HM TREASURY

05/09

19 January 2009

Statement on financial intervention to support lending in the economy

With the global economic downturn intensifying in the past two months, the Government is today announcing a comprehensive package designed to reinforce the stability of the financial system, to increase confidence and capacity to lend, and in turn to support the recovery of the economy.

Today's announcements aim to address the current barriers to lending by:

- extending the drawdown window for new debt under the Government's Credit Guarantee Scheme (CGS) which is designed to reduce the risks on lending between banks;
- establishing a new facility for asset backed securities;
- extending the maturity date for the Bank of England's Discount Window Facility which provides liquidity to the banking sector by allowing them to swap less liquid assets;
- establishing a new Bank of England facility for purchasing high quality assets;
- offering capital and asset protection scheme for banks, with proposals for this to be co-ordinated internationally; and
- clarifying the regulatory approach to capital requirements, through an announcement by the Financial Services Authority (FSA).

The Government intends to negotiate with the banks participating in certain facilities lending responsibility agreements that will have specific and quantified lending commitments and that will be binding and externally audited.

The likely impact of today's announcements on the public finances will be mostly temporary, as investments will be held for no longer than is necessary to ensure stability and protect taxpayer interests; liabilities will be backed by assets; and fees will be charged for relevant schemes.

Today's announcements build on previous Government measures to support the economy through the economic downturn:

- in October 2008, the Government announced a comprehensive package of support for the financial system both to support stability of the banking system and to protect savers and depositors. Similar measures were adopted by other governments;
- in November 2008, in its Pre Budget Report, the Government announced a comprehensive fiscal stimulus package to support the wider economy, businesses, homeowners and consumers. Again, similar packages have been introduced by other governments;
- last week, measures to support lending to small and medium sized businesses.

The Government's measures in October 2008 to recapitalise the banking system significantly increased the capital ratios of the major banks, and provided them with a buffer to withstand the current challenging economic conditions.

Over the past two months in particular, the global financial and economic situation has continued to deteriorate. In particular, internationally, banks' confidence to increase lending has been constrained by uncertainty about the value of past investments. Lending by foreign banks, non-bank institutions and smaller lenders for UK borrowers has reduced. The Government is clear that meeting lending demand to otherwise creditworthy businesses, homeowners and consumers is essential for supporting economic recovery. Today's comprehensive measures therefore, target the principal sources of continuing uncertainty in the financial system, and aim to improve confidence, allowing UK lenders to increase its lending and so play a more effective role in supporting the wider economy.

Credit guarantee scheme

As part of the Government's additional measures to encourage lending by financial institutions, the Government is extending the drawdown window of the CGS from 9 April 2009 to 31 December 2009, subject to state aid approval. This will support orderly issuance of debt guaranteed under the CGS. All other aspects of the scheme will remain the same, including the final maturity date of 9 April 2014. During the drawdown window, banks can issue new debt – and once it has been issued, they can keep rolling it over after the window closes (all of it until 13 April 2012 and up to one-third of the total until 9 April 2014). Further details of the scheme's operation are available on the website of the Debt Management Office (DMO).

Guarantee scheme for asset backed securities

In addition to the extension of the credit guarantee scheme, the Government is announcing a new guarantee scheme for asset backed securities, drawing on the recommendations of Sir James Crosby, to improve banks' access to wholesale funding markets, help support lending, and promote robust and sustainable markets over the longer-term. The Government will, in consultation with issuers and investors, provide full or partial guarantees to be attached to eligible triple-A rated asset-backed securities, including mortgages and corporate and consumer debt. UK banks and building societies eligible to participate in the CGS will be able to access the new scheme subject to fulfilling the scheme's conditions. Banks and building societies accessing the scheme will follow international standards and best practice on underwriting, disclosure, reporting and valuation. The Government will set conforming criteria to ensure that only transparent structures and high quality assets are eligible. The scheme will commence in April 2009, subject to state aid approval.

The Government will work closely with the industry and keep the scope of the scheme under review. Mortgage-backed securities supported a third of mortgage lending and the revival of this market is an important element of increasing the capacity of lenders to provide mortgages as demand increases in future. Further details will be announced by the DMO in due course.

Mortgages and Northern Rock

The Government will also consider further ways of addressing the loss of mortgage lending capacity in markets. As a first step, the Government can confirm that Northern Rock is no longer actively pursuing a policy of rapidly reducing its existing mortgage book. Northern Rock is releasing a separate statement on this.

Bank of England liquidity facilities

Since October 2008, the Bank has provided a permanent Discount Window Facility to banks, with a normal length of borrowing of 30 days. The Special Liquidity Scheme, introduced as a temporary facility in April 2008, will close on 30 Januray 2009 as planned, remaining operational for three years thereafter. Upon its closure in order to ensure the availability of long-term liquidity provided by the SLS is continued, the Bank will extend its Discount Window Facility, with its maturity increasing from 30 days to 1-year for an incremental fee of 25bps. This will enable banks to continue to have access to long-term liquidity on demand.

Bank of England asset purchase facility

As a further step to increase the availability of corporate credit, by reducing the illiquidity of the underlying instruments, the Bank of England will set up an asset purchase programme implemented through a specially created fund. The Bank will be authorised by the Treasury to purchase high quality private sector assets, including paper issued under the CGS, corporate bonds, commercial paper, syndicated loans and a limited range of asset backed securities created in viable securitisation structures. The Treasury will authorise initial purchases of up to £50 billion, financed by the issue of Treasury bills. Given the scale of the programme, the Bank will be indemnified by the Treasury. This programme will come into effect from 2 February.

The programme also provides a framework for the Monetary Policy Committee of the Bank of England to use asset purchases for monetary policy purposes should the MPC conclude that this would be a useful additional tool for meeting the inflation target. In such circumstances, the scale of the scheme could be expanded, a further announcement would be made.

Further details of the arrangements for the Asset Purchase Facility will be set out in an exchange of letters between the Chancellor and Governor before the end of January.

Asset protection scheme

To provide certainty and confidence to banks in their lending, the Government is today announcing its intention to offer capital and asset protection on those assets most affected by the current economic conditions. This will reduce banks' uncertainty about the value of past investments, so providing them with greater confidence to lend in the future to creditworthy businesses, homeowners and consumers. The Government is publishing a separate notice setting out the outline terms of the scheme. The Government will make a further statement on the details of the scheme by the end of February.

Capital regulation

In addition, to address any potential uncertainty and to mitigate unintended pro-cyclical effects, the FSA is today publishing a statement clarifying its expectations around bank capital ratios. The FSA's statement makes clear that there are no new statutory requirements for capital and that it sees the capital buffers built in as part of the recapitalisation exercise as playing a role in both withstanding losses and facilitating continued lending. The FSA's statement is consistent with the statement by the Basel Committee on Banking Supervision issued on 16 January.

In the longer term, the Government and the FSA believe that it would be preferable for the capital regime to incorporate counter cyclical measures which lead to banks building up buffers in good years which they can draw down during economic downturns, and the FSA and the Bank will be strongly supporting the work by the Financial Stability Forum and Basel Committee in this area.

The Government will also continue to collaborate internationally with to stabilise and strengthen the global financial system, ahead of the London Summit on 2 April.

The Government will continue to take all necessary measures to ensure the stability of the financial system, ensure lending to the economy, businesses and homeowners, and limit the depth and duration of the current recession and support the subsequent recovery.

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