19 January 2009

Asset Protection Scheme

As part of a comprehensive package designed to reinforce the stability of the financial system, to increase confidence and capacity to lend, and in turn to support the recovery of the economy the Government is today announcing its intention to offer protection on those assets most affected by the current economic conditions. The Asset Protection Scheme is designed to protect financial institutions against exposure to exceptional future credit losses on certain portfolios of assets. In conjunction with the steps already taken by the UK authorities and in co-ordination with their international partners, the Scheme is designed to restore confidence to financial markets, supporting financial stability and the availability of credit to creditworthy borrowers in the economy. The Government will be taking forward discussions in the coming weeks with its international partners about the establishment and co-ordination of such schemes by a number of countries. This document summarises the headline terms of how a UK scheme would be implemented.

1. Introduction

1.1 Under the Scheme, in return for a fee, the Treasury will provide to each participating institution protection against future credit losses on one or more portfolios of defined assets to the extent that credit losses exceed a "first loss" amount to be borne by the institution. It is intended that the Scheme will target those asset classes most affected by current economic conditions.

1.2 The Treasury protection will cover the major part but not all of the credit losses which exceed this "first loss" amount. Each participating institution will be required to retain a further residual exposure, which is expected to be in the region of 10 per cent. of the credit losses which exceed the "first loss" amount. This residual exposure will provide an appropriate incentive for participating institutions to endeavour to keep losses to a minimum.

1.3 The Treasury currently expects that the fee will usually be satisfied by the issue of capital instruments of the participating institution. These instruments are not expected to include ordinary shares, but will include a range of alternative capital instruments. The Treasury will be open to consider other forms of fee, including cash.

2. Eligible Institutions

2.1 The Treasury will, in the first instance, offer protection to UK incorporated authorised deposit-takers (including UK subsidiaries of foreign institutions) with more than £25 billion of eligible assets. Affiliated entities will also be considered by the Treasury for protection under the Scheme in the light of its assessment of the impact on financial market stability and the overall economy and the most effective possible use of public resources.

2.2 The Treasury will subsequently consider extending the Scheme more widely to other UK incorporated authorised deposit-takers (including UK subsidiaries of foreign institutions). Further participation in the Scheme will be at the discretion of the Treasury taking account of the advice of the Bank of England and the FSA on the basis of its best judgment of how important the deposit-taker concerned is to financial market stability and the overall economy and the most effective possible use of public resources.

2.3 The Government's recapitalisation and credit guarantee schemes continue to be available to those institutions which are eligible to participate in those schemes. The Government remains prepared to provide capital to any eligible institution either directly or, alternatively, on a contingent basis under the recapitalisation scheme.

2.4 Each applicant to any of the Government schemes (including the Scheme) will be required to satisfy the Treasury that:

- it is adequately capitalised and funded or has a realistic plan for accessing adequate capital and funding;
- it has a sustainable business model and delivery plan;
- its funding profile, sources and mix are clear, broad-based and sustainable; and
- its senior management team is credible, with demonstrable ability to deliver its business model and delivery plan.

3. Conditions and lending commitments

3.1 Participation in the Scheme will be subject to a number of further conditions, including a verifiable commitment agreed between the participating institution and the Treasury to support lending to creditworthy borrowers in a commercial manner.

3.2 A number of further conditions will apply to the Scheme, including in relation to remuneration policy.

4. Disclosure

4.1 All participants in the Scheme will be required to meet the highest international standards of public disclosure in relation to their asset books.

4.2 Subject to maintaining appropriate commercial confidentiality, the Treasury will publish and lay before Parliament the agreements which it enters into with participating institutions in relation to the operation of the Scheme.

5. Eligible Assets

5.1 The Scheme will provide protection for portfolios containing assets each of which must be eligible for the Scheme. The Treasury expects to provide protection for those assets on an institution's balance sheet where there is the greatest degree of uncertainty about the future performance of those assets. Assets may be denominated in any currency. It is intended that the following categories of assets will be eligible for the Scheme, subject to assessment by the Treasury for inclusion on a case-by-case basis:

- Portfolios of commercial and residential property loans most affected by current economic conditions;
- structured credit assets, including certain asset-backed securities;
- certain other corporate and leveraged loans;
- and any closely related hedges, in each case, held by the participating institution or an affiliate as at 31st December 2008.

5.2 The Treasury may consider the inclusion of other asset classes in the Scheme, subject to appropriate investigation by the Treasury and its advisers and the determination of an appropriate fee.

5.3 Assets to be included in the Scheme will be subject to appropriate investigation by the Treasury and its advisers in order to assess the probability of future loss. An applicant will be required to give the Treasury and its advisers open access to all information required for this purpose.

5.4 The level of protection offered by the Treasury will be determined following detailed discussions with eligible institutions and their demand for the Scheme.

6. Assessment of "First Loss" Amount and Fee

6.1 In setting the terms under which protection will be offered, the Treasury and its advisers will take into account their estimation of the performance of the assets of the institution to be included in the Scheme. The fee, "first loss" amount to be borne by the institution and residual exposure will be set accordingly.

6.2 It is intended that pricing of the Scheme will be structured having regard to international practice so as to provide appropriate incentives to participating institutions to meet their commitments agreed with the Treasury to support lending to creditworthy borrowers and to ensure appropriate protection for taxpayers.

6.3 Participating institutions will be entitled to cancel the protection, subject to the agreement of the Treasury and payment of an appropriate termination fee.

7. Management of the Assets

7.1 Assets included in the Scheme will continue to be managed by the institution and will remain on its balance sheet but will be required to be "ring-fenced" by the institution so that actions in relation to them, including enforcement and disposal, will be subject to appropriate Treasury controls. The Scheme may also provide for the Treasury to take over ownership and/or management of the assets in certain defined circumstances.

7.2 The Scheme will include appropriate further requirements as to the management of the assets by the institution.

7.3 The Treasury will require open access to all information it considers necessary in connection with the Scheme and will require regular reporting by the institution to the Treasury.

8. Duration of the Scheme

The duration of the coverage will be determined following examination of the assets to be included in the Scheme and is expected to be not less than 5 years and to be consistent with the tenor of the assets.

9. Administration of the Scheme

9.1 The Scheme is expected to be administered by the Treasury or an entity to be established or designated by the Treasury.

9.2 References in this summary to the Treasury include, where appropriate, an entity as described in paragraph 10.1.

9.3 The cost of establishing and administering the Scheme will be borne by participating institutions.

10. Regulatory approvals

The Scheme is subject to applicable regulatory and state aid approvals.

10.1. Timing

10.2 It is not currently intended that there will be any further announcement relating to the details of the Scheme until the last week of February.