

Evaluating Asset-Backed Commercial Paper

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The asset-backed commercial paper (ABCP) credit process for the Global Cash Management incorporates an analysis of the following:

- Sponsor/administrator
- Servicer
- Underlying assets
- Investment guidelines
- Structure
- Credit enhancement
- Liquidity provider

In analyzing a program, an in-depth due diligence is performed by our Credit Research team on the conduit sponsor/administrator and servicer, including a review of ratings, operations, systems and financials. Underlying assets are evaluated with respect to the following metrics: asset industry type, collateral, asset ratings, seller ratings, loss coverage and historical performance. A review of the investment guidelines, eligibility criteria and conduit structure is conducted to determine the risk tolerance of the conduit and the rights of the ABCP investor. The final element of analysis includes an assessment of the credit enhancement levels of both the underlying assets and programs, and a review of the liquidity provider. The credit decision is highly dependent on the strength of the liquidity provider (often a systemically important bank) as it is ultimately responsible for repayment of ABCP in the event of a liquidity crisis or market event.

The current global ABCP market is about \$315 billion with approximately \$280 billion of which consists of US-based sponsors/liquidity providers.¹ By concentration, the largest segment of the market consists of traditional multi-seller conduit issuers, where sponsors/liquidity providers are funding assets that are a subset of their traditional bank lending relationships. There is also a segment of the ABCP market (collateralized commercial paper) that is utilizing a total rate of return swap structure (or similar instruments) to help fund a banks' repurchase agreement book. This structure of banks are trying to term out some of their repo funding and is approximately 17% of total outstandings. There is also a small single-seller segment of the market (~4% globally).²

Asset classes for US ABCP issuers funded in the largest volume³ are:

- Auto loans and leases (currently ~37% of all loans funded by US ABCP issuers)
- Trade receivables for its corporate clients (17% of total)
- Various forms of corporate commercial loans — including equipment finance, floorplan finance, and unsecured commercial (17%)
- Unsecured consumer loans (6%)
- Student loans (6%)
- Credit card receivables (5%)
- Repurchase facilities (5%)

Asset classes for EMEA ABCP issuers funded in the largest volume⁴ are:

- Trade receivables for its corporate clients (currently ~48% of all loans funded by EMEA ABCP issuers)
- Auto loans and leases (~26% of total)
- Unsecured consumer loans (5%)
- Equipment leases (4%)
- Credit card receivables (3%)
- Residential mortgages (3%)

**Fully-supported
Versus Partially-
Supported
ABCP Programs**

The term “fully-supported” in this context means that the program has one sole external support: usually a letter of credit, cash collateral account or an irrevocable revolving commitment from a highly rated bank which can cover 100% of liquidity risk and credit risk. For these programs, the rating agencies don’t review the underlying assets. Their assessment is solely based on the provider of the external support (i.e. the highly rated bank). Approximately 80% of current global ABCP programs are fully supported.⁵

Partially supported means that the program has two types of support:

- 1** Program wide credit enhancement (PWCE), which covers credit risk and liquidity risk.
- 2** Liquidity facility, which covers liquidity risk.

The PWCE covers losses on the underlying assets up to a specific amount, determined by the rating agency and depends on the asset class. The rating agencies size this amount based on the largest obligors/concentrations in the program and make an assumption on potential defaults plus accrued interest. For the liquidity facility, it is sized equal to the program size. If the PWCE also provides liquidity protection, it’s the difference between the total program size and the PWCE.

Partial support is when the rating agencies fully review the underlying assets and determines the potential losses (via their models, assumptions, etc.). In this manner, based on the losses, they determine the appropriate levels of PWCE and liquidity facility to maintain a particular credit rating.

Credit Enhancement

The first level of credit protection is transaction-specific credit enhancement and may exist in a variety of forms such as overcollateralization, direct recourse, subordination and cash collateral. In addition to transaction-specific credit support, conduits rely on program-wide credit enhancement. Program-wide credit enhancement may include a bank provided letter of credit, surety bond, cash collateral, total rate of return swap and/or put agreement. The program-wide credit enhancement providers are reviewed with respect to ratings and financials to ensure that they possess adequate liquidity.

Liquidity Provider

A liquidity facility is established to fund the timing difference between asset cash flows and the payment of maturing liabilities (ABCP). Liquidity facilities are also available to a conduit administrator for market-wide events that prevent the program from issuing new ABCP to repay maturing ABCP (i.e. 9/11).

According to current rating agencies' methodologies, the ratings of the ABCP program are dependent upon the ratings of the program's liquidity providers.

There are two types of liquidity facilities:

- 1 Program level in which the liquidity facility supports the entire program.
- 2 Seller-specific in which a liquidity provider's commitment relates solely to the assets from a specific seller.

The majority of conduits have program level liquidity facilities, whereas not all assets have seller specific liquidity. The strength of the program level liquidity provider is the integral part of the credit decision.

For ABCP conduits with a full liquidity guarantee, the sponsor provides a line that can be drawn as long as the assets are not in default. Full-liquidity programs are far more prevalent than partial-liquidity programs. Full-liquidity programs typically provide 102% liquidity support to the transactions within the ABCP conduit. The surplus 2% liquidity support is used to mitigate interest rate risk.

Essentially, ABCP programs that do not provide full liquidity guarantee have become extinct. In a structured investment vehicle, only a portion of conduit liabilities were covered by the line. However, these programs/structures became quite out of favor during and after the global financial crisis, and as such, there are no such programs in the market.

Credit Approval Process

All ABCP purchased for Global Cash Management funds are approved in writing (via Issuer Credit Review analysis or commentary in Credit Views) prior to purchase. The approval authority requirement varies based on the specific credit request. In general, approval authorities include the Director of Credit Policy and Senior Analysts in the Global Cash Credit Research group. Any updates or changes are addressed at the analyst's discretion in the form of an Issuer Credit Review analysis or a brief memo/e-mail format.

Issuer Credit Review Analysis

Issuer Credit Review provides a detailed credit assessment analysis of an ABCP program. In general, the analysis focuses on three core areas — sponsor/liquidity provider, program structure (focus on structural features, risks and mitigants, program wide credit enhancement, outs to liquidity funding), and asset performance/collateral profile. As part of the analyst recommendation, the review should conclude with a summary of the program's deal's strengths and weaknesses along with its mitigating factors (if applicable) and assigns the appropriate asset limit and maturity restriction for each site. All credit documentation is uploaded into our internal credit research portal, for review of reference by our credit research analysts and portfolio managers.

Surveillance

Surveillance is performed on each ABCP program on a regular basis (usually monthly) addressing any changes specific to:

- Program (structural, certain program event triggers),
- Balance updates (program outstanding by commercial paper or medium term note),
- Liquidity support, (program wide credit enhancement),
- Recent developments/announcements from the issuer

A standard template is applicable for all ABCP programs. The surveillance reports are documented and uploaded in into our internal credit research portal, for review of reference by our credit research analysts and portfolio managers.

Endnotes

- 1 Citigroup Research, "Global CP Market Commentary", March 30, 2020.
- 2 Moody's Investor Services, "ABCP Tracker", March 2020.
- 3 Moody's Investor Services, "ABCP — US: Sector Update", October 2019.
- 4 Moody's Investor Services, "EMEA ABCP Sector Update", October 2019.
- 5 Moody's Investor Services, "ABCP Tracker", March 2020.

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- Build from breadth
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