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Commercial Paper: Legal & Regulatory Developments

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Agenda

- State of the Market
- Introduction to Commercial Paper
- Commercial Paper Market Characteristics
- Who Are the Issuer and Investors
- Developments
- Introduction to European Commercial Paper
- Asset-backed Commercial Paper
- UK/EU Law for ABCP Conduits
- Appendix

2025 ABCP Outlook

Market Trends

- Overall issuance volumes set to increase again in 2025
- S&P, Moody's and Fitch all have a stable/neutral outlook for ABCP (in EMEA and US) in 2025
  - 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" CP
- 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

Introduction to Commercial Paper

What is Commercial Paper?

- Commercial paper means corporate short-term debt securities. Maturities are typically less than 12 months.
  - Why is commercial paper important?
- Corporate 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
- The commercial paper market peaked at $2.2 Trillion prior to the financial crisis
- Today there is a resurgence of commercial paper issuance, particularly ABCP

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."

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
- 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

JOBS Act Changes to 4(a)(2) Offers

- Title II of the Jumpstart Our Business Startups (JOBS) Act of 2012 directed the SEC to eliminate the ban on general solicitation and general advertising for certain offerings under Rule 506 of Regulation D and under Rule 144A
- Under the SEC rulemaking, new paragraph (c) was added to Rule 506 to permit general solicitations under certain circumstances
- Rule 144A was also amended to permit public solicitation as long as sales are only made to QIBs
- Thus, a Rule 144A program no longer risks being out of the market for 30 to 60 days as a result of an inadvertent publicity problem
- This rulemaking now permits general solicitation in an offering even though the issuer is relying on Section 3(c)(1) or 3(c)(7) of the 1940 Act, which prohibits a public offering

Disadvantages of 4(a)(2) Paper

- 4(a)(2) commercial paper is still a “restricted security”
- Some investors have limits on the amount that they can invest in restricted securities
- This might have some impact in the secondary market, but generally the secondary market is a dealer market, i.e., most sales in the secondary market are back to dealers who may hold or may resell the paper to other customers
- Generally, however, the 4(a)(2) commercial paper market is just a liquid as the 3(a)(3) market

State Regulatory Scheme

- Federal securities regulation does not preempt all state regulation of securities
- Section 18 of the Securities Act provides an exemption for “covered securities”
  - Sales to ‘qualified purchasers’ – SEC has not defined
  - Certain sales under Section 3, including Section 3(a)(3)
  - Sales under Section 4(a)(1) or (3) of securities of SEC reporting companies
  - Sales under Section rules or regulations issued under 4(a)(2)—e.g., Reg D
    - Note that Rule 144A was not adopted under Section 4(a)(2)
- However, most states provide an exemption for sales to ‘institutions’
  - There remain a handful of states that are a problem for 144A offerings
  - This can be problematic when an issuer has no listed debt or equity securities
  - Some issuers have moved to the 3(a)(3) market for this reason

CP 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.)*

- 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

Tenors

- Historically, almost 90% of all commercial paper was issued with maturities of 21 days or under
- With the match funding of asset maturities by ACBP conduits, longer maturities became more common
- Additionally, LCR considerations for banks have led to commercial paper with longer maturities
- The commercial paper market has also developed redeemable, extendible and puttable commercial paper, which has led to longer maturities. Banks in particular favor longer tenor, redeemable commercial paper for LCR reasons

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
- The market for tier 2 paper is more difficult
- Liquidity backstop is an important consideration in ratings

Primacy of Liquidity

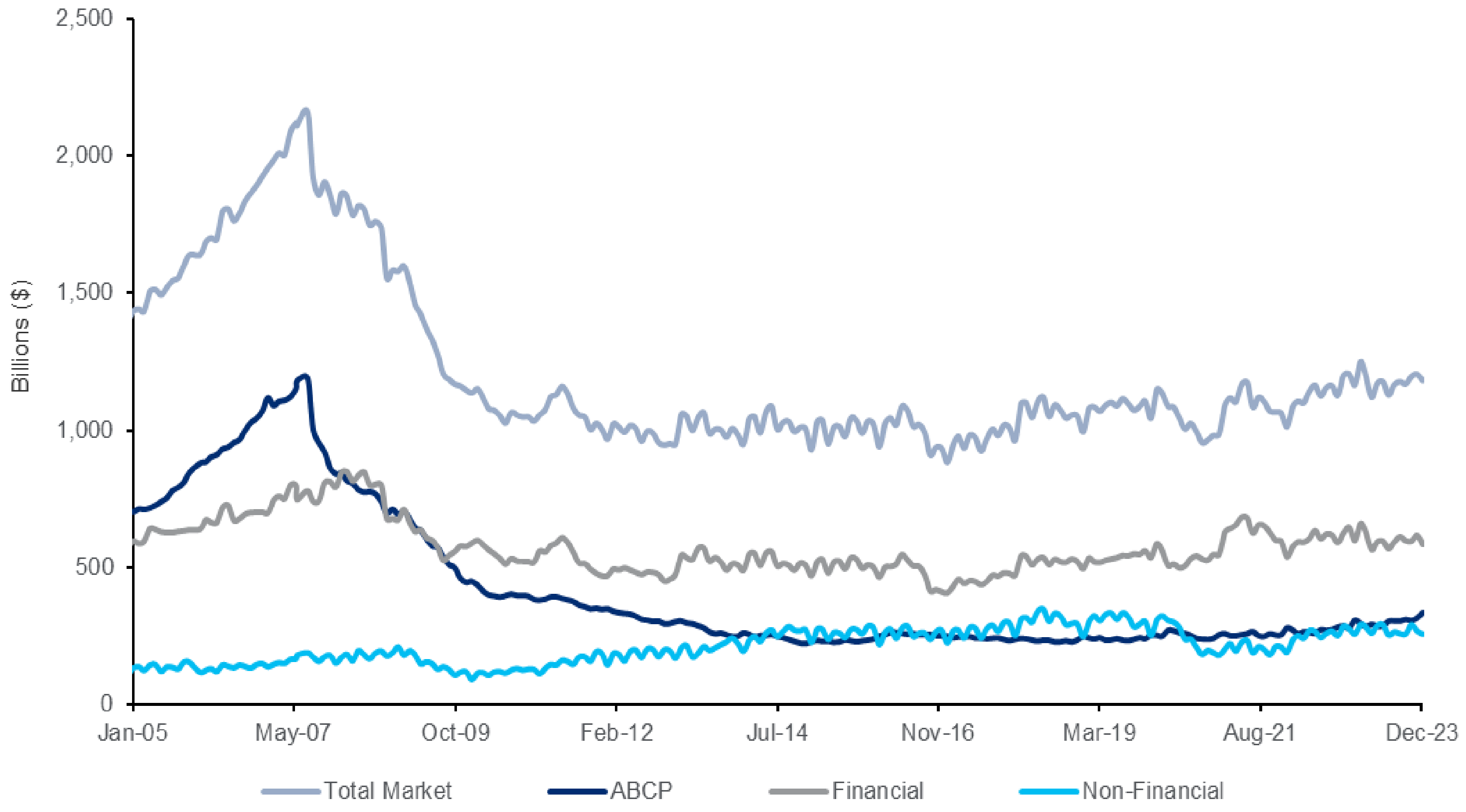
- Particularly for ABCP programs, but also for corporate issuers, available liquidity is a key rating factor
- Unlike term debt, there are no grace periods for commercial paper
- Accordingly, a commercial paper issuer must have access to same-day funds on very short notice; this is generally provided 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

CP Investors

Commercial Paper Investors

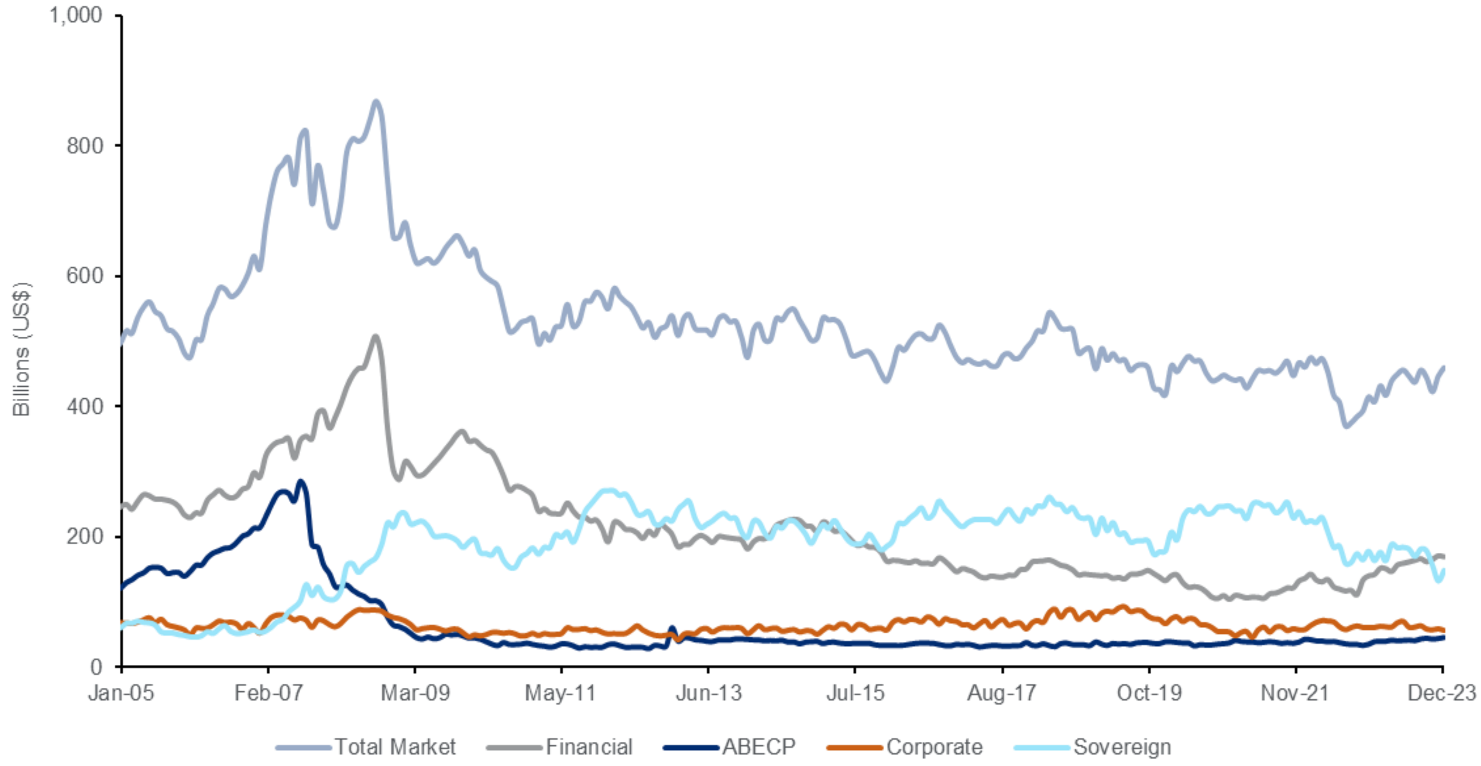
- Financial institutions
- Foreign financial institutions
- Some governments – domestic and foreign
- Corporate treasuries
- Municipalities
- Short-term bond funds
- Banks
- Insurance companies
- Money market funds

USCP Outstandings



Source: Federal Reserve

ECP Outstandings



Source: Dealogic

Developments

Regulatory Developments

- Basel II Endgame – regulatory capital rules
  - 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
- Money Market Fund rule changes
- Regulatory capital – Liquidity Coverage Ratio (LCR)
  - Banks need to hold HQLA against obligations with <30-day maturities
- Regulatory capital – Accounting consolidation
  - Generally bank ABCP conduits are consolidated for accounting purposes
  - Additional capital for conduit assets
  - Incentive for guaranteed or fully supported bank conduits

Regulatory Developments *(cont.)*

- 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
  - Harder to obtain off balance sheet structures
  - Reduced incentive to securitize
- Jobs Act changes to 4(a)(2) offers
  - Bad actor rule reduces Reg D issuance
  - Section 18 exemption is unavailable

Regulatory Developments *(cont.)*

- Rule 15c2-11
  - The 2019 proposing release suggested that the Rule applied to debt securities
  - Would have required issuers in 2023 to make financial information publicly available in order for dealers to provide bids in secondary market
  - Most dealers concluded the Rule requirements were manageable
    - Maturities of 270-days or less were viewed as outside the Rule because of Section 10 of the Exchange Act
  - However, the Rule could have caused complications for:
    - Pricing, portfolio valuation, compliance, auditing
  - December 2021 and November 2022 no action letter extended the interim treatment through 2025
  - In October 2023, the Commission exempted sales under Rule 144A
  - In November 2024, a no action letter withdrew the 2022 letter and specified securities for exemption

Other Developments

- Sustainable and green commercial paper
  - Less interest from issuers in the U.S. compared to Europe
  - Sustainable and green projects more likely to use term funding

European Commercial Paper

ESG Commercial Paper

ESG Commercial Paper - Overview

There is an increasing focus on ESG considerations in the 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.
- October 2024: ICMA publishes new paper on the role of commercial paper in the sustainable finance market » ICMA
- 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. There are currently 244 ESG-focused money market funds with over EUR 1.5tn in AUM (Source: Bloomberg/NatWest).
- Is there an ESG CP Greenium?
- The sustainable CP market is growing, with **33 sustainable CP programmes** identified in the EU. Of these, **23** are **Use of Proceeds CP** programmes, and **10** are **Sustainability-Linked CP programmes**. Use of Proceeds CP programmes representing up to EUR 265 billion and Sustainability-Linked CP programmes approximately EUR 34 billion.

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ESG Commercial Paper – Structuring Considerations

Sustainable CP programmes can be structured in different ways

Categorisation	Description
Use of Proceeds Commercial Paper	Commercial paper where the net proceeds (or an equivalent amount) are exclusively applied towards financing or refinancing eligible green, social or sustainable projects or activities, as defined in, and in alignment with, an issuer's Sustainable Financing Framework.
Sustainability-Linked Commercial Paper	Commercial paper that is linked to an issuer's performance based on sustainability Key Performance Indicators (KPIs) or ESG ratings/scores which are consistent with the issuer's Sustainability-Linked Financing Framework or sustainability strategy.

Key structuring considerations

- **Dual or sole use Programme?**
- **Greenwashing concerns** – Risk Factors/Reporting/Tie in with ICMA aligned Framework
- **Penalties** for failing to meet targets typically involve restrictions on future CP issuance or financial penalties in the form of donations to charities or NGOs.
- **Double counting**
- **Level of Disclosure** – US v EU programmes

Asset-Backed Commercial Paper

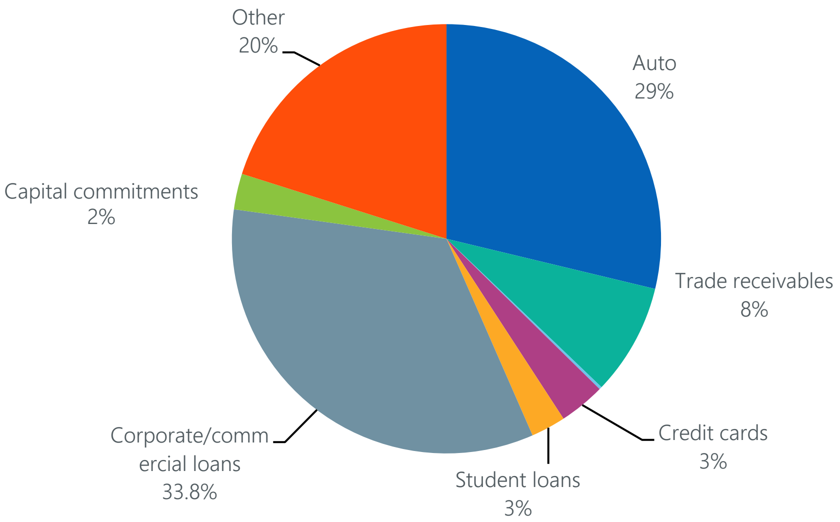
ABCP

- The development of securitization in the 1980s did not by-pass commercial paper
- Merrill Lynch/Citi 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, 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

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

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ABCP Key Features

- Revolving on both asset purchases and funding sides
- Maturity match 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

Types of ABCP Programs: Bank Sponsored Multi-Seller Programs

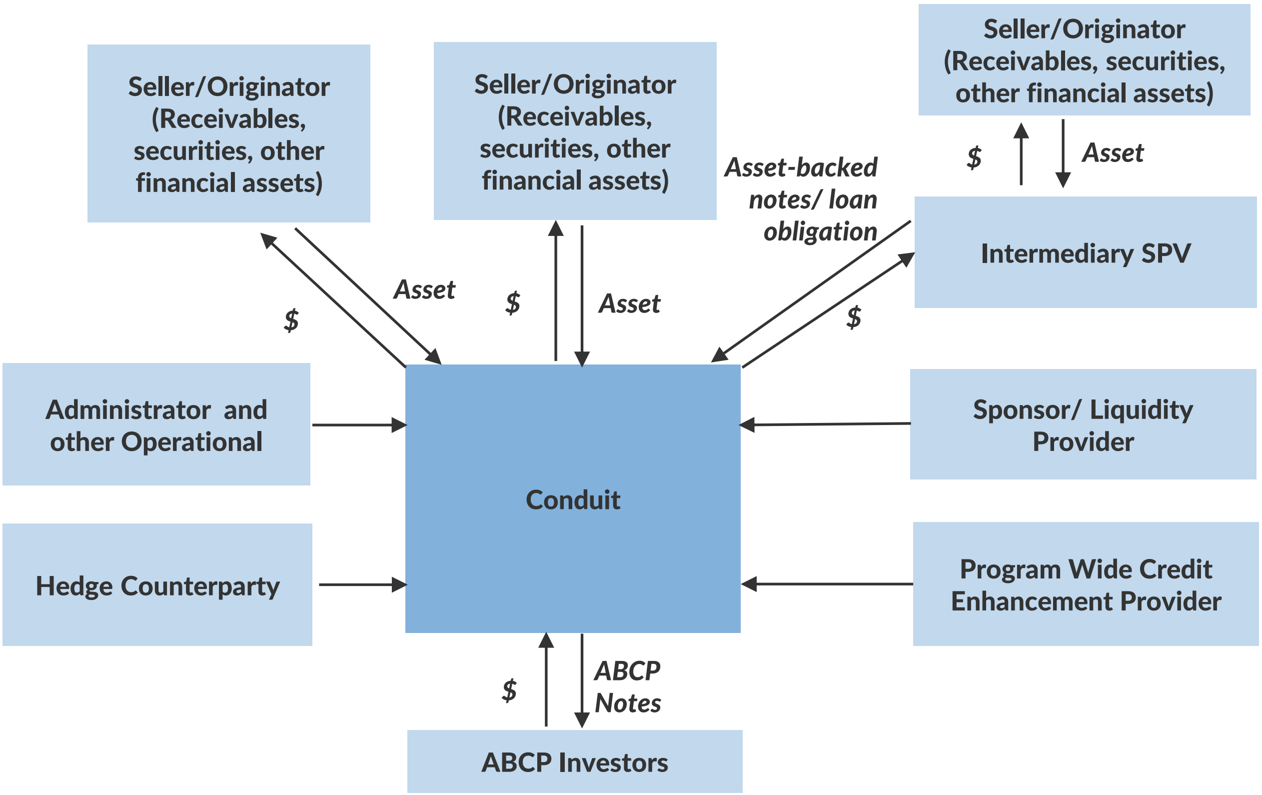
- A Multi-Seller ABCP Conduit is a limited purpose, bankruptcy-remote SPV that provides financing for receivables pools generated by multiple, unaffiliated originators/sellers
- Multi-seller programs are most commonly established and "sponsored" by large commercial banks and typically provide financing 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
  - Originator diversification
  - Asset diversification and Deal-Specific Credit Enhancement
  - Program-Wide Credit Enhancement and 100% Liquidity Support
  - Bank Sponsorship

Types of ABCP Programs: Independent Structured CP

- An aggregator entity (Guggenheim, Nearwater, Mountcliff, Northcross, Capitolis) receives small, but high volume, fees by providing CP access to funding for bank customer transactions
- These programs are also designed to serve funding needs at banking institutions; however, more focused on bank-specific needs and less on bank client origination funding
- Fully supported by one or several banks, generally large global financial institutions
- Can have some off-balance sheet benefits and optimization for banks depending on bank's regulatory regime (RW capital, LCR, NSFR) and changing market conditions
- Banks can be at mercy of liquidity shortage to aggregator, but each ABCP issuance is term matched to a financing agreement reducing uncertainty

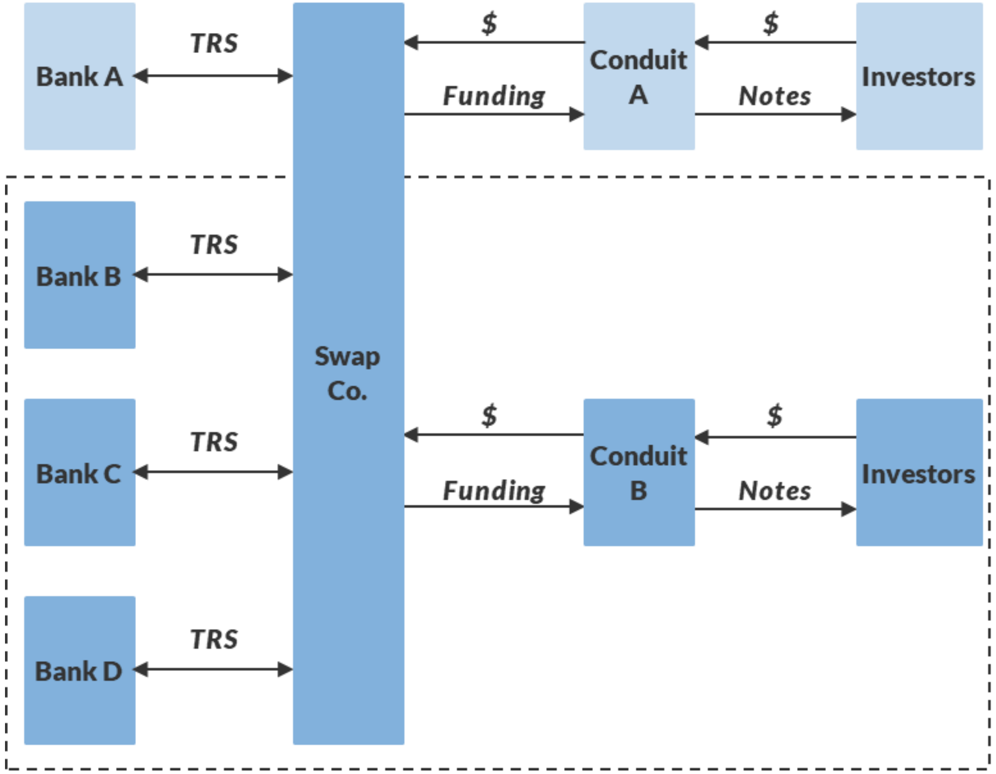
Types of ABCP Programs: Multi-Seller and

Example Multi-seller ABCP Program



Source: Fitch Ratings

Example: Independent Structured CP Program



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
- And if selling from U.S. to European investors or from Europe to U.S. investors, both EU and UK securitization regulations come into play

UK/EU Law for ABCP Conduits

EU/UK regulatory considerations for ABCP

Main features of EU/UK rules 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 Rules**
  - 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 Rules.
  - EU/UK Securitisation Rules 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 Rules**
  - 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

Additional Resources

LinkedIn Group. Stay up to date on structured and market-linked products news by joining our LinkedIn group.

Suggestions? *REVERSEinquiries* is committed to meeting the needs of the structured and market-linked products community, so you ask and we answer. Send us questions that we will answer on our LinkedIn anonymously or topics for future issues.

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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
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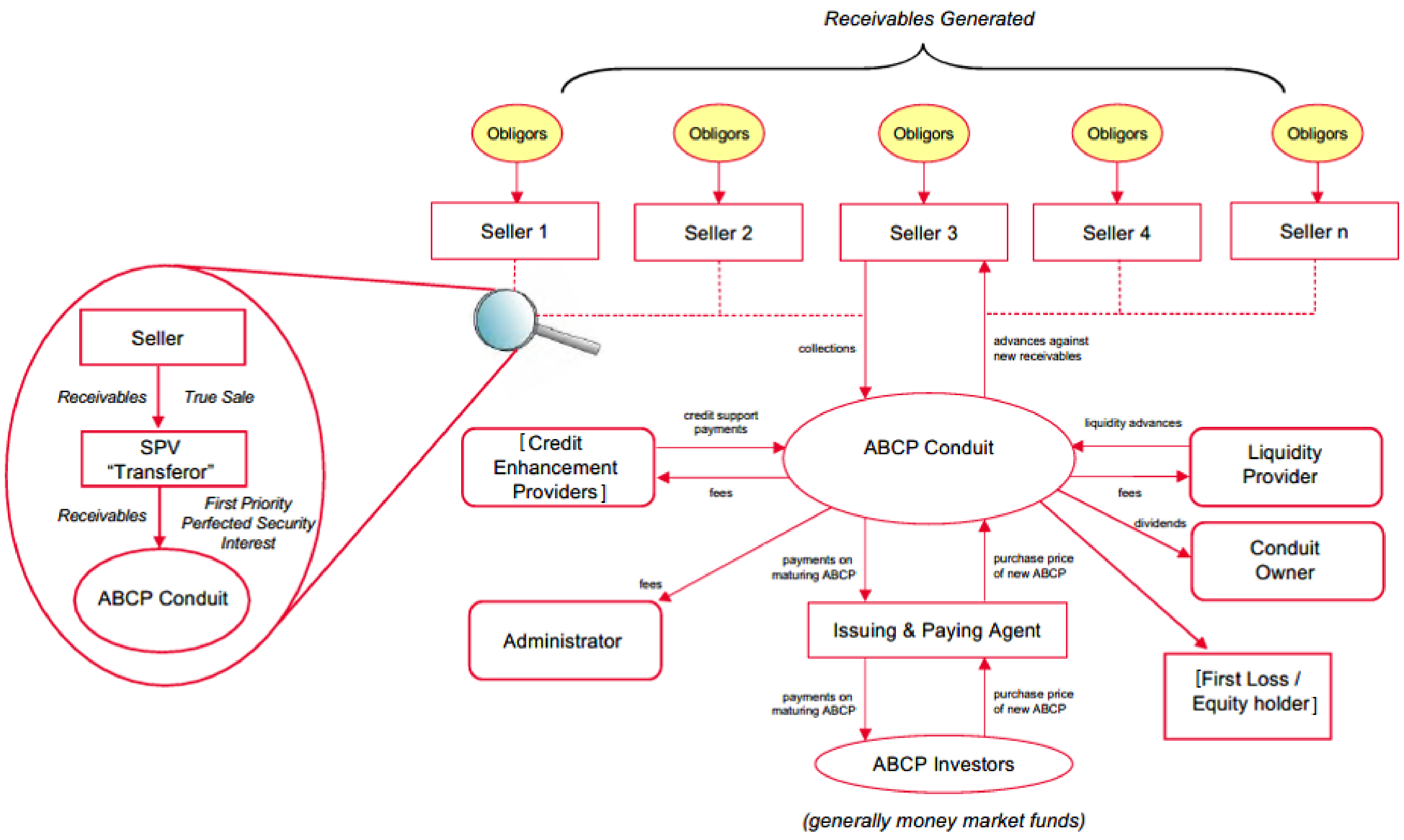
Types of ABCP Programs: Multi-Seller Schematic



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

A. Location of CP issuance
   - USCP
   - ECP
   - other
   - ➢ currencies

B. Types of customer transactions
   - typical private securitizations (trade, warehouses, etc.)
   - subscription facilities
   - repos
   - other
   - ➢ currencies

ABCP program - General considerations (cont'd)

C. Full support vs. partial support
D. CP tenor
   - all short term
   - longer term
   - extendible, puttable, callable
E. On balance sheet vs. off balance sheet
F. Wholly owned vs. third party owned
G. Identity of dealers
H. Identity of depositary, issuing and paying agent
I. Identity of collateral trustee, if applicable
J. Identity of rating agencies
K. Location of conduit issuer and desirability of US co-issuer

ABCP program – Legal considerations

A. US Investment Company Act exemption
B. US and other securities law exemptions
C. Volcker Rule "covered fund" analysis
D. US and EU risk retention compliance
E. Rating agency regulation, including US rule 17g-5 website
F. Tax domicile and related issues
G. Money market fund investor issues and 2a-7
H. 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

- 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:
    1. 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;
    2. is ***not a re-securitisation*** and the exposures underlying the securitisation at the level of each ABCP transaction do not include any securitisation position;
    3. 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.

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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