Annual Report on the Bank's official market operations 2018–19

June 2019

BANK OF ENGLAND

Contents

Executive summary

The Bank conducts a range of operations in sterling markets. These operations are either conducted on the Bank's balance sheet, which could be through the Sterling Monetary Framework (SMF), via standalone facilities, or through the Asset Purchase Facility (APF), which is a subsidiary of the Bank. The APF was incorporated in January 2009, to fulfil the remit of the Chancellor of the Exchequer announced on 19 January 2009.(1) This remit was subsequently expanded to enable the fund to be used as a monetary policy tool. The APF is fully indemnified by HM Treasury.(2)

This year saw the ongoing operation of the Bank's regular liquidity insurance facilities. The Funding for Lending Scheme (FLS) and Term Funding Scheme (TFS) also remained in place, although both are closed to new lending.

In February and March 2019, the Bank made further enhancements to its liquidity insurance facilities, announcing an increase in the frequency of Indexed Long-Term Repo (ILTR) operations for a period, and a new Liquidity Facility in Euros (LiFE).

Overall use of the Bank's lending facilities was broadly flat over the year as loans made under the FLS ran off, but loans made through ILTR operations increased (see **Chart 2** on page 3). The TFS closed to new drawings on 28 February 2018, but as TFS funding was for a term of up to four years, almost all of the original loans remain outstanding. On 21 January, all TFS drawings, and the collateral backing them, were transferred from the APF to the Bank of England's balance sheet.

The Monetary Policy Committee (MPC) voted to increase Bank Rate to 0.75% on 2 August 2018. This Bank Rate change was passed on smoothly to both unsecured and secured money market rates.

Since early 2018, the Bank has been addressing the recommendations in the Independent Evaluation Office (IEO) report on the Bank's approach to providing sterling liquidity.(3) Among other actions, further details on collateral eligibility have been published, and familiarisation sessions have been held for ILTR participants.

On 23 April 2018, the Bank implemented reforms to the SONIA (Sterling Overnight Index Average) interest rate benchmark, including taking on responsibility for calculating and publishing the rate each day.(4)

Except where otherwise stated, this report covers the period (the 'review period') from 1 March 2018 to 28 February 2019, and focuses on the Bank's official market operations during that time.

The Bank welcomes thoughts or comments from interested parties on this report or on the Bank's official operations more broadly. Details of how to submit views are provided on page 6.

Objectives of the Bank's operations

The Bank's mission is to promote the good of the people of the United Kingdom by maintaining monetary and financial stability.

In support of these objectives, the Bank conducts a range of market operations, collectively designed to:

1. **Implement the MPC's decisions to meet the inflation target**. This is usually achieved by paying interest at Bank Rate on the reserves balances held at the Bank of England by SMF participants.(5)

2. **Reduce the cost of disruption to critical financial services**, including liquidity and payment services, supplied by SMF participants to the UK economy. The Bank does this by standing ready to provide liquidity by offering to take in high-quality but less liquid collateral and swap it for liquid assets (a so-called 'liquidity upgrade').

The majority of these operations form part of the Bank's primary operating framework, known as the SMF, with details outlined collectively in the 'Red Book'.(6) The Bank also offers a number of standalone facilities outside the SMF, for which details are published separately.

Reserves accounts

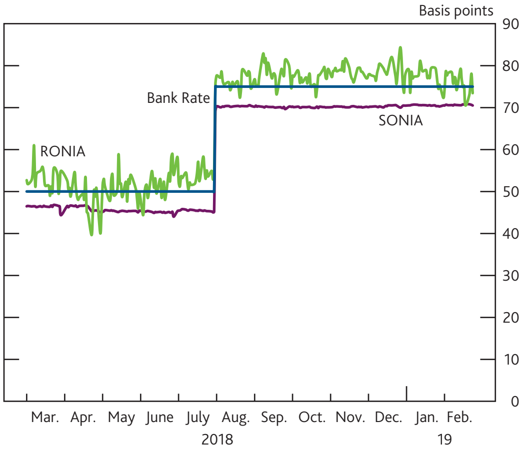
Reserves accounts are effectively sterling current accounts for SMF participants. Reserves balances can be varied freely to meet day-to-day liquidity needs. Reserves accounts can also be used by SMF members for settlement of obligations arising as a result of direct participation in UK payment systems.

The Bank implements the MPC's interest rate decisions by paying Bank Rate on reserves. This keeps short-term market interest rates in line with Bank Rate. The Bank currently pays Bank Rate on all reserves balances for banks, building societies and broker-dealers. Central counterparties (CCPs), however, are required to hold a target average daily balance to receive Bank Rate.

(1) The Chancellor's statement is available here.
(2) Further details on the APF can be found in the *Asset Purchase Facility Annual Report 2018–19*.
(3) See 'Evaluation of the Bank of England's approach to providing sterling liquidity', January 2018.
(4) Further information on the SONIA rate can be found here.
(5) Banks, building societies, designated investment firms ('broker-dealers'), and central counterparties (CCPs) are eligible to participate in the SMF.
(6) For further information see 'The Bank of England's Sterling Monetary Framework', June 2015. The Bank intends to issue a revised version of this publication in 2019.

On 2 August 2018, the MPC announced an increase in Bank Rate from 0.5% to 0.75%. The Bank monitors both secured and unsecured rates to assess the effectiveness of monetary policy implementation. Both secured and unsecured rates responded to the increase in Bank Rate (**Chart 1**).

Chart 1 Sterling overnight interest rates(a)

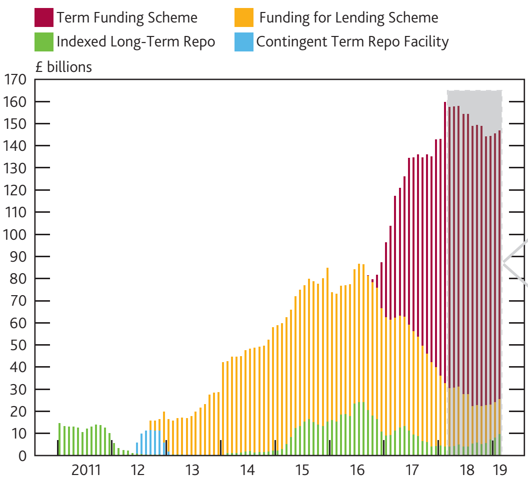


Sources: Bank of England and WMBA Ltd.

(a) SONIA (Sterling Overnight Index Average) is a measure of the rate at which interest is paid on sterling short-term wholesale funds in circumstances where credit, liquidity and other risks are minimal. Transactions included within the SONIA calculation are unsecured, of one-day maturity, settled same-day, and greater than or equal to £25 million in value. RONIA (Repurchase Overnight Index Average) is based on brokered sterling overnight transactions where collateral is provided as a security.

The total amount of reserves decreased slightly from £492.2 billion to £490.4 billion over the year. This was mainly driven by decreases in FLS and TFS drawings of £12.6 billion and £5.6 billion respectively, partially offset by an increase in outstanding ILTR drawings of £5.5 billion (see **Chart 2a** and **2b**) as well as other autonomous factors.

Chart 2a Outstanding amounts lent in SMF liquidity facilities, the FLS and TFS 2011–19



Source: Bank of England.

Alongside the 2 August 2018 MPC decision, the Bank also published a discussion paper on the Bank of England's future balance sheet and framework for controlling interest rates.(7)

Lending operations

The Bank's lending operations under the SMF are designed to provide liquidity support to market participants. In addition, the TFS and FLS are designed to assist the pass-through of monetary policy and boost lending to the real economy respectively. **Chart 2** shows the total amount lent by the Bank since January 2011.

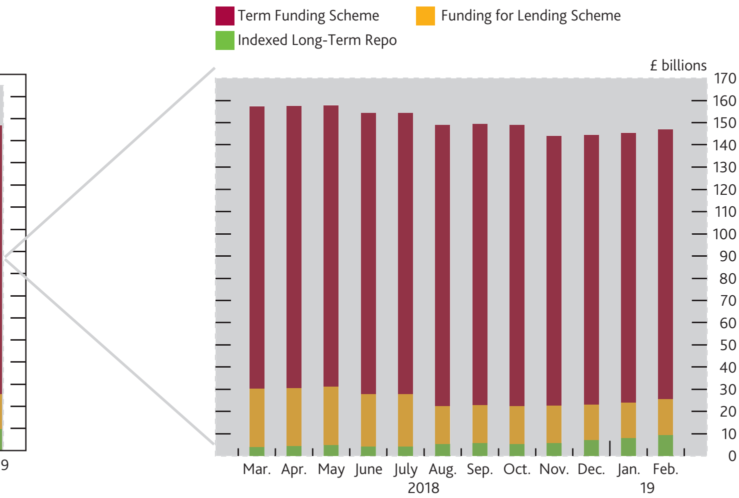
Operational Standing Facilities

Operational Standing Facilities (OSFs) allow SMF participants to deposit reserves with, or borrow reserves directly from, the Bank overnight.

The rate paid on the Operational Standing Deposit Facility remained at 25 basis points below Bank Rate. As all reserves account balances are remunerated at Bank Rate there remains little incentive for reserves account holders to use this facility. Reflecting this, there was very limited use of the deposit facility over 2018–19.

The rate charged on the Operational Standing Lending Facility remained at 25 basis points above Bank Rate. Given the large aggregate supply of reserves there was no demand from market participants to use this facility during the review period.

Chart 2b Outstanding amounts lent in SMF liquidity facilities, the FLS and TFS in the review period



(7) See 'The Bank of England's future balance sheet and framework for controlling interest rates', August 2018.

Indexed Long-Term Repo operations

The Bank's market-wide Indexed Long-Term Repo (ILTR) operations are aimed at institutions with a predictable need for liquid assets. They allow participants to bid for reserves against the full set of eligible collateral, which ranges from Level A collateral (highly liquid, high-quality sovereign securities) to Level C collateral (less liquid securities and portfolios of loans).

During the review period, these operations were carried out monthly. However, as described in Box 1, the Bank announced on 26 February 2019 that the frequency of ILTR operations would increase to weekly for a period.

The Bank ran 12 ILTR operations during the review period, over which there was a net increase in ILTR balances of £5.5 billion, with £9.6 billion of ILTRs maturing and £15.1 billion of new ILTRs allocated. ILTR usage by SMF participants remained at lower levels than the peaks reached in 2016, despite heightened market uncertainty during this period.

During 2018–19, 20.3% of ILTR drawings were made against Level A collateral, 12.6% against Level B and 67.2% against Level C. This is a continuation of the trend seen in 2017–18 towards greater use of Level C collateral and lower use of Level A collateral, with the stock of ILTR borrowing against Level A collateral falling in the past two years from almost 75% to 28.5% at end-February 2019.

The switch to less liquid collateral could reflect lower demand to use the ILTR as a means of converting UK Treasury bills borrowed under the FLS into central bank reserves, given the closure of the FLS to new borrowings in January 2018. The TFS involved loans of sterling cash rather than Treasury bills.

Contingent Term Repo Facility

The Contingent Term Repo Facility (CTRF) is a liquidity facility that the Bank can activate in response to actual or prospective market-wide stress. The Bank reserves the right to activate the facility as it deems appropriate. Throughout the review period the Bank judged that CTRF auctions were not required.

Discount Window Facility

The Discount Window Facility (DWF) is a bilateral on-demand facility provided to institutions anticipating or experiencing heightened liquidity needs or a firm-specific or market-wide liquidity shock. It allows participants to borrow gilts in return for less liquid collateral in potentially large size, either to bridge to the next ILTR auction or for a variable term. The Bank may lend sterling cash instead of gilts to smaller participants or if, for example, government bond repo markets fail to function properly.

Box 1
Additional liquidity operations

In 2019 Q1 the Bank announced that it was taking steps to provide additional flexibility in its provision of liquidity insurance. These additional operations were introduced as a precautionary step supporting the functioning of markets that serve households and businesses, and not in response to any specific concern about liquidity stress.

On 26 February, the Bank announced an increase in the frequency of ILTRs from monthly to weekly during March and April 2019, subsequently extended to end-June,(1) mirroring the change in frequency enacted around the EU referendum in 2016. And on 5 March, the Bank announced a new Liquidity Facility in Euros (LiFE),(2) under which it would offer to lend euros on a weekly basis until further notice. This was consistent with the Bank's position as set out in the November 2018 *Financial Stability Report*, that it stands ready to provide liquidity in all major currencies. This facility allows SMF participants to borrow in euros from the Bank of England. The transactions were facilitated by the activation of a standing swap line between the Bank and the European Central Bank as part of the existing international network of standing swap lines which provide an important tool for central banks in pursuit of financial stability objectives.

The Bank continues to monitor market conditions and keeps its operations, including their frequency, under review.

(1) See 'Extension of weekly Indexed Long-Term Repo operations', April 2019.
(2) See 'Further enhancements to the Bank of England's liquidity insurance facilities', March 2019.

The Bank publishes quarterly data of DWF usage with a five-quarter lag. There was no DWF usage recorded up to the most recent DWF disclosure period (the three months to 31 December 2017). However, the Bank undertakes a regular programme of test trades with DWF participants and applicants to ensure operational readiness.

Term Funding Scheme

The Term Funding Scheme (TFS) was part of the MPC's package of stimulus measures launched in August 2016. The TFS provided four-year term funding to banks at rates close to Bank Rate, to reinforce the transmission of Bank Rate cuts to those interest rates faced by households and businesses in the UK.

The drawdown period ran from 19 September 2016 to 28 February 2018. 62 bank and building society groups joined the Scheme and the total amount of loans made through the TFS at the end of the drawdown period was £127 billion. At end-February 2019, there was £121.4 billion outstanding in aggregate drawings.

On 21 January 2019, outstanding loans made through the TFS were transferred from the Asset Purchase Facility (APF) to the Bank of England's balance sheet. This transfer aligned with the new capital and income framework for the Bank agreed on 21 June in a new Memorandum of Understanding between the Bank and HM Treasury.(8) The framework captures a set of principles for determining which monetary policy or financial stability operations should be undertaken on the Bank's balance sheet and which should be indemnified by the Treasury.

Funding for Lending Scheme

The Funding for Lending Scheme (FLS) was launched by the Bank and HM Treasury on 13 July 2012. The FLS was designed to encourage banks and building societies to lend more to businesses and households. The quantity and price of funding was linked to participants' lending performance. The Scheme's initial drawdown period ran until 31 January 2014. The drawdown period for the FLS extension opened on 3 February 2014 and was extended several times before closing on 31 January 2018.

The outstanding stock of FLS drawings was £31.4 billion at the closure of the Scheme. At end-February 2019 there was £15.9 billion of FLS drawings outstanding, with the reduction due to maturities and repayments.

US dollar repo operations

The Bank's US dollar repo operation offers to lend dollars on a weekly basis. Participants can bid for unlimited funds for a 7-day term at fixed spread, secured against Level A, B and C collateral. The facility makes use of the international network of standing swap lines between participating central banks; in this case the Bank makes use of the swap line with the US Federal Reserve.

There was no use of this facility during the review period.

Asset purchase operations

The Bank purchases assets to implement monetary policy as set by the MPC. These purchase operations are conducted through a subsidiary of the Bank, the APF.

Gilt purchases

The purpose of purchases of UK government bonds, financed by central bank reserves, is to impart monetary stimulus, by lowering the cost of borrowing for households and companies and by triggering portfolio rebalancing into other assets by sellers of gilts.(9)

On 28 February 2019, the stock of purchases of UK government bonds was at its target of £435 billion. The Bank conducts periodic operations to purchase additional gilts to replace those which have matured. These operations accounted for the purchase of £18.8 billion of gilts in 2018–19.

In June 2018 the MPC updated its guidance on asset purchases. It noted that it 'intended not to reduce the stock of purchased assets until Bank Rate reached around 1.5%, compared to previous guidance of around 2%'.(10)

Corporate Bond Purchase Scheme

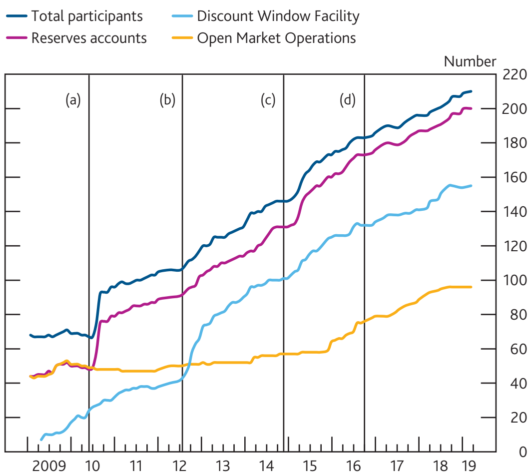
The Corporate Bond Purchase Scheme was launched as part of the August 2016 monetary policy package. The target for corporate bond purchases of £10 billion was met in April 2017. No further corporate bond operations were held in the review period. The stock of corporate bonds held by the APF at 28 February 2019, valued at initial purchase price, was £9.6 billion because of redemptions. The article in the 2017 Q3 *Quarterly Bulletin* 'Corporate Bond Purchase Scheme: design, operation and impact' provides further details.

SMF membership

SMF membership increased in 2018–19 from 198 to 210 participants. In addition, nine existing participants signed up for additional facilities.

Interest in joining the SMF comes from a range of firms, both UK banks and those headquartered outside of the UK. Some are new firms, while others are existing SMF participants wishing to sign up for additional facilities (**Chart 3**).

Chart 3 SMF membership



Source: Bank of England.

(a) Extension of SMF eligibility.
(b) CTRF and FLS announced.
(c) TFS launched.
(d) Broker-dealers and CCPs admitted.

(8) The Memorandum of Understanding and exchange of letters are available here.
(9) From time to time, the Bank also separately purchases a much smaller amount of assets to invest cash ratio deposits and the Bank's free capital and reserves.
(10) The summary and minutes of the June MPC meeting can be found here.

The Bank continues to keep its SMF access policy under review.

The Bank worked with the larger UK banks throughout the review period to implement ring-fencing regulations and ensure that firms have appropriate membership of SMF facilities either side of the ring-fence, in line with SMF access policy.

Progress in establishing a Shari'ah compliant central bank deposit facility

In September 2018, the Bank announced that it would be establishing a Bank of England Alternative Liquidity Facility (BEALF) as a subsidiary of the Bank, to house a new Shari'ah Compliant Facility (SCF). The SCF, once launched, will enable UK Islamic banks to place deposits directly with the Bank, providing them with greater flexibility in managing their liquidity and meeting the Liquidity Coverage Ratio (LCR) requirement in a Shari'ah compliant manner. During 2018–19 the Bank developed policy and legal aspects of the SCF. In 2019–20, work will commence on the technology build and the changes to the Bank's systems required to launch the facility.

Risk management

There is a presumption of access to the SMF for firms that meet the Prudential Regulation Authority's (PRA's) supervisory threshold conditions and which have the requisite collateral. A firm's SMF eligibility is subject to a regular and independent review of creditworthiness by the Bank's financial risk management function. The due diligence process includes a regular review of the firm's business viability and strategy, asset quality, funding and liquidity, and both current and prospective capital position. The resulting firm rating enables the Bank to monitor its risk and exposures by the underlying riskiness of its counterparties across multiple operations. To produce credit assessments, data and information are sourced from PRA supervisory colleagues, publicly available information such as annual reports and news items, and the member firms themselves, including through onsite interviews with the firm's executive management, where appropriate.

This analysis is reviewed and updated regularly to ensure it still holds. Provided the firm still meets threshold conditions and is not failing or likely to fail, then there is a presumption that the Bank will lend to that firm. All lending is secured against collateral. Collateral haircuts are set to protect the Bank's balance sheet in a severe stress by avoiding procyclicality — the intention is that haircuts would not need to be increased when lending is required. The Bank in principle accepts as eligible collateral any asset it judges it can effectively and efficiently risk manage. It does this to enable a broad range of counterparties to have access to SMF facilities. The eligible collateral list is therefore very broad, including a wide range of securities and portfolios of residential mortgage loans, asset finance, consumer, auto, corporate, SME (small and medium-sized enterprise), PFI (private finance initiative) and social housing loans.[11]

Haircuts for SMF collateral start at 0.5% for sovereign securities, 12% for residential mortgage-backed securities or covered bonds, and 30% for portfolios of senior corporate bonds. Loan pool haircuts across all collateral types are 14%–52%. Residential mortgage collateral continues to make up the majority of collateral delivered to the Bank.

The total amount the Bank could lend through its market operations based on the amount of collateral available stood at £322 billion on 28 February 2019, £27 billion more than on 28 February 2018.

About this report

Following a recommendation by the Bank's Independent Evaluation Office (IEO), the Bank now publishes a shorter, factual annual report covering key developments in the facilities and their usage. This is the second such report. The Bank will publish a more in-depth review of the SMF every three years; the first of these will be published next year.

Feedback

The Bank welcomes ongoing feedback from interested parties on any aspect of this report. Comments can be sent to:

Head of Sterling Markets Division
Bank of England
Threadneedle Street
London, EC2R 8AH

Or by email to: SMFfeedback@bankofengland.co.uk.

(11) Details of eligible collateral can be found here.

Annex

Table A.1 Results of operations, FLS and TFS drawings

£ millions	Total stock outstanding(a) Feb. 2018	Mar. 18	2018 Q2 Apr.	May	June	2018 Q3 July	Aug.	Sep.	2018 Q4 Oct.	Nov.	Dec.	2019 Q1 Jan.	Feb.	Total stock outstanding(b) Feb. 2019
SMF														
OSF	**0**	0	0	0	0	-200	0	0	0	0	0	0	0	**0**
ILTR	**4,115**	357	1,325	825	750	590	1,633	785	845	1,227	2,084	1,560	3,130	**9,631**
Level A	**1,335**	5	10	0	0	0	305	200	0	230	985	795	530	**2,740**
Level B	**520**	212	5	370	50	90	305	50	50	55	200	100	417	**872**
Level C	**2,260**	140	1,310	455	700	500	1,023	535	795	942	899	665	2,183	**6,019**
CTRF(c)	**0**	0	0	0	0	0	0	0	0	0	0	0	0	**0**
FLS(d)	**28,598**	-2,226	–	–	-2,634	–	–	-6,814	–	–	-939	–	-26	**15,959**
TFS(e)	**127,016**	0	–	–	-555	–	–	-13	–	–	-5,005	–	-42	**121,401**

Note: FLS/TFS data taken from website publication and all data are as of 28 February.

(a) Aggregate drawings outstanding as at 28 February 2018.
(b) Aggregate drawings outstanding as at 28 February 2019.
(c) The CTRF was not activated during this period.
(d) FLS and FLS Extension, net drawdowns for each period (drawdowns less repayments and maturities).
(e) TFS, net drawdowns for each period (drawdowns less repayments).

Table A.2 Balances held in reserves accounts

£ millions	Total(a) Feb. 2018	Mar. 18	2018 Q2 Apr.	May	June	2018 Q3 July	Aug.	Sep.	2018 Q4 Oct.	Nov.	Dec.	2019 Q1 Jan.	Feb.	Total(b) Feb. 2019
Reserves account balances(c)	**492,226**	490,100	–	491,114	486,855	–	490,015	490,164	–	488,639	486,999	–	485,179	**490,411**

(a) Total reserves balances as at 28 February 2018.
(b) Total reserves balances as at 28 February 2019.
(c) Monthly reserves balances are averages for maintenance periods (the period between MPC meetings).