FREQUENTLY ASKED QUESTIONS ABOUT COMMERCIAL PAPER AND COMMERCIAL PAPER PROGRAMS

Understanding Commercial Paper

What is commercial paper?

Commercial paper ("CP") is a term used to refer to short-term debt securities that are in the form of a promissory note and have maturities of nine months or less (although typically 30 days or less). CP is usually unsecured, issued in large denominations of $100,000, €100,000, £100,000 or more and sold at a discount from the face value. CP is typically non-interest bearing. Institutional money market investors, including money market funds, insurance companies and banks, have been the main purchasers of CP, and these purchasers are almost always (1) in the United States, either qualified institutional buyers ("QIBs") or institutional accredited investors ("IAIs") and (2) in Europe, qualified investors.

CP is issued to U.S. investors pursuant to U.S. CP programs and to European investors pursuant to Euro CP programs. We discuss the differences between U.S. CP programs and Euro CP programs below under "Structure of U.S. Commercial Paper Programs" and "Structure of Euro Commercial Paper Programs."

Why is commercial paper attractive?

CP is an attractive funding alternative for issuers for several reasons. First, CP issuers frequently use CP proceeds to fund short-term liquidity needs instead of relying on short-term borrowings under revolving credit facilities and other lines of credit from banks. Second, CP issuers can easily roll over CP, which means that the proceeds from new issuances are used to pay the obligations resulting from maturing issuances. As such, CP issuers can often continue to utilize CP proceeds uninterrupted. Third, there are clearly defined exemptions from registration under the Securities Act of 1933, as amended (the "Securities Act"), for CP. Fourth, CP programs are relatively straightforward to set up and do not require extensive disclosures.

CP has been attractive to institutional money market investors mainly because the short-term maturity of CP enables such investors to satisfy certain liquidity and investment rating requirements under the Investment Company Act of 1940, as amended (the "Investment Company Act"). For more information, *see "Is commercial paper rated? Is a back-up bank facility required?"* below.

Is commercial paper rated? Is a back-up bank facility required?

CP is often rated, in the United States, by a nationally recognized statistical rating organization ("NRSRO"), and in Europe, by a credit rating agency, such as Standard & Poor's, Moody's and Fitch. There is no express rule requiring that CP be rated, but existing guidance from the Securities and Exchange Commission (the "SEC") and practical considerations have created a de facto rating requirement in the United States. As is discussed below in "*What U.S. offering exemptions are used for commercial paper?*," CP in the United States is issued pursuant to the exemption from registration under Section 3(a)(3) of the Securities Act ("Section 3(a)(3)") or in a private placement pursuant to Section 4(a)(2) of the Securities Act ("Section 4(a)(2)"). The SEC, in an interpretive release and subsequent no-action letters, has established various criteria that must be satisfied in order for an issuer to rely on Section 3(a)(3). Among these requirements is that CP must be of prime quality.

This prime quality condition has customarily been satisfied when CP is rated highly by an NRSRO. If CP is unrated or rated less than investment grade, then the CP issuer could obtain a back-up bank facility, although it is unclear whether the SEC would issue a no-action letter permitting this arrangement. Alternatively, if CP is unrated, the sponsoring dealer could provide a letter to issuer's counsel stating that in such dealer's view the CP would, if rated, be given a prime rating and that issuer's counsel may use such letter as the basis for opining that the CP is entitled to the exemption under Section 3(a)(3).

Without a rating provided by an NRSRO or some alternative arrangement that confers the comfort of a "prime" rating, a CP issuance under Section 3(a)(3) is not possible. Money market funds, which have traditionally been major purchasers of CP, had previously been subject to restrictions under Rule 2a-7 under the Investment Company Act ("Rule 2a-7") that limited their ability to invest in securities that are not in the two highest rating categories.[1]

Standard & Poor's, Moody's and Fitch utilize three generic short-term ratings, which apply to CP, in order of credit quality from high to low: tier-1, tier-2, and tier-3. Standard & Poor's and Fitch have also used a plus (+) with respect to their tier-1 rating to denote overwhelming safety. Since the analytical approach in assigning a short-term rating is virtually identical to the one followed in assigning a term debt rating (*i.e.*, medium-term note and/or long-term bond), a strong link or "correlation" between an issuer's short-term and term debt ratings has evolved for the rating agencies, as follows:

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[1] In March 2011, the SEC proposed amendments to Rule 2a-7 to remove references to credit ratings. The amendments were intended to implement the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), specifically section 939A, which is designed to reduce reliance on credit ratings in response to the financial crisis of 2008. The SEC re-proposed these amendments in July 2014 and adopted them in September 2015. Under the amendments, money market fund boards (or their delegates) must determine that portfolio securities have "minimal credit risk" and apply a four-pronged test instead of relying in part on objective standards, such as credit ratings. In addition, other money market reforms, including the requirement of a basis point floating net asset value (NAV) per share on institutional prime and tax-exempt money market funds and the imposition of liquidity fees and redemption gates, which were adopted in July 2014, have resulted in money market funds moving away from CP in order to improve liquidity. Since the effectiveness of these money market reforms in October 2016, approximately $1 trillion of funds have moved away from CP, which is significant given that the size of the money market fund industry is approximately $2.6 trillion. Source: Bloomberg Markets.

Term Rating	CP Rating
AAA to AA	Tier-1+
AA- to A	Tier-1
A- to BBB	Tier-2
BBB- and lower	Tier-3 and lower

Can a guaranty be used instead of a back-up bank facility?

Yes, commercial paper can be guaranteed by an organization with excellent credit, such as a bank.[2] In such cases, a letter of credit is typically used for this purpose (such CP is referred to as "letter of credit CP"). The letter of credit is an unconditional obligation of the issuing bank to pay out of its own funds maturing CP, in exchange for a fee which is a certain percentage of the amount of CP issued. Most letters of credit are "direct-pay" (*i.e.*, the letter of credit bank pays the CP holders and the issuer or the issuer's parent reimburses the letter of credit bank pursuant to a reimbursement agreement). The other type of letter of credit is a "stand-by" letter of credit. Under a stand-by letter of credit, the letter of credit bank must pay only in the event that the issuer does not. Due to certain negative case law, the short-term nature of CP and the expectation of CP investors to quickly receive interest, if applicable, and principal payments, a stand-by letter of credit is not as popular with CP investors as a direct-pay letter of credit.

What U.S. offering exemptions are used for commercial paper?

CP is not registered under the Securities Act and is issued pursuant to the exemption from registration under Section 3(a)(3) or in a private placement pursuant to Section 4(a)(2). In addition, CP can also benefit from the general exemption under Section 3(a)(2) of the Securities Act ("Section 3(a)(2)") for securities that are either issued or guaranteed by certain banks or supported by a letter of credit from a bank.

Would any filing or action be required under the Office of the Comptroller of the Currency's Securities Offering Disclosure Rules (12 C.F.R. Part 16) if the issuer of the letter of credit is a national bank?

No. The Office of the Comptroller of the Currency (the "OCC") does not view a letter of credit as security, but as a loan. Therefore, it is not necessary to find an exemption from the OCC's Securities Offering Disclosure Rules for the letter of credit. However, the SEC would view a letter of credit issued by a bank as a guarantee, which would be an exempt security under Section 3(a)(2) and would also cause the CP itself to be an exempt security under Section 3(a)(2), as the CP would be a security guaranteed by a bank.

Structure of U.S. Commercial Paper Programs

Are there different types of U.S. commercial paper programs?

Yes, a U.S. CP program can be structured for the issuance of CP pursuant to Section 3(a)(3) or Section 4(a)(2). Some issuers even maintain a Section 3(a)(3) program and a Section 4(a)(2) program simultaneously. For a helpful summary of the

[2] The amendments to Rule 2a-7 also included the removal from the rule's issuer diversification requirement the exclusion for securities that are guaranteed by a non-controlled person. Accordingly, a money market fund is required to limit its investments in securities of a non-governmental issuer to no more than 5% of the money market fund's total assets, regardless of whether or not the security is guaranteed by a non-controlled person.

differences between Section 3(a)(3) programs and Section 4(a)(2) programs, *see* the "Comparison Table" at the end of these Frequently Asked Questions.

What are the requirements for issuing commercial paper pursuant to Section 3(a)(3)?

Section 3(a)(3) itself is brief and exempts "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 not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited." However, a long line of SEC releases, no-action letters and other guidance have established that CP must:

- be of prime quality and negotiable;
- be of a type not ordinarily purchased by the general public;
- be of a type eligible for discounting by Federal Reserve banks;
- have a maturity not exceeding nine months; and
- be issued to facilitate current transactions.

How is the "prime quality and negotiable" requirement satisfied?

The prime quality requirement has customarily been satisfied when CP is rated highly enough by an NRSRO. Such ratings depend on the creditworthiness of the issuer or the guarantor, if any. If the CP is unrated or rated less than investment grade, then the CP issuer could obtain a back-up bank facility, although it is unclear whether the SEC would issue a no-action letter permitting this arrangement. Alternatively, if the CP is unrated, the sponsoring dealer could provide a letter to issuer's counsel stating that in such dealer's view the CP would, if rated, be given a prime rating and that issuer's counsel may use such letter as the basis for opining that the CP is entitled to the Section 3(a)(3) exemption.

How is the "type not ordinarily purchased by the general public" requirement satisfied?

With respect to the requirement that the CP be of a "type not ordinarily purchased by the general public," the relevant factors are (1) denomination, (2) type of purchaser and (3) manner of sale. The minimum denomination described in SEC no-action letters is typically $100,000, although in practice CP usually is sold in higher denominations. CP purchasers should be institutional investors or highly sophisticated individuals and SEC no-action letters often refer to sales to "institutions or individuals who normally purchase commercial paper." The marketing of CP also should be clearly aimed at appropriate purchasers and advertising in publications of general circulation should generally be avoided. However, the SEC has not objected to tombstone advertisements announcing Section 3(a)(3) program establishments or limited advertisements in publications of general circulation.

How is the "type eligible for discounting by Federal Reserve banks" requirement satisfied?

Regulation A of the Federal Reserve Board ("Regulation A") sets forth the eligibility requirements for discounting, which is the method by which a non-interest bearing note is valued prior to maturity.[3]

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[3] One of the functions of Federal Reserve banks is to extend temporary credit to member banks of the Federal Reserve System, thereby assisting the member banks with absorbing sudden withdrawals of deposits or seasonal requirements that cannot be replenished from the member banks' own resources. A member bank may borrow from a Federal Reserve bank in one of two ways. It can rediscount short-term commercial, industrial, agricultural or other business paper that it has

Regulation A provides that a Federal Reserve bank may discount for a member bank a negotiable note, draft, or bill of exchange bearing the endorsement of a member bank that: (1) has a maturity not exceeding 90 days (except agricultural paper which may carry a maturity of up to nine months); (2) has been issued or drawn, or the proceeds of which are to be used in producing, purchasing, carrying or marketing goods or in meeting current operating expenses of a commercial, agricultural or industrial business; and (3) is to be used neither for permanent or fixed investment such as land, buildings or machinery, nor for speculative transaction or transactions in securities (except direct obligations of the U.S. government). However, even if CP fails to satisfy the eligibility requirements under Regulation A, such CP may still qualify for the Section 3(a)(3) exemption if such CP is "of a type" so eligible for discounting.[4] Notwithstanding the above, the SEC in various no-action letters has considered as satisfied the requirement that CP be of a "type eligible for discounting by Federal Reserve banks" if the prime quality requirement also is satisfied for such CP.

How is the "maturity not exceeding nine months" requirement satisfied?

The requirement that the CP have a maturity not exceeding nine months can be satisfied by limiting the permitted maturity to 270 days in the documentation establishing the CP program. Demand notes and notes with automatic rollover, extension or renewal provisions that extend maturity past the 270-day mark would not meet this requirement.

How is the "current transactions" requirement satisfied?

The current transactions requirement has been the subject of the majority of the SEC no-action letters regarding Section 3(a)(3). For corporate issuers, it is often clear enough that the proceeds of the CP will be used for current transactions, including financing of inventory or accounts receivable (also referred to as "working capital"), recurring or short-term operating expenses, such as the payment of salaries, rent, taxes, dividends or general administrative expenses and the interim financing of equipment or construction costs, pending permanent financing, for a period of not longer than one year. The proceeds of CP are often used to pay off maturing CP.

In those cases where it is not possible to trace particular proceeds to particular uses, the SEC has accepted the use of limitations on the amount of CP issued according to formulas based on various categories of current transactions. The more expansive of these formulas include limiting the amount of CP outstanding at any one time to not more than the aggregate amount utilized by the CP issuer for specified current transactions, including in circumstances where the proceeds are loaned or advanced to a guarantor or its subsidiaries. The SEC also has indicated that a CP issuer should use a balance sheet test for determining the relevant CP capacity, whereby the CP issuer determines the capital it has committed to current assets and the expenses of operating its business over the preceding 12-month period. Principal uses of proceeds that clearly do not qualify for current transaction status include financing the purchase of securities, whether in connection with a takeover, for investment purposes or

previously discounted for its customers (under this method, the borrowings are referred to as discounts). Alternatively, it can issue its own promissory notes secured by paper eligible for discounting, government securities or other acceptable collateral (borrowing of this type is referred to as "advances").

[4] A Federal Reserve bank, if it chooses, may make advances on notes regardless of whether such notes conform to the eligibility requirements set forth in the regulations regarding automatic discountability of such notes.

as issuer repurchases, capital expenditures such as the purchase of land, machinery, equipment, plants or buildings, and the repayment of debt originally incurred for an unacceptable purpose.

What are the requirements for issuing commercial paper pursuant to Section 4(a)(2)?

Section 4(a)(2) programs are structured so that the sale of CP by the issuer (either to dealers acting as principals or directly to purchasers) is exempt from registration under Section 4(a)(2) or the safe harbor provided by Rule 506 of Regulation D under the Securities Act ("Regulation D"). Under Rule 506(b) of Regulation D, an issuer can be assured it is within the Section 4(a)(2) exemption by satisfying the following standards:

- the issuer cannot use general solicitation or advertising to market the securities;
- the issuer may sell its securities to an unlimited number of accredited investors and up to 35 other purchasers (all non-accredited investors, either alone or with a purchaser representative, must be sophisticated);
- the issuer must decide what information to give to accredited investors, so long as it does not violate the anti-fraud prohibitions of the federal securities laws (but the issuer must give non-accredited investors disclosure documents that are generally similar to, but briefer than, those used in registered offerings and if the issuer provides information to accredited investors, it must make this information available to non-accredited investors as well);
- the issuer must be available to answer questions by prospective purchasers; and
- the financial statement requirements are the same as for Rule 505 of Regulation D.

Resales of CP by dealers to QIBs (or to purchasers that dealers and any persons acting on the dealers' behalf reasonably believe to be QIBs) are exempt under the safe harbor of Rule 144A under the Securities Act ("Rule 144A"). Resales of CP by dealers to IAIs are exempt under the so-called "Section 4(a)(1½)" exemption. In addition, resales of CP by dealers (including dealers no longer acting as underwriters with respect to such CP) to IAIs are exempt under the dealer exemption under Section 4(a)(3) of the Securities Act.

Because resales by dealers and secondary market transfers are made in reliance on Rule 144A, a Section 4(a)(2) program issuer (and guarantor, if any) must comply with the information requirements of Rule 144A(d)(4). Public companies are automatically in compliance if they continue to file reports under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Section 4(a)(2) program private placement memorandums ("PPMs") include language offering purchasers the opportunity to ask questions of, and receive answers from, the issuer/guarantor about the terms and conditions of the offering or generally about the company in accordance with Rule 502(b)(2)(iv) of Regulation D.

What are the advantages and disadvantages of using the Section 3(a)(3) exemption?

The Section 3(a)(3) exemption is an exemption for the CP itself. Therefore, if the conditions established by the SEC are met, there is no need for the issuer or secondary market resellers to ensure that each sale of CP is a private placement in accordance with the Securities Act. As a result, Section 3(a)(3) programs are often preferred

to Section 4(a)(2) programs. However, issuers often are unable to use the Section 3(a)(3) exemption because they plan to use the proceeds of a CP issuance for purposes that do not clearly meet the current transactions requirement or the CP will have a maturity longer than nine months. Some issuers simultaneously maintain a Section 3(a)(3) program and a Section 4(a)(2) program and issue CP under the Section 4(a)(2) program when raising money for the purchase of a fixed asset or for takeover financing. In such cases, the SEC has issued no-action letters to the effect that it will not apply the "integration doctrine" to the CP issuances so long as the purpose and use of proceeds of the two programs are distinct.

What are the advantages and disadvantages of using the Section 4(a)(2) exemption?

An issuer may decide to structure its CP program as a Section 4(a)(2) program in order to avoid the current transactions requirement and the 270-day limitation on maturity under Section 3(a)(3). The issuers in a Section 4(a)(2) program can use the proceeds for any purpose, including to finance capital expenditures or acquisitions or to refinance existing debt originally incurred for these purposes (subject to restrictions under Regulation T of the Board of Governors of the Federal Reserve System ("Regulation T"), which are discussed below). Although a Section 4(a)(2) program would not be subject to a 270-day maturity limitation, the maturity of CP rarely exceeds 397 days, because money market funds (which are major purchasers of CP) are restricted under Rule 2a-7 from purchasing notes with maturities exceeding 397 days.

The drawbacks to a Section 4(a)(2) program mostly stem from the fact that the offering and resale of Section 4(a)(2) CP, unlike Section 3(a)(3) CP, is restricted. Therefore, each resale of CP, including each resale by a purchaser in the secondary market, must be made in a private placement transaction. However, the practical impact of this is somewhat lessened due to the fact that investors often hold CP until maturity. In addition, a broker-dealer's purchase, as principal, of restricted securities, such as Section 4(a)(2) CP, is subject to Regulation T, which restricts broker-dealers from extending unsecured credit if the proceeds are used by the CP issuer to buy, carry or trade in securities. Furthermore, some investors have limitations on the amount that they can invest in restricted securities, such as money market funds which, under Rule 2a-7, can only purchase and hold a limited amount of illiquid securities.

Can a Section 3(a)(3) commercial paper program be converted into a Section 4(a)(2) commercial paper program? Can a Section 3(a)(3) commercial paper program be operated simultaneously with a Section 4(a)(2) commercial paper program?

It is not uncommon for issuers to convert Section 3(a)(3) CP programs to Section 4(a)(2) programs, particularly if the issuer would like to use the CP program to fund an acquisition. In such a case, there is a concern with avoiding integration of the resulting Section 4(a)(2) program with the issuer's other offerings and programs. However, this concern is addressed by covenants in the dealer agreement whereby the CP issuer agrees for a six-month period to use CP proceeds for current transactions and to issue CP with maturities of nine months or less.

Some issuers also simultaneously maintain a Section 3(a)(3) program and a Section 4(a)(2) program.

In such a case, there has to be careful segregation of the proceeds of each program and the use of proceeds of each program need to be distinct due to the current transactions requirement under Section 3(a)(3).

Structure of Euro Commercial Paper Programs

What offering exemption is used?

Euro CP is exempt from registration with the SEC pursuant to Regulation S under the Securities Act due to the fact that the issuers of Euro CP are targeting investors outside of the United States. In addition, Euro CP is not typically listed on an exchange.

How are Euro commercial paper programs different from U.S. commercial paper programs?

There are a few differences between CP issued under U.S. CP programs and CP issued under Euro CP programs. First, Euro CP can have a maturity less than one year (*e.g.*, 364 days). Second, Euro CP typically is issued in bearer form (in which case title passes by delivery) rather than registered form. Third, Euro CP clears through the European clearing entities Euroclear Bank SA/NV ("Euroclear") and Clearstream Banking, *société anonyme* ("Clearstream") rather than the U.S. clearing entity The Depository Trust Company ("DTC"). Fourth, Euro CP sometimes carries the Short-Term European (STEP) label, which CP issuers can apply for and which indicates to investors that the CP issuer and the Euro CP program have met certain standards relating to the disclosure of information, the format for documentation and settlement of the Euro CP. The criteria for a STEP label is set out in the STEP Market Convention which is available at http://www.stepmarket.org/assets/files/STEP%20Docs/STEP%20Market%20Convention_19May2015_signed_searchable.pdf.

The documentation for Euro CP programs is similar to the documentation for U.S. CP programs (which we discuss below under "Disclosure and Documentation for Commercial Paper and Commercial Paper Programs"), although there are a few differences. The offering document for a Euro CP program, which is referred to as an "information memorandum," typically contains the form of the CP, and Euro CP programs use global notes rather than master notes. A "signing memorandum" is often used which is a formal checklist of documents and responsibilities. Euro CP programs also have a "deed of covenant" under which holders of Euro CP are given direct rights of enforcement against the CP issuer or guarantor, if applicable, should the CP issuer default on a payment.

The Securities Industry and Financial Markets Association ("SIFMA") has published standard forms of dealer agreements for U.S. CP programs (pursuant to Section 3(a)(3) and Section 4(a)(2)), which are available at http://www.sifma.org/services/standard-forms-and-documentation/corporate-credit-and-money-markets/. Similarly, the International Capital Markets Association ("ICMA") has published standard forms of information memorandum, dealer agreement and global note for Euro CP programs, which are available under Section 7(X) of the ICMA Primary Market Handbook, which is available to ICMA members and subscribers at http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/ipma-handbook-home/.

For a helpful summary of the differences between U.S. CP programs and Euro CP programs, *see* the

"Comparison Table" at the end of these Frequently Asked Questions.

Distribution and Settlement of Commercial Paper

How is commercial paper distributed?

CP issuers can market directly to investors, but most issuers choose to use the services of dealers. CP programs, like medium-term note ("MTN") programs, may include more than one dealer. In Section 4(a)(2) programs, dealers are sometimes referred to as placement agents, and in Euro CP programs, dealers are sometimes referred to as managers. Companies issue CP by calling a dealer's CP desk directly and, upon agreeing on terms, dealers buy an issuer's entire daily issuance and resell it to investors. There is generally no involvement of counsel in the daily issuance of CP.

What are the roles and responsibilities of dealers?

Dealers are responsible for the distribution of CP. Dealers purchase CP from issuers as "principal" and then immediately resell the CP to investors or place the CP as "agent" directly with investors. The lead dealer for a CP program (referred to as an "arranger" for a Euro CP program) also serves two additional functions: (1) coordinating the establishment of the CP program with the issuer and the drafting of the legal documentation (with the assistance of legal counsel); and (2) coordinating with the issuer to make sure that the CP program stays current. Investment banks appointed as initial dealers under the CP program can be possible dealers of any future CP issued under the program, and most CP programs allow for additional dealers to be appointed under the program from time to time.

Is there a secondary market for commercial paper?

Yes, but it is limited. CP has a very short maturity and most investors in the CP market purchase CP at issuance and hold it until maturity. If investors sell CP, they typically sell CP back to CP dealers. In addition, CP issued pursuant to Section 4(a)(2) is restricted. As a result, there is little trading of CP in secondary markets. Instead, many investors continuously roll over maturing CP, which means that they purchase newly issued CP from the same issuer once their holdings of CP mature. As a result, CP issuers usually finance the repayment of maturing CP with newly issued CP.

Is a master note used?

The CP issued under a particular CP program is typically represented by a single master note, registered in the name of Cede & Co., as nominee for DTC, and held by the issuing and paying agent ("IPA") as custodian for DTC. DTC makes available a standard form of master note for corporate CP. Most CP transactions are settled in book-entry form through DTC's Money Market Instrument ("MMI") program and most CP is identified by a CUSIP number. DTC provides dealers with a record of the transactions and dealers provide investors with trade confirmations. Secondary market trades also are settled in book-entry form through the facilities of DTC.

Unlike a global note, which represents just one issue of securities (or a portion of one issuance that exceeds $500 million), a master note can represent all issuances under a CP program. The terms of each particular CP issuance are recorded in the IPA's records. Those records are continuously updated by the IPA as CP matures and new CP is issued. DTC's master note form allows the attachment of riders, and riders typically

include legends required for the relevant registration exemptions (in the case of a Section 4(a)(2) program or a Rule 144A program) and where a program contemplates interest-bearing CP, details regarding interest calculations and procedures for interest payments.

As discussed above, Euro CP is typically in bearer form, global notes are typically used and the clearing entity is Euroclear or Clearstream.

Disclosure and Documentation for Commercial Paper and Commercial Paper Programs

What documentation is used for commercial paper programs? How is it different from stand-alone issuances of commercial paper?

The documents used in a CP program are fairly standardized. They are generally not heavily negotiated compared to the documents for an MTN program. The key documents for a CP program are the following:

- the PPM in the case of a Section 4(a)(2) program, the offering circular in the case of a Section 3(a)(3) program and the information memorandum in the case of a Euro CP program;[5]
- the dealer agreement;
- the issuing and paying agent agreement ("IPAA");
- the master note (in the case of a Euro CP program, global notes are used);
- the guaranty, if applicable; and
- the legal opinions.

For a discussion of CP program legal opinions, *see* "Due Diligence and Securities Act Liability—*What level of due diligence is required?* and *Are legal opinions required?*"

When an investment grade issuer establishes a CP program through a subsidiary (as is typically the case for foreign issuers wishing to access the U.S. market), the CP issued by the subsidiary is guaranteed by the parent, which executes a stand-alone guaranty. The SIFMA form dealer agreements for guaranteed CP also include guaranty forms, which dealers are typically reluctant to negotiate (the ICMA form dealer agreement does not include a guaranty form).

The documentation required for a stand-alone issuance of CP is geared towards a one-off issuance instead of repeated issuances under a program. As such, the mechanics are much simpler, the roles of the IPA and dealer are circumscribed (since they are not involved in repeat issuances) and a stand-alone issuance of CP has a global note instead of a master note. In addition, CP programs can have more than one dealer, whereas stand-alone issuances of CP only have one dealer.

What information is provided in the private placement memorandum or information memorandum?

A typical CP PPM or information memorandum includes a very short description of the CP issuer and/or guarantor. The rest of the PPM or information memorandum describes the CP itself, including the terms, ratings, denominations, the relevant exemption from registration (in the case of a U.S. CP program) and the use of proceeds. A brief section describing the tax treatment of payments under the CP may be included, particularly if the CP issuer or guarantor is a non-U.S. entity. In a Section 4(a)(2) program, the PPM may also

[5] References in these Frequently Asked Questions to PPM shall also be understood to refer to an offering circular.

include the deemed representation of the purchasers that they are IAIs.

CP PPMs and information memoranda are much shorter than prospectuses used in registered offerings (or in offerings in Europe that are compliant with Directive 2003/71/EC (as amended, including by Directive 2010/73/EU)) and the information memoranda used in other unregistered offerings, because investors rely mainly on the credit ratings of the CP issuer or guarantor, rather than disclosure, when deciding whether to purchase. Nevertheless, CP PPMs and information memoranda may incorporate by reference or include the publicly available or filed disclosure of the issuer and/or guarantor for the benefit of investors. In addition, for Section 4(a)(2) programs, the PPM typically includes language stating that purchasers will have the opportunity to ask questions of, and receive answers from, the issuer or the guarantor.

What is covered by the dealer agreement?

The dealer agreement (also called the placement agreement in a Section 4(a)(2) program) governs the relationship between the CP issuer and the dealers for the duration of the CP program and sets the terms for any sales of CP to or through the dealers. The dealers' role is to advise the CP issuer regarding pricing and potential investors. The dealers also coordinate with the ratings agencies as most CP is rated investment grade.

SIFMA publishes model dealer agreements for Section 3(a)(3) and Section 4(a)(2) programs (for Euro CP programs, ICMA publishes a model dealer agreement). These model agreements include forms of legal opinion letters and include explanatory notes. Each dealer usually has its own standard form of dealer agreement in the same way that each underwriter has a standard form of underwriting agreement. If a CP program has more than one dealer, the CP issuer typically enters into a separate dealer agreement with each dealer.

The dealer agreement typically allows the parties to agree, on an issuance-by-issuance basis, either for the dealers to purchase CP from the issuer as principal (which is similar to a firm commitment underwriting) or for the dealers to act as agents and arrange for sales from the issuer to purchasers. However, for most issuances, dealers act as principal in purchasing CP from the issuer and reselling the CP to investors that the dealers have identified in advance. Investors usually hold CP to maturity, but dealers may provide liquidity to their clients by repurchasing the CP prior to maturity. Generally, dealers may be compensated through a reselling commission. Alternatively, the CP issuer compensates the dealers by paying them a fee based on the amount of CP outstanding.

The dealer agreement also contains representations, warranties and covenants by the CP issuer that are deemed to be made on the date the CP program commences and again each time CP is issued or the PPM or information memorandum is amended. The representations, warranties and covenants, among other things, establish the factual basis for the relevant registration exemption, confirm the accuracy of the PPM or information memorandum and confirm the due corporate existence of the CP issuer and guarantor and the due authorization, execution and enforceability of the CP program documents.

The dealer agreement also requires the CP issuer to deliver closing certificates and legal opinion letters, as well as executed versions of the other CP program documents, and to undertake to inform the dealers of

material developments. The CP issuer also agrees to indemnify the dealers for losses arising from material misstatements or omissions in the PPM or information memorandum (which may include the CP issuer's public filings and other public information included or incorporated by reference in the PPM or information memorandum) and from the CP issuer's breach of a representation, warranty or covenant in the dealer agreement, including any CP issuer action that may invalidate the relevant registration exemption.

What is covered by the issuing and paying agency agreement?

In order to establish a CP program, the issuer will need to appoint an IPA, which is a third-party trust company or bank that serves a function similar to a trustee under an indenture.[6] The IPA plays various roles under a CP program, including coordinating settlement of CP with DTC, processing CP payments, assigning CUSIP numbers to each issuance of CP and acting as custodian of the master note representing the CP issued under the program.

The IPAA governs the relationship between the CP issuer and the IPA. The IPAA includes provisions regarding the following:

- communications between the CP issuer and the IPA regarding CP issuances and the timing of such communications;
- the issuance and delivery of the CP;
- the mechanics for payment of principal and interest to holders of the CP;
- the amount of the IPA's fees;
- the removal of the IPA and the appointment of successors; and
- representations and warranties and indemnification from the CP issuer to the IPA for purposes of protecting the IPA from liability to the CP purchasers.

Each IPA has a preferred form of IPAA which contains terms that are usually market standard and non-controversial.

Due Diligence and Securities Act Liability

What level of due diligence is required?

Since CP is issued daily, it is not practical to have management due diligence sessions or legal opinions and accountant's comfort letters provided for each issuance of CP. As a result, some dealers have established credit departments to monitor their issuers continuously. Generally, dealers act conservatively and may refuse to continue to purchase and sell an issuer's CP if there are any rating downgrades or headline events, thus forcing that issuer to rely on bank lines of credit for its short-term funding needs.

Are legal opinions required?

CP issuers (and guarantors, if any) are expected to deliver legal opinions to the dealers when a CP program is established. In the case of U.S. CP programs, outside U.S. counsel typically delivers many of the required opinion paragraphs, while in-house and/or local counsel qualified in the issuer's or guarantor's jurisdiction deliver others (such as the opinion paragraphs regarding (1) no litigations or governmental proceedings and (2) no liens, encumbrances, violations

[6] A trustee under an indenture acts as a fiduciary for the noteholders and represents the noteholders in dealings with the issuer, whereas an IPA under an IPAA performs administrative functions and noteholders must act independently and have no way of communicating with each other.

or breaches). Since the offering documents for CP programs are fairly short and most of the disclosures regarding the CP issuer are incorporated by reference from the CP issuer's periodic reports filed with the SEC or (in the case of Euro CP programs) published in the CP issuer's home country, negative assurance letters typically are not required.

The SIFMA form of dealer agreement includes a form of opinion for issuer's counsel, which includes opinion paragraphs on the following:

- the corporate existence of the CP issuer;
- the due authorization, execution and enforceability of the CP program documents by and against the CP issuer;
- the due authorization and enforceability of the CP by and against the CP issuer;
- no requirement for the registration of the CP under the Securities Act;
- no consent or action of, or filing or registration with, any governmental or public regulatory body or authority is required to authorize, or is otherwise required in connection with the execution, delivery or performance of, the dealer agreement, the CP or the IPAA;
- neither the execution and delivery of the dealer agreement and the IPAA, nor the issuance of the CP, nor the fulfillment of or compliance with the terms and provisions of either thereof by the CP issuer, will (i) result in the creation or imposition of any mortgage, lien, charge or encumbrance of any nature whatsoever upon any of the properties or assets of the CP issuer, or (ii) violate or result in a breach or default under any of the terms of the CP issuer's charter documents or by-laws, any contract or instrument to which the CP issuer is a party or by which it or its property is bound, or any law or regulation, or any order, writ, injunction or decree of any court or government instrumentality, to which the CP issuer is subject or by which it or its property is bound;
- no litigation or governmental proceeding pending, or to the knowledge of such counsel threatened, against or affecting the CP issuer or any of its subsidiaries which might result in a material adverse change in the condition (financial or otherwise), operations or business prospects of the CP issuer or the ability of the issuer to perform its obligations under the dealer agreement, the CP or the IPAA;
- the CP issuer not being an investment company under the Investment Company Act;
- neither the CP issuer nor any of its revenues, assets or properties having any right of immunity from service of process or from the jurisdiction of competent courts of the CP issuer's jurisdiction of organization and the United States or the State of New York in connection with any suit, action or proceeding, attachment prior to judgment, attachment in aid of execution of a judgment, or execution of a judgment or from any other legal process with respect to its obligations under the dealer agreement, the IPAA or the CP.
- the absence of foreign withholding tax;
- the choice of New York law as valid, effective and irrevocable choice of law;
- the submission by the CP issuer to the jurisdiction of the courts of the United States District Court and the State of New York

located in the Borough of Manhattan as valid and binding upon the CP issuer; and

- any final judgment rendered by any federal or state court of competent jurisdiction located in the State of New York in an action to enforce the obligations of the CP issuer under the dealer agreement, the IPAA or the CP is capable of being enforced in the courts of the CP issuer's jurisdiction of organization.

The legal opinions provided by guarantor's counsel are very similar, except that an opinion on the enforceability of the guarantee (rather than the CP) is provided. In addition, in the case of Euro CP programs, the legal opinions provided tend to be more limited than those provided in U.S. CP programs.

Dealers and IPAs sometimes hire their own counsel for CP programs. More often, CP dealers instead rely on the opinion delivered to them by issuer's counsel, which is in contrast to other types of offerings (*e.g.*, Rule 144A/Regulation S offerings, Section 4(a)(2) private placements and Section 3(a)(2) offerings).

Are there any Securities Act liability considerations?

There is no liability under Section 11 of the Securities Act for issuers of CP issued under either Section 3(a)(3) or Section 4(a)(2). After the decision of the U.S. Supreme Court in *Gustafson v. Alloyd*, there is also no liability under Section 12(a)(2) of the Securities Act for issuers of privately placed CP. However, Securities Act Section 17 will support SEC actions and Sections 12(a)(2) and 17 of the Securities Act do apply to Section 3(a)(3) CP. For CP investors, Rule 10b-5 under the Exchange Act provides the principal remedy against both CP dealers and issuers, a private cause of action for material misstatements or omissions in offering documents. It is worth noting the exclusion from the definition of a "security" in Section 3(a)(10) of the Exchange Act for "any note which has a maturity at the time of issuance of not exceeding nine months," as this language appears to exclude Section 3(a)(3) CP. However, CP that does not satisfy the "prime quality" standard has been held to fall outside this exclusion.

After the SEC's enforcement proceeding against and settlement with Goldman Sachs arising out of the Penn Central bankruptcy in 1970 and resulting CP default of Penn Central, many dealers have assumed that they will be unable to avoid liability for any defaulted CP. The SEC stated that Goldman Sachs had failed to conduct a reasonable investigation of Penn Central and had implicitly represented to its customers that the CP issuer was creditworthy.

Asset-Backed Commercial Paper

How is asset-backed commercial paper structured?

Although the majority of CP is issued by corporate issuers, CP can also be asset-backed ("ABCP"), in which case a bankruptcy-remote special purpose vehicle ("SPV") or conduit is used for issuance. The SPV uses the proceeds of an issuance primarily to purchase interests in various types of assets. Repayment of the ABCP issued by the conduit depends primarily on the cash collections received from the assets purchased and the conduit's ability to issue new ABCP. Typically, a bank or other financial institution will provide liquidity support to bridge any gap when maturing ABCP cannot be refinanced by the issuance of new ABCP. Some common assets financed with ABCP include trade receivables, consumer debt receivables, and auto and equipment loans and leases. An ABCP conduit may

also use proceeds to invest in securities, including asset- and mortgage-backed securities, corporate and government bonds, and CP issued by other entities, and to make unsecured corporate loans.

Starting in the 1980s, ABCP programs became common. Under accounting rules at the time, the sponsor of an ABCP program could operate the program off-balance sheet. Accordingly, the sponsor did not have to hold any capital against the SPV's underlying asset portfolio. However, numerous ABCP programs foundered during the financial crisis of 2008, as declining asset values put a strain on the ABCP market. Some ABCP issuers continued to access the market though mainly on an overnight basis. In addition, several government-sponsored programs, such as the Commercial Paper Funding Facility (CPFF) and the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), helped ensure that liquidity was still available to issuers and investors. Nevertheless, the ABCP market was never able to fully recover from the financial crisis of 2008 and its aftermath.

Why did the asset-backed commercial paper market fail and is it coming back?

The ABCP market failed during the financial crisis because of losses in portfolio assets, including residential mortgage-backed securities (RMBS), which backed the ABCP. These losses were significant because the portfolio assets had longer maturities than the ABCP and thus required continuous new financing. Once issuers began extending maturities for ABCP in response to falling asset prices and the maturity mismatch, investors began reassessing the riskiness of ABCP. This made it more difficult for issuers to roll over ABCP, thus creating a contagion effect that resulted in a liquidity shock to the banking sector. Although the government-sponsored programs were helpful in stemming some losses, they could not prevent the collapse of the ABCP market.

Today ABCP programs are less common and it does not appear likely that the ABCP market will return to its pre-financial crisis levels. ABCP volumes have declined from a high of approximately $1.2 trillion to approximately $242.6 billion as of January 14, 2016. Revised accounting rules and other regulatory developments have made it increasingly difficult to maintain ABCP programs off-balance sheet, eliminating much of the rationale for sponsors to maintain these programs through an SPV. ABCP programs though are still used today for trade receivables financing and other short-term, maturity-matched lending situations.

What is collateralized commercial paper and how is it different from asset-backed commercial paper?

ABCP is backed by liquidity agreements that are usually provided by the sponsoring bank, and collateralized commercial paper ("CCP") is issued with portfolio assets consisting of repurchase agreements ("repos"). This means that CCP investors have access to repo collateral and the repo counterparty in the event that the issuer does not meet its obligations under the CPP, while ABCP investors have the benefit of a liquidity provider. CCP is similar to unsecured CP in the sense that while CCP investors can claim repo collateral if there is any delay or default in payments, it is primarily the obligation of the issuer or the parent to make payments on a timely basis. On the other hand, in the case of ABCP, the ultimate borrowers are often anonymous to the investors, and since an ABCP conduit

is a legally separate SPV, ABCP investors do not have legal recourse against the sponsors of the vehicle but do have recourse to the underlying assets.

CCP was first introduced by Barclays Bank plc in November 2010 and thus far has been issued predominantly by financial institutions. Financial institutions have used the proceeds from CCP to fund the term repo positions of their broker-dealer subsidiaries affected by the 2010 money market reforms (reflected in the 2010 amendments to Rule 2a-7). CCP is attractive to investors because it is collateralized, and it also allows money market funds to overcome maturity restrictions as CCPs are typically backed by term repos which are designated illiquid securities under Rule 2a-7 (term repos do not meet maturity restrictions imposed on money funds to meet liquidity requirements and are now confined to less than 5% of a money market fund's holdings).

The use of SPVs and the presence of repo collateral have caused some to question whether CCP creation is just another form of ABCP. This is a valid viewpoint since the financial crisis of 2008 partially resulted from subprime mortgages and financial receivables of questionable credit quality becoming part of the vast anonymous asset pools backing ABCP programs. The off-balance sheet SPVs, typically having full liquidity support from sponsoring banks, provided side pockets for banks to profit from additional asset pools without having to disclose their existence. The recent regulatory overhaul has resulted in on-balance sheet consolidation of ABCP and higher costs to administer them. There currently is no consensus from regulators and industry participants whether CCP should be treated as an unsecured obligation of the issuer or subject to the same treatment ABCP receives.

Miscellaneous

Is there a foreign withholding tax?

Depending on the home jurisdiction of the CP issuer and/or guarantor, foreign withholding tax requirements may apply to CP payments. Foreign and U.S. tax counsel should be involved in the planning stages of the CP program establishment when a foreign issuer or guarantor is involved. This is particularly true when dealing with jurisdictions where at-source withholding tax relief is available only through investor certifications.

Are there any Investment Company Act considerations for foreign issuers of commercial paper?

When foreign issuers enter the U.S. CP market, they often do so by forming a U.S. corporate subsidiary to act as the CP issuer under the CP program and lend the proceeds to the parent. In such cases, it is likely that the CP issuer will fall within the definition of an "investment company" under the Investment Company Act. Therefore, the CP issuer will need to find an applicable exemption from registration under the Investment Company Act. Some common exemptions used in these circumstances include Rule 3a-5 (an exemption for certain finance subsidiaries) and Rule 3a-3 (available if the CP issuer has only short-term securities with maturities of 270 days or less outstanding) under the Investment Company Act. Sections 3(c)(1) and 3(c)(7) of the Investment Company Act also provide exemptions for issuers that issue only short-term CP. However, use of Sections 3(c)(1) or 3(c)(7) of the Investment Company Act may raise considerations under the Volcker Rule. In addition, in order to establish these exemptions, both the subsidiary

and the foreign parent must meet certain requirements. Counsel for the CP issuer often must analyze the foreign parent's unconsolidated financial statements and obtain back-up certificates confirming certain facts before being able to deliver an opinion as to the entity's investment company status. Because these considerations can require structural changes to the CP program and involve significant administrative efforts for the CP issuer, they should be discussed as early as possible in the process for establishing the CP program.

By, Ze'-ev D. Eiger, Partner,
Jeremy Jennings-Mares, Partner
and Jerry R. Marlatt, Senior Of Counsel,
Morrison & Foerster LLP

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COMPARISON TABLE

The following table provides a summary of the main differences between U.S. CP programs and Euro CP programs. The table is not a complete discussion of all applicable requirements and should be read in conjunction with the Frequently Asked Questions and the applicable rules.

Type of CP Program	Offering Exemption	Requirements	Advantages	Disadvantages	Investors	Listing	Settlement
U.S. CP program	Section 3(a)(3)	CP must: • be of prime quality and negotiable; • be of a type not ordinarily purchased by the general public; • be of a type eligible for discounting by Federal Reserve banks; • have a maturity not exceeding nine months; and • be issued to facilitate current transactions; and • be issued to facilitate current transactions	• CP is not restricted • No need for the issuer or secondary market resellers to ensure that each sale of CP is a private placement • Can use general solicitation	• Must satisfy the current transactions requirement • Cannot have a maturity longer than nine months	Institutional money market investors	None	DTC
U.S. CP program	Section 4(a)(2)	• Cannot use general solicitation • Dealers must resell securities to QIBs • Issuer must be available to answer questions by prospective purchasers • Financial information must be furnished under Rule 144A(d)(4)	• No current transactions requirement • Can have a maturity longer than nine months	• CP is restricted (although resales permitted under Rule 144A) • Cannot use general solicitation • Potential integration with other private placements	Institutional money market investors	None	DTC
Euro CP program	Regulation S	Sales only to non-U.S. persons in “offshore transactions” with no “directed marketing efforts” in the U.S.	• No current transactions requirement • Can have a maturity longer than nine months	• CP is restricted • Investors cannot be U.S. persons • Cannot have directed marketing efforts in U.S.	Non-U.S. qualified investors	None, but may have Short-Term European (STEP) label	Euroclear/ Clearstream