



# ASSET BACKED COMMERCIAL PAPER: IT'S NO LONGER 2008

For some, the term “asset-backed commercial paper” may rekindle bad memories of the 2008 financial crisis, when problems with asset-backed securities shook the credit industry. Structure and support mechanisms have changed since then; asset-backed commercial paper isn’t what is used to be.

## A PRIMER

Asset-backed commercial paper (ABCP) is a short-term senior secured debt instrument used by money market funds globally. Unlike financial or corporate commercial paper, which is an unsecured exposure to an issuer, ABCP is backed by a pool of assets such as trade receivables, credit cards loans and auto loans that offer additional layers of protection in the form of collateral.

ABCP programs, more commonly known as conduits, come in different structures, of which the largest is multi-seller. In multi-seller programs, multiple entities sell assets to the conduit. This provides increased diversification versus a single-seller program.

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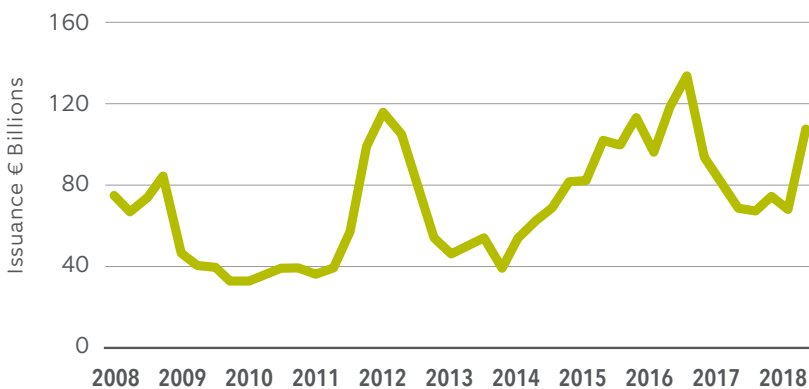
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## EUROPEAN ABCP ISSUANCE



Source: Association for Financial Markets in Europe (AFME)

From a liquidity perspective, multi-seller programs are completely supported by an underlying sponsor and have as much as 100% credit support. In the event of a market disruption, these programs have access to funding that can be managed through either an interim or permanent loss of market access. Even if performance deteriorates to severely stressed levels, there exists sufficient credit enhancement to cover any losses. Since the end of 2017, all European asset-backed commercial paper programs were 100% backed by the sponsor against illiquidity and credit losses.

### What Happened in 2008

In the years leading up to the 2008 financial crisis, banking and non-banking institutions created a number of additional structures to enhance profitability. These structures deviated from the traditional multi-seller conduits. Some didn't provide sponsor liquidity or credit support, and they included assets with lower credit scores and less liquidity. This combination proved to be fatal. Several programs outright defaulted and others were absorbed into sponsors' balance sheets. After the crisis, these flawed structures quickly disappeared.

However, the underlying asset strategy and structure of multi-seller ABCPs allowed them to survive the crisis and remain a vibrant source of funding for financial institutions. It is noteworthy that during the financial crisis, this portion of the ABCP market did not experience loss and the underlying pools in the programs did not require extraordinary credit support. While the banks experienced some stress, they emerged from the crisis with stronger liquidity and capital positions, aided by new regulations.

### How We Protect Clients

In the multi-seller sector, Northern Trust Asset Management's internal processes continue to serve our clients well. Our approval and credit maintenance process for multi-seller ABCP investments includes a review of the originator, collateral and structure. Most importantly, we consistently review the underlying banks and only invest in multi-seller ABCP programs where the underlying sponsor bank meets our strict criteria. Any concerns we have with the bank would also impact our investment stance with the related multi-seller ABCP program.

In Europe, recent money market reform regulation provides guidance on the use of ABCPs by money market funds. The regulation has made the use of ABCPs eligible for money market funds as long as the program is fully supported by a regulated credit institution that covers all liquidity, credit and material dilution risks.

The changes to the ABCP market since 2008, including the establishment of fully supported structures and the inclusion of guidance on ABCP within European money market fund regulation, has given us confidence in the multi-seller sector and has led us to re-include ABCP as an eligible investment within our global cash funds.

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