

Clients & Friends Memo

Bank of England Asset Purchase Facility – A Panacea for the U.K. Corporate Credit Markets?

17 February 2009

On 19 January 2009 the U.K. Treasury announced a package of measures designed to increase the confidence and capacity of lend of U.K. financial institutions.¹ One of the measures announced was the establishment by the Bank of England (the BoE) of a £50 billion Asset Purchase Facility to purchase high quality financial assets.

Further details of the Asset Purchase Facility were set out in an exchange of letters between the U.K. Treasury and the BoE dated 29 January 2009.² The letters noted that purchases of assets under the Asset Purchase Facility could help to improve liquidity in credit markets that are currently not functioning normally. The U.K. Treasury specified the following types of sterling-denominated assets as eligible for purchase under the Asset Purchase Facility:

- (1) commercial paper;
- (2) corporate bonds;
- (3) bonds issued under the U.K.'s Credit Guarantee Scheme;³
- (4) syndicated loans; and
- (5) asset backed securities "created in viable securitisation structures".⁴

¹ www.hm-treasury.gov.uk/press_05_09.htm

² Letter from U.K. Treasury to the BoE: www.hm-treasury.gov.uk/d/ck_letter_boe290109.pdf

Letter from the BoE to U.K. Treasury: www.bankofengland.co.uk/markets/apfgovletter090129.pdf

³ The Credit Guarantee Scheme was established on 13 October 2008 and is managed by the U.K. Debt Management Office. U.K. incorporated banks (including U.K. subsidiaries of foreign institutions) that have a substantial business in the UK and U.K. building societies, are eligible to participate in the Credit Guarantee Scheme. Under the Credit Guarantee Scheme the U.K. Government guarantees specified bank and building society bonds issued by participating institutions during the period from 13 October 2008 and before 31 December 2009. Further details on the Credit Guarantee Scheme are available on the website of the U.K. Debt Management Office: www.dmo.gov.uk/index.aspx?page=CGS/CGSIntro

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However, the BoE will review on an on-going basis the merits of expanding the types of assets and currencies eligible for purchase under the Asset Purchase Facility and may propose to the U.K. Treasury that additional types of assets and/or currencies be eligible.

On 6 February 2009 the BoE issued a Market Notice setting out further details of the Asset Purchase Facility. A new company, BoE Asset Purchase Facility Fund Limited (the Fund), a wholly-owned subsidiary of the BoE, will hold the assets purchased under the Asset Purchase Facility. The BoE will act as agent for the Fund in operating the Asset Purchase Facility.

The Market Notice distinguishes between the different types of assets eligible for purchase under the Asset Purchase Facility. The Market Notice sets out:

- (1) details of a Commercial Paper Facility to be operational from 13 February 2009;
- (2) an outline proposal for a Corporate Bond Secondary Market Scheme and request for feedback from interested parties;
- (3) a less-detailed outline proposal for a facility for paper issued under the U.K.'s Credit Guarantee Scheme and request for feedback from interested parties; and
- (4) an indication of some of the points which the BoE wishes to discuss with interested parties in advance of formulating proposals in relation to the purchase of syndicated loans and asset backed securities under the Asset Purchase Facility.

Purpose of the Asset Purchase Facility

The purpose of Asset Purchase Facility, as set out in the letter from the U.K. Treasury to the BoE, is to increase the availability of credit to U.K. corporate borrowers by increasing liquidity and trading activity in corporate credit markets.

Different from the U.S. Troubled Asset Relief Programme

The Asset Purchase Facility is very different from the asset purchase plan that was originally the primary component of the U.S. Troubled Asset Relief Programme (TARP) as enacted in the Emergency Economic Stabilisation Act of 2008. The TARP allowed the U.S. Treasury to purchase or insure up to U.S.\$700 billion of "troubled assets" which were defined as:

- “(A) residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case

⁴ Neither the letters between the U.K. Treasury and the BoE nor the subsequent Market Notice issued by the BoE give any indication as to what "viable securitisation structure" means or how the viability of a securitisation structure is to be assessed.

was originated or issued on or before March 14, 2008, the purchase of which the [U.S. Treasury] Secretary determines promotes financial market stability; and

- (B) any other financial instrument that the [U.S. Treasury] Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, but only upon transmittal of such determination, in writing, to the appropriate committees of Congress.”

The TARP originally envisaged the purchase from U.S. banks of previously-originated “toxic” asset backed securities in order to allow such banks to remove these illiquid, opaque and difficult-to-value assets from their balance sheets and avoid further losses and instability in their capital ratios. However, the direction of the TARP changed so that rather than shoring up bank balance sheets by acquiring their “toxic” asset backed securities, the U.S. Treasury instead did so by injecting additional capital into banks by acquiring preferred stock and warrants issued by them.

Back-stop purchaser of corporate debt

The U.K., like the U.S. and many other countries, has injected significant amounts of additional capital into banks over the past six months in order to shore up their capital ratios. However, such capital injections have not increased the willingness of U.K. banks to extend corporate lending. The Asset Purchase Facility is intended to increase the availability of credit to corporates by creating a Fund which, by acting as a back-stop purchaser of corporate debt, would encourage secondary market liquidity in corporate debt, in particular by facilitating market-making by banks and dealers. Such secondary market liquidity in corporate debt would in turn increase the willingness of banks and investors to extend credit to corporates in the primary markets, whether in the form of loans or debt securities.

The Asset Purchase Facility's role as a back-stop purchaser rather than a long-term source of corporate credit is the reason for the requirements set out in the letter from the U.K. Treasury to the BoE that

- (i) assets are to be purchased using the Asset Purchase Facility only if the BoE is satisfied that they are assets of high quality and of equivalent standard to investment grade; and
- (ii) there will be a viable private market demand for such assets when conditions in financial markets return to normal.

The Asset Purchase Facility is not to be a repository for poor-quality or “toxic” assets.⁵ Neither is the Asset Purchase Facility to be used to acquire assets that would not be marketable in normal market conditions. One of the concerns in relation to central bank repo lending against asset backed securities is that recently issued asset backed securities have been structured solely to meet the requirements necessary to be eligible repo collateral and would not attract investors even in normal market conditions.⁶ The purpose of the Asset Purchase Facility is very much to facilitate secondary market trading and liquidity in the assets purchased and such secondary market trading will be adversely affected if assets are structured such that they could be purchased by the Asset Purchase Facility but would not be marketable to investors in normal market conditions.

Commercial Paper Facility

Commercial paper is the only asset type for which the Market Notice sets out details of the application of the Asset Purchase Facility. In the Market Notice the component of the Asset Purchase Facility which will acquire commercial paper is termed the Commercial Paper Facility. The Commercial Paper Facility is to be operational from 13 February 2009.

Eligible commercial paper

The Market Notice provides that commercial paper must satisfy the following criteria to be eligible for purchase under the Commercial Paper Facility:

- (1) *Issuer:* Issued by either:
 - (a) a company that makes a material contribution to economic activity in the U.K. or by a finance subsidiary of that company;⁷ or
 - (b) a non-bank financial company that makes a material contribution to corporate financing in the U.K. and that is not a leveraged investment vehicle.⁸

⁵ The U.K. Treasury has separately announced an Asset Protection Scheme under which the U.K. Treasury will assume the majority of credit risk in relation to certain eligible assets of U.K.-incorporated banks and building societies held on their balance sheets as at 31 December 2008. The U.K. Treasury’s statement of 19 January 2009 on the Asset Protection Scheme is at www.hm-treasury.gov.uk/press_07_09.htm. Further details of the Asset Protection Scheme are expected to be published at the end of February 2009.

⁶ Fitch Ratings, “*Limited SF Impact from ECB Repo Criteria Change; Transition Issues Remain*” (21 January 2009)

⁷ The Market Notice states that an issuer will normally be regarded as making a material contribution to economic activity in the U.K. if:

- (i) it is incorporated in the U.K. and capable of issuing a bond into the capital markets, i.e. is a U.K. PLC; and
- (ii) has genuine business in the U.K.

⁸ The Market Notice does not provide any definition of “leveraged investment vehicle” or any indication as to what it includes.

- (2) *Denomination*: Denominated in sterling.
- (3) *Maturity*: Maturity of three months if issued to the Fund at issue via a dealer or residual maturity of three months or less if sold to the Fund in the secondary market.
- (4) *Rating*: Issuer (or, in the case of securities issued by a finance subsidiary, guarantor):
 - (a) has a short-term credit rating from at least one of S&P, Moody's and Fitch;
 - (b) is not rated below A-3 / P-3 / F3 by any of S&P, Moody's and Fitch; and
 - (c) if rated A-3 / P-3 / F3 by any of S&P, Moody's and Fitch is not on negative watch from such rating agency.⁹
- (5) *Clearing*: Clears through Crest, Euroclear or Clearstream.
- (6) *Other*: Not have non-standard features¹⁰ and not be asset backed commercial paper.¹¹

Before an eligible counterparty can offer secondary market commercial paper under the Commercial Paper Facility it must confirm in advance the eligibility of such commercial paper with the BoE.¹² The BoE will not be publishing or publicly disclosing a list of those commercial paper issuers eligible for the Commercial Paper Facility.

The Market Notice states that the BoE reserves the right at its sole discretion to deem any commercial paper issue, including commercial paper issues that it has previously purchased, ineligible for any reason.

Eligible counterparties

The Fund will purchase commercial paper both:

- (i) in the primary market from dealers acting as principal; and
- (ii) from secondary market holders.

⁹ If an issuer is downgraded such that it fails to satisfy these minimum rating requirements, any commercial paper of the issuer then held by the Fund will be permitted to mature as normal but the Fund will not acquire any further commercial paper of such issuer until such issuer again satisfies the minimum rating requirements.

¹⁰ The Market Notice expressly specifies extendibility and subordination as non-standard features for commercial paper but notes that further details of non-standard features will be available from the BoE following consultation.

¹¹ The Market Notice states that asset backed commercial paper (ABCP) will not initially be eligible for purchase under the Commercial Paper Facility but that the BoE is ready to discuss with interested parties the possible use of ABCP as a means to enable a broader range of companies to access the Commercial Paper Facility.

¹² By email to apf_eligibility_enquiries@bankofengland.co.uk.

The Market Notice states that all counterparties from which the Fund purchases commercial paper must be appropriately authorised for the purposes of the Financial Services and Markets Act (FSMA).¹³

Any entity wishing to be participate as a counterparty for the Commercial Paper Facility must complete the Application Form and Questionnaire for Applicants wishing to become Counterparties in the Bank of England’s Commercial Paper Facility¹⁴ and submit it to the BoE.¹⁵

Calculation of purchase price

Commercial paper purchased in the primary market will be purchased at a discount using a spread over the risk free rate, being the maturity-matched overnight index swap (OIS rate)¹⁶ as determined by the BoE on the day of purchase.¹⁷ The spread over the risk free rate depends on the credit rating of the issuer and, initially, is to be determined in accordance with the following table.

Credit rating of issuer	A-1 ¹⁸ /P-1/F1	A-2/P-2/F2	A-3/P-3/F3
Spread over maturity-matched OIS rate ¹⁹	75 bps	125 bps	300 bps

Commercial paper purchased in the secondary market will be purchased for the lower of

- (i) the price determined for such commercial paper using the method set out above for determining the price of commercial paper purchased in the primary market and

¹³ From the Application Form and Questionnaire for Applicants wishing to become Counterparties in the Bank of England’s Commercial Paper Facility it is clear that “authorised for the purposes of the Financial Services and Markets Act 2000” includes not just entities authorised by the U.K. Financial Services Authority under the Financial Services and Markets Act 2000 but also entities authorised under the laws of another member state of the European Economic Area and providing services into the U.K. on a cross-border basis pursuant to the Markets in Financial Instruments Directive (Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004) or the Credit Institutions Directive (Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006).

¹⁴ Available at www.bankofengland.co.uk/markets/apf/appform-questionnaire-cpf.doc.

¹⁵ Submission is by email to apf_applications@bankofengland.co.uk.

¹⁶ An overnight index swap (OIS) is an interest rate swap agreement where a fixed rate is swapped against a pre-determined published index of a daily overnight reference rate e.g. in the case of sterling, Sterling Overnight Index Average (SONIA), for an agreed period.

¹⁷ The Market Notice states that the BoE will publish this three-month rate on its wire services page at 9 a.m. on each business day.

¹⁸ We assume that this reference to an A-1 rating from S&P includes an A-1+ rating from S&P.

¹⁹ Where an issuer has a split rating, the spread will be derived from the lowest rating.

(ii) amortised cost from the issue price,

less, in each case, an additional amount, which the BoE states it is currently minded to set at 25 bps.

Timing and size of purchases

Any purchase by the Fund under the Commercial Paper Facility will be in a minimum nominal amount per commercial paper issue of at least £1 million or an integral multiple of £100,000 in excess thereof.²⁰

In addition, the BoE is minded to limit to the purchase by the Fund of the commercial paper of a particular issuer to one eligible counterparty only per day so that, in the case of purchases of commercial paper in the primary market, all sales of commercial paper to the Fund will have to be effected through a single dealer.

Limits on purchases by issuer

Purchases under the Commercial Paper Facility of commercial paper in the primary market are limited by issuer.²¹ The BoE will make available on request to an issuer, but not to any other entity, the limit applying in respect of that particular issuer.

There is no reference in the Market Notice to purchases under the Commercial Paper Facility of commercial paper in the primary market being limited by issuer. However, there is nothing in the Market Notice that suggests that the purchase of any particular commercial paper under the Commercial Paper Facility is other than at the discretion of the BoE.

Corporate Bond Secondary Market Scheme

Eligible corporate bonds

The Market Notice provides that corporate bonds must satisfy the following criteria to be eligible for purchase under the Corporate Bond Secondary Market Scheme:

²⁰ The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (as amended) already provides that in order that commercial paper is not treated as regulated deposit-taking activity it must be transferable only in minimum amounts of at least £100,000 (or equivalent).

²¹ 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.

- (1) *Issuer:* Issued by either:
 - (a) a company that makes a material contribution to economic activity in the U.K. or by a finance subsidiary of that company; or
 - (b) a non-bank financial company that makes a material contribution to corporate financing in the U.K. and that is not a leveraged investment vehicle.²²
- (2) *Denomination:* Denominated in sterling.²³
- (3) *Ranking:* Conventional senior, unsubordinated debt.
- (4) *Maturity:* The Market Notice does not specify any requirements in relation to the maturity of the corporate bonds but does request feedback on whether or not there should be such requirements.
- (5) *Rating:* Issuer (or, in the case of securities issued by a finance subsidiary, guarantor):
 - (a) has a long-term credit rating from at least two of S&P, Moody's and Fitch;
 - (b) is not rated below BBB- / Baa3 by any of S&P, Moody's and Fitch; and
 - (c) if rated BBB- / Baa3 by any of S&P, Moody's and Fitch is not on negative watch from such rating agency.
- (6) *Listing:* Must be listed.²⁴
- (7) *Clearing:* Clears through Crest, Euroclear or Clearstream.
- (8) *Issue Size:* The Market Notice suggests that a corporate bond must have a minimum issue size of £100 million and requests feedback on this.

²² This is the same requirement as applies in respect of commercial paper under the Commercial Paper Facility.

²³ The Market Notice notes that the BoE will keep under review whether it should in the future propose that the Fund purchase corporate bonds denominated in currencies other than sterling.

²⁴ The Market Notice does not state whether the listing must be on any particular exchange or exchanges. However, under U.K. tax law, in order to qualify as quoted Eurobonds, and therefore enabling interest to be paid gross without deduction of income tax, corporate bonds have to be listed on a stock exchange is a stock exchange designated as a recognised stock exchange by the Board of Her Majesty's Revenue & Customs under section 841 of the Income and Corporation Tax Act 1988 and section 1005 of the Income Tax Act 2007. Details of those stock exchanges currently designated as recognised stock exchanges can be found at www.hmrc.gov.uk/fid/rse.htm.

- (9) *Other:* Not have complex or non-standard features. The Market Notice expressly specifies convertibility or exchangeability as non-standard features. The Market Notice requests feedback on whether corporate bonds with a standard call feature²⁵ should be eligible.

The Market Notice does not require that an eligible counterparty confirm in advance the eligibility of a corporate bond with the BoE before offering it to the Fund under the Corporate Bond Secondary Market Scheme. Such a requirement is provided for in the case of commercial paper offered under the Commercial Paper Facility. However, it is not clear whether the absence of a reference such a requirement in respect of corporate bond under the Corporate Bond Secondary Market Scheme means that such a requirement does not apply in respect of corporate bonds.

The BoE will not be publishing or publicly disclosing a list of those corporate bonds eligible for the Corporate Bond Secondary Market Scheme.

The Market Notice states that the BoE reserves the right at its sole discretion to deem any corporate bond, including corporate bonds that it has previously purchased, ineligible for any reason.

Eligible counterparties

The Market Notice gives only an initial indication of the BoE's thinking as to which entities will be eligible counterparties from which the Fund may acquire corporate bonds under the Corporate Bond Secondary Market Scheme.

The Market Notice suggests that, in line with the purpose of the Corporate Bond Secondary Market Scheme to facilitate market-making by banks and dealers, eligible counterparties initially be limited to those entities that are:

- (i) market makers in sterling corporate bonds; and
- (ii) counterparties in the BoE's gilt-purchase Open Market Operations.

However, the Market Notice states that the BoE would consider extending the range of eligible counterparties to certain regulated investors in light of experience in operating the Corporate Bond Secondary Market Scheme, in particular, if market making did not revive.

²⁵ A call feature allows the issuer of a bond to redeem or "call" all or part of the issue before the maturity date. The issuer usually retains this right in order to have flexibility to refinance the bond in the future if the market interest rate drops below the coupon rate. The call right of the issuer can usually only be exercised after a specified part of the term of the bond has expired.

Calculation of purchase price

The BoE would privately set a minimum spread for each corporate bond. The BoE would not purchase securities at prices higher than the sale price reflecting that minimum spread (the Maximum Sale Price). Having set the Maximum Sale Prices, the Fund would then purchase corporate bonds using one of the following purchase mechanisms

- (1) by bilateral purchases in the secondary market; or
- (2) by reverse auctions on a uniform price basis²⁶ with a separate reverse auction in respect of each individual corporate bond which would involve:
 - (a) the Fund tendering for offers to sell a fixed quantity of the relevant corporate bond; and
 - (b) eligible counterparties offering to sell such corporate bond at sale prices set by such eligible counterparties; and
 - (c) the BoE ranking those offered sale prices that are less than the Maximum Sale Price and allocating purchases to the relevant eligible counterparties starting with the eligible counterparty offering the lowest sale price until the fixed quantity of such corporate bond has been allocated; or
- (3) by reverse auctions on a uniform price basis following a procedure similar to that in (2) above, but with a range of similar corporate bonds being purchased in a single auction and the quantities of the individual corporate bonds purchased being adjusted in light of the relative sale prices offered for the different prices.

The BoE has requested feedback from interested parties regarding the relative merits of the above purchase mechanisms in light of (i) the objective of stimulating greater secondary market trading of corporate bonds and (ii) the need to avoid adverse selection in the corporate bonds offered to the Fund under the Corporate Bond Secondary Market Scheme.

Timing and size of purchases

The BoE does not intend to restrict the total amount of corporate bonds purchased from a single eligible counterparty. However, the BoE proposes, for operational reasons, to limit the daily number of offers of any individual corporate period that an eligible counterparty may make to the Fund. The BoE has requested views on these points from interested parties.

²⁶ A reverse auction on a uniform price basis involves all successful sellers receiving the same sale price which, although not expressly stated in the Market Notice, would presumably be the sale price offered by the successful seller offering the highest sale price.

Limits on purchases by corporate bond and by issuer

The BoE is considering setting limits on:

- (i) the percentage of any individual corporate bond issue that can be held by it at any time; and
- (ii) the percentage of the Corporate Bond Secondary Market Scheme portfolio that can be held in the corporate bonds of an individual issuer.

The BoE has requested feedback from interested parties regarding whether to impose these limits, including the percentages that should apply in respect of each limit.

Limit on purchases by eligible counterparty

The BoE has said that it does not propose to restrict the total amount of corporate bonds purchased from an eligible counterparty. However, eligible counterparties would be restricted to a single or small number of offers in each corporate bond each day. The BoE has invited views on these point from interested parties.

Credit Guarantee Scheme Bond Facility

The Market Notice contains only an outline proposal for a facility under which the Fund would acquire bonds issued by banks and building societies under the U.K.'s Credit Guarantee Scheme.

The outline proposal suggests that the facility would involve the Fund providing a backstop for intermediaries that committed to provide regular prices as market makers in respect of Credit Guarantee Scheme bonds. This can be taken as an indication that the terms of the Credit Guarantee Scheme bond facility would be similar to those of the Corporate Bond Secondary Market Scheme set out above. All Credit Guarantee Scheme bonds would, having already met the criteria necessary to be eligible for the Credit Guarantee Scheme, presumably be eligible for purchase under the Credit Guarantee Scheme bond facility and so, unlike in the case of corporate bonds, no additional eligibility criteria would need to be applied to them.

The outline proposal suggests that eligible counterparties for the Credit Guarantee Scheme bond facility be limited to those entities that have entered into a commitment to provide regular prices as market makers in the relevant Credit Guarantee Scheme bonds to be purchased by the Fund. The scope of eligible counterparties for the Credit Guarantee Scheme bond facility would therefore be similar to, but slightly different from, the scope of eligible counterparties for the Corporate Bond Secondary Market Scheme. In particular, although the Corporate Bond Secondary Market Scheme requires that eligible participants be market makers in sterling corporate bonds it does not require that eligible participants have entered into a commitment to

provide regular prices. The BoE will discuss with dealers and issuers of Credit Guarantee Scheme bonds the requirement to commit to provide regular prices.

Syndicated Loans and Asset Backed Securities

The Market Notice does not set out proposals in relation to the purchase of syndicated loans and asset backed securities under the Asset Purchase Facility. It contains only an indication of some of the points which the BoE wishes to discuss with interested parties in advance of formulating such proposals.

In relation to syndicated loans, the BoE states in the Market Notice that there are a variety of syndicated loan structures that could be purchased the Fund, including bridge loans, term loans and revolving credit facilities. However, the Fund would purchase only syndicated loans comparable to investment grade.

In relation to asset backed securities, the BoE states in the Market Notice that it wishes to investigate with interested parties the possibility of asset backed security structures that support the financing of smaller companies and/or companies below investment grade quality. Such asset backed security structures could have as underlying assets comprise sterling denominated corporate loans, trade receivables or equipment leases with different investors, including the Fund, purchasing all or part of the capital structure of such asset backed securities.

Does Asset Purchase Facility Fulfil its Purpose?

The U.K. Treasury has stated that Asset Purchase Facility is established for the purpose of improving the availability of corporate credit in the U.K. As noted above, although large amounts of capital funding have been provided by the U.K. government to U.K. banks there is concern that this funding is not supporting the availability of corporate credit but is being retained by the banks to shore up their reserves and protect against possible future losses on their pre-existing loan books. The Asset Purchase Facility is to facilitate secondary market trading and liquidity in corporate debt and thereby stimulate both the issuance of debt by corporate borrowers and the purchase of such debt by investors.

More valuable for listed corporates

Credit to corporates may take the form of capital markets funding, such as corporate bonds or commercial paper, or loan funding. Only larger corporates with listed equity are likely to have access to capital markets funding. Other corporates rely on receiving loan funding from banks or other lenders. Both the Commercial Paper Facility and the Corporate Bond Secondary Market Scheme outlined in the Market Notice relate only to capital markets funding for corporates. Therefore, they will be of assistance only to those larger corporates who have listed equity and not to smaller corporates without existing listed debt or equity.

Admittedly, commercial paper issued by non-bank financial companies which “make a significant contribution to corporate financing in the U.K.” is eligible for purchase under the Commercial Paper Facility. However, commercial paper issued by “leveraged investment vehicles” is not eligible. Certainly, further guidance is needed from the BoE as to what constitutes a “leveraged investment vehicle”. Any non-bank financial company that issues commercial paper will therefore have debt and will therefore be leveraged. Similarly, any non-bank financial company will have some equity investors.

Limitation to sterling assets

Only sterling denominated assets may be purchased by the Asset Purchase Facility. However, the markets for sterling debt, whether in the form of commercial paper or corporate bonds, are less liquid than for U.S. dollar or euro denominated debt. For many larger U.K. corporates, in particular those trading internationally, U.S. dollar or euro denominated funding may be more attractive than sterling funding. Given that the purpose of the Asset Purchase Facility is to improve the availability of credit to U.K. corporates it does not seem very logical to limit the application of the Asset Purchase Facility to sterling denominated debt.

Limitation to investment grade assets

The letter from the U.K. Treasury to the BoE in respect of the Asset Purchase Facility stated that only assets that are of equivalent standard to investment grade should be purchased under the Asset Purchase Facility. The difficulty with this is that many U.K. corporates will not have an investment grade rating, in many cases because they are too small to have a rating at all. It is the non-investment grade corporates that are in fact suffering most from the current disruption in the credit markets as the credit that is available flows to safer investment grade corporates. Provided the difference in credit risk is factored into the price paid by the Fund for non-investment grade debt, it is difficult to see why only investment grade debt should be purchased under Asset Purchase Facility.

Asset backed securities as a solution?

The BoE appears to recognise that in light of its purpose that the restriction on the Asset Purchase Facility to investment grade debt makes little sense and that the Commercial Paper Facility and the Corporate Bond Secondary Market Scheme will not be of assistance in improving the availability of credit to unlisted corporates.

The reference in the Market Notice to the BoE being keen to investigate the possibility of asset backed security structures that enable the purchase of assets that support the financing of small companies and/or companies of below investment grade quality suggests that the BoE thinks that asset backed securities may play an important role in having the Asset Purchase Facility improve funding for unlisted and non-investment grade corporates.

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If you have any questions regarding the foregoing, please contact:

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