

## **BANK OF ENGLAND MARKET NOTICE: ASSET PURCHASE FACILITY**

1 Following consultation with the market as part of implementing the Bank's Asset Purchase Facility, this Market Notice sets out the details and operation of the Corporate Bond Secondary Market Scheme that will come into place from Wednesday 25 March. It also describes the Credit Guarantee Scheme (CGS) Bond Secondary Market Scheme which the Bank stands ready to activate contingent on a deterioration in market conditions.

2 Through the Corporate Bond Secondary Market Scheme, the Bank will offer to make regular small purchases of a wide range of high-quality corporate bonds. The Bank initially intends to hold reverse auctions four days a week, where at least once a week it will stand ready to purchase each eligible security in sizes of up to £2mn or £5mn. The initial focus of this Scheme is to facilitate market-making by banks and dealers, to help to reduce liquidity premia on high-quality corporate bonds, and so remove obstacles to corporate access to capital markets.

3 Through the CGS Bond Secondary Market Scheme, and contingent on a deterioration in market conditions, the Bank will also stand ready to make small purchases of bonds issued by banks under HMG's Credit Guarantee Scheme (CGS). To gauge market conditions, the Bank will engage in regular dialogue with intermediaries and also consult with issuers and investors. Should the Bank judge it beneficial to activate the Scheme, it will broadly adopt the same format as for the purchase of corporate bonds.

4 As with purchases of commercial paper and gilts with effect from 6 March, purchases of corporate bonds and CGS bonds under these Schemes will contribute towards the MPC's objective for asset purchases funded by central bank reserves. It is likely, however, that the majority of overall purchases by value will come through the purchase of gilts, as set out in the Market Notice of 5 March.

## **CORPORATE BOND SECONDARY MARKET SCHEME**

### Introduction

5 The Fund will offer 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 will be on facilitating market-making by banks and dealers, to help to reduce liquidity premia on high-quality corporate bonds, and so remove obstacles to corporate access to capital markets.

### Eligible issuers

6 The Fund will purchase corporate 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, with a genuine business in the UK will normally be regarded as meeting this requirement.

7 Corporate bonds issued by non-bank financial companies, excluding building societies, will in principle be eligible, subject to the Bank being satisfied that the issuer makes a significant contribution to corporate financing in the UK. Bonds will not be eligible if issued by leveraged investment vehicles or from companies within groups that are predominantly banks, investment banks or building societies.

### Eligible securities

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

9 The Fund will offer to purchase, via reverse auctions, 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, Moody's and Standard and Poor's. Issuers with split ratings where one or more rating is below the minimum will not be eligible. Issuers at the lowest eligible rating and also on negative watch or negative outlook from the same agency will not be eligible.

- Cleared and settled through Euroclear and/or Clearstream.
- Minimum amount in issue of £100 million.
- Minimum residual maturity of twelve months; no perpetual debt.
- At least one month since the security was issued.
- Securities will need to be admitted to official listing on an EU stock exchange.

10 Bonds with complex or non-standard structures will not be eligible. Convertible or exchangeable bonds will not be eligible.

11 Corporate bonds that contain a “Spens clause” will normally be eligible. These provide that on early redemption a cash payment is made to the bond holders that is the higher of the outstanding principal and the foregone interest and principal payments discounted at a rate equal to the redemption yield of a gilt of comparable maturity. Other corporate bonds that contain callable features will not normally be eligible.

12 Securities issued by a finance subsidiary will normally require a guarantee from within the issuer’s group. The Bank reserves the right to require a parent company guarantee in a form and substance satisfactory to the Bank.

13 The Bank will publish an initial list of eligible securities for the Scheme on the Bank’s website<sup>1</sup> that may be updated from time to time, including at the request of counterparties if considered appropriate by the Bank.

14 Requests from counterparties to confirm the eligibility of specific securities should be made using the template provided at [www.bankofengland.co.uk/markets/apf/index.htm](http://www.bankofengland.co.uk/markets/apf/index.htm). The Bank may seek full documentation.

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<sup>1</sup> <http://www.bankofengland.co.uk/markets/apf/corp-bond-eligibilitylist.xls>

15 The Bank will reserve the right in its sole discretion to deem any security ineligible for any reason, and to deem ineligible securities that it has previously offered to purchase and vice versa.

#### Eligible counterparties and applications

16 Initially, the Fund will purchase sterling corporate bonds only via firms that are market makers in such securities in order to facilitate their activities in supporting secondary market liquidity.

17 The Bank will initially take receipt of applications to become a counterparty only from those firms that are also counterparties in its gilt-purchase Open Market Operations.

18 In order to assist the Bank in assessing whether the Scheme is achieving its objectives, counterparties will be expected to submit to the Bank information each week on their indicative bids and offers for eligible bonds; actual spreads to reference gilts at which they have bought or sold eligible bonds; and the volume of their transactions in eligible bonds. The Bank will provide further detail to counterparties on how to provide this information.

19 If any counterparty abuses, or seeks to abuse, the reverse auctions or the Scheme more generally, the Bank retains the discretion immediately to exclude the counterparty from the Scheme and take up the issue with the Senior Management of the organisation.

20 There is one application form for applicants applying for the Corporate Bond Secondary Market Scheme and/or the CGS Bond Secondary Market Scheme. Those wishing to participate as counterparties should complete the Application Form for the Corporate Bond Secondary Market Scheme and/or the CGS Bond Secondary Market Scheme available at [www.bankofengland.co.uk/markets/apf/index.htm](http://www.bankofengland.co.uk/markets/apf/index.htm) and submit it by e-mail to [APF\\_applications@bankofengland.co.uk](mailto:APF_applications@bankofengland.co.uk). Applicants who have previously applied to become counterparties in other elements of the Asset Purchase Facility may refer back to material in their previous application.

21 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](http://www.bankofengland.co.uk/markets/apf/index.htm).

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

23 The Bank will 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 or in the Bank's view the initial set of counterparties were not acting in a way consistent with the objectives of the Scheme.

#### Purchase frequency

24 Initially, purchases will take the form of four reverse auctions per week, undertaken on Tuesdays, Wednesdays, Thursdays and Fridays.

25 Each day the Bank will include in the auction a range of eligible securities with similar maturities. The Bank plans to include each eligible security in an auction at least once a week.

#### Size of purchases

26 In each auction the Bank will initially stand ready to purchase up to £2mn of each bond from issues with under £250mn outstanding and up to £5mn of each bond from issues with £250mn and over outstanding.

27 The Bank reserves the right to review the fixed quantities the Bank is willing to purchase in the light of the pattern of participation in the Scheme, and market conditions.

#### Purchase process

28 Auctions will be undertaken on a uniform spread basis so that all successful offers in any individual bond will be allotted at the same spread. Offers at the clearing spread may be pro-rated. The Bank will reserve the right to reject any offer, for any reason, including in the light of other offers received.

29 The Bank will, for each security, privately set a minimum spread to the yield on a specified reference gilt. It will not purchase securities at offers below this spread. Successful offers above the Bank's minimum spread will be ranked and allocated until the fixed quantity the Bank is willing to purchase has been allocated.

30 The Bank will keep under review the level of the minimum spreads and the size of purchases in the light of the pattern of participation in the Scheme, market conditions, and the delivery of the objectives of the Scheme. It will also keep under review the auction mechanism. In particular, in the light of experience, the Bank may modify its approach by holding reverse auctions in which it would offer to buy from a pool of certain eligible securities, up to an amount set for the pool rather than for individual securities.

31 The Bank will not normally restrict the total amount purchased from a single participant although it reserves the right to do so.

#### Submission of offers

32 The list of eligible securities for which the Bank is inviting offers in the reverse auction will be published on the Bank's wire services pages<sup>2</sup>, and on the Bank's website<sup>3</sup>, the day before the auction at 14.00, along with the reference gilt for each security.

33 Offers to sell corporate bonds to the Fund should initially be submitted by phone to the Bank's Sterling dealing desk between 11.00 and 12.00 using the direct lines or the phone number made available in the counterparty admission letter.

34 Offers must be expressed as a basis point spread to the relevant reference gilt, in increments of whole basis points.

35 Counterparties must provide the specified ticker of the security; and the nominal amount offered. All yields will be quoted on a semi-annual basis.

36 Counterparties should make no more than three offers for an individual security in a single operation.

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<sup>2</sup> Reuters BOE/Markets1; Bloomberg BOEO 1

<sup>3</sup> <http://www.bankofengland.co.uk/markets/money/Round2.html>

37 Counterparties submitting multiple offers across the operation should also provide the weighted average spread of those offers to 3 decimal places.

38 Reference gilt yields will be set for each bond as those published on the UK Debt Management Office's wire service pages at 13:00.

39 The minimum offer size for 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 minimum allocation amount is £0.1 million nominal. Allocation amounts will be expressed in increments of £0.1 million nominal.

41 The Bank's sterling dealers will confirm from 13.00 or soon after by return phone call whether an offer has been accepted and will confirm the cash amount.

42 The Bank intends to introduce its electronic system, Btender, for the submission of offers, which should remove the need for a constraint on the number of offers per security. It should also in future reduce the length of the operation, including the time between the end of the operation and the publication of results. The use of Btender is subject to the Asset Purchase Facility Btender Terms, available at [www.bankofengland.co.uk/markets/apf/index.htm](http://www.bankofengland.co.uk/markets/apf/index.htm).

#### Published information

43 At 13.00 or soon after the Bank will publish on its wire services pages and on the Bank's website<sup>4</sup> information on the successful yield spreads and quantities purchased in individual eligible bonds.

44 Each Friday at 10.00 the Bank will also publish on the Bank's wire services pages and on the Bank's website the total amount of corporate bonds purchased from the previous Friday up until the previous day, in terms of the amount paid to the sellers; and the sum of corporate bonds purchased, less redemptions, to date.

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<sup>4</sup> <http://www.bankofengland.co.uk/markets/money/Round2.html>

### Settlement arrangements

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

46 The Fund's purchases of corporate bonds will normally settle on a T+3 basis.

47 Counterparties must comply with the Settlement Procedures for the Asset Purchase Facility, available at [www.bankofengland.co.uk/markets/apf/index.htm](http://www.bankofengland.co.uk/markets/apf/index.htm) .

### Limits

48 So as not to adversely affect liquidity in individual securities, the Bank will set a private limit on the maximum proportion of each security that it will be willing to hold.

49 To manage concentration risk, the Bank will also set a private limit on the maximum proportion of an issuers' outstanding bonds that it will be willing to hold through the Scheme.

### Other

50 The Bank intends to consult with market participants about the possibility of lending corporate bonds from the portfolio it will acquire.

51 The Bank will reserve the right to offer for sale any corporate bonds that it had previously purchased.

## **CGS BOND SECONDARY MARKET SCHEME**

### Introduction

52 The Fund will stand ready to make purchases of bonds issued by banks under HMG's Credit Guarantee Scheme (CGS), in order to provide a backstop bid for intermediaries that provide regular prices as market makers in such securities.



### Eligible securities

53 Initially, the facility will cover only the sterling-denominated publicly-issued instruments, as listed on the website of the Debt Management Office (DMO). The Bank will keep under review whether it should propose including foreign-currency denominated instruments in the future.

### Purchase process

54 The Bank will stand ready to purchase eligible securities, contingent on a deterioration in market conditions such that the Bank judges it beneficial to provide a backstop bid for eligible securities. To gauge market conditions, the Bank will engage in regular dialogue with intermediaries and also consult with issuers and investors. These discussions will, *inter alia*, cover the ability of market makers to provide secondary market liquidity in CGS bonds, investor demand for CGS bonds and any frictions impeding market functioning.

55 Should the Bank judge it beneficial to activate the Scheme and provide a backstop bid for eligible CGS securities, it will do so through reverse auctions. Auctions would broadly adopt the same format as those for the Corporate Bond Secondary Market Scheme.

56 Specifically, the Bank would announce, via its wire services pages, an invitation for offers on eligible securities. The Bank would privately set a minimum spread to a specified reference gilt yield and would not purchase securities at offers below this spread. The Bank will keep under review the level of the minimum spreads and the size of purchases in the light of the pattern of participation in the Scheme, market conditions, and the delivery of the objectives of the Scheme.

57 The Bank intends to consult with market participants about the possibility of lending CGS securities it acquires.

58 The Bank would reserve the right to offer for sale any CGS securities that it had previously purchased.

### Eligible counterparties and applications

59 As for the Corporate Bond Secondary Market Scheme, the Fund will stand ready to purchase sterling CGS securities only from those firms that are market makers in such securities, in order to facilitate their activities in supporting secondary market liquidity. The Bank will initially take receipt of applications to become a counterparty only from those firms that are also counterparties in its gilt-purchase Open Market Operations.

60 In order to assist the Bank in assessing whether the Scheme is achieving its objectives, counterparties will be expected to submit to the Bank information each week on their indicative bids and offers for eligible bonds; actual spreads to reference gilts at which they have bought or sold eligible bonds; and the volume of their transactions in eligible bonds. The Bank will provide further detail to counterparties on how to provide this information.

61 If any counterparty abuses, or seeks to abuse, the reverse auctions or the Scheme more generally, the Bank retains the discretion immediately to exclude the counterparty from the Scheme and take up the issue with the Senior Management of the organisation.

62 There is one application form for applicants applying for the Corporate Bond Secondary Market Scheme and/or the CGS Bond Secondary Market Scheme. Those wishing to participate as counterparties should complete the Application Form for the Corporate Bond Secondary Market Scheme and/or the CGS Bond Secondary Market Scheme available at [www.bankofengland.co.uk/markets/apf/index.htm](http://www.bankofengland.co.uk/markets/apf/index.htm) and submit it by e-mail to [APF\\_applications@bankofengland.co.uk](mailto:APF_applications@bankofengland.co.uk). Applicants who have previously applied to become counterparties in other elements of the Asset Purchase Facility may refer back to material in their previous application.

Bank of England  
19 March 2009