BANK OF ENGLAND

Press Office
Threadneedle Street
London EC2R 8AH
T 020 7601 4411
F 020 7601 5460
press@bankofengland.co.uk
www.bankofengland.co.uk

News release

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Special Liquidity Scheme

The Bank of England is today launching a scheme to allow banks to swap temporarily their high quality mortgage-backed and other securities for UK Treasury Bills.

With markets for many securities currently closed, banks have on their balance sheets an 'overhang' of these assets, which they cannot sell or pledge as security to raise funds. Their financial position has been stretched by this overhang so banks have been reluctant to make new loans, even to each other.

Under the Scheme, banks can, for a period, swap illiquid assets of sufficiently high quality for Treasury Bills. Responsibility for losses on their loans, however, stays with the banks. By tackling decisively the overhang of assets in this way, the Scheme aims to improve the liquidity position of the banking system and increase confidence in financial markets.

The scheme has three key features:

- The asset swaps will be for long terms. Each swap will be for a period of 1 year and may be renewed for a total of up to 3 years.
- The risk of losses on their loans remains with the banks.
- The swaps are available only for assets existing at the end of 2007 and cannot be used to finance new lending.

Mervyn King, Governor of the Bank of England, said "The Bank of England's Special Liquidity Scheme is designed to improve the liquidity position of the banking system and raise confidence in financial markets while ensuring that the risk of losses on the loans they have made remains with the banks."

Banks will be able to enter into new asset swaps at any point during a six-month window, starting today. Those swaps will be for a term of one year. Banks will be able, at the discretion of the Bank of England, to renew them each year for, at most, a total of three years. After that, the scheme will close. The length of these transactions will provide banks with the certainty about liquidity that is needed to boost confidence. During the lifetime of an asset swap, banks will be required to pay a fee based on the 3-month London interbank interest rate (Libor).

The Debt Management Office will supply the Bank of England with the necessary Treasury Bills. Banks will be able to swap for those Bills a range of high-quality assets, including AAA-rated securities backed by UK and European residential mortgages. But to prevent banks relying on the Scheme to finance new lending, they will be able to swap securities formed only from loans that were already on their balance sheets at the end of 2007.

Given its scale, the Scheme is indemnified by the Treasury, but is designed to avoid the public sector taking on the risk of potential losses. Banks will need, at all times, to provide the Bank of England with assets of significantly greater value than the Treasury Bills they have received. If the value of those assets were to fall, the banks would need to provide more assets, or return some of the Treasury Bills. And if their assets pledged as security were to be down-rated, the banks would need to replace them with alternative highly-rated assets.

Usage of the scheme will depend on market conditions. Discussions with banks suggest that use of the scheme is initially likely to be around £50bn.

The Scheme will be ring-fenced and independent of the Bank of England's regular money market operations. So it will not interfere with the Bank's ability to implement monetary policy.

Special Liquidity Scheme: Information
http://www.bankofengland.co.uk/markets/Documents/sls/sls-information.pdf

Special Liquidity Scheme: Market Notice
http://www.bankofengland.co.uk/markets/Documents/money/marketnotice080421.pdf

Special Liquidity Scheme: Addendum to the Market Notice of 21 April 2008
http://www.bankofengland.co.uk/markets/Documents/sls/sls-addendum080814.pdf