6806063

Annual Report 2009/10

Bank of England Asset Purchase Facility Fund Limited

BANK OF ENGLAND

Directors' Report for the period ended 28 February 2010

The Directors present their report and the audited financial statements of the Bank of England Asset Purchase Facility Fund Limited ('the Company') for the period from 30 January 2009 to 28 February 2010

The Company was incorporated in England and Wales on 30 January 2009 with the company number 06806063 and started trading on 13 February 2009

Business review and principal activity

The Company was established as a wholly-owned group subsidiary by the Bank of England ('the Bank') on 30 January 2009 in order to fulfil the remit of the Chancellor of the Exchequer given to the Bank on 19 January 2009[1] and detailed in an exchange of letters with the Governor of the Bank of England on 29 January 2009 This remit was subsequently expanded to enable the Company's operations to be used as a monetary policy instrument, at the request of the Monetary Policy Committee (MPC) of the Bank, as detailed in the exchange of letters on 17 February 2009 and 3 March 2009 The exchange of letters can be found on the Bank and HM Treasury websites [2]

Directors

The Bank's Executive Directors for Markets and for Monetary Analysis and Statistics have been appointed as Directors of the Company as follows

Spencer Dale
Appointed 30 January 2009

Paul Tucker
Appointed 30 January 2009 to 1 March 2009

Paul Fisher
Appointed 1 March 2009

The Directors have the benefit of an indemnity against personal civil liability granted to the Company by HM Treasury in 2009, provided that the Company is not in wilful default or reckless disregard of its obligations

None of the Directors had a beneficial interest at any time during the financial year in the shares of the Company The annual reports and accounts have been reviewed by the Audit and Risk Committee of the Bank

Review of 2009/10

The Company was initially authorised to purchase up to a total of £50 billion of private sector assets financed by Treasury bills When its remit was extended to enable the Company's operations to be used as a monetary policy instrument, the Company was authorised to purchase for that purpose up to £150 billion of assets, including UK government securities (gilts), of which up to £50 billion could be used to purchase private sector assets At the request of the MPC, that limit was increased twice, to £175 billion in August and £200 billion in November 2009

The first purchases of commercial paper began on 13 February 2009 and the Company began to buy gilts on 11 March 2009 and corporate bonds on 25 March 2009 The Company stood ready to purchase bank debt issued under the Credit Guarantee Scheme should conditions in that market have deteriorated On 3 August 2009, the Bank launched a secured commercial paper facility, in which the Company stood ready to buy qualifying securities On 22 December 2009, the Bank announced, following a consultation process, that the Company would act as a seller, as well as a buyer, of corporate bonds in the secondary market The first sales operation took place on 8 January 2010

Purchases of assets by the Company are financed by a loan from the Bank Prior to 6 March 2009 and from 4 February 2010, drawings under this loan were financed through the issuance of Treasury bills and the Debt Management Office's cash management operations From 6 March 2009 to 4 February 2010, drawings under the loan were financed by the issuance of central bank reserves

At its February 2010 policy meeting, the MPC voted to maintain the stock of asset purchases financed by the issuance of central bank reserves at £200 billion The reasons for the Committee's decision are given in the minutes published on 17 February 2010 [3] Facilities for commercial paper, corporate bonds and secured commercial paper continued to be offered

The Bank publishes a quarterly report on the transactions of the Company, and information about the MPC's decisions can be found in the *Inflation Report* Both reports can be found on the Bank's website [4]

At 28 February 2010, total purchases net of sales and redemptions amounted to £200 billion During the course of the period gross purchases of gilts were £198 3 billion, commercial paper £8 0 billion and corporate bonds

(1) The Chancellor's statement is available at www hm-treasury gov uk/press_05_09 htm
(2) The exchange of letters is available at www hm-treasury gov uk/d/ck_letter_boe290109 pdf, www bankofengland co uk/monetarypolicy/pdf/govletter090305 pdf and www hm-treasury gov uk/d/chxletter_boe050309 pdf
(3) See www bankofengland co uk/monetarypolicy/decisions/decisions10 htm
(4) See www bankofengland co uk/publications/other/markets/apf/quarterlyreport htm for the *Asset Purchase Facility Quarterly Report* and www bankofengland co uk/publications/inflationreport/irlatest htm for the *Inflation Report*

£1 6 billion Gross redemptions in commercial paper during the period were £7 8 billion and gross sales in corporate bonds £0 1 billion

Risk management

The Company's operations are fully indemnified for loss by HM Treasury ('the Indemnity'), and any surplus from these operations after the deduction of fees, operating costs and any tax payable is due to HM Treasury As such, the Company is not exposed to financial risk, but manages the relevant risks on the underlying portfolio on HM Treasury's behalf

The Company operates within a control framework agreed with HM Treasury Subject to the policy objectives, the aim is to minimise overall risk through the appropriate choice of portfolio and risk management practices A set of high-level financial risk parameters is in place for the Company's operations, relating to eligible asset classes, investment limits, credit risk and counterparties

A Steering Group chaired jointly by the Directors meets on a frequent basis to review the operations of the Company, and board meetings are held quarterly In addition, an Asset Purchase Facility Corporate Risk Group, chaired by the Head of Risk Management Division of the Bank supports the monitoring and where appropriate active management of high-risk exposures, and directs the development of Asset Purchase Facility corporate credit risk policy

Financial results

The Company's financial statements for the period ended 28 February 2010 are given on pages 5–13 Debt securities showed a marked-to-market loss, largely due to a decline in the market value of the Company's gilt holdings, and £1 8 billion was due from HM Treasury under the Indemnity, leaving a nil profit Because of the Indemnity and any profit being due to HM Treasury, the Company will never show a profit or a loss

The balance sheet of the Company stood at £200 billion at 28 February 2010 The Company's principal liability was the loan from the Bank The fair value of the Company's holdings of securities was £194 5 billion, of which £192 8 billion represented gilts, £1 5 billion corporate bonds and £0 2 billion commercial paper The Company's cash holdings at the balance sheet date were £3 8 billion, representing primarily coupons received, and the amount due from HM Treasury under the Indemnity was £1 8 billion

It is important to note that fluctuations in the fair value of the Company's securities are entirely offset by the amount due to, or from, HM Treasury under the Indemnity, and therefore imply offsetting financial flows within the public sector as a whole Moreover, broader factors that are not included in the Company's accounts, including the fact that stimulation of economic activity resultant from the Company's activities will raise tax receipts, and the fact that the Company's purchases have lowered gilt yields below where they would otherwise be, thereby reducing the Government's funding costs, mean that these accounts cannot be used to draw implications for the overall impact on the public sector's financial position Further information on this can be found in a speech made by Charlie Bean, the Bank's Deputy Governor for Monetary Policy, in October 2009 [1]

Political and charitable contributions

The Company made no political or charitable donations or incurred any political expenditure during the year

Disclosure of information to auditors

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware, and each Director has taken all steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information

Statement of Directors' responsibilities in respect of the Directors' Report and the financial statements

The Directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations

Company law requires the Directors to prepare financial statements for each financial period Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and applicable law

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period In preparing these financial statements, the Directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether they have been prepared in accordance with IFRSs as adopted by the EU, and

(1) See 'Quantitative easing an interim report', available at www bankofengland co uk/publications/speeches/2009/speech405 pdf

- prepare the financial statements on the going-concern basis unless it is inappropriate to presume that the Company will continue in business

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006 They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Bank of England's website Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

Auditors

KPMG Audit Plc were appointed as Independent Auditor on 30 January 2009

By order of the board

P Fisher
Director

S Dale
Director

Independent Auditor's Report to the members of Bank of England Asset Purchase Facility Fund Limited

We have audited the financial statements of Bank of England Asset Purchase Facility Fund Limited ('the Company') for the period ended 28 February 2010 set out on pages 5–13 The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed

Respective responsibilities of directors and the auditor

As explained more fully in the Directors' Responsibilities Statement set out on pages 2–3, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (United Kingdom and Ireland) Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website, available at www frc org uk/apb/scope/UKNP

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 28 February 2010 and of its result attributable to equity holders for the period then ended,
- have been properly prepared in accordance with IFRSs as adopted by the EU, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial period for which the financial statements are prepared is consistent with the financial statements

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of Directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit

M StJ Ashley (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
8 Salisbury Square
London
EC4Y 8BB
30 June 2010

Statement of Comprehensive Income for the period to 28 February 2010

	Note	2010* £m
Interest received and similar income	4	8
Net interest income		8
Net loss from financial instruments at fair value	5	(2)
Total income		6
Administrative expenses	6	(6)
Profit before tax		–
Tax		–
Profit after tax and total comprehensive income attributable to equity shareholders		–

* Opening period runs from 30 January 2009 to 28 February 2010

Statement of Changes in Equity

The entire capital comprising 100 ordinary shares of £1 was issued, fully paid, to the Governor and Company of the Bank of England on 30 January 2009 There were no other changes in equity during the period

The notes on pages 8 to 13 are an integral part of these financial statements

Balance Sheet as at 28 February 2010

	Note	2010 £m
Current assets		
Cash	7	3,761
Due from HM Treasury under Indemnity	8	1,752
Debt securities	9	194,481
Other assets	10	7
Total assets		**200,001**
Current liabilities		
Loans and other borrowings	11	200,000
Other liabilities	12	1
Total liabilities		**200,001**
Equity		
Capital	13	–
Retained earnings		-
Total equity attributable to shareholders		–
		200,001

The financial statements on pages 5 to 7 were approved by the board on 30 June 2010 and signed on its behalf by

P Fisher
Director

S Dale
Director

The notes on pages 8 to 13 are an integral part of these financial statements

Statement of Cash Flows for the period to 28 February 2010

	Note	2010 £m
Profit after tax and Indemnity		–
Adjustments		
Interest income	4	(8)
Changes in operating assets and liabilities		
Due from HM Treasury	8	(1,752)
Debt securities	9	(194,301)
Interest received		7
Other assets		(6)
Other liabilities		1
		(196,051)
Net cash from operating activities		**(196,059)**
Cash flows from financing activities		
Share capital		–
Loans and other borrowings		200,000
Net cash from financing activities		**200,000**
Net increase in cash and cash equivalents	14	**3,941**

The notes on pages 8 to 13 are an integral part of these financial statements

Notes to the Financial Statements

1 Bases of preparation

Form of presentation of the financial statements

The financial statements comprise the Statement of Comprehensive Income, the Balance Sheet, the Statement of Cash Flows, Statement of Changes in Equity and related notes

This is the Company's first set of annual accounts and runs for a 13-month period There are no comparative numbers

The Company's financial statements have been prepared and approved by the Directors in accordance with requirements of International Financial Reporting Standards (IFRSs) and interpretations of International Financial Reporting Interpretations Committee as adopted by the EU (together, 'adopted IFRS')

The financial accounts have been prepared on the going-concern basis, under the historical cost convention, as modified to include the revaluation of financial assets and liabilities that are held at fair value through profit or loss and in accordance with the Companies Act 2006 and applicable accounting standards

The principal accounting policies applied in the preparation of the financial statements are set out below These policies have been consistently applied

There were no new standards in the year which were both relevant to the Company and available for early adoption

2 Accounting policies

The following principal accounting policies have been applied consistently in the preparation of the financial statements

a) Functional and presentational currency

The financial statements are presented in sterling, which is the Company's functional and presentational currency

b) Financial instruments financial assets and liabilities designated at fair value through the profit or loss

i) Classification

The Company designates certain assets and liabilities at fair value through profit or loss to eliminate or significantly reduce the accounting mismatch that would otherwise arise from measuring financial assets and liabilities, or recognising gains or losses on them in the profit and loss account, on different bases Such assets and liabilities are debt securities, the Indemnity and loans and other borrowings The fair value designation is made on initial recognition and is irrevocable

ii) Initial recognition of financial instruments

Financial instruments are initially recognised at fair value through, and transaction costs are immediately recognised in, profit or loss Financial instruments are recognised/(derecognised) on the date the Company commits to purchase (sell) the instrument (trade date accounting)

iii) Subsequent measurement

Gains and losses arising from changes in the fair value of assets classified as at fair value through profit or loss are included in the Statement of Comprehensive Income in the period in which they arise

The fair values of quoted investments in active markets are based on current bid prices In other cases, the Bank establishes fair value by using appropriate valuation techniques The policy for establishing fair values of securities in non-active markets is described in note 3 'Significant accounting estimates and judgements in applying accounting policies' below

c) HM Treasury Indemnity

The Company's operations are fully indemnified for loss by HM Treasury, and any surplus from these operations, after deduction of fees, operating costs and any tax payable is due to HM Treasury This arrangement is accounted for as a derivative under IAS 39 as it contains contractual obligations and rights as regards to the transfer of cash at a future date and the value changes in respect of the underlying assets and liabilities of the Company As such, the Indemnity is fair valued on the basis of the difference between the fair value of the Company's assets and liabilities

d) Cash and cash equivalents

For the purposes of the Statement of Cash Flows, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, consisting of cash and commercial paper

e) Equity capital

The entire equity capital comprising 100 £1 ordinary shares is held by the Governor and Company of the Bank of England

3 Significant accounting estimates and judgements in applying accounting policies

The Company makes estimates and assumptions that affect the reported amounts of assets within the financial statements Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances

a) Fair value in non-active markets

Where possible, the Company uses a market price to value securities Where no such market price exists, the Company uses a model designed to deliver a price that is as close as possible to what a market price would be had such a price existed Back-testing has been carried out to validate model-based prices Pricing, the use of spreads in models and collateral are under regular review (see note 16)

4 Interest received and similar income

	2010 £m
On cash	**8**

5 Net loss from financial instruments at fair value

	2010 £m
Net loss on changes in fair value from financial instruments	**(2)**

6 Administrative expenses

	2010 £m
Management fee payable to Bank of England	**(6)**

All staff costs are contained within the management fee charged by the Bank of England

The Directors have not received any emoluments in respect of their services to the Company during the period ended 28 February 2010

	2010 £000
Audit fees for the statutory audit	
Fees relating to current year	55
Fees payable for other services	
Tax services	42

7 Cash

	2010 £m
Balance with the Bank of England	**3,761**

8 Due from HM Treasury under Indemnity

	2010 £m
Due from HM Treasury under Indemnity	**1,752**

An Indemnity has been given by HM Treasury against any loss incurred by the Company and any profit made by the Company will be passed to HM Treasury The Indemnity is valued on a marked-to-market basis (see note 2(c))

9 Debt securities

	2010 £m
Commercial paper	180
Gilts	192,768
Other debt securities	1,533
Total debt securities	**194,481**

At 28 February 2010 securities held at fair value through profit or loss included cash and cash equivalents of £180 million

As at 28 February 2010 gilts with a fair value of £3 9 billion were lent (see note 17)

10 Other assets

	2010 £m
Accrued interest	1
Items in course of settlement	6
Total other assets	**7**

11 Loans and other borrowings

	2010 £m
Loan from Bank of England	**200,000**

12 Other liabilities

	2010 £m
Accrued expense	**1**

13 Capital

The entire capital comprising of 100 authorised, issued and fully paid ordinary shares of £1 is held by the Governor and Company of the Bank of England

In view of the Indemnity from HM Treasury, the Company requires only nominal capital

14 Cash and cash equivalents

	Note	At 30 January 2009 £m	Cash flow £m	At 28 February 2010 £m
Cash	7	–	3,761	3,761
Debt securities	9	–	180	180
Total cash and cash equivalents		**–**	**3,941**	**3,941**

15 Contingent liabilities
There were no contingent liabilities as at 28 February 2010

16 Financial risk management
The Company's operations are fully indemnified for loss by HM Treasury, and any surplus for these operations, after deduction of fees, operating costs and any tax payable, is due to HM Treasury As such, the Company is not exposed to financial risk, but manages credit risk and monitors market risk on HM Treasury's behalf The Company does not face liquidity risk

The governance arrangements to manage and monitor these risks are described in a control framework document (which sets out the controls and procedures for undertaking transactions, monitoring risk, accounting and making payments), reviewed and approved annually by the Directors There is also a set of high-level risk standards applying to the Company agreed between HM Treasury and the Bank

The Company's management seek to ensure that effective risk management processes exist for monitoring and managing risk, within clear risk policies The Bank of England's Risk Management Division within the Markets Directorate is responsible for the development of the appropriate framework, and articulation of appetite, for the management and monitoring of financial risks The Market Strategy and Risk Operations Division of the Bank is responsible for the implementation of the agreed risk framework, including reporting on credit, market and liquidity risk

a) Credit risk
Credit risk is the risk of loss arising from the failure of a counterparty or issuer to meet its financial obligations to the Company Credit risk in the Company's asset portfolio arises as a result of purchasing debt security instruments issued by the UK Government and investment-grade companies

The Company's credit risk polices are those defined by the Bank The Bank defines high-level credit risk parameters under which credit risk is monitored and controlled Credit exposures to companies are controlled by a system of limits

The table below represents an analysis of debt securities and commercial paper by credit risk groupings, based on external rating agency designation or equivalent at 28 February 2010

Credit risk groupings of debt securities

	Gilts £m	Corporate £m
AAA	192,768	–
AA	–	120
A	–	608
BBB	–	805
Total	**192,768**	**1,533**

	Commercial paper £m
A2/P2/F2	155
A3/P3/F3	25
Total	**180**

Sector concentration of assets

	Government £m	Corporate £m
Debt securities		
Bonds	192,768	1,533
Commercial paper	-	180
As at 28 February 2010	**192,768**	**1,713**

b) Market risk

Market risk is defined as the risk of loss as a result of changes in market risk factors These include interest rates, foreign exchange rates, commodity prices and credit spreads Market risk in the Company's asset portfolio arises as a natural consequence of its policy objectives, principally through the repricing of its assets as a result of changes in market interest rates

The Company monitors interest rate risk in the form of 'delta', which is the change in valuation from a 1 basis point increase in market interest rates The delta at 28 February 2010 was £177 million

The Company also undertakes stress tests on the Company's operations, the results of which are reported to management alongside the delta measure

c) Liquidity risk

Liquidity risk is the risk of encountering difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset The Company does not face liquidity risk Upon receipt of notification of the Company's intention to draw down under the loan, the Bank of England is required to make the advance, provided that the request is within authorised limits The Bank may only obtain repayment with the agreement of the Company The loan is ultimately repayable on termination of the Company's operations

d) Fair value

The table below shows financial instruments carried at fair value by valuation method

	Level 1 £m	Level 2 £m	Total £m
Assets			
Due from HM Treasury under Indemnity	-	1,752	**1,752**
Debt securities	194,301	180	**194,481**
Liabilities			
Loans and borrowings	–	200,000	**200,000**

Level 1 Valued using unadjusted quoted prices in active markets for identical financial instruments

Level 2 Valued using techniques where all the inputs that have a significant impact on the valuation are based on observable market data These categories of instrument comprise commercial paper, discounted using the overnight index swap curve plus a credit spread, the Indemnity from HM Treasury, calculated as the difference between the fair value of the assets and liabilities of the Company, and the loan from the Bank of England to the Company, effectively discounted at Bank Rate

In the balance sheet the carrying value of cash, other assets and other liabilities approximates to the fair value

17 Related party transactions

The Company has related party transactions with its shareholder, the Bank of England, and other related parties

The Bank of England

As at 28 February 2010 the Company had borrowed £200 billion Interest on this loan amounted to £626 4 million

In the period £6 million administrative fees were charged by the Bank of England

HM Treasury

HM Treasury has indemnified the Company against any losses it may incur in connection with its operations Any surplus from these operations after the deduction of fees, and any tax payable is due to HM Treasury

Debt Management Office (DMO)

In the latter part of the period the Company commenced the lending overnight of a small proportion of its gilts portfolio to the DMO As at 28 February 2010 the outstanding fair value of gilts lent by the Company for use by the DMO to on lend through their normal repo market activities was £3 9 billion The Company earned a fee for these transactions of less than £0 1 million during the period

Other related parties

As part of the asset purchase scheme, the Company has purchased assets in a competitive process from commercial banks in their capacity as market makers For the period ended 28 February 2010, management estimate that 11% of the Company's purchases of assets were made from market makers that were partly owned by the UK Government These transactions were conducted in the ordinary course of the Company's business on terms comparable to those with other entities that were not government related

Key management

The Directors of the Company are considered to be the only key personnel as defined by IAS 24 The Directors have not received any emoluments in respect of their services to the Company during the period ended 28 February 2010

Bank of England Asset Purchase Facility Fund Limited
8 Lothbury
London
EC2R 8AH

Company Number 06806063

ISSN 2041-1936 (online)