Allspring

Understanding ABCP

BY ALLSPRING MONEY MARKET CREDIT RESEARCH TEAM

Key takeaways

- ASSET-BACKED COMMERCIAL PAPER (ABCP) IS USED TO ADD DIVERSIFICATION AND A POTENTIAL YIELD ADVANTAGE TO SHORT-TERM BOND PORTFOLIOS AND MONEY MARKET FUNDS.
- WE CONDUCT IN-DEPTH CREDIT ANALYSIS ON THE ISSUERS AND STRUCTURE OF EACH PROGRAM.
- THE ABCP MARKET IS IMPORTANT, ACCOUNTING FOR NEARLY 25% OF THE OVERALL COMMERCIAL PAPER (CP) MARKET.

ABCP is an important source of financing for financial institutions and their customers. It may benefit investors with additional yield and diversification in their short-duration portfolios and prime money market funds. A lack of understanding about this asset class by many investors, however, can enable active asset managers with substantial credit analysis capabilities to benefit from the knowledge gap that exists. We often find relative value in this asset class.

We invest in ABCP issued by programs with 100% liquidity support from sponsors, which are strong financial institutions that are approved separately. In addition, the sponsors of the program often provide some form of credit enhancement to provide additional support.

What is ABCP?

ABCP is a form of short-term borrowing that is limited to a maturity of no more than 397 days. However, most ABCP is issued for a term of less than three months. ABCP allows financial institutions to diversify their funding. These assets may consist of trade receivables, consumer receivables, auto loans and leases, student loans, corporate loans, or other types of financial assets. Most ABCP programs have 100% liquidity support provided by a financial institution. Programs are classified as either single-seller or multi-seller programs. Single-seller programs will source all of their assets from a single entity (such as a bank or finance company), while multi-seller programs can source assets from different entities.

Why invest in ABCP?

- 100% liquidity support
- Strong program liquidity and credit support providers
- Diversification from a variety of underlying asset types
- Transparency in monthly reporting
- Flexibility due to a range of short-term maturities

Our process for evaluating ABCP

Our large, experienced team of credit analysts allows us to undertake rigorous credit analysis across investment types, industries, and individual credits. Our team consists of nine analysts specifically dedicated to our money market funds, many with more than 20 years of industry experience. In addition, two of our senior analysts have been covering the ABCP market for more than a decade.

Our credit team continually performs due diligence on each approved ABCP program. This analysis includes an in-depth review of the administrator, underlying asset pools, performance, and liquidity and credit support providers. Our analysts regularly monitor ABCP programs and holdings. They also perform periodic formal reviews, which can include an analysis of the credit quality, sector, or geographic concentration and the performance of the underlying assets. Our due diligence includes consistent and ongoing meetings with conduit administrators. All of our approved ABCP programs have a 100% liquidity backstop from internally approved financial institutions.

Critical components

- The credit enhancement and liquidity facilities are critical components of our review. Given the maturity mismatch between ABCP program assets and liabilities, a liquidity facility is a key structural component to ensure timely repayment of the ABCP. Liquidity facilities are provided by highly rated financial institutions. A fully supporting liquidity facility will fund regardless of asset performance, thus providing full credit enhancement coverage for the program.
- The quality, composition, and performance of the assets are additional key components of our ABCP credit review. Credit deterioration needs to be avoided, and we approve only ABCP administrators with in-depth monitoring systems.
- Asset composition is a critical review. Considerations include asset concentration in terms of type, geography, and the ability of the administrator to manage the risks associated with the assets. International exposure can also require hedging, so we verify the administrator's capabilities for handling any currency mismatches.
- We purchase slightly less than half of the approximately 44 different ABCP administrators in the market as of December 2022, focusing on the larger programs and administrators. Our approved administrators must have strong track records in managing ABCP conduits, experienced personnel, and resources to operate the business. We review their experience in systems, underwriting, and securitization. We also need to make certain that the administrator has expertise in the asset class included in the conduit. Many of those that do not make our list are too small, too inexperienced, poorly structured, or have large exposures to undesirable asset classes.

- We purchase from experienced ABCP administrators with detailed monitoring mechanisms. We look to understand their exit strategy in the event that an underlying asset starts to show any signs of weakness. The conduits need to have the platforms in place to track their customers and performance on the underlying assets. Again, only those administrators with sufficient depth and expertise can make our approved list.
- In its ABCP Program Index, Moody's noted there were 112 ABCP conduits at the end of December 2022. Of those programs, we have 53 active programs on our approved list. First, we approve the administrator, then we consider a specific conduit for possible inclusion on our approved list.
- We don't buy all programs. One example of this was conduits backed by extendible liquidity. Extendible CP does not have traditional bank liquidity support. In the event of a market disruption, the extendible CP may be extended at the issuer's option. These programs were once a significant portion of the CP market (nearly $200 billion outstanding at its peak), but we chose not to purchase these securities for our clients' portfolios because we didn't feel the option was priced at an appropriate level for the risk. When this segment's liquidity was stressed at the beginning of the 2008 financial crisis, many of the programs extended. Eventually, many programs were either shut down or restructured into traditional ABCP programs with 100% liquidity backstops. At this time, there are no extendible CP programs in the market.

The basics of how an ABCP program works

01 The ABCP program is established as a bankruptcy-remote, special-purpose vehicle (SPV) by a sponsor, which is typically a highly rated bank or other financial institution.

02 The SPV purchases receivables or other assets into the program.

03 The asset pools are structured to meet the credit and diversification requirements designated by the program sponsor. One objective of these requirements is to meet the rating standards set by the rating agencies.

04 The purchase of these asset pools is funded by selling CP to investors.

05 Investors' maturities are typically repaid by the issuance of additional CP. In the event that CP can't be placed in the market, the program will draw on a liquidity facility or use cash flow from assets in order to repay investors.

Conclusion

We believe ABCP is an important security type to include in both investment guidelines and as part of the opportunity set when constructing portfolios for the following reasons:

- ABCP has frequently offered a yield advantage over other short-term asset types. This occurred, in part, because it has been a less-well-known asset type. Due to the resulting pricing inefficiencies, we often found it to be a source of relative value.
- ABCP is a well-established asset class, but it requires more experience to assess its creditworthiness and value. Our portfolio managers are supported by a large credit team performing a detailed analysis on the key factors discussed above.

To learn more

We want to help clients build for successful outcomes, defend portfolios against uncertainty, and create long-term financial well-being. To learn more, investment professionals can contact us.

For more information, please contact:

- Institutional Sales Desk: **1-888-253-6584**
- Website: **allspringglobal.com**

If you're an institutional investor, when you visit the website, click on your location and select your role on the welcome screen as "Institutional Cash Investor."

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Diversification does not ensure or guarantee better performance and cannot eliminate the risk of investment losses.

All investing involves risks, including the possible loss of principal. There can be no assurance that any investment strategy will be successful. Investments fluctuate with changes in market and economic conditions and in different environments due to numerous factors, some of which may be unpredictable. Each asset class has its own risk and return characteristics.

Floating NAV

For floating NAV money market funds: You could lose money by investing in the fund. Because the share price of the fund will fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them. The fund may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The fund's sponsor has no legal obligation to provide financial support to the fund, and you should not expect that the sponsor will provide financial support to the fund at any time.

Retail

For retail money market funds: You could lose money by investing in the fund. Although the fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. The fund may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The fund's sponsor has no legal obligation to provide financial support to the fund, and you should not expect that the sponsor will provide financial support to the fund at any time.

Government

For government money market funds: You could lose money by investing in the fund. Although the fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The fund's sponsor has no legal obligation to provide financial support to the fund, and you should not expect that the sponsor will provide financial support to the fund at any time.

Bond values fluctuate in response to the financial condition of individual issuers, general market and economic conditions, and changes in interest rates. Changes in market conditions and government policies may lead to periods of heightened volatility in the bond market and reduced liquidity for certain bonds held by the fund. In general, when interest rates rise, bond values fall and investors may lose principal value. Interest rate changes and their impact on the fund and its share price can be sudden and unpredictable.

For municipal income funds: A portion of the fund's income may be subject to federal, state, and/or local income taxes or the alternative minimum tax. Any capital gains distributions may be taxable.

Carefully consider a fund's investment objectives, risks, charges, and expenses before investing. For a current prospectus and, if available, a summary prospectus, containing this and other information, visit allspringglobal.com. Read it carefully before investing.

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