

BANK OF ENGLAND MARKET NOTICE: OPERATIONAL STANDING LENDING AND DEPOSIT FACILITIES; DISCOUNT WINDOW FACILITY

This Market Notice covers the operation of two new facilities, as described in the consultative paper issued by the Bank on 16 October 2008. These are the Operational Standing Lending and Deposit Facilities; and the Discount Window Facility. The terms of this Market Notice apply with immediate effect.

In the case of the Discount Window Facility, this Market Notice represents the first phase of implementation. In its consultative paper the Bank made clear that the population of eligible collateral will be broad and will be widened over time, to include for example certain diversified portfolios of equities and possibly loans. The Bank also plans over time to establish detailed eligibility criteria for collateral covering, for example for securitised assets, both the structure of securitisations and the composition of the underlying collateral pools. The Bank will issue updates and refinements in due course, following consultation with market participants and analysts.

OPERATIONAL STANDING FACILITIES

- 1 The previous Standing Lending and Deposit Facilities are replaced with new Operational Standing Lending and Deposit Facilities.
- 2 The purpose of the Operational Standing Facilities is to stabilise expectations that overnight market interest rates will be in line with Bank Rate; and, to that end, to give banks a means to manage unexpected 'frictional' payments shocks that could otherwise take their reserves accounts either below zero or to a level where they would otherwise be unremunerated. The Bank will seek to satisfy itself that use of the facility is consistent with these purposes.
- 3 Given that they enable Participants in the reserves scheme to meet their reserves targets, the Bank requires reserves-scheme members to have access to the Operational Standing Lending and Deposit Facilities. All the other banks and building societies that are required to place cash ratio deposits (CRDs) at the Bank are also eligible to have access to the Operational Standing Lending and Deposit Facilities. All Participants in the previous Standing Facilities are deemed to become Operational Standing Facilities Participants.

4 Where a firm is not the primary entity within its Group, the Bank may require a guarantee from the primary entity in a form satisfactory to the Bank. Existing guarantees provided in respect of the Sterling Monetary Framework will apply to the Operational Standing Facilities. A pro forma guarantee and a pro forma legal opinion on the guarantee are available on the Bank's website at www.bankofengland.co.uk.

5 On each day in a monthly maintenance period, the rate charged on the Operational Standing Lending Facility is 25 basis points above Bank Rate; and the rate paid on the Operational Standing Deposit Facility is 25 basis points below Bank Rate.

6 In all other respects the Operational Standing Lending and Deposit Facilities operate in the same way as the previous Standing Lending and Deposit Facilities. Specifically, eligible collateral for the Operational Standing Lending Facility will comprise the high-quality debt securities that are routinely eligible as collateral in the Bank's short-term repo Open Market Operations¹; and the Operational Standing Deposit Facility will be unsecured. Transactions will be for overnight maturity. The Bank is today publishing an updated version of the Documentation for the Sterling Monetary Framework to reflect the changes set out in this Market Notice.

7 The average daily aggregate amount outstanding in each of the Facilities during each maintenance period will be published on the Bank's wire services pages at 10.00 on the third Wednesday of the following maintenance period.

8 In consequence, the Bank has suspended its publication of daily reserves data, including the previous day's use of the Operational Standing Facilities. The Bank has suspended the separate identification of the balance outstanding under the standing facilities in the weekly non-statutory Bank Return. The Bank will also cease to publish a list of banks and building societies signed up for access to its Operational Standing Facilities and the reserves-averaging scheme.

9 The Bank will review the disclosure arrangements for the Operational Standing Facilities after it and the market have gained experience of how the new facilities will operate, in normal and stressed conditions.

¹ <http://www.bankofengland.co.uk/markets/money/eligiblesecurities.xls>

DISCOUNT WINDOW FACILITY

1 The Discount Window Facility (DWF) operates as follows.

Purpose of the Facility

2 The purpose of the DWF is to provide liquidity insurance to the banking system. The Discount Window Facility is not intended for firms facing fundamental problems of solvency or viability.

3 Institutions eligible to participate will be banks and building societies that are required to pay cash ratio deposits (CRDs) and which otherwise meet the requirements for eligibility, as determined by the Bank, for the Bank's other Sterling Monetary Framework facilities.

Gilts loaned by the Bank

4 Under the DWF, HM Government gilt-edged securities ("gilts") will be lent against collateral as listed below. Gilts will be delivered by the Bank using the CREST 'Delivery-by-Value' (DBV) facility or, at the request of a participant and subject to the Bank's consent, in the form of a basket of specific gilts as determined by the Bank. Gilts delivered in DBV will comprise the DBV class 'Unstripped UK government stock (UBG)'. Gilts delivered in the form of a basket of specific gilts will comprise conventional gilts excluding rump stocks.

5 The DWF is not a facility to obtain particular gilts, for example those trading 'special' in the repo market. That would be contrary to the purpose of the DWF and could interfere with HMG's debt management policy and operations, which are the responsibility of HM Treasury and the UK Debt Management Office.

6 At its discretion, in exceptional circumstances, the Bank may agree to lend sterling cash, rather than gilts, against eligible collateral.

7 Banks will not be permitted to borrow gilts from the DWF simply to use them in the Operational Standing Lending Facility in order to obtain cash against DWF eligible collateral. That would be contrary to the purpose of the Operational Standing Facilities, which is to give banks a means to manage short-term frictional problems in the payment systems and overnight money markets. Gilts borrowed in the DWF may be used as collateral in the Bank's Open Market Operations.

Applications to draw under the DWF

8 All drawings under the DWF are subject to approval by the Bank. Given the purposes of the DWF and its above-normal-market pricing, the Bank expects institutions to use it as a backup rather than a regular source of liquidity. The Bank will have the right to ask about the circumstances that have given rise to any application. Depending on those circumstances, the Bank may ask the applicant to provide further information at the point of drawdown, and subsequently during their use of the DWF.

9 Following pre-positioning of eligible securities with the Bank, authorised drawing requests should be initiated by phone to the Bank's Sterling Markets Division. Requests made before 14.00 will settle on the day of the drawing request.

10 The Bank will seek to accommodate requests made after that time on a best endeavours basis. Participants should nevertheless seek to contact the Bank, as soon as possible on the day of an application to draw, if not earlier, to discuss their application for use.

Term of the transactions

11 The term of the transactions will normally be for 30 days. Participants will have the option to repay at any time.

12 Participants may apply to roll DWF transactions, to which the Bank may at its discretion consent.

13 At its discretion, and in the light of market conditions and the degree of stress facing the financial system, the Bank may choose to lengthen the maturity of loans under the DWF.

Eligible collateral

14 The population of eligible collateral will be broad and will be developed over time. A first list, to be used with immediate effect, is set out in Annex 1 to this notice.

15 Instruments eligible as collateral will be classified into four Levels. Initially:

- Level A collateral will consist of high-quality debt securities that are routinely eligible as collateral in the Bank's short-term repo Open Market Operations and Operational Standing Lending Facility, as published on the Bank's website.²
- Level B collateral will consist of third-party debt securities that are, in the Bank's judgment, trading in liquid markets.
- Level C collateral will consist of other third-party debt securities including those that are not trading in liquid markets in the Bank's judgment.
- Level D collateral will consist of own-name securitisations and own-name covered bonds.

16 'Third-party securities' are defined as those issued, originated or guaranteed by persons without close links, as determined by the Bank, to the institution, or by entities not in the same group as the institution, entering into the transaction under the Discount Window Facility. 'Own-name securitisations' and 'own-name covered bonds' are defined as those issued, originated or guaranteed by persons with close links, as determined by the Bank, to the institution, or by entities in the same group as the institution, entering into the transaction under the Discount Window Facility.

17 Given current market conditions, the Bank expects that, with the exception of securities routinely eligible as collateral in its short-term repo OMOs, most of the instruments listed in Annex 1 will initially be placed within Levels C or D. In due course, and after any appropriate consultation, the Bank may publish a list of instruments by Level. In the meantime the Bank will confirm on application the collateral Level into which a particular instrument is placed.

18 Instruments may be deemed ineligible if the Bank judges that they were created for the express purpose of obtaining funding from the Bank.

19 Lists of collateral securities to be checked for eligibility by the Bank ahead of pre-positioning, should be submitted to the Bank at the following address: discountwindow-eligibility@bankofengland.co.uk . They should be accompanied by a formal

² <http://www.bankofengland.co.uk/markets/money/eligiblesecurities.xls>

assurance of compliance with the criteria specified above and in Annex 1. Participants have a responsibility to ensure that collateral securities comply with the Bank's eligibility criteria.

20 The Bank reserves the right to reject any security offered or provided as collateral, for any reason, at any time.

Margin ratios

21 Margin ratios to be applied to eligible collateral are set out in Annex 2 to this Notice. Annex 2 also sets out the circumstances in which additional haircuts are applied including, amongst other things, where securities are denominated in currencies other than sterling; where securities have no observable market price; where previously AAA asset-backed securities have been downgraded; and where the quality of the underlying collateral pool warrants a higher haircut in the Bank's judgment.

Valuations

22 Eligible collateral will be valued by the Bank, where possible using observed market prices that the Bank deems independent, reliable and routinely publicly available. The Bank reserves the right to use its own calculated prices. If, in the Bank's judgment, an independent market price is unavailable, the Bank will use its own calculated price and apply a higher margin ratio. The Bank's valuation is binding.

Fee

23 The fee payable on use of the DWF will vary according to the Level of collateral and the total stock of borrowing by the participant, relative to the size of the aggregate sterling eligible liabilities of all entities in the group, as used for the calculation of the most recent payment of CRDs.

24 Each counterparty will incur a fee on each day dependent on the type of collateral and level of usage of the DWF on that day. Fees are available from the Bank each day.

Fee table for drawings of gilts

Fee in basis points % of sterling Eligible Liabilities	Collateral type			
	Level A	Level B	Level C	Level D
0-10%	50	75	125	200
10-20%	75	125	200	300
20-30%	100	175	275	400
>30%	At the discretion of the Bank			

25 For drawings of gilts, the fee is applied to the total market value of gilts outstanding under the DWF on each day.

26 For any drawings of sterling cash permitted by the Bank, the fee will be indexed Bank Rate plus the fees set out in the table above.

27 In calculating the fee, the Bank will assume that for mixed buckets of collateral (for example where total drawings are against collateral from more than one Level) the collateral from the lower Level is used ‘first’ (eg Level A before Level B and so on).

28 The fee will be payable on the first business day of each calendar month or the maturity of the final outstanding drawing on the DWF if earlier. The fee payable then will be equal to the total of daily fees incurred since the start of each calendar month.

29 The fee may vary at the Bank’s discretion.

Settlement of eligible collateral

30 Eligible collateral instruments must be deliverable to the Bank:

- Via CREST (securities may not be delivered free of payment using CREST’s Delivery-by-Value (DBV) facility);
- Via the European Correspondent Central Banking Model;
- For instruments issued directly into the International Central Securities Depositories, Euroclear or Clearstream;
- To the Bank of England's account at the Federal Reserve Bank of New York, Bank of New York Mellon (DTC only), the Bank of Canada or the Bank of Japan;
- Via international links maintained by Euroclear;

- Via international links maintained by Clearstream;
- Via such other delivery mechanism as the Bank shall specify, from time to time, as set out in the DWF Operating Procedures.

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

32 Eligible collateral must be pre-positioned with the Bank in advance of a drawing. In exceptional circumstances the Bank may permit drawing against collateral delivered on the day of drawing.

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

Margin arrangements

34 Re-margining will take place daily based on updated valuations of the eligible collateral provided, of the securities lent, and of unpaid and estimated future fees, across all DWF transactions with a participant, subject to a threshold of £1 million.

35 Margin securities may consist of eligible securities as listed in Annex 1. Where delivery of margin securities results in a participant transferring a different mix of collateral Levels against its drawings from the DWF, the fee applied would change to reflect the new holdings on that and subsequent days. Amended fees will be available from the Bank.

Substitutions

36 Collateral substitutions are permitted at any time, subject to the Bank's consent. Where collateral substitutions result in a participant transferring a different mix of collateral Levels against its drawings from the DWF, the fee applied would change to reflect the new holdings on that and subsequent days. Amended fees will be available from the Bank.

Admission to the DWF

37 Eligible institutions incorporated in the United Kingdom that are already participants in the Sterling Monetary Framework and that seek to draw on the DWF will be deemed to have accepted the terms. Their Admission Letters will be deemed to be amended to admit them into the DWF, subject only to an appropriate guarantee being provided if they are not

the primary entity of their group. Existing guarantees provided in respect of the Sterling Monetary Framework will also apply to the DWF.

38 CRD payers that are incorporated outside the United Kingdom will need to apply to the Bank to draw from the DWF. Upon such application, if they are already an OMO or an Operational Standing Facilities Participant, they will be sent a letter admitting them to the DWF and where necessary amending the terms to take account of the law of their country of incorporation. They will also be required first to provide relevant legal opinions on their legal capacity to enter into DWF Transactions. A country legal opinion may also be required. Pro forma legal capacity and country opinions are on the Bank's website at www.bankofengland.co.uk. Existing guarantees provided in respect of the Sterling Monetary Framework will also apply to the DWF.

39 Where a firm, whether or not incorporated in the United Kingdom, is not the primary entity within its Group, the Bank may require a guarantee from the primary entity in a form satisfactory to the Bank. It may also require a legal opinion on the guarantor's legal capacity and the enforceability of the guarantee. A pro forma guarantee and a pro forma legal opinion on the guarantee are on the Bank's website at www.bankofengland.co.uk.

40 Within a group, only one eligible institution may access the DWF.

41 Institutions that are not already OMO or Operational Standing Facilities Participants will first have to complete the combined application form and questionnaire for the Sterling Monetary Framework, available on the Bank's website³.

Published information

42 The Bank will publish on its wire services pages the average aggregate daily value of gilts (or cash) lent under the DWF during each calendar quarter at 10.00 on the first Tuesday following the final working day of the following calendar quarter.

Documentation

43 This Market Notice forms part of the Documentation for the Bank of England's operations under the Sterling Monetary Framework and should be read in conjunction with the main SMF Documentation and the DWF Terms and Conditions and DWF Operating

³ <http://www.bankofengland.co.uk/markets/money/documentation/index.htm>

Procedures, each as amended from time to time. This Documentation is available on the Bank's website.

44 The Market Notice will be supplemented and refined over time, including in the light of feedback on the Bank's 16 October consultative paper 'The Development of the Bank of England's Market Operations'.

45 The Bank retains discretion to alter any of the terms of the Discount Window Facility at any time.

Bank of England
20 October 2008

Annex 1: Eligible collateral

1 Eligible collateral for the DWF will initially comprise:

- Securities that are routinely accepted in the Bank's short-term repo Open Market Operations.⁴
- Bonds issued by G10 sovereigns rated Aa3/AA- or higher, subject to any settlement constraints.
- Bonds issued by G10 government agencies explicitly guaranteed by national governments, rated AAA.
- Conventional debt security issues of the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Corporation and the Federal Home Loan Banking system, rated AAA.
- UK and EEA covered bonds rated A3/A- or above, provided that they were rated AAA at issue. The underlying assets may be either public sector debt or residential mortgages. Own-name covered bonds will be accepted.
- UK, US and EEA covered bonds where the underlying assets are commercial mortgages and that are rated A3/A- or above, provided that they were rated AAA at issue. Own-name covered bonds will be accepted.
- The most senior tranches of UK, US and EEA asset-backed securities (ABS) backed by credit cards; student loans; consumer loans; auto loans; and certain equipment leases rated A3/A- or above, provided that they were rated AAA at issue. Own-name ABS will be accepted.
- The most senior tranches of UK and EEA residential mortgage-backed securities (RMBS) rated A3/A- or above, provided that they were rated AAA at issue. Own-name RMBS will be accepted.
- The most senior tranche of UK, US and EEA commercial mortgage-backed securities (CMBS) rated A3/A- or above provided that they were rated AAA at issue. Securities containing construction loans will not be eligible. The collateral pool must be diversified. Own-name CMBS will be accepted.

⁴ <http://www.bankofengland.co.uk/markets/money/eligiblecurities.xls>

- The most senior tranche of UK, US and EEA securitised portfolios of senior secured or on-balance sheet, corporate loans rated A3/A– or above, provided that they were rated AAA at issue. Portfolios containing leveraged loans are not permitted. The collateral pool must be diversified. Own-name securities will be accepted.
- The most senior tranches, rated A3/A- or higher, of UK, US and EEA securitised portfolios of corporate bonds, provided that the tranches were rated AAA at issue. Portfolios containing high-yield bonds are not permitted. The collateral pool must be diversified. Own-name securities will be accepted.
- Some types of UK, US and EEA asset-backed commercial paper (ABCP) with the highest short-term ratings (A-1+/P1/F1+). Only the most senior paper will be accepted. A liquidity line must be in place from a bank with a short-term rating of A1/A+ or higher. The eligibility of individual programmes must be agreed with the Bank. The Bank will assess programmes against criteria that must be satisfied by the underlying assets; and against transparency requirements. The underlying assets must be of a type that is itself eligible for delivery in the Bank’s Discount Window Facility.
- Portfolios of senior corporate bonds rated at least A3/A– and commercial paper rated at least A2/P2/F2, issued by non-financial companies in UK, US, and the EU are eligible, subject to a diversification requirement that no more than 10% of the total value of the portfolio may be from any single issuer. For the purposes of this requirement, legal entities in the same group or those with close links as determined by the Bank, will be treated as a single issuer.
- Bank debt guaranteed under HM Government’s bank debt guarantee scheme announced by the UK Government on 8 October 2008.

2 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 only, yen.

3 The Bank will consider widening the list of eligible currencies of denomination and countries of origin of ABS in specific cases, as well as broadening the list of eligible collateral following the process outlined in its consultative paper.

4 In each case the underlying assets must be cash, not synthetic (i.e. not derivatives). Securities whose rating is on the basis of a guarantee or insurance provided by a third party (“a wrap”) will not be eligible (with the exception of government guaranteed instruments noted above).

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

6 Un-listed securities will be eligible at the Bank’s discretion.

7 For the purposes of determining the fee:

- Level A collateral will consist of debt securities that are routinely eligible as collateral in the Bank’s short-term repo Open Market Operations and Operational Standing Facilities, as published on the Bank’s website.⁵
- Level B collateral will consist of third-party debt securities that are, in the Bank’s judgment, trading in liquid markets.
- Level C collateral will consist of other third-party debt securities including those that are in the Bank’s judgment, not trading in liquid markets.
- Level D collateral will consist of own-name securitisations and covered bonds.

8 The Bank will confirm the Level of collateral securities to participants that pre-
position collateral with the Bank. The Bank will reserve the right to switch instruments from one Level to another, including during the life of a drawing from the Discount Window Facility.

9 Margin ratios for the Discount Window Facility collateral are set out in Annex 2 to this Market Notice. Annex 2 also sets out the circumstances in which additional haircuts are applied including, amongst other things, where securities are denominated in currencies other than sterling; where securities have no observable market price; where previously AAA asset-backed securities have been downgraded; and where the quality of the underlying collateral pool warrants a higher haircut in the Bank’s judgment.

⁵ <http://www.bankofengland.co.uk/markets/money/eligiblesecurities.xls>

10 Margin ratios will be kept under review. They will be updated and refined in the light of developments in financial markets and the financial system, and continuing consultation with market participants and analysts.

Annex 2: Discount Window Facility: Margin Ratios for extended collateral

	OMO eligible and Sovereign paper	Government guaranteed agencies and US GSEs	Bank and building society debt securities guaranteed under HM Government's guarantee scheme	RMBS, covered bonds backed by residential mortgages	ABS backed by credit cards and other consumer debt	ABS backed by corporate loans and bonds	CMBS, covered bonds backed by commercial mortgages	Corporate bonds and commercial paper issued by non-financial companies
<i>Credit rating (on Moody's scale)</i>	Aa3/AA- or higher	AAA		AAA not own-name	AAA not own-name	AAA not own-name	AAA not own-name	Corporate bonds A3/A- or higher Commercial paper A2/P2/F2 or higher
Floating rate	1.06	1.09	1.09	1.20	1.25	1.33	1.43	1.54
Fixed interest rate under 3 years to maturity	1.06	1.09	1.09	1.20	1.25	1.33	1.43	1.54
Fixed interest rate 3-5 years to maturity	1.07	1.10	n/a	1.23	1.28	1.37	1.47	1.59
Fixed interest rate, 5-10 year maturity	1.09	1.15	n/a	1.28	1.33	1.43	1.54	1.67
Fixed interest rate, 10-30 year maturity	1.12	1.23	n/a	1.37	1.43	1.54	1.67	1.82
Fixed interest rate, more than 30 year maturity	1.13	Available from the Bank on request						

Margin Ratios for asset-backed commercial paper (ABCP) will be determined by the Bank for each issue following the agreement of the specific ABCP programme and will be in the range of 1.20-1.43 depending on the underlying asset classes and the diversification of the pool.

An additional 0.03 will be added to Margin Ratios to allow for currency risk when securities are non-sterling.

Additional notes

Note on calculation: adjusted collateral value (post-haircut) = collateral value x ((1 / margin ratio) – haircut add-ons).

A haircut add-on of 5pp will be applied to own-name eligible covered bonds, RMBS, CMBS, ABS and portfolios of corporate bonds where appropriate.

A haircut add-on of 5pp will be applied to eligible collateral for which no market price is observable.

A haircut add-on of 5pp will be applied to eligible covered bonds, RMBS, CMBS and ABS that have been downgraded from AAA to Aa/AA; a further 5pp will be added for eligible covered bonds, RMBS, CMBS and ABS that have been downgraded from AAA to A.

Haircut add-ons may apply for portfolios of corporate bonds that are not well diversified, where the largest single bond concentration by market value exceeds 2% of the total market value of corporate bonds delivered.

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

Margin ratios and haircut add-ons will be kept under review. The Bank reserves the right to alter them, including on outstanding transactions.

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