

BANK OF ENGLAND: ASSET PURCHASE FACILITY

CONSULTATION ON PROPOSALS FOR WORKING CAPITAL FACILITIES

1 This paper sets out, for consultation, proposals for possible extensions to the Bank's Asset Purchase Facility (APF) to cover a broader range of instruments that are used to finance working capital. Specifically, it covers the proposed operation of a Secured Commercial Paper (SCP) Facility and an outline proposal for a Supply Chain Finance (SCF) Facility. Questions for consultation are highlighted throughout the document and are summarised in the Annex.

2 Market Notices concerning the APF have explained that the Bank's operations would vary according to the structure of, and conditions prevailing in, particular markets; and would evolve through time, in the light of experience with operating the APF and feedback from the market.

3 In recent months, the Bank has been engaged in a broad dialogue on ways in which the APF might be extended, with a view to improving liquidity in credit markets that are currently not functioning normally, and to support the Bank's responsibilities for UK monetary and financial stability. In particular, consideration has been given to whether the APF could help improve the function of markets for the raising of short-term working capital, for example through the purchase of securities backed by appropriate assets, by companies that make a material contribution to economic activity in the United Kingdom.

4 The addition of these securities to the list of assets purchased by the APF will broaden the range of companies that might benefit via improved conditions for financing working capital.

5 The APF's purchases under the SCP Facility would adopt a similar operational format to purchases under the existing Commercial Paper Facility. The proposed purchases would be consistent with the APF's objective to purchase assets only of high credit quality. The Bank also wishes to explore the possibility of a Supply Chain Finance Facility, potentially to improve the ability of investment grade companies to support their suppliers.

6 The Bank is consulting on the proposals in this paper, with a view to launching the Facilities shortly. The Bank would be pleased to receive comments on the proposals, particularly on the areas specifically highlighted. Comments should be e-mailed by 19 June to the following address: APF_consultation@bankofengland.co.uk .

SECURED COMMERCIAL PAPER FACILITY

Operation of the Facility

7 The APF would purchase asset-backed commercial paper securities (“securities”) from approved programmes during a defined period each business day.

8 The APF would purchase, at a minimum spread over risk-free rates, newly issued securities in the primary market via dealers and, after issuance, from other eligible counterparties in the secondary market. The purpose of the Facility is to support a private market by standing ready to make primary market purchases and by acting as a backstop for secondary market investors.

Length of Facility

9 The Bank’s intention is for the Facility to operate for as long as the abnormal conditions in corporate credit markets persist and materially impair the financing of real economic activity. The Bank will also ensure that appropriate time is allowed to enable eligible programmes to be established.

10 It is the Bank’s intention to provide 12 months notice of any withdrawal of the Facility. And recognising the lead time to set up programmes, the Bank would commit not to serve such notice during an initial ‘start-up’ period after the Facility’s launch date. Subject to consultation, the Bank is minded to set this start-up period at three months. Thereafter, the notice period would only be served in response to evidence to the satisfaction of the Bank that conditions in corporate credit markets were normalising. Following the announcement of any withdrawal, the Facility would remain open to programmes which had been confirmed as eligible, or have applications

lodged with the Bank, which subsequently lead to their becoming eligible, for the Facility.

Financing of Facility

11 Purchases under the Facility may be financed by advances to the Bank from the Debt Management Office or, with authorisation by the Monetary Policy Committee, by the issuance of central bank reserves.

Eligible securities

12 In line with its overall objective, the APF would only finance assets where the underlying borrower makes a material contribution to economic activity in the United Kingdom. Specifically, the maximum proportion of a programme's outstanding securities considered eligible for the APF would be based on the proportion of the underlying assets in the programme providing credit to borrowers that met this criterion. For example if 80% of the assets met the criterion, up to 80% of the securities issued by the programme would be eligible for purchase. **The Bank welcomes views on the feasibility of achieving this objective and the information about assets underlying programmes that it would need to collect to ensure the criteria were met.**

13 In addition to the above condition, and consistent with setting appropriate constraints on risk exposures incurred by the APF, the Bank would specify strict criteria for qualifying underlying assets. The Bank would discuss the assets underlying the programmes, and any credit enhancement, in detail with the programme sponsor prior to a programme's approval. The Bank's initial views on the assets it is minded to accept as suitable are outlined below. **The Bank would appreciate comments on these proposals:**

- Direct short-term credit to companies, such as trade receivables and equipment leases
- Short-term credit to consumers, such as for credit cards and short-term loans.
- Asset-backed securities will not generally be permitted as assets in programmes. Synthetic assets will not be permitted.

- The Bank plans to exclude longer-term assets, such as mortgages and term loans, on risk grounds given the maturity transformation involved in funding via short-term securities. There may therefore need to be a maximum weighted average maturity of assets.
- The Bank is minded to purchase securities from ‘single-seller’ and ‘multi-seller’ programmes **but seeks views from investors on the viability of each. In case of ‘multi-seller’ programmes, the Bank welcomes views on what concentration limits would be consistent with investors’ preferences.**
- There would be concentration limits on the sectoral exposure of the assets underlying eligible securities. **The Bank would welcome views on how best to structure and implement these sectoral limits.**
- There would not be any restriction on the currency of the assets but the purchased securities would all be sterling denominated.
- The Bank would expect programmes to disclose sufficient information to the Bank for the Bank to be able to assess whether programmes meet the above criteria. **It would be grateful for views from market participants on whether such disclosures should be encouraged more widely.**

14 The Fund would purchase only sterling-denominated securities, with the following additional characteristics:

- a maturity of one week to nine months if sold to the Bank at issue via a dealer; or
- an original maturity of nine months or less if sold to the Bank by a secondary market holder; and
- a minimum initial short-term credit rating of A-1 / P-1 / F-1 from at least two of Standard & Poor’s, Moody’s and Fitch. Programmes with split ratings where one rating is below the minimum would not be eligible. Programmes rated A-1 / P-1 / F-1 that are on negative watch would be eligible; and
- issued directly into Crest, Euroclear or Clearstream.

15 Consistent with the Bank’s approach generally, were an approved programme to be downgraded below the minimum credit ratings set out above – and subject to the securities remaining investment grade and the Bank being satisfied as to the quality of the underlying assets – the Bank would seek to discuss with the programme sponsor the circumstances of the downgrade before determining how that merited any change to that programme’s eligibility.

16 The Bank will not approve as eligible any security which has non-standard features (e.g. extendibility, subordination).

17 Eligible counterparties that wish to offer securities to the Bank in the secondary market will require confirmation of the eligibility of specific securities ahead of their offering them for sale. **The Bank would be grateful for views on whether it should publish the programmes eligible for the Facility, or whether secondary market participants should instead seek such information from the Bank on a bilateral and confidential basis.**

18 The Bank recognises that there are currently likely to be few programmes which meet all of the above criteria. It is hoped that the ability of the APF to purchase securities of this kind will, over time, lead to the creation of new programmes that are acceptable to the APF and also to private sector investors. **The Bank would be grateful for views on this from investors, potential investors and other interested parties.**

19 The Bank reserves the right at its sole discretion to deem any security ineligible for the Facility for any reason.

Eligible Programmes

20 The Fund will purchase securities issued by programmes that the Bank has agreed meet the eligibility criteria set out above. The Bank will require programme sponsors whose securities will be offered to the Bank in the primary market to contact the Bank directly, to discuss their eligibility and to provide the necessary documentation. The Bank will require such programme sponsors to sign a confidentiality agreement. When the Bank confirms a programme's eligibility before 16:00, securities will be eligible for sale to the Bank from the following business day.

Limits on the Bank's holdings

21 Purchases will be limited by programme and limits will be communicated to programme sponsors.

22 The maximum proportion of a programme's outstanding securities considered eligible for purchase by the APF would be based on the proportion of the underlying assets in the programme providing credit to borrowers that made a material contribution to economic activity in the UK, as agreed by the programme sponsor with the Bank.

23 Other than the above restriction, the APF would not impose additional limits on its purchases of securities issued by an approved programme. This would ensure that the APF is effective in supporting market activity by acting as a 'backstop' purchaser, but is not intended to crowd out private investors.

Eligible counterparties

24 The Fund will purchase securities in the primary market from counterparties which are dealers acting as principal; and will also purchase securities from secondary market holders. Counterparties must, inter alia, be appropriately authorised for the purposes of the Financial Services and Markets Act (FSMA). All eligible counterparties to the Bank's Commercial Paper Facility would automatically be eligible for the SCP Facility and would be deemed to become counterparties in the SCP Facility.

25 Participation will be governed by the Terms and Conditions for the Asset Purchase Facility available at <http://www.bankofengland.co.uk/markets/apf/index.htm>.

26 The Bank reserves the right to reject applications without explanation.

Prices

27 The Fund proposes to purchase securities at a spread above the risk-free rate, as based on the maturity-matched overnight index swap (OIS) curve as determined by the Bank on the day of purchase. The Bank will announce the pricing structure in its final Market Notice setting out the details of this Facility.

28 The Bank will keep its pricing under review in the light of market conditions and its experience in operating the Facility.

29 Securities purchased in the primary market will be discounted using a rate based on the maturity-matched overnight index swap (OIS) rate, as determined by the Bank on the day of purchase. Money market yield conventions will be applied.

30 Securities purchased in the secondary market will be purchased at the lower of amortised cost from the issue price and the price as given by the method for primary market purchases described above. The Bank plans to apply an additional fee for use of the secondary Facility, payable separately.

Submission of offers

31 Offers to sell securities to the Facility should be submitted by phone to the Bank's Sterling dealing desk between 10.00am and 11.00am.

32 For primary market sales, counterparties must provide, inter alia, details of the issuing entity and the nominal amount offered. Maturity dates will follow the "modified following" convention. For secondary market sales, counterparties must provide the ISIN/ticker of the security; the money market yield on an amortised cost basis; the maturity date; and the nominal amount offered.

33 The minimum size of an individual security that the Fund will purchase from an individual participant is £1 million nominal. The offer amount should be expressed in increments of £0.1 million nominal.

34 The Bank's Sterling dealers will confirm as soon as possible by return phone call whether an offer has been accepted and will confirm the cash amount and, for primary market sales, maturity date. In instances where offers to sell securities to the APF would result in a breach of the limit agreed with programme sponsors, the offer or offers received that day would be pro-rated such that those limits were not breached.

Settlement arrangements

35 The Bank will send a written electronic confirmation of each transaction on the day of purchase.

36 The Fund's purchases of securities will normally settle on a T+2 basis.

37 Counterparties must comply with the Settlement Procedures for the Asset Purchase Facility, available at www.bankofengland.co.uk/markets/apf/index.htm .

Published information

38 The Bank plans to publish each Friday information on the use of this Facility as follows: (i) the total amount of securities purchased that week up until the previous day, in terms of the amount paid to the sellers; and (ii) the sum of securities purchased, less redemptions, to date.

OTHER FORMS OF WORKING CAPITAL FINANCE

39 The Bank wishes to consult on a possible Supply Chain Finance (SCF) Facility, which would be a means to provide working capital financing to the supplier base of UK investment grade companies.

40 It is anticipated that the operation of any SCF Facility would also take a form similar to that of the existing CP Facility, whereby the Bank would invest in a tradable security, with the underlying credit risk being to the relevant company whose payables are being financed. **The Bank would welcome feedback on how best to structure such a Facility. Specifically:**

- **What is the breadth and depth of appetite for the APF funding Supply Chain Finance?**
- **What practical steps would need to be undertaken in order for Supply Chain Finance obligations to take the form of a tradable security?**
- **What is the breadth and depth of potential private sector investors in Supply Chain Finance obligations?**

41 The Bank would also be grateful for views on **whether there would be interest in facilities for other forms of finance for working capital which are consistent with the objectives of the Asset Purchase Facility.**

Next steps

42 As described above, the Bank seeks views on the proposals above by 19 June.

Bank of England
8 June 2009

ANNEX: QUESTIONS FOR CONSULTATION

Questions relating to the Secured Commercial Paper Facility

- 1 The maximum proportion of a programme's outstanding securities considered eligible for purchase by the APF would be based on the proportion of the underlying assets in the programme providing credit to borrowers making a material contribution to economic activity in the United Kingdom. The Bank welcomes views on the feasibility of achieving this objective and the information about assets underlying programmes that it would need to collect to ensure the criteria were met.
- 2 The Bank would appreciate general comments on the assets it is minded to accept as suitable for inclusion in programmes as described in paragraph 13. Specifically:
 - a) The Bank is minded to purchase securities from 'single-seller' and 'multi-seller' programmes but seeks views from investors on the viability of each market. In case of 'multi-seller' programmes, the Bank welcomes views on what concentration limits would be consistent with investors' preferences.
 - b) There would be concentration limits on the sectoral exposure of the assets underlying eligible securities. The Bank would welcome views on how best to structure and implement these sectoral limits.
 - c) The Bank would expect programmes to disclose sufficient information to the Bank for the Bank to be able to assess whether programmes meet its criteria. It would be grateful for views from market participants on whether such disclosures should be encouraged more widely.
- 3 The Bank would be grateful for views on whether it should publish the programmes eligible for the Facility, or whether secondary market participants should instead seek such information from the Bank on a bilateral and confidential basis.
- 4 It is hoped that the ability of the APF to purchase securities of this kind will, over time, lead to the creation of new programmes that are acceptable to the APF and also to private sector investors. The Bank would be grateful for views on this from investors, potential investors and other interested parties.

Questions relating to other forms of Working Capital Finance

- 5 What would be the best ways to structure a Supply Chain Finance Facility?
- 6 What is the breadth and depth of appetite for the APF funding Supply Chain Finance?
- 7 What practical steps would need to be undertaken in order for Supply Chain Finance obligations to take the form of a tradable security?
- 8 What is the breadth and depth of potential private sector investors in Supply Chain Finance obligations?
- 9 Would there be interest in facilities for other forms of finance for working capital which are consistent with the objectives of the Asset Purchase Facility?