

7 October 2008

TENDER PROCEDURE FOR THE PROVISION OF US DOLLARS TO EUROSYSTEM COUNTERPARTIES

Following a decision by the ECB's Governing Council, the Eurosystem central banks will conduct operations with the following characteristics.

Type: Provision of US dollar term funding to Eurosystem counterparties against ECB-eligible collateral as set out in Chapter 6 of the General Documentation on Eurosystem monetary policy instruments and procedures¹ (the 'GD'), in accordance with the procedures set out for long term refinancing operations, in particular in sections 3.1.3 and Chapter 5 of the GD with the deviations contained in this statement of tender procedure.

Intended volume: The intended volume will be communicated in the announcement of each operation.

Type of auction: The auction type will be fixed rate tender or variable rate tender and will be communicated in the announcement of each operation.

Auction details: For operations with a duration of approximately 28 or 84 days: Fixed rate tender, with the rate not being known by market counterparties at the time of bidding: market counterparties would be informed that the rate they would pay on the allotted amount would be equal to the marginal rate of the simultaneous Federal Reserve System's auction under the Term Auction Facility. The minimum bid amount is equal to USD 5 million. Bids exceeding this amount must be expressed as multiples of USD 0.1 million. The maximum bid amount is equal to 10% of the volume of the operation. The publication of the announcement of the tender and the allotment will take place on wire services.

For operations with a duration shorter than approximately 28 days: Variable rate tender in the form of a single rate auction (Dutch auction) or a multiple rate auction (American auction). Counterparties may submit bids for up to two different interest rate levels. In each bid, the counterparties must state the amount and the respective interest rate. The interest rates bid must be

¹ Annex I of Guideline ECB/2000/7 of 31 August 2000 on monetary policy instruments and procedures of the Eurosystem (OJ L 310, 11.12.2000, p. 1) Guideline as last amended by Guideline ECB/2007/10 (OJ L 284, 30.10.2007, p. 34).

expressed as multiple of 0.01 percentage point. The minimum bid amount is equal to USD 5 million for each bid. Bids exceeding this amount must be expressed as multiples of USD 0.1 million. The total cumulated maximum bid amount of all bids submitted by an individual bidder is equal to 10 % of the volume of the operation. The publication of the announcement of the tender and the allotment will take place on wire services.

Eligible counterparties: In the euro area, all institutions which are eligible for the ECB's marginal lending facility and which have provided their US dollar standard settlement instructions (SSIs) and a Statement of Acknowledgement (specified below) to their respective national central bank (NCB) in advance of the bid submission are deemed eligible.

Risk control measures: In the euro area, the usual haircuts as defined in Section 6.4 of the GD will be applied and in addition an initial margin of 10% for operations with a duration of approximately one day, 12% for operations with a duration of approximately one week, 17% for operations with a duration of approximately 28 days and 20% for operations with a duration of approximately 84 days will be applied to cater for foreign exchange rate risk. For possible operations with a different duration, the initial margin will be communicated in the announcement of each operation.

The euro value of the USD liquidity provided will be computed once, on the allotment date, using the last available ECB reference rate for EUR/USD. While the collateral position will not be subject to any daily revaluations or margin calls due to movements in the exchange rate, it will be subject to the normal daily mark to market valuation and variation margins applied to Eurosystem eligible collateral. The initial margin therefore caters for the foreign exchange risk to which the Eurosystem will be exposed for the whole of the duration of the operation and for the expected time required to liquidate assets in case of the default of a counterparty.

For background information on risk control measures please refer to the Annex to this note.

Settlement details: Similar to the settlement of other Eurosystem credit operations, there must be a delivery of euro-denominated collateral by the counterparty in advance of the provision of credit by the NCB. On the settlement date, market counterparties are required to deliver eligible euro-denominated collateral to their local NCB by 16:00 CET for operations with a duration of approximately 28 or 84 days and by 15:00 CET for operations with a duration shorter than approximately 28 days. Possible changes to this rule will be communicated in the announcement of each operation. On receipt of such collateral, the NCB

will submit the corresponding US dollar payment instruction to the Federal Reserve Bank of New York (FRBNY) as soon as possible thereafter and ideally before 20:00 CET on the settlement date. On the maturity date, market counterparties are required to pay back US dollar funds to the accounts of NCBs at the FRBNY by 16:00 CET. Market counterparties are advised that in case US dollar funds are repaid after 16:00 CET, the respective NCB cannot guarantee return of euro-denominated collateral on the maturity date but will aim to do so on a 'best effort' basis.

Legal requirements: The operations set out in this note will take place in principle using existing legal documentation between the respective NCB and its eligible market counterparties. If certain NCB amendments are needed to such legal documentation, the NCBs will implement such amendments for the purposes of such operations.

Market counterparties wishing to participate in any US dollar tender are required, before bidding, to provide to their respective NCB their US dollar SSIs and a Statement of Acknowledgement. In such Statement of Acknowledgement, market counterparties are required to explicitly acknowledge – as a condition of their participation in the tender –

- that they are bound by the conditions of the tender set out in this note and communicated in the tender announcement; and
- the applicability of existing legal documentation between the counterparty and the NCB to the operation in question (unless amendment of the legal documentation is necessary).

The provision of US dollar SSIs by market counterparties to their respective NCB should be effected via SWIFT. The Statement of Acknowledgement may similarly be communicated via SWIFT or in another form as required by applicable national laws.

In the event of non-compliance by a counterparty with the requirements set out in this document, the procedures and sanctions set out in Annex 6 of the GD will be applicable.

Monitoring: Going forward, the Bank of England, the European Central Bank, the Swiss National Bank and the Federal Reserve will re-assess the effectiveness of the overnight US dollar funding operations, and reserve the right to adjust auction sizes consistent with evolving market conditions. Effectiveness will be judged by reference to both the scale of bids and the clearing price, for example if tender rates were consistently below a level of 50 basis points over the target US Federal Funds rate then the scale of the auctions would likely be reduced.

ANNEX:

BACKGROUND INFORMATION ON THE METHODOLOGY APPLIED TO DEFINE THE FOREIGN EXCHANGE ADD-ON MARGIN TO BE APPLIED TO EURO COLLATERAL UNDERLYING US DOLLAR LIQUIDITY PROVISION

Collateral assets underlying Eurosystem credit operations are subject to risk control measures. These risk control measures are applied to protect the Eurosystem against the risk of financial loss if the collateral has to be realised owing to the default of a counterparty. For US dollar liquidity backed by euro denominated collateral, the Eurosystem incurs a foreign exchange rate (FX) risk relating to possible movements in the US dollar exchange rate, in addition to the risk of change in value of the euro denominated collateral.

The FX risk is catered for by adding an initial margin computed on the amount of the US dollar liquidity provided. The euro value of the liquidity provided in US dollars is computed on the allotment day using the ECB reference rate of the allotment date and is frozen for the duration of the operation. This results in a longer exposure to FX risk and a higher margin than would normally be experienced in an operation with shorter maturity (e.g. one week).

To obtain an adequate level of risk control for this FX risk in line with best market practices, first the volatility of the EUR/USD exchange rate is estimated for the relevant period. Then, Value at Risk (VaR) is estimated on the basis of the initial margin needed to reflect the maximum loss of market value due to adverse movements in the exchange rate with a given level of statistical confidence over the relevant period. The length of this period corresponds to the duration of the operation plus the time expected to be required for the liquidation of the assets in case of default by a counterparty.