



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Rt Hon Andrew Tyrie MP  
Chairman  
Treasury Select Committee  
House of Commons  
London SW1H 9NB

15 January 2016

Dear Andrew,

### **CERBERUS**

Thank you for your letter regarding UKAR's recent sale of former Northern Rock mortgages to Cerberus.

The mortgages concerned were acquired when Northern Rock was nationalised in 2008, early in the financial crisis. The then-Government was clear when it did so that Northern Rock should be returned to the private sector when market conditions made that possible. This is an approach with which this Government has always agreed and it was this Government that successfully sold Northern Rock plc back into the private sector at the start of 2012.

At that time, market conditions were such that it was necessary to retain the majority of Northern Rock's mortgage assets in the public sector. However, thanks to the success of this Government's long-term plan, this is now changing – as the recent sale demonstrates. Selling these mortgages returns them to the private sector where they originated and where, had it not been for the failure of Northern Rock, they would have always remained. It takes us a further very significant step towards returning all of Northern Rock to the private sector, where it rightly belongs.

You ask for assurance over the price at which these mortgages were sold. It was, of course, critically important to us that the sale achieved good value – in line with that which a commercial seller of such assets would expect to receive. We are wholly satisfied that the final price of c. £280m above UKAR's carrying value of the assets achieves this. If that had not been the case, then we would simply not have proceeded with the sale.

We applied a three part test to assure ourselves of value.

First, we sought assurance that market conditions were indeed right to support such a sale. You will have no doubt seen that James Leigh Pemberton at UKFI wrote to the Chancellor on 18 March 2015 to confirm his view that market conditions were at that point as helpful as they have been since before the crisis, and that he therefore expected to see significant market demand for the sale. This letter was released alongside the March 2015 Budget. We are satisfied that market conditions remained supportive throughout to a sale of this type of asset.

Second, the sale itself followed a highly competitive process. The sale was only launched after UKAR and its advisers had first tested the market to ascertain that sufficient demand for the assets existed to generate competition. The transaction itself was then structured in such a way as to ensure that genuine competition was retained throughout the process. If at any point competition for the sale had fallen away, in a way likely to prevent it from delivering value, then we had the option to withdraw or otherwise restructure the transaction process. In the event, the transaction remained highly competitive throughout, with three bidders being retained right through to the delivery of final bids in October.

Third, UKAR and UKFI tested all bids against benchmark valuations at the key decision points during the sale process. Ahead of bids being received, UKAR developed a reserve price and UKFI made its own assessment of fair market value – building on, but derived separately from, UKAR's own assessment. These benchmarks were based on precedent market transactions and comparators and were designed to ensure that any sale could only take place on properly commercial terms. In each case, both UKAR and UKFI tested their respective benchmarks independently against the views of their respective advisers. For obvious reasons of commercial confidentiality, I cannot tell you where these reserve price and fair values were set, but I can confirm that the final winning bid exceeded them.

You ask about the potential impact of the sale on future tax revenues. The sale itself was structured as a UK sale and the taxes resulting directly from the sale will therefore be paid in the UK. Beyond that, we did not make adjustments for tax reasons – and did not limit the sale to or otherwise discriminate in favour of companies with a UK tax jurisdiction. Given the importance of competition in maximising value, it would have been counter to the interests of best value if we had done so and, given our status as a European Union member, also of dubious legality.

You also ask about the impact of the sale on customers. As UKAR made clear when it announced the sale, the continued fair treatment of customers was a key consideration throughout the process. In line with that, UKAR undertook its own due diligence of each of the bidders and found nothing in the course of that to prevent the sale from taking place. The mortgages will continue to be serviced by the same people in UKAR who service them today, bringing to bear the expertise and experience in working with these mortgage customers that they have developed over recent years. And there is no change in the terms and conditions of the mortgages being sold.

As with any contract, a mortgage contract can only be changed with the agreement of both parties to it. The rights held by both the customers and the new owners of the mortgages will therefore be consistent with those held previously, both under UKAR's ownership – acting commercially in the public sector – and, of course, in the private sector under Northern Rock when customers first took these mortgages out.

One of those rights, as on many other UK mortgages, is the ability to vary Standard Variable Rates (SVRs). Clearly, in setting SVRs, the new owners will have an eye to their own commercial interests, which in itself will act as a check against rates being raised above the wider market – for fear of losing customers to other mortgage providers. Given the importance of this issue to customers, UKAR has also put an additional protection in place, securing an agreement from Cerberus that it will not increase SVRs by more than any increase in the Bank of England base rate for a 12 month period after the sale completes. This is consistent with the approach that UKAR has taken on previous sales – and strikes a balance between providing an additional protection to customers while not undermining the ability to secure value for the taxpayer through the sale.

But the ultimate comfort that customers can take is that these mortgages are regulated in full by the Financial Conduct Authority (FCA). The new owner's conduct in managing the mortgages will be subject to the FCA's full Mortgage Conduct of Business rules, including within that the overarching need to ensure that all customers are treated fairly – including both those who can easily remortgage elsewhere and those who cannot. This applies to any decision the new owners might make to vary SVRs, just as much as it does to any other action they take. To be clear, if the FCA considers that the new owner of any of these mortgages is varying its SVR in a way that is unfair to any of its customers, then it has the necessary powers to act to ensure that customers are properly protected – just as it has on any other UK regulated mortgage.

I trust that this answers your questions.

A handwritten signature in black ink, appearing to read "H. Baldwin". The signature is written in a cursive, flowing style.

HARRIETT BALDWIN