

BANK OF ENGLAND MARKET NOTICE: ASSET PURCHASE FACILITY

1 This Market Notice sets out how the Bank intends initially to operate the Asset Purchase Facility agreed with HM Government and described in an exchange of letters between the Chancellor and the Governor dated 29 January 2009¹. Further Notices will be issued as necessary.

2 The Bank has been authorised to purchase up to £50bn of high-quality private sector assets under this Facility. The following sterling assets are initially eligible for purchase: commercial paper, corporate bonds, paper issued under the Credit Guarantee Scheme (CGS), syndicated loans and asset-backed securities created in viable securitisation structures.

3 The Bank's operations will vary according to the structure of, and conditions prevailing in, particular markets; and will evolve through time, in the light of experience with operating the Asset Purchase Facility and feedback from the market. This Notice sets out:-

- Details of a Commercial Paper Facility to enable the purchase of investment grade sterling commercial paper issued by UK corporates, both at issuance and in the secondary market, subject to a minimum spread.

This could channel funds directly to parts of the corporate sector whilst also underpinning secondary market activity and helping to enlarge the private issuance market, and so removing obstacles to corporate access to capital markets.

The Bank expects that this Facility will be operational on 13 February.

- An outline proposal for a Corporate Bond Secondary Market Scheme under which the Bank would propose to provide a back-stop offer to purchase modest amounts of a wide range of investment-grade sterling UK corporate bonds with the aim of improving secondary market liquidity, initially by facilitating market-making by banks and dealers.

By so doing it may help to reduce liquidity premia on high-quality corporate bonds, and so remove obstacles to corporate access to capital markets.

¹ Available at www.bankofengland.co.uk/markets/apf/index.htm

The Bank is consulting on this proposed facility, with a view to moving to launch as soon as possible.

4 In addition, the Bank is seeking feedback on an outline proposal for a planned facility for paper issued under the Government's Credit Guarantee Scheme (CGS) Facility for banks. Such a scheme could involve the Bank standing ready to transact in banks' CGS public bonds with intermediaries that commit to provide regular prices to counterparties as market makers in such securities, underpinning market-making and so secondary market activity.

5 More generally, the Bank plans to engage in a broader dialogue on ways in which the APF might be used to purchase syndicated loans and asset-backed securities with viable securitisation structures, with a view to improving liquidity in those markets and so their role in providing finance to the real economy.

6 The Bank will keep under review whether there is a case for proposing to the Chancellor that the list of eligible assets or currencies could usefully be expanded.

7 Comments on the issues raised in this notice are sought and should be sent to APF_consultation@bankofengland.co.uk as soon as possible. The Bank will be glad to discuss issues with interested parties.

Background

8 The Asset Purchase Facility is described in the exchange of letters between the Chancellor and the Governor dated 29 January.

9 The broad aim is to help improve financing conditions for companies making a material contribution to the UK economy in support of the Bank's objectives for monetary and financial stability in the UK.

10 In order to control the financial risks associated with such transactions, the Bank is authorised by the Chancellor to purchase only high quality assets, broadly comparable to investment grade.

11 Assets are to be purchased by Bank of England Asset Purchase Facility Fund Limited (BEAPFF, “the Fund”), a wholly-owned subsidiary of the Bank, which is the legal counterpart to market transactions. The Bank acts as agent for the Fund.

COMMERCIAL PAPER FACILITY

12 Subject to feedback on the plans set out in this Market Notice, the Bank envisages that the Commercial Paper Facility will be implemented in the following way. The Bank is seeking detailed comments on its planned approach and in particular on the specific issues set out below.

Operation of the facility

13 The Fund will purchase Commercial Paper (CP) during a defined period each business day.

14 The Fund will purchase, at a minimum spread over risk-free rates, newly issued CP in the primary market via dealers, and after issuance from other eligible counterparties in the secondary market.

Length of Facility

15 The Facility may operate for as long as the highly abnormal conditions in corporate credit markets persist and materially impair the financing of real economic activity.

Eligible issuers

16 The Fund will purchase CP issued by companies, including their finance subsidiaries, that make a material contribution to economic activity in the United Kingdom. UK incorporated companies, including those with foreign-incorporated parents, of sufficient size to sustain a CP programme and with a genuine business in the UK, will normally be regarded as meeting this requirement.

17 Paper issued by non-bank financial companies will in principle be eligible, subject to the Bank being satisfied that the issuer makes a significant contribution to corporate financing in the UK. Paper issued by leveraged investment vehicles will not be eligible.

18 Companies that do not currently issue CP but are capable of doing so will in principle be eligible to utilise the CP Facility.

19 The Bank will require issuers whose CP will be offered to the Bank in the primary market to contact the Bank directly, to discuss its eligibility and to provide the necessary documentation. Issuers should contact the Bank at APF_applications@bankofengland.co.uk. The Bank will require such issuers to sign a confidentiality agreement. Securities will be eligible for sale to the Bank from the business day following the Bank's confirmation of issuer eligibility.

Eligible securities

20 Initially, the Fund will purchase only sterling-denominated CP. The Bank will keep under review whether to propose any extension of the list of currencies in the future.

21 The Fund will purchase the sterling CP of eligible issuers, with the following characteristics:

- A maturity of three months if issued to the Bank at issue via a dealer.
- A residual maturity of three months or less if sold to the Bank by a secondary market holder.
- A minimum short-term credit rating of A-3 / P-3 / F-3 from at least one of Standard & Poor's, Moody's and Fitch. Securities with split ratings where one or more rating is below the minimum are not eligible. Securities at the lowest rating that are on negative watch will not be eligible.
- Issued directly into Crest, Euroclear or Clearstream.

22 If a security is downgraded below the minimum credit ratings set out above, the CP will be permitted to mature as normal, but the issuer will be unable to access the Fund again until they meet the required minimum credit ratings; and the Bank will not make any further secondary market purchases.

23 The Bank will not approve as eligible any CP which has certain non-standard features (eg extendibility, subordination). Further details will be available from the Bank, in the light of consultation.

24 Securities issued by a finance subsidiary should be appropriately guaranteed.

25 Eligible counterparties that wish to offer CP to the Bank in the secondary market must confirm its eligibility with the Bank prior to offering it for sale. The Bank will require full documentation. Eligible counterparties should contact the Bank at [APF eligibility enquiries@bankofengland.co.uk](mailto:APF_eligibility_enquiries@bankofengland.co.uk). Confirmation of eligibility will be provided bilaterally to the counterparty submitting the request. A security will not be eligible for sale to the Bank until the business day following the Bank's confirmation of its eligibility.

26 The names of issuers and securities purchased or eligible will not be disclosed publicly.

27 The Bank reserves the right at its sole discretion to deem any security ineligible for any reason, and to deem ineligible securities it has previously purchased and vice versa.

Limits on the Bank's holdings

28 Purchases of CP in the primary markets will be limited by issuer. Any such limits applying to individual issuers will be made available, on request, to the issuer only.

29 Where two or more issuers are part of the same Group, an aggregate limit may be applied within which any limits applying to the individual issuers are wholly or partly fungible.

Eligible counterparties

30 The Fund will purchase CP in the primary market from dealers acting as principal; and will also purchase CP from secondary market holders. Counterparties must, inter alia, be appropriately authorised for the purposes of the Financial Services and Markets Act (FSMA).

31 More than one legal entity in a Group may participate where they undertake different kinds of activity (eg banking and asset management).

Prices

32 The Fund will purchase securities at a spread above the risk-free rate, as based on the current overnight index swap (OIS) curve.

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

34 CP 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. The Bank will publish the 3-month rate that it will apply on its wire services page at 09.00 on each business day. Money market yield conventions will be applied. The spread to the OIS rate at which the Bank will purchase CP will vary according to the credit rating of the issuer. Initially it will be as shown in the table below :-

	A1/P1/F1	A2/P2/F2	A3/P3/F3
Spread to maturity-matched OIS rate	75bp	125bp	300bp

35 CP 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. The Bank is currently minded that it should be 25bp.

36 Where an issuer has a split rating, the spread will be that derived from the lowest rating.

Submission of offers

37 Offers to sell CP to the Fund should be submitted by phone to the Bank's Sterling dealing desk between 9.00 and 11.00.

38 For primary market sales, counterparties must provide, inter alia, details of the issuing entity and the nominal amount offered. For secondary market sales, counterparties must provide the ISIN/ticker of the security; the issue price; the issue date; the maturity date; and the nominal amount offered.

39 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.

40 The Bank's sterling dealers will confirm as soon as possible by return phone whether an offer has been accepted and will confirm the cash amount.

41 In its primary market purchases, the Bank is minded to purchase the CP of a particular issuer from one dealer only each day. In that case, the Bank would accordingly require issuers seeking to sell CP to the Bank in the primary market via a number of dealers to ensure that only one such dealer seeks to sell its CP to the Bank on any particular day.

Settlement arrangements

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

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

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

Published information

45 The Bank plans to publish each week the total amount of CP purchased under this Facility.

Applications to participate

46 Those wishing to participate as counterparties, both CP dealers and investors, should complete the Application Form for the Commercial Paper Facility available at www.bankofengland.co.uk/markets/apf/index.htm and submit it by e-mail to APF_applications@bankofengland.co.uk .

47 Participation will be governed by the Terms and Conditions for the Asset Purchase Facility also available at www.bankofengland.co.uk/markets/apf/index.htm

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

Next steps

49 As described above, companies that do not currently issue CP but are capable of doing so, and of meeting the Bank's eligibility criteria, will be able to utilise the CP Facility if they so choose. The Bank stands ready to discuss with such companies and other interested parties how to ensure that the facility could be effective for such potential new issuers.

50 The Bank will be glad to receive detailed comments on these plans from all interested parties - existing and potential new issuers, investors, intermediaries and infrastructure providers, including issuing and paying agents and ratings agencies. Comments should be sent to APF_consultation@bankofengland.co.uk.

51 Subject to those comments, the Bank currently expects that the Facility will be operational on 13 February. The Bank will update this Market Notice as necessary.

Asset-backed CP

52 Asset-backed CP will not initially be eligible for sale into the Facility. The Bank is ready to discuss with interested market participants the possible use of asset-backed CP as a means to enable a broader range of companies to be able to access the Facility, if that can be achieved consistently with the objective of the Fund to invest in assets of high credit-quality.

CORPORATE BOND SECONDARY MARKET SCHEME

High-level design of the scheme

53 The Bank is minded to be in the market to make regular small purchases of a wide range of high credit-quality corporate bonds, in order to aid secondary market liquidity. The initial focus would be on facilitating market-making by banks and dealers. The broad framework for such an approach is set out below.

54 The Bank is seeking comment on a number of aspects of this outline of its possible approach, as set out below and summarised in the annex.

Eligible issuers

55 The Fund would purchase bonds issued by companies, including their finance subsidiaries, that make a material contribution to economic activity in the United Kingdom. UK incorporated companies, including those with foreign-incorporated parents, capable of issuing a bond into the capital markets and with a genuine business in the UK, would normally be regarded as meeting this requirement.

56 Bonds issued by non-bank financial companies would in principle be eligible, subject to satisfying the Bank that the issuer makes a material contribution to corporate financing in the UK. Paper issued by leveraged investment vehicles would not be eligible.

Eligible securities

57 Initially, the Fund would purchase only sterling-denominated bonds. The Bank would keep under review whether it should propose that the Fund purchase foreign currency-denominated bonds in the future.

58 The Fund would stand ready, on certain conditions, to purchase the sterling corporate bonds of eligible issuers, with the following characteristics:

- Conventional senior, unsubordinated debt.

- A minimum long-term credit rating of BBB-/Baa3 from two or more of Fitch, Moodys and Standard and Poor's. Securities with split ratings where one or more rating is below the minimum would not be eligible. Securities at the lowest rating that are on negative watch would not be eligible.
- Issued directly into Crest, Euroclear or Clearstream.
- Minimum issue size of, perhaps, £100 million.

59 Securities would need to be listed.

60 The Bank is minded to exclude bonds with complex and non-standard structures. Convertible or exchangeable bonds would not be eligible. The Bank would be interested in views on whether bonds with a standard call feature should be eligible in any such Scheme.

61 The Bank would be pleased to receive feedback on whether or not there should be a restriction on the maturity of bonds purchased.

62 Securities issued by a finance subsidiary would need to be appropriately guaranteed.

63 The Bank would reserve the right in its sole discretion to deem any security ineligible for any reason, and to deem ineligible securities that it has previously purchased and vice versa.

Eligible counterparties

64 Initially, the Fund might purchase sterling corporate bonds only via firms that can be market makers in order to facilitate their activities in supporting secondary market liquidity. If so, the Bank would be minded to permit as counterparties those firms that are also counterparties in its gilt-purchase Open Market Operations.

65 The Bank would, however, consider extending the range of eligible counterparties further to certain regulated investors in the light of experience in operating this Scheme and, in particular, if market making did not revive.

66 The Bank would reserve the right to reject applications without explanation.

Frequency and size of purchases

67 The mechanics of such a Scheme could take a variety of forms.

68 Under one possible approach, the Bank could stand ready to purchase every eligible security each day. Alternatively, the Bank could rotate the securities it purchases through a transparent schedule, based, for example, on the sector in which a security trades (utilities, manufacturing, retail etc) or some other classification.

69 The Bank would plan to purchase small amounts of securities consistent with the aim of this Scheme to catalyse secondary market liquidity, with the size possibly depending on the frequency with which it offered to buy an individual security. The Bank is keen to understand counterparties' views on whether it should offer to purchase all or a subset of securities each day and on the quantity of a security it should offer to purchase, given its objective to facilitate greater secondary market trading of high-quality corporate bonds.

Purchase process

70 The purchase process will be designed to balance the objectives of stimulating greater secondary market trading of corporate bonds than now and reflecting the need to avoid adverse selection in the bonds offered to the Bank.

71 The Bank could either undertake bilateral purchases in the secondary market or it could hold reverse auctions. It would be grateful for views on the appropriateness of such purchase mechanisms given the objectives above.

72 The Bank could, for each security, privately set a minimum spread. It would not purchase securities at offers below this spread, and would keep the level of the minimum spread under review in the light of the pattern of participation in the scheme, and market conditions.

73 If it were to employ auctions, the Bank could offer to purchase a fixed quantity of each individual security. Offers above the Bank's minimum spread would be ranked and allocated until the fixed quantity the Bank was willing to purchase had been allocated.

74 Alternatively, the Bank could offer to purchase a range of similar bonds in a single auction. And the Bank could adjust the quantities of individual bonds purchased in the light of the relative prices offered in the auction.

75 In either case, the Bank would be minded to auction bonds on a uniform price basis so that all successful offers were at the same price. The Bank would reserve the right to reject any offer, for any reason, including in the light of other offers received.

76 The Bank would plan not to restrict the total amount purchased from a single participant and invites views on this issue.

77 In the interests of operational simplicity, the Bank could restrict counterparties to a single or small number of offers in each security each day. The Bank invites views on this issue.

Limits on the Bank's holdings

78 Repeat purchases of individual securities may entail the Fund eventually holding significant quantities of individual securities, which may adversely affect liquidity in that security. The Bank would therefore be minded to set a maximum proportion of a security that it should hold. The Bank is keen to hear counterparties' views on where to set such a limit, particularly given views on the size of offers to purchase each day.

79 The Bank may limit the maximum proportion of its portfolio that could be held in an individual issuer's bonds. It is keen to understand counterparties' views on the potential consequences of a limit on the proportion of its portfolio to be held in the securities of an individual issuer.

ANNEX - ISSUES FOR CONSULTATION

80 The Bank will be glad to receive comments on these proposals from all interested parties. It is seeking feedback on the following issues in particular:-

- Whether bonds with a standard call feature should be eligible.
- Whether the Bank should restrict the maturity of bonds purchased.
- Whether it should offer to purchase all or a subset of securities each day, and on the quantity of a security it should seek to purchase, given its objective to stimulate secondary market trading of corporate bonds.
- Whether to undertake bilateral purchases in the secondary market or hold reverse auctions.
- Whether or not to restrict the total amount purchased from a single participant.
- Whether, in the interests of operational simplicity, to restrict counterparties to a single or small number of offers in each security each day.
- Whether to set a maximum proportion of a security that the Bank should hold and, if so, on where to set such a limit, particularly given views on the appropriate size of offers to purchase each day.
- The potential consequences of a limit on the proportion of the Bank's portfolio to be held in the securities of an individual issuer.

81 The Bank will reissue this Market Notice to reflect feedback received in the consultation process. Comments should be sent to APF_consultation@bankofengland.co.uk. Subject to that consultation, the Bank aims to launch as soon as possible.

PLANNED CGS FACILITY

Operation of the Facility

82 The Bank could in principle establish a facility under which it stood ready to transact in bonds issued by banks under HMG's Credit Guarantee Scheme. The Bank would in effect provide a backstop for intermediaries that committed to provide regular prices as market makers in such securities. Any such window could open each business day or periodically.

83 Initially the Fund would purchase CGS securities, at spreads aimed at incentivising market-makers to provide liquidity services to their customers. Also, and depending on the scale of any purchases, the Fund might over time offer to sell certain of the CGS securities that it held.

84 The Bank is seeking comment on this outline proposal.

Eligible securities

85 The Fund would purchase publicly-issued securities guaranteed under the CGS, as listed on the website of the Debt Management Office (DMO).

86 Initially the Fund would purchase only sterling-denominated instruments. The Bank would keep under review whether the Bank should propose that the Fund purchase foreign-currency denominated instruments in the future.

Eligible counterparties

87 Under the approach outlined here, the Fund would commit to purchase CGS securities only from those institutions that have entered into a commitment to provide regular prices as market makers in such securities. That requires discussion with the dealer community, including issuers of securities under the CGS, but not necessarily limited to those firms.

88 The Bank would reserve the right to reject applications without explanation.

NEXT STEPS ON PLANNED PURCHASES OF SYNDICATED LOANS AND ABS

89 In addition to commercial paper, corporate bonds and paper issued under the Credit Guarantee Scheme, the Fund is also authorised to purchase syndicated loans and asset-backed securities created in viable securitisation structures.

90 The Bank is keen to discuss with interested parties how to make effective any such purchases, consistent with the objective of the Fund to improve the availability of corporate credit.

91 For example, there are a variety of syndicated loan structures that the Bank could, in principle, consider purchasing – covering bridge/term loans and/or revolving credit facilities - with different credit risk and operational consequences. There are also different purchase mechanisms through which the Bank could pursue its policy aims. The Bank would need to ensure that the Fund purchased high-quality assets, broadly comparable to investment grade.

92 Similarly, the Bank is also keen to investigate with interested parties the possibility of asset-backed security structures that enable the purchase of assets that support the financing of smaller companies and/or companies of below investment grade credit-quality. Various structures are in principle possible, in which the underlying assets comprise sterling denominated corporate loans, with different investors, including the Fund, purchasing whole ABS, or equity or senior tranches. Such structures may take time to create. The Bank is keen also to explore whether other asset-backed securities may be used to meet the Fund's objectives – these may include, but are not necessarily limited to, trade receivables and equipment leases.

93 The Bank is keen to engage on these issues, and in due course on detailed operational requirements for their implementation, with market participants or institutions that deliver working capital finance for mainstream companies in the UK.