



Memorandum

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■ Credit facility with commercial paper as collateral

Background

The international financial unrest is continuing and banks have found funding increasingly difficult as the financial crisis has worsened in the autumn of 2008. The Riksbank, in cooperation with other authorities, for instance the National Debt Office and Finansinspektion (the Financial Supervisory Authority), has taken a number of measures to facilitate the banks' financing. At the same time, there are also major disturbances in corporate funding. There is a risk of these disturbances leading to a considerable tightening of credit. This warrants directed measures by the Riksbank to improve financing by and the supply of credit to non-financial companies as well. The measures are to be regarded as temporary, pending a return to a credit market that functions more normally.

Considerations

In view of the increasing credit squeeze, the Riksbank should facilitate bank lending to companies as directly as possible. However, the Riksbank should not lend directly to non-financial companies because that would be a departure from the Riksbank's traditional role as the banks' bank. Moreover, the Riksbank does not have operational conditions for lending to a wider circle. The loans should therefore be made to the banks, which thereby also carry the credit risks and handle contacts with the companies. Furthermore, to provide the Riksbank with adequate security, the loans in this programme should be restricted to companies with a satisfactory credit rating. In that liquidity is provided specifically for lending to these companies, the banks can also have a possibility of increased lending to other companies.

For these loans, the Riksbank should accept security in the form of commercial paper for which the issuer or the commercial paper programme has a sufficiently sound external rating. In this case that means an external rating of at least A-2, K-1, P-2 or F2. These ratings are somewhat lower than those the Riksbank currently accepts but from historical data they are expected to raise the probability of default from about 0.06% to no more than about 0.23%. The absence of an external rating should not disqualify. The Riksbank's major counterparties have internal rating systems that comply with Basel II. The banks are therefore in a position to

confirm that issuers whose commercial paper programme they wish to be eligible for this programme have a creditworthiness equivalent to A-2/P-2. The Riksbank shall also have a possibility of not accepting a particular debt instrument if special circumstances exist and shall also have the right to request information about the banks' credit assessments. However, this does not imply that the Riksbank generally undertakes independent credit assessments.

The type of company that can be considered for this credit facility is non-financial companies registered in Sweden. A financial limited company that is accountable for borrowing in a non-financial group should in this context be regarded as a non-financial limited company. Commercial paper issued by municipalities and county councils is not acceptable as collateral.

The loans should be provided in an auction procedure with the first auction on Wednesday 5 November, regularly followed by an auction once a fortnight. The maximum amount for the first auction should be SEK 40 billion. To ensure that the loans are made to companies, only commercial paper issued after 1 October 2008 should be eligible as collateral.

The minimum interest rate for these loans should harmonise with current monetary policy and other SEK loans. This rate should therefore be based on the repo rate, just like the Riksbank's earlier SEK loans. A maturity supplement should be added to that rate. As with previous three-month SEK loans, this maturity supplement should be 0.25 percentage points. Since the collateral which the Riksbank accepts for these loans is somewhat inferior to what is eligible for its normal lending, there should be an additional supplement of 0.15 percentage points. The proposed combined supplement is 0.40 percentage points.

The proposed credit facility departs from current collateral requirements in four respects: (i) a lower rating is acceptable, (ii) rating information from sources other than official rating institutions is acceptable, (iii) a stock-exchange listing is not required, and (iv) a minimum volume of outstanding issues is not required. Considering that the credit facility represents a departure from current collateral requirements, the haircut from valuations should be generally higher than normal. For collateral without an external rating, the haircut should be higher than for collateral that does have an external rating. This serves to protect the Riksbank from errors in the banks' assessments.

The Riksbank needs to establish a list of the programmes whose commercial paper is eligible as collateral for this credit facility. It must also be possible to revise the list when necessary. The Executive Board should therefore delegate the task of establishing the list of eligible commercial paper programmes to the head of the Financial Stability Department.

The Executive Board should delegate to the Head of the Asset Management Department the task of deciding whether or not the commercial paper programmes which counterparties want to be able to use as collateral for the various offers are acceptable.

The precise terms for these auctions are difficult to finalise in advance, so some flexibility in the final structure of the auctions may be needed. It is therefore proposed that the Head of the Monetary Policy Department, after consultation with the Head of the Financial Stability Department, is to formulate the terms in more

detail and, if necessary, adjust the amount to be auctioned to the prevailing market conditions and tendered bids.

Proposed decision

It is proposed that the Executive Board decides that

1. The Riksbank shall offer SEK credit to the Riksbank's monetary policy counterparties with collateral in the form of commercial paper with maturities from 30 days up to one year. The first tendering procedure concerning an announced amount of SEK 40 billion with three months maturity shall take place on Wednesday 5 November, with Tuesday 11 November as payment date. After that, auctions shall be held every second week.
2. The interest rate for these loans shall be set not lower than the repo rate plus a supplement of 0.40 percentage points.
3. Security for these loans shall be provided in the form of commercial paper issued after 1 October 2008 by non-financial limited companies registered in Sweden. A financial limited company that is accountable for funding for a non-financial group is in this context regarded as a non-financial limited company. The commercial paper shall to have a maturity of 30 days up to one year.
4. To be eligible, a commercial paper programme shall be issued by a company with sound creditworthiness. This creditworthiness shall be equivalent to an external credit rating of A-2, K-1, P-2 or F2 from Standard and Poors', Moody's Investor Services or Fitch Ratings, respectively. In the case of a company or a commercial paper programme for which an external rating is not available, a counterparty shall confirm that according to its assessment the company meets the creditworthiness requirement. Such confirmation can be provided only by counterparties that are authorised by the relevant supervisory authority to apply the Internal method in accordance with EC Directive 2006/48/EG.
5. The Head of the Asset Management Department is given the task of deciding whether the commercial paper programmes that counterparties want to use as collateral for these loans shall be accepted.
6. The Head of the Asset Management Department is given the task, after consultation with the Head of the Monetary Policy Department, the Head of the Financial Stability Department and the General Counsel, of deciding collateral requirements in greater detail.
7. The head of the Monetary Policy Department is given the task, after consultation with the Head of the Financial Stability Department, of deciding the more detailed formulation of credit terms and tendering procedures.