Commercial Paper: Legal & Regulatory Developments

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Agenda

- Introduction to Commercial Paper
- Commercial Paper Market Characteristics
- Who Are the Issuer and Investors
- Developments
- Introduction to European Commercial Paper
- Who Are the Issuers and Investors
- Developments in ECP
- Asset-backed Commercial Paper
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Introduction to U.S. Commercial Paper

What is Commercial Paper?

- Commercial paper is a term that tends to be used to refer to corporate short-term debt securities. Maturities are typically less than 12 months.
  - Why is commercial paper important?
- Commercial paper is used for working capital: inventory, wages, receivables, operating expenses, etc.
- Pre-Civil War roots of commercial paper
- Started with merchants selling trade receivables to money market investors
- Transitioned to banks as the primary investors and then to corporates selling short-term securities to fund receivables and inventory
- Strong growth in CP volume in 1960/1970 due to increased bank issuance
- The market peaked at $2.2 trillion prior to the financial crisis
- By 1933, commercial paper was a well-established means of finance, but it was an oddity in the effort to regulate securities offerings; Treasury pushed for an exemption
- The result was Section 3(a)(3) of the Securities Act of 1933

Federal Regulatory Scheme

- Classically, commercial paper meant debt securities issued under Section 3(a)(3) of the Securities Act
  - Any note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited;
- In 1961, the SEC stated in Rel. 33-4412:
  - The legislative history of the Securities Act makes clear that Section 3(a)(3) applies only to prime quality negotiable commercial paper of a type not ordinarily purchased by the general public, that is, paper issued to facilitate well-recognized types of current operational business requirements and of a type discountable by Federal Reserve banks.
  - [T]he staff of the Commission has interpreted Section 3(a)(3) to exclude as not satisfying the nine-month maturity standard, obligations payable on demand or having provisions for automatic "roll-over."

Section 3(a)(3) Requirements *(cont'd)*

- The SEC imposed six separate characteristics as necessary for qualifying for Section 3(a)(3):
  - Negotiable
  - Prime quality
  - Eligible for discount at Federal Reserve banks
  - Not ordinarily purchased by the general public
  - Used to facilitate "current transactions"
  - Maturity of nine months or less with no automatic roll-over

Section 3(a)(3) as Public Offering

- Section 3(a)(3) provides an exemption from the requirement in Section 5 of the Securities Act to register any offer or sale of securities with the SEC
- 3(a)(3) commercial paper is not a privately placed security
  - This is important, for example, in connection with 1940 Act exemptions under Sections 3(c)(1) and 3(c)(7), which may not be used if the issuer is making a public offering. However, the short-term paper exemption is available in 3(c)(1)
- To meet the “not ordinarily purchased by the general public” standard, commercial paper is normally issued in minimum denominations of $100,000
- 3(a)(3) commercial paper is usually rated investment grade to satisfy the prime quality standard

Private Commercial Paper

- Nowadays, commercial paper may also be issued under Section 4(a)(2) as a private placement of securities
- Historically, the 3(a)(3) market was larger and deeper than the 4(a)(2) market because privately placed securities are restricted securities.
- Today, the two markets provide about the same liquidity, but most issuance relies on 4(a)(2)
- The advantage of Section 4(a)(2) is that the section does not have any maturity limitations, so longer dated paper can be issued, and proceeds do not have to be used for current transactions
- Most privately placed commercial paper is issued in Rule 144A programs, although some programs also include distribution to institutional accredited investors
- Typical minimum denomination for 4(a)(2) commercial paper is $250,000

USCP Market Characteristics

Commercial Paper Market Characteristics

- Continuously offered
- Typically same day settlement
- Not purchased by the public
- Not SEC registered
- $100,000 or $250,000 minimum denominations
- 3(a)(3) offering is a public offering
- New issuance proceeds typically pay off maturing notes
- Average outstanding maturity is about 60-days
- No involvement of counsel in daily issuances
- Capacity – measured by total outstanding, not total issuance

Commercial Paper Market Characteristics *(cont'd)*

- Single master note – IPA tracks issuance/outstanding on its records
  - Dealer informs IPA of issuance daily - no continuous issuer authentication
- A new CUSIP each day for each maturity for discount CP and for each maturity date/coupon/feature combination for floating rate CP
- No tax opinion (although in some ABCP programs)
- No 10b-5 letter
- No comfort letter from auditors
- Very slim disclosure for corporate commercial paper
- Commercial paper desk – how does it work?
- Dealer as initial investor – no marketing period

CP Outstanding

Billions of dollars

Period	Total	Nonfinancial			Financial			Asset-backed	Other
		Total	Domestic	Foreign	Total	Domestic	Foreign		
Dec.	1,182.0	257.1	216.6	40.6	586.3	217.8	368.6	337.1	1.4
Weekly (Wednesday) levels									
Dec. 27	1,252.7	278.1	227.5	50.6	641.9	265.4	376.4	331.3	1.4
Jan. 3	1,232.6	266.2	224.6	41.6	631.6	260.3	371.4	333.4	1.4
Jan. 10	1,243.9	266.9	221.7	45.2	647.0	268.0	379.1	328.6	1.3
Jan. 17	1,264.6	287.1	229.6	57.5	649.0	272.4	376.6	327.0	1.5
Jan. 24	1,259.8	292.4	230.8	61.5	645.8	277.6	368.1	320.2	1.6

Source: Federal Reserve

CP Maturity Profile

Period	Amount 1								Number of issues						
		Days to maturity								Days to maturity					
	Total	1 - 4 days	5 - 9 days	10 - 20 days	21 - 40 days	41 - 80 days	81+ days		Total	1 - 4 days	5 - 9 days	10 - 20 days	21 - 40 days	41 - 80 days	81+ days
Annual average															
2022	121,237	83,340	14,203	4,945	6,919	3,738	8,093		4,541	2,744	516	287	380	187	426
2023	115,630	78,012	15,262	4,619	6,585	2,951	8,202		4,625	2,730	546	286	462	178	423
2024*	122,965	80,151	17,450	5,754	7,025	4,044	8,541		4,947	2,799	632	367	442	243	464

Source: Federal Reserve

Importance of Ratings

- Investment grade rating is essential for market access
- A strong market for issuers rated below A-1/P-1, but market access and quality of execution deteriorates as ratings approach non-investment grade
- Liquidity backstop is an important consideration in ratings

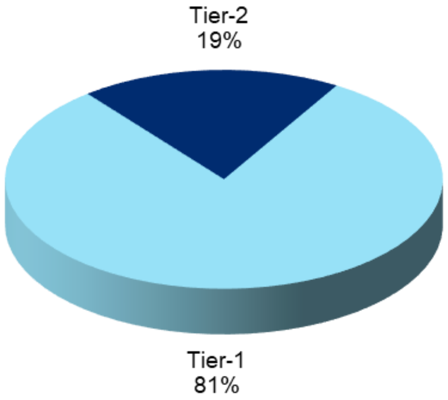
Primacy of Liquidity

- Particularly for ABCP programs, but also for corporate issuers, available liquidity is a key rating factor
- Unlike term debt, there are no grace periods for commercial paper
- Accordingly, a commercial paper issuer must have access to same-day funds on very short notice; this is generally provided by bank lines of credit
- In the event an issuer is unable to issue commercial paper due to a market disruption, maturing commercial paper must still be paid timely through draws on liquidity

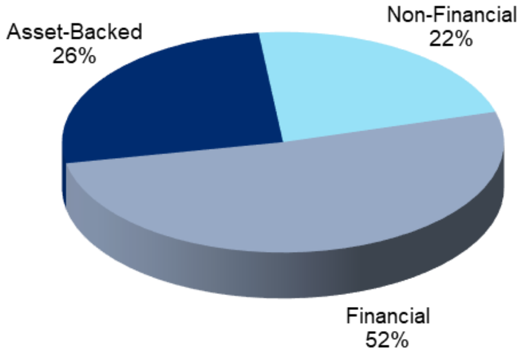
Issuers and Investors

U.S. Commercial Paper Market Overview

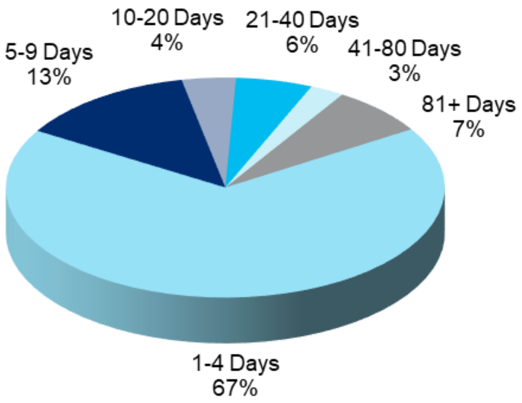
Rating Breakdown



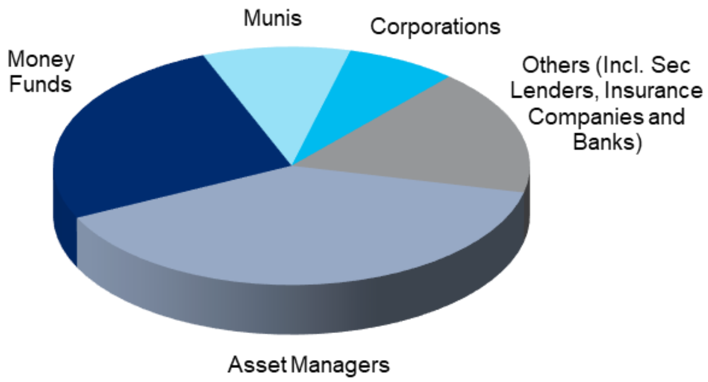
Sector Breakdown



Maturity Breakdown (Days)



Sample USCP Investor Breakdown

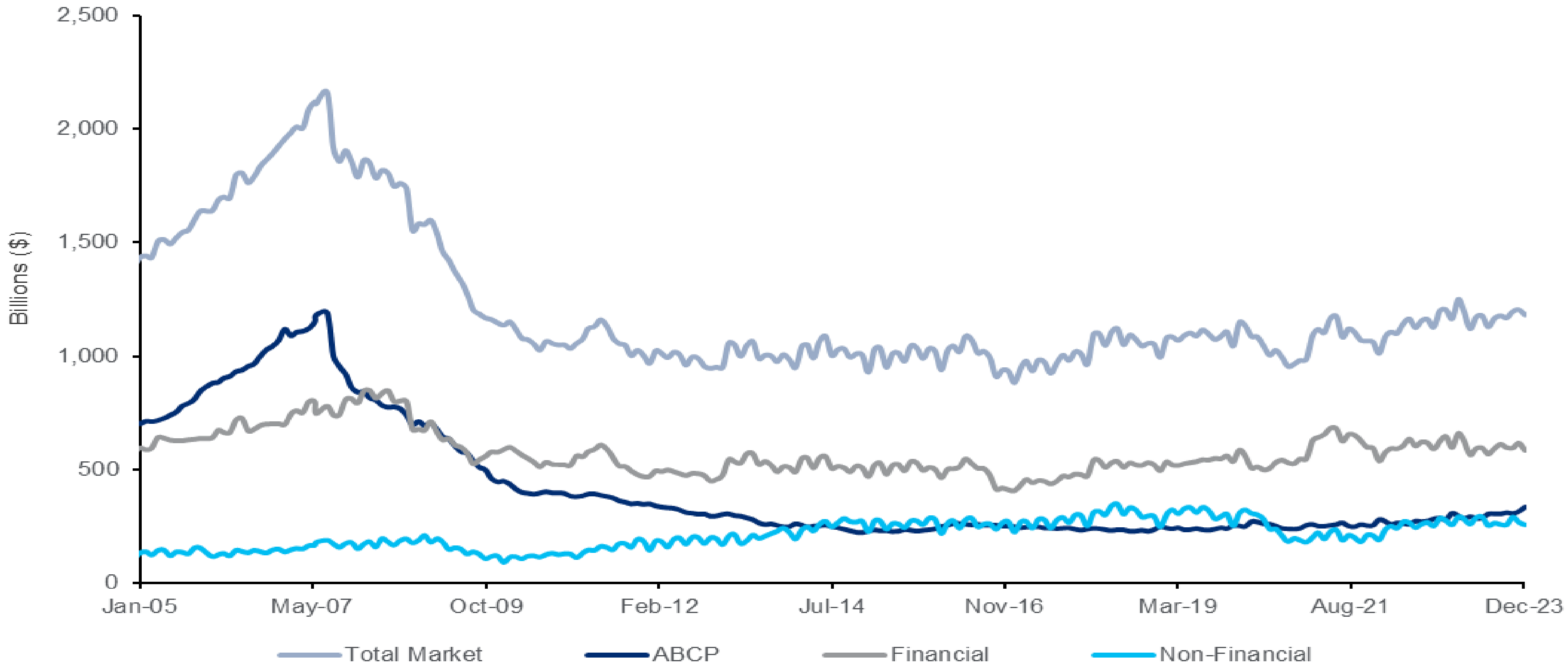


Investor Categories

Money Funds	• Money market mutual funds governed by Rule 2a-7 and other liquidity portfolios managed by money fund managers (e.g. enhanced cash, SMAs)
Asset Managers	• Investment management companies or similar pooled investment vehicles, including hedge funds
Municipalities	• State and local municipalities, including general liquidity portfolios and pension assets
Insurance Companies	• Short-term investment component of a property, casualty or life insurance portfolio
Corporations	• Liquidity portfolio managed by corporate treasury
Sec Lenders	• Banks with security lending operations that reinvest cash into short-dated securities including CP
Banks	• Bank treasury liquidity portfolios / trust portfolios managed on behalf of individual bank clients
Other	• Includes short-term investments of non-profits, sovereign wealth funds and estate/trust portfolios

Source: Citi, Federal Reserve

USCP Outstandings



Source: Federal Reserve

USCP Developments

Regulatory Developments

- Basel II Endgame
  - The U.S. bank regulators have proposed changes to the capital rules for banks that would increase the capital requirements for banks, in some areas very significantly [88 FR 64028 (Sep. 18, 2023)]
    - The comment period was extended to January, but is now closed
  - Even an undrawn commitment to a corporate borrower will now attract capital, where it did not previously attract capital if the commitment was unconditionally cancelable and less than one year.

Regulatory Developments *(cont'd)*

- Money Market Fund rule changes adopted:
  - 2016 reforms seen as not effective in the pandemic
    - Created first-mover incentives
  - Changes removed 2016 redemption gates and changed liquidity fees
    - *See* Rel. No. 33-11211 (Jul. 12, 2023);
    - Removed the tie of liquidity fees to weekly liquid asset threshholds
  - Increased significantly minimum daily and weekly liquidity requirements
    - From 10% and 30% of total assets to 25% and 50% must be liquid assets
    - Increases LCR tension
  - Fed wants more conduit funding diversity
  - Short-duration ETFs and private funds as an alternative

Regulatory Developments *(cont'd)*

- Volcker Rule
  - Today most conduits rely on Rule 3a-7 under the Investment Company Act
    - Reliance on Section 3(c)(1) or 3(c)(7) is problematic under the Volcker Rule
- Accounting consolidation
  - Many bank ABCP conduits are consolidated for accounting purposes
  - Harder to obtain off balance sheet structures
  - Additional capital required; reduced incentive to securitize
  - Creates Rule 2a-7 concentration issues for MMF purchasers
- JOBS Act changes to 4(a)(2) offers
  - Bad actor rule reduces Reg D issuance
  - Section 18 exemption is unavailable

Regulatory Developments *(cont'd)*

- Regulatory Capital – bank liquidity
  - Recently the Acting Comptroller of the Currency has suggested changes to bank liquidity requirements that would involve:
    - Banks pre-positioning collateral at the Federal Reserve sufficient for borrowing funds for 5 days of liquidity
    - Some haircuts for HQLA and an adjustment to reflect deposit run off risk

Economic Developments

- Federal Reserve is removing liquidity from the market
  - Tapering the purchase of securities for its portfolio
- Federal Reserve has been raising interest rates
  - Although now the market is pricing in a cut in interest rates
- Increasing reliance on short-term funding
  - Increased market volume in 2021, 2022 and 2023

European Commercial Paper

Introduction to ECP

Overview

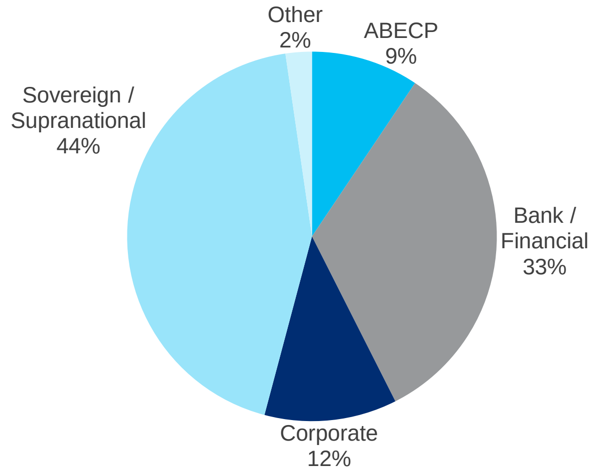
- The European Commercial Paper (ECP) programme is a **short-term, unsecured debt issuance programme** designed for large corporations and financial institutions to raise funds in the money market.
- It is an important market for **short-term and working capital requirements** of large corporations and financial institutions.
- ECP is a flexible funding tool, enabling issuers to tailor their issuance to meet specific funding needs and market conditions. It offers the ability to issue in **various currencies, maturities and sizes**.
- The ECP market is **one of the largest short-term debt markets globally** and provides an important source of funding for many large corporations and financial institutions.
- The European **Asset-Backed Commercial Paper (ABCP)** market is a subset of the ECP market and is backed by a pool of financial assets such as trade receivables, credit card receivables, and auto loans.

Market Development

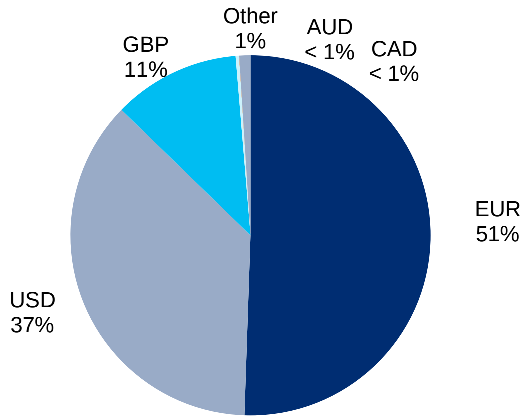
- The ECP market is part of the **wider European short-term credit market**, which is fragmented into a number of different markets with varying legal frameworks, practices, and participant types.
- Increasing participation from non-bank entities, with an higher demand for highly-rated issuers following the Covid-19 pandemic and a shift towards shorter maturities.
- **Covid-19** pandemic had a significant impact on market functioning and liquidity, highlighting potential areas for improvement. In particular, the fragmentation and the lack of harmonisation across markets presents challenges for issuers and investors, having an impact on the liquidity and efficiency of the system.
- In the UK, a number of new programmes were set up to take advantage of the UK HMT and Bank of England **Covid Corporate Financing Facility** (CCFF). This has now closed.
- ESG factors are becoming more important in investors' decision-making processes, leading to increased issuance of **sustainable commercial paper**.
- ICMA recommendations to develop the European CP/CD market focussed on **standardisation, transparency, secondary market liquidity** and **automation** to help develop the market (See: ICMA-CPC-white-paper-The-European-Commercial-Paper-and-Certificates-of-Deposit-Market-September-2021-290921.pdf (icmagroup.org)).

Euro Commercial Paper Market Overview

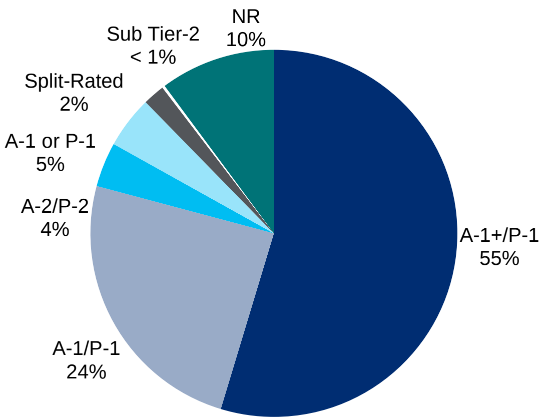
Sector Breakdown



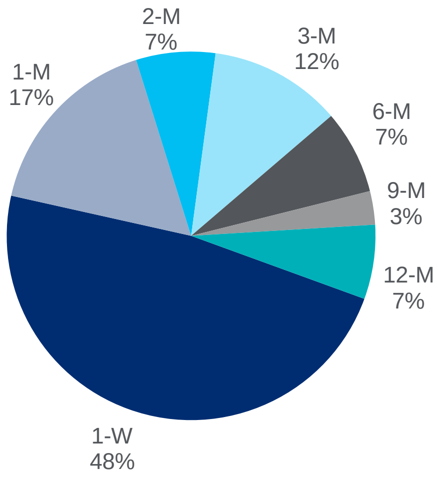
Currency Breakdown



Rating Breakdown

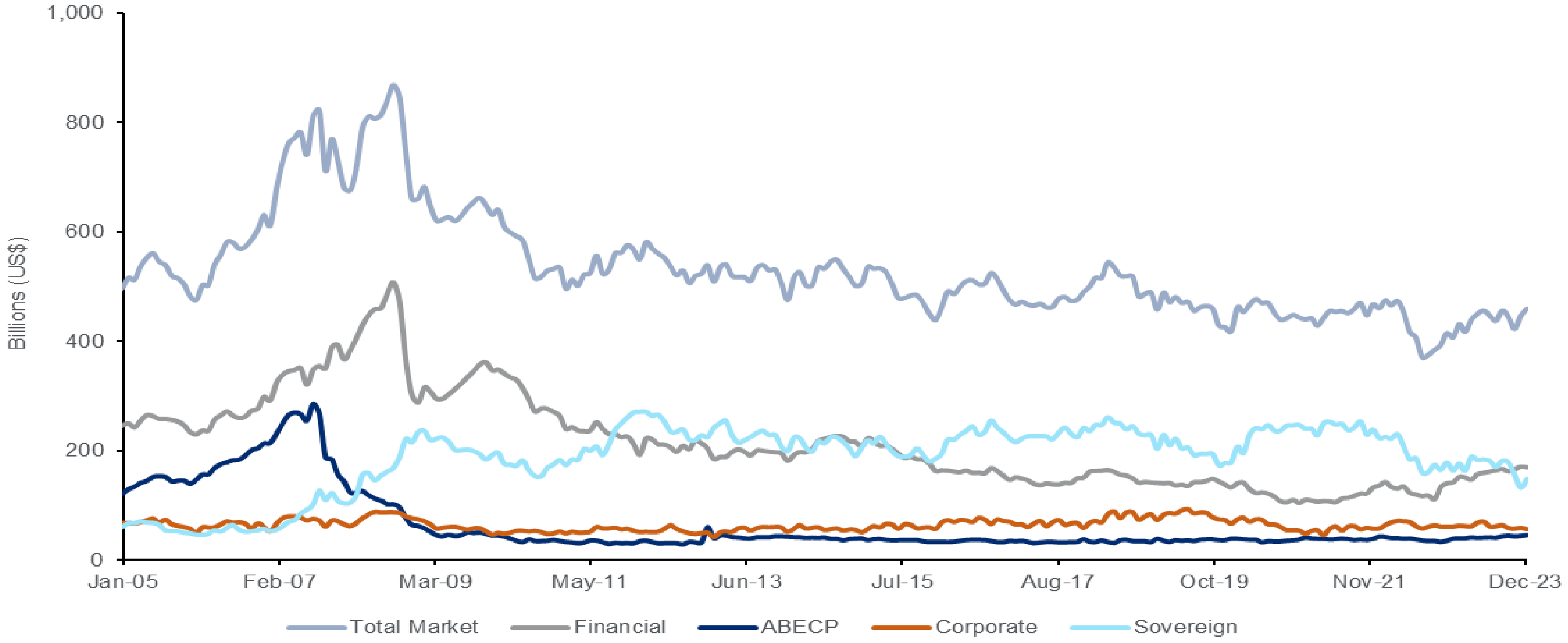


Maturity Breakdown (Months)



Source: Dealogic – CPWare as of 12/31/23

ECP Market Outstandings



Source: Dealogic

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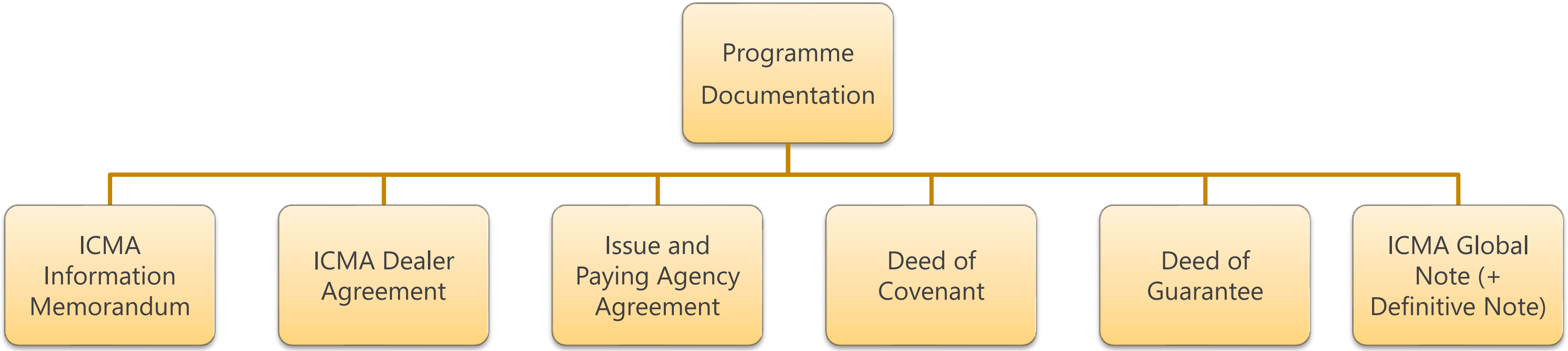
Basics of Documentation

- Main features of the CP programmes
  - Issuers are usually investment grade/higher rated companies and banks, which are often frequent capital market issuers in other markets.
  - CP programmes are characterised by short maturity (usually overnight to 364 days). Thus, there are no events of default and no negative pledge. ECP has simple terms - issued at discount, fixed and floating rates. Typically governed by English law.
  - Bearer Notes (but not subject to TEFRA owing to short maturity).
  - The set of documentation is much lighter compared to MTN programme and based on **International Capital Market Association (ICMA) standard forms**.
  - ECP is not typically listed, therefore no need to prepare a full prospectus, instead a short-form information memorandum is sufficient. This will have limited disclosure and incorporate future financial information and filings.
  - Unlike EMTN Programmes, ECP programmes are not subject to annual update requirements (save in relation to STEP which has a 3 year update cycle) and do not require supplements for new financial information.
  - Some CP programmes apply for the STEP (Short-Term European Paper) Label. STEP aims to foster the integration of the European markets for short-term paper through the convergence of market standards and practices. A STEP label is also used where the programme is intended to be ECB eligible.

Basics of Documentation *(cont'd)*

- Documentation of English law CP programmes is heavily standardised and based on the **ICMA standard form** Information Memorandum, Dealer Agreement and Global Note. Note, for STEP programmes there is a **standard STEP form of Information Memorandum** that also needs to be taken into account



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Basics of Documentation *(cont'd)*

- Other features of CP Programmes
  - For UK companies, CP is UK withholding tax exempt on account of maturity of less than one year
  - Institutional and not retail investor base
  - Clearing in Euroclear and Clearstream is the norm
  - Representations, undertaking and warranties in the Dealer Agreement follow ICMA form (albeit often with amendments to align with provisions of existing MTN programmes)
  - No comfort letter or 10b-5 disclosure letter. No due diligence
  - Investment grade rating is essential for market access
  - ICMA documentation has been updated to include new RFR wording, based on ISDA calculation method, for floating rate notes
  - ICMA documentation specifically caters for issuance in USD, EUR, GBP, Yen, CHF, CNY, AUD, CAD, NZD and HKD with the flexibility to issue in any other currency subject to legal and regulatory requirements
  - Index linked ECP is no longer a feature of ECP programmes
  - No outside counsel involvement in issuances

EU/UK regulatory considerations for commercial paper

- Main features of EU/UK regulation applicable to CP programme:
  - **Prospectus regulation**: CP is exempt from the requirements of the EU and UK Prospectus Regulations (but it is classified as a 'financial instrument' for the purposes of EU MiFID II, UK MiFIR and the FCA Handbook). CP is exempt because it is treated as a money market instrument with a maturity less that 12 months and therefore not a "transferable security". The minimum denomination of CP is always higher than €100,000 which also means there is no obligation to publish a prospectus pursuant to EU and UK Prospectus Regulations.
  - **PRIIPS/Selling restrictions**: Market consensus is that CP does not constitute a PRIIP and therefore it is not necessary to include the PRIIPS legend in the CP documentation. Investor base is not retail.
  - **Product Governance**: Depending on whether the ECP issuer is a MiFID II firm or a FCA authorised firm (and therefore a "manufacturer") or the relevant dealer considers itself to be a "distributor" and not a "manufacturer", particular disclosure language will need to be inserted in the Information Memorandum and Dealer Agreement. Generally, underwriters do not consider themselves manufacturers.
  - **FSMA Deposit Taking**: Where commercial paper is issued by issuers who are not authorised or exempt, the standard ICMA selling restrictions requires that the managers represent and agree that the commercial paper is only offered to investors whose ordinary activities involve them acquiring, holding, managing or disposing of investments. To fall within this exemption, it is also customary for commercial paper to have a minimum denomination of at least GBP100,000 (or equivalent in another currency).

ESG Commercial Paper

- There is an increasing focus on ESG considerations in the European short-term credit markets, in particular on the development of ESG programs and the potential for green CP and CD.
  - The ESG CP market is predominantly driven by organisations that already have ESG-labelled term debt: 95% of issuers have already issued green or sustainability-linked public bonds and they are looking to extend ESG features across their capital structure.
  - There isn't clear guidance for market participants. Note, in the French market, the Paris marketplace launched a ESG NEU CP – NEU MTN Working Group and IM Template for ESG issuances on the Banque de France's website.
  - Issuers are now issuing sustainable use of proceeds CP through the adoption of a specific ESG framework and the obtainment of a second-party opinion in order to have an external firm performing specific procedures to provide assurance to investors.
  - In an economic environment characterised by capital market volatility, access to short-term markets with ESG features has grown in importance and money market funds are attracting meaningful inflows. Due to this increasing appeal, ICMA has set-up a Sustainable CP taskforce to develop official guidance on sustainable CP market.

ESG Commercial Paper *(cont'd)*

- Sustainable CP programmes can be structured in different ways:
  - "Use of proceeds" sustainable CP
  - Sustainability target-linked CP
  - Sustainability commitment CP
- These programmes do not always comply with the ICMA Green, Social or Sustainibility Bonds principles (because the use of proceeds for ECP is working capital) or the ICMA Sustainability-Linked Bond principles (as the ECP is too short-term to have testing on sustainability KPIs).
- In general, there are no events of default, penalties or other consequences for the issuer that ceases to meet the sustainability or the ESG target/condition. The risk is primarily reputational and the issuer will not be able to issue further sustainable CP under the relevant programme.
- Important to ensure that Programmes are correctly structured, explained and disclaimed as there is significant and increasing public, investor and regulatory scrutiny around ESG financial products.
- Advantages: Potential "real world" impact, investor demand, alignment with rest of Issuer's funding and corporate strategy.
- Challenges: Availability of assets, matching short-term maturity, identifying ESG CP, greenwashing concerns.

ESG Commercial Paper – Existing Programmes

ESG CP PROGRAMMES

Search All

Entity	CP type	ESG label	Currency	Amount (M)	Creation date	Arranger
Acoss	NeuCP	Social UoP	EUR	70,000	2022-3-28	Société Générale
Crédit Mutuel Arkéa	NeuCP	Sustainable UoP	EUR	4,000	2022-3-1	None
Terna	ECP	ESG-linked	EUR	1,000	2021-7-16	CitiGroup
Alliander	ECP	Green UoP	EUR	1,500	2021-7-15	CitiGroup
Endesa	ECP	KPI-linked	EUR	4,000	2021-5-7	Banco Santander
Iberdrola	ECP	KPI-linked	EUR	5,000	2021-4-15	Barclays
Cofinimmo	ECP	Sustainable UoP	EUR	1,250	2021-12-7	Belfius Bank
Lafarge Holcim Ltd	ECP	ESG-linked	EUR	3,000	2020-9-27	Natwest
Munchener Hypotheken...	ECP	Green UoP	EUR	5,000	2020-6-26	Münchener Hypo...
Enel S.p.A	ECP	KPI-linked	EUR	6,000	2020-5-4	CitiGroup
IDB Invest	ECP	Sustainable UoP	USD	3,000	2020-12-22	CitiGroup
Spam	ECP	ESG-linked	EUR	2,500	2020-11-25	Citigroup
Alpine Securitization	ABCP	Green UoP	USD	300	2020-1-23	Credit suisse
Dios	ECP	Green UoP	SEK	3,500	2019-9-24	Handelsbanken
Fabege AB	ECP	Green UoP	SEK	5,000	2019-6-12	Handelsbanken
Vasakronan	ECP	Green UoP	SEK	25,000	2018-9-18	SEB
Rabobank	ECP	ESG-linked	EUR	5,000	2018-7-25	Rabobank

Source: Public Market Data (onbrane.app)

Asset-Backed Commercial Paper

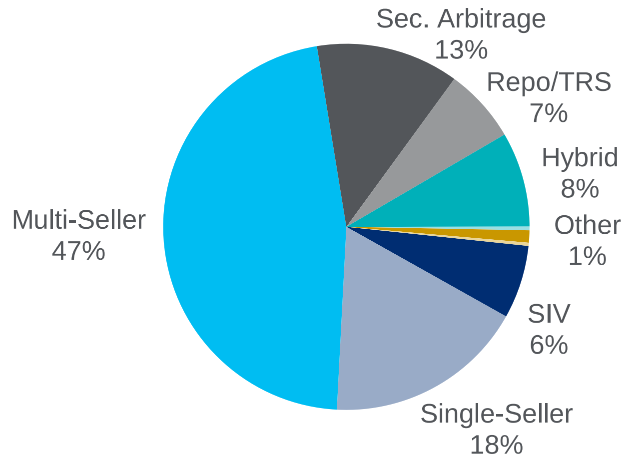
ABCP

- The development of securitization in the 1980s did not by-pass commercial paper
- Merrill Lynch/Citibank developed first receivables conduits, which would buy receivables from corporates funded by commercial paper issuance by the conduit. This provided many corporates with capital markets access and cheaper funding than available through loans
- In a defensive response, other banks started their own competing conduits
- The success of the conduit structure led to funding other asset types, including mortgages, portfolio securities, ABS and short-term loans

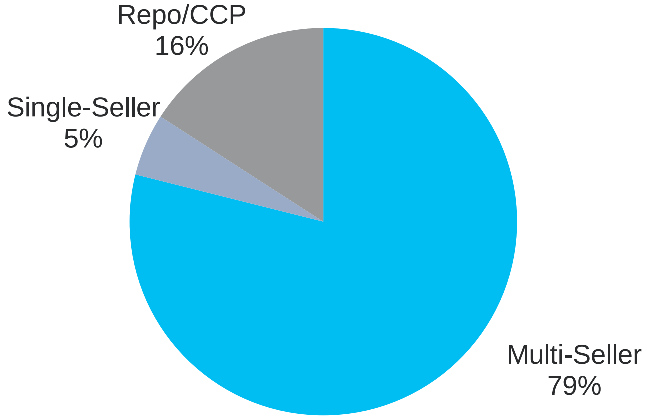
Evolution of the ABCP Market

The ABCP market has undergone a significant transformation since 2007. The ABCP market is more concentrated among multi-seller programs with a higher percentage of programs utilizing full support liquidity.

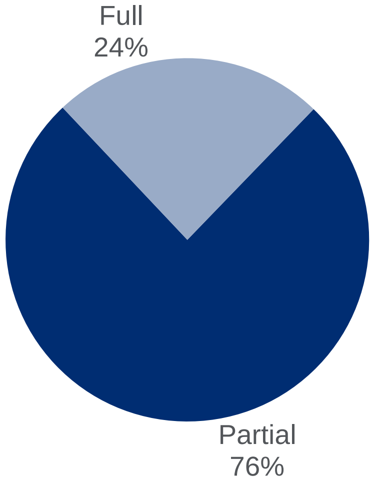
2007 U.S. ABCP Outstandings by Program Type



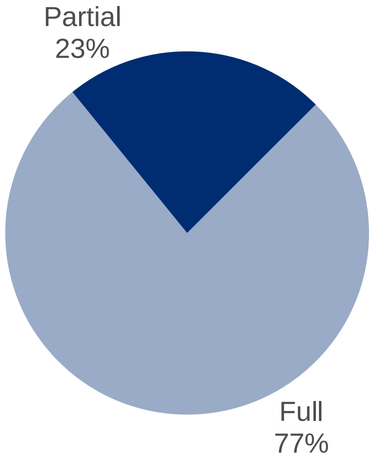
2023 U.S. ABCP Outstandings by Program Type



2007 U.S. ABCP Outstandings by Support Type



2023 U.S. ABCP Outstandings by Support Type



Source: Citi, Federal Reserve, Moody's Program Index (3Q07 and 3Q23)

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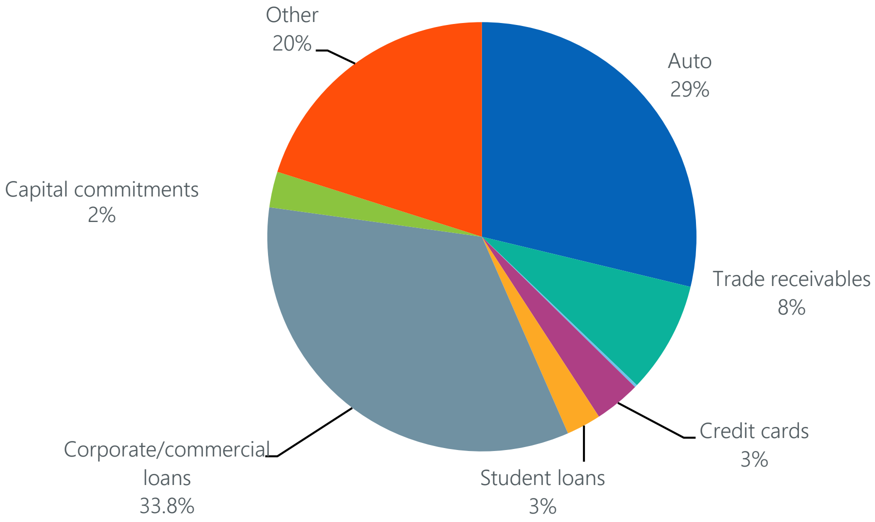
ABCP

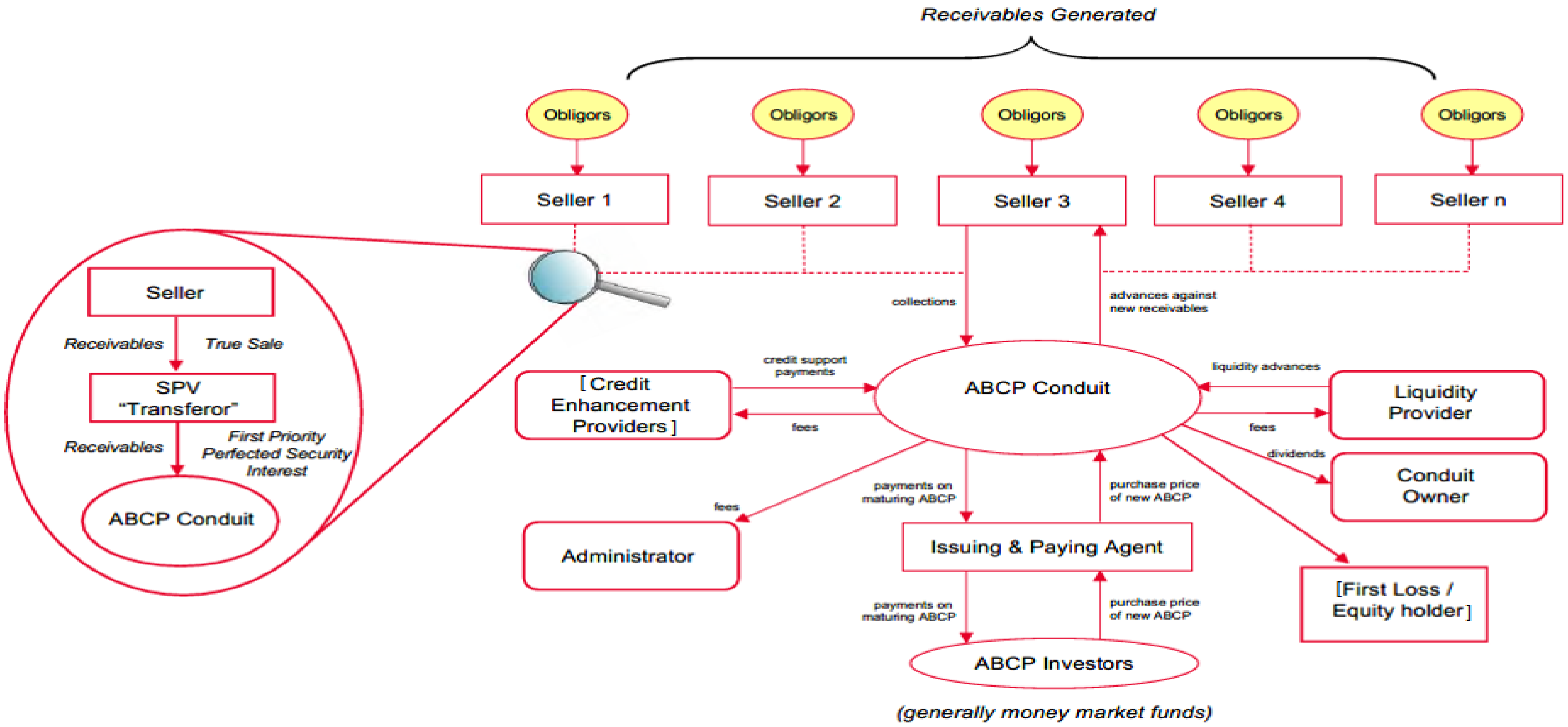
- A structured commercial paper conduit is a bankruptcy remote limited-purpose finance company that issues commercial paper to finance the purchase of assets;
- Asset types include receivables generated from trade, credit cards, auto loan/leases, equipment leases, and others;
- Programs are typically established and administered by commercial banks to provide flexible and competitive low cost financing to their customers;
- Unlike term securitizations, these programs are ongoing entities and do not wind down after a few years;
- Typically maturing CP is paid down with the proceeds of newly issued CP;
- The proceeds of collections from matured receivables are reinvested in newly generated receivables (assuming revolving period).

Fitch US Multi-Seller Asset Distribution



Source: Fitch Ratings

Types of ABCP Programs: Multi-Seller Schematic



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ABCP Key Features

- Revolving on both asset purchase and funding sides
- Maturity matched assets with funding
  - Unless fully supported or guaranteed
- Bankruptcy remoteness
- CCP structures – common method for banks to finance their inventory positions
- Warehousing – commonly multi-seller structure
- Receivables financing still common
- Series CP issuers

Additional Legal Considerations

- ABS considerations come into play
  - Risk retention, Rule 17g-5 website, 40 Act exemption, Volcker Rule
  - LSTA and Kirschner cases and some SEC C&DI statements can avoid
- Rule 2a-7 obligor concentrations
- Security interest in assets

EU / UK regulatory considerations for ABCP

- EU/UK Securitisation Regulation
  - An ABCP transaction will typically use the proceeds from the issuance of ABCP to obtain an interest in transactions that have tranched credit exposure and qualify as securitisations for EU/UK regulatory purposes.
  - ABCP (and liquidity or asset purchase facilities) will therefore also typically be securitisation positions for the purpose of the EU/UK Securitisation Regulation.
  - EU/UK Securitisation Regulation requires:
    - Initial and ongoing due diligence by EU/UK institutional investors in relation to a securitisation position
    - Risk retention of at least a 5% of net economic interest in the securitisation transaction
      - But fully supported ABCP programs do not require risk retention at transaction level
    - Disclosure to investors, competent authorities and, on request, potential investors
      - Transaction summary
      - Monthly asset-level report and investor report (Annexes 11 & 13 of ESMA templates)
      - ‘Significant event' disclosure

EU / UK regulatory considerations for ABCP *(cont'd)*

- EU / UK Securitisation Regulation
  - STS - ACBP transactions or programmes which qualify as STS (simple, transparent and standardised) may result in reduced regulatory capital requirements or other regulatory benefits for bank holders of an exposure to the transaction/programme
    - STS criteria for ABCP transactions include requirements relating to:
      - Simplicity, including true sale and underwriting standards, homogeneity
      - Standardisation, including risk retention
      - Transparency, including provision of information to potential investors
      - Sponsor and sponsor support for the ABCP programme
    - criteria for ABCP programmes to be STS require:
      - All underlying transactions to be STS (except that a maximum of 5 % of the aggregate amount of the exposures may temporarily be non-compliant a period of no more than six months)
      - Programme to be fully supported by the sponsor
      - Remaining weighted average life of the underlying exposures to not be more than two years
      - ABCP may not include call options, extension clauses or other clauses that have an effect on final maturity, where such options or clauses may be exercised at the discretion of the seller, sponsor or the conduit
  - No resecuritisation at ABCP Transaction level - securitised exposures transferred by the seller to the conduit may not be resecuritisations.

EU / UK regulatory considerations for ABCP *(cont'd)*

- Money Markets Fund Regulation
  - Money market funds may invest
    - Up to 20% of their assets in ABCP which is STS
    - Up to 15% of their assets in non- STS ABCP

EU Money Market Funds Regulation – eligible ABCP

- ABCP is eligible if (liquid and good credit quality and) “issued by an ABCP programme which:
  - Is fully ***supported*** by a regulated credit institution that covers all liquidity, credit and material dilution risks as well as ongoing transaction costs and ongoing programme wide costs related to this commercial paper if necessary to guarantee towards the investor the full payment of any amount under the asset back commercial paper;
  - is ***not a re-securitisation*** and the exposures underlying the securitisation at the level of each ABCP transaction do not include any securitisation position;
  - does ***not include synthetic securitisations*** as defined by [Art. 242(11) CRR].”
- Maturity limits for eligible ABCP:
  - Short term MMF: residual maturity or legal maturity at issuance is 397 days or less;
  - Standard MMF : legal maturity at issuance or residual maturity is 2 years or less and time remaining until next interest rate reset date is 397 days or less
  - (No limit on maturity of underlying assets, though earlier proposed)
- Future change: a consultation has opened where the EU is taking information as to how well this regulation is functioning, no concrete proposals as of yet.

Stay Connected

Watch for our upcoming ABCP webcast

Subscribe to our mailing lists and receive timely legal updates and invitations to our events directly to your inbox.

Appendix

Types of ABCP Programs

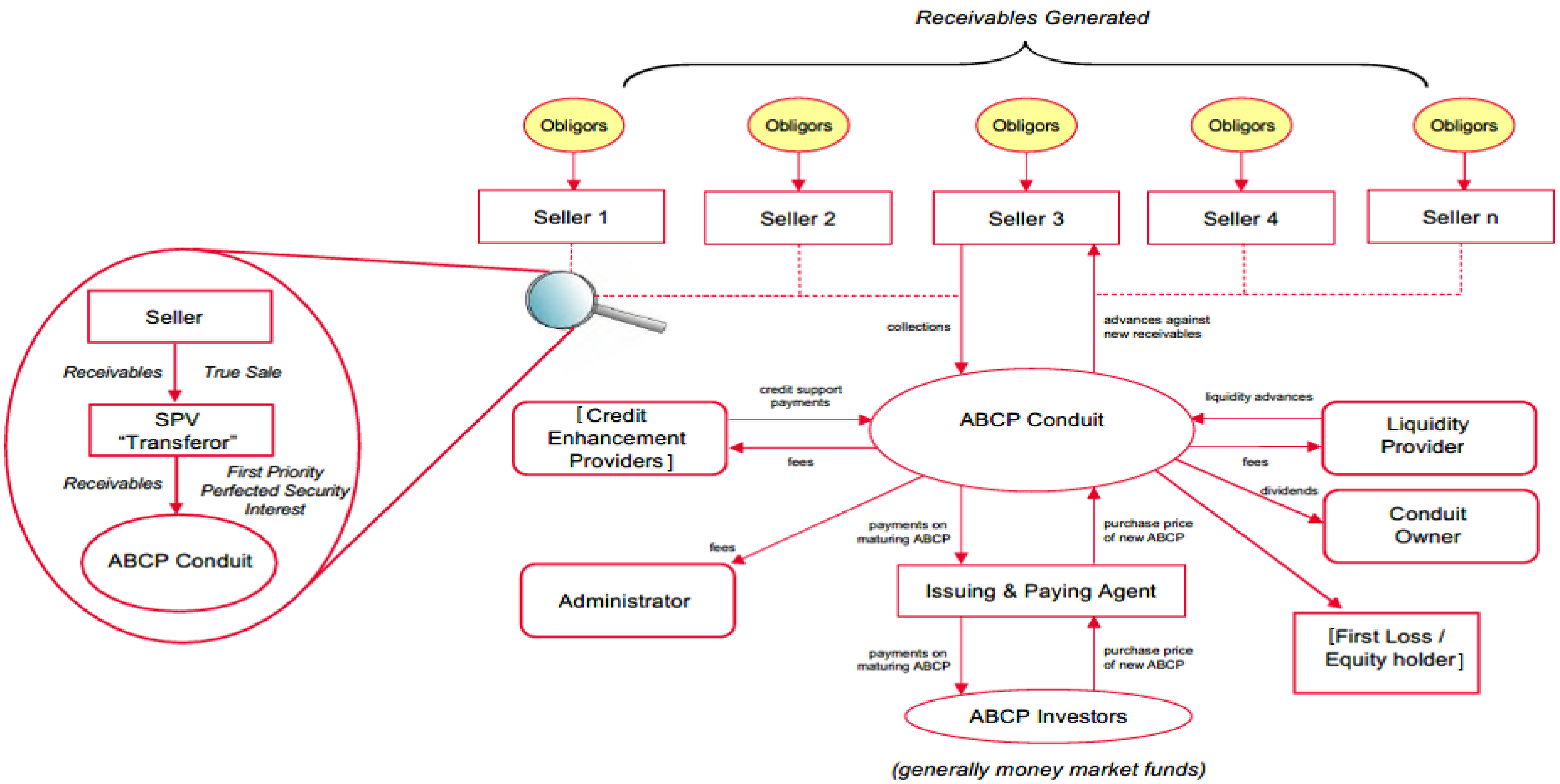
Types of ABCP Programs

- ABCP Program Structures employed today include the following:
  - Bank sponsored Multi-Seller
  - Aggregator sponsored Multi-Seller
  - Bank sponsored CCP/Repo
  - Aggregator sponsored CCP/Repo
  - Single Seller/Market Value Programs no longer exist as such
  - Securities Arbitrage (including SIVs) no longer exist as such

Types of ABCP Programs: Bank Sponsored Multi-Seller Programs

- A Multi-Seller ABCP Conduit is a limited purpose, bankruptcy-remote SPV that provides financing for receivables pools generated by multiple, unaffiliated originators/sellers
- Multi-seller programs are most commonly established and “sponsored” by large commercial banks and typically provide financing to that bank’s corporate clients
- These banks typically serve as Program Administrator or Administrative Agent for the Conduit, and commonly provide liquidity and credit support as well
- Multi-seller Conduits are typically structured to:
  - Make loans against or purchase interests in receivables pools
  - “Warehouse” assets prior to a term ABS take-out, and/or
  - Purchase securities
- ABCP issued from a large multi-seller vehicle is typically perceived as low risk for investors due to
  - Originator diversification
  - Asset diversification and Deal-Specific Credit Enhancement
  - Program-Wide Credit Enhancement and 100% Liquidity Support
  - Bank Sponsorship

Types of ABCP Programs: Multi-Seller Schematic



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Types of ABCP Programs: Aggregator Sponsored Multi-Seller Programs

- These programs serve the same function as bank sponsored multi-seller programs
- An aggregator entity (Guggenheim, Nearwater, Mountcliff, Northcross, Capitolis) receives small, but high volume, fees by providing CP access to funding for bank customer transactions fully backed by bank liquidity and credit support
- Can have some off-balance sheet benefits for banks depending on bank's regulatory regime (RW capital, LCR, NSFR)
- Banks can be at mercy of liquidity shortage to aggregator

Types of ABCP Programs: Bank Sponsored CCP/Repo Programs

- A Bank sponsored CCP (or repo) program can involve CP issued directly by the bank or through a limited purpose, bankruptcy-remote SPV
- Typically designed as an alternative funding source for bank securities and/or loans
- In addition to other legal issues that impact these programs, Reg U and Reg T issues are implicated

Types of ABCP Programs: Aggregator Sponsored CCP/Repo Programs

- These programs function similarly to aggregator sponsored Multi-Seller Programs but typically fund securities books of banks/broker dealers, as opposed to customer transactions

Considerations for Setting up an ABCP Conduit

ABCP program - General considerations

- Location of CP issuance
  - USCP
  - ECP
  - Other
  - Currencies
- Types of customer transactions
  - Typical private securitizations (trade, warehouses, etc.)
  - Subscription facilities
  - Repos
  - Other
  - Currencies

ABCP program - General considerations *(cont'd)*

- Full support vs. partial support
- CP tenor
  - All short term
  - Longer term
  - Extendible, puttable, callable
- On balance sheet vs. off balance sheet
- Wholly owned vs. third party owned
- Identity of dealers
- Identity of depositary, issuing and paying agent
- Identity of collateral trustee, if applicable
- Identity of rating agencies
- Location of conduit issuer and desirability of US co-issuer

ABCP program – Legal considerations

- US Investment Company Act exemption
- US and other securities law exemptions
- Volcker Rule “covered fund” analysis
- US and EU risk retention compliance
- Rating agency regulation, including US rule 17g-5 website
- Tax domicile and related issues
- Money market fund investor issues and 2a-7
- US intermediate holding company (IHC) considerations

US Investment Company Act

- Prior to Volcker, most programs relied on 3(c)(1) or, more rarely, 3(c)(7)
- Bank programs now typically rely on 3a-7 or, more rarely, 3(c)(5) or, if ABCP Safe Harbor available for Volcker, 3(c)(1)
- Aggregator programs may still rely on 3(c)(1) / 3(c)(7)

US Securities Law Exemptions

- For Multi-Seller programs, generally 4(a)(2), although some may still rely on 3(a)(3)
- CCP/Repo programs may want both 4(a)(2) / 3(a)(3) in order to manage margin regulations
- Reg S can be difficult for US CP issuers

Volcker Rule Analysis

- Bank programs <u>must meet</u> an exemption at conduit <u>and</u> customer transaction level
  - Conduit
    - 3a-7 exempt
    - 3(c)(5) exempt
    - Some conduits may satisfy ABCP safe harbor
  - Underlying Deals
    - Also may satisfy 3a-7 or 3(c)(5)
    - SOTUS may be an option for non-US banks and non-US deals
    - LSE may be available
    - No ownership interest
- Aggregator Programs may use covered funds and rely on no ownership interest

US risk retention rules – options for ABCP conduits

- Standard risk retention options
  - Eligible vertical interest (EVI) – 5% of each class or single pro rata interest
  - Eligible horizontal interest residual interest (EHRI) – subordinated claim to principal and interest – 5% of fair value
  - Eligible horizontal reserve account (EHRA)
  - Any combination of above
  - Sponsor could buy 5% of conduit's ABCP, or
    provide 5% funded programme credit enhancement
  - EU bank sponsors comply through unfunded credit enhancement
- Specialised ABCP option for "eligible ABCP conduit"
  - Each ABCP interest acquired from an intermediate SPV, underwriter or initial purchaser at **initial issuance**
  - Each originator-seller retains via standard risk retention option or revolving pool securitisation option (Note: required even if transaction not otherwise required to comply)
  - 100% full support liquidity facility from regulated liquidity provider
  - Retention by sponsor via full support liquidity (unfunded) and by each originator-seller

US risk retention rules – options for ABCP conduits *(cont'd)*

- Safe harbour for "foreign" transactions
  - Securities Act registration not required
  - Not more than 10% of all issued ABS interests sold to US persons (defined more widely than in Reg S)
  - Neither sponsor nor issuer is US entity or branch
  - Not more than 25% of assets acquired from affiliate or branch in US
- Some aggregator conduits do not comply at all – no sponsor or no ABS

EU Money Market Funds Regulation – eligible ABCP

- ABCP is eligible if (liquid and good credit quality and) "issued by an ABCP programme which:
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  - (No limit on maturity of underlying assets, though earlier proposed)
- Future change: a consultation has opened where the EU is taking information as to how well this regulation is functioning, no concrete proposals as of yet.

US Rule 2a-7 Issues

- Money market funds are important ABCP investors
- 2a-7 disclosure is a non-starter
- Multi-purpose strategies include:
  - Using RSPEs
  - Splitting among multiple conduits
  - Move to a “non-2a-7” conduit
  - Substitute bank as primary obligor
  - Particular issues during ramp up

IHC Considerations

- Are non-bank owned conduits affiliates of bank for IHC purposes?
  - Recent changes presume yes if consolidated
  - <u>But</u> no need to move under IHC

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