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Changes to the Credit Guarantee Scheme

United Kingdom: HM Treasury

HM Treasury Press Release: Changes to the Credit Guarantee Scheme

The Government is today announcing proposals for changes to the Credit Guarantee Scheme. These changes are designed to enhance the effectiveness of the Scheme in supporting stability in the financial sector and maximise its impact on wider economic stability through supporting lending to the economy. They draw on experience gathered over recent weeks of operating the scheme and follow discussions with participating banks.

Taking account of international experience, and market developments (in particular the falls in bank risk premia), the Government is adjusting the formula that determines the fees paid by participating institutions for use of the Government guarantees. This will lead to those institutions paying a lower – but still commercial – fee for use of the Scheme, reducing their cost of funding under the scheme, and more closely aligning the scheme with those in other countries. This in turn will support their ability to continue to extend credit to the economy. The Government will, through the Lending Panel, ensure that this is reflected in the terms and availability of credit to households and businesses.

To enable participating institutions to manage better the transition from guaranteed to wholly unsupported funding the government will also lengthen the scheme, from 3 to 5 years, ending in April 2014. Within that the 3 year maximum term of individual instruments will be retained, with some flexibility to roll them over as agreed with the Treasury. At present the Scheme guarantees borrowing in Sterling, Euros and US Dollars. In future participants will also be able to borrow in a wider range of currencies, further extending the investor base in UK banks and building societies.

These changes will enable banks and building societies to borrow from a diverse range of investors, improve their financial positions, and therefore pave the way for them to lend to the economy.

The Scheme is open for an interim period of 6 months initially. This, and the size of the Scheme, will be kept under review. These proposals vary the Scheme as approved by the European Commission on 13 October 2008 and are subject to the Commission's approval under the state aid rules. The Government has informed the European Commission of these proposals and will bring forward changes to the rules of the Scheme to implement these proposals once it has obtained the Commission's approval.

Background:

On 8th October the Government announced a Credit Guarantee Scheme, as part of a comprehensive package of measures to address the extreme stress in financial markets, and to prevent the collapse of the banking sector. Similar measures were subsequently adopted by a number of other countries and have achieved their intended effect of stabilising the banking system.

Detailed arrangements for implementing the Credit Guarantee Scheme were announced on 13 October 2008. The basic principle was to charge a commercial fee for the guarantee, to ensure that the taxpayer was properly remunerated for the risk involved. The scheme was implemented rapidly, and the Government expects that by the end of 2008 approximately £100bn of guarantees will have been made to participating institutions. In total, the Government estimates participating institutions will issue £250bn of guaranteed debt. Following the announcement of the scheme and the Government's proposals for recapitalising the banks, the positive market reaction has reduced the risk premium (or credit default swaps) of UK banks. As a result the Government decided to look again the pricing structure of the scheme to ensure it continued to reflect commercial terms.

The Chancellor announced on 25 November that the Government would undertake a quick review of the arrangements for this scheme and assess whether they have any implications for the Crosby proposals and how it was working in practice, to maximise its impact on financial and wider economic stability while ensuring it did not crowd out market-based lending now or when better market conditions return. In particular the review considered whether changes could increase the flow of competitively priced funds to needy borrowers. The Chancellor said that the review would be completed before Christmas.

The Government will continue to monitor the effectiveness of the scheme and will keep under review the pricing structure of the scheme, to ensure that it continues to reflect commercial terms, taking account of the changing market circumstances.

As announced in the Pre-Budget Report, the Government is developing Sir James Crosby's report on finance in mortgage markets. To implement Sir James's recommendation, the Government would need to obtain State Aid approval from the European Commission and resolve some technical and practical considerations. The Government is proceeding to work up a detailed scheme and seeking State Aid approval to proceed. This will take into consideration the interaction between this proposal and the Credit Guarantee Scheme.