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Summary of Government Interventions
European Central Bank (and the Eurosystem)

Overview

The co-ordinated efforts of the European Central Bank (the "**ECB**") and the various national central banks ("**NCBs**") of the member states of the European Union that have adopted the Euro (together with the ECB, the "**Eurosystem**") have been instrumental in providing liquidity to qualifying financial institutions (i.e., generally any institution that is subject to the Eurosystem's minimum reserve system and is considered to be financially sound) during the economic downturn. Whilst the primary objective of the Eurosystem is to maintain "price stability" (i.e., the avoidance of prolonged periods of inflation or deflation), it is also charged with the objective of supporting the general economic policies, which include a high level of employment and sustainable, non-inflationary growth, of its euro area community.

To achieve the above objectives, the Eurosystem has been given sole authority over certain functions, most relevant of which is to define and implement the Eurosystem's monetary policy. It is under this authority that the Eurosystem has principally intervened to counteract the lack of liquidity in the euro area.

Eurosystem liquidity provisions

The primary instruments through which the Eurosystem implements its monetary policy generally fall within one of the following three categories: (1) open market operations, (2) standing facilities and (3) minimum reserve requirements. Whilst the level of liquidity may be affected by operations conducted under any of the three categories, it is through changes to its open market operations and standing facilities that the Eurosystem has primarily addressed liquidity shortfalls. Specifically, with respect to its open market operations and standing facilities, as explained below, the Eurosystem has revised its financial instruments collateral framework, implemented additional long-term transactions, instituted US dollar liquidity operations and lowered interest rates.

Eurosystem Collateral Framework

Open market operations and standing facility operations are both facilitated through various transactions, such as reverse transactions (i.e., repurchase agreements (repos) and collateralised loans), outright purchases and sales and exchange swaps. Each of these types of transactions is similar in that it must be supported by collateral meeting the standards of the Eurosystem's financial instruments collateral framework (the "**Collateral Framework**"). One approach taken by the Eurosystem to increase liquidity within the euro area has been to widen the list of eligible assets accepted under its Collateral Framework.

For example, on 15 October 2008, the Governing Council of the ECB widened the Collateral Framework by (1) expanding it to include marketable debt instruments denominated in certain currencies (i.e., US dollar, pound sterling or Japanese yen) other than the Euro and (2) lowering the required credit rating for marketable and non-marketable assets, other than asset-backed securities ("**ABS**"), from "A-" to "BBB-". However, in each case, an additional haricut is imposed on top of what would normally apply to such assets if they had otherwise qualified under the Collateral Framework.

On the other hand, the Eurosystem has at times during the economic downturn narrowed the Collateral Framework to maintain its overall credit risk exposure and protect against potential losses from its monetary policy operations. The most recent example occurred on 20 January 2009 when the Governing Council of the ECB announced that the required rating at the time of issuance for otherwise eligible ABS issued on or after 1 March 2009 would be increased from "A" to at least "AAA" (thereafter, the ABS will still be eligible so long as the rating is at least "A").

Provision for Longer Term Refinancing

In normal economic conditions, transactions under the Eurosystem's open market operations are typically for terms of 1 week or 3 months. However, as part of its efforts to ease liquidity in the euro area, the Eurosystem has scheduled supplementary long-term refinancing operations for terms of 3 and 6 months in addition to its usual scheduled operations. As of 5 March 2009, the Governing Council of the ECB has indicated that it intends to continue these supplementary long-term refinancing operations for as long as necessary and at least through the end of 2009.

US Dollar Liquidity Operations

On 18 September 2008, in co-operation with the Bank of England, the Bank of Canada, the Federal Reserve, the Bank of Japan and the Swiss National Bank, the Eurosystem announced it would participate in measures (the "**US Dollar Liquidity Operations**") designed to address problems in the US dollar short-term funding markets. Under the US Dollar Liquidity Operations, the Eurosystem banks will permit qualifying financial institutions to swap eligible collateral for US dollars. As of 3 February 2009, the US Dollar Liquidity Operations are funded in 7-, 28- and 84-day maturities and are scheduled to remain open until 30 October 2009. Initially, the amount offered to swap US dollar funds against eligible collateral in the Eurosystem was USD 40bn and, on 13 October 2008, the Governing Council of the ECB announced that there would be no limit on the amount that could be swapped by Eurosystem banks under the US Dollar Liquidity Operations.

On 19 March 2009, the ECB confirmed its decision to continue conducting US Dollar Liquidity Operations at the same maturity terms. The operations are to continue to take the form of repurchase operations against ECB eligible collateral and to be carried out as fixed rate tenders with full allotment. The Governing Council of the ECB, on 6 April 2009, also decided to establish a temporary reciprocal currency arrangement with the Federal Reserve. This agreement will provide the Federal Reserve with the capacity to offer liquidity of up to EUR 80 billion.

Interest Rates

Consistent with the interest rates set by other central bank authorities during the economic downturn, the current interest rates set by the Governing Council of the ECB are at historically low levels. As of 8 April 2009, the effective interest rates on the main refinancing operations, the marginal lending facility and the deposity facilty were 1.25 per cent., 2.25 per cent. and 0.25 per cent., respectively.

Summary of proposed key legislation/regulation

Whilst no specific measures have been enacted, a number of proposals have been made to cede greater regulatory oversight of the euro area's financial system to the ECB. For example, the de Larosière Report – which is a recent, highly publicised report mandated by the President of the European Commission to review and suggest improvements for the European Union's existing financial regulatory framework – recommends that the ECB should play a major role in both macro- and micro-prudential supervision. The report recommends that the ECB should have an instrumental role in analysing the macro-level economy and providing early warning of systemic risk, whilst on a micro-level the report recommends that the ECB should have a supervisory role over cross-border banks in the euro area.

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