MAYER | BROWN

ABCP: Market and Regulatory Developments

27 March 2024

Neil Hamilton
Partner, *Mayer Brown LLP*
nhamilton@mayerbrown.com

Jerry Marlatt
Partner, *Mayer Brown LLP*
jmarlatt@mayerbrown.com

Peter Pears
Partner, *Mayer Brown LLP*
ppears@mayerbrown.com

Remmelt Reigersman
Partner, *Mayer Brown*
rreigersman@mayerbrown.com

Chelsea Weiermiller
Associate, *Mayer Brown*
cweiermiller@mayerbrown.com

Agenda

- Introduction
- State of the Market
- CP and ABCP Introduction
- US Law for ABCP Conduits
- UK/EU Law for ABCP Conduits
- Tax Considerations for ABCP
- Mechanics of ABCP
- Various ABCP Structures
- Appendix

2024 ABCP Outlook

Market Trends

- Overall issuance volumes set to increase in 2024
- S&P, Moody's and Fitch all have a stable/neutral outlook for ABCP (in EMEA and US) in 2024
  - Even if assets deteriorate in an uncertain economy, rating agencies maintain stable outlook for ABCP conduits supported by GSIBs
  - Bank ratings expected to stay resilient
- Continued investor interest in "green" ABCP
- Asset portfolio stability
  - in US – autos and leases, trade receivable and corporate/commercial loans have been top three asset classes
  - In EMEA – trade receivables, auto loans and leases and equipment leases most common asset types
- In US and EMEA, expectation of continued interest in derivative financing arrangements, TRS and repurchase agreements

Sources: S&P Global Ratings and Fitch Ratings

CP and ABCP Introduction

What is Commercial Paper?

- Commercial paper is a term that is used to refer to corporate short-term debt securities. Maturities are typically less than 12 months.
- 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
- 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
- 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

What is Asset-Backed Commercial Paper?

- 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 bank loans
- In a defensive response, other banks started their own competing ABCP conduits
- The success of the conduit structure led to funding other asset types, including mortgages, portfolio securities, ABS and short-term loans

ABCP Key Features

- Revolving on both asset purchase and funding sides
- Maturity matched assets with funding
  - Unless fully supported by liquidity or guaranty
- 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

US Law for ABCP Conduits

ABCP program – US Legal considerations

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

33 Act and 40 Act

- ABCP may be issued under with Section 3(a)(3) or Section 4(a)(2) of the Securities Act of 1933, as amended.
  - Privately placed CP is more common today
  - CCP/Repo programs may want both 4(a)(2) / 3(a)(3) in order to manage margin regulations
- ABCP conduits need an exemption from registration as investment companies under the Investment Company Act of 1940, as amended
  - Conduits may rely on Section 3(c)(1), 3(c)(5), 3(c)(7) or Rule 3a-7
  - 3(c)(1) for short-term paper, *but see* Volcker discussion
  - 3(c)(5) for mortgage loans and merchandise receivables and loans to certain manufacturers, wholesalers and retailers
  - 3(c)(7) for the most flexibility, *but see* Volcker discussion
  - Rule 3a-7 for any "financial asset", but with restrictions on classes of investors and on trading in the assets

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 Rule 3a-7 or, more rarely, Section 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)

Volcker Rule

- The "Volcker Rule" was adopted pursuant to Section 619 of the Dodd Frank Act of 2010 by the five agencies in 2013
- An issuer that relies on Section 3(c)(1) or Section 3(c)(7) of the 40 Act for an exemption from registration as an investment company is a "covered fund" under the Volcker Rule
- The Rule imposes significant restrictions on bank transactions with a covered fund and particularly on holding an "ownership interest" in a covered fund
- There are a number of exemptions available under the Rule, including
  - Loan securitization exemption: assets consist only of loans
  - Qualifying ABCP conduit: assets consist of loans permissible for the loan securitization exemption or ABS issued by an entity relying on the loan securitization exemption acquired in the initial issuance
- Often we can conclude that ABCP is not an ownership interest
  - "ownership interest" is defined as "any equity, partnership, or other similar interest"; senior debt or loan expressly excluded

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 (solely outside the US) 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

Risk Retention

- Section 15G requires a "securitizer" of an "asset-backed security" to retain not less that 5 per cent of the credit risk of the securitized assets
- "securitizer" is defined in Rule 246.2 as the depositor or the sponsor
- "sponsor" is defined as " a person who organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity"
- "asset-backed security" is defined in Section 3(a)(79) as "a fixed-income or other security collateralized by any type of self-liquidating financial asset . . ."
- Some sponsors hold 5 per cent of the commercial paper issued by an ABCP conduit (an eligible vertical interest)
- Others may hold a 5 per cent first loss piece (an eligible horizontal residual interest)
- Other sponsors may provide full-warp liquidity, a liquidity asset purchase agreement or a guaranty
- And in other cases, the sponsor will rely on the LSTA decision, which held that the sponsor was not a sponsor under Reg RR because it did not transfer assets, directly or indirectly, to the issuer

Risk Retention *(cont)*

- SEC C&DI - Section 301.03 Item 1101(c) regarding whether notes of an SPV holding a funding agreement of an insurance company would be asset-backed securities
- The SEC staff said
  - "... an assessment of the cash flows servicing the payments on the notes requires looking through the funding agreement to the general account of the insurance company for the following reasons:
    - The structure of the funding agreement-backed notes is meant to replicate payments made by the insurance company under the funding agreement;
    - The funding agreement is a direct liability of the insurance company; and
    - Payments on the funding agreement-backed notes are based solely on the ability of the insurance company to make payments on the funding agreement.
    - Therefore, we would not consider the funding agreement-backed notes to be asset-backed securities under either Item 1101(c) of Regulation AB or Section 3(a)(79) of the Exchange Act"

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 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 program credit enhancement
  - EU bank sponsors comply through unfunded credit enhancement
- Specialized ABCP option for "eligible ABCP conduit"
  - Assets consist solely of ABS interests issued by an intermediate SPV
  - Each ABS 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

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

Other Considerations

- Swap dealer – if the ABCP conduit enters into swaps other than interest rate or currency swaps, consider whether it may be required to register as a swap dealer or a security-based swap dealer
- Investment advisor – consider whether the sponsor should register as an investment advisor under the Investment Advisor Act of 1940, as amended

Diversity for Money Market Funds

- Money market funds are important ABCP investors
- Rule 2a-7 prohibits a money market fund from investing more than 5% of its assets in the securities of a single issuer
- Rule 2a-7 provides for ABS investments that any person whose obligations constitute 10% of more of the underlying assets shall be deemed the issuer of that portion of the ABS
- Disclosure of 10% obligors by a conduit is a non-starter
- Multi-purpose strategies include:
  - Using RSPEs (restricted special purpose entities)
  - Splitting among multiple conduits
  - Move to a “non-2a-7” conduit
  - Substitute bank as primary obligor
  - Particular issues during ramp up

Bankruptcy

- Bankruptcy remoteness of the conduit is a requirement of the rating agencies, similar to the requirement for term securitizations
- Each agreement to which the issuer is a party will contain limited recourse and non-petition provisions
- *But see* the discussion on the NCSLT case

Accounting and Regulatory Capital Considerations

- Accounting consolidation
  - Particularly for CCP conduits where the sponsor provides credit support, the conduit may be consolidated on the bank's financial statements
  - If consolidated, the bank may be required to maintain capital against the assets of the conduit
  - And the LCR requirements would apply to CP with a maturity of 30 days or less
- Capital cost of liquidity
  - Under the Basel III Endgame proposed rules the capital requirement for <u>undrawn</u> liquidity lines would increase from zero to 10 per cent

IHC Considerations

- Are non-bank owned conduits affiliates of bank for intermediate holding company (IHC) purposes?
  - Recent changes presume yes if the conduit is consolidated with the bank
  - <u>But</u> no need to move the conduit under the IHC

Impact of NCSLT

- On March 19, the Third Circuit issued its decision in CFPB v. National Collegiate Student Loan Trusts
- The court held that the trusts were covered persons subject to the Consumer Finance Protection Act and that the trusts engaged in both student loan servicing and debt collection, activities subject to the enforcement authority of the CFPB.
- The court held that when third party servicers brought suit against borrowers to collect on delinquent loans, they were acting for the benefit of the trusts
- As such, the trusts cannot claim that they did not take part in “collecting debts”.

Security Interest in Assets

- Today it is common for ABCP to be secured by a perfected security interest in the assets of the issuer
- This will involve a perfection analysis under the Uniform Commercial Code of the jurisdiction in which the issuer is located and, if the issuer is located in a foreign jurisdiction, an analysis of the laws of that jurisdiction.
- Also, the type of assets in which the conduit grants a security interest may involve the law of other jurisdictions where the asset is located

Rating Agencies

- In order to obtain a rating for the ABCP from a rating agency, the sponsor must establish a password-protected website as required by Rule 17g-5
  - All information provided to the rating agency for the purpose of determining a rating on the ABCP must be posted on the website
  - All information provided to the rating agency for the purpose of undertaking credit rating surveillance must be posted to the website, including information about the characteristics and performance of the underlying assets of the conduit

UK/EU Law for ABCP Conduits

EU/UK regulatory considerations for ABCP

Main features of EU/UK regulation applicable to ABCP:

- **Prospectus regulation:** ABCP 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 classified as a money market instrument with a maturity less that 12 months and therefore not a “transferable security”. The minimum denomination of ABCP 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:** Not sold to retail.
- **Product Governance:** Depending on whether the ABCP 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. Again, not sold to retail.
- **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).

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 - ABCP 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)
- **MMF Future change - EU**: a consultation has opened where the EU is taking information as to how well this regulation is functioning, no concrete proposals as of yet.

Regulatory Considerations

- **MMF Future Change - UK**
- **December 2023** - HM Treasury published a policy note on reform of the UK Money Markets Fund Framework, together with a draft version of the Money Market Funds Regulations 2024.
- The draft regulations form part of the Smarter Regulatory Framework and will replace the retained EU law version of the EU Money Markets Fund Regulation. The consultation is now closed and we await the Policy Statement and final rules.
- No proposal to amend the limits set out above but the FCA is proposing a significant increase in the minimum proportion of highly liquid assets that all UK MMF types have to hold. The aim is to ensure that MMFs have enough liquid assets to withstand large amounts of withdrawals over a short period in severe but plausible market stresses.

CLE CODE:

ABCP27

Scan here for
the CLE form.

Please send completed forms to cle-events@mayerbrown.com.

Tax Considerations for ABCP

US Tax Considerations

- ABCP generally treated as indebtedness for US tax purposes
  - US or foreign issuer
  - Source of payments; impact of US tax forms and reporting obligations
- Credit support and/or liquidity support from sponsor
  - Consider recharacterization possibilities and US tax consequences
- Cross border considerations
  - Jurisdiction of issuer vs sponsor
  - Withholding on fees

Mechanics of ABCP

Revolving Finance Structures

- As noted above, ABCP conduits are revolving finance entities. Unlike many term securitizations, conduits can continue issuing CP for many years
- Also, ABCP conduits are constantly acquiring new assets as existing assets mature. And when assets are not match funded, a conduit may issue CP multiple times before an asset matures.

Primacy of Liquidity

- For conduits with assets having uncertain maturities, such as trade receivables, or assets with long maturities, like mortgage loans or auto loans, liquidity facilities are critical
  - If the conduit cannot issue new CP to pay maturing CP, same day funds from liquidity facilities must be available to pay maturing CP
  - There are not grace periods for CP
- Only when CP maturities can be matched with the maturity of an A-1/P-1 obligation, like a repo agreement, is liquidity unnecessary

Credit Support

- Generally, in order to ensure its ability to repay CP at maturity, conduits will maintain credit support for its assets, unless the asset represents the obligation of an A-1/P-1 obligor
- The credit support may take many different forms,
  - 100% full wrap liquidity
  - Guaranty
  - Letter of credit
  - Credit default swap
  - Insurance
  - Over-collateralization
  - EHRI

Co-Issuer Structures

- The investment authority of some U.S. investors may limit the portion it their assets that may be invested in securities of non-U.S. issuers
- Accordingly, some European conduits will establish a U.S.-based co-issuer of CP sold in the U.S.
- Usually, the co-issuer is a Delaware LLC that
  - Does not receive any of the proceeds of CP issuance; proceeds are sent directly to the European conduit
  - Has no assets
  - Will be indemnified by the European conduit for any claim or loss related to its co-issuance
- The co-issuer could also loan the proceeds to the European conduit, in which case the co-issuer will hold one or more promissory notes as an asset

Puttable/Callable CP Considerations

- Sometimes it is desirable to have flexibility maturity dates on the CP
- This may be the case if the conduit is making loans and the borrower needs the ability to prepay the loan
- Or it may be desirable to offer CP investors the opportunity accelerate the maturity of the CP they hold
- In the first case, the CP funding the loan needs to be callable (prepayable by the conduit)
- In the second case, the conduit must be able to accelerate the maturity of the asset funded by the CP, e.g., accelerate a loan funded by the CP

Various ABCP Structures

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

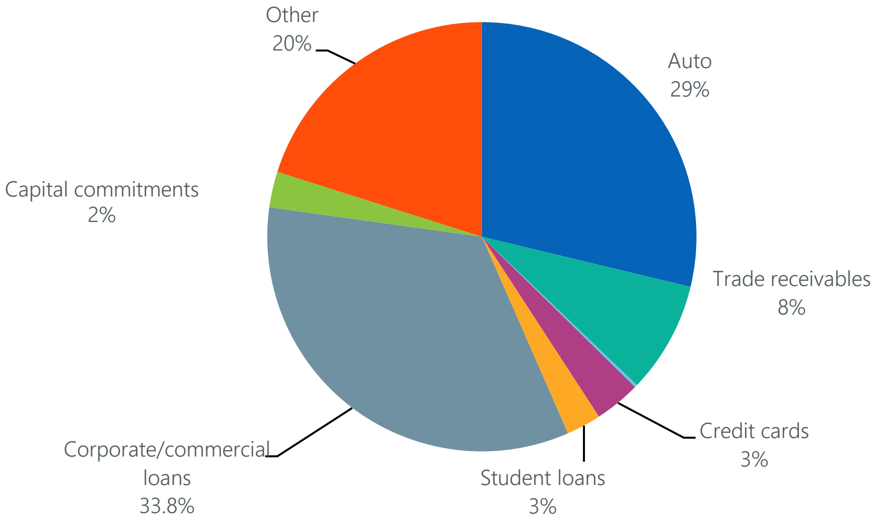
ABCP program - General considerations *(cont'd)*

- 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

- 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



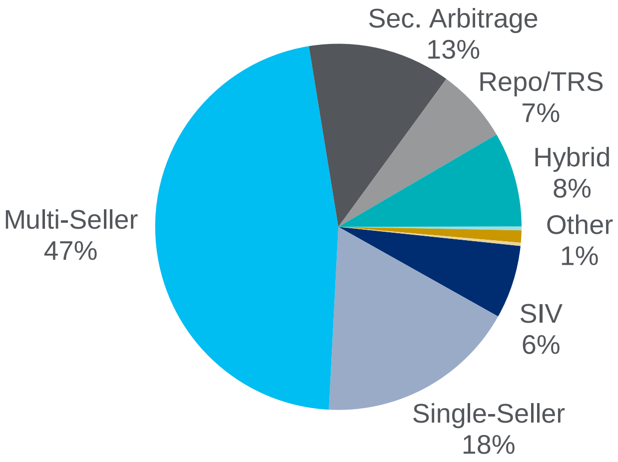
Source: Fitch Ratings

MAYER | BROWN

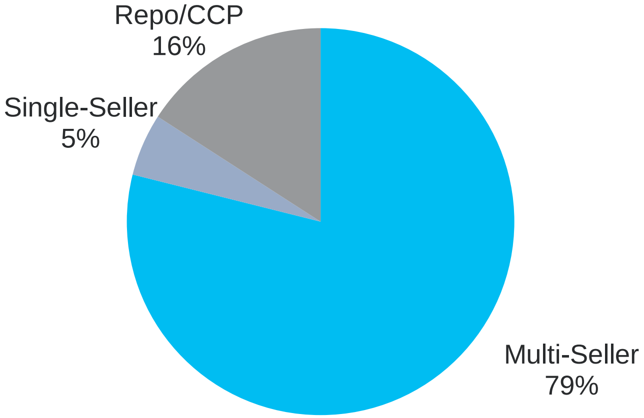
Evolution of the ABCP Market

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.

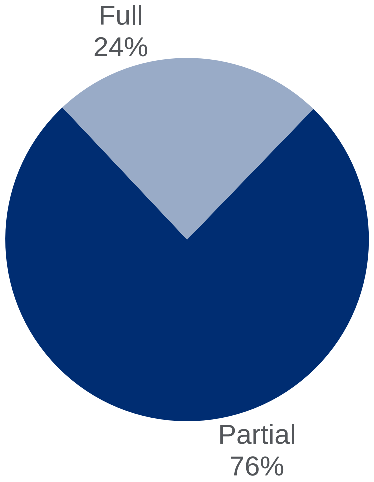
2007 U.S. ABCP Outstandings by Program Type



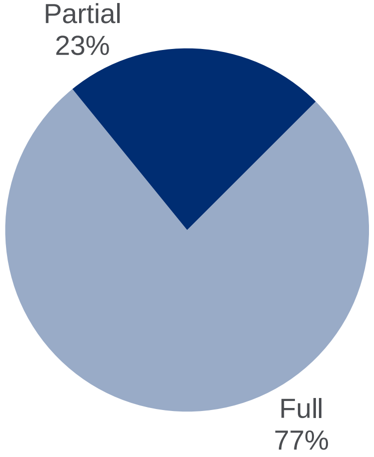
2023 U.S. ABCP Outstandings by Program Type



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)

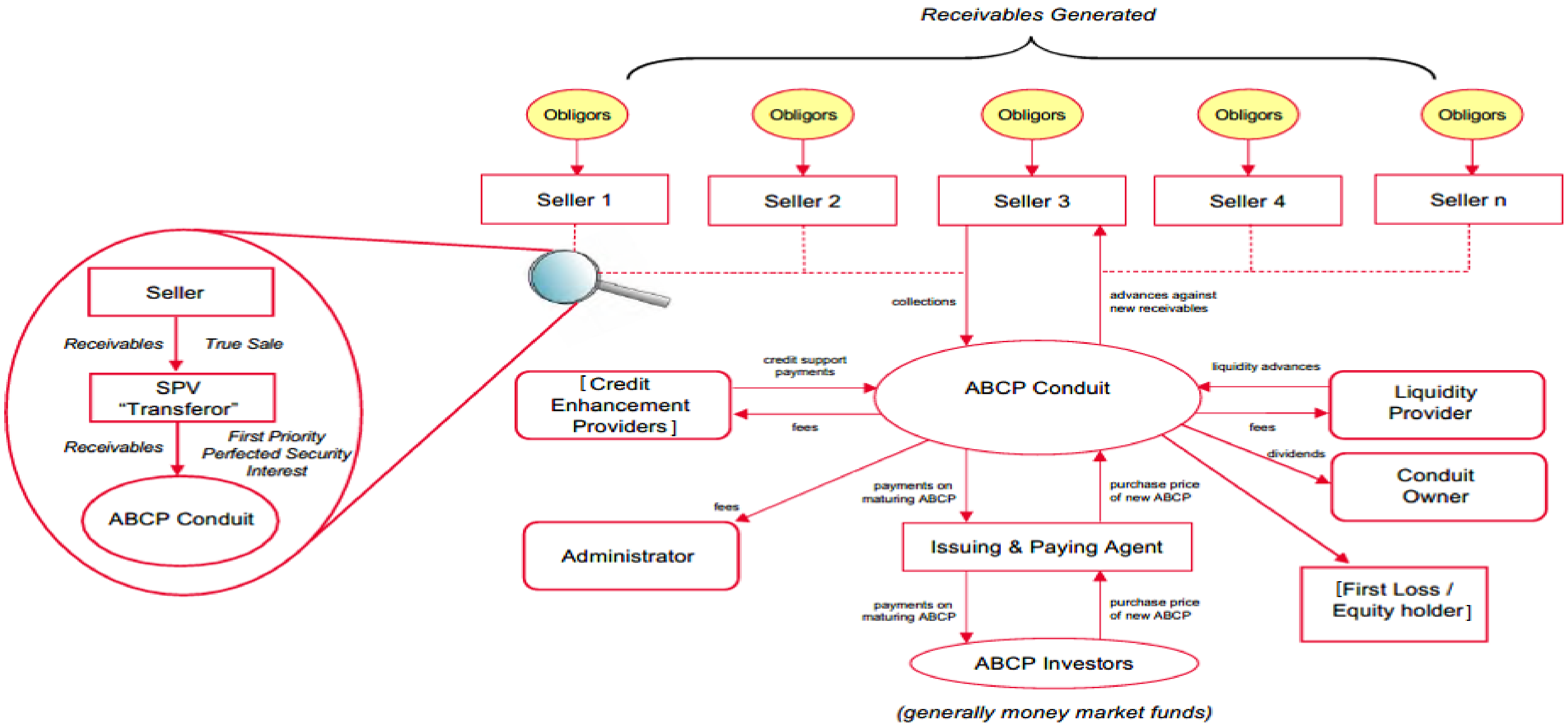
Types of ABCP Programs

- 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



MAYER | BROWN

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
- For example, a conduit may provide funding for a wide variety of assets under reverse repurchase agreements with A-1/P-1 counterparties

Types of ABCP Programs: TRS Vehicles

- More popular before Dodd-Frank, the conduit will enter into total return swaps on equity securities with an A-1/P-1 counterparty,
- The conduit hedges its exposure under the TRS by using CP proceeds to purchase the equity securities
- Post Dodd-Frank, the security-based swap regulations will be implicated

Types of ABCP Programs: CRT Vehicles

- Banks may seek capital relief through credit risk transfers
- The credit risk transfer may take a variety of forms:
  - A credit linked note issued by the bank and purchased by the conduit
  - An asset purchase agreement under which the conduit agrees to purchase assets from the bank
  - A guaranty of bank assets by the conduit, secured by the proceeds of CP
  - A credit default swap issued by the conduit

Appendix

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

CLE CODE:

ABCP27

ACCESS THE CLE FORM HERE.

Please send completed forms to cle-events@mayerbrown.com.

Additional Resources

Get the Cover(ed) Story at US-Covered-Bonds.com

Find recent developments and news on covered bonds in the United States.

VISIT & SUBSCRIBE TO OUR DERIVATIVES BLOG
LONGANDSHORTBLOG.COM

The Long and Short of It is Mayer Brown's derivatives blog designed to provide clients updates and analysis on legal and regulatory developments impacting derivative products. Blog contributors from our offices worldwide provide insights which will be useful to product specialists and non-specialists alike.

FREE WRITINGS + Perspectives

OUR FREE WRITINGS & PERSPECTIVES BLOG PROVIDES NEWS AND VIEWS ON SECURITIES REGULATION AND CAPITAL FORMATION.

The blog provides up-to-the-minute information regarding securities law developments and commentary on developments relating to private placements, IPOs, and other securities topics.

SUBSCRIBE

Writing on the Wall

Translating Securities with Mayer Brown

FOR EXPLANATIONS OF OVER 900 SECURITIES, DERIVATIVES, FINANCIAL SERVICES, AND CAPITAL MARKETS TERMS AND PHRASES.

writingonthewall.com

Read and subscribe to **REVERSEinquiries**, Mayer Brown's structured and market-linked products-focused newsletter.

We invite you to join our **REVERSEinquiries LinkedIn Group**, a resource maintained by Mayer Brown for issuers and financial intermediaries involved in, or interested in, developments affecting the structured and market-linked products market.

REVERSE inquiries