

Commercial Paper Facility (UK)

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July 25, 2017

Updated March 15, 2020

Abstract

In January 2009, following continued increases in commercial paper spreads, Her Majesty's Treasury authorized the Bank of England to begin purchasing commercial paper under the Asset Purchase Facility in order to maintain UK-based corporations' access to short-term financing. Under the Commercial Paper Facility (CPF), the Bank purchased commercial paper from both primary issuers and secondary holders at a rate that was favorable to issuers during the credit crunch, but that would no longer be attractive once the markets recovered. By serving as a backstop, or Market Maker of Last Resort (MMLR), the Bank helped to restore liquidity to corporate credit markets. By February 2010 almost all issuers could find more favorable spreads in the market, and in November 2010 the Bank gave twelve months' notice of the facility's withdrawal. At peak utilization, the Bank purchased £2.4 billion of commercial paper in late April 2009.

Keywords: Commercial paper, Bank of England, liquidity

Commercial Paper Facility

At a Glance

Despite capital funding flowing to UK banks and the Bank of England's decision to cut the Bank Rate, or the interest rate that the Bank charged for overnight lending, to .5%, a corporate credit crunch was intensifying in early 2009. As a result, the Chancellor of the Exchequer of Her Majesty's Treasury authorized the Bank of England to begin purchasing private assets as part of an

Asset Purchase Facility (APF). The ceiling for the APF was initially set at £50 billion, and was subsequently increased by the Bank subject to the Treasury's approval. As part of the larger APF, the Bank established a Commercial Paper Facility (CPF) under which the Bank would readily purchase commercial paper from both primary issuers and secondary holders.

Summary of Key Terms

Purpose: To serve as a ready buyer for commercial paper, thereby restoring liquidity to corporate credit markets

Announcement Date January 19, 2009

Facility Opened February 13, 2009

Facility Closed November 15, 2011

Peak Utilization £2.4 billion

Managed by Bank of England, HM Treasury

The framework for the APF was announced on January 19, 2009, and the CPF became operational on February 13, 2009. It was managed by the Bank of England, but all losses were indemnified by the British government. As long as it met a set of broad criteria, any firm could theoretically access the facility. The Bank's intention was always to close the CPF once liquidity was restored to corporate credit markets. Given improvements in the markets throughout 2009 and 2010, the Bank announced in November 2010 that the CPF would be withdrawn in a year. Purchases of commercial paper through the facility peaked in late April 2009 at £2.4 billion.

Summary Evaluation

The CPF was a very small component of the larger APF. In addition, a few months into the program, the Bank decided to fund the facility through the issuance of central bank reserves, or quantitative easing. As a result, it is challenging to isolate the effects of the CPF from these broader initiatives. Bank officials pointed to decreasing market spreads for commercial paper as well as a decline in usage of the facility by early 2010 as evidence that the CPF had been successful in restoring liquidity to the corporate credit markets.

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I. Overview

Background

During the global financial crisis, corporate credit markets froze up, as investors demanded liquidity premiums to offset increased risk. Prior to 2009, the British government provided substantial capital funding to UK banks. However, these efforts did little to increase liquidity in credit markets, as banks held on to funds to protect against future losses. This was evidenced by the fact that in early 2009, spreads in the interbank market soared to fifteen times their pre-crisis amounts (Dale 2010).

Throughout 2008 and early 2009, the Bank of England cut interest rates, eventually lowering the Bank Rate to .5%. However, the Bank's Monetary Policy Committee (MPC) believed that these efforts were not enough to stimulate spending to reach the UK's 2% inflation target (Benford et al. 2009). Early 2009, commercial paper spreads remained at a level higher than any estimate consistent with the risks involved, and therefore, this market seemed to be a prime target for intervention so as to facilitate otherwise credit-worthy firms in maintaining their access to short-term finance. (Fisher 2010)

Program Description

In order to increase the availability of credit to UK corporate borrowers, in January 2009 the British government authorized the Bank of England to begin purchasing investment grade sterling commercial paper as part of a new fund called the Asset Purchase Facility (APF) (Bank of England, "Market Notice: Asset Purchase Facility," 2009). The facility aimed to "increase the availability of corporate credit, in order to support the Bank of England's responsibilities for financial stability and monetary stability in the United Kingdom" (Darling 2009).

One piece of the APF was the Commercial Paper Facility (CPF), which allowed the Bank to purchase commercial paper either directly, through dealers in the primary market, or from certain counterparties in the secondary market. In order to be eligible, commercial paper had to be issued either by companies that made a "material contribution to economic activity in the United Kingdom" or by non-bank financial companies that significantly contributed to corporate financing in the U.K. (Bank of England, "Market Notice: Asset Purchase Facility," 2009). Interested issuers and counterparties had to apply to the Bank to determine eligibility. Commercial paper was deemed eligible if it was sterling-denominated, up to three months maturity, and investment-grade. The Bank purchased commercial paper at a spread to the overnight index swap (OIS) rate that was favorable at the time of the crisis, but that would become increasingly unappealing to issuers as liquidity was restored to the market (Fisher 2010). For primary issuers, the spread was 75-300 bp depending on the credit rating of the issuer. The spread for secondary holders was assessed similarly, and they were charged an additional 25 bp fee. Minimum amount for individual securities purchased through the facility was £1 million, and offer amounts had to be stated in increments of £0.1 million (Bank of England, "Market Notice: Asset Purchase Facility," 2009).

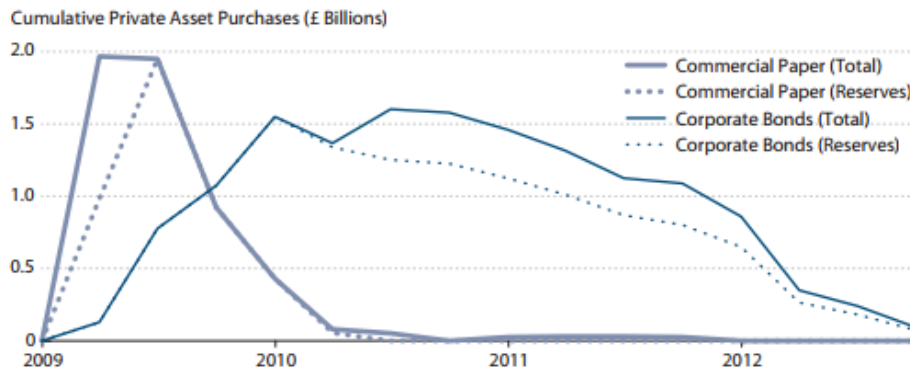
Originally, purchases of commercial paper were financed through the issuance of Treasury bills by the Debt Management Office. In March 2009, the MPC announced that asset purchases, including through the CPF, would be financed by central bank reserves as part of the Bank’s quantitative easing program. This program aimed to stimulate spending, bringing inflation to target by injecting money into the economy through the purchase of public and private sector assets (Bank of England, “Market Notice: Sterling Monetary Framework; Asset Purchases,” 2009).

All of the commercial paper purchased through the facility was held off the Bank’s balance sheet in the Bank of England Asset Purchase Facility Fund (BEAPFF). The Fund was a wholly-owned subsidiary of the Bank of England and was indemnified by the British government (Fisher 2010).

Rather than setting a specific timeline or target purchase amount for the CPF, the Bank of England designed the facility to last, “for as long as the highly abnormal conditions in corporate credit markets that were impairing finance of real economic activity persisted,” (Bank of England, “Asset Purchase Facility – Commercial Paper (2009-2011)”). This reflected the Bank’s desire to be a short-term Market Maker of Last Resort (MMLR), rather than a long-term source of corporate financing (Fisher 2010).

Outcomes

At peak utilization, the Bank purchased £2.4 billion of commercial paper in late April 2009. (Fisher 2010) Commercial paper comprised a small portion of the larger Asset Purchase Facility, which overwhelmingly purchased gilts (Fawley and Neely 2013). The majority of purchases through the CPF took place in early 2009, as depicted in the table below.¹



Note: The table shows net purchases of private assets separated into commercial paper and corporate bonds. The solid lines show total net purchases; the dashed lines show net purchases funded by central bank reserve issuance.

Source: *Bank of England Asset Purchase Facility Quarterly Reports; Fawley and Neely 2013*

¹ Any available information on who used the program? Compare primary and secondary market purchases?

For high grade commercial paper, market spreads fell below spreads offered by the Commercial Paper Facility in August of 2009. In February 2010, the Bank held only £300 million in commercial paper, which was attributed to a restored ability for issuers to find more favorable spreads in the market (Fisher 2010).

The Bank last made purchases under the facility in the second quarter of 2010 (see Bank of England, “Asset Purchase Facility Quarterly Reports”). In November 2010 the Bank gave a twelve month notice for the termination of the Commercial Paper Facility, citing improvements in the corporate credit market. The Facility was closed on November 15, 2011 (Bank of England, “Asset Purchase Facility – Commercial Paper (2009-2011)”).

II. Key Design Decisions

1. The CPF was launched to restore liquidity to the corporate credit markets.

In order to increase the availability of credit to UK corporate borrowers, in January 2009 the British government authorized the Bank of England to begin purchasing investment grade sterling commercial paper as part of a new fund called the Asset Purchase Facility (APF) (Bank of England, “Market Notice: Asset Purchase Facility,” 2009). The facility aimed to “increase the availability of corporate credit, in order to support the Bank of England’s responsibilities for financial stability and monetary stability in the United Kingdom” (Darling 2009).

One piece of the APF was the Commercial Paper Facility (CPF), which allowed the Bank to purchase commercial paper either directly, through dealers in the primary market, or from certain counterparties in the secondary market. (Bank of England, “Market Notice: Asset Purchase Facility,” 2009).

2. The CPF was announced without a size limit and an end-date.

CPF was a part of an Asset Purchase Facility (APF) which had a ceiling initially set at £50 billion. However, for CPR, rather than setting a specific timeline or target purchase amount the Bank of England designed the facility to last, for as long as the highly abnormal conditions in corporate credit markets that were impairing finance of real economic activity persisted. (Bank of England, “Market Notice: Asset Purchase Facility,” 2009)

3. The Bank received the Chancellor’s approval for the APF which the CPF was launched under.

The government was to indemnify the Bank of England from any losses arising out of APF. Therefore, to launch the APF, the Bank of England received the Chancellor’s approval as the taxpayers were taking on the risk from all APF facilities. (Darling 2009)

4. The Bank consulted with the industry in the design of the CPF

Before the operation of the CPF, a market notice announcing the program requested feedback from the industry. The request included invitation for detailed comments from all interested parties - existing and potential new issuers, investors, intermediaries and infrastructure providers, including issuing and paying agents and ratings agencies. (Bank of England, “Market Notice: Asset Purchase Facility,” 2009)

5. The Bank purchased newly issued commercial paper from dealers in the primary market and from eligible counterparties in the secondary market

All prospective counterparties were required to submit an application to the Bank via email to ascertain eligibility. If the Bank was able to confirm eligibility before 4:00 PM, securities could be sold to the Bank the next business day. Once approved, offers to sell commercial paper to the CPF had to be submitted between the window of 10 AM and 12 PM. Dealers acting as principle in the primary market had to provide details on the issuing entity and the

nominal amount offered; counterparties in the secondary market had to provide the ISIN/ticker of the security, the money market yield on an amortized cost basis, the maturity date, and the nominal amount offered. Each individual security had to be at least £1 million, and offers had to be expressed in £0.1 million increments (Bank of England, “Market Notice: Asset Purchase Facility,” 2009).²

By allowing both primary issuers and secondary market holders to participate in the facility, the Bank aimed to increase issuer and investor confidence by serving as a ready buyer. The Bank believed that this would give all banks and investors, not just those that participated in the facility, the confidence to resume normal lending, which would help to further restore liquidity to corporate debt markets (Benford et al. 2009).

6. The facility was specifically designed to help corporations making a material contribution to the UK economy

In order to be eligible, commercial paper had to be issued by corporations that made a “material contribution to economic activity in the United Kingdom.” This was defined as a company that was incorporated in the United Kingdom and was capable of issuing bonds, and that had genuine business in the United Kingdom. In addition, commercial paper issued by non-bank financial companies was eligible as long as the issuer made significant contributions to corporate financing in the UK. Leveraged investment vehicles were not eligible for participation. The Bank also restricted purchases to sterling-denominated commercial paper (Bank of England, “Market Notice: Asset Purchase Facility,” 2009).

7. Only Investment-grade commercial paper was eligible for purchase under the facility

In his letter authorizing the CPF, the Chancellor of the Exchequer asked that the Bank, “be satisfied that there will be a viable private market demand for the types of assets that it buys when conditions in financial markets return to normal” (Darling 2009). To ensure this, the Treasury required that the Bank only purchase investment-grade assets that satisfied the following criteria:

- a) A maturity of one week to three months if issued to the bank at issue via a dealer, or a residual maturity of three months or less if sold to the bank by a secondary market holder;
- b) A minimum short-term credit rating of A-3/P-3/F-3 from at least one of S&P, Moody’s and Fitch; and
- c) Issued directly into Crest, Euroclear or Clearstream (Bank of England, “Market Notice: Asset Purchase Facility,” 2009).

² Were there individual counterparty limits? Fisher 2010 indicates such existed.

Asset-backed commercial paper was not eligible for sale into the Commercial Paper Facility (Bank of England, “Market Notice: Asset Purchase Facility,” 2009).

If an issuer of the CP was downgraded below the minimum credit ratings, the CP was permitted to mature as normal, but the issuer was unable to access CPF again until it re-satisfied the required minimum credit ratings again. (Bank of England, “Market Notice: Asset Purchase Facility,” 2009)

8. Maturity and pricing were both determined in order to be attractive in stressed conditions, but less attractive as conditions normalized

As discussed below, the CPF was never intended to serve as a long-term corporate credit source. Only commercial paper with three months maturity (when purchased directly) or with a residual maturity of no more than three months (when purchased from holders in the secondary market) was eligible for participation. Commercial paper was purchased “at spreads which were significantly below those in the market at the time, but which were significantly above those expected to prevail in normal conditions,” (Fisher 2010). The spread to the maturity-matched overnight index swap (OIS) rate was determined based on the issuer’s credit rating, and can be seen in the table below.

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

Source: Bank of England, “Market Notice: Asset Purchase Facility,” 2009.

The Bank purchased commercial paper from secondary holders at the lower of the price determined by the above method and the amortized cost from the issue price. In addition, counterparties on the secondary market were charged a 25 bp usage fee (Bank of England, “Market Notice: Asset Purchase Facility,” 2009). This pricing mechanism was designed so that the CPF would be “self-liquidating,” or less appealing as corporate credit markets improved (Fisher 2010).

9. The Bank sterilized the asset purchase program before March 2009 and after February 2010, but funded it through reserves for 11 months to support its quantitative easing program

Initially, purchases of commercial paper were funded by Treasury bills issued by the Debt Management Office. Every purchase of private assets, including commercial paper, was financed through the issuance of short-term gilts, which did not affect the monetary supply. This was to sterilize the operation, that is, to make sure that the purchases did not have an expansive impact on monetary policy. On February 17, 2009, shortly after the program was launched, the Bank’s Monetary Policy Committee revised the scope of the program so that it could also support monetary policy. Starting on March 6, 2009, the Bank financed the CPF

through creation of new central bank money as part of a broader quantitative easing program (Benford et al. 2009). Starting on February 4, 2010, the program was again funded by Treasury bills to maintain the level of central bank reserves. (Bank of England APF Annual Report 2009/10)

10. All assets were held off the balance sheet in the Bank of England Asset Purchase Facility Fund (BEAPFF)

A wholly-owned subsidiary company, called the Bank of England Asset Purchase Facility Fund (BEAPFF), was specifically created by the Bank to purchase assets including commercial paper. The Bank loaned money to BEAPFF to finance these purchases, but the source of funding depended on whether the Asset Purchase Facility, and CPF by extension, operated under the quantitative easing program, which it did between March 2009 and February 2010. In its authorization of the CPF, the Treasury agreed that all losses incurred by BEAPFF would be indemnified by the UK government. (Darling 2009) The Bank did not consolidate the Fund's assets and liabilities on its financial statements because, due to the indemnity, it had "no economic interests in its activities. (Bank of England Annual Report 2009)

11. The facility was terminated once liquidity was restored to corporate markets

The CPF was designed to operate as a short-term solution to the corporate credit crisis. The Bank agreed to regularly monitor market liquidity to assess the continued necessity of the facility. The Bank's intention was always to wind down the facility once the market rebounded, either as assets matured or through sales. As a result, it only purchased commercial paper for which it believed there would be a private market at such a time (King 2009).

III. Evaluation

Bank of England's quarterly bulletin for markets and operations consistently reported that the CPF was a success. For the second quarter of 2009, the Bank observed that the issuance prices of CP in primary markets to non-APF investors suggested that spreads narrowed, particularly for lower-rated corporates, towards the rates at which the CPF offered to purchase CP. It concluded this shows some corporates benefited from issuing to other investors at these lower rates (Bank of England Markets and Operation Q2). During the third quarter of 2009, the Bank again observed the sterling primary market CP spreads narrowing further. The Bank suggested that this combined with the fall in CPF net purchases and the increase in the total amount of sterling-denominated CP outstanding for UK corporate and non-bank financial firms, represented that some issuers found it more economic to issue to investors rather than use the CPF (Bank of England Markets and Operation Q3). In the last quarter of 2009, the Bank reported that quoted primary market CP spreads narrowed even further and remained below the spreads at which the CPF offered to purchase CP. This meant that some issuers found it more economic to issue to investors rather than use the CPF and the Bank concluded that this facility successfully acted as a backstop following temporary reductions in market liquidity (Bank of England Markets and Operation Q4).

Fawley and Neely, in a comparative study of the quantitative easing programs of the Federal Reserve, Bank of England, European Central Bank, and Bank of Japan argue that in the UK “the presence of a market maker of last resort quickly restored market functioning and the price floor established by the purchase programs did not bind for long” (2013). Additionally, Fisher emphasize that although the program seemed small compared to other liquidity programs during the GFC, purchases peaked at £2.4 billion in late April 2009 which amounted to one third of the sterling commercial paper market at the time. (Fisher 2010)

IV. References

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V. Key Program Documents

Summary of Program

Asset Purchase Facility – Commercial Paper (2009-2011) – Bank of England summary of
Asset Purchase Facility Program
<http://www.bankofengland.co.uk/markets/Pages/apf/cp/default.aspx>

Bank of England Market Notice: Asset Purchase Facility – *Bank of England document outlining the structure of the Commercial Paper Facility*
<http://www.bankofengland.co.uk/markets/Documents/marketnotice090213.pdf>

Asset Purchase Facility – *Letter from Alistair Darling, Chancellor of the Exchequer, to Mervyn King, Governor of the Bank of England authorizing the Asset Purchase Facility*
http://webarchive.nationalarchives.gov.uk/20120803125245/http://www.hm-treasury.gov.uk/d/ck_letter_boe290109.pdf

Letter from King to Darling – *response from Mervyn King to Alistair Darling further outlining the Bank’s plan for the APF*
<http://www.bankofengland.co.uk/markets/Documents/apfgovletter090129.pdf>

Bank of England Market Notice: Sterling Monetary Framework; Asset Purchases – *Bank of England document announcing Quantitative Easing Program*
<http://www.bankofengland.co.uk/markets/Documents/marketnotice090305.pdf>

The Bank of England’s Balance Sheet: Monetary Policy and Liquidity Provision during the Financial Crisis (Fisher 2009) – *Speech given by Paul Fisher on the structure and theory behind the Bank’s Quantitative Easing program*
<http://piketty.pse.ens.fr/files/capitalisback/CountryData/UK/VariousOfficialSeries/BalanceSheetBoE/Fisher09.pdf>

Quantitative Easing (Benford et al. 2010) – *Bank of England publication outlining the justification for quantitative easing program and the inclusion of APF in the program*
<https://search.proquest.com/docview/215030543?pq-origsite=gscholar>

Bank of England Asset Purchase Facility Fund Limited (BEAPFF) – *House of Commons briefing paper on BEAPFF*
<http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN06488#fullreport>

Implementation Documents

Terms and Conditions for Counterparties in the Bank of England’s Asset Purchase Facility – *terms and conditions governing transactions between the Bank of England as agent for BEAPFF and Counterparties in the APF.*
<http://www.bankofengland.co.uk/markets/Documents/apf/termsandconditions090206.pdf> (earlier version)
<http://www.bankofengland.co.uk/markets/Pages/apf/documentation.aspx> (later version)

Application Form and Questionnaire for Applicants Wishing to Become Counterparties in the Bank of England’s Commercial Paper Facility – *Bank of England document that all*

prospective counterparties to the CPF must complete prior to participating in the APF.
www.bankofengland.co.uk/markets/Documents/apf/appform-questionnaire-cpf.doc

Settlement Procedures for Counterparties Participating in the Bank of England's Asset Purchase Facility (APF)
<http://www.bankofengland.co.uk/markets/Documents/apf/settlementprocedures160804.pdf>

Press Releases/Announcements

News Release (01/19/2009) – *Bank of England press release announcing the authorization of the APF*
<http://www.bankofengland.co.uk/archive/Documents/historicpubs/news/2009/002.pdf>

News Release (02/06/2009) – *Bank of England press release announcing the Asset Purchase Facility*
<http://www.bankofengland.co.uk/archive/Documents/historicpubs/news/2009/009.pdf>

News Release (11/15/2010) – *Bank of England press release announcing intention to close the Commercial Paper Facility*
<http://www.bankofengland.co.uk/archive/Documents/historicpubs/news/2010/088.pdf>

APF Market Notices – *Bank of England collection of all Market Notices related to APF*
<http://www.bankofengland.co.uk/markets/Pages/apf/notices.aspx>

Media Stories

Bank of England May End Bond Buying (New York Times – 8/5/2009) – *article discussing MPC decision about whether to continue Asset Purchase Facility in mid-2009*
<http://www.nytimes.com/2009/08/06/business/global/06pound.html?rref=collection%2Ftimestopic%2FBank%20of%20England>

Key Academic Papers

The United Kingdom's Quantitative Easing policy: Design, Operation and Impact (Joyce, Tong, and Woods 2010) – *paper evaluating the impact of asset purchases from the quantitative easing program on financial markets and the broader British economy.*
<https://poseidon01.ssrn.com/delivery.php?ID=98100806402210702209308008908511508712703202804605002501411807508811409502709811402201806009900902404211310109911700101100900704205108803403909200509912012111709505>

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Four Stories of Quantitative Easing (Fawley and Neely 2013) – *comparative study of quantitative easing programs in the US, UK, EU, and Japan*
<https://files.stlouisfed.org/files/htdocs/publications/review/13/01/Fawley.pdf>

Reports/Assessments

Asset Purchase Facility Quarterly Reports – *database of all Bank of England Quarterly Reports on the APF with data on CPF purchases*
<http://www.bankofengland.co.uk/publications/Pages/other/markets/apf/quarterlyreport.aspx>

The Corporate Sector and the Bank of England's Asset Purchases (Fisher 2010) – *speech specifically addressing the impact of the Bank's credit easing operations*
<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech423.pdf>

QE – One Year On (Dale 2010) – *speech outlining the theoretical foundation of Quantitative Easing and assessing the effects of asset purchases in the first year of the program.*
<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech428.pdf>