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UK Asset Resolution (UKAR)

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U.K. Asset Resolution Limited (UKAR)

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Abstract

As the Global Financial Crisis began to unfold, the UK saw two of its largest mortgage lenders in Bradford & Bingley (B&B) and Northern Rock, begin to weaken dramatically under the pressure that housing and financial markets were facing. Northern Rock and B&B both faced severe funding problems due to a worsening global credit crunch and both would be nationalized in 2008 (NRAM; B&B). Despite this effort, the crisis continued to worsen globally, and, amongst other programs that the UK government instituted, it created UK Asset Resolution Limited (UKAR) on October 1, 2010 (UKAR Overview). This organization's goal was to wind down and maximize the return on the £115.8 billion in closed mortgage books that the government still had from B&B and what was now Northern Rock Asset Management (2019 Annual Report - pp. 11). In order to adequately manage UKAR's massive portfolio of residential and commercial loans, mortgage-backed securities, and derivative instruments, HM Treasury and the Financial Services Compensation Scheme (FSCS) provided £48.7 billion in funding to the company (2011 Annual Report - pp. 16). Through a mix of large, competitive sales, buy-backs, and loan redemptions, UKAR consistently has been able to reduce its balance sheet and turn a profit every year since its inception (2018 Annual Report - pp. 14, 21). As of June 2019, the company has made approximately £8.1 billion in profit and has only £11.4 billion in assets remaining on its balance sheet (2019 Annual Report - pp. 14). Recently, the company has also been able to pay off the entirety of its government loans and now has been soliciting bids to sell the remaining piece of NRAM and B&B outright (2019 Annual Report - pp. 9). This may be done as soon as 2020.

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UK Asset Resolution Limited (UKAR)

At a Glance

As the Global Financial Crisis began to unfold, the UK saw two of its largest financial institutions in Bradford & Bingley (B&B) and Northern Rock, begin to weaken dramatically under the pressure that housing and financial markets were facing. These firms faced severe funding problems due to a global credit crunch would subsequently be nationalized in 2008.

Despite this effort, the crisis continued to worsen globally, and, amongst other programs that the UK government instituted, it created UK Asset Resolution Limited (UKAR) on October 1, 2010 (UKAR Overview). This organization's goal was to wind down and maximize the return on the £115.8 billion in closed mortgage books that the government still had from B&B and what was now Northern Rock Asset Management (2019 Annual Report - pp. 11).

In order to adequately manage UKAR's portfolio of residential and commercial loans, mortgage-backed securities, and derivative instruments, HM Treasury and the Financial Services Compensation Scheme (FSCS) provided £48.7 billion in funding to the company (2011 Annual Report - pp. 16). UKAR was not able to write new loans, and thus its primary goal was careful and timely management and disposition of the assets on its balance sheet while maximizing taxpayer return (2012 Annual Report - pp. 7).

Purpose: "To maximize value for the taxpayer and reduce costs by combining business infrastructure and sharing best practice in customer service" in winding down the closed mortgage books of B&B and Northern Rock Asset Management."	
Launch Dates	March 24, 2010 (Announced) October 1, 2010 (Operational) October 1, 2010 (First Transfer)
Wind-down Dates	October 1, 2010 (One transfer) Ongoing asset disposition.
Program Size	Not specified.
Usage	Peak of £115.8 billion in assets.
Types of Assets	Residential and commercial loans, mortgage-backed securities, unsecured loans.
Disposition v. Management	Disposition and management
Ownership	Public-owned
Centralized v. Decentralized	Decentralized
Outcomes	£11.4 billion in assets remaining; profit of approx. £8.1 billion
Notable Features	Consumer-centered communication strategy; No new or current loans written or extended

UKAR used competitive sales, buy-backs, and loan redemptions to dispose of its assets (2018 Annual Report - pp. 21). To inform its disposition decisions, UKAR engaged in a communication strategy that focused primarily on consumer well-being and ensuring that there would be minimal disruption of service when a sale was completed (UKAR – Apr. 2, 2019). The organization also waived Early Repayment Charges (ERCs), opted to reimburse any customers that had been falsely sold Payment Protection Insurance (PPI) by NRAM or B&B, and partnered with organizations in the debt help industry to assist troubled borrowers as a result (2011 Annual Report - pp. 7, 8, 11). As a whole, UKAR has managed to turn a profit of approximately £8.1 billion and reduce its balance sheet to £11.4 billion in assets (2019 Annual Report - pp. 14). As of June 2019, the company also repaid all of its government funding and is now in the process of selling the remainder of B&B and NRAM (2019 Annual Report - pp. 8 - 9).

Summary Evaluation

Some of the company's models and valuation techniques were criticized as being potentially sensitive to changes in the macroeconomic environment (2017 Annual Report - pp. 80). The degree of judgment given to management as to how to structure these models was also challenged (2017 Annual Report - pp. 79 - 81). Despite there being minimal academic evaluation of UKAR, numerous independent audits have suggested that, overall, the asset management process has been efficient, with minimal issues (2019 Annual Report – Independent auditor reports).

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I. Overview

Background

Prior to the Global Financial Crisis, Northern Rock was the fifth largest mortgage lender in the UK (HC 394 (2008-09) - pp. 5). It was an institution that was heavily reliant on short-term, wholesale funding and, because of this, acutely vulnerable to the stresses that the global financial system would sustain in 2007(Case NN 70/2007 - pp. 6). As funding markets dried up, Northern Rock requested emergency assistance from the Bank of England (HC 394 (2008-09) - pp. 5). Upon hearing of this request, a huge run on retail deposits in September of 2007 would occur, with approximately £4.6 billion being withdrawn (HC 394 (2008-09) - pp. 5). Despite receiving this emergency support from the UK government, Northern Rock continued to issue "together" loans, containing a secured and unsecured element, which were tied to a single interest rate and monthly payment. These could be written at up to 125% of the property's value (HC 298 (2008-09) - pp. 7). In addition to writing these risky loans, Northern Rock also consistently understated its number of arrears (HC 394 (2008-09) - pp. 11).[2] At first, a private buyer was sought out, but there were no banks that were both 1) willing to tackle the problematic Northern Rock balance sheet, and 2) able to raise the financing necessary to repay the £51 billion in emergency aid and guarantees that the Bank of England had provided (HC 394 (2008-09) - pp. 10). This left the UK government little choice other than to nationalize the troubled lender on February 22, 2008 (Case C 14/2008 - pp. 7). By the end of 2009, a restructuring plan had been approved for Northern Rock, in which the troubled institution would be split in two (UKAR - Jan. 4, 2010). The "bad" bank, called Northern Rock Asset Management (NRAM), would contain the bulk of the institution's mortgage book, as well as any government loans and guarantees (UKAR - Jan. 4, 2010; BBC - Jun. 26, 2009). All other parts of Northern Rock's business were kept as a separate entity with the same name: Northern Rock plc.

Throughout this same period, the bank Bradford & Bingley (B&B) experienced similar funding issues. Creditors such as TPG Capital pulled their investments after the lender experienced a ratings downgrade (Treanor 2008). As a result, the bank found itself not only incapable of raising enough funds to meet its obligations but forced to ask the government for emergency aid as its share price plummeted in September 2008 (Case NN 41/2008 - pp. 2). Just as in the case of Northern Rock, the government searched for a willing buyer but, due to the continued stresses of the Global Financial Crisis, initially found none. On September 29, 2008 a partial nationalization of the bank was finalized (B&B Overview). Due to the state of its mortgage-related assets, lending balances, and non-savings businesses, the UK government opted to sell the bank's deposits and branches to Satander for approximately £600 million (BBC - Sep. 28, 2008; CNN - Sep. 29, 2008).

[2] Northern Rock was required to curb the level of new lending activity as a requirement to receive aid from the Bank of England. However, over £750 million of additional Together mortgages were written in the period after they had received aid and before they were nationalized. Following their nationalization, Together products were completely removed from the market.

The task of managing both the "bad bank" portions of Northern Rock and Bradford & Bingley were eventually taken over by the newly-created UK Financial Investments Limited (UKFI) in November of 2008 (HM Treasury - Nov. 3, 2008). UKFI was a company that operated at arms-length from the government and established during the financial crisis to manage the UK government's holdings in key institutions (UKFI 2015 Annual Report - pp. 6). At the time of nationalization, there was no permanent resolution structure for insolvent financial institutions. However, the Banking Act 2009 formalized the Special Resolution Regime, which empowered the Bank of England as a resolution authority. On October 1, 2010, after approval from the Financial Services Authority (FSA), UKFI was phased out on as manager in favor of a new holding company and subsidiary of UKFI, called UK Asset Resolution Limited (UKAR) (UKAR - Oct. 1, 2010). Its purpose was to wind down the closed mortgage books of B&B and NRAM after the acute phase of the Global Financial Crisis had subsided (UKAR - Oct. 1, 2010).

Program Description

UKAR was a state-owned holding company created to manage the closed mortgage portfolios of Bradford & Bingley and Northern Rock Asset Management. The two mortgage lenders were separate subsidiaries of the company and had been managed by UKFI subsequent to their respective nationalizations in 2008 (2011 Annual Report - pp. 25). UKFI would retain a major role as the parent company and primary supervisor of UKAR until April of 2018 (Framework (Apr. 2018) - pp. 2).

Its primary objective, aside from an orderly wind-down of its balance sheet, was to maximize the return of this wind-down to the taxpayer (2011 Annual Report - pp. 27). The corporation was funded by HM Treasury and the Financial Services Compensation Scheme (FSCS), which was the UK's deposit insurance institution. HM Treasury contributed £33 billion and the FSCS £15.7 billion (2011 Annual Report - pp. 16). At the time of its creation, UKAR held a total of £115.8 billion, consisting of hundreds of thousands of residential and commercial mortgages, and a smaller portion of mortgage-backed securities, derivatives, and unsecured loans (2019 Annual Report - pp. 11). A large amount of the corporation's funding came from wholesale funding sources of B&B and NRAM (2011 Annual Report - pp. 16).

UKAR was much narrower both in its scope and duties than many asset management companies. It was only in charge of the portfolios of two failed lenders and, because these portfolios were closed, did not issue any new mortgages or write any new loans (2012 Annual Report - pp. 7). There were no additional and thus, potentially conflicting, secondary mandates that UKAR had to follow, either. UKAR's function, then, was two-fold. It was required to not only manage and monitor the performance of thousands of mortgages, but also to gradually dispose of and wind down the portfolios without adversely affecting real-estate markets (UKAR - Oct. 10 2010; C/2004 244/02 - pp. 4). It was not allowed to write any new mortgages or to allow any of their customers to extend their mortgages past their original terms (2012 Annual Report - pp. 7). Contracted employees that were hired and paid for by B&B staffed the organization (2011 Interim Report - pp. 27). NRAM and UKAR had no direct employees.

Table 1: UKAR Balance Sheet breakdown (December 31, 2010)

As of December 31, 2010	Amount (£ millions)
Cash and Balances at Central Banks	7,291.8
Loans and Advances to Banks	5,615.6
Investment Securities[3]	3,924.6
Loans and Advances to Customers	83,544.6
Derivative Financial Instruments	9,471.6
Fair value adjustments on portfolio hedging	762.8
Other Assets[4]	263.4
Total	110,874.4

Source: UKAR Annual Report (2011)

Most of these assets, as explained above, consisted of residential, commercial, or unsecured loans that had been made prior to the nationalization process (2019 Annual Report). There were residual amounts of mortgage-related securities and derivative instruments, as well (2019 Annual Report - pp. 68). However, the bulk of UKAR's assets were residential and commercial mortgages and thus, much of its time was spent servicing these loans and ensuring borrowers were able to meet their payments (2014 Annual Report - pp. 48).

As of June 31, 2011, the total number of customers UKAR was servicing was approximately 771,000 (2011 Annual Report - pp. 8 - 9). As such, the corporation partnered with certain participants in the debt-help industry, waived early redemption charges, reimbursed customers for Payment Protection Insurance (PPI), and brokered several sales to outside institutions in efforts to better assist its customer base (2011 Annual Report - pp. 7, 8, 11; UKAR - Press Releases). These strategies were all part of a broader communications effort

[3] Investment securities also includes unsecured investment loans.

[4] "Other Assets" includes the following items: Other Assets, Current Tax Assets, Deferred tax assets, Retirement benefit assets, Investment Property, Property, plant and equipment, and Intangible assets

by UKAR to make consumers who might be under financial stress aware of the number of options available to them.

By the end of December 2010 approximately 38,515 loans were in arrears or in the process of repossession. This fact prompted the UKAR to establish relationships with Payplan, the Consumer Credit Counselling Service, Citizens Advice Bureau, the National Debt Line and Money Advice Service, which were providers of free debt solutions (2011 Annual Report - pp. 5). UKAR was extremely active in referring any customers with substantial debt to these nonprofit, charity-based companies, such as PayPlan, who would then create a Debt Management Plan with the goal of reducing monthly payment stresses on the borrower (2012 Annual Report - pp. 9). "Buy-to-let" loans were those specifically made to landlords, who would then rent out, or "let" the property obtained by the loan to tenants ("'Buy-to-let' mortgages"). If a buy-to-let loan was in arrears, UKAR had a system in place that would allow it to directly collect rent from the tenants so they would not have to leave in the event of repossession (2014 Annual Report - pp. 11). Though it did not happen frequently, UKAR was sometimes forced to engage in repossession efforts if a borrower was still unable to repay their loan, though this was only after all other options had been exhausted (2012 Annual Report - pp. 7).

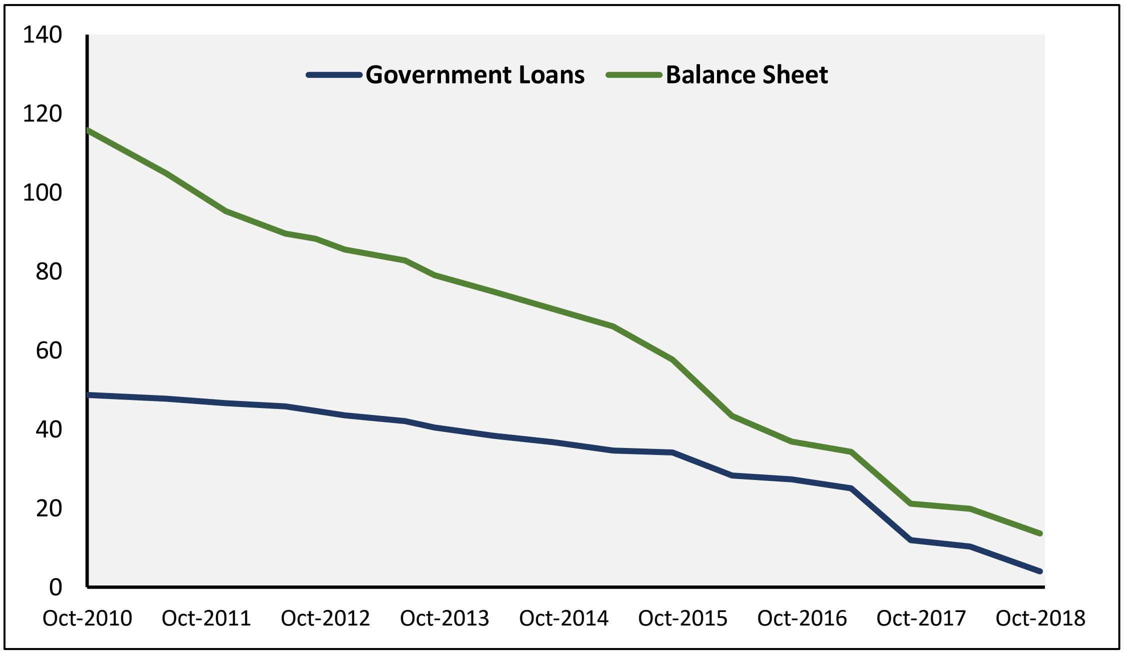
Initially, early redemption charges (ERCs) were enforced at both B&B and NRAM (B&B 2009 Annual Report - pp. 5; UKAR - Jul. 29, 2011 for NRAM). ERCs were added to loans so lenders could protect themselves against early refinancing or to recoup potential profits if interest rates fell ("Early Repayment Charges"). However, UKAR quickly realized that, in order to more rapidly wind down its balance sheet, it would be more beneficial to simply waive these charges (2011 Annual Report - pp. 8). Additionally, many of UKAR's customers were inappropriately sold PPI by their previous lenders (2011 Annual Report - pp. 11). Rather than issue a blanket statement to honor all PPI obligations, false or otherwise, UKAR informed their customers that it would address any complaints and compensate customers if they felt they had been mis-sold PPI (2011 Annual Report - pp. 11).

Finally, the corporation engaged in multiple sales of various portfolios of mortgages and mortgage-related assets to private entities (UKAR - Press Releases). These portfolios of assets were put up for large, multinational financial institutions such as Barclays and Citigroup to bid on (2018 Annual Report - pp. 7; UKAR - Apr. 2, 2019). UKAR ultimately had the final say in who would become the owner of these assets, and in every case specified that, "...there [would] be no changes to the terms and conditions of the loans as a result of the transaction (UKAR - Apr. 26, 2018)". Additionally, the company strongly advocated for "continuity of service" by selecting a winning bidder who would keep the same mortgage servicer (UKAR - Apr. 26, 2018). This could not always be done, but in the majority of sales, the same servicer was able to be kept (UKAR - Oct. 14, 2014). Equity-release mortgages, which involve the home being returned to the lender when the borrower dies or is put into long-term care, were a small, but difficult-to-dispose of part of UKAR's portfolio (The Guardian - Feb. 6, 2013; 2018 Annual Report - pp. 13 - 14). No-Negative-Equity-Guarantees

(NNEG) had been placed on them which negatively impacted their sale price.[5] (2018 Annual Report - pp. 13).

Outcomes

Figure 1: UKAR Government Loan Balance and Balance Sheet Assets (£ billions)



Source: UKAR Annual Reports (2011 - 2018)

UKAR's disposition and management efforts are still ongoing, with substantial progress being made since its inception. UKFI, due to its function as a crisis-era organization, shut down on March 31, 2018, and had its management and administrative responsibilities transferred to UK Government Investments (UKGI) (UKGI Framework (2018) - pp. 10). UKGI, which was created on April 1, 2016, was another government-owned company designed to be "The UK Government's centre of excellence in corporate finance and corporate governance", and to bring together the functions of a multitude of financial market-related institutions under the same umbrella (UKGI Framework (2018) - pp. 11). UKFI was made a subsidiary of UKGI shortly after its creation, but management duties of

[5] NNEGs were standard guarantees placed on equity-release mortgages that capped the amount of a mortgage redemption at the lesser of the amount that the property sold for or the loan amount. If a property with an equity release mortgage was sold at less than the face value of the loan and it had a NNEG, then the lender, or buyer of these mortgages, would only receive the amount the property sold for rather than the higher face value of the loan.

UKAR would remain with UKFI until its shutdown in March of 2018 (UKGI Framework (2018) - pp. 10).

As of June 2019, the corporation's balance sheet has been reduced to just £11.4 billion from its original size of £115.8 billion (2019 Annual Report - pp. 6). These reduction efforts were largely due to loan redemptions, asset sales, and natural run-off (2019 Annual Report - pp. 65, 68).

Despite turbulent housing and financial markets during its early years, UKAR managed to turn a profit every year after 2010 (2019 Annual Report - pp. 14). Statutory profit peaked at £1.5 billion in the reporting period from December 2010 to December 2011, and reached its lowest point as of March 31, 2019, at £0.3 billion (2019 Annual Report - pp. 14). In total, the company has made approximately £8.1 billion as of June 2019. Key metrics, such as loans in arrears, number of repossessions, and overdue payments, continued to fall as well. The number of arrears peaked in 2010, with 39,532 loans (2019 Annual Report - pp. 14). Repossessions would follow a similar trend, peaking in 2011, at 8,848 (2012 Annual Report - pp. 17). However, these would steadily decline as UKAR's balance sheet shrank and it became more familiar with servicing these loans (2019 Annual Report - pp. 17).

As the company's balance sheet wound down and the number of customers lessened, it began contracting out some key functions, such as mortgage servicing, to third-party firms. On May 4, 2016, UKAR announced a seven year contract with mortgage servicer Computershare (UKAR - May 4, 2016). The contract, for about £30 billion in assets, officially began on June 6 and saw approximately 1,700 UKAR employees transfer to the organization to aid in the mortgage servicing process (UKAR – Jun. 6, 2016).

With its asset sale on April 2, 2019, UKAR announced its intent and ability to repay the remainder of the £30 billion government loan made by HM Treasury (UKAR - Apr. 2, 2019). The £15.7 billion loan made by the FSCS was repaid about a year earlier, on April 26, 2018 (UKAR - Apr. 26, 2018). However, HM Treasury stated that, if UKAR required additional funding, it was willing to step in and provide it until the beginning of 2021 (2019 Annual Report - pp. 96). As of March 2019, UKAR still has about £11.4 billion in assets remaining on its balance sheet (2019 Annual Report - pp. 14) .

II. Key Design Decisions

1. UKAR was established in connection with the nationalizations of B&B and Northern Rock in order to manage their remaining "bad" assets.

In the years leading up to the crisis, the composition of Northern Rock's liabilities shifted away from retail deposits to wholesale funding, with over two-thirds of its funding coming from wholesale sources (Case C 14/2008 - pp. 2). This made the lender much more vulnerable to tightening credit conditions. Bradford and Bingley found itself unable to find affordable financing in the wake of several credit rating downgrades (Case NN 41/2008 - pp. 2). Both Northern Rock and B&B were unable to recoup the losses they sustained as a result of these continued pressures and were nationalized on February 22, 2008 and September 29, 2008, respectively (NRAM Overview; B&B Overview). Authority for the nationalizations came from the Banking (Special Provisions) Act 2008 (Banking (Special Provisions) Act 2008).

NRAM was split from Northern Rock plc on January 1, 2010 as part of a governmental restructuring effort (HC 20 (2012-13) - pp. 4). It contained the corporation's mortgage book and all of its unsecured loan accounts. As of July 2011, B&B and NRAM held approximately 771,000 mortgage loans (2011 Interim Report - pp. 8). [6]

2. UKAR was established as a state-owned corporation, and had to comply with the European Commission's state-aid guidelines.

UKFI was the authority in charge of oversight of UKAR and all its subsidiaries (Framework (Mar. 2017)). UKFI was a company that operated at arms-length from the government and was established during the financial crisis to manage the UK government's holdings in several key institutions, such as the Royal Bank of Scotland and UKAR (UKFI 2015 Annual Report - pp. 6). After UKFI shut down on March 31, 2018, all management responsibility transferred to UK Government Investments (UKGI), which was created on April 1, 2016 (Framework (Apr. 2018) - pp. 2). UKGI was a government-owned company that provided a private-sector perspective into corporate governance and finance policy, while managing the government's stake in several key financial institutions (UKGI 2017 Annual Report - pp. 6; Framework (Apr. 2018) - pp. 2). UKGI managed UKFI as a subsidiary shortly after its creation date in order to bring together the functions and staff of several crisis-era institutions under one holding company (UKGI - What we do). However, responsibility for managing UKAR was not given to UKGI until March 31, 2018, when UKFI shut down. (Framework (Apr. 2018) - pp. 2; UKGI Overview).

Because NRAM and B&B had already been nationalized and given state aid, the creation of UKAR itself did not require approval from the European Commission, but the initial aid offered to Northern Rock and B&B did. The establishment of UKAR, however, required to approval from the Financial Services Authority (FSA), which was the two firms' primary

[6] B&B services approximately 231,000, and NRAM approximately 540,000.

regulator (UKFI - Mar. 24, 2010). The organization would be operated in accordance with state aid rules per EC guidelines, which are expanded upon below (UKFI - Mar. 24, 2010).[7]

Ordinarily, state aid is considered "incompatible" with the common market per Article 87 of the Treaty of the European Commission (EC Treaty - Article 87). However, ad-hoc measures that constitute state aid are allowed under Article 87, section 3(b) if they are to "remedy a serious disturbance in the economy of a member state…", so long as such aid does not adversely affect trading conditions or the competitive environment of the common market (EC Treaty - Article 87).

The European Commission ruled that the initial aid offered to Northern Rock and B&B was permissible per Article 87(3)(b), despite the government of the UK not notifying the Commission prior to initiating it (Case NN 70/2007 - pp. 9; Case NN 41/2008 - pp. 10). In its decision, the European Commission also cited its Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty as a primary tool to determine eligible state aid (Case NN 70/2007 - pp. 7-9 ; Case NN 41/2008 - pp. 7-9).

3. **UKAR emphasized the importance of consumer-friendly policies in its communications about how it would manage and dispose of assets.**

UKAR took strong consideration of the customers that would be affected by the sale of assets. In all of its press releases that referenced a specific sale, the company stated that the "continued fair treatment of customers" was a key consideration in selecting a buyer for their assets (UKAR - Apr. 2, 2019; UKAR - Press Releases). UKAR required its bidders to accept certain non-negotiable customers protections as a part of the process. MP John Glen explained that, "For past sales, these protections required that: the servicer of the mortgages is regulated by the Financial Conduct Authority (FCA); the terms and conditions of the mortgages are not changed; and purchasers abide by restrictions on how the Standard Variable Rate (SVR) can be set (HoC - Written Question: 226546)."

UKAR also referred struggling borrowers to a number of free debt advice providers, avenues that customers could contact if they were struggling to pay their mortgages (2014 Annual Report - pp. 11). UKAR referred customers to third-party free debt advice companies such as Payplan, the Consumer Credit Counselling Service, Citizens Advice Bureau, National Debt Line and the Money Advice Service. (2011 Annual Report - pp. 5). These companies would then work to create a Debt Management Plan with the goal of reducing monthly payment stresses on the borrower (2012 Annual Report - pp. 10).

Other, more minor initiatives, such as reimbursing customers for inappropriately sold Payment Protection Insurance (PPI) and waiving Early Redemption Charges (ERCs), were additional ways in which UKAR advocated for consumers (2011 Annual Report - pp. 8, 11). Payment Protection Insurance was something that a borrower could sign up for that would cover repayments if a borrower was unable to make them (FCA - "PPI Explained"). However, customers often bought PPI under false pretenses or were billed for it despite not knowing

[7] See section 25 of the European Commission's *Community guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty* for more information.

about it (FCA - "Mis-selling of PPI"). ERCs, which were commonplace at both NRAM and B&B prior to the crisis, were waived in the interest of encouraging borrowers to repay their loans without penalty (NRAM Mortgage Redemption info; B&B Mortgage Redemption Info).

4. **Initially, the Corporation was overseen by UK Financial Investments (UKFI) and HM Treasury, and had a shared board of governors for each of the entities.**

Prior to March 31, 2018, UKFI, a crisis-era government corporation, was the primary manager and representative of HM Treasury's 100% stake in UKAR (Framework (Mar. 2017)). UKFI had a mandate to "develop and execute an orderly and active disposal of HM Treasury's investments in financial institutions (including the UKAR subsidiaries) (Framework (Mar. 2017) - pp. 6). According to UKFI's framework document, any Investee Company that was wholly owned, such as UKAR, acted "in a manner similar to that in which a financial sponsor would engage with a wholly-owned portfolio company" (UKFI Investment Mandate (October 2010) - pp. 7). UKFI acted on behalf of HM Treasury, and met with some of its members quarterly to discuss the implementation of UKFI's investment strategies (UKFI Investment Mandate (October 2010) - pp. 4).

Under the governance agreement, UKFI would:

1) Appoint the Chairman of the Board of directors, and had the option to appoint additional Non-Executive directors (Framework (Apr. 2018) - pp. 3);

2) approve or disapprove the appointment of other members of the Board, and had to be consulted on any appointments (Framework (Apr. 2018) - pp. 3);

3) analyze the performance of and enforce the objectives of the business plan that UKAR created (Framework (Apr. 2018) - pp. 4);

4) evaluate and approve or decline any potential transactions that met certain criteria (Framework (Apr. 2018) - pp. 4, 11).[8]

Additionally, UKAR was required to regularly engage with UKFI (later UKGI) in monthly reviews about its performance, and to provide UKFI (later UKGI) with monthly "financial and business performance monitoring to assist this process (Framework (Apr. 2018) - pp. 9)." Per its governance agreement, the company also was required to publish annual reports that would be given to the members of Parliament, who could request the Chairman and CEO of UKAR to attend any relevant meetings (Framework (Apr. 2018) - pp. 10).

UKAR, NRAM, and B&B all shared the same board of directors. The Board was made up of a variety of ex board members from NRAM and B&B, as well as other individuals that had spent a great deal of time in the financial services industry or in government (2011 Annual Report - pp. 25 - 27). Staffing levels peaked at 2,424 as of December 31, 2012 then declined over time (2014 Annual Report - pp. 81). However, all the employees that were providing support for the two banks were contracted and paid for by B&B (2011 Interim Report - pp. 27). NRAM and UKAR had no direct employees. NRAM, per the Northern Rock Transfer Order 2009, had all its employees transferred to Northern Rock plc, thus ensuring that the B&B-contracted

[8] See KDD 10 for more details.

employees would work for one of the two nationalized lenders (2011 Annual Report - pp. 63).

Subsequent to March 31, 2018, however, UK Government Investments (UKGI) became UKAR's manager after UKFI shut down (Framework (Apr. 2018) - pp. 2). No major changes to the governance framework occurred because of this switch.

5. **The maximum size of UKAR's balance sheet was not defined, and there was some talk of adding additional "bad banks" to it.**

At the time of the corporation's inception, B&B and Northern Rock Asset Management had a combined £115.8 billion in assets that were transferred over to UKAR (2018 Annual Report - pp. 14). During the early days of its lifespan, there was talk of potentially bringing parts of other financial institutions, such as the Royal Bank of Scotland (RBS), onto UKAR's balance sheet (Thompson and Jenkins, 2013). However, this did not happen, and the balance sheet never increased beyond what was initially brought onboard from the initial acquisition of B&B and NRAM (2019 Annual Report - pp. 14).

6. **HM Treasury and the Financial Services Compensation Scheme (FSCS) provided £48.7 billion in government loans to UKAR to help resolve the books of B&B and NRAM.**

Of this £48.7 billion, UKAR borrowed £33 billion from HM Treasury, and £15.7 billion from the FSCS, which was the UK's deposit insurance agency (2011 Annual Report - pp. 16). As of June 2019, this amount has been repaid in full (2019 Annual Report - pp. 14).

7. **There were no eligibility constraints on the types of assets that UKAR managed.**

No new loans have been made by UKAR since they took these two institutions over (2012 Annual Report - pp. 7). The assets that the company took were comprised primarily of residential and commercial mortgages and loans, with other, unsecured loans, mortgage-backed securities, and related derivative products, which were primarily used for hedging purposes (2019 Annual Report - pp. 68).

Certain classes of assets, such as equity release mortgages, were more difficult to sell due in no small part to the standard No Negative Equity Guarantees (NNEGs). These guarantees, which were important for protecting borrowers, negatively affected the sale price of equity-release portfolios (UKAR - Sep. 27, 2018). Additionally, tens of thousands of loans that UKAR acquired were in arrears or impaired in some way (2011 Annual Report - pp. 4).

8. **NRAM and B&B became subsidiaries of UKAR on October 1, 2010.**

B&B and NRAM were nationalized by HM Treasury on September 29, 2008 and February 22, 2008, respectively (NRAM Overview; B&B Overview). Both the companies, as well as all of their remaining assets, were transferred under UKAR on October 1, 2010 (UKAR - Oct. 1, 2010).

9. NRAM and B&B were kept as separate legal entities after their integration into UKAR.

The one-time acquisition of the two nationalized institutions kept them as separate legal entities and allowed them to continue to operate individually despite being managed by UKAR (2019 Annual Report - pp. 23). The company was the sole shareholder of the two lenders, which were managed under a singular management structure and board.

10. UKAR was required to maximize value from asset disposition for the taxpayer, keep track of the effects of these disposition efforts, and promote healthy competition.

In its framework agreement, UKAR's overarching objective for disposing of its investments had three provisions:

1) Maximizing sustainable value for the taxpayer while keeping risk in mind (Framework (Apr. 2018) - pp. 2).

2) Monitoring the impact of disposal and restructuring transactions on financial stability (Framework (Apr. 2018 - pp. 2).

3) Promoting healthy competition that "operates to the benefit of consumers and respects the commercial decisions of the financial institutions" (Framework (Apr. 2018) - pp. 2).

11. UKAR disposed of its assets through a variety of sales and redemptions, and an estimated 2020 sunset date has been set by the company.

Asset sales followed a general process:

1) UKAR would analyze market conditions and determine whether it was appropriate to sell a selection of assets (2019 Annual Report - pp. 15).

2) The company would then ensure that the potential sale would encourage enough competition amongst potential buyers that it would be reasonably compensated (2019 Annual Report - pp. 15).

3) "Reasonable compensation" was determined through a market-oriented valuation framework that included macroeconomic aggregates and potential cash-flows to determine what a fair price would be (2019 Annual Report - pp. 15).

There were no restrictions on who was allowed to bid on the assets, although, in recent sales, UKAR would actively solicit bids from top "active" lenders, or institutions who were already engaged in lending (2019 Annual Report - pp. 15 - 16). This was done because customers could, in theory, restructure or refinance with the new owner of the loan, if the owner was an active lender (2019 Annual Report - pp. 15).

Transactions that met certain criteria required approval from the supervising institution (initially UKFI, later UKGI) if they:

1) had proceeds of 250 million pounds or more (Framework (Apr. 2018) - pp. 11);

2) had a net profit of 25 million pounds or more for UKAR or any of its subsidiaries (Framework (Apr. 2018) - pp. 11);

3) involved assets being sold at a discount or premium that is "not in line" with those in the market for similar assets / liabilities (Framework (Apr. 2018 - pp. 11).

Redemptions of loans were another, more indirect disposition method (2018 Annual Report - pp. 21). Redemption rates varied depending on the level of house prices and mortgage refinancing. These things, in combination with the natural runoff that occurs as customers repay their loans couple with a lack of new lending, were the strategies that UAKR utilized to reduce its balance sheet.

Throughout its lifespan, the company avoided giving too many details on its wind-down procedures, but more recent communications have indicated that its operations may cease as soon as 2020. As of March 2019, its £115.8 billion balance sheet has been reduced by £104.4 billion (2019 Annual Report - pp. 14). Despite the types of assets UKAR had to manage, it managed to turn a profit every year since its inception (2019 Annual Report - pp. 14). By June of 2019, UKAR had also paid off the entirety of the £48.7 billion in government loans, leaving approximately £11.4 billion on its balance sheet for disposal (2019 Annual Report - pp. 69).

These significant advances have allowed UKAR to position itself to sell off what remains of B&B and NRAM in their entirety within the next year. In its latest annual report, the company stated that "We are now working with advisors in order to complete our objective of returning the UK taxpayers' investment in NRAM and B&B to the private sector in full through the sale of the B&B and NRAM legal entities."(2019 Annual Report - pp. 9, 16) In fact, the company has said that they believe they could broker a sale sometime during 2020, as they have already invited several potential bidders to tender as of April 2019 (2019 Annual Report - pp. 16).

III. Evaluation

UKAR has been subject to audits through its Audit Committee since its inception and has published the results of these in the appropriate annual reports. Aside from these audits, there hasn't been much evaluation of the program due to the small number of lenders involved and the relatively contained nature of the program. Several major accounting firms, such as Deloitte and PwC, as well as the National Audit Office (NAO), were involved in the auditing process (2019 Annual Report - pp. 51; and 2017 Annual Report - pp. 48).

Loan loss impairment. One of the most continually examined parts of the program had to do with the calculation of loan-loss impairments. The independent auditors took great care to zero in on these because, as mentioned in one of the reports, "…the Directors make complex and subjective judgments over both the timing of the recognition of impairments and the estimation of the extent of the impairment." (2014 Annual Report - pp. 61) The construction of impairment models, then, often involved making assumptions that include the probability of default and changes in future home prices, among others. (2014 Annual

Report - pp. 61) Some of these assumptions were not directly data-driven, either, such as one that adjusted for potential valuation fraud (2017 Annual Report - pp. 80). Auditors would also compare the data produced by the UKAR's models to those created by major industry players. While the models that were audited were seen as sufficient, one audit did mention that they were "…sensitive to the micro and macro-economic environment in the UK…"(2017 Annual Report - pp. 80)

Customer Redress. UKAR had allocated a not inconsequential portion of its balance sheet to addressing redress claims (2011 Annual Report - pp. 11, "Provision for Customer Redress"). These were particularly noteworthy because many of their customers had been mis-sold PPI by B&B or NRAM and, as a result, were eligible to be reimbursed by the company (2014 Annual Report - pp. 61). Just as in the case of loan loss impairments, the judgment required of UKAR's management in estimating future redress payments was at the forefront of the independent auditing procedures (2016 Annual Report - pp. 89).

Hedge Accounting. Initially, UKAR inherited a broad subset of derivative instruments from B&B and NRAM, adding some inherent volatility to its income statements (2015 Annual Report - pp. 86). While these were almost exclusively used for hedging interest rate and foreign currency risk, the auditors took their time to carefully evaluate the models used to value these derivatives (2015 Annual Report - pp. 86).

There were other, minor concerns that the independent auditing teams professed, but none, including the three outlined above, suggested any significant risk. The audits were largely centered around challenging the degrees of independence that some of the management staff had when making estimations and valuations for models that had an impact on UKAR's financial statements (2015 Annual Report - pp. 84 - 86).

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