SPECIAL LIQUIDITY SCHEME

On 21 April 2008, the Bank of England launched the Special Liquidity Scheme (SLS) to improve the liquidity position of the banking system by allowing banks and building societies to swap for up to three years some of their illiquid assets for UK Treasury Bills. As announced on 17 September, the drawdown period for the SLS closed on 30 January.

This notice sets out how the Scheme has been used.

Treasury Bills with a face value of approximately £185bn have been lent under the Scheme. Since April 2008, the number of banks and building societies accessing the Scheme was 32. In aggregate, those firms account for over 80% of the sterling balance sheet of the financial institutions eligible to use the scheme.

The total nominal value of securities held by the Bank as collateral in the Scheme amounts to approximately £287bn. The Bank's valuation of those securities as at 30 January 2009 was approximately £242bn, an effective discount to par of about 16%.

Most of the collateral received has been Residential Mortgage-Backed Securities or residential mortgage covered bonds.

The haircuts currently applied to eligible securities are shown in the annex. During the remaining life of the Scheme the Bank will continue to call for margin should the haircut-adjusted value of the collateral fall relative to the value of Treasury bills lent. The Bank also reserves the right to vary haircuts on the collateral.

The haircuts are designed to protect against the risk of loss in the event of a counterparty defaulting, and are therefore set taking into account uncertainty about possible valuations of the Bank's collateral, including in the event of default. In addition to 'base' haircuts, additional haircut add-ons are applied to reflect, inter alia: currency risk; where securities are own name (reflecting the risk of correlation between the quality of the collateral and the creditworthiness of the counterparty; and the services provided by the counterparty to the securitisation structures); and for securities where market prices are not available.

Securities are valued by the Bank using observed market prices that are independent and routinely available publicly. The Bank reserves the right to use its own calculated prices, including where such independent market prices are unavailable. Those calculated prices are designed to deliver valuations taking account of securities' contracted cash flows and yields of comparable securities, but not individual loan-by-loan analysis of portfolios. To account for the risk that a calculated price is an over-estimate of what a market price would have been had it existed, an additional haircut is added. The Bank's valuation of all securities is binding.

To borrow Treasury Bills under the Scheme, banks and building societies are charged a fee based on the spread between 3-month LIBOR and the 3-month General Collateral gilt repo rate. The average spread over the drawdown period was about 115 basis points.

Bank of England
3 February 2009

Annex: Special Liquidity Scheme: Haircuts

The following haircuts have been applied to eligible securities. These may be varied at the Bank of England's discretion.

	OMO eligible and G10 Sovereign paper	G10 Government guaranteed agencies	US GSEs	RMBS and covered bonds Not own-name	Credit card ABS Not own-name	Bank and building society debt securities guaranteed under HM Government's guarantee scheme
Credit rating (on Moody's scale)	Aa3 or higher	AAA	AAA	AAA	AAA	AAA
All floating rate	1	3	3	12	15	3
Fixed interest rate, under 3 years to maturity	1	3	3	12	15	3
Fixed interest rate, 3-5 years to maturity	1.5	4	4	14	17	n/a
Fixed interest rate, 5-10 years to maturity	3	8	8	17	20	n/a
Fixed interest rate, 10-30 years to maturity	5.5	14	14	22	25	n/a
Fixed interest rate, over 30 years to maturity	Available on request	Available on request	Available on request	Available on request	Available on request	n/a

Additional Notes

An additional 3pp is added to haircuts to allow for currency risk when securities are non-sterling.

An additional 5pp is applied to own-name eligible covered bonds, RMBS and credit card ABS; but not to own-name debt securities guaranteed under the government's guarantee scheme.

An additional 5pp is added to securities for which no market price is available.

Credit ratings must have been provided by two or more of Fitch, Moody's and Standard and Poors.

Note on calculation: adjusted collateral value (post-haircut) = collateral value x (100-haircut)%

The Bank may make further specific haircut add-ons for particular eligible collateral or a particular participant's circumstances, at its discretion.

Haircuts and haircut add-ons are kept under review. The Bank reserves the right to alter them on outstanding transactions.