Sign-up

- Banks and building societies (participants) sign up to the Bank's facilities, known as the Sterling Monetary Framework.
- They are then able to borrow from the Bank's lending facilities, but they need to provide assets to the Bank as collateral for their borrowing to protect the Bank.

Collateral

- Participants need to bring collateral to the Bank **before** they want to borrow against it.
- The collateral the Bank accepts includes tradable securities (for example, government bonds) or pools of raw loans originated by the participant (for example, mortgages).
- For raw loan pools, there is a 'prepositioning' process, detailed in: **Loan collateral: guidance for participants in the Sterling Monetary Framework**. We summarise this process below.
- For pools of vanilla residential mortgage loans, this prepositioning process typically takes 4-5 months. For more bespoke pools, the timing can be longer.

Due diligence

- Before the Bank accepts pools of raw loans as collateral, it needs to conduct 'due diligence' to ensure the loans provide good security. This due diligence includes:
  - The participant providing details about each individual loan, such as the loan amount and details of any security. This is known as a 'data tape';
  - A data audit, where an audit firm checks that the details in the data tape are accurate;
  - The participant completing the Banks Due Diligence Questionnaire followed by the Bank conducting an on-site visit;
  - A legal review, to check that the loans can be transferred to the Bank appropriately; and
  - An internal analysis by the Bank to determine the riskiness of the loan pool, which sets a 'haircut'.

'Haircuts'

- The 'haircut' the Bank sets reduces the amount a participant can borrow against a loan pool, which provides the Bank with additional protection in case the collateral falls in value.
- For example, if the Bank sets a haircut of 20% on a pool of mortgages totalling £100mn, the participant can only borrow up to £80mn from the Bank.
- This is similar to a bank providing a mortgage to an individual, where it will only lend up to say 80% of the value of the property, to protect itself.

Lending

- Once assets have been positioned, Participants may borrow in the Bank's liquidity insurance facilities, such as the Indexed Long-Term Repo, 'encumbering' prepositioned collateral.
- Once the participant repays the Bank, the Bank releases the collateral by 'unencumbering' it.