Bank of England Asset Purchase Facility Fund Limited Annual Report and Accounts

1 March 2016–28 February 2017

BANK OF ENGLAND

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Contents

Directors' Report for the year ended 28 February 2017

The Directors present their report and the audited financial statements of the Bank of England Asset Purchase Facility Fund Limited ('the Company') for the year ended 28 February 2017.

Business review and principal activity

The Company was established as a wholly-owned subsidiary of 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 Her Majesty's Treasury (HM Treasury) websites.(2)

The Company is fully indemnified by HM Treasury: that is, any financial losses as a result of the asset purchases are borne by HM Treasury, and any gains are owed to HM Treasury. Initially, it was envisaged that payments due under the indemnity would be settled when the asset purchase scheme ended. But as the scale and likely duration of the scheme increased, on 9 November 2012 it was agreed that the Company would transfer the expected cash balance at 31 March 2013 as partial settlement of the Indemnity to HM Treasury over a nine-month period, commencing January 2013. The total amount transferred under this arrangement was £34.7 billion.

A process was also established for quarterly cash transfers for cash accumulated from 1 April 2013. The first of these payments was made on 26 July 2013 and the total amount transferred under this arrangement was £37.3 billion as at 28 February 2017. The quarterly cash transfer arrangement applies to both transfers from the Company to HM Treasury, and from HM Treasury to the Company should cash shortfalls in the Company arise at some point in the future.(3)

This arrangement has allowed the Government to manage its cash more efficiently in line with standard cash management processes, and is also in line with the practices of the US Federal Reserve and the Bank of Japan.(4)

Directors

The Bank's Chief Economist and Executive Director for Monetary Analysis and Statistics, and the Executive Director for Markets were Directors of the Company during the year:

Andy Haldane
Chris Salmon

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. As determined by the Directors, the annual report and accounts have been reviewed by the Audit and Risk Committee of the Bank.

Risk management

The Company's operations are fully indemnified by HM Treasury and in return any surplus from these operations after the deduction of fees, operating costs and any tax payable are 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.

Board meetings chaired by Chris Salmon are held quarterly.

Political contributions

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

(1) The Chancellor's statement is available at http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/press_05_09.htm.
(2) The exchange of letters is available at http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/ck_letter_boe290109.pdf; www.bankofengland.co.uk/monetarypolicy/pdf/govletter090305.pdf; and http://webarchive.nationalarchives.gov.uk/20100408190827/http://www.hm-treasury.gov.uk/d/chxletter_boe050309.pdf.
(3) See 'The profile of cash transfers between the Asset Purchase Facility and Her Majesty's Treasury', *Bank of England Quarterly Bulletin*, Vol. 53, No. 1, pages 29–37, available at www.bankofengland.co.uk/publications/Pages/quarterlybulletin/2013/f13.aspx.
(4) The exchange of letters is available at www.bankofengland.co.uk/monetarypolicy/Documents/pdf/govletter121109.pdf and www.hm-treasury.gov.uk/d/chx_letter_091112.pdf.

Dividend policy

As a result of the Indemnity agreement, all profits and losses are passed onto HM Treasury. As a result there is no specific dividend policy required.

Disclosure of information to the Auditor

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 Auditor is unaware; and each director has taken all the 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 Auditor is aware of that information.

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

The Directors are responsible for preparing the Strategic Report, 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 year. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRS) 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 IFRS as adopted by the EU; and
- 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.

By order of the board

A Haldane Director	C Salmon Director

29 June 2017

Strategic Report for the year ended 28 February 2017

Review of 2016/17

During the year, lending and additional asset purchases were undertaken by the Company.

Specifically, on 4 August 2016, the Monetary Policy Committee (MPC) voted to introduce a package of measures to support the UK economy. A Term Funding Scheme (TFS) was introduced by the Company to provide term funding to banks at rates close to Bank Rate, with the aim of reinforcing the transmission of Bank Rate cuts to those interest rates actually faced by households and businesses in the United Kingdom. Lending under the TFS is financed by the creation of central bank reserves and borrowing by counterparties is collateralised. A new Corporate Bond Purchase Scheme (CBPS) was set up by the Company to purchase high-quality private sector assets, financed by the creation of central bank reserves. The CBPS may buy up to £10 billion worth of sterling-denominated bonds of firms making a material contribution to the UK economy. Also, the Company increased the target for the stock of purchases of gilts, financed by the creation of central bank reserves, by £60 billion to £435 billion. These actions were intended to boost the supply of money and credit in order to raise the rate of growth of nominal spending to a level consistent with meeting the inflation target in the medium term.

Purchases to implement the MPC's decision to increase the stock of gilts held by the Company to £435 billion started on 8 August 2016. During the year, there were two gilt redemptions, the cash flows associated with which were reinvested. At 28 February 2017, the total amount of gilts purchased, less redemptions, valued at initial purchase price was £431.9 billion (operations to increase this to £435 billion concluded on 13 March 2017).

The drawdown window for the TFS opened on 19 September 2016. The total amount of loans made through the TFS since the drawdown window opened, until 28 February 2017, less repayments, was £42.3 billion.

CBPS purchases began on 27 September 2016. Since the first CBPS operation until 28 February 2017, the sum of corporate bonds purchased, less redemptions, valued at initial purchase price, was £7.7 billion. On 27 April 2017, the Bank announced that it had completed the operations necessary to achieve the current target for corporate bond purchases totalling £10 billion.

Since the inception of the Company until 28 February 2017, total purchases of gilts and eligible corporate bonds, net of redemptions and sales, valued at initial purchase price, and the total amount lent under the TFS net of repayments, was £481.9 billion.

The Company has also previously purchased private sector assets to help improve liquidity in credit markets that are not functioning normally, namely, through the Commercial Paper Facility[1] (CPF), the Secured Commercial Paper Facility[2] (SCPF) and the Corporate Bond Secondary Market Scheme[3] (CBSMS). The CPF was closed on 15 November 2011. In 2013, the CBSMS was moved to operating only if warranted by market demand. There was no indication of such demand in the intervening period and, with the introduction of the CBPS, the CBSMS was closed on 4 August 2016. The SCPF had not been used since 2011 and so was also formally closed on 4 August 2016.

The Company completed a review of its control framework during the year to ensure that it continues to manage risk appropriately in conjunction with implementation of the new package of measures.

At 28 February 2017 partial settlement of the indemnity totalling £72.0 billion had been paid over to HM Treasury.

Financial results

The Company's financial statements for the year ended 28 February 2017 are provided on pages 9–20. Debt securities showed a marked-to-market gain, attributable to an increase in the market value of the Company's gilt holdings. This was offset by an increase in the amount due to HM Treasury under the indemnity. Because of the Indemnity, the Company will never show an overall profit or a loss.

The balance sheet of the Company totalled £536.5 billion at 28 February 2017 (2016: £414.7 billion). The Company's principal liability was the loan from the Bank of England of £485.2 billion (2016: £375.3 billion), the remaining liability representing the net amount payable to HM Treasury under the Indemnity of £50.3 billion (2016: £39.3 billion). The fair value of the Company's holdings of securities was £488.0 billion (2016: £413.3 billion), of which £480.2 billion represented gilts and £7.8 billion represented corporate bonds (2016: £413.3 billion represented gilts, £nil represented corporate bonds). The fair value of TFS loans issued was £42.3 billion (2016: £nil). The Company's cash holdings at the balance sheet date were £6.2 billion (2016: £1.3 billion), primarily representing coupon income received, net of transfers to HM Treasury.

(1) For more details see www.bankofengland.co.uk/markets/apf/cp/index.htm.
(2) For more details see www.bankofengland.co.uk/markets/apf/securedcpf/index.htm.
(3) For more details see www.bankofengland.co.uk/markets/apf/corporatebond/index.htm.

The Company's accounts do not provide a meaningful guide to the overall impact of its purchases on the public finances. The amount due to or from HM Treasury under the Indemnity does not indicate whether the public sector as a whole made a profit or loss from the Company's asset purchases and lending. The bulk of assets held by the Company are gilts and are liabilities of the broader public sector. The impact on the public sector as a whole of any change in the market value of the gilts held by the Company is matched by changes in the market value of those gilts on the liability side of the public sector balance sheet.(1)

Further information on the broader impact of quantitative easing on the economy and the public finances can be found in Charlie Bean's 2009 speech(2), a 2016 Bank Working Paper(3) co-authored by Andy Haldane, and Ben Broadbent's letter to the Treasury Select Committee in March 2017.(4)

By order of the board

A Haldane
Director

C Salmon
Director

29 June 2017

(1) The corresponding debt liabilities in the public accounts have not been marked to market.
(2) Bean, C (2009), 'Quantitative easing: an interim report'; www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2009/speech405.pdf.
(3) Haldane, A, Roberts-Sklar, M, Wieladek, T and Young, C (2016), 'QE: the story so far', *Bank of England Staff Working Paper No. 624*; www.bankofengland.co.uk/research/Pages/workingpapers/2016/swp624.aspx.
(4) www.parliament.uk/documents/commons-committees/treasury/Correspondence/Ben-Broadbent-BoE-post-2008-UK-monetary-policy-6-4-17.pdf.

The Certificate and Report of the Comptroller and Auditor General to the Houses of Parliament

I certify that I have audited the financial statements of the Bank of England Asset Purchase Facility Fund Limited for the year ended 28 February 2017 under the Bank of England Act 1998. The financial statements comprise the Statement of Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity, Statement of Cash Flows and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as adopted by the European Union.

Respective responsibilities of the directors and the auditor

As explained more fully in the Statement of Directors' responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with the Bank of England Act 1998. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition I read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament, and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Opinion on regularity

In my opinion, in all material respects the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Opinion on financial statements

In my opinion:

- the financial statements give a true and fair view of the state of the company's affairs as at 28 February 2017 and of the result for the year then ended; and
- the financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and
- the financial statements have been prepared in accordance with the Companies Act 2006 and HM Treasury directions issued under the Bank of England Act 1998.

Opinion on other matters

In my opinion:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements and these reports have been prepared in accordance with the applicable legal requirements; and
- in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, I have not identified any material misstatements in the Strategic Report or the Directors' Report.

Matters on which I report by exception

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- adequate accounting records have not been kept or returns adequate for my audit have not been received from branches not visited by my staff; or
- the financial statements are not in agreement with the accounting records and returns; or
- I have not received all of the information and explanations I require for my audit.

Report

I have no observations to make on these financial statements.

Sir Amyas C E Morse 3 July 2017
Comptroller and Auditor General

National Audit Office
157–197 Buckingham Palace Road, Victoria, London, SW1W 9SP

Statement of comprehensive income for the year to 28 February 2017

	Note	2017 £m	2016 £m
Interest received		14	18
Net gains/(losses) on financial instruments		8,408	6,652
Coupon income received on financial instruments		14,274	14,032
Fee income received on TFS		17	–
Total Income		**22,713**	**20,702**
Interest paid on the loan from the Bank of England		(1,410)	(1,881)
Administrative expenses	4	(4)	(2)
Net indemnity for the year due (to)/from HM Treasury	8	(21,299)	(18,819)
Total Expenses		**(22,713)**	**(20,702)**
Profit before taxation		–	–
Taxation		–	–
Profit after tax and total comprehensive income attributable to equity shareholder		–	–

Statement of other comprehensive income for the year to 28 February 2017

There were no items of other comprehensive income during the year ended 28 February 2017 (2016: £nil).

The notes on pages 13–20 are an integral part of these financial statements.

Statement of financial position as at 28 February 2017

	Note	2017 £m	2016 £m
Assets			
Cash	11	6,217	1,322
Debt securities	5	487,965	413,346
TFS loans	6	42,267	–
Other assets		2	–
Total assets		**536,451**	**414,668**
Liabilities			
Loans and other borrowings	7	485,238	375,326
Due to HM Treasury under Indemnity	8	50,325	39,342
Other liabilities	9	888	–
Total liabilities		**536,451**	**414,668**
Equity			
Capital	10	–	–
Retained earnings		–	–
Total equity attributable to shareholders		–	–
Total liabilities and equity attributable to shareholders		**536,451**	**414,668**

The financial statements were approved by the board on 29 June 2017 and signed on its behalf by:

A Haldane
Director

C Salmon
Director

Company number: 06806063

The Company is exempt from the requirements of Part 16 of the Companies Act 2006.

The notes on pages 13–20 are an integral part of these financial statements.

Statement of changes in equity for the year to 28 February 2017

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

The notes on pages 13–20 are an integral part of these financial statements.

Statement of cash flows for the year to 28 February 2017

	Note	2017 £m	2016 £m
Cash flows from operating activities			
Profit after tax and indemnity		–	–
Adjustments for:			
Interest income		(14)	(18)
Interest on Bank of England loan		1,410	1,881
		1,396	1,863
Changes in operating assets and liabilities			
Increase/(decrease) in amount due to HM Treasury		10,983	10,291
(Increase)/decrease in value of debt securities		(74,619)	(10,164)
(Increase)/decrease in value of TFS loans		(42,267)	–
(Increase)/decrease in other assets		(2)	
(Increase)/decrease in other liabilities		888	–
Cash generated from operations		(103,621)	1,990
Interest received		14	18
Net cash from operating activities		**(103,607)**	**2,008**
Cash flows from financing activities			
Loans and other borrowings	7	109,912	10
Interest expense		(1,410)	(1,881)
Net cash from financing activities		**108,502**	**(1,871)**
Net increase/(decrease) in cash and cash equivalents	11	**4,895**	**137**
Cash and cash equivalents at 1 March	11	1,322	1,185
Cash and cash equivalents at 28 February	11	**6,217**	**1,322**

The notes on pages 13–20 are an integral part of these financial statements.

Notes to the financial statements

1 Basis of preparation

Form of presentation of the financial statements

The financial statements comprise the Statement of Comprehensive Income, Statement of Financial Position, the Statement of Cash Flows, Statement of Changes in Equity and related notes.

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

The financial accounts have been prepared on a 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.

2 Accounting policies

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

In addition the Company has considered the potential effect of forthcoming EU-adopted standards which have not been adopted in the financial statements; none of these are expected to materially impact the Company.

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, loans made under TFS, 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, and transaction costs are immediately recognised in profit or loss. Financial securities are recognised/derecognised on the date the Company commits to purchase/sell the instrument (trade date accounting). The loan from the Bank of England is recognised on a settlement date basis.

Fair value is deemed to be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

iii) Subsequent measurement

Gains and losses arising from changes in the fair value of assets classified 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 and loans made under the TFS 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 in return 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 financial instrument 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 valued on the basis of the difference between the fair value of the Company's assets and liabilities.

Following the alteration to the Indemnity agreement in November 2012, a process for partial settlement of the indemnity between the Company and HM Treasury was established. The Indemnity is presented after giving effect to payments made or received.

d) Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise cash balances with less than three months' maturity from the date of acquisition.

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.

Fair value of TFS loans

Loans made by the Company through the TFS are valued on present value methodology, using expected future cash flows, and discounted using Bank Rate to provide a net present value. The discount rate adopted is deemed appropriate as it represents the funding cost to the Company of providing the loans. The deviation away from using a 'market implied rate' is justified as TFS loans are unique in their nature, provided at an indiscriminate rate to achieve the policies set by the Bank of England in its function as a central bank. As such there is not an equivalent product or market with which to compare to.

All participants that drawdown on TFS will be assessed at the end of the reference period against their level of net lending. Based on the outcome of this assessment, an additional Scheme fee over Bank Rate may be applied to the cost of the loan. This additional Scheme fee has not been factored into the valuation.

Fair value in non-active markets

Where possible, the Company uses a market price to value securities. In relation to the Indemnity, the instrument is valued on the basis of the difference between the fair value of the Company's assets and liabilities which is the amount due under the indemnity.

4 Administrative expenses

	2017 £m	2016 £m
Management fee payable to Bank of England	(4)	(2)

The Bank of England meets all of the costs of the Company, including staff costs, and recharges it in full. The Directors have not received any emoluments in respect of their services to the Company during the year ended 28 February 2017 (2016: £nil).

	2017 £000	2016 £000
Audit fees		
Fees relating to current year	30	30
Fees payable for other services		
Other fees	–	–

Fees in relation to audit services fees are paid for by the Bank of England and recharged to the company through the management fee.

5 Debt securities

	2017 £m	2016 £m
Gilts	480,161	413,346
Corporate bonds	7,804	–
Total debt securities	**487,965**	413,346

As at 28 February 2017 gilts with a fair value of £0.6 billion were lent to the Debt Management Office (2016: £0.6 billion) (see note 14).

The CBPS was set up to purchase high-quality private sector assets financed by the creation of central bank reserves. The CBPS may buy up to £10 billion worth of sterling-denominated bonds issued by companies (including their finance subsidiaries) where the company makes a material contribution to economic activity in the United Kingdom.

The Company considers a number of factors in making its eligibility decisions. Companies with significant employment in the United Kingdom or with their headquarters in the United Kingdom will normally be regarded as meeting this requirement, but the Company will also consider whether the company generates significant revenues in the United Kingdom, serves a large number of customers in the United Kingdom or has a number of operating sites in the United Kingdom.

6 TFS loans

	2017 £m	2016 £m
TFS loans	**42,267**	–

TFS loans are cash loans made to eligible participants financed by the issuance of central bank reserves, secured against eligible collateral. The term of each loan is four years; participants can terminate, in part or in full, before the maturity date. Participants are charged interest on the loans equal to Bank Rate plus a Scheme fee. The fee will be determined based on the net lending of each participant over the reference period of the scheme. This fee will range from 0 basis points to 25 basis points.[1]

7 Loans and other borrowings

	2017 £m	2016 £m
Total loan from Bank of England	**485,238**	375,326

BEAPFF will commence full or partial repayment of the loan from the Bank of England at such time as the Bank's MPC votes to begin an unwind of the quantitative easing programme. Interest charges on the loan are accrued and paid to the Bank of England on each scheduled MPC meeting date.

(1) For more details see Asset Purchase Facility: Term Funding Scheme Market Notice, available at www.bankofengland.co.uk/markets/Documents/marketnotice160804apftfs.pdf.

8 Due to HM Treasury under Indemnity

	2017 £m	2016 £m
Net due to HM Treasury under indemnity 1 March	39,342	29,051
Change in fair value of indemnity	21,299	18,819
Cash paid to HM Treasury	(10,316)	(8,528)
Net due to HM Treasury under Indemnity 28 February	**50,325**	39,342

An Indemnity has been provided 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 Other liabilities

	2017 £m	2016 £m
Accrued expense	2	–
Security purchases in course of settlement	886	–
Total other liabilities	**888**	–

Security purchases in course of collection relates to debt securities purchased in the year but not settled as at 28 February 2017. These purchases settled on 1 March 2017.

10 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.

11 Cash and cash equivalents

	As at 29 February 2016 £m	Cash flow £m	**As at 28 February 2017 £m**
Cash	1,322	4,895	**6,217**

12 Contingent liabilities

There were no contingent liabilities as at 28 February 2017 (2016: £nil).

13 Financial risk management

The Company's operations are fully indemnified for loss by HM Treasury, and any surplus/deficit for these operations after deduction of fees, operating costs and any tax payable are due to/from 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 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. Specialist teams and committees support senior management in ensuring that agreed standards and policies are followed.

The Financial Risk Management Division (FRMD) within the Bank's Markets Directorate is responsible for analysing the financial risks faced by the Bank in its operations in financial markets.

The Financial Risk and Resilience Division (FRRD) is responsible for challenge of risk decisions and risk management frameworks.

Middle Office is responsible for the pricing, valuation and financial control of exposures and collateral positions arising from the Bank's market operations, including counterparty and instrument management.

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 or lending to counterparties via the TFS.

The Company's credit risk policies are those defined by the Bank within the arrangements agreed with HM Treasury. 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. Credit assessments are performed on all market counterparties, issuers and customers to whom and Company is exposed. These are performed both regularly, following a timetable that reflects the risk of the actual or potential exposure, and dynamically, in response to market or specific entity conditions.

The Bank's internal committees, chaired by the Head of FRMD, review the creditworthiness of issuers, counterparties and customers to whom the Bank and company may have credit exposures. The Bank's internal committees are supported by a credit risk analysis team.

The table below represents an analysis of debt securities and TFS loans by credit risk groupings, based on external rating agency designation(1) at 28 February 2017 with prior year comparatives:

Credit risk groupings of debt securities and TFS loans

	2017 £m	2016 £m
AAA	47	–
AA	480,724	413,346
A	22,749	–
BBB	21,386	–
BB	–	–
B	204	–
Not quoted	5,122	–
Total	**530,232**	413,346

Not all TFS counterparties are quoted by external rating agencies. The credit risk for TFS is managed by ensuring that exposures are fully collateralised (with appropriate haircuts) by a wide range of private and public sector collateral.

(1) Analysis of external credit ratings as at 28 February 2017 of the company's debt securities and TFS loans by credit risk groupings, these ratings are based on the average of several market providers.

The table below shows the geographical concentration of the company's assets:

Location — Geographical concentration of assets

	2017 £m	2016 £m
United Kingdom	527,005	413,346
Rest of Europe	2,189	–
Other	1,038	–
Total	**530,232**	413,346

Assets categorised outside of the United Kingdom are held in the CBPS scheme and meet the required eligibility criteria. See note 5 for additional information on CBPS eligibility criteria.

Under the CBPS the Company has looked to ensure purchases are representative of eligible issuance at a sector level, in order to impart broader economic stimulus. It has established an internal framework to aid portfolio diversification among corporate sectors, single name issuers and issuance. The table below shows the sector concentration of these assets:

Corporate bond — Sector concentration of assets

	2017		2016	
	£m	Per cent	£m	Per cent
Communications	985	12	–	–
Consumer, cyclical	845	11	–	–
Consumer, non-cyclical	1,241	16	–	–
Electricity	1,635	21	–	–
Energy	207	3	–	–
Gas	550	7	–	–
Industrial and transport	1,021	13	–	–
Property and finance	339	4	–	–
Water	981	13	–	–
Total	**7,804**	**100**	–	–

Collateral management

In providing liquidity via TFS, credit risk is managed by ensuring that exposures are fully collateralised (with appropriate haircuts) by a wide range of collateral. The collateral can include mortgage-backed securities, covered bonds backed by mortgages or public sector securities, or portfolios of loans in unsecuritised form. The collateral must meet published eligibility criteria. A summary of eligible collateral can be found on the Bank's website.

The Company manages the risk in this collateral portfolio by applying haircuts to take account of all material risks to the realisable value of the collateral. Where appropriate the Company undertakes stress testing of collateral in order to ensure that haircuts are sufficient to protect against idiosyncratic risk in the underlying collateral pool and counterparty risk. The Company may vary haircuts at its discretion, including on individual securities.

A Collateral Risk Committee chaired by the Head of FRMD reviews issues relating to the full range of collateral and considers policy issues relating to stress testing, valuation and eligibility of collateral including in response to market or entity-specific conditions. It also reviews eligibility of a counterparty to pledge portfolios of loans as collateral, based on an assessment of the firm's risk management policies, and also reviews eligibility of individual portfolios.

Models used for calculating haircuts are designed by FRMD, then independently reviewed and validated by the FRRD.

b) Market risk

Market risk is defined as the risk of loss as a result of changes in market conditions, including changes to 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 2017 was £506.3 million (2016: £412.1 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 loan is ultimately repayable on termination of the Company's operations.

d) Other financial risk

The company has a £485.2 billion (2016: £375.3 billion) loan from the Bank. A 1 basis point increase in Bank Rate would increase the funding cost by £48.5 million (2016: £37.5 million) per annum.

e) Fair value

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

As at 28 February 2017

	Note	Level 1 £m	Level 2 £m	Total £m
Asset				
Debt securities	5	487,965	–	**487,965**
TFS loans	6	–	42,267	**42,267**
Liabilities				
Loans and borrowings	7	–	485,238	**485,238**
Due to HM Treasury under indemnity	8	–	50,325	**50,325**

As at 29 February 2016

	Note	Level 1 £m	Level 2 £m	Total £m
Asset				
Debt securities	5	413,346	–	**413,346**
Liabilities				
Loans and borrowings	7	–	375,326	**375,326**
Due to HM Treasury under indemnity	8	–	39,342	**39,342**

There have been no transfers between levels in the year.

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

Level 2: The categories of instruments comprise: the Indemnity to/(from) HM Treasury, calculated as the difference between the fair value of the assets and liabilities of the Company, the loan from the Bank of England to the Company and TFS loans issued to counterparties.

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

14 Collateral

At 28 February 2017 the Company held securities with a fair value of £0.6 billion (2016: £0.6 billion) as collateral for gilts lent by the Company to the Debt Management Office through the Debt Management Account with a notional value of £0.6 billion (2016: £0.6 billion). This lending is performed as part of the normal course of business of the Company and within the agreed scheme framework.

The Company held eligible collateral with a notional value of £83.5 billion (2016: £nil), as collateral for cash lent under the Term Funding Scheme with a face value of £42.3 billion.

BEAPFF has not sold any of these assets to third parties but, subject to applicable law and regulations, is entitled to do so.

15 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 2017 the Company had borrowed £485.2 billion (2016: £375.3 billion). Interest on this loan amounted to £1.4 billion (2016: £1.9 billion).

The Company was charged an administrative fee of £4.0 million (2016: £2.0 million) 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. During the year £10.3 billion (2016: £8.5 billion) was transferred to HM Treasury as partial settlement of the indemnity in accordance with the altered Indemnity agreement (see note 2(c)).

Debt Management Office and Debt Management Account (DMA)

During the year the Company lent overnight a small proportion of its gilts portfolio to the DMO through the DMA. The position at 28 February 2017 is shown in note 5.

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. 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 year ended 28 February 2017 (2016: £nil). The Directors have received emoluments from the parent company, the Bank of England, a portion of which is recharged to the Company in respect of their services provided to the Company.

16 Ultimate parent company

The ultimate parent company of BEAPFF Limited is HM Treasury.

17 Events after the balance sheet date

There were no events that had a material effect on the accounts after the end of the reporting period.

18 Preparation of accounts

The accounts were approved for distribution on 3 July 2017.

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