



Bank of England Asset Purchase Facility Fund Limited (BEAPFF)

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Author: Grahame Allen
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This short note provides background on the recent announcement that the Bank of England is to transfer to the Exchequer excess cash held by the Bank as part of its programme of Quantitative Easing (QE).

Background information on QE can be found in the Library Standard Note [Quantitative Easing](#)

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1 Quantitative Easing

Quantitative Easing (QE) in the UK was originally authorised by the then Chancellor Alistair Darling in January 2009 and is carried out through the Asset Purchase Facility (APF). The majority of assets purchased have been Treasury Bonds (Gilts).

APF transactions are undertaken by a subsidiary company of the Bank of England, the Bank of England Asset Purchase Facility Fund Limited (BEAPFF). The BEAPFF borrows from the Bank to pay for the purchases it makes (at the Bank's base rate, currently 0.5%).

Lending to the BEAPFF appears on the Bank's balance sheet as an asset. The liability corresponding to this asset depends upon how it has been funded. Where purchases by the BEAPFF have been made as part of the QE programme, the Bank finances the loan by creating central bank reserves (by printing 'electronic money'). This is reflected in an increase in the level of the Bank's Reserves Balances. When QE is "paused" the lending appears under 'Other liabilities' (financed via a deposit from the UK [Debt Management Office \(DMO\)](#)).¹

Any losses made from the operation of the APF are indemnified (paid) by the Government. As the [Letter from the Chancellor to the Governor](#) authorising the APF in 2009 stated:²

As we set out in the market notice issued on 19 January, I authorise the Bank to purchase up to £ 50 billion of high quality private sector assets under this facility. The Government will indemnify the Bank and the fund specially created by the Bank of England to implement the facility from any losses arising out of or in connection with the facility.

1.1 Interest receipts

According to an article in the Q3 2011 edition of the Bank's [Quarterly Bulletin](#):³

[...] interest receipts from gilts purchased accumulate in the APF, and so will repayments of principal when they fall due.

Toby Nangle stated in a recent [article](#) that: "All profits (and any losses) associated with BEAPFF belong to HM Treasury"⁴ but that:⁵

[...] the Bank of England does not see any likelihood of this cash mountain being divided back to HM Treasury before the quantitative easing programme is ultimately terminated and the accumulated portfolio of gilts is sold back to the market. Only at this point will the full fiscal cost or profit of the quantitative easing programme be known, and the Bank has suggested that only at this point might dividends be paid.

An Article from the University of York (summarising a workshop organised by Jagjit Chadha and Sean Holly) provided an example of the amount of interest involved:⁶

[...] a back of the envelope calculation would suggest that if the average coupon on purchased gilts (absent the small quantity of corporate bonds bought) is some 5 per cent, £200bn of bonds pays the Treasury £10bn a year, while the interest paid on the

¹ [Bank of England](#) website

² HM Treasury, [Letter from the Chancellor to the Governor](#), 29 January 2009

³ Bank of England, [Quarterly Bulletin 2011 Q3](#), 19 September 2011

⁴ His source: "See note 2(c) on page 8" [page 7] of the Bank of England [Annual Report](#)

⁵ Toby Nangle, [The unspent fiscal dividends of quantitative easing](#), July 2012

⁶ www.york.ac.uk/res/mmf/documents/QE.pdf

increased reserves at the Bank of England is only 0.5 per cent. It looks like the Treasury is making a tidy profit of more than £9bn, or at least subsidising its own payment of interest by that amount. This of course has to be set against possible capital losses as the APF sells bonds in the future back into the bond markets. But if easing lasts for the five years that the Bank of Japan maintained QE, then it would require a very large rise in yields on debt to wipe out the profit.

The actual annual interest (coupon) on the Gilts purchased by the APF is not available from published material. The BEAPFF's 2011/12 [Annual Report](#) on the APF suggests that cash holdings at the "balance sheet date were £20.7 billion (2011: £11.8 billion), primarily representing coupons received". However, the total amount payable to HM Treasury (under the Indemnity) held in the APF in the year ending Feb 2012 was £41.1 billion (to Feb 2011 this was £9.8 billion). This would include all interest (from gilts and other assets purchased by the APF) etc. from the creation of the APF.

The [Treasury's annual report and accounts](#) from July 2012 set out that the APF had accumulated £23.8 billion of excess cash. This excess cash currently held in the APF was expected to increase to around £35 billion by the end of March 2013.

2 Recent changes to cash management operations

On 9 November 2012, the Chancellor announced that excess cash held at the Bank of England's Asset Purchase Facility (APF) would be transferred to the Exchequer.

In a [letter to the Governor](#) confirming the agreement they had reached on the "excess cash holdings"⁷ in the APF, the Chancellor stated that they would "normalise the cash management arrangements for the APF" by transferring the excess cash to the Exchequer "on a regular basis".⁸

Holding large amounts of cash in the APF is economically inefficient as it requires the Government to borrow money to fund these coupon payments. Transferring the net income from the APF will allow the Government to manage its cash more efficiently, and should lead to debt interest savings to central government in the short-term. It would bring these arrangements into line with standard cash management practices for government activities, and is also in line with the practices of the Federal Reserve and the Bank of Japan.

The transfer of the balance of excess cash to the Exchequer is expected to commence in 2012/13 with the excess cash accumulated in 2012/13 being transferred over the year and the excess cash accumulated up to the end of 2011/12 being "drawn down" over 2013/14. From 2013/14, the excess cash generated will be transferred on a quarterly basis.⁹

⁷ Defined in the letter to the Governor as "the "APF's coupon income, net of the interest paid by the APF on its loan from the Bank of England and other cash flow items such as operating costs"

⁸ [Letter from the Chancellor of the Exchequer to the Governor of the Bank of England](#), 9 November 2012

⁹ HM Treasury, [Changes to cash management operations](#) , press notice 109/12 , 9 November 2012

2.1 The impact on the public finances

The ONS has not yet stated how the transfers will be accounted for in the National Accounts. The [Office for Budget Responsibility](#) (OBR) has suggested that the ONS:¹⁰

may treat most of this transfer as a financial transaction, not revenue. In that case, it would reduce net debt, but not net borrowing. We expect that the ongoing transfers would affect net debt and net borrowing.

It is expected that the transfer of excess cash will have a positive effect on the public finances in the short-term. Under the new arrangements, the transfers will show in the public finances as the excess cash is transferred, rather than as a one-off 'hit' to the Exchequer when QE has been 'unwound' and the facility closed. The Background Notes to the [Treasury's press notice](#), announcing the changes, states:¹¹

6. Any cash flow received by the Government now in terms of coupon transferred to the Exchequer must be viewed in the context of future payments by Government under the indemnity. For that reason, cash transferred from the APF to the Exchequer will be used to benefit the public finances and to reduce debt.

In his [response](#) to the Chancellor's letter, the Governor states: "as the [MPC] Committee noted, your intention is to use any funds transferred to the Exchequer to reduce the stock of outstanding government debt".¹²

The latest [Public Sector Net Debt](#) figures (for October 2012) show net debt (excluding financial interventions) at 68% of UK GDP. As at [29 November 2012](#), the APF had purchased £374,949 million of Gilts. This is 25% of [2011 nominal GDP](#) (£1,519,134 million). £35 billion is around 2.3% of 2011 nominal GDP and 3.3% of net debt excluding financial interventions (Net debt excluding financial intervention in October 2012: £1,068.8 billion).

In the longer term, any gains from transferring the excess cash are likely to be reversed under the Government's indemnity as QE is 'unwound'. In his [letter to the Governor](#) on 9 November 2012 the Chancellor noted that:¹³

At some stage it is likely that the cash flows from the APF to HM Treasury will need to be reversed in order to meet the terms of the indemnity, as monetary conditions normalise and Bank Rate rises, or capital losses crystallise as gilts are sold or allowed to redeem without reinvestment. I am happy to reaffirm my predecessor's commitment that any future losses incurred by the APF will be met in full by the Government. For this reason, net coupon income transferred from the APF to HM Treasury should be used solely to benefit the public finances and to reduce debt.

As monetary policy tightens (interest rates rise - which is likely to be one of the signals for unwinding QE) then the yield on Gilts is likely to rise making it more costly for the Government to sell future debt. The value of Gilts sold from the APF is also likely to fall. The OBR has summarised the outcomes in the short/long-term as:¹⁴

- Public sector net borrowing will be lower in the near term than it otherwise would have been, as the Treasury receives the coupon payments on the gilts

¹⁰ [OBR press notice](#), 9 November 2012

¹¹ HM Treasury, [Changes to cash management operations](#), press notice 109/12, 9 November 2012

¹² Bank of England, [Letter from the Governor of the Bank of England to the Chancellor of the Exchequer](#), 9 November 2012

¹³ [Letter from the Chancellor of the Exchequer to the Governor of the Bank of England](#), 9 November 2012

¹⁴ [OBR press notice](#), 9 November 2012

held by the APF, minus the interest that the APF has to pay the Bank for the loan that allowed it to purchase them.

- Net borrowing is then likely to be higher in future years as the APF moves into deficit and the Treasury has to cover this. The APF's interest payments will increase when Bank Rate starts rising. And the sale or redemption of gilts is likely to leave it facing capital losses, as the amounts received will probably be smaller than the amounts paid for them.

The actual cost/profit of the APF part of the QE operations will not be known until the APF is 'wound up'. The main 'unknowns' here are about when and how and this will occur and at what cost

Winding up of QE

The general opinion is that the APF will sell Gilts back through the secondary market but it could be that the APF will continue to operate until all the Gilts it holds mature. Other options may include using the APF as a 'bank' which can then lend to business through high street banks (as the Bank does currently through its Funding for Lending scheme) or as a kind of UK 'sovereign wealth fund'. It could be that when the APF is wound up that the market conditions mean that it does make a loss. The Bank will not make a loss on the APF. Should the APF make a loss then the Government will cover this.

The OBR is expected to quantify the possible impact of the decision on the public finances in its forthcoming Economic and fiscal outlook on 5 December 2012:¹⁵

To give a full picture, we will do so over the full potential lifetime of QE and not just over our usual five-year forecasting horizon. The size and timing of the flows between the APF and the Treasury – and the eventual aggregate profit or loss to the Exchequer – will depend on several factors, including the behaviour of gilts prices and when and how QE is unwound.

The analysis is also expected to make "illustrative assumptions for these factors and show how sensitive the results are to alternative assumptions".

¹⁵ [OBR press notice](#), 9 November 2012