The Association of Corporate Treasurers

Comments in response to
Asset Purchase facility - Consultation on proposals for working capital facilities
Issued by Bank of England, 8th June 2009

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The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments.

We canvas the opinion of our members through our monthly e-newsletter to members and others, *The Treasurer magazine*, events and discussions, our Policy and Technical Committee, topic working groups and in this case via a specific e-mail alert to all UK based members.

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General

We have been impressed by the bank's willingness, within its risk constraints, to extend the availability of cost competitive credit to UK industry under the asset purchase facilities already in place. The exemplary effect of the Bank's involvement is potentially important over a period of time.

The credit rating criteria applied to the existing facilities naturally limit their direct effect to investment grade companies. They may however have the effect of releasing bank balance sheets to undertake lending to smaller or weaker credits . The effects of this are likely to be slower and more limited given the general capital pressures on banks, though every little helps.

We welcome the new proposals which may extend the reach of the bank's direct financing support for UK businesses. We would hope that the potential presence of the Bank in the two new forms of Asset Purchase Facility may, over time, stimulate other investors in this area of activity.

For the scheme to succeed, the Bank will need to make clear that it intends to be regularly standing ready to buy paper in the secondary market. This necessary to reassure the potential other market investors and thus encourage a re-emergence of liquidity. The Bank needs to be seen as a market maker of last resort[1] and by doing so it will stimulate other investors so that in practice it would rarely be needed to fulfil that sort of role in any quantity. That is to say that success of any scheme launched would not normally be measured by the volume of paper on the Bank's balance sheet but the overall market volumes.

The time it takes to create the necessary structures should not, however, be underestimated. Assurance that the Bank, if it goes ahead, will not rapidly withdraw from the activity would be important for the setting up work even to begin being considered.

We are very conscious of significant difficulties in making schemes of the kind envisaged work smoothly and easily and in encouraging suppliers (and their customers, where relevant) and other lenders to participate. For the first, ABCP, scheme there is a danger that the complexities of creating the required securities and getting them rated will put off many borrowers save a few larger and better resourced companies who might well not be the sort of companies that this facility is really aimed at.

The second outline proposals for a Supply Chain Finance Facility could, in a broadly similar fashion, provide finance to companies on the strength of their receivables from a well rated customer, mostly irrespective of the company's own credit standing.. If it is envisaged that the initiative could come from the purchasing customer we believe that some of the complexities of the secured commercial paper facility might be overcome more easily and some scale efficiencies achieved to make it all a more practical proposition. There are already specialist companies which facilitate this kind of action. We can envisage firms stepping up to organise something similar for suppliers to investment grade companies that do not themselves take the initiative.

It is important to note that investment grade companies that already participate in comparable schemes to the SCF in which the debts are sold to banks commonly restrict cooperation to sales that will be to banks other than their own relationship banks in order to avoid potentially restricting their own access to credit from them. Adding the Bank as a potential purchaser would be welcome in such cases.

The proposals as they stand do not provide enough information to assess them in detail. As the practical details crystallise, the ACT is very willing to discuss them further with the Bank. For example the proposals are not clear on the volume of finance that the Bank is likely to provide nor whether it will normally restrict itself to a certain percentage of any issue. For the scheme to generate confidence in other market participants the Bank will need to stand ready to be a market maker of last resort.

Whatever new forms of Asset Purchase Facility are finally decided upon we urge the Bank to try and make best use of whatever structures and market expertise already exist within existing firms.

[1] The Repertoire of Official Sector Interventions in the Financial System: Last Resort Lending, Market-Making, and Capital' Speech by Paul Tucker, 28 May 2009

Miscellaneous feedback

We have informed all our members about your proposals by an e-mail alert and, in the few days allowed, have received feedback from this. A variety of points were raised which we list here:

Asset Backed Commercial Paper

1. Many companies have existing loan and bond covenants restricting the giving of security over assets or sale of financial assets such as receivables or restrictions on the application of funds obtained thereby. Such companies would need to take care to operate within any limits or to ensure the structures are such that do not trigger a breach.

2. Businesses providing software and information support services naturally welcome any expansion of this sort of asset backed finance since it can be very systems intensive on a day to day basis. They warn however of that it can be slow for companies to acquire, customise and train staff for the systems necessary. Companies would need to be confident that such systems would have long-term use before undertaking the work and cost.

3. Trade receivables can for some businesses be highly seasonal. The finance that can be raised from receivables will also be seasonal. In some cases then, sales financing might not necessarily match with the seasonal financing needs of such companies.

4. Single seller programmes may well often be too small to be viable in the market. If the Bank is to succeed in getting a broad reach for its programmes then the inclusion of multi-seller programmes may be needed . We are glad that the Bank had already recognised this in the proposals.

5. We wonder why the Bank has stipulated that the ABCP paper and the tradable paper generated under the Supply Chain finance programme should attract an A1/P1/F1 rating whereas the Commercial Paper and Bond facilities have an A3/P3/F3 limit. It has the effect of greatly limiting the new activity.

6. The eligibility criteria refer to “a material contribution to economic activity…”. If the intent is to provide finance across a wider range of companies presumably the interpretation of material will be suitably wide ranging too.

7. Looking from the investors point of view, the ABCP market has been a genuine casualty of the credit crisis. There may be some sense in which this is a market failure: discrimination about the underlying assets did not seem a strong point. The Bank can help correct such failure by helping give confidence in secondary market liquidity, helping by its own requirements in improving transparency on the underlying risks and illustrating the potential suitability of investment in appropriately backed paper. Prior to the credit crisis these assets were an important component of the diversified investment of some groups and some of that can return.

8. Of course the pricing offered by the Bank can ultimately influence the cost of finance in the underlying trade. When the market is working well, market demand can leave the Bank's pricing uncompetitive, allowing a natural and orderly run down – until the next crisis. With good fortune, this could be achieved after quite small total transaction amounts for the Bank.

9. The widespread provision of detailed ABCP programme information together with the eligibility of programmes is very important. The current mechanisms (via dealer request usually) for getting ongoing programme information are not very reliable or responsive. Ideally this information would be available from their more rigorous inclusion on, for example, Bloomberg description screens, rather than bespoke data provision by the Bank.

10. While in the past many investors were willing to rely on the top rating alone for ABCP, this is unlikely to be the case going forward. Some members doubt that prospective buyers have the manpower or sophistication to look properly at the programmes. In any case, there may be a temptation for investors to see a Bank eligibility stamp as sufficient due diligence. This may be of assistance in getting a market going, but would have consequences for the longevity of the market if the Bank pulled out of this facility.

11. There is a tension between keeping the underlying structure of eligible programmes as simple as practicable, e.g. not including multi-seller programmes, may help would-be investors to do the proper due diligence but may limit supply by limiting the achievement of scale economies..

12. There was widespread concern that the preparations required in order to be able to transact under this sort of programme may be onerous and time consuming, and that this would create a block on many being able to take advantage of the Bank's proposals.

13. The assets that are eligible for inclusion in a structured programme include short term credit card receivables but would not cover consumer finance provided on longer term purchases such as furniture and cars. We accept that long term assets such as mortgages are inappropriate to include here (and in any case they are catered for in other support packages) but perhaps there is room for maturities beyond 9 months.

14. The operational difficulties in creating an asset backed programme cause us to wonder if there are any alternative mechanisms that could achieve the same aim but through a different route – at least for obligations of appropriately rated companies.

    Factoring of invoices is used, and perhaps extensively, by some of the companies the Bank wants to assist. We wonder if there could be any method to support the providers of factoring finance in a targeted manner. Many of the factoring

Supply chain

15. Unfamiliarity can make quite long the time taken in the UK to set up arrangements such as those contemplated.

16. Of course, many suppliers that might benefit from what is under consideration are already signed up to receivable financing/ factoring arrangements. These can involve a commitment to the discounter/factor that may be difficult to get out of and slow to expire. (See also the final comment under Asset Backed Commercial Paper, 14 above.)

17. It should be noted that banks are already marketing the provision of supplier finance very heavily. It seems very profitable for them in relation to the capital required.

18. We think that there is a familiar tradable paper available for use in supply chain finance which the Bank could buy. It is the trade bill of exchange. In order for this to help the supplier, the bill would have to be marked "Without recourse to the drawer" to make it single name paper – but this should be acceptable to the Bank if the acceptor (the trade purchaser) were of the same rating as the scheme floor or better.

19. Finally we note that the old basic form of trade finance, bankers acceptances (drawn in respect of current trade), which the Bank used to be wiling to buy and which counted for Sterling liquid assets (SLA) purposes could solve many of the problems which the new proposals seek to address.

    Furthermore, at this time the FSA is tightening banks' required holdings of SLAs. Inclusion of bankers acceptances as SLAs would provide a natural source of trade finance, able to grow with trade and potentially avoiding some of the negative effects on trade finance of a general deleveraging combined with a requirement for additional SLAs that exclude trade financing obligations[2].

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2 See Reintroduction of bankers' acceptances market - Stimulating banks to provide finance to trade and industry, 8 December 2008
http://www.treasurers.org/node/4505

ANNEX: QUESTIONS FOR CONSULTATION

Questions relating to the Secured Commercial Paper Facility

1 The maximum proportion of a programme's outstanding securities considered eligible for purchase by the APF would be based on the proportion of the underlying assets in the programme providing credit to borrowers making a material contribution to economic activity in the United Kingdom. The Bank welcomes views on the feasibility of achieving this objective and the information about assets underlying programmes that it would need to collect to ensure the criteria were met.

It would seem reasonable to be able to do this since it is the contribution of the borrower that is being tested not the wide and diverse group of those to whom he is selling product. The Bank has not suggested any further haircut as to how much of the programme would be eligible and this is welcome.

2 The Bank would appreciate general comments on the assets it is minded to accept as suitable for inclusion in programmes as described in paragraph 13. Specifically:

a) The Bank is minded to purchase securities from 'single-seller' and 'multi-seller' programmes but seeks views from investors on the viability of each market. In case of 'multi-seller' programmes, the Bank welcomes views on what concentration limits would be consistent with investors' preferences.

   Ultimately it is the sector exposure on the underlying debtors being financed that is more critical rather than the sector of the borrower.

b) There would be concentration limits on the sectoral exposure of the assets underlying eligible securities. The Bank would welcome views on how best to structure and implement these sectoral limits.

   Realistically some sorts of sector limits may be desirable to meet investor preferences, although it may be that the rating criteria will perform this constraint in any case.

c) The Bank would expect programmes to disclose sufficient information to the Bank for the Bank to be able to assess whether programmes meet its criteria. It would be grateful for views from market participants on whether such disclosures should be encouraged more widely.

   Transparency on any programmes, right down to information on the underlying assets, suitable aggregated, is essential. Investors want to and indeed should be looking beyond the formal credit rating. If the Bank insists on this for any eligible programmes it could have a highly beneficial effect in the market generally if it encourages good disclosure to become the market norm.

3 The Bank would be grateful for views on whether it should publish the programmes eligible for the Facility, or whether secondary market participants should instead seek such information from the Bank on a bilateral and confidential basis.

Definitely publish. Efficient markets need good information and transparency

4 It is hoped that the ability of the APF to purchase securities of this kind will, over time, lead to the creation of new programmes that are acceptable to the APF and also to private sector investors. The Bank would be grateful for views on this from investors, potential investors and other interested parties.

Agreed, especially if the Bank fulfils the market maker of last resort role.

Questions relating to other forms of Working Capital Finance

To an extent some of our comments above (bullets 15 to 19) already address your specific questions below.

5 What would be the best ways to structure a Supply Chain Finance Facility (SCF)?

It would be possible to create a form of asset backed CP issued by a vehicle that acquired all the receivables generated by suppliers to one larger credit worthy company in much the same way as in the Secured Commercial Paper Facility (SCP) you have proposed. In this case the credit risk would be solely the company whose payables were being financed. Although similar to the SCP if the rationale for the special vehicle is coming from this direction it might be easier to set up and indeed if the company whose payables are being financed takes a leading role it would ease the setting up effort required from their suppliers.

As discussed above an SCF could be created without the need for a special vehicle and instead the bank could directly finance all the invoices issued by one larger company's suppliers either through an existing factor or by acquiring the receivables themselves, possible in the form of bills.

6 What is the breadth and depth of appetite for the APF funding Supply Chain Finance?

We have no data to determine the amount of demand for supply chain finance but based on the marketing efforts by banks to be involved in this area they must perceive it as a large market or a lucrative one.

7 What practical steps would need to undertaken in order for Supply Chain Finance obligations to take the form of a tradable security?

See above

8 What is the breadth and depth of potential private sector investors in Supply Chain Finance obligations?

Again we have no data on the appetite of investors , but since this form of finance can have high yields we would expect a good level of interest if the mechanisms can be created with the minimum of complexity.

9 Would there be interest in facilities for other forms of finance for working capital which are consistent with the objectives of the Asset Purchase Facility?

We have already mentioned that slightly longer term finance or finance extending to lower credit ratings could be considered. Credit insurance is another form of assistance on working capital but this is already covered by other Government schemes to top up commercial insurance although their help is rather half hearted. For exporters ECGD is consulting on extending their letter of credit guarantees too. Of course a relatively straightforward way of helping businesses with their working capital requirements would be for all Government departments and other public authorities to make a special effort to pay their suppliers rapidly.

And we have referred to trade bills (see 18 above) and bankers' acceptances (drawn in respect of current trade) (see 19 above) in our general observations above.

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The ACT is the international body for finance professionals working in treasury, risk and corporate finance. Through the ACT we come together as practitioners, technical experts and educators in a range of disciplines that underpin the financial security and prosperity of an organisation.

The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the world's leading examining body for treasury, providing benchmark qualifications and continuing development through training, conferences, publications, including *The Treasurer* magazine and the annual *Treasurer's Handbook*, and online.

Our 3,600 members work widely in companies of all sizes through industry, commerce professional service firms.

Further information is available on our website (below).

Our policy with regards to policy and technical matters is available at http://www.treasurers.org/technical/resources/manifestoMay2007.pdf .

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