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The UK Response: A Summary of the UK Government Programmes In Response to the Credit Crisis

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As a result of the global economic downturn and increasing instability of the UK financial sector, the UK Government has in the last year introduced a number of ongoing measures to counter market volatility. To date, six identifiable schemes have been implemented by the UK Government, with the aim of restoring liquidity to the UK's financial sector.

- **Bank Recapitalisation Programme** – a short term financing scheme to inject capital into the UK's largest banks by way of a £50 billion equity investment available to UK banks.
- **Credit Guarantee Scheme** – a scheme guaranteeing certain eligible securities issued by UK banks.
- **Bank of England Liquidity Measures** – which include:
  - A. the Discount Window Facility (the "DWF") allowing UK banks to borrow UK gilts in exchange for certain eligible securities; and
  - B. the Special Liquidity Scheme, a pre-cursor to the DWF allowing UK banks to borrow UK gilts for a more limited range of eligible securities.
- **Bank of England Asset Purchase Facility** – a scheme to acquire commercial paper and/or corporate bonds issued by certain eligible UK incorporated companies.
- **Asset Backed Securities Guarantee Scheme** – a scheme to partially guarantee payments or put/call options due under certain eligible asset backed securities.
- **Asset Protection Scheme** – a scheme to protect UK banks from credit losses on portfolios of commercial and residential property loans, certain structured credit assets, corporate and leveraged loans and related hedges – now closed to new participants.

These programmes were introduced by the UK Government with the intent to re-establish the credit markets by either providing liquidity for certain debt assets or assisting bank institutions in raising capital funds. The programmes established in the UK have been among the more progressive liquidity and stability programmes introduced in any jurisdiction. Most notably, many of these programmes are open to non-UK entities and are not limited to entities that are banks. The purpose of this memorandum is to briefly summarise the programmes that have been introduced to date.

1) Bank Recapitalisation Programme

On 8 October 2008, the UK Government announced the introduction of measures designed to permit UK banks and building societies to issue up to £50 billion in Tier 1 capital in a programme in which the UK Government would agree to underwrite the issuance of such capital.

Pursuant to this programme, the UK Government offered to purchase a mixture of ordinary shares, preference shares or permanent interest bearing shares (PIBS) issued by eligible participants. A new arms-length company, UK Financial Investments Limited ("UKFI"), was formed by the UK Government to manage its investments in such banks and building societies. UKFI will be charged with overseeing that participating banks and building societies comply with the conditions for subscribing to the recapitalisation fund, such as the requirement to provide competitively priced lending to home owners and small businesses at 2007 levels. It is also the intent that over time the UKFI will manage the UK Government's investments in Northern Rock plc and part of Bradford & Bingley.

Eligible Participants

There is no automatic right of access to the recapitalisation programme. Any eligible participant must still be approved by HM Treasury. Eligible participants comprise any UK incorporated bank (including UK subsidiaries of foreign institutions) which have a substantial business in the UK, and UK building societies.

With respect to each of the banks that have subscribed to the recapitalisation programme, they agreed, among other things, to the following:

- no bonuses for directors for the first year of the investment;
- appointment of HM Treasury approved directors (the number of which is determined according to the UKFI shareholding of the eligible participant); and
- a commitment to restore and maintain mortgage and SME lending to levels comparable with the eligible participants' 2007 lending activities.

Currently, only RBS and HBOS-Lloyds have subscribed to the scheme by drawing an investment of £20 billion and £17 billion, respectively.

Preference shares issued by RBS and HBOS-Lloyds under the scheme have paid a 12 per cent annual dividend. On 19 January 2009 the UK Government agreed with RBS to convert its preference share interest into ordinary shares in exchange for a commitment to extend lending to large enterprises and increase the overall amount by £6 billion. A similar conversion agreement was announced on 7 March 2009 with HBOS-Lloyds in return for agreeing to participate in the Asset Protection Scheme.

As a result of the conversion, the UK Government now owns approximately 70 per cent of the ordinary shares of RBS and 43 per cent of the ordinary shares of HBOS-Lloyds.

2) Credit Guarantee Scheme

The Credit Guarantee Scheme ("CGS") was launched simultaneously with the Bank Recapitalisation Programme in October 2008 to encourage bank lending by assisting eligible participants in raising capital through the issuance of unsecured debt securities, with terms up to 36 months. This assistance is in the form of a guarantee by HM Treasury of such debt securities issued by such eligible participants. The UK Government estimates that approximately £250 billion debt securities will be guaranteed during the life of the scheme.

Eligible Participants

Eligible participants to the CGS must meet the following requirements:

- be a UK incorporated deposit-taking bank (including subsidiaries of foreign institutions) or building society having "substantial business in the UK"; and
- have an appropriate level (as determined by HM Treasury) and form of Tier 1 capital that has been raised, or committed to be raised.

Only one entity in the group of each eligible participant is allowed to participate (typically the primary deposit taker), and must engage in regular consultation with the Debt Management Office ("DMO") regarding issue

of guaranteed securities.

Within six months of acceptance to the CGS, eligible participants must communicate plans to HM Treasury to restore capacity to borrow without reliance on the guarantee.

As of 26 February 2009, each of Barclays, HBOS, RBS, Lloyds TSB, Nationwide Building Society, Clydesdale Bank, Standard Life Bank, Tesco Personal Finance and Yorkshire Building Society have issued debt securities with guarantees under the CGS.

Eligible Securities

Debt securities are eligible to be guaranteed under the CGS if they:

- are senior unsecured debt being in the form of either certificates of deposit, commercial paper, bonds or notes;
- do not provide for an event of default triggered by cross-default or cross-acceleration;
- are denominated in any of sterling, US dollars, euros, yen, Australian dollars, Canadian dollars or Swiss francs;
- mature within three years of the date of issue; and
- are issued between 13 October 2008 and 31 December 2009 (the "Drawdown Window").

After the closure of the Drawdown Window, eligible participants can continue rolling over any outstanding guaranteed debt securities (all until 13 April 2012 and up to one-third until 9 April 2014).

Fees

A fee based on 100 per cent of the eligible participants' median five-year credit default swap ("CDS") spread for July 2007-July 2008 (as calculated by HM Treasury using publicly available data) will apply. In the event that CDS spread data is not available, HM Treasury may use its own discretion to determine the appropriate basis for the fee.

In addition, a per annum rate of 50 basis points ("bps") will apply to the principal (of an interest bearing debt security) or gross proceeds of the issue (on a non-interest bearing debt security).

The fee accrues from the earlier of (i) the date of issue of the guaranteed debt security or (ii) the third business day after the date of the Guarantee Certificate, and is payable in arrear at three-month intervals and the final day of maturity of the guaranteed debt security.

3) Bank of England Liquidity Measures

The Bank of England ("BOE") has introduced two special facilities for availability to UK banks for short, medium and long term liquidity purposes. Currently, only one of these facilities remains available for drawing by eligible participants. The other facility remains open for roll overs on existing drawings.

A) The Discount Window Facility ("DWF")

The DWF was introduced by the BOE on 20 October 2008. The purpose of the BOE is to provide liquidity insurance to the banking system. The DWF allows eligible participants to borrow UK gilts (or cash at the discretion of the BOE) from the BOE against a range of debt securities for a period of 30 or 364 days.

The DWF is available to eligible participants on the same day if a request has been received and accepted by the BOE before 2:00pm on any business day.

Gilts are delivered by the CREST 'Delivery-by-Value' ("DBV") facility as 'Unstripped UK government stock[1]', or, at the request of an eligible participant and subject to the BOE's consent, in the form of a basket of conventional gilts[2] excluding rump stock[3].

Eligible Participants

Eligible participants for the DWF are banks that have been accepted into the BOE Sterling Monetary Framework and are required to pay a Cash Ratio Deposit ("CRD") to the BOE. Such eligible participants are:

- financial institutions authorised to accept

deposits;

- with eligible liabilities exceeding £500 million; and
- required to place 0.11 per cent of those liabilities as non-interest bearing deposits with the BOE.

In addition to the above requirements:

- only one member of a group is allowed to access DWF and may require a guarantee if not the group's primary entity; and
- non-UK incorporated CRD payers must make a special application to the BOE to become eligible to draw from the DWF.

The BOE has the power to investigate and reject eligible securities on a discretionary basis. For example if misuse is suspected, such as using the facility to arbitrage against "special" gilt repo markets, the BOE may reject.

Eligible Securities

The BOE will accept a range of debt securities as security for borrowing. The current list of eligible securities comprises:

- Securities routinely accepted in the BOE's short-term repo Open Market Operations, a comprehensive list of which can be found on the BOE website[4];
- Bonds issued by G10 sovereigns rated Aa3/AA- or higher and bonds issued by G10 government agencies rated AAA;
- Debt security issues of the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Corporation and Federal Home Loan Banking System rated AAA;
- UK and EEA covered bonds rated A3/A- or above, provided they were rated AAA at issue; the underlying assets may be either public sector debt or residential mortgages;
- UK, US and EEA covered bonds where the underlying assets are commercial mortgage loans and that are rated A3/A- or above, provided they were rated AAA at issue;
- Most senior tranches of UK, US and EEA ABS backed by credit cards, student loans, consumer loans, auto loans and certain equipment leases rated A3/A- or above, provided they were rated AAA at issue;
- Most senior tranches of UK and EEA RMBS rated A3/A- or above, provided they were rated AAA at issue;
- Most senior tranches of UK, US and EEA 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;
- Most senior tranches of UK, US and EEA securitised portfolios of senior secured or on-balance sheet, corporate loans rated A3/A- or above, provided they were rated AAA at issue; portfolios with leveraged loans are not permitted; the collateral pool must be diversified;
- Most senior tranches, rated A3/A- or higher, of UK, US and EEA securitised portfolios of corporate bonds, provided that they were rated AAA at issue; portfolios containing high yield bonds are not permitted; the collateral pool must be diversified;
- Some types of UK, US and EEA asset-backed commercial paper with the highest short-term ratings (A-1+/P1/F1+); only the most senior paper will be accepted; the BOE will assess eligibility of CP;
- 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 the UK, US and EU, subject to additional limitations; and
- Bank debt guaranteed by HM Treasury under the Credit Guarantee Scheme or bank debt guaranteed under the guarantee schemes of Australia, New

Zealand or Ireland.

The underlying assets of eligible securities must not be purely synthetic in nature, and should be denominated in sterling, euro, US dollars, Australian dollars, Canadian dollars, Swedish krona, Swiss francs or, in the case of Japanese government bonds and the CGS only, yen.

Market price is used to determine the value of the eligible securities. If such information is not publicly available, the BOE will determine the relevant value and may apply a higher haircut at its discretion.

The value of an eligible security will in effect be reduced by a margin ratio in the range of 1.06-1.82 depending on the type, quality and term, with extra haircuts of up 5 percentage points applied in certain circumstances[5], for example non-sterling assets, no public market price or a downgraded rating. These measures help protect the BOE from a sudden fall in value of the security relative to the amount borrowed by the eligible participant.

Fees

Each eligible security will be categorised according to a level (the "Level") to determine the applicable fee payable for participation in the DWF:

A. high-quality debt securities routinely eligible as collateral in the BOE's short-term repo Open Market Operations and Operational Standing Lending Facility (attracting a fee of 50 – 100 bps, or more at the discretion of the BOE);

B. third-party debt securities (not issued, originated or guaranteed by a member of the same group as the eligible participant and without 'close links' as determined by the BOE) that are trading in liquid markets (attracting a fee of 75 – 170 bps, or more at the discretion of the BOE);

C. other third-party debt securities (not issued, originated or guaranteed by a member of the same group as the eligible participant and without 'close links' as determined by the BOE) including those not trading in liquid markets (attracting a fee of 125 – 275 bps, or more at the discretion of the BOE); or

D. own-name securitisations and covered bonds (issued, originated or guaranteed by a member of the same group as the eligible participant or with 'close links' as determined by the BOE) (attracting a fee of 200 – 400 bps, or more at the discretion of the BOE).

The above fee ranges are applied on a daily basis, and will vary according to the Level of the debt security and the total stock of borrowing by the eligible participant, relative to the size of the aggregate sterling liabilities of all entities in the same group as the eligible participant as used for the most recent CRD payment. The daily aggregate is payable on the first business day of each calendar month for as long as the drawing period remains open.

An additional fee of 25 bps will be applied to any part of the eligible participant's drawings with an initial maturity of more than 30 days.

B) The Special Liquidity Scheme ("SLS")

The SLS was a pre-cursor to the DWF launched on 21 April 2008 as a measure to improve bank liquidity by allowing banks to swap their high quality mortgage-backed and other securities for UK Treasury Bills for a term of up to three years. The list of eligible securities was far more limited than those for the DWF. The drawdown window for the SLS closed on 30 January 2009, however the scheme remains operational for eligible participants who have swapped eligible securities for Treasury Bills in that these draws can be rolled over for a maximum of three years from 30 January 2009 and eligible securities remain subject to re-margining.

Eligible participants to the SLS were the same banks as are eligible for the DWF i.e. those required to pay a CRD to the BOE.

Eligible securities were a subset of those eligible for the DWF, and did not include securities routinely accepted in the BOE's short-term repo Open Market Operations,

commercial mortgage-backed securities or US covered bonds. The SLS also had an additional requirement for the eligible securities to be held on eligible participants' balance sheets at 31 December 2007.

To borrow Treasury Bills under the scheme, eligible participants are charged a fee based on the spread between 3-month LIBOR and the 3-month General Collateral gilt repo rate. The average spread over the drawdown period was approximately 115 basis points.

Treasury Bills with a face value of approximately £185bn have been lent under the SLS. The total nominal value of securities held by the BOE as collateral in the SLS amounts to approximately £287 billion. The BOE's valuation of those securities as at 30 January 2009 was approximately £242 billion, an effective discount to par of about 16 per cent.

Most of the collateral received was residential mortgage-backed securities or residential mortgage covered bonds.

4) Bank of England Asset Purchase Facility ("APF")

On 30 January 2009 the UK Government authorised the BOE to purchase up to £50 billion of high-quality private sector assets under the APF. The purpose of the APF is to improve the availability of financing for companies that make a material contribution to the UK economy. The assets are to be acquired through a new government entity entitled Bank of England Asset Purchase Facility Fund Limited (the "BOE Fund"). The BOE, acting as agent for the BOE Fund, has the authority to utilise central bank reserves to purchase commercial paper ("CP") and corporate bonds in both the primary and secondary markets.

The BOE is authorised to deal on commercial terms with corporate entities and adopt a pricing model rather than charge fees.

A) Commercial Paper Trading

Eligible Participants

Eligible participants to the scheme must be either dealers in the primary market acting as principals or investors that hold such CP in the secondary market. In any case, they must be entities appropriately authorised for the purposes of the UK Financial Services and Markets Act.

Eligible Securities

The BOE will only purchase CP (at its discretion) with the following characteristics:

- Must be issued by an eligible issuer, which will be an entity meeting each of the following requirements:
    - A company that makes a material contribution to economic activity and corporate financing in the UK; leveraged investment vehicles and companies within groups that are predominantly banks, investment banks or building societies will not be eligible; and
    - An entity capable of sustaining a CP programme (as determined by the BOE);

    While the terms of the APF do not require that the issuer of the CP be a UK corporate entity, it does state that UK incorporated companies, including those with foreign incorporated parents, of sufficient size to sustain a CP programme and with a genuine business in the UK, will normally be regarded as meeting the eligibility requirements.
- Denominated in sterling.
- A maturity of one week to three months if issued via a dealer.
- A residual maturity of three months or less if sold by a secondary market holder.
- Issued directly into Crest, Euroclear or Clearstream.
- No non-standard qualities such as extendibility or subordination.

- Guaranteed if issued by a finance subsidiary of an eligible participant. A minimum short-term credit rating of A-3 / P-3 / F-3 from at least one of Standard & Poor's, Moody's and Fitch. Issuers with split ratings (e.g. where one or more rating agencies have provided differing ratings for the same issuance) where one or more rating is below the minimum, or are at the lowest rating and on negative watch, are not eligible.

If an issuer is downgraded below the minimum credit ratings above, the CP will be permitted to mature as normal, but the issuer will be unable to access the BOE Fund again until they meet the required minimum credit ratings. The BOE will also not make any further secondary market purchases from the eligible participant.

The CP must meet other standard characteristics, such as must be standard form (e.g., extendability; subordination) and if issued by a finance subsidiary it should be appropriately guaranteed.

Fees

CP purchased in the primary market will be discounted using a rate based on the maturity-matched overnight index swap ("OIS") rate, as determined by the BOE on the day of purchase. The spread to the OIS rate will range 75 bps – 300 bps according to the credit rating of the issuer. Where an issuer has a split rating, the spread will be derived from the lowest rating.

For CP purchased on a secondary market, pricing will follow the same method as for primary market pricing, or the amortised cost from the issue price (whichever is lower).

B) Corporate Bond Secondary Market Trading

The Fund will make small purchases of a wide range of investment grade corporate bonds from the secondary markets.

Reverse auctions will take place three times a week where the BOE will list a range of eligible securities with similar maturities and a reference gilt for each eligible security to determine a spread. The BOE will stand ready to purchase up to £2 million of each eligible security that has under £250 million outstanding, and £5 million of each eligible security that has over £250 million outstanding.

Eligible Participants

The fund will only purchase eligible securities from entities meeting the following conditions:

- market makers that are also counterparties in the BOE gilt-purchase Open Market Operations; and
- such entity submits weekly updates on:
  - their indicative bids and offers for eligible securities;
  - actual spreads to reference gilts at which they have bought or sold bonds; and
  - volume of transactions in eligible securities bonds.

The BOE may at its discretion exclude any eligible participant if it suspects abuse of the reverse auctions or the APF generally.

Eligible Securities

The BOE will only purchase bonds with the following characteristics:

- issued by a company that makes a material contribution to economic activity and corporate financing in the UK; leveraged investment vehicles and companies within groups that are predominantly banks, investment banks or building societies will not be eligible; while the terms of the APF do not require that the issuer of the CP be a UK corporate entity, it does state that UK incorporated companies, including those with foreign incorporated parents, of sufficient size to sustain a CP programme and with a genuine business in the UK, will normally be regarded as meeting the eligibility requirements;
- denominated in sterling;

- a minimum long-term credit rating of BBB-/Baa3 from at least two of Standard & Poor's, Moody's and Fitch. Issuers with split ratings where one or more rating is below the minimum are not eligible. Issuers at the lowest rating that are on negative watch will not be eligible;
- cleared and settled through Euroclear and/or Clearstream;
- minimum amount in issue of £100 million;
- minimum residual maturity of twelve months; no perpetual debt;
- at least one month since the debt security was issued;
- admitted to official listing on an EU stock exchange; and
- not convertible or exchangeable, and without non-standard qualities such as extendibility or subordination.

Eligible securities issued by the finance subsidiary of a company will normally require a guarantee from the issuers group that is satisfactory to the BOE.

Fees

Auctions will be on a uniform spread basis so that all successful offers in any individual bond will be allotted the same spread. The BOE will privately set a minimum spread to the yield on a specified reference gilt, and not purchase eligible securities below this spread. Successful offers above the minimum spread will then be ranked and allocated until the fixed quantity the BOE is willing to purchase has been allocated.

The BOE will keep under review the level of minimum spreads and the size of purchases in the light of scheme participation and market conditions.

Umbrella Schemes

In addition to general bond trading of eligible securities, the BOE Fund will also stand ready to make purchases of bonds issued by banks under the CGS.

The facility will only cover sterling-denominated publicly issued debt securities as listed by the DMO. In all other respects the purchases will be conducted in the same manner as the Corporate Bond Secondary Market Trading Scheme.

5) Asset Backed Securities Guarantee Scheme

On 22 April 2009 the UK Government published detailed information on a scheme to provide guarantees for asset-backed securities sponsored by eligible participants (the "ABS Guarantee Scheme") that was initially proposed on 19 January 2009 (the "Proposal"). The purpose of the ABS Guarantee Scheme is to implement a recommendation made by Sir James Crosby to the UK Government in November 2008. The scheme is designed to improve banks' access to wholesale funding markets by encouraging investment, which will ultimately result in improved lending conditions in the credit markets.

Eligible participants in the scheme may apply for one of two available guarantees that are available for coverage over any eligible security until 22 October 2009 (subject to any extension at the discretion of HM Treasury). The first guarantee is a credit guarantee over the timely payments of amounts due from eligible securities. The second is a liquidity guarantee covering the failure of an issuer to exercise a put or call option pursuant to the terms of the eligible security. Eligible participants will have the option of either guarantee over an eligible security, but not both at the same time.

The guarantee in respect of an eligible security will have a maximum term of either three or five years; however, only one third of the guarantees issued can have a term of up to five years. In return for the guarantee, a fee will be charged, and a counter-indemnity from the eligible participant and the issuer required.

Eligible Participants

Eligible participants who qualify for the CGS will be eligible to the scheme. That is, entities

meeting the following conditions:

- any UK incorporated deposit-taking bank (including subsidiaries of foreign institutions) or building society having "substantial business in the UK"; and
- have an appropriate level (as determined by HM Treasury) and form of Tier 1 capital that has been raised, or committed to be raised.

Eligible Securities

Eligible securities to the ABS Scheme must meet the following conditions:

- must be RMBS backed by mortgage loans to residential properties in the UK only;
- denominated in a single currency of only sterling, euro, US dollars, yen, Australian dollars, Canadian dollars, Swiss francs (or other currency at the discretion of HM Treasury);
- admitted to the official list and to trading on the regulated market of the London, Dublin or Luxembourg stock exchanges; and
- rated AAA (or equivalent) on the basis that they do not carry a guarantee by at least two of Standard & Poor's, Moody's and Fitch.

The initial Proposal in January had indicated that the ABS Scheme would cover other consumer related ABS in addition to RMBS. This did not happen in the final rules, although HM Treasury had indicated they may extend the scheme to other ABS in the future.

With respect to programmes in which new residential loans may be added at subsequent dates, the scheme has added restrictions as to the requirements for such loans with respect to any programme in which a guarantee has been issued. Subsequent to a guarantee being issued, a residential mortgage may be sold into the related RMBS programme by an eligible participant, but must meet the following conditions:

- secured by a valid first ranking charge over the property;
- not made before 1 January 2008;
- a current balance not exceeding £500,000;
- loan-to-value not exceeding 90 per cent of the lower of the purchase price or most recent property valuation, and a weighted loan-to-value of all mortgages in a pool backing the eligible security not exceeding 75 per cent; and
- made to borrower that:
    - is a natural person and is not "self-certified", with no adverse credit history and would be lent to by a reasonable and prudent mortgage lender; and
    - made at least one full payment in respect of their mortgage and has not been in arrears at any time prior to entry into the mortgage pool.

Fees

A fee based on a per annum rate of 25 bps plus 100 per cent of the eligible participants' median five-year CDS spread for 1 July 2007-1 July 2008 (as calculated by HM Treasury using publicly available data) will apply. In the event that CDS spread data is not available, HM Treasury may use its own discretion to determine an amount.

The above fee will be applied to the principal amount outstanding from time to time of the eligible security and will be payable in sterling in arrears on the relevant interest payment date of an eligible security, and will accrue on a daily basis for the period starting from the date of issue to:

i. in the case of a credit guarantee, the earlier of the date at which the eligible

security is redeemed in full or the guarantee expires; or

ii. in the case of a liquidity guarantee, the earlier of the date at which the eligible security is redeemed in full or the relevant put or call date of the security.

6) Asset Protection Scheme

As part of the proposals announced on 19 January 2009, the UK Government launched a scheme to protect eligible participants from credit losses on eligible securities (the "APS"). Entrance to the scheme closed on 31 March 2009.

Pursuant to such scheme, HM Treasury agreed to cover 90 per cent of all losses on eligible securities (over and above a "first loss amount" to be covered by the eligible participant). A ledger is required to be maintained for each eligible participant that makes claims under the APS to HM Treasury on specified quarterly dates.

For an eligible participant to claim for a loss, a credit event must occur on a covered eligible security. Credit events are defined under the term sheet of the programme to consist of: (i) non-payment (ii) bankruptcy, or (iii) certain other events (at the discretion of HM Treasury). Losses arising from mark-to-market, accounting write-downs or disposals will not constitute a credit event or result in a claim under the programme. Combined with a duty to mitigate all losses, it is currently unclear as to what actions an insured entity can take in connection with realising upon a defaulted asset. For example, given the current state of the market, is it possible for the insured entity to liquidate a defaulted asset in the current market? Or would such a liquidation give rise to an uninsured mark-to-market loss?

Any future recovery made against a loss is split pro rata between HM Treasury and eligible participant.

The scheme was aimed at (but not limited to) any institution holding more than £25 billion in assets eligible for protection.

Only RBS and HBOS-Lloyds participated in the Asset Protection Scheme. RBS obtained asset protection over a portfolio with a par value of £325 billion; the first loss of these assets was sized at £23 billion and RBS paid a fee of £6.5 billion for the guarantee. With respect to HBOS-Lloyds, asset protection was provided over a pool with a par value of £260 billion; the first loss was sized at £10 billion and the fee paid by HBOS-Lloyds was £15.6 billion. With respect to both RBS and HBOS-Lloyds, the UK Government will absorb 90 per cent of all losses above the agreed first loss. There is no information over which assets were included in the portfolio for asset protection.

Eligible Participants

Any UK incorporated deposit taker (including subsidiaries of foreign institutions) may apply.

Eligible participants must show:

- a reasonable level of capital, or alternatively, a viable plan for accessing capital and funding should it be required;
- a sustainable business model and delivery plan;
- its funding profile, sources and mix is clear, broad-based and sustainable;
- its senior management team is credible, with demonstrable ability to deliver its business model and delivery plan; and
- willingness to operate according to various policies relating to remuneration control, confidentiality and compliancy as dictated by HM Treasury.

Eligible Securities

Eligible securities for protection comprised:

- corporate and leveraged loans;
- commercial and residential property loans;
- structured credit assets, including RMBS, CMBS, CLOs and CDOs;

- participations in respect of the above; and
- any other assets or exposures HM Treasury may consent to.

Eligible securities are also subject to the following requirements:

- must be denominated in sterling, euro or US dollars;
- must be ring-fenced by the eligible participant in order to maintain transparent control;
- must have fixed or determinable payments and a defined or imputed maturity date;
- must not be an equity or equity-linked asset;
- must not include the eligible participant (or related entity) as an obligor; and
- in each case must held by eligible participants from at least 31 December 2008.

HM Treasury will examine eligible security on a case-by-case basis before accepting it into the scheme.

Fees

A fee calculated in relation to the size and cost of administration of the protected assets was charged to each eligible participant in the programme. Payment was permitted in capital instrument form, with cash also accepted. An entry fee applied, and if an eligible participant cancels its protection before the agreed time, an exit fee will also be incurred.

Conclusion

The UK Government has been progressive in its approach to countering economic instability by using a variety of measures not limited in scope to a single area of the financial markets.

It is particularly notable that from early stages eligibility has not been heavily restricted to UK banks only. In this respect, the UK has been one of the few jurisdictions to recognise the global nature of the financial markets by allowing foreign institutions and other non-banking entities access to some of the programmes. It remains to be seen whether this tactic will pay off, however industry response has generally been positive to schemes which offer greater flexibility in terms of function and participation.

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[1] This is the most common UK gilt class where the income is not separated (stripped) into separate cash flows, for example coupon and principal repayment.

[2] Gilts on which interest payments and principal repayments are fixed in nominal terms.

[3] A relatively small gilt (in terms of nominal outstanding) as declared by the DMO, in which Gilt-edged market makers ("GEMMs") are not required to make a market, but which the DMO will be prepared to make a bid price if requested by a GEMM.

[4] See http://www.bankofengland.co.uk/markets/money/eligiblesecurities.xls

[5] For example: if a borrower seeks £1 million, then an applied margin of 1.20 will treat the amount sought as £1.2 million, as such the borrower will have to supply security to the value of £1.2 million. If an additional haircut of 5 percentage points is applied, £1.263 million should be given so that the post-haircut value equals £1.2 million.