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Outright Purchases of Corporate Financing Instruments

Bank of Japan/Central Bank of Japan

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January 22, 2009
Bank of Japan

Outright Purchases of Corporate Financing Instruments^[NOTE]

The Bank of Japan examined additional measures in the area of corporate financing including outright purchases of CP, and has established the following basic principles regarding the outright purchases of corporate financing instruments to facilitate corporate financing.

Based on these principles, the Bank decided to begin, from this month, outright purchases of CP and ABCP based on the scheme outlined in the Attachment. In addition, the Chairman instructed Bank staff to investigate ways to implement outright purchases of corporate bonds with a residual maturity of up to 1 year and swiftly map out a concrete plan.

1. Distinctive features in the outright purchases of corporate financing instruments

- The degree of taking on the credit risks of individual private firms is greater in the case of outright purchases of corporate financing instruments than when these instruments are taken as collateral for providing credit to financial institutions. Therefore, outright purchases involve a relatively higher probability of imposing costs on taxpayers by incurring losses, and deepen the involvement of the Bank in microeconomic resource allocation among individual firms.
- In addition, outright purchases involve higher risks, compared to other policy measures, of damaging the financial health of the Bank by incurring losses and ultimately undermining confidence in the currency and monetary policy.
- Given these considerations, outright purchases of corporate financing instruments should be regarded as an exceptional measure for a central bank, and their implementation as well as ways to implement them should be examined accordingly.

^[NOTE] Voting for the action: Mr. M. Shirakawa, Mr. H. Yamaguchi, Mr. K. G. Nishimura, Mr. A. Mizuno, Mr. T. Noda, Mr. S. Nakamura, and Mr. H. Kamezaki. Voting against the action: Ms. M. Suda.

2. Necessary conditions for the implementation

- Outright purchases of corporate financing instruments with a view to facilitating corporate financing should be implemented only when the following conditions are met.
 - a) A significant decline in market functioning of corporate financing instruments is observed in, for example, a significant rise in interest rates regardless of issuing firm's conditions or in fewer transactions, leading to tight corporate financing conditions on the whole.
 - b) The Bank's outright purchases of corporate financing instruments as an exceptional measure, taking full account of the factors below, are judged necessary to improve the situation in light of the Bank's mission.

3. Factors to be considered in the implementation

(1) Preventing the purchases from functioning as arbitrary funds allocation among individual firms

- In order to prevent the purchases from functioning as arbitrary funds allocation among individual firms, the Bank will adopt an appropriate purchasing scheme that may include conditions such as (1) purchasing from financial institutions that are counterparties of the Bank instead of purchasing directly from issuers and (2) purchasing by means of competitive auctions.

(2) Conducting the purchases only for a term required and in an appropriate scale

- The Bank will set either the date of the termination or the conditions for the termination to ensure that purchases are conducted only for a term required.
- The Bank will conduct purchases in an appropriate scale in order to avoid a further decline in market functioning due to excessive reliance on the Bank's purchases.
- The Bank will adopt a purchasing scheme that will ensure purchases in an appropriate scale and facilitate, when necessary, the smooth termination of purchases by, for example, structuring the scheme in a way that the incentive to sell the instrument to the Bank becomes smaller as the market recovers its functioning.

(3) Ensuring the Bank's financial health

- Given the higher risk of incurring losses compared to other monetary policy measures, the Bank will properly manage credit risks arising from outright purchases. Accordingly, the Bank will set certain conditions on financial instruments to be purchased in terms of their creditworthiness and residual maturities. The Bank will also set a limit on the total amount of purchases and take measures to avoid concentration of credit risks in a specific firm.
- In addition to the appropriate management of credit risks, the Bank will ensure its financial health through appropriate disposal of losses and maintenance of adequate capital in the process of settling Bank's account. The Bank will seek the government's understandings for these principles.

Outline of Outright Purchases of CP

1. CP to be Purchased

CP and ABCP that are eligible as the Bank's collateral, a-1 rated, issued before or on the auction date and with the residual maturity of up to 3 months.

2. Eligible Counterparties

Financial institutions that wish to be counterparties of this operation among those who are already counterparties in the Bank's CP repo operations or those who are to borrow funds at the Bank's Head Office in the Bank's Funds-Supplying Operations against Pooled Collateral.

3. Method for Auctions

A multiple-price competitive auction in which a minimum yield equally applied to CP and ABCP is set according to their residual maturity as below and counterparties bid the non-negative yield spread from the minimum yield. Minimum yields are subject to change.

(A residual maturity of up to 1 month)

The targeted uncollateralized overnight call rate plus 20 bps

(A residual maturity of more than 1 month and up to 3 months)

The targeted uncollateralized overnight call rate plus 30 bps

4. Amount to be Purchased

The outstanding amount of CP (including ABCP) purchased by the Bank shall not exceed 3 trillion yen.

The outstanding amount of a single issuer's CP (including ABCP) purchased by the Bank shall not exceed 100 billion yen. In addition, if the outstanding amount of a single issuer's CP purchased by the Bank exceeds 25% of the "upper limit" (the highest end-of-the-month figure for the CP issued by an issuer between July 2008 and December 2008), the CP would be excluded from the eligible list of CP until the outstanding amount of the issuer's CP purchased by the Bank falls below the upper limit by redemptions.

5. Duration of Purchases

All outright purchases of CP will be conducted by March 31, 2009.

6. Schedule, etc.

10 purchases are scheduled and they will be offered on January 30, February 4, 10, 16, 20 and 25 and March 2, 6, 11 and 16. The schedule is subject to change.

The amount of each purchase is planned to be 300 billion yen.