# BANK OF ENGLAND UPDATED MARKET NOTICE: SPECIAL LIQUIDITY SCHEME

1 The Bank of England's Special Liquidity Scheme operates as follows:

## Access to the Scheme

2 Institutions eligible to participate are banks and building societies which are eligible to sign up for the Bank's Operational Standing Facilities.

3 Each participating institution must use the Scheme for a minimum amount set by the Bank. Drawdowns above the minimum were subject to approval by the Bank.

4 The period for new drawdowns ("the Drawdown Period") closed on 30 January 2009.

## Securities advanced

5 Under the Scheme, UK Treasury Bills ("Bills") are lent against collateral consisting of eligible securities as listed in the Eligible Securities section below.

6 The Bills lent under the Scheme have an original maturity of nine months and were created within the month preceding the drawdown. The Bills must be delivered back to the Bank in a window of between 20 to 10 business days prior to their maturity and will be exchanged for the prevailing 9-month Bill.

## Term of the transactions

7 The Scheme will operate for up to three years from the end of the Drawdown Period, at the Bank's discretion. The term of the transactions will be for one year or to the maturity of the eligible securities as held under the Scheme at the end of the Drawdown Period, whichever is the shorter.

**Fee**

8 The fee payable on borrowings of Bills will be the spread between 3-month LIBOR and 3-month General Collateral gilt repo rate, as observed by the Bank, subject to a floor of 20bps. The fee may vary at the Bank's discretion.

9 The spread will be fixed on the date of a drawdown and will be re-fixed thereafter every 3 months, with daily calculation of the fee based on the mark-to-market value of the Bills at closing Debt Management Office (DMO) reference prices. The fee will be paid every 3 months at the end of the re-fix period, or upon termination.

**Eligible securities**

10 The eligible securities will comprise, subject to paragraph 12:

- Debt issued by G10 sovereigns rated Aa3 or higher, excluding securities eligible in the Bank's normal Open Market Operations, subject to any settlement constraints.

- Debt issued by G10 government agencies explicitly guaranteed by national governments, rated AAA.

- Conventional debt issued by the US Government Sponsored Enterprises (Freddie Mac, Fannie Mae and Federal Home Loans), rated AAA.

- UK and EEA Covered bonds rated AAA, including those issued by the institution, or entities in the same group as the institution, entering into the transaction. The underlying assets must be either mortgages, social housing loans or public sector debt.

- AAA-rated tranches of UK, US and EEA Asset-Backed Securities (ABS) backed by social housing loans or credit cards, including those originated by the institution, or entities in the same group as the institution, entering into the transaction. The underlying assets must not be synthetic (i.e. not derivatives).

• AAA-rated tranches of UK and EEA Residential Mortgage-Backed Securities (RMBS) backed by UK and EEA mortgages. The underlying assets must not be synthetic (i.e. not derivatives). RMBS backed by mortgages originated by the institution, or entities in the same group as the institution, entering into the transaction are permitted.

• Bank debt guaranteed under HM Government's Credit Guarantee Scheme for bank debt announced on 8 October 2008. [1]

Securities may be denominated in sterling, euro, US dollars, Australian dollars, Canadian dollars, Swedish krona or Swiss francs or, in the case of Japanese government bonds and bank debt issued under the UK government's Credit Guarantee Scheme, yen.

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

12 Each participant may deliver as collateral only eligible securities held on balance sheet as at 31 December 2007 and eligible securities formed from underlying loans, including sellers' claims on Master Trusts, held on balance sheet at that date ("the legacy asset principle"). Participating institutions may deliver securities held, or formed from assets held, on the balance sheet of the participating legal entity. Subsidiaries' assets satisfying the legacy asset principle are also eligible provided that the subsidiary is owned by the participating legal entity. Assets held in subsidiaries that are consolidated for accounting purposes but not owned by the participating legal entity are not eligible. For this purpose, a participating entity is treated as owning a subsidiary if it holds a majority of the voting rights in the subsidiary.

13. The Bank may consider including securities formed from underlying assets previously owned by the participating institution (or a subsidiary owned by the institution) that were warehoused in an off balance-sheet structure or vehicle as at 31 December 2007. Whether the Bank includes such assets would depend on, for example, the structure and legal maturity date of existing financing.

[1] http://hm-treasury.gov.uk/press_100_08.htm

14. The Bank will not accept as collateral, securities, including covered bonds, formed in whole or in part from underlying commercial loans. The Bank interprets commercial loans to include loans to Small and Medium Enterprises, including those secured on land or commercial property. Buy-to-let loans to private residential landlords are eligible.

15. The Bank will not accept as collateral, securities, including covered bonds, formed in whole or in part from residential mortgages secured on properties not located in the UK or other EEA countries.

16. The Bank forms its own independent view of the risks in collateral it takes in its operations and reserves the right to deem a security ineligible at any time, including securities previously deemed eligible. Should collateral be downgraded below the minimum credit ratings set out above, the Bank would seek to understand the circumstances of the downgrade before determining whether that merited any change to the security's eligibility.

**New covered bond issues and securitisations for SLS usage**

17. Institutions considering new securitisations or new covered bond issues (e.g. for future substitutions) should establish a point of contact in the Sterling Markets Division of the Bank at an early stage in the process. In order to facilitate checks of whether collateral is eligible in the SLS, the Bank requires institutions to provide a response to a set of standard questions, available via the institution's relationship manager.

18 The Bank will require each participant to certify compliance with the legacy asset and eligibility criteria, and reserves the right to seek independent verification of compliance, at the cost of the participant, in certain circumstances. Details of new securitisation and covered bond programmes intended for use in the Scheme should be discussed with the Bank at the earliest opportunity.

**Top-ups and amortisation limits for revolving structures**

19 For participants delivering covered bonds and non-pass through RMBS collateral amortisation limits are applied over the three year life of the SLS when the original legacy assets are topped-up or substituted for by assets originated after 31 December 2007 in order

to determine the maximum value of such securities that can be delivered by each institution under the SLS. The amortisation limit in year 1 of the Scheme is the sum of the value of AAA covered bonds and non-pass-through RMBS held on balance sheet as at 31 December 2007, the value of sellers' shares in RMBS Master Trusts as at 31 December 2007 and the total value of unencumbered residential mortgage loans held on balance sheet, including any issuance capacity in covered bond programmes, as at 31 December 2007, minus any residential mortgage loans used to back pass-through issuance since 31 December 2007. In year 2 of the Scheme, participants may deliver AAA covered bond and non-pass-through RMBS collateral up to two-thirds of the Year 1 limit. In year 3 of the Scheme, participants may deliver AAA covered bond and non-pass-through RMBS collateral up to one-third of the Year 1 limit. The participants must ensure that the characteristics of new loans entering into pools are consistent with the eligibility criteria of the SLS in all other respects.

20 Eligible pass-through RMBS are not subject to amortisation limits as they do not contain non-legacy assets. Other RMBS or covered bond programmes where the issuer has committed to the Bank not to top up or otherwise replenish the collateral pool with non-legacy assets will be treated as pass-though structures for the purposes of amortisation limits.

**Valuations and haircuts**

21 Eligible securities will be valued by the Bank using observed market prices that are independent and routinely publicly available. The Bank reserves the right to use its own calculated prices. If an independent market price is unavailable, the Bank will use its own calculated price and apply a higher haircut. The Bank's valuation is binding.

22 Haircuts are defined in the Annex to this Notice.

23 Custody fees incurred by the Bank in holding eligible collateral, including where securities have been pre-positioned with the Bank, will be charged back to participants.

**Early rolling of transactions**

24. To help participants manage their drawings from the Scheme, the Bank will accommodate SLS participants which wish to roll swap transactions early by entering into

replacement transactions before the original transaction's scheduled maturity date. If required, such rolls can take place once transactions have less than three months to maturity, and must take place on the final re-fix date of the swap. In those circumstances, the Bank will terminate the original transaction and replace it with a new 364-day transaction or a transaction to the maturity of the eligible collateral, whichever is shorter. The Bank requires 5 business days notice for requests to roll transactions early.

25. SLS participants should speak to their relationship manager for further details on this process.

**DMO Treasury-bill issuance facility**

26. As described above, equivalent securities to Bills lent under the Scheme must be delivered back to the Bank in a window of between 20 to 10 business days prior to their maturity and will be exchanged for the prevailing 9-month Bill. Equivalent Bills for redelivery to the Bank may either be purchased in the market, or obtained from the DMO using its bilateral bill issuance facility. Details of the DMO's bilateral Bill issuance facility can be found at:

[www.dmo.gov.uk/index.aspx?page=tbills/tbills_Discretionary](www.dmo.gov.uk/index.aspx?page=tbills/tbills_Discretionary).

**FSA guidance on treatment of transactions**

27. The FSA has issued guidance on the regulatory treatment of SLS transactions, including that Bills obtained via the SLS can be considered as liquid assets until the maturity of the Scheme. Further details are available from FSA line supervisors.

**Settlement**

28 Eligible securities must be deliverable via;

- Euroclear or Clearstream, for instruments issued directly into the International Central Securities Depositories;
- international links maintained by Euroclear or Clearstream;

- such other delivery mechanism as the Bank shall specify.

The Bank reserves the right to reject any security offered for any reason at any time.

**Margin arrangements**

29 Re-margining will take place daily based on updated valuations of the eligible securities provided, and of the Bills lent under the Scheme, across all Scheme transactions with a participant, subject to a threshold of £1 million.

30 Margin securities may consist of eligible securities as listed above, and additionally of securities that are routinely eligible as collateral in the Bank's Open Market Operations and Operational Standing Facilities, as published on the Bank's website. The latter must be delivered by the delivery mechanisms specified in the legal agreements for the Scheme's transactions and will be subject to the haircuts specified in the annex to this notice.

**Substitutions**

31 Collateral substitutions are permitted throughout the life of the scheme. Following the end of the Drawdown Period, if eligible securities substituted into the Scheme have a shorter maturity than the underlying collateral swap, the term of the collateral swap is similarly reduced.

**Early maturity**

32 Subject to maintaining the minimum participation level, participants may mature, or partially mature, particular transactions before their contractual maturity date against surrender of the Bills.

**Published information**

33 On 3 February 2009, the Bank published the total outstanding value of Bills lent under the Scheme as at the end of the Drawdown Period.

Bank of England

25 September 2009

Annex: Haircuts

The following haircuts will be applied to eligible securities and may be varied at the Bank of England's discretion.

| Haircuts for Scheme operations | OMO eligible and G10 sovereign paper | | G10 Government guaranteed agencies | US GSEs | Bank and building society debt securities guaranteed under HM Government's Credit Guarantee Scheme | RMBS, covered bonds backed by residential mortgages | Credit card ABS |
|---|---|---|---|---|---|---|---|
| *Credit rating (on Moody's scale)* | Aa3 or higher | | Aaa | Aaa | n/a | Aaa | Aaa |
| | Coupon | Zero Coupon | | | | | |
| All floating rate | 0.5 | 0.5 | 3.0 | 3.0 | 3.0 | 12.0 | 15.0 |
| Fixed interest rate up to 1 year maturity | 0.5 | 0.5 | 3.0 | 3.0 | 3.0 | 12.0 | 15.0 |
| Fixed interest rate 1-3 years to maturity | 1.5 | 1.5 | 5.0 | 5.0 | 5.0 | 14.0 | 17.0 |
| Fixed interest rate 3-5 years to maturity | 2.0 | 2.0 | 6.0 | 6.0 | n/a | 15.0 | 18.0 |
| Fixed interest rate 5-10 years to maturity | 3.0 | 3.5 | 8.0 | 8.0 | n/a | 17.0 | 20.0 |
| Fixed interest rate 10-20 years to maturity | 4.5 | 6.0 | 10.0 | 10.0 | n/a | 19.0 | 22.0 |
| Fixed interest rate 20-30 years to maturity | 6.0 | 8.5 | 13.0 | 13.0 | n/a | 22.0 | 25.0 |
| Fixed interest rate more than 30 years to maturity | 7.5 | 14.0 | 15.0 | 15.0 | n/a | 24.0 | 27.0 |

*Additional notes:*

*An additional 6pp will be added to haircuts to allow for currency volatility when securities are non-sterling.  A further haircut add-on of 2pp is applied to yen-denominated securities to allow for higher volatility in the sterling/yen exchange rate.*

*An additional 5pp will be 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 will be applied to securities for which no market price is observable.*

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

*Margin ratios and haircuts will be kept under review.  The Bank reserves the right to alter them at any time, including on outstanding transactions.*