Bank of England

The Rt Hon Jeremy Hunt MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Andrew Bailey
Governor

17 October 2022

Dear Jeremy,

On 8 September 2022, HM Treasury and the Bank announced the establishment of a joint scheme (the Energy Markets Financing Scheme – 'EMFS') to address the extraordinary liquidity requirements faced by energy firms operating in UK wholesale physical gas and electricity markets.

The overarching aim of the EMFS is to improve the resilience of UK energy markets – and therefore the economy as a whole – supporting other government measures aiming to ensure lower and less volatile energy costs for businesses and consumers. Since the announcement we have continued working together to prepare for the scheme's launch for applications on 17 October 2022. Once the EMFS is launched firms will have until 27th January 2023 to apply for entry. The scheme will have a maximum 12-month tenor from when the guarantee described below is issued.

The EMFS will enable short-term financial support to wholesale energy firms of good credit quality through a period of high and volatile prices caused by Russia's invasion of Ukraine. It is designed to supplement existing commercial financing and is structured and priced accordingly, such that it would only be used by firms after other sources of financing have been exhausted. Any scheme fees would be paid to HM Treasury net of the Bank's costs of operating the scheme and commercial lenders' cost of funding.

Support under the EMFS will be granted through the use of guarantees on additional tranches of existing credit facilities provided by PRA authorised banks, and will be available to firms that can prove that they meet the scheme's eligibility criteria including that they are otherwise in sound financial health, and make a material contribution to the UK electricity and/or gas markets.

In accordance with the EMFS legal documentation, the Bank will issue a guarantee to the commercial lender(s) extending credit to applicant energy firms. The aim of the guarantee is to act as a supplement to existing sources of liquidity, supporting overall market liquidity by increasing the ability of market participants to meet extraordinary margin calls.

The Bank will act on an agency basis and will be fully indemnified by HM Treasury from any losses, liabilities, and expenses arising from the EMFS and will bear no credit risk, and accordingly, judgements on credit risk will be taken by HM Treasury.

The credit drawn from the guaranteed tranches of these credit facilities may only be used by energy firms to meet financing needs relating to the supply of energy to the UK market, specifically to meet margin calls.

The Bank will receive and process applications and perform an initial screening against published eligibility criteria. Firms that pass the initial screening will move on to the detailed due diligence phase, which will be led by HM Treasury. To support this process, HM Treasury has appointed and will convene an Advisory Committee which will consider the credit risks associated with the potential guarantee. The maximum size of the guarantee which may be offered to each energy firm in the EMFS will be determined by HM Treasury on a case-by-case basis, informed by the conclusions of the Advisory Committee. HM Treasury will engage the Bank and will share information in advance of taking a decision. HM Treasury ministers will make a decision on whether to approve or reject an application. Consistent with the Bank's agency role under the EMFS, the Bank will issue the guarantee in accordance with HM Treasury's final decision, subject to due consideration of non-financial risks relevant to the Bank as guarantor.

HM Treasury, supported by UK Government Investments (UKGI), will manage and monitor usage of the scheme once launched, including with respect to credit risk. HM Treasury and UKGI will provide regular updates to the Bank. The Bank will also report back any information that it receives, as well as continuing to provide market monitoring information as it does now.

In the event of a default of the energy firm, the lender will have the right to call upon the guarantee provided by the Bank for timely payment. Once notified by the Bank of the payment request and timing, HM Treasury will transfer the required funds to the Bank in advance of it settling the claim on the guarantee. The Bank will then immediately transfer default ownership to HMG under an assignment arrangement, at which point responsibility for managing the lender and their borrower will lie entirely with HM Treasury. Claims arising under the scheme will not create reserves on the Bank of England's balance sheet.

Officials at the Bank and HM Treasury have worked closely together in developing the EMFS and will continue to work closely as it is implemented with a view to achieving its objectives and purpose.

Yours sincerely

Andrew Bailey