HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

4 February 2010

The Rt Hon John McFall MP
Chairman
Treasury Select Committee
House of Commons
London
SW1A 0AA

Dear John

ASSET PURCHASE FACILITY

At its meeting today the MPC voted to maintain the stock of asset purchases financed by the issuance of central bank reserves unchanged at £200 billion. The Asset Purchase Facility already includes facilities for commercial paper, corporate bonds, and secured commercial paper. These facilities will continue to be offered. However, future purchases of these assets will no longer be financed by the issuance of central bank reserves. They will now be financed by the issuance of Treasury Bills, in line with the arrangements set out in my letter to the Governor of the Bank of England on 29 January 2009. I attach a copy of that letter.

Under these arrangements, the contingent liabilities that may arise from the Asset Purchase Facility will apply to any losses that may arise on the <u>total</u> purchases made by the Asset Purchase Facility, that is to existing purchases that have been financed by the issuance of central bank reserves and to future purchases financed by the issuance of Treasury Bills.

Yours Sincerely

ALISTAIR DARLING

HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

29 January 2009

Mervyn King
Governor
Bank of England
Threadneedle Steet
London
EC2R 8AH

Dear Mervyn

ASSET PURCHASE FACILITY

In my statement to Parliament on 19 January 2009, I announced that the Government had authorised the Bank of England to create a new fund, the Asset Purchase Facility.

I am writing to set out the terms of the authorisation. I am asking the Bank to set up and operate this facility, consistent with the framework set out in this letter, including a risk control framework agreed with the Treasury.

The Bank will be accountable for the operation of this scheme, and I would like you to put in place the internal governance arrangements you intend to follow for managing the facility.

The objective of this facility is to increase the availability of corporate credit, in order to support the Bank of England's responsibilities for financial stability and monetary stability in the United Kingdom. Asset transactions by the Bank could increase liquidity and trading activity in some UK financial markets, and could stimulate issuance by corporate borrowers and the resumption of capital market flows.

As we set out in the market notice issued on 19 January, I authorise the Bank to purchase up to £ 50 billion of high quality private sector assets under this facility. The Government will indemnify the Bank and the fund specially created by the Bank of England to implement the facility from any losses arising out of or in connection with the facility.

The following sterling assets will be eligible for purchase by the Asset Purchase Facility: paper issued under the Credit Guarantee Scheme (CGS), corporate bonds, commercial paper, syndicated loans and asset backed securities created in viable securitisation structures. The Bank should be satisfied that there will be a viable private market demand for the types of assets that it buys.

The list of eligible assets will be authorised by the Treasury, informed by the Bank's assessment of market conditions. The Bank may propose that this list be amended, by writing to me, requesting my approval of their proposed changes.

The Bank's transactions should be guided by an assessment of which transactions would be most likely to restore the flow of finance to corporate borrowers. It should be satisfied that there will be a viable private market demand for the types of assets that it buys when conditions in financial markets return to normal.

Under this facility, the Bank should only purchase assets that are high quality and of equivalent standard to investment grade. The Bank's operations should conform with a risk control framework, that is agreed with the Treasury, to ensure that risks on assets purchased on this facility are managed appropriately.

This facility will be financed by the issue of Treasury bills and the DMO's cash management operations. The Bank should provide Treasury officials with the information necessary for them to monitor the operation and financial performance of the facility.

You will also need to ensure that regular public reporting of the scheme provides a transparent account of the Fund's operations, together with an assessment of developments in corporate debt markets.

The aim of this facility is to improve levels of liquidity in some UK financial markets. I expect the Bank to wind down the fund as normal conditions return. The facility will consequently be withdrawn when it is no longer needed. Having consulted the Bank, I will confirm at each Budget whether I intend to authorise the continued operation of the facility in the following financial year.

As announced on 19 January, this facility provides a framework for the Monetary Policy Committee of the Bank of England to use asset purchases for monetary policy purposes should the Monetary Policy Committee conclude that this would be useful for meeting the inflation target.

Given the range of assets that will be purchased and the indemnity that HM Treasury is providing, financing of this facility by Central Bank money will require my consent. In the event that the Monetary Policy Committee were to consider this necessary, you, as Chairman of the Committee should write to me setting out the Committee's reasons. I will reply to the Committee and I will also advise Parliament that I have given such consent and I shall also keep Parliament informed in relation to any changes to this authorisation that I might make. This could include changes to the maximum amount of assets that can be held by the fund and the assets that are eligible to be purchased.

I am copying this letter to the Rt. Hon John McFall MP.

Yours sincerely

ALISTAIR DARLING