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Eurozone: Central Bank Swap to United Kingdom, 2019¹

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Abstract

In 2019, the Bank of England (BoE) determined that a disorderly exit of the United Kingdom from the European Union (EU)—commonly referred to as Brexit—could disrupt the flow of financial services that EU firms provided to UK households and businesses. To ensure that UK banks, building societies, and broker-dealers would have access to euro liquidity in that scenario, on March 5, 2019, the European Central Bank (ECB) and Bank of England took the precautionary step of activating a standing bilateral swap line of unlimited size that had been agreed to in 2013. The BoE immediately announced that it was ready to lend euros to UK financial institutions through its new euro repurchase agreement weekly Liquidity Facility in Euros (LiFE), mirroring an existing weekly US dollar facility that relied on a similar swap arrangement between the BoE and the Federal Reserve. The BoE closed its LiFE facility in October 2021 after no real use except for minimal test cases. Although the ECB said that it also stood ready, if needed, to lend pounds sterling to eurozone banks under the swap arrangement that had been agreed to in 2013, its 2019 annual report noted that it had not activated pound sterling operations.

Keywords: activation of swap line, Brexit, currency swap lines, LiFE, liquidity, Liquidity Facility in Euros

¹ This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering central bank swap line programs. Cases are available from the *Journal of Financial Crises* at <https://elischolar.library.yale.edu/journal-of-financial-crises/>.

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Overview

In 2019, the Bank of England (BoE) determined that a disorderly exit from the European Union (EU)—commonly referred to as Brexit—could lead to a euro liquidity shortage in the United Kingdom and disrupt the flow of financial services that EU firms provided to UK households and businesses (BoE 2019c). In response, on March 5, 2019, the European Central Bank (ECB) and the BoE activated a standing swap line of unlimited size that had been agreed to in 2013 (ECB 2019; Fed 2013; French 2023). Under the swap line, the ECB provides euros to the BoE in exchange for pounds sterling that it holds as collateral. The BoE named its new weekly euro repurchase agreement (repo) lending facility the Liquidity Facility in Euros (LiFE) (BoE 2019a). The BoE had a similar weekly dollar facility already in place, backed by a similar swap arrangement with the US Federal Reserve (BoE 2019d).

The ECB said in its press release:

The European Central Bank (ECB) and the Bank of England have decided to activate a standing swap line through which the Bank of England will offer to lend euro to UK banks on a weekly basis. The activation marks a prudent and precautionary step by the Bank of England to provide additional flexibility in its provision of liquidity insurance, supporting the functioning of markets that serve households and businesses. (ECB 2019)

LiFE operations enabled banks, building societies, and broker-dealers to secure euro liquidity against “the full range of collateral eligible in the Bank’s Sterling Monetary Framework [SMF],” the BoE’s

Key Terms

Purpose: To “provide additional flexibility in [the] provision of liquidity insurance, supporting the functioning of markets that serve households and businesses” in connection with Brexit (ECB 2019)

Participating Parties	European Central Bank and Bank of England
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Type of Swap	The standing arrangement is bilateral and reciprocal; activation of the line in 2019 was unidirectional
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Currencies Involved	The BoE could obtain euros from the ECB in exchange for pounds sterling
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Launch Date	The swap agreement was originally signed on October 31, 2013; Activation announcement: March 5, 2019
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End Date	The LiFE program ended on October 1, 2021; the standing swap arrangement remains in place
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Date of First Usage	March 13, 2019
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Interest Rate and Fees	Spot exchange rate; the BoE is required to pay a fee equivalent to the amount of the euros it draws from the ECB multiplied by a rate known as the ECB rate at the initiation of the swap transaction
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Peak Usage Amount and Date	EUR 10 million on March 13, 2019, August 14, 2019, and August 21, 2019
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Downstream Use/Application of Swap Funds	The BoE committed to lend euros to UK banks and building societies through the LiFE facility
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(continued)

framework for upholding monetary and financial stability (BoE 2019d). The BoE suspended the LiFE facility on October 1, 2021 (BoE 2021b).

Outcomes

There was minimal use under the LiFE facility for test purposes; it ended on October 1, 2021. The standing swap arrangement remains in place

As part of the same press release on March 5, 2019, the ECB stated that it “stood ready” to lend pounds sterling to eurozone banks, if the need arose (ECB 2019). However, unlike the BoE with its LiFE facility, the ECB never activated pound sterling lending operations (ECB 2020).

Notable Features

Not applicable

The ECB-BoE swap arrangement was part of a network of standing arrangements among six central banks, also including the Bank of Canada (BoC), Bank of Japan (BoJ), Federal Reserve, and Swiss National Bank (SNB) (ECB 2019). This network allowed “for the provision of liquidity in each jurisdiction in any of the five currencies foreign to that jurisdiction, should the two central banks in a particular bilateral swap arrangement judge that market conditions warrant such action in one of their currencies” (Fed 2013).

Summary Evaluation

Although our research has not located any articles that specifically evaluate the efficacy of LiFE and the 2019 ECB-BoE swap line, both BoE and ECB officials commented on the value of the facilities as a precautionary measure amid concerns about Brexit.

The Financial Policy Committee (FPC) of the BoE judged that the UK financial system was prepared to face a worst-case disorderly Brexit. The FPC noted that the BoE had operations in place to lend in all major currencies as a further precaution. It also welcomed the BoE’s decision to increase the frequency of its sterling facility operations and to implement LiFE in conjunction with the existing weekly dollar lending facility (BoE 2019d).

Mario Draghi, then president of the ECB, wrote in a letter dated June 14, 2019, that the status of the UK following its withdrawal from the EU would not affect the existing standing swap line with the BoE and that the scope of this arrangement had evolved to enhance financial stability (Draghi 2019).

Context: United Kingdom 2019–2020		
GDP (SAAR, nominal GDP in USD)		\$2.9 trillion in 2019
		\$2.7 trillion in 2020
GDP per capita (SAAR, nominal GDP in USD)		\$42,747 in 2019
		\$40,319 in 2020
Sovereign credit rating (five-year senior debt)	2019	Moody's: Aa2u
		S&P: AAu
		Fitch: AA
	2020	Moody's: Aa3u
		S&P: AAu
		Fitch: AA-u
Size of banking system		\$3.7 trillion in 2019
		\$3.9 trillion in 2020
Size of banking system as a % of GDP		131% in 2019
		143.3% in 2020
Size of banking system as a % of financial system		Data not available in 2019
		Data not available in 2020
Five-bank concentration of banking system		61.6% in 2019
		61% in 2020
Foreign involvement in banking system		Data not available in 2019
		Data not available in 2020
Existence of deposit insurance		Yes in 2019
		Yes in 2020
<i>Sources: Bloomberg; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset.</i>		

Key Design Decisions

- 1. Purpose and Type: The ECB and BoE activated a standing bilateral swap line, as a precautionary measure ahead of Brexit, under which the ECB would provide euros that the BoE could then lend to UK financial institutions through a new weekly euro repo liquidity facility.**

On March 5, 2019, the ECB and the BoE activated a standing swap line pursuant to which the ECB would provide to the BoE euros in exchange for pounds sterling, which would allow the BoE to lend euros to UK banks, building societies—member-funded lending institutions—and broker-dealers on a weekly basis through a new euro repo liquidity facility (BoE n.d.; BoE 2019a). UK banks included all banks that were part of the Sterling Monetary Framework; hence, banks with subsidiaries and branches in the UK were also eligible to borrow under the LiFE facility. Although the press release made an explicit reference to banks and building societies only, we know from the eligibility criteria of the BoE that this included broker-dealers (BoE 2021a). The ECB would receive pounds sterling from the BoE in exchange for euros. The activation of this swap line was meant to be a precautionary measure by the BoE to provide additional flexibility in its provision of liquidity to UK financial institutions ahead of Brexit (ECB 2019).

The standing swap line was part of a network of bilateral swap arrangements among six major central banks—the BoC, BoE, BoJ, ECB, Fed, and SNB—that were announced in October 2013 (Fed 2013).

- 2. Part of a Package: LiFE and the swap line activation were part of BoE’s preparation for the potential impacts of Brexit; the swap was launched under a bilateral arrangement that was part of a wider network of bilateral and reciprocal swap arrangements among six major central banks.**

While implementing LiFE backed by the euro swap line, the BoE took other measures to address the possible impacts of Brexit. It created a similar weekly US dollar repo facility, based on its standing swap arrangement with the Fed, and it began to provide weekly sterling operations through indexed long-term repos, or ILTRs, starting February 26, 2019 (BoE 2019a).

The ECB-BoE swap line was activated under a bilateral arrangement between the ECB and BoE. The arrangement was part of a network of bilateral swap arrangements among six central banks. These arrangements allowed “for the provision of liquidity in each jurisdiction in any of the five currencies foreign to that jurisdiction, should the two central banks in a particular bilateral swap arrangement judge that market conditions warrant such action in one of their currencies” (Fed 2013).

The ECB and BoE had created a temporary bilateral swap line on December 17, 2010 (ECB 2010). At that time, the purpose of the swap line was specifically to allow the BoE to provide pounds sterling to the ECB that the ECB could then provide to the Central Bank of Ireland,

which was facing a bank crisis and a sovereign debt crisis (Wiggins 2023). This swap line was set to expire on September 30, 2011, but the two parties extended it three times, and it was to expire on September 30, 2014 (ECB 2010; ECB 2013). On October 31, 2013, six major central banks (the BoC, BoE, BoJ, ECB, Fed, and SNB) announced the conversion of temporary bilateral swap lines into standing arrangements (Fed 2013).

3. Legal Authority: The ECB's Governing Council makes high-level decisions on currency swap agreements. The Bank of England's role in liquidity insurance programs is described in the Financial Services Act (2012).

The Governing Council of the ECB has the authority to enter into a foreign currency swap agreement (ECB 2021a).

It is well established that the BoE has the authority to engage in foreign currency swaps. The legal basis for the bank's liquidity insurance facilities is provided by the BoE Act (1998), the Financial Services and Markets Act (2000), the Banking Act (2009), and the Financial Services Act (2012). This legislation is supported with a system of memoranda of understanding (MOUs) and concordats, as well as by the regular exchange of letters between the chancellor of the Exchequer and the governor of the BoE (IMF 2016).

The BoE's Market Operations Guide describes the governance of liquidity programs that execute its monetary and financial stability objectives (BoE 2021a). That guide describes key terms for short-term, non-sterling—that is, foreign currency—liquidity facilities that the BoE funds through swaps with foreign central banks.

4. Governance: The ECB Governing Council makes high-level decisions regarding the swap line, while the Monetary Policy Committee (MPC) is the BoE's decision-making body.

The Governing Council, the ECB's decision-making body, makes decisions regarding whether to enter into a foreign currency swap agreement (ECB 2021a). The ECB reported on the swap line in its 2019 annual report (ECB 2020).

Relevant MOUs state that the FPC “will approve the scope and principles which determine the design of the Bank's liquidity insurance facilities and their resultant ability to reduce systemic risk” (BoE 2017; BoE 2023). The Monetary Policy Committee has the overall responsibility for formulating monetary policy and achieving its mandate to maintain price stability. Accordingly, it has decision-making authority over all tools deployed to help it achieve its mandate, including foreign exchange intervention, but takes into consideration the input from the FPC regarding liquidity principles (BoE 2018).

The FPC said in the minutes of its February 26, 2019, meeting that it “welcomed” the initiation of the LiFE program (BoE 2019d, 14).

5. Administration: To facilitate a draw on the swap lines, the ECB makes euro deposits available in the ECB account at the BoE in exchange for an equivalent value of pounds sterling deposited at the BoE account at the ECB.

Although our research has not been able to determine which body of the ECB made the management decisions regarding the ongoing operation of the swap in regards to the LiFE facility on a day-to-day basis, the reciprocal swap arrangements require the ECB to either provide euros in exchange for the relevant foreign currency accepted as collateral or provide euro as collateral in exchange for the relevant foreign currency borrowed, according to the requirement of the situation (ECB 2022).

The reciprocal swap arrangement between the ECB and the BOE requires the ECB to deposit euros into the “ECB Account” maintained in the books of the BOE in exchange for pounds sterling deposited by the BOE into the “BOE Account” maintained in the books of the ECB. The swap agreement also requires each party to update the other party with a statement of account pertaining to each movement on the other party’s account with respect to this transaction (ECB and BoE 2014).

6. Communication: The ECB and BoE announced the activation of the swap arrangement via press releases.

The ECB issued a press release announcing the activation of the swap line with the BoE on March 5, 2019. The stated goal was to provide additional flexibility in BoE’s provision of liquidity insurance, supporting the functioning of markets that serve households and businesses. The ECB’s press release stated that the “ECB will continue to work closely with the Bank of England to monitor market conditions carefully and keep its operations under review” (ECB 2019).

The ECB also stated that it “stood by” to provide pounds sterling to eurozone banks if needed, but it did not create a similar liquidity facility to provide pounds to eurozone banks (ECB 2019). Comments by Mario Draghi, then ECB president, suggest that the exclusion of central counterparties (CCPs) (which are financial market infrastructures that seek to minimize counterparty credit risk in transactions by acting as intermediaries between a buyer and a seller of an original trade) was important to the ECB. In a letter dated June 14, 2019, he wrote: “It should be emphasised that these operations are only available to UK banks, hence possible emergency liquidity provision to UK CCPs is not covered by the precautionary activation of the swap line” (Draghi 2019; Rehlon and Nixon 2013).

The BoE announced the activation on the same date as the ECB and at the same time announced that it would make weekly euro lending operations available to eligible UK banks and building societies that were members of the Sterling Monetary Framework through LiFE (BoE 2019a).

In this regard, the announcements served to communicate (i) the ECB’s readiness to provide euros under the swap if needed, (ii) readiness and availability to provide euros under the BoE’s LiFE facility to UK entities, and (iii) the ECB’s willingness to provide pounds sterling liquidity to eurozone banks if needed (ECB 2019).

The BoE also coordinated with the ECB to suspend its LiFE facility on October 1, 2021 (BoE 2021b).

7. Eligible Institutions: The ECB and the BoE activated the bilateral arrangement on March 5, 2019. Institutions eligible for downstream usage of euros included banks, broker-dealers, and building societies that were part of the Sterling Monetary Framework.

The ECB-BoE swap line is reciprocal, meaning that either of these central banks are eligible to draw the currency of the other (ECB and BoE 2014). In this case, the intent of the swap line activation was to enable the BoE to draw euros in exchange for pounds sterling from the ECB (BoE 2019a).

The ECB and BoE activated their standing swap arrangement explicitly to provide euros to UK banks, building societies, and broker-dealers that were members of the Sterling Monetary Framework through the BoE's LiFE facility, where needed (BoE 2019a; ECB 2022). The BoE published terms and conditions regarding the eligibility for downstream lending of funds drawn from the facility in a Market Notice (BoE 2019b).

8. Size: The BoE could make drawings for an unlimited amount of euros under the reciprocal swap line it had with the ECB. The LiFE facility permitted full allotment of requested amounts.

The swap agreement permitted the BoE to request from the ECB an unlimited amount of euros in exchange for pounds sterling (ECB 2022). There was no maximum bid size for UK financial institutions seeking to borrow through LiFE; the minimum bid amount was EUR 5 million (USD 4.4 million)³ (BoE 2019b). The LiFE facility permitted full allotment of requested amounts (BoE n.d.). See Figure 1 for more information.

9. Process for Utilizing the Swap Agreement: The BoE could make draws on the swap line from the ECB whenever UK financial institutions sought to borrow euros through the LiFE program.

The BoE stated in its press release that weekly auctions under LiFE would start on March 13, 2019, and would continue to run until further notice (BoE 2019a).

The swap agreement states that in the event of a nonrepayment by the BoE, the unpaid amount of the swap transaction along with any fee pertaining to the shortfall could be rolled over by the ECB into a new overnight swap transaction. Notwithstanding the rollover, the swap agreement permits the ECB to set off any obligations it has against the BoE pertaining to such swap transactions (ECB and BoE 2014).

³ Per Yahoo Finance, USD 1 = EUR 0.88 on March 5, 2019.

10. Downstream Use of Borrowed Funds: The funds from the activation of the swap would be lent to UK financial institutions through LiFE.

Activating the swap line enabled the BoE to lend euros to UK banks and building societies through a new weekly euro repo facility called the Liquidity Facility in Euros (BoE 2019a; ECB 2019). Borrowers drew on the line for only the minimum amount of EUR 5 million (USD 4.4 million) on a handful of occasions, for test purposes; the cumulative value of those draws was EUR 75 million (USD 66 million) (BoE n.d.). (See Figure 1.)

Figure 1: Amount Lent through the LiFE Facility

Operation date	Term (days)	Settlement date	Maturity date	Fixed bid rate	Operational amount (EUR mn)	Amount allocated (EUR mn)	Total bids (EUR mn)	% OMO bid allocated
3/13/19	7	3/14/19	3/21/19	Fixed rate	Unlimited	10	10	100
3/20/19	7	3/21/19	3/28/19	Fixed rate	Unlimited	5	5	100
8/14/19	7	8/15/19	8/22/19	Fixed rate	Unlimited	10	10	100
8/21/19	7	8/22/19	8/29/19	Fixed rate	Unlimited	10	10	100
10/16/19	7	10/17/19	10/24/19	Fixed rate	Unlimited	5	5	100
10/23/19	7	10/24/19	10/31/19	Fixed rate	Unlimited	5	5	100
12/11/19	7	12/12/19	12/19/19	Fixed rate	Unlimited	5	5	100
3/18/20	7	3/19/20	3/26/20	Fixed rate	Unlimited	5	5	100
5/27/20	7	5/28/20	6/4/20	Fixed rate	Unlimited	5	5	100
7/15/20	7	7/16/20	7/23/20	Fixed rate	Unlimited	5	5	100
10/14/20	7	10/15/20	10/22/20	Fixed rate	Unlimited	5	5	100
9/1/21	7	9/2/21	9/9/21	Fixed rate	Unlimited	5	5	100
Total						75	75	

Source: BoE n.d.

11. Duration of Swap Draws: The swap draws have a maximum duration of 88 days. The LiFE transactions had a maturity of one week.

According to the swap agreement between the ECB and the BoE dated January 16, 2014, the swap transactions have a maximum duration of either 88 days or a duration mutually decided upon by both the parties (ECB and BoE 2014). The LiFE transactions had a maturity of one week (BoE 2019a, 1).

12. Rates and Fees: The swap transactions are executed at the prevailing market spot exchange rates. BoE is required to pay a fee in connection with the swap transactions.

The swap agreement between the ECB and the BoE dated January 16, 2014, states that the swap transactions are to be executed at the spot exchange rate that prevails in the market.

Under this agreement, the BoE is required to pay a fee equivalent to the amount of the euros it draws from the ECB multiplied by a rate known as the ECB rate at the initiation of the swap transaction. The fee is to be calculated on a 360-day basis from the day the swap transaction takes place until the maturity date (which was excluded) (ECB and BoE 2014).

UK financial institutions seeking to borrow through LiFE would submit bids including the interest rate and the amount of funds they wished to borrow, as described in the Market Notice (BoE 2019b). Although our research has not uncovered the exact interest rates involved, the LiFE transactions followed full allotment at fixed rates (BoE n.d.). Eligible financial institutions could borrow against the full range of collateral eligible in the BoE's Sterling Monetary Framework, based on the BoE's usual haircuts. Haircut add-ons were applied to securities that were non-euro denominated to allow for currency volatility (BoE 2019b).

13. Balance Sheet Protection: The risk associated with the swap was mitigated by the currency deposited in exchange.

The ECB received pounds sterling in exchange for euros lent to the BoE (ECB 2019). The ECB's 2020 annual report states that the risks of the swap lines were "considered to be mitigated to some extent by the payments received" (ECB 2021b, 73).

14. Other Restrictions: Our research has not ascertained if other restrictions were put in place.

Our research has not discovered if other restrictions were put in place.

15. Other Options: No information is available on the other options pursued by the ECB.

Our research has not discovered any alternative strategies pursued by the ECB to address demand for euros in the event of a disorderly Brexit in 2019.

16. Exit Strategy: The LiFE program ended on October 1, 2021, but the swap line remains available under the standing arrangement agreed to in 2013.

The BoE suspended its downstream euro lending program, LiFE, on October 1, 2021, after running its last operation on September 29, 2021. This decision to suspend was taken on account of the improvements witnessed in the "funding market conditions" (BoE 2021b). The swap line remains in effect (Fed 2013). The press release from the BoE announcing the suspension of the LiFE facility stated that:

The Bank of England, in co-ordination with the European Central Bank, stands ready to re-adjust the provision of euro liquidity, including restarting LiFE, as warranted by market conditions. The swap line between the Bank of England and the European Central Bank is an available standing facility and serves as an important liquidity backstop to ease strains in global funding markets, thereby helping to mitigate the effects of such strains on the supply of credit to households and businesses, both

domestically and abroad. (BoE 2021b)

With the suspension of LiFE, the BoE and ECB effectively deactivated the currency swap line. The BoE would need to activate it again at potentially different terms to restart the facility.

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