BANK OF ENGLAND

Liquidity insurance at the Bank of England: developments in the Sterling Monetary Framework

October 2013

Liquidity insurance at the Bank of England: developments in the Sterling Monetary Framework

1 The Bank of England uses its sterling balance sheet for two main purposes: to implement monetary policy by setting Bank Rate or making asset purchases; and to support financial stability by acting as a backstop provider of liquidity insurance to the UK banking system. The Bank publishes the principles and tools it uses for these purposes in the Sterling Monetary Framework (SMF).

2 The SMF has been substantially reformed in recent years in response to developments in the economy and financial markets, and more broadly to lessons learned during the early part of the financial crisis. In 2012, the Court of the Bank asked Bill Winters to review how these reforms were working in practice, and to consider whether further changes were warranted. In light of the recommendations from that review,(1) together with the Bank's own assessment of the changing regulatory and financial market landscape, the Bank is announcing a number of further significant changes to the SMF's liquidity insurance toolkit. Taken together, those changes are designed to increase the availability and flexibility of that insurance, by providing liquidity at longer maturities, against a wider range of collateral, at lower cost and with greater predictability of access.

3 Section I of this document explains the principles used to guide the latest reforms and outlines the main features of the revised framework. Section II sets out the specific changes. Section III outlines next steps. A comprehensive description of the framework is contained in an updated edition of the Bank's 'Red Book'.(2)

I The Bank's published framework for liquidity insurance

4 Because banks and building societies (henceforth shortened to 'banks') make long-term loans but fund themselves through on-demand or short-term deposits, they are subject to liquidity risk: the risk that a material part of their funding is withdrawn before the assets can be realised at their true economic value. Within certain bounds, liquidity risk is a standard feature of banking, and responsibility for managing normal day-to-day fluctuations falls to banks themselves, through a combination of holding some of their assets in liquid form, and seeking where possible to lengthen the maturity of their liabilities. But it is inefficient for banks to have to self-insure against extreme or 'tail' liquidity risks (such as those caused by sudden market dysfunction) by holding excessively large stocks of safe liquid assets, or to have to undertake costly 'fire sales' of assets or sharp reductions in lending if such risks crystallise. In such circumstances, central banks are well placed, as the monopoly suppliers of the most liquid means of payment — banknotes and central bank reserves — to act as backstop providers of liquidity to solvent banks: so-called 'liquidity insurance'.

5 The Winters Report concluded: that the Bank's liquidity insurance facilities had been consistently improved through a series of major reforms both before and after the onset of the financial crisis; that the Bank had been responsive to changing conditions; and that the SMF functioned properly, was robust, and broadly fit for purpose. However, given the experience of recent years, the Report encouraged the Bank to consider whether even more could be done to improve the usability and flexibility of its facilities, and the certainty with which banks could expect to access them. The Report also made a number of recommendations regarding the governance of the SMF.

6 As the Report highlighted, a number of other market and regulatory changes are also under way, with important implications for the future provision of central bank liquidity. First, banks and other financial institutions have an increasing need for high-quality liquid assets to meet, among other things, tougher microprudential liquidity regulations and the new post-crisis rules for derivatives margining which require the posting of collateral. Second, it is timely to review the role of central bank liquidity provision in light of significant changes to other parts of the macro and microprudential toolkit, including stronger supervisory tools, liquidity regulation and bank resolution powers. And, third, an increasing amount of maturity transformation and other traditional banking functions is being carried out in capital markets and by financial institutions lying outside the banking sector, raising questions about access to the Bank's own facilities, which has historically been largely limited to banks.

7 With these developments in mind, the Bank has organised its response around the following principles:

i. **Liquidity insurance is a core function of the Bank of England.** It directly supports the Bank's second Core Purpose — to protect and enhance the stability of the financial system — and can indirectly help to ensure monetary stability, by reducing the incidence of large and unpredictable shifts in the demand for central bank money.

ii. **Effective liquidity insurance involves the Bank standing ready to provide solvent counterparties with highly liquid assets in exchange for a wide range of collateral assets of good credit quality but lower market liquidity. This insurance should be available in sufficient size and at an appropriate term.** The amount and term of lending available from the Bank, and the range of eligible collateral, has expanded greatly since the start of the crisis. But

(1) The Winters Report is available at www.bankofengland.co.uk/publications/Documents/news/2012/cr2winters.pdf. The Bank's initial response, published in March 2013, is available at www.bankofengland.co.uk/publications/Documents/news/2013/nr051_courtreviews.pdf.
(2) www.bankofengland.co.uk/markets/Documents/money/publications/redbook.pdf.

potential demand has also grown, in part reflecting the increased use of assets as collateral in market transactions.

iii. **The terms of the Bank's liquidity insurance facilities should be set to ensure counterparties have the incentive to manage their liquidity primarily through private markets in normal times.** When borrowing from the Bank, firms should therefore expect to pay a fee commensurate with both the degree of illiquidity of the collateral provided and the amount drawn. Haircuts on collateral will be set to reflect the contingent risk taken by the Bank, in order to ensure that, should the Bank need to sell the collateral in the market, it can be confident of recovering the value of the loans it has made.

iv. **Counterparties should be given as much certainty as possible about the circumstances in which they can expect to borrow** from the Bank's published facilities, so they can factor it into their liquidity planning. They should also have confidence their access to liquidity from the Bank will not be prematurely disclosed, where that disclosure may threaten financial stability by casting doubt on the soundness of the borrowing institution.

v. Although the provision of central bank liquidity insurance by a central bank always has the potential to induce potential beneficiaries to take on greater risk (so-called 'moral hazard'), the Bank now has a number of other tools to manage this, including through liquidity regulation and other powers of the Prudential Regulation Authority (PRA), and *in extremis* through its powers to resolve banks and building societies. As a result, **the SMF no longer has to shoulder as much of the burden of managing moral hazard as it has in the past, allowing a re-positioning of the Bank's lending facilities**.

vi. Given the difficulty of knowing where future liquidity risks will emerge, **the SMF should maintain a range of liquidity insurance facilities capable of tackling a wide variety of eventualities, rather than 'one size fits all'**. Where SMF facilities do not apply, the authorities may decide to extend Emergency Liquidity Assistance (ELA), subject to the terms of the Memorandum of Understanding on financial crisis management,(1) or innovate in other ways (as happened for example with the Special Liquidity Scheme and the Funding for Lending Scheme). The framework for the provision of ELA, which by definition must be more open-ended than the SMF, was reviewed separately by Ian Plenderleith in 2012. In response, a work programme is under way to maximise the Bank's capability to undertake such operations in a wide range of circumstances.(2)

8 The Bank will be investigating the scope for expanding the SMF to reflect the increasing role of non-banks and capital markets. Historically, the Bank has primarily relied on the banking sector to channel central bank liquidity to the wider economy, supplementing it as necessary with specially designed schemes such as the Asset Purchase Facility. The question raised in the Winters Report is whether, in view of the increasing role of non-banks and capital markets in providing finance to the UK economy, the SMF should itself be expanded to encompass some types of non-bank or a more formalised market maker of last resort role in periods of market dislocation. The Bank is carrying out further work on these issues, and will provide a fuller response in 2014.

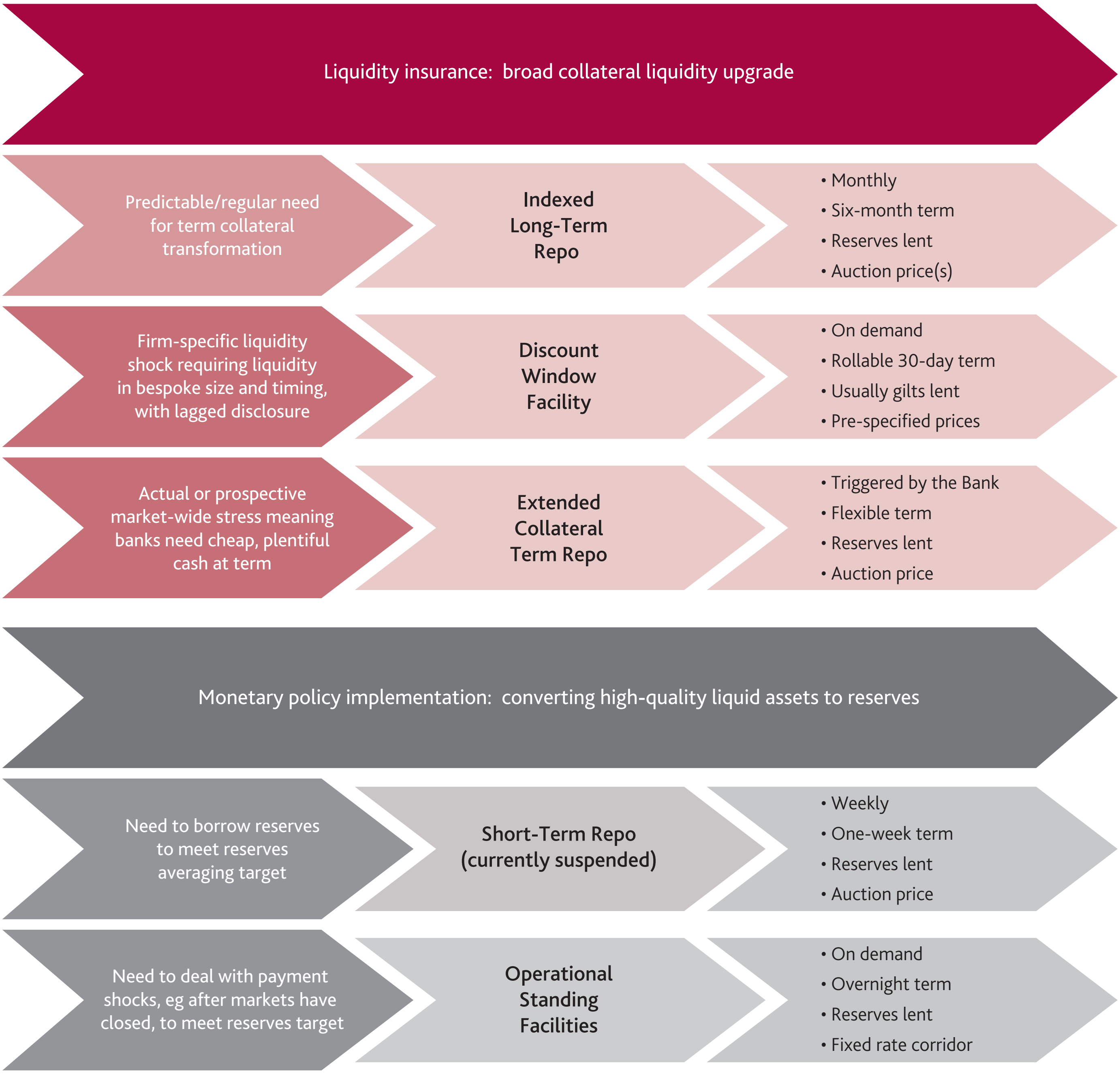
9 The Winters Report contains a detailed discussion of the potential for some central bank facilities to become 'stigmatised'. Stigma describes the risk that drawings from such facilities may be taken as a signal (by investors, depositors, rating agencies, regulators or even firms' own boards of directors) of more serious weaknesses at the firm in question. Stigma may in principle be affected by a number of design features of central bank facilities, including the price of those facilities, doubts about the certainty of access, and the risks of premature disclosure. The Bank does not believe that the effectiveness of its market-wide facilities is materially impaired by stigma, and expects the reforms described in this document to help reduce any perceptions of stigma in the bilateral Discount Window Facility. But, to the extent that liquidity insurance is focused on risks more extreme than those encountered in normal market conditions, complete elimination of stigma in all cases would be unrealistic. For that reason, the Bank will also use the new opportunities made available by the creation of the PRA to ensure that banks make use of the SMF's facilities at the appropriate time, as discussed further in Section II.

10 Taken together, these principles have led the Bank to conclude that the basic architecture of the liquidity insurance facilities in the SMF remains fit for purpose, but that there is scope to increase its flexibility, offering more liquidity at longer term (to help reduce uncertainty), against wider collateral (to provide a more credible backstop given the greater use of collateral in market transactions), and at lower cost (reflecting the scope to re-position the facilities highlighted in principle (v) above). To underscore its willingness to provide liquidity insurance, the Bank is making it clear that it has a presumption that all banks and building societies that meet the PRA's threshold conditions for authorisation may sign up for the SMF and have full access to borrow in its facilities (see paragraph 21 below).

11 **Figure 1** summarises the full set of lending facilities that will be available under the SMF. The key components of that framework are set out below. Further detail is given in Section II and the revised Red Book.

(1) Available at www.bankofengland.co.uk/about/Documents/mous/moufincrisis.pdf.
(2) The Bank's full management response is available at www.bankofengland.co.uk/publications/Documents/news/2013/nr051_courtreviews.pdf.

Figure 1 Summary of SMF lending facilities



12 SMF members seeking to exchange less liquid for more liquid assets will have access to three facilities, each with a different purpose. The increased use of collateral in market transactions creates the need for collateral transformation services. While the Bank expects these needs to be met primarily in private markets, it recognises that a backstop may be required:

- The regular monthly market-wide **Indexed Long-Term Repo (ILTR)** auctions are aimed at banks with a predictable need for liquid assets. From 2014, the ILTR will be extended to provide consistent six-month committed liquidity, at cheaper (auction-determined) rates, and against the full range of eligible SMF collateral.
- The bilateral on-demand **Discount Window Facility (DWF)** is aimed at banks experiencing a firm-specific or market-wide shock. It allows participants to borrow highly liquid assets in return for less liquid collateral in potentially large size and for a variable term.
- The market-wide **Extended Collateral Term Repo (ECTR)**(1) allows the Bank to provide liquidity against the widest collateral at any time, term and price it chooses, in response to actual or prospective exceptional market-wide

(1) The ECTR will be renamed as the 'Contingent Term Repo Facility' in 2014 to differentiate it more clearly from the ILTR, once the ILTR is extended to accept the full range of eligible SMF collateral.

Summary of key changes

To reduce stigma and increase the flexibility of the Bank's liquidity insurance:

- The **monthly market-wide Indexed Long-Term Repo auctions will be expanded** from 2014, reducing the price and extending the amount, term and range of eligible collateral.
- The **bilateral Discount Window Facility (DWF) has been repriced**, introducing a lower, flat-rate 'entry fee', and smoothing the increase in fees for higher usage. The Bank has sought to **reduce the financial stability risks posed by premature disclosure of DWF drawings**, by extending its own disclosure lag and ensuring firms have the capacity to turn over their liquid assets in markets regularly. The Bank will continue to argue the case for ensuring that new national and international disclosure regimes do not increase that risk through other channels.
- The **market-wide Extended Collateral Term Repo is being retained**, allowing the Bank to provide whatever liquidity is required in conditions of market-wide stress, against the widest collateral, and at a price it chooses.
- The **Bank's list of eligible collateral**, which has already been expanded significantly in recent years, will be extended further to include the drawn portions of corporate revolving credit facilities.
- The **certainty with which banks can expect to be able to borrow from the Bank has been reinforced** through a presumption that all banks and building societies that meet the Prudential Regulation Authority's (PRA's) threshold conditions may sign up for the Sterling Monetary Framework (SMF) and have full access to borrow in its facilities (see paragraph 21).
- The **Bank will use the new opportunities made available by the creation of the PRA** to ensure that banks better integrate the availability of liquidity insurance into their liquidity planning and use the Bank's facilities at the appropriate time.
- The **Bank's rule limiting banking groups to a single reserves account has been relaxed**.

To improve the governance of the SMF:

- **New decision-making machinery has been set up**, led by a Deputy Governor and overseen by Court, to ensure that SMF decisions draw on a wide range of advice, and the views of Deputy Governors are recorded.
- **The engagement of the Monetary Policy Committee and Financial Policy Committee in the SMF has been clarified and strengthened**, through concordats setting out arrangements for information sharing and consultation.
- Starting in 2014, **the Bank will compile and publish an annual review of the SMF**, drawing on a wide range of internal and external views.

Over the coming year the Bank will:

- Examine the case for **extending SMF access to some non-banks**.
- Examine whether it can further clarify the circumstances in which, during periods of market-wide stress, it would be willing to act as **market maker of last resort** or **extend term credit**.
- Assist Court in its evaluation of the **appropriate capital base for the Bank**.

When market expectation begin to point to a near-term rise in Bank Rate, the Bank will:

- **Evaluate the case for returning to reserves averaging** (versus retaining the current 'floor' system for setting Bank Rate).

stress. Use of this facility successfully helped to bring down short-term sterling funding costs in 2012 at a time of heightened uncertainty in the euro area. It will remain in the Bank's toolkit as a flexible way to respond to unexpected market developments. The terms of the facility will be determined each time it is deployed, in light of prevailing market conditions.

13 The Bank's Short-Term Repos and Operational Standing Facilities — which allow conversion of high-quality liquid assets into central bank reserves and are primarily associated with the reserves averaging regime for the implementation of monetary policy (currently suspended) — are unaffected by the reforms set out in this document.

14 The Bank recognises that use of its liquidity insurance facilities is likely to remain limited in the near term, reflecting the large quantity of commercial bank reserves injected into the system as a consequence of the Monetary Policy Committee's asset purchase programme, and the availability of four-year funding against wide collateral in the Funding for Lending Scheme until the start of 2015. The revised framework nevertheless sets out how the Bank envisages the SMF operating in more normal conditions.

II Key changes to the SMF

15 This section describes the key changes in more detail. The box on page 4 provides a summary; and the Annex shows the Bank's response to all 22 recommendations in the Winters Report.

Reforms aimed at increasing the usability and flexibility of the Bank's facilities

16 From 2014, when the ILTR is extended, banks will be able to borrow against the full range of eligible collateral in all three of the Bank's main liquidity insurance facilities. The Bank's collateral list is already broad — including both securities and portfolios of loans to households and non-financial businesses — and extends in principle to any asset that it judges can be effectively and efficiently risk managed, subject to appropriate haircuts. The Bank's capacity to risk manage collateral is continuously evolving, and as part of that process the Bank will in future accept the drawn portions of corporate revolving credit facilities, as recommended in the Winters Report. In response to the recommendation that the pricing of the Bank's facilities be simplified, the number of sub-divisions within the overall collateral list is being reduced from four to three, merging the existing Level C and D sets into one. The SMF collateral categories, and their use across the Bank's facilities from 2014, are shown in **Table A**.

Table A The Bank's revised SMF collateral categories

	Operational Standing Facilities	Short-Term Repo	Indexed Long-Term Repo(a)	Discount Window Facility	Extended Collateral Term Repo
Level A (eg highly liquid high-quality sovereign debt)	✓	✓	✓	✓	✓
Level B (eg liquid high-quality sovereign, supranational, mortgage and corporate bonds)	×	×	✓	✓	✓
Level C (eg less liquid securitisations, own-name securities and portfolios of loans)	×	×	✓	✓	✓

(a) Level C collateral eligible in the ILTR from 2014.

17 Banks seeking a regular source of liquidity against the widest range of collateral should expect to rely primarily on the monthly ILTR auctions. The basic structure of the ILTR will remain, but from 2014 the Bank will make four changes. First, the term of all new ILTR lending will be extended to six months, providing greater certainty of committed funding. Second, the Bank will amend the auction mechanism so bids will be accepted at somewhat lower rates. Third, the design of the auctions will be adjusted so that participants can bid against the full range of eligible collateral. And, fourth, the size of the auctions will be increased, with the Bank being willing to supply an increasing amount of liquidity as signs of market stress rise. Implementation of these changes requires a number of systems changes at the Bank of England. Further operational details will be provided when the extension is implemented in 2014.

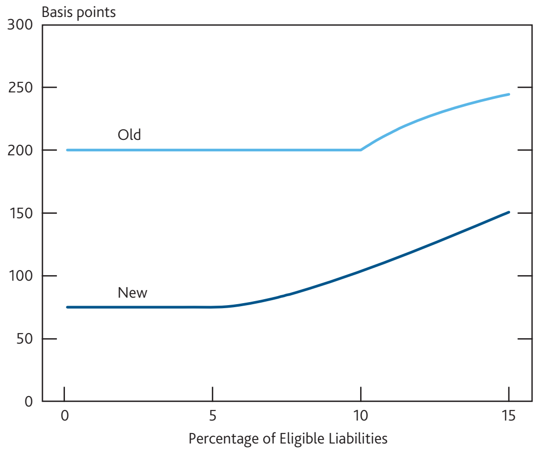
18 Banks facing an idiosyncratic (ie firm-specific) liquidity shock should expect to make use of the on-demand bilateral DWF. The importance attached to this facility is demonstrated by the large amount of collateral that banks have pre-positioned for potential use with the Bank, giving a current aggregate borrowing capacity, after haircuts, of some £230 billion. The Bank is keen that the DWF should be seen as usable when needs arise, and is therefore making changes to DWF pricing, disclosure, term and access. First, the Bank is reducing the cost of borrowing in the DWF. The first tranche of borrowing (up to 5% of banks' 'Eligible Liabilities', which is currently £115 billion for the UK banking system as a whole) will now be available at a materially lower price. This 'entry' cost of borrowing against the least liquid collateral will be 75 basis points, compared with 200 basis points previously; the 'entry' cost of using more liquid collateral has also been reduced (**Table B**). The marginal cost of borrowing between 5% and 15% of Eligible Liabilities will now rise smoothly with the amount drawn, rather than stepping sharply upwards periodically, as it did previously. The net effect of these changes (illustrated for the case of the least liquid collateral in **Chart 1**) is to bring the cost of using the DWF for lower volumes of borrowing closer to estimates of prevailing market prices, and reduce the step-up in price from the Bank's other liquidity insurance facilities, while still giving banks an incentive to use private markets in normal periods.

Table B Fee for borrowing gilts up to 5% of Eligible Liabilities in the DWF

Basis points

	Against collateral in...		
	Level A	Level B	New Level C
New fee	25	50	75
Old fee	50	75	200

Chart 1 Average cost of borrowing against wide (new Level C) collateral in the DWF



19 Second, the Bank recognises that banks using the DWF may be concerned about the risk of premature disclosure of usage, which may worsen the wider financial stability impact of the original liquidity shock. The design of the DWF already seeks to minimise the risk of this occurring from the Bank's publications, by ensuring that DWF usage is only ever disclosed in aggregate, averaged over a calendar quarter, and with a delay. But to provide further reassurance, the Bank has decided to extend the disclosure lag to five quarters. The Bank will also continue to argue the case for ensuring that new national and international disclosure regimes do not increase any risk of premature disclosure through other channels.

20 Third, the Bank is making it clear that banks can expect to be able to roll 30-day DWF drawings into longer effective terms if required. The more expensive 364-day option is consequently redundant, and has been removed.

21 Fourth, the Bank agrees that banks' uncertainty about the circumstances in which they can expect to be able to borrow, in particular in the DWF, should be minimised. The SMF is already highly transparent by international standards. And central banks cannot provide a 100% guarantee to lend in all circumstances, given the need to ensure that liquidity support is not generally extended to insolvent institutions. Nevertheless, to reduce any residual uncertainty about its willingness to lend, the Bank is making it clear that it has a presumption that all banks and building societies that meet the PRA's threshold conditions for authorisation may sign up for the SMF and have full access to borrow in SMF facilities against eligible collateral. Participation in the SMF is subject to the Bank being satisfied that its legal and operational requirements are met, and may be subject to the provision of a guarantee from another group entity. In view of this, and the Bank's other risk management tools, the Bank does not believe a 'second tier' DWF, as suggested in the Winters Report, is required for cases requiring more rigorous monitoring.

22 The Winters Report suggested that, in order to minimise any uncertainty about being able to draw, the Bank should consider going a step further and auction options providing banks with a guaranteed commitment from the Bank to lend. The Bank has not ruled this idea out. But its viability depends on whether, and on what terms, such options will be eligible as liquid assets in the Liquidity Coverage Ratio (LCR), an issue currently under discussion in the Basel Committee on Banking Supervision. Whether there would be demand for such options would also depend on: the effectiveness of the reforms set out in this document designed to increase the usability of the Bank's other borrowing facilities; the extent to which a combination of disclosure arrangements, pricing and LCR eligibility can be designed that avoids the purchase of such options itself being stigmatised; and the willingness of banks to pay for liquidity insurance through an upfront fee. The Bank will keep these issues under review as international discussions evolve.

23 As noted in Section I, even after the reforms set out in this document, usage of the Bank's liquidity insurance facilities is likely to remain limited in the near term. The Bank does not believe that it is desirable, or feasible, to tackle periods of low usage by requiring (or incentivising) regular use of the DWF sufficient to provide 'cover' for potential live drawings. It will, however, require counterparties to test their operational readiness for DWF drawings regularly, and will ensure firms have the capacity to turn over their liquid assets in repo and/or cash markets. And the Bank's Markets Directorate will work closely with the PRA to ensure that banks better integrate liquidity insurance into their liquidity planning, and use the Bank's facilities at the appropriate time.

24 Finally, the Bank has relaxed its previous rule limiting banking groups to a single reserves account. Where a case can be made that this restriction increases risks to groups, imposes excessive costs, or works against the thrust of regulatory policy — as would be the case, for example with ring-fenced banks under the Independent Commission on Banking proposals now being implemented in UK legislation — the Bank will allow more than one legal entity within a group to have a reserves account.

Reforms to the governance of the SMF

25 The Winters Report recommended that, while decision making on the SMF should remain in the hands of the Bank Executive, and ultimately the Governor, new arrangements should be put in place to ensure that it benefited from a broader range of input and challenge from both inside and outside the Bank, and was subject to periodic scrutiny by the Bank's Court and the public.

26 The Bank agrees with the main recommendations, which in many cases formalise changes that were already under way:

- First, internal decision making has been strengthened by establishing new machinery for decision-making on strategic issues relating to the Bank's financial markets operations. The new process, led by a Deputy Governor, draws together staff from around the Bank, gives them an opportunity to input views about the operation and design of the SMF, and ensures that, as recommended by the Winters Report, the views of Deputy Governors are recorded. It is already in use, and is overseen by the Oversight Committee of Court, which has full access to its minutes and papers.

- Second, the engagement of the Monetary Policy and Financial Policy Committees in the design and review of SMF operations relevant to their remits has been clarified and strengthened. Concordats have been agreed with each Committee setting out arrangements for consultation and information sharing.[1] These arrangements are already in force, and have been used for example on the extension of the Funding for Lending Scheme in April, and the Bank's response to the Winters Report itself.

- Third, the SMF will now be subject to an annual review to examine whether it remains fit for purpose. The process, agreed with Court, will give key stakeholders, including the Monetary Policy Committee and the Financial Policy Committee, an opportunity to input views; HM Treasury will be engaged with the process, not least through their membership of/attendance at those Committees. The review will also be published to facilitate external scrutiny; the first such annual report will be published in 2014.

III Next steps

27 Most of the Bank's responses have already been implemented, or are being implemented with publication of the revised Red Book and supporting legal documentation. A few, however, remain under way, as set out earlier in this document. The new ILTRs are expected to be implemented in 2014. And the Bank is undertaking further work into the potential scope for bringing some types of non-bank financial institutions into the SMF, and setting out more clearly the circumstances in which it would act as market maker of last resort on an outright purchase/sale basis, or extend term credit. The Bank will say more on these issues in 2014.

(1) Available online at www.bankofengland.co.uk/about/Documents/legislation/fpcconcordat.pdf and www.bankofengland.co.uk/about/Documents/legislation/mpcconcordat.pdf.

Annex
Detailed response to the Winters Report recommendations

No.	Recommendation	Response
	Monetary policy and reserves	
1	The Bank should consider returning to a reserves averaging approach in future, but this is not critical. As monetary policy is normalised, Court should ensure the Executive evaluates the relevant factors in deciding whether to move away from the current floor regime.	Agreed. The current presumption remains a return to reserves averaging, as publicly indicated. But the Bank stands ready to evaluate the case for returning to averaging (versus retaining the current 'floor' system), when market expectations point to a near-term rise in Bank Rate.
2	If the Bank decides to return to reserves averaging, it should maintain a system of voluntary reserves setting, that places a burden on the banks to assess the level of reserves required for the proper functioning of the payments and other interbank systems.	Agreed. This would be the intention if there is a return to reserves averaging.
11b	The Bank should also specifically consider whether the restriction of only one legal entity per group accessing the full range of Sterling Monetary Framework (SMF) facilities is reasonable. This will be particularly relevant in future in the case of non-ring fenced banks.	Complete. The Bank's rule limiting banking groups to a single reserves account has been relaxed, where a case can be made that a single account increases risks to groups, imposes excessive costs, or works against the thrust of regulatory policy.
	Liquidity insurance	
3	The Bank should consider changes to its Discount Window Facility (DWF) to make it more accessible to banks. This could include: removing the on-the-day conditions to borrowing in favour of continuous assessment; increasing the certainty of available funds; and reducing pricing. In particular, the Bank should rely less on penal pricing as a means to manage moral hazard.	Agreed. The Bank has: (i) repriced the Discount Window Facility, introducing a significantly lower 'entry fee' for lower volumes of borrowing and smoothing the extent to which the fee increases with usage; (ii) reduced the financial stability risks of unintended disclosure of DWF drawings by extending the disclosure lag to five quarters for all drawings and ensuring that firms have the capacity to turn over their liquid assets in repo and/or cash markets. The Bank will also continue to push the case for ensuring that new liquidity disclosure regimes do not increase any risk of premature disclosure through other channels; (iii) made clear its presumption that all banks and building societies that meet the Prudential Regulation Authority's threshold conditions for authorisation may sign up for the SMF and have full access to borrow in its facilities (see paragraph 21); (iv) agreed to ensure that the Bank's Markets Directorate and PRA work together to bring banks to the Bank's facilities at the appropriate time.
4	The Bank should further consider concrete action to reduce any remaining reluctance of banks to use the DWF. The best way to accomplish this would be to regularise its use so that crisis usage is less visible and, hence, less stigmatised.	The Bank will, over time, review the efficacy of the reforms set out in this document designed to ensure appropriate use of the DWF. It disagrees with the idea of requiring continuous usage in size, but does insist on regular operational readiness testing, and will ensure that firms have the capacity to turn over their liquid assets in repo and/or cash markets regularly.
5	The Bank should also consider moving to a pricing structure for the DWF that incorporates payment of an upfront premium reflecting the value of the insurance being provided to the banks.	The Bank will keep this recommendation under review while the question of whether, and how, such a facility might be eligible for the Liquidity Coverage Ratio is under discussion internationally.
6	In addition to the above changes, the Bank could consider having a second tier DWF, which would provide liquidity against pre-positioned collateral on less generous terms, to deal with cases where the Bank's Risk Management Division had determined that more rigorous monitoring of drawings was necessary.	Not needed, given the other reforms being announced, and the Bank's existing risk management procedures.
7	The Bank should consider regularising facilities such as the Extended Collateral Term Repo (ECTR) that are currently exceptional. It might do this by combining the ECTR with the Indexed Long-Term Repo (ILTR) facility to create a regular auction facility allowing banks to access term funding against a wider collateral pool.	Underlying objective agreed. Rather than merge the ECTR and ILTR, the monthly market-wide ILTR auctions will be significantly expanded in 2014, reducing the price, extending the term to six months, extending the eligible range of collateral, and linking the amount of liquidity on offer to the degree of market stress.
8	There may be merit, nevertheless, in retaining an ECTR-type operation that could be used to respond to a market-wide shock.	Agreed. The ECTR will be retained (and will be renamed the Contingent Term Repo Facility in 2014 alongside the other changes to the ILTR).
9	The Bank should continue to broaden the range of eligible collateral for its DWF and other facilities beyond the substantial portion of bank assets already allowed. Criteria for broader eligibility should focus on the Bank's policy objectives of financial stability and preventing disruptions to payment and settlement services provided to the wider economy, not merely the assets held by banks and, as such, might include allowing drawn revolving credit facilities as eligible collateral.	Agreed. The Bank's already long list of eligible collateral types will be extended to include the drawn portions of corporate revolving credit facilities. The Bank will continue to analyse areas where the list could be extended further to other assets that can be effectively and efficiently risk managed, subject to appropriate haircuts.

No.	Recommendation	Response
	Liquidity insurance	
10	The SMF should be more explicit in its role in providing a maturity transformation backstop in extraordinary situations where banks appear likely to curtail their maturity transformation provision to their customers. The Bank might consider whether it should extend the maturity of some of its current facilities or develop other facilities that would give banks the necessary confidence to maintain or extend the term of credit provision.	The Bank has demonstrated its willingness to extend term credit in stressed periods through the SLS and FLS. It is challenging to define the circumstances in which this might happen again with any precision, given the uncertainties over how future stresses may arise. But this issue will be the subject of more detailed work over the coming year.
11a	The Bank should consider making certain liquidity facilities in the SMF available to non-banks, including for example central counterparties.	This is an important medium-term challenge for all central banks. It will be the subject of more detailed work over the coming year.
12	As an extension of the previous recommendations, the Bank should address more directly its role as a market maker of last resort (MMLR). Structural changes to the ways markets operate and the role of banks in markets may call for the Bank to make its MMLR actions more predictable and consistent.	The Bank has acted as MMLR in selected markets during the recent crisis. As with recommendation 10, it is challenging to define the circumstances in which this might happen again with any precision, given the uncertainties over how future stresses may arise. But this issue will be the subject of more detailed work over the coming year.
13	The Bank should co-ordinate policies closely with the Financial Services Authority (FSA)/Prudential Regulation Authority (PRA) and other domestic and international bodies to the greatest extent possible such that policy actions the Bank pursues to encourage acceptance of Bank liquidity facilities are not effectively offset or rendered redundant by the actions of others.	Agreed. The Bank's Markets Directorate and the PRA will work closely together to ensure that the availability of liquidity insurance is better integrated into banks' liquidity planning, that liquidity monitoring processes are well aligned across the Bank, and that banks make use of the Bank's facilities at the appropriate time. The Bank stands ready to escalate issues, including over disclosure, with other authorities as necessary.
14	As an overarching recommendation, the Bank should avoid constructive ambiguity in its published framework. Specifically, it could provide even greater clarity upfront about the terms on which it would expect to provide liquidity insurance in a range of circumstances.	The Bank will ensure that the Sterling Monetary Framework remains one of most transparent regimes globally.
	Governance	
15	The formal arrangements around internal governance could usefully be clarified. While the Governor must retain the final say, he should be required to formally seek the views of his Deputies and those Deputies should be required to record any dissenting views. Minutes should be taken and reviewed by Court, although not disclosed for some time. Court should assure that these consultative processes are carried out.	Complete. A new Operations Committee began meeting in February 2013, comprising relevant members of the Executive and chaired by a Deputy Governor. Minutes and papers of this Committee are shared with Court.
16	The Court should regularly assess the efficiency of decision-making around issues relating to the SMF to ensure that the right issues are raised to senior management for a decision, with a balanced set of views and options, and that appropriate accountability is in place throughout the organisation for decisions taken in the process leading up to this.	Agreed. A new SMF annual review process has been approved by Court, and will culminate in a public report, the first of which is scheduled for 2014.
17	Consideration should be given to the establishment of a regular forum at which the Governors of the Bank meet key stakeholders in the Bank's liquidity operations. For example, the Governors, the Chancellor and/or senior HM Treasury representative and the chair of Court might meet annually to discuss current issues around liquidity provision.	This will be covered under the annual review process mentioned in the response to recommendation 16.
18	Thought should be given to the appropriate level of capital for the Bank.	This is a matter for the Government, as sole shareholder of the Bank, and Court as the shareholder's representative.
19	The roles of the Monetary Policy Committee (MPC) and the Financial Policy Committee (FPC) in relation to the design and implementation of the Bank's SMF should be clarified.	Complete. Concordats agreed and published.
20	The FPC and the MPC have clear interests in aspects of the Bank's liquidity operations. The Review suggests that it would be useful for the FPC to provide as much clarity as possible to the Executive over its views regarding the Bank's provision of liquidity insurance.	Complete. Governance framework established under recommendation 19.
21	The MPC should continue to have authority over any operations intended primarily to influence monetary conditions. And it should be informed of the implications for monetary conditions of other liquidity operations, and have the opportunity to express views on such operations if those implications were likely to be material.	Complete. Governance framework established under recommendation 19.
22	The processes described above will require a high level of communication and co-operation between the Executive, the MPC and the FPC regarding the Bank's liquidity operations. Court should be responsible for ensuring the proper communication and co-ordination channels are in place.	Agreed. Court regularly monitors internal SMF decision making, and will take stock more formally as part of the annual review process mentioned in the response to recommendation 16.