PUBLIC® TRUST ADVISORS

The ABCs of ABCP

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Government Investment Officers Association

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What is it?	Definition and Origin
Why Participate?	Yield and Diversification
Who invests in ABCP?	Liquidity: Market Size & Depth
Is it safe?	Safety: Structures & Monitoring
Q&A	Questions

What is ABCP?

Origins of Asset-Backed CP (ABCP)

- Created in 1980s to provide a capital efficient method for banks to lend to clients
- ABCP is a value-added offering to very large, very important core clients of a bank
- Trading also generates a modest profit for the participating broker-dealers

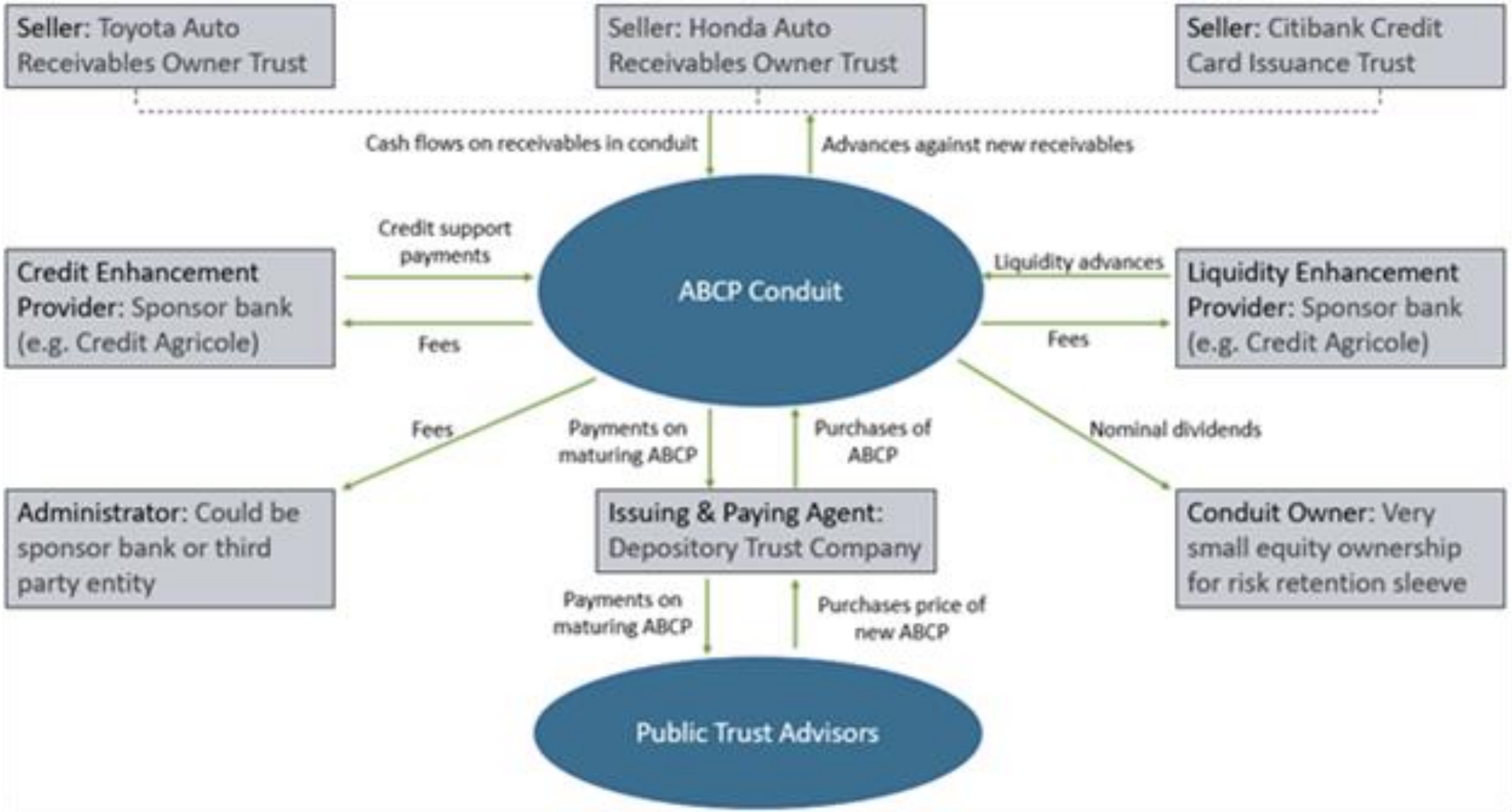
What is ABCP?

- ABCP is issued by high-grade issuers, generates yields above treasuries in a flexible range of maturities, and provides exposure to diverse asset classes (i.e. auto loans, receivables, credit card balances)
- Issuers are bankruptcy remote entities called "conduits" that may be fully or partially backed by a sponsoring bank
- Low-cost financing alternative to bank loans for short-term liquidity needs
- Exempt from SEC registration which is more costly and takes time for approval
- Primary risk is systemic

What is ABCP?

- Conduits are bankruptcy remote entities that securitize assets of a bank or bank client in order to generate cash
  - A finance company, the **originator**, generates a high volume of consumer loans; for example, auto loans - the auto finance company would like to sell these loans, so it can make more loans
  - **Securitization**: the originator bundles a group of loans into a pool, packaged to sell. A pool represents a particular asset type from a seller or originator. For example, the auto finance company, such as Toyota Motor Credit Corp., might sell its auto loan receivables balance to a **special purpose vehicle (SPV)**
  - An **SPV** is a bankruptcy-remote entity that sells ABCP and uses those funds to acquire and finance specific assets - in this case, the receivables of the auto lender. Investor cash flows come from the repayment of the underlying assets

Typical ABCP Structure



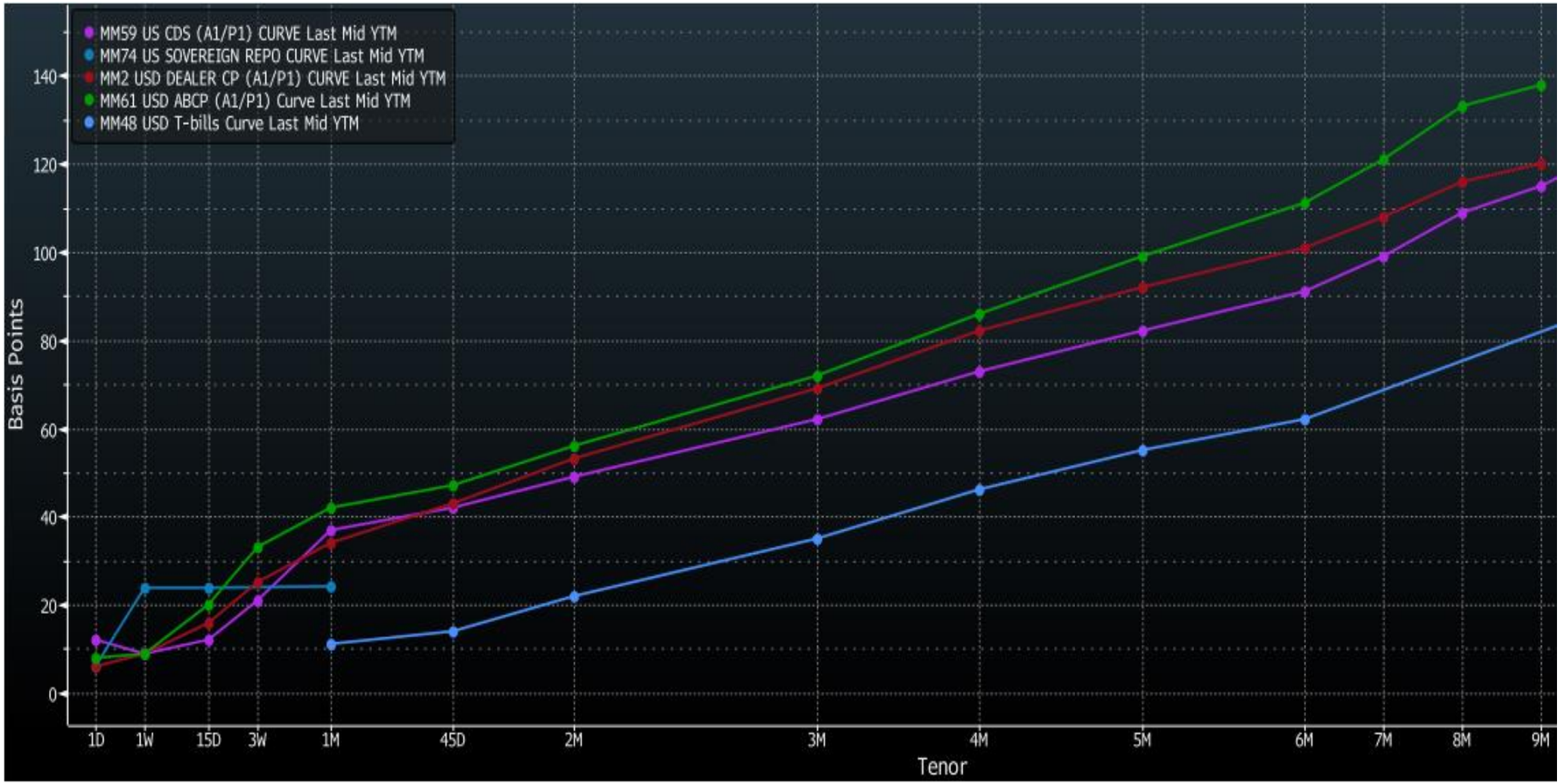
Source: Public Trust Advisors and Moody's, "The Fundamentals of Asset-Backed Commercial Paper," February 3, 2003

Why Participate?

Why do Investors Buy ABCP?

- ABCP is secured, and the credit risk is analogous to CP and CDs
- ABCP programs are high-grade with yields offering customizable tenors and exposure to diverse asset classes
- Supported or backstopped by either the sponsoring bank's balance sheet or the conduit's credit and liquidity enhancements
- Investors reap a spread above commercial paper, the "complexity spread"
  - Compensation for the additional due diligence burden and the relatively smaller market size compared to traditional CP

Yield

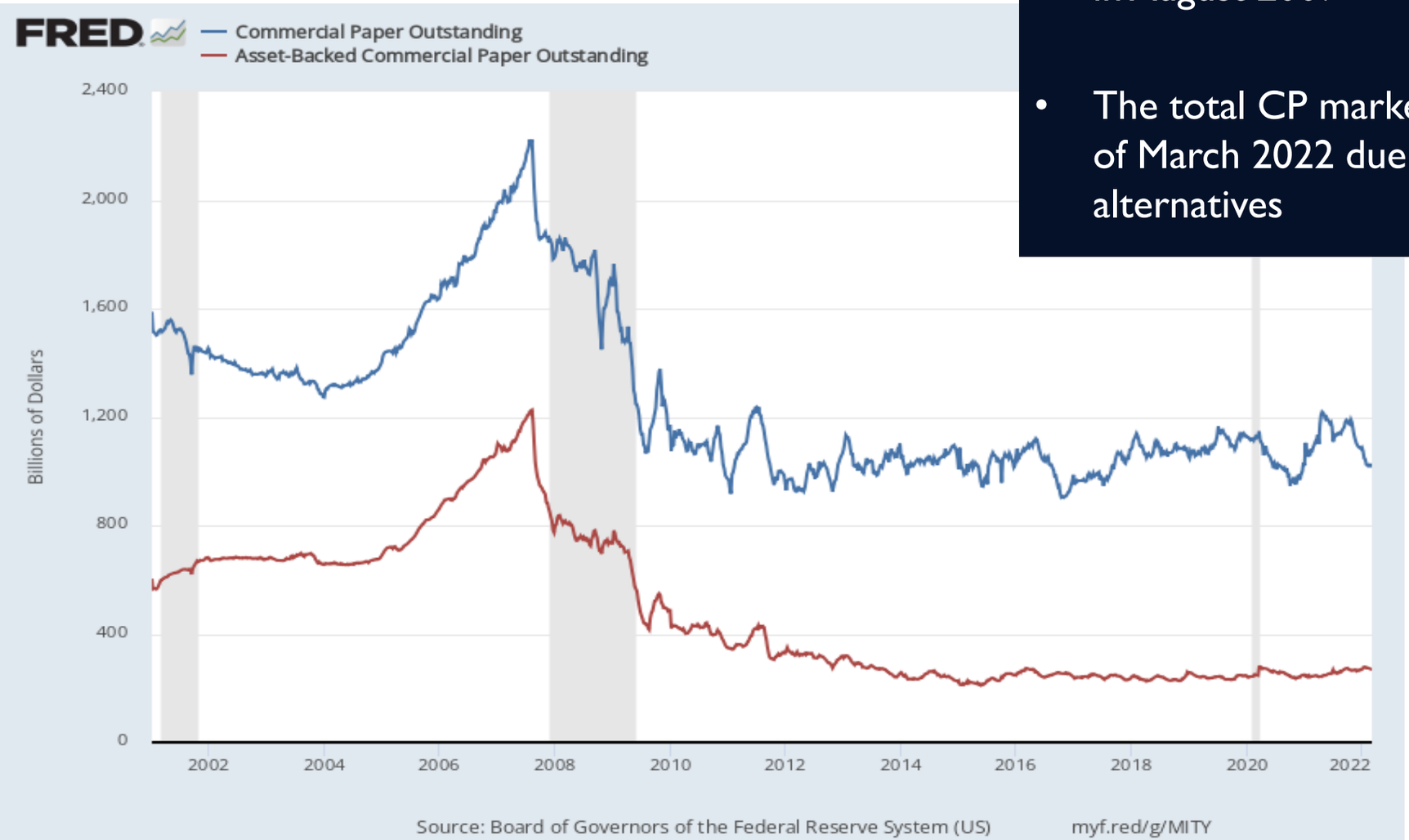


Source: Bloomberg, March 8, 2022

Who Invests in ABCP?

Liquidity

- Total commercial paper market peaked at $2.2T in August 2007
- The total CP market has declined to $1.03T as of March 2022 due to cheaper financing alternatives



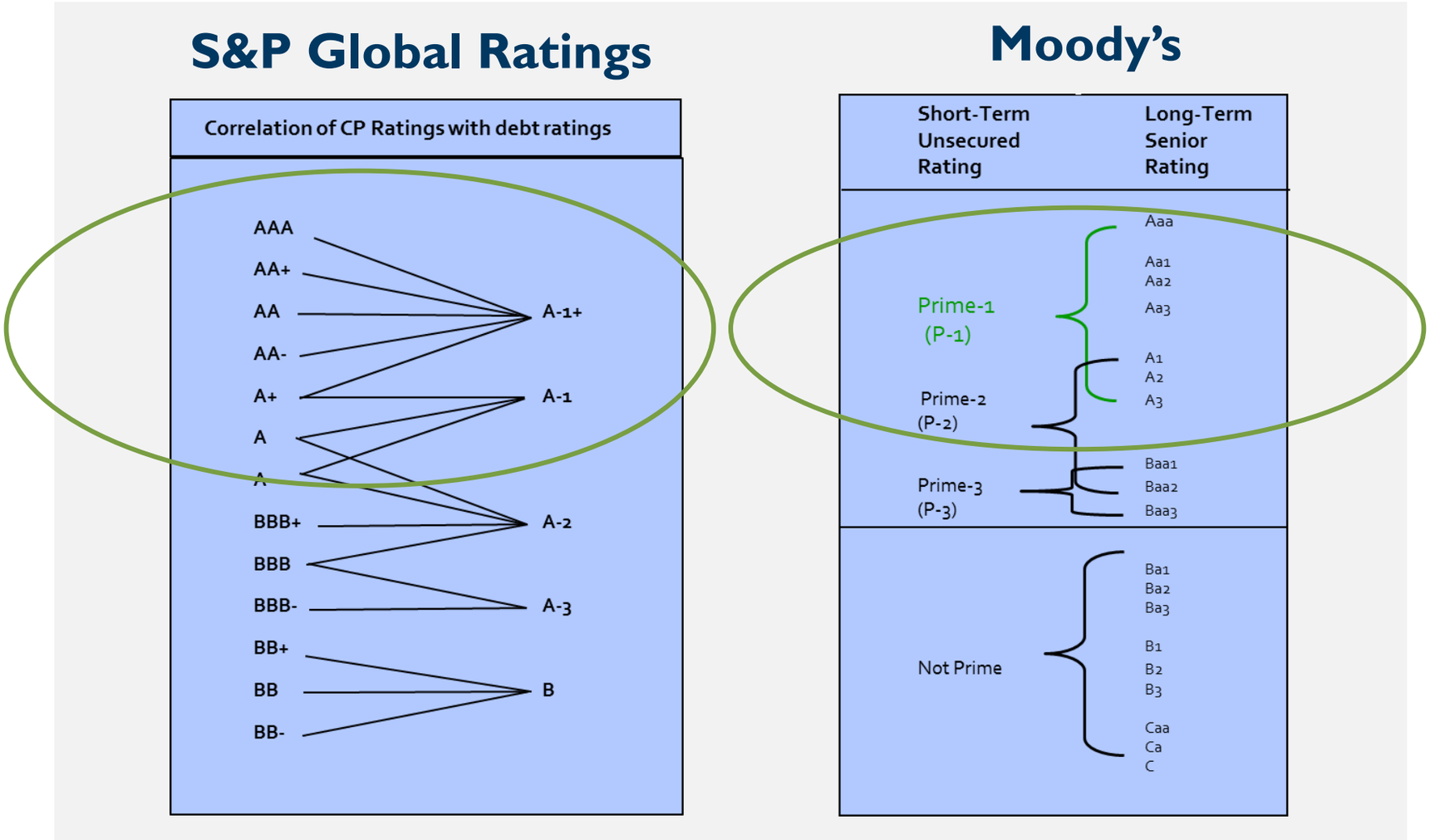
Source: Board of Governors of the Federal Reserve System (US), Commercial Paper Outstanding, retrieved from FRED, March 8, 2022

SEC Rule Change

- In the fall of 2020, the SEC revised QIB/Accredited Investor rules to enable expanded local governments participation in various investment structures
  - Institutional accredited investors managing more than $100M in assets would be considered qualified institutional buyers (QIB)
  - Before the change, non-QIB municipal investors generally invested in 3(a)3 exempt commercial paper and had little exposure to 4(a)2 exempt issuance
    - Nearly 70% of ABCP conduits covered by Public Trust Advisors are 4(2) exempt

Is it Safe?

Safety


S&P Global Ratings
Correlation of CP Ratings with debt ratings
AAA
AA+
AA
AA-
A+
A
A
BBB+
BBB
BBB-
BB+
BB
BB-
A-1+
A-1
A-2
A-3
B
Moody's
Short-Term Unsecured Rating
Long-Term Senior Rating
Prime-1 (P-1)
Prime-2 (P-2)
Prime-3 (P-3)
Not Prime
Aaa
Aa1
Aa2
Aa3
A1
A2
A3
Baa1
Baa2
Baa3
Ba1
Ba2
Ba3
B1
B2
B3
Caa
Ca
C

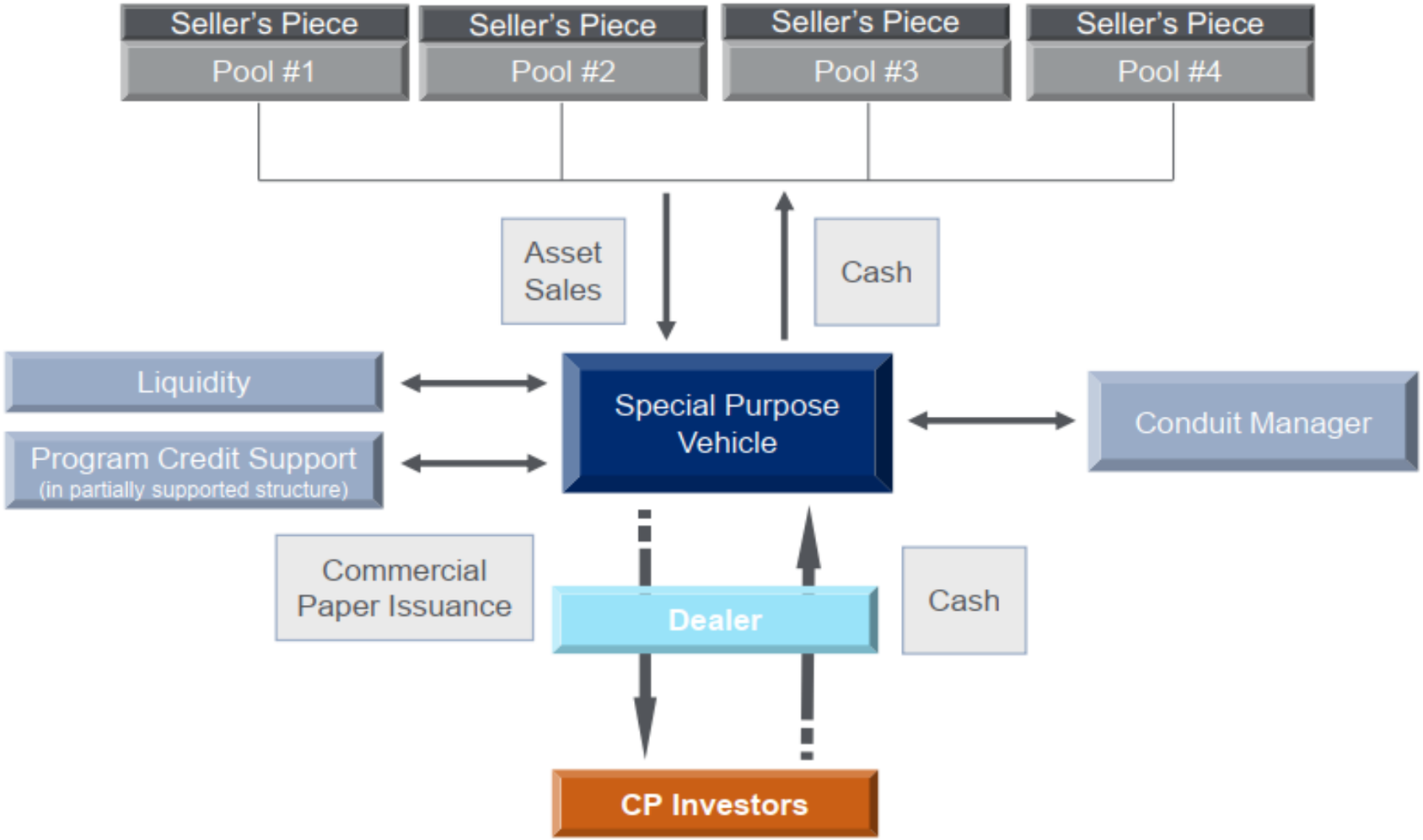
Structure of ABCP

- Composed of a variety of collateral types
  - Receivables
  - Repurchase agreements
  - Total return swaps
- Will have either full or partial support from sponsoring bank or another tier-1 bank
- May be managed by internal bank affiliated managers or independent third-party managers

How do Banks Support ABCP?

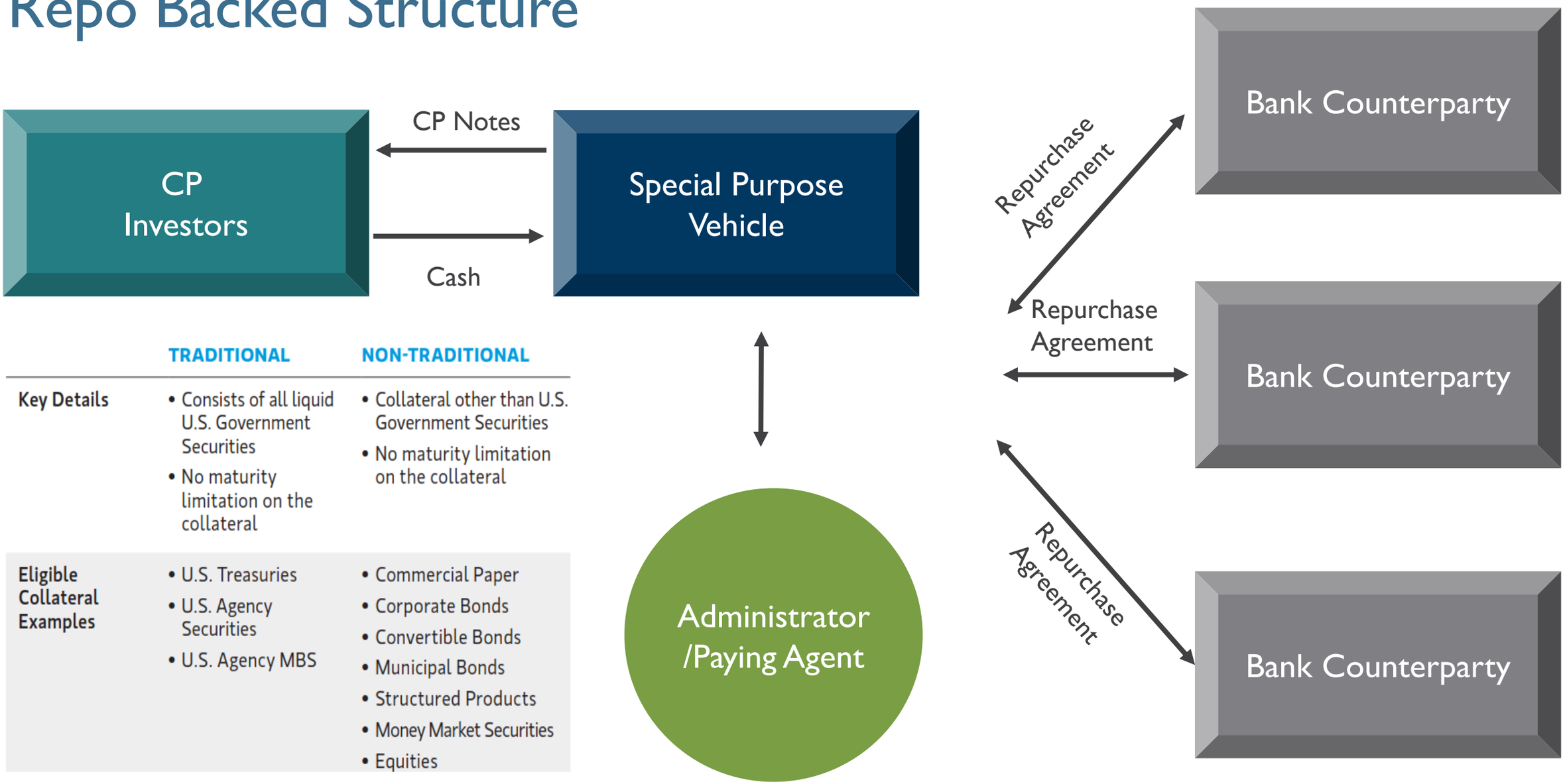
- The bankruptcy remote conduit is protected from the bank's credit risk meaning that the bank cannot subsume the conduit's assets
- The bank provides either full or partial support. Most support structures include:
  - **Transaction Level Enhancement** – overcollateralization, reserve accounts (cash generated by excess spread), subordination
  - **Liquidity Support** - designed to bridge potential cash flow mismatches/lack of market liquidity
  - **Enhancement** - program-wide enhancement is utilized only if the liquidity agreements have not provided sufficient support or there is risk of default
- Fully supported conduits rely on the sponsoring bank
- Partially supported conduits rely on the underlying cash flows and enhancement

Receivables Backed Structure



Source: Citi Institutional Clients Group

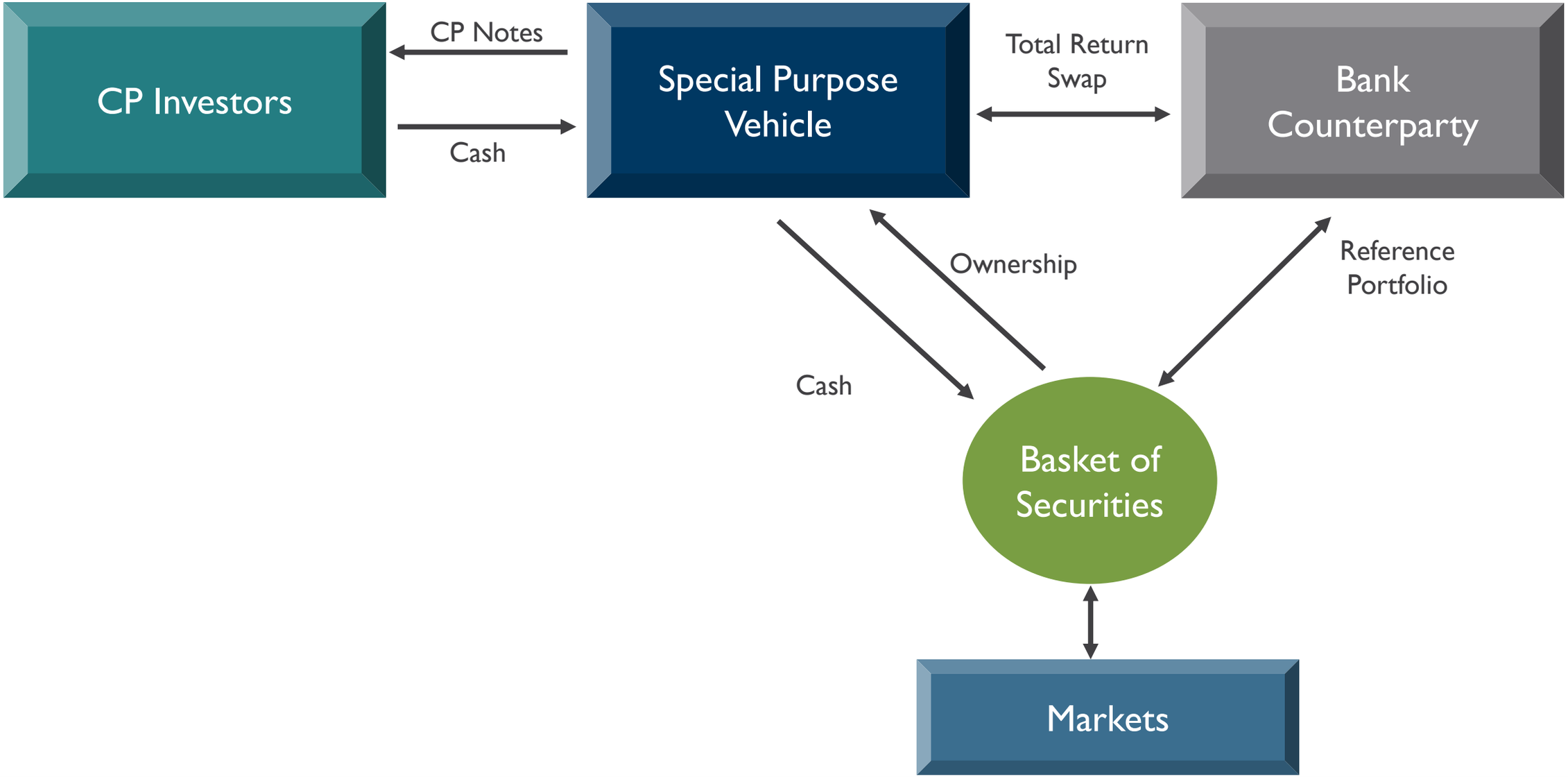
Repo Backed Structure



	TRADITIONAL	NON-TRADITIONAL
Key Details	• Consists of all liquid U.S. Government Securities • No maturity limitation on the collateral	• Collateral other than U.S. Government Securities • No maturity limitation on the collateral
Eligible Collateral Examples	• U.S. Treasuries • U.S. Agency Securities • U.S. Agency MBS	• Commercial Paper • Corporate Bonds • Convertible Bonds • Municipal Bonds • Structured Products • Money Market Securities • Equities

Source: Citi Institutional Clients Group

Total Return Swap (TRS) Backed Structure



Source: Citi Institutional Clients Group

How do Investors Evaluate ABCP?

Idiosyncratic Risk

- Fully supported conduits: focus on the credit risk of program sponsor
- Partially supported conduits: understand assets & credit enhancements
- Analysis of program size and liquidity

Systemic Risk

- The primary risk is systemic. One method is to decompose and re-aggerate risk for a more comprehensive view.

ABCP Exposure		
Exposure	**$MM**	**% of Pool**
Repo	385.0	15.9%
Trade Receivables	114.8	4.7%
Auto Loans, Leases, Floorplans & Receivables	77.5	3.2%
Consumer/Commercial Loans	21.1	0.9%
Consumer Credit	13.8	0.6%
Credit Cards Receivables	13.1	0.5%
Equipment Loans, Rentals, Receivables	7.9	0.3%
Student Loans	5.5	0.2%
Transportation Finance	4.2	0.2%
Residential Mortgages	4.0	0.2%

Source: Public Trust Advisors

Why do Investors Fear ABCP?

- Bad actors during the Global Credit Crisis - failed programs were single-issuer, often sponsored by asset managers and heavily involved with private label mortgage-backed securities (MBS)

- Now the market is largely comprised of programs that survived the Global Credit Crisis; bad actors have washed out

  – Since 2007, the ABCP market has declined from $1.2 trillion to approximately $250 billion. The decline is related to lower supply rather than decreased investor demand. 95% of the 2017 issuances were multi-seller or securities lending programs compared to 54% in 2007. The dramatic increase is a result of survival. Those programs were and still are designed to weather difficult market conditions.

- Post-crisis regulations have improved credit quality and market liquidity (via Basel III, money market reform, Dodd-Frank)

Conclusion

Asset-backed commercial paper offers compelling yields and diversifying risk

Investor's effort and expertise are rewarded through the complexity yield

Rigorous analysis provides confidence

Understand your credit risk – there is no free lunch

Questions?

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