those which Monitor has a role in approving, which we can only do when we are satisfied that the trusts involved have taken the necessary preparatory steps. Statutory transactions comprise:

- mergers between NHS foundation trusts or NHS foundation trusts and NHS trusts;
- acquisitions by an NHS foundation trust of an NHS trust or another NHS foundation trust;
- separations of NHS foundation trusts into two or more NHS foundation trusts; and
- dissolutions of NHS foundation trusts.

We have updated Appendix C of the *Risk Assessment Framework* to clarify our view of the necessary preparatory steps that one or both trusts involved in the statutory transaction will need to take to demonstrate that they have adequately prepared for it. This is set out in Annex II and is consistent with our current approach to statutory transactions, but we have clarified what is necessary for each classification of transaction, as summarised in the table below.

Classification	Necessary preparatory steps
Small	• The trust(s) have submitted all the relevant documents for the statutory transaction
Material	• The trust(s) have submitted all the relevant documents for the statutory transaction; • The trust(s) have reported the statutory transaction to Monitor; and • The trust(s) have submitted the required certifications to Monitor, and we are satisfied with them.

Significant	• The trust(s) have submitted all the relevant documents for the statutory transaction; • The trust(s) have reported the statutory transaction to Monitor; • The trust(s) have submitted the required certifications to Monitor, and we are satisfied with them; and • The statutory transaction has been through Monitor's detailed review and has achieved a single transaction risk rating of green or amber.

Section 3: Full list of consultation questions for your consideration

Having read the consultation, we ask you to consider the questions which appeared within it and send your responses to us, using this online form, by **5pm on Friday 28 February 2014**.

The full set of questions is repeated below. On the online form you can also submit any further comments you may have.

1. Do you agree with the proposal to amend the threshold triggering a detailed transaction review?

2. Is the approach to identifying risks for the threshold clear?

3. Do you agree with the detailed scoping questions and good practice against which we will assess a transaction?

4. Do you agree that when a transaction is rated “amber”, it may be appropriate to require some degree of enhanced monitoring by Monitor to ensure specific risks are addressed?

5. Do you agree that a single transaction risk rating would be helpful to the sector?

6. Do you agree with the proposed changes to the certification requirements?

Section 4: Updated Appendix C to *Risk Assessment Framework*

As part of its overall assessment of NHS foundation trusts' compliance with the continuity of services and governance conditions of their licences, Monitor will consider the impact of transactions involving these trusts. We will take a proportionate approach, with our view of the risks involved in undertaking a transaction determining the degree of analysis and assurance required.

Transactions will be classed as "small", "material" or "significant". Monitor's level of scrutiny will depend on these classifications.

Transactions that Monitor considers "significant" (as defined under *Threshold for reporting and detailed review* below) will be subject to a detailed review. Where a trust has incorporated its own definition of a significant transaction into its constitution, this may differ from our definition of "significant". Monitor's definition applies for the purposes of determining whether we conduct a detailed review.

Our approach to transactions involving NHS foundation trusts is twofold.

1. Statutory transactions

Under the 2006 Act, as amended by the 2012 Act, we have a statutory role in approving (where we are satisfied trust/s have taken the necessary preparatory steps):

- mergers between NHS foundation trusts or NHS foundation trusts and NHS trusts;
- acquisitions by an NHS foundation trust of an NHS trust or another NHS foundation trust;
- separations of NHS foundation trusts into two or more NHS foundation trusts; and
- dissolutions of NHS foundation trusts.

Trusts undertaking these transactions are required under the 2006 Act, as amended by the 2012 Act, to make a formal application (with accompanying documents) to Monitor. This will involve a number of statutory actions (eg, obtaining the approval of a majority of governors) set out in Annex II below.

Annex II clarifies what we consider are the necessary preparatory steps for a small, material or significant statutory transaction.

NHS foundation trusts must follow the guidance set out in this appendix before they make a formal application to Monitor in order to satisfy Monitor that they have completed all the preparatory steps required for formal approval of the transaction.

2. Other transactions

In addition to assessing statutory transactions, we will also assess other transactions to determine whether they are likely to represent a risk to trusts' compliance with the continuity of services or NHS foundation trust governance licence conditions.

Such transactions include:

- projects funded through private finance initiatives (PFI);
- contracts to provide services;
- material capital investments;
- mergers, acquisitions, investments or divestments;
- joint ventures; and
- changes in indemnity arrangements that exceed the thresholds shown in Diagram 2.

Where we consider such a transaction to be significant, we will conduct a detailed review to consider the risk involved in undertaking the transaction and communicate this in a letter to the trust board.

Where a transaction represents in our view a substantial level of risk to a trust's compliance with its continuity of services or governance licence conditions, we will consider whether we need to use our powers to mitigate that risk.

Engagement with Monitor

If an NHS foundation trust's potential transaction meets any one of the criteria set out in the following section, which details the thresholds for reporting transactions to Monitor and for a detailed review, the trust should report the transaction to Monitor. This section describes how we will engage with trusts on all reportable transactions, and details how we will engage with foundation trusts planning mergers and acquisitions in particular.

A number of different strategic and/or operational changes made by NHS foundation trusts (including but not limited to transactions) may raise issues under the competition rules that apply to providers of NHS services. NHS foundation trusts should inform themselves at an early stage whether the proposed changes are likely to raise any issues under these rules as this will enable an informed decision to be taken on how best to proceed. Further details on the types of competition issues that can arise and how Monitor can help trusts understand them can be found here.

All reportable transactions

If a potential transaction, statutory or otherwise, will need to be reported to Monitor according to the criteria set out under *Threshold for reporting and detailed review* below, the trust should contact Monitor before finalising an Outline Business Case to agree:

- whether the proposed transaction is "significant" and will therefore require a detailed review by Monitor;
- the likely timing of any detailed review; and
- the scope of any detailed review.

Trusts that are considering an investment that may require approval from the Department of Health or HM Treasury (eg, PFI investments) for their planned investment should engage with Monitor at an early stage (that is, as soon as they believe there is a significant likelihood that they will want to undertake the transaction).

Mergers and acquisitions

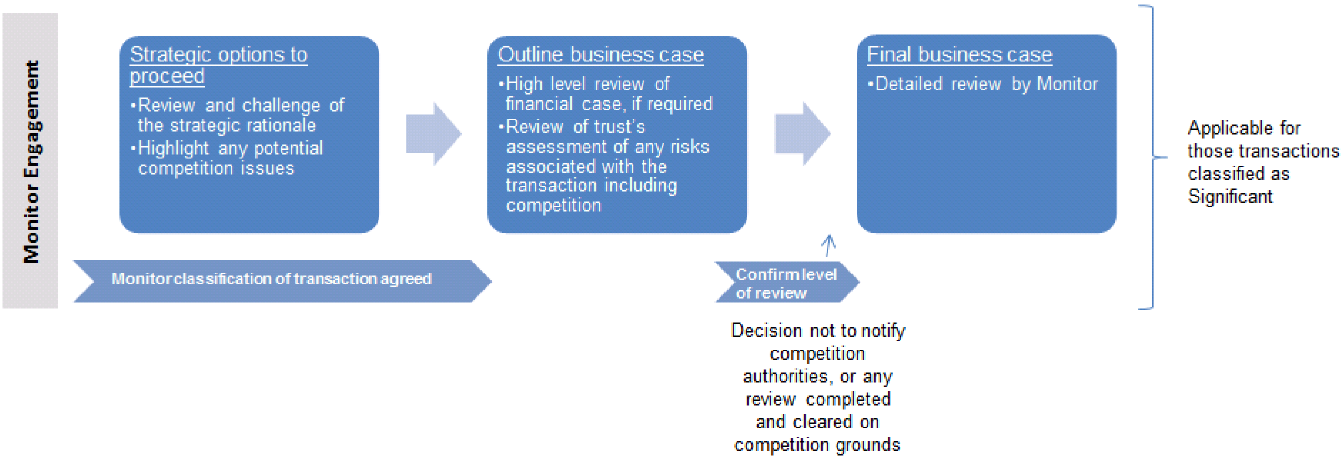
Monitor will work closely with trusts considering a merger or acquisition to help them navigate the relevant regulatory issues (including any implications of competition rules) by engaging at several points as a transaction develops.

This is to ensure the proposals work in the best interests of patients, from both good governance and competition perspectives.

In line with our roles of assessing NHS foundation trusts' compliance with the continuity of services and governance licence conditions as well as supporting trusts in understanding any competition issues, we will review the trust's assessment of its strategic rationale for the transaction at an early stage. The level of work that we conduct will depend on our classification of the transaction. **NHS foundation trusts contemplating a merger or acquisition should therefore engage with Monitor at an early stage** (that is, as soon as they believe there is a significant likelihood that they will want to undertake a transaction).

Diagram 1, below, shows the anticipated points of engagement between Monitor and a trust during the planning process for a merger or acquisition. We then give further detail on each stage of engagement.

Diagram 1: Monitor and NHS foundation trust engagement for mergers and acquisitions



Stage 1: Strategic options to proceed

Monitor would offer relatively informal support and advice at this stage, with two objectives:

a) **To consider the robustness of the underlying strategy**. Monitor's intention is not to approve the proposed strategy at this stage but to pose key questions that might include:

- What challenges faced by the trust is the transaction strategy seeking to address?
- What options other than this transaction were considered for addressing those challenges?
- What was the basis for selecting the proposed (transaction) approach?

We will offer views on how robustly the trust has answered these questions, but it will be for the trust to decide how to proceed.

b) **To highlight the type of competition issues that might arise.** At this stage we would also advise whether we believe the transaction might give rise to any competition issues and, if so, what the trust should do to determine more precisely the nature and extent of those issues. We would also advise in general terms on how to assess relevant patient benefits.

We would also set out Monitor's likely transaction classification at this stage, where there is sufficient information to do so.

Stage 2: Review of Outline Business Case

Once a trust has developed an outline business case and identified its preferred option we may undertake a further review of the case, before the trust commits significant resources. This work would comprise:

a) a review and challenge of the strategic rationale supporting the transaction and, potentially, a high-level review of the financial case if the transaction triggers the reporting thresholds set out in Monitor's *Risk Assessment Framework*. The purpose here would be to identify any 'show stoppers' before significant resources have been committed;

b) a review of the trust's own assessment of any competition issues resulting from the proposed transaction, comparing these with Monitor's own assessment; and

c) a preliminary review of the trust's approach to assessing relevant patient benefits, including the robustness of plans to realise those benefits, as well as commissioning intentions in the local area.

These discussions would culminate in a more formal meeting between Monitor and the trust board, after which we would send a letter to the trust setting out:

- any strategic business issues that we feel need further attention;
- our view on whether the proposed transaction is likely to give rise to any competition issues and, if necessary, our suggestions on what work the trust needs to do to examine these potential issues; and
- our view as to what, if any, further work is needed to complete the analysis and presentation of relevant patient benefits.

It would be for the trust to decide whether or not to proceed with the proposed merger and whether or not to notify the Office of Fair Trading (OFT). Trusts are not required to notify the OFT of the proposed merger and it is for the trust to decide whether to do so. However, there are risks of not notifying a merger where it might give rise to competition issues as the OFT may call the merger in for review.

Monitor would not normally start work on a detailed transaction review until the competition authorities have cleared the transaction (if required).

Stage 3: Monitor detailed review of Final Business Case

The scope of the detailed review (if required) will, where possible, be determined at Stage 1, the review of the strategic option to proceed, and refined at Stage 2, the review of the outline business case. The classification of the transaction will remain subject to there being no material changes in the risk profile of the transaction before it is completed. Further detail of the potential scope and output of a detailed review is set out below.

Threshold for reporting and detailed review

Reporting transactions to Monitor

Diagram 2: Monitor reporting requirements

If a potential transaction meets any one of the criteria below, the NHS foundation trust should report it to Monitor

		Reporting requirements	
Ratio	**Description**	**Non-healthcare/ International**	**UK Healthcare**
Assets	The gross assets* subject to the Transaction, divided by the gross assets of the foundation trust	> 5%	> 10%
Income	The income attributable to: • the assets; or • the contract associated with the Transaction, divided by the income of the foundation trust	> 5%	> 10%
Consideration to total foundation trust capital	The gross capital** or consideration associated with the Transaction divided by the total capital*** of the foundation trust following completion, or the effects on the total capital of the foundation result resulting from a Transaction	> 5%	> 10%

* Gross assets is the total of fixed assets and current assets
** Gross capital equals the market value of the target's shares and debt securities, plus the excess of current liabilities over current assets
*** Total capital of the foundation trust equals taxpayers' equity

For capital investments, the investment may be made over a number of years, with revenue attributable to the investment potentially only being achieved in future years. For the asset ratio, estimated capital spend will be compared with the audited asset values, and for income ratio the full year impact of projected revenue from the investment will be compared with projected foundation trust revenue in that year.

Where an NHS foundation trust chooses to cease membership of the NHS Litigation Authority's various schemes, including the Clinical Negligence Scheme for Trusts (CNST), and enters into alternative indemnity arrangements, and this affects the capital (taxpayers' equity) on the trust's balance sheet, this may trigger a transaction review according to the thresholds set out in this section.

For any other transaction types, the data used for the transaction classification will be considered on a case-by-case basis. NHS foundation trusts should seek guidance from Monitor if there is any uncertainty.

Where there has been a material or significant transaction since the date of the last audited accounts (ie, those accounts do not include that transaction), we will consider the data used for the transaction classification on a case-by-case basis. Foundation trusts should seek guidance from Monitor if there is any uncertainty.

In the case of an acquisition where there has been a material change in the financial position of either the NHS foundation trust or the business being acquired since the last accounts date, and the ratio at that time is not considered representative of the likely contribution of the acquired business to the foundation trust, Monitor may, following discussions with the foundation trust, choose to recalculate the ratios on a pro-forma basis using current or future year data.

In all cases Monitor may, following discussions with the foundation trust, choose to recalculate the ratios using data that we reasonably consider to be a more appropriate measure of the relative size of the transaction.

Even where a proposed transaction does not trigger the reporting requirements for investments or divestments set out below, boards are encouraged to take account of Monitor's best practice advice described in *Risk Evaluation for Investment Decisions by NHS Foundation Trusts* (REID) when evaluating the processes which they should undertake to ensure that reputational and financial risks are fully understood and governance obligations met.

Threshold for detailed review

Monitor's view of the risks inherent in a potential transaction will determine whether it is classified as "small", "material" or "significant".

Those transactions which do not meet the reporting requirements, as set out in Diagram 2 are classified as "Small" transactions. If the Small transaction is nevertheless a statutory transaction, a trust must make a formal application to Monitor and demonstrate that it has taken the necessary preparatory steps, as set out in Annex II. In any other type of small transaction, Monitor would not normally expect to be notified or otherwise involved.

All reportable transactions will be classified as either material or significant.

Once a transaction has been reported, Monitor will seek to understand more about the risks associated with the transaction to determine its regulatory approach. Potential risks will include:

- the relative size of the transaction compared to the NHS foundation trust;
- the leverage expected in the enlarged organisation following the transaction;

- the degree of experience in the acquiring organisation of the services provided by the target (where relevant), or of any change in services following the investment;
- the existing level of financial risk and quality risk in the target (where relevant);
- the existing level of financial risk and quality risk in the NHS foundation trust; and
- risks identified as part of Monitor's early engagement with the trust (where relevant), for instance poor options appraisal or a lack of strategic rationale.

Monitor will assess the nature and scale of these risks. Based on our assessment, we will determine whether a detailed review is required and, if so, the scope of the detailed review. If a detailed review is required, the transaction will be classified as "significant".

Those transactions which trigger the reporting requirements above but do not require a detailed review are classified as "material" transactions.

Monitor will decide to classify the transaction as significant and therefore requiring a detailed review according to whether the transaction meets one of the following criteria:

- A relative size of greater than 40% in any of the tests set out in Diagram 2 will always lead to a detailed review.
- A relative size of between 25% and 40% of the tests set out in Diagram 2 will lead to a detailed review where an additional risk factor has been identified by Monitor and is considered relevant.
- A relative size of between 10% and 25% of the tests set out in Diagram 2 will lead to a detailed review where, in Monitor's view, one or more major risk or more than one other risk has been identified by us and is considered relevant.

A non-exhaustive list of examples of risk factors are set out in the table below to provide trusts with an indication of what Monitor may consider to be a major risk or otherwise.

Risk factor	Example of major risk	Example of other risk
Leverage	Capital servicing capacity of enlarged organisation is <1.75 (as defined in the *Risk Assessment Framework*)	Capital servicing capacity of enlarged organisation is <2.5 (as defined in the *Risk Assessment Framework*)
Experience of services provided by target	A significant change in scope of activity of acquirer	A minor change in scope of activity of acquirer
Acquirer quality	Governance is “red” or subject to “formal investigation” in the acquirer	Governance is subjective to “narrative” monitoring in the acquirer
Acquirer financial	Continuity of services risk rating ≤2 in the acquirer	Continuity of services risk rating of 2*/3 in the acquirer
Target quality	Target is rated “inadequate” by the Care Quality Commission (CQC)	Target is rated “requires improvement” by the CQC
Target financial	Target has significant current and/or historical deficits	Target has minor current and/or historical deficits

Monitor will look at each potential transaction on a case by case basis and we may change our relative weighting of the risks outlined above, if we consider this appropriate. Trusts should keep Monitor informed if there is any change to the risk profile of the transaction. We may change our view of classification based on this information.

Material transactions – requirements

Where a transaction is classified as material, Monitor will, as part of its overall assessment of financial and governance risk, request evidence in the form of a certification that the board has satisfied itself in a number of areas set out in Annex I. The certification should be submitted to and agreed with Monitor before the trust enters into any legally binding arrangements in relation to the transaction. In addition, within six months of the transaction occurring, the new organisation should make a revised corporate governance statement (see Appendix D of the *Risk Assessment Framework*) and send this to Monitor, with the exception of the statement concerning quality governance for which an appropriate timescale for compliance should be determined by the trust board and agreed with Monitor.

If the board is not able to certify to Monitor that it is satisfied that the above matters have been addressed, or provide material on request to support the certification, it should explain why. Monitor will consider this in assessing the risk associated with the transaction and whether additional assurance work is required.

Significant transactions – requirements

Where a transaction is classified as significant, NHS foundation trusts should, in addition to the evidence requested for a material transaction, provide Monitor with a greater degree of assurance regarding the risk to breach of the continuity of services or NHS foundation trust governance licence conditions.

This detailed review will normally be conducted at Final Business Case stage.

The purpose of the detailed review is to consider how the proposed transaction may affect the risk profile of the ongoing NHS foundation trust (or the new NHS foundation trust in the event of a merger).

Monitor will perform detailed work in up to four areas, depending on the nature and risks of the proposed transaction:

- strategy;
- transaction execution;
- quality; and
- finance.

Monitor will assess each of these areas using the key questions set out below, with reference to good practice guidance to be published in spring 2014.

Strategy

1. Is the trust's overall strategy well reasoned and can the board demonstrate how the transaction supports its delivery?
2. Has there been a detailed options appraisal and is there a clear rationale for the option that the trust has selected?
3. Does this rationale set out why it is the best option for patients, the trust and the local health economy?
4. Does the board have the capability, capacity and experience to deliver the trust's strategy?

Transaction execution

1. Does the board have the appropriate capability and capacity to minimise execution risks?

2. Is the board able to identify and quantify transaction risks appropriately (including risks associated with the competition rules, if any)? Is its approach to due diligence robust, and is there evidence that key risks have been recorded?
3. Has the board effectively mitigated the key risks and established effective processes for the continued management of these risks, post transaction?
4. Is there a robust and comprehensive plan for delivery of the transaction, including integration and realisation of other benefits?
5. Is the integration plan sufficiently supported by clear lines of accountability, governance processes, delivery milestones and dedicated resource?
6. Has the trust met all regulatory and legal requirements (including Monitor certification), and is it planning the transaction with reference to good practice guidance?

Quality

1. Has the trust received an unqualified quality governance opinion in relation to the transaction? (where relevant)
2. Has the medical director provided a certification to Monitor?
3. What is the CQC's view of both trusts and the impact of the planned transaction?
4. Would the enlarged organisation trigger any governance concerns under the *Risk Assessment Framework*?*

Finance

1. Does the trust's plan demonstrate financial viability and sustainability, post transaction?*
2. Has the trust received an unqualified FRP opinion? (where relevant)
3. Has the trust received an unqualified working capital opinion? (where relevant)

   Note: The ability of the trust board's to manage downside financial risk will be assessed as part of question 3 under "transaction execution". The key question for consideration is:

   Can the board articulate future mitigation plans and demonstrate the capability to deliver these plans?

*Post investment adjustment

Additional assurances

Monitor may, on a case-by-case basis, seek additional evidence concerning the assurance the board has received in relation to the transaction. This may include any or all of the following:

- post-transaction integration plans;
- a working capital board memorandum prepared in relation to the transaction;
- financial reporting procedures board memorandum; and
- plans for applying appropriate quality governance arrangements across the new organisation.

Monitor may request external reports from independent accountants to provide an opinion on the post-transaction integration plans and working capital board memorandum and may also require an independent opinion on the financial reporting procedures and on the trust's post transaction quality governance arrangements.

The information requested by Monitor will take into account the specific risks of the proposed transaction. Lack of any or all of the information requested is likely to have a bearing on Monitor's view of the degree of risk the transaction represents.

Transaction risk rating

Small and material transactions will not be risk rated by Monitor.

For significant transactions, following completion of the detailed review, Monitor will assign the transaction with an overall risk rating: green, amber or red.

This rating will be based on an aggregation of the risks identified under each of the four areas that could constitute a detailed review (see *Significant transactions – requirements* section above), noting that some risks could by themselves be so significant that they drive the overall rating. Monitor's assessment of risk will be based on a trust's adherence to good practice guidance to be published in spring 2014. The risk rating definitions are set out below:

- Green – no material concerns arising out of Monitor's detailed review.
- Amber – some significant issues arising which will require action by the trust to address and may require ongoing regulatory monitoring. However, issues not so serious that the transaction ought to be stopped or deferred.
- Red – issues considered to be sufficiently serious to warrant deferring the transaction to allow time to restructure it (if possible) to address the risks

involved. If this is not considered possible, the transaction ought to be stopped, through the use of regulatory powers if appropriate.

Investment adjustments

In order not to discourage NHS foundation trusts from undertaking transactions with short-term negative implications for Monitor's risk ratings, NHS foundation trusts may apply for investment adjustments before Monitor assigns the transaction a risk rating.

An investment adjustment will be considered by Monitor on a case-by-case basis and may apply only in the following circumstances:

- written application is made by the NHS foundation trust to Monitor requesting an investment adjustment and providing supporting information; and
- the relevant transaction is a material or significant transaction.

Continuity of services risk rating adjustments

For continuity of services risk rating adjustments, trusts are required to provide evidence that:

- risks and potential rewards, and their likely timing, are demonstrated in accordance with REID; and
- the NHS foundation trust's plan supporting the investment identifies the potential risk adjusted costs and returns over the period of the investment.

In assessing a potential investment adjustment, Monitor may require a presentation from the NHS foundation trust setting out the basis on which it considers it appropriate, including detailed analysis of cash flows and associated risks.

Governance rating adjustments

Trusts seeking such an adjustment based on a revised performance threshold should, in the first instance, submit to Monitor, alongside the standard requirements for a transaction:

- a proposed threshold trajectory for each governance indicator for the acquired business by quarter, showing how the trust will return to the target threshold within an appropriate timeframe agreed with Monitor;
- a proposed threshold trajectory for each indicator against which the trust should be scored across the combined business, rather than separately; and
- a rationale for the thresholds above.

Monitor will investigate the rationale before agreeing to any trajectory.

Monitor will generally not provide a transaction adjustment related to risks triggered by CQC concerns.

Transactions involving NHS foundation trusts meeting investigation triggers

Monitor may vary its approach to calculating risk ratings for transactions where there is a pre-existing risk that the NHS foundation trust is in breach of its licence conditions.

Where an NHS foundation trust has met one of Monitor's investigation triggers, and Monitor is currently considering whether to investigate formally, or is formally investigating that trust, Monitor may:

- for material transactions, postpone submission of trust certifications concerning the transaction in question; and
- for significant transactions, postpone assigning a risk-rating to the transaction until Monitor has determined whether the trust is, or is not, in breach of the governance or continuity of services conditions of its licence and whether regulatory action is necessary.

Transactions involving NHS foundation trusts in breach of the continuity of services or governance conditions of their licence

Where an NHS foundation trust is in breach of the continuity of services or governance conditions of their licence, Monitor may consider any material transaction as a significant transaction and consequently undertake a detailed review. Monitor will have regard to this in our assessment of the overall level of risk inherent in the transaction and therefore the appropriate transaction classification.

Aggregation of transactions in a twelve month period

Transactions completed with the same counterparty during the twelve months before the date of the latest transaction may be aggregated with that transaction for the purposes of Monitor's reporting thresholds. Monitor should be informed at an early stage of the latest transaction in such cases.

Joint ventures

NHS foundation trusts entering into major joint ventures, including Academic Health Science Centres (AHSCs), that meet any of the triggers set out below are required:

- as part of the annual plan each year, to certify anticipated continued compliance with the requirements set out in Appendix E of the *Risk Assessment Framework*; and

- by exception, to notify Monitor where an NHS foundation trust ceases to comply with the requirements set out in Appendix E of the *Risk Assessment Framework*.

The relevant triggers are:

- Control, ie, where a separate decision-making body has influence over the development and/or delivery of an NHS foundation trust's strategy. Where the separate decision-making body is a legal entity, influence would normally be defined as at least 20% ownership.

- Financial conditions – where an NHS foundation trust's:

    - assets within the vehicle are greater than 10% of its total assets (per the most recent quarterly monitoring submission); or

    - share of income or expenditure from the partnership exceeds 10% of the foundation trust's total income or expenditure respectively in any full financial year.

- Legal arrangement, ie, for "accredited" AHSCs only, where an NHS foundation trust enters into a legal agreement establishing the legal arrangement of the partnership.

Annex I – Certification requirements

Where a potential transaction is deemed to be material, based on the thresholds in Diagram 2, Monitor will, as part of its overall assessment of financial risk and governance, request evidence that the board is satisfied that it has:

- considered a detailed options appraisal before deciding that the transaction delivers benefits for patients and the trust in delivering its strategy;
- assured itself that a proposed transaction will meet the requirements of the choice and competition licence conditions;
- conducted an appropriate level of financial, clinical and market due diligence relating to the proposed investment or divestment;
- considered the implications of the proposed investment or divestment on the resulting entity's continuity of service risk rating, having taken full account of reasonable downside sensitivities;
- conducted appropriate inquiry about the probity of any partners involved in the proposed investment or divestment, taking into account the nature of the services provided and likely reputational risk;
- conducted an appropriate assessment of the nature of services being undertaken as a result of the investment or divestment and any implications for reputational risk arising from these;
- received appropriate external advice from independent professional advisers with relevant experience and qualifications;
- taken into account the best practice advice in REID or commented by exception where this is not the case;
- resolved any accounting issues relating to the investment or divestment and its proposed treatment;
- addressed any legal issues, including those associated with the transfer of staff (either via an acquisition, divestment or fixed term contract);
- complied with any consultation requirements;
- established the organisational and management capacity and skills to deliver the planned benefits of the proposed investment or divestment;
- conducted an appropriate level of clinical due diligence relating to the proposed investment or divestment;

- involved senior clinicians at the appropriate level in the decision-making process and received confirmation from them that there are no material clinical concerns in proceeding with the investment or divestment, including consideration of the subsequent configuration of clinical services;
- in the case of a contract of a specified period, ensured appropriate legal protection in relation to staff, including on termination of the contract;
- ensured relevant commercial risks are understood;
- made provision for the transfer of all relevant assets and liabilities;
- at the time of the acquisition, a corporate governance statement (see Appendix D of the *Risk Assessment Framework*) for the acquirer; and
- at the time of the acquisition, a board statement that plans are in place to be able to make the corporate governance statement (see Appendix D of the *Risk Assessment Framework*) in the new organisation within six months, with the exception of the following statement concerning quality governance for which an appropriate timescale for compliance should be determined by the trust board and agreed with Monitor:

  "The board is satisfied:

  (f) that there is clear accountability for quality of care throughout [insert name] foundation trust including but not restricted to systems and/or processes for escalating and resolving quality issues including escalating them to the Board where appropriate."

Annex II – Statutory transactions: other requirements

NHS foundation trusts undertaking a statutory transaction are required under the 2006 Act, as amended by the 2012 Act, to make a formal application, which involves a number of statutory actions. The application should be submitted after completing any applicable processes of assurance and risk assessment as specified elsewhere in this Appendix.

Mergers

A joint application by two NHS foundation trusts, or an NHS foundation trust and an NHS trust, for a merger must be accompanied by:

- written acknowledgement from the foundation trust/s of Monitor's risk rating where the transaction was classed as significant;
- evidence of approval by a majority of governors of each party which is an NHS foundation trust;
- in the case of a merger with an NHS trust, a letter of support from the Secretary of State;
- details of the property and liabilities being transferred; and
- the constitution of the proposed new organisation following the transaction.

Acquisitions

A joint application by two NHS foundation trusts, or a foundation trust and an NHS trust for an acquisition by the acquiring foundation trust must be accompanied by:

- Written acknowledgement from the foundation trust/s of Monitor's risk rating where the transaction was classed as significant;
- evidence of approval of the transaction by a majority of the governors of the NHS foundation trust(s);
- in the case of an acquisition of an NHS trust, a letter of support from the Secretary of State; and
- the constitution of the acquiring NHS foundation trust following the transaction.

Dissolutions

An application by an NHS foundation trust for its dissolution must be accompanied by:

- evidence of approval of a majority of the trust's governors; and

- evidence that the trust has no liabilities.

Separations

An application by an NHS foundation trust for its separation into two or more new foundation trusts must be accompanied by:

- evidence of approval of a majority of governors of the NHS foundation trust;
- specification of the property and liabilities proposed to be transferred to each new NHS foundation trust; and
- the constitutions for each proposed new NHS foundation trust.

Monitor will check the application and the accompanying documents for accuracy and completeness. Monitor may seek additional supporting information if necessary, but will not conduct an in depth review of the contents.

Statutory transactions: steps necessary to prepare for the transaction

Monitor can only grant an application for a statutory transaction where it is satisfied that the trust(s) have undertaken the steps necessary to prepare for the transaction.

The table below sets out Monitor's view of what constitutes the necessary steps according to whether the transaction is small, material or significant.

Classification*	**Necessary preparatory steps**
Small	• The trust(s) have submitted all the relevant documents for the statutory transaction
Material	• The trust(s) have submitted all the relevant documents for the statutory transaction • The trust(s) have reported the transaction to Monitor • The trust(s) have submitted the certifications to Monitor and we are satisfied with them
Significant	• The trust(s) have submitted all the relevant documents for the statutory transaction • The trust(s) have reported the transaction to Monitor • The trust(s) have submitted the certifications to Monitor and we are satisfied with them • The transaction has been through Monitor's detailed review and has achieved a transaction risk rating of green or amber

*For definitions of "small", "material" and "significant", please refer to *Threshold for detailed review* section above.

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Making the health sector work for patients

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