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Summary of Government Interventions in Financial Markets
United Kingdom

Overview

Beginning in April 2008 and accelerating from there on, the UK began taking numerous and substantial actions in order to combat the economic downturn. Amongst the most important measures enacted by the UK are:

- Bank Recapitalisations;
- Credit Guarantee Scheme;
- Bank of England Liquidity Provisions;
- Guarantee Scheme for Asset-Backed Securities;
- Bank of England Asset Purchase Facility, and
- Asset Protection Scheme.

In addition to the above measures, the UK has enacted several other significant measures that will also be discussed below.

as at 19 March 2009

Investments/recapitalisation

Bank Recapitalisation Scheme

On 8 October 2008, the UK announced several significant measures (the "**Initial Stability Measures**") to provide financial stability to the economy by ensuring that banks and building societies in the UK had sufficient access to (i) short-term liquidity, (ii) new capital and (iii) funds for medium-term lending. Of the Initial Stability Measures, the UK's scheme (the "**Bank Recapitalisation Scheme**") to help banks increase the level of their tier 1 capital above the regulatory requirements was arguably the most significant.

Under the Bank Recapitalisation Scheme, the UK sought and obtained the commited participation of many of the largest UK banks and building societies (specifcally, Abbey, Barclays, HBOS, HSBC Bank, Lloyds TSB, Nationwide Building Society, RBS and Standard Chartered), however the scheme is available to any "eligible insitution" (which are UK incorporated banks (including UK subsidiaries of foreign institutions) that have substantial business in the UK and building societies). The participating institutions agreed that they would increase their aggregate tier 1 capital by GBP 25bn. These insititutions could raise this new capital on their own accord or through assistance from the UK, which made GBP 50bn available for the Bank Recapitalisation Scheme.

If tier 1 capital is provided by the UK, certain terms and conditions that appropriately reflect the financial commitment being made by the taxpayer, such as requirements that the institution maintain certain lending levels to consumers and small businesses, homeowner support, restrictions on remuneration of senior executives, government involvement in appointment of non-executive directors and divident policy, are required.

On 3 November 2008, the UK established UK Financial Investments Limited to manage its shareholdings in recapitalised institutions on a professional and wholly commercial basis, and create value for the taxpayer. The UK does not intend to remain a permanent investor in the recapitalised institutions and, therefore, intends that UK Financial Investments Limited will over time seek to dispose of the investments in an orderly way, through sale, redemption, buy-back or other means, in accordance with its objectives.

State guarantees

Credit Guarantee Scheme

As part of the Initial Stability Measures, the UK also implemented a credit guarantee scheme (the "**Credit Guarantee Scheme**") pursuant to which the UK would guarantee senior unsecured debt instruments of varying terms of up to 36 months, in any of sterling, US Dollars, Euros, Yen, Australian dollars, Canadian dollars and Swiss francs. In return, the UK will receive a commercial fee to ensure proper remuneration for the credit risk it has assumed. The institutions that will be permitted to take advantage of the Credit Guarantee Scheme are the same eligible institutions that may participate in the Bank Recapitalisation Scheme, provided they have a sufficient of amount of tier 1 capital in a form satisfactory to the UK.

The Credit Guarantee Scheme has an open drawdown period that ends on 31 December 2009. During the drawdown period, banks can issue new debt with the guarantee of the UK. Once the debt has been issued, it can be rolled over after the drawdown period ends until 13 April 2012 and up to one-third of the total until 9 April 2014.

Bank of England liquidity provisions

Liquidity facilities

On 21 April 2008, the Bank of England launched a scheme (the "**Special Liquidity Scheme**") that allowed banks to swap high quality mortgage-backed securities and other securities for Treasury bills. The Special Liquidity Scheme was intended to enable banks to obtain liquidity using certain types of assets of sufficient quality that existed at the end of 2007 and for which the financial markets were not providing sufficient liquidity. Risk of loss remains with the banks and, as of 8 October 2008, the amount set aside for the Special Liquidity Scheme was GBP 200bn. The drawdown period of the Special Liquidity Scheme ended on 30 January 2009.

On 18 September 2008, the Bank of England, in co-operation with the Bank of Canada, the European Central Bank (ECB), the Federal Reserve, the Bank of Japan and the Swiss National Bank, announced it would participate in measures designed to address problems in the US dollar short-term funding markets (the "**US Dollar Liquidity Operations**"). Specifically, the Bank of England offered to swap overnight US dollar funds against eligible collateral in an initial aggregate amount of up to USD 40bn. The amount was later increased to USD 80bn and, on 13 October 2008, the Bank of England announced that there would be no limit on the amount that could be swapped under the US Dollar Liquidity Operations. On 3 February 2009, the Bank of England announced that its US Dollar swap lines were being extended until 30 October 2009.

Market Operations

On 20 October 2008, the Bank of England made three significant reforms to its market operations. First, the Bank of England amended the terms of its overnight standing repurchase facilities for very high-quality industrialised-country sovereign bonds. Specifically, in order to minimise fluctuations in the overnight rate, the Bank of England reduced the range in which the rates were permitted to fluctuate to 25 basis points. Also, the Bank of England moved to reduce any stigmatisation attached to the use of its standing facilities by changing the related disclosure requirements.

Second, the Bank of England established a permanent discount window facility that allows banks to borrow gilts or, at the Bank of England's discretion, cash, against a wide range of eligible collateral. The normal length of borrowing under the discount window facility is 30 days, but in order to ensure liquidity during the economic downturn the Bank of England will extend the maturity to 364 days for an incremental fee of 25 basis points.

Finally, the Bank of England broadened the classes of collateral that could be used in its long-term repurchase market operations.

Guarantee Scheme for Asset-Backed Securities

On 19 January 2009, the UK announced that it would establish a credit guarantee scheme for asset-backed securities. The guarantees will be full or partial guarantees of eligible "AAA" asset-backed securities, including mortgage-backed securities. The institutions that will be eligible for participation in this guarantee scheme are the same that are eligible for particiaption in the Credit Guarantee Scheme (subject to any additional requirements). The details for this guarantee scheme are forthcoming from the Debt Management Office and the programme is expected to commence in April 2009.

Bank of England Asset Purchase Facility

On 29 January 2009 the UK authorised the Bank of England to establish an asset purchase facility (the "**Asset Purchase Facility**") to purchase up to GBP 50bn of high-quality private sector assets, including debt backed under the Credit Guarantee Scheme, commercial paper, corporate bonds, syndicated loans and some asset-backed securities. The initial GBP 50bn was to be funded through the issuance of UK treasury bills and the UK Treasury agreed to indemnify the Bank of England. The commercial paper purchasing facility became operational on 13 February 2009.

On 5 March 2009, the UK revised the Asset Purchase Facility to allow maximum asset purchases of up to GBP 150bn and to add UK Government debt to the list of eligible assets. The UK also indicated that going forward the Bank of England would fund asset purchases under the Asset Purchase Facility by crediting the purchase price to the account of the selling institution. In other words, the Bank of England now funds these purchases by creating new money rather than by issuing UK treasury bills as initially contemplated. The UK left it to the Bank of England to determine the amount and timing of asset purchases under the Asset Purchase Facility. Following the UK's authorisation on 5 March, the Bank of England announced that it intended to purchase up to GBP 75bn worth of assets. A portion of the targeted GBP 75bn will continue to be used to purchase private sector assets, but the Bank of England expects that the majority of this amount will be used to purchase medium- and long-term conventional gilts. It is expected that it will take the Bank of England approximately 3 months to purchase the full GBP 75bn worth of assets.

Asset Protection Scheme

The UK has implemented a scheme (the "**Asset Protection Scheme**") whereby financial institutions may purchase credit protection for those assets most affected by the current economic conditions, including corporate and leveraged loans; commercial and residential property loans; structured credit assets (e.g., residential mortgage-backed securities, commercial mortgage-backed securities, collateralised loan obligations and collateralised debt obligations); and participations in any of the preceding. The credit protection offered under the Asset Protection Scheme will insure each participating institution against any future credit losses on the designated assets over and above a "first loss" amount of 10 per cent., which is to be borne by the participating institution.

UK incorporated deposit-takers (including UK subsidiaries of foreign institutions) with more than GBP 25bn in eligible assets may participate in the Asset Protection Scheme, as long as such institution also agrees to increase its availability of business loans and residential mortgage loans. The final rules of the Asset Protection Scheme will be published once negotiations are finalised between the Treasury and the institutions intending to participate.

Summary of proposed key legislation/regulation

The Banking Act 2009

On 21 February 2009 the Banking Act 2009 (the "**Banking Act**") became effective. The primary purpose of the Banking Act is to strengthen the UK's statutory framework for addressing bank crises, protecting depositors and, ultimately, maintaining financial stability. Under the Banking Act a special resolution regime (the "**SRR**") was developed to replace the temporary powers provided by the Banking (Special Provisions) Act 2008 (the "**Temporary Act**"), which expired on 20 February 2009 and was the basis for much of the UK's reaction to the economic downturn, including the nationalisation of Northern Rock and other financial institutions. The core provisions of the SRR expand and refine the provisions of the Temporary Act designed to deal with financial institutions in distressed financial positions. The UK also established the Banking Liaison Panel to provide on-going guidance to the UK on the effects of the SRR (including any related secondary regulation).

Other Legislation

Eighteen bills and other non-legislative actions, organised into four themes (Economic Stability, Making the Most of Your Potential, Personalisation and Improvement of Public Services and Handing Power Back to the People), have been introduced for this year's Parlimentary session to address the economic downturn. The principal aims of these proposals are to address financial stability, protect consumers, and minimise the impact of the economic downturn on the overall economy. Only the Banking Act has been enacted. The other prosposed legislative bills have been consolidated, dropped or are being considered further.

Other developments

Short-sale ban and disclosure

On 18 September 2008, the Financial Services Authority ("**FSA**") announced a ban on short selling of certain shares until 16 January 2009. The affected shares included: Alliance & Leicester plc, Barclays Bank plc, Bradford & Bingley plc, European Islamic Investment Bank plc, HBOS plc, HSBC Bank plc, Islamic Bank of Britain plc, Lloyds TSB Bank plc, The Royal Bank of Scotland plc and Standard Chartered plc. On 16 January 2009 the short-sale ban expired, but the FSA continued to require disclosure of a net short position in the stock of a UK financial sector company once a position reaches 0.25 per cent. of a relevant firm's issued share capital. However, further disclosure is only required if a short position changes by a further 0.1 per cent. of issued share capital.

On 6 February 2009 the FSA published a discussion paper on short-selling generally, in which it has proposed that disclosure requirements be put in place in respect of all UK listed stocks. The consultation period on this proposal ends on 8 May 2009.

Increased deposit guarantee

With effect from 7 October 2008, the UK increased the statutory guarantee of savings deposits from GBP 35,000 to GBP 50,000 per depositor and institution.

The UK has also taken additional steps to ensure that savings deposits are protected following various bank failures, such as when the UK subsidiaries of the Icelandic banks Landsbanki and Kaupthing failed.

Homeowner Mortgage Support Scheme

On 3 December 2008, the UK announced a 2-year homeowner mortgage support scheme (the "**Homeowner Mortgage Support Scheme**") to compliment its many actions to protect homeowners from losing their homes. Under the Homeowner Mortgage Support Scheme, homeowners that are suffering a temporary shortfall in income will be given assistance to ensure that they can remain in their homes. The Homeowners Mortgage Support Scheme will provide a bridge, giving homeowners who are experiencing financial problems sufficient time to find new employment or recover income.

Under the Homeowner Mortgage Support Scheme, borrowers that meet certain eligibility requirements will be permitted defer monthly mortgage payments until their financial conditions have improved. The UK will guarantee the lender against a proportion of any loss incurred on the deferred interest payments in case the borrower defaults for a maximum time period or until the borrower is able to commence normal payments.

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