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Investing in Commercial Paper and Banker's Acceptances

PRESENTED BY **EILEEN STANIC, CTP®**, SR. PUBLIC FUNDS ADVISOR
AND **SCOTT GRUBER, CMT**, DIRECTOR, ADVISORY SERVICES



MEEDER
PUBLIC FUNDS

- Definitions
- Statutory Requirements
- Types of Commercial Paper
- Investment Considerations
- Credit Rating Agencies
- Credit Research Process



Today's Presenters



Eileen Stanic, CTP®
Regional Director, Advisory
Services
614.923.1152
estanic@meederinvestment.com



Scott Gruber, CMT
Director, Advisory Services
614.760.2156
sgruber@meederinvestment.com



Definitions

What is a Commercial Paper?

SHORT-TERM UNSECURED
PROMISSORY NOTES

Backed by Issuing company, not by collateral

ISSUED BY VARIOUS
LARGE CORPORATIONS

Used for short-term credit needs, such as Payrolls,
Inventory and Current Liabilities

MOSTLY ISSUED AT A DISCOUNT

Occasionally can be issued as interest bearing CP at PAR

MAXIMUM MATURITY OF 270 DAYS

Threshold for having to register securities with the SEC

TYPICALLY ISSUED IN DENOMINATIONS
OF \$100,000 OR MORE

Issuer may market the securities directly
or sell them through a dealer

What are Banker's Acceptances?

TIME DRAFT DRAWN ON
AND ACCEPTED BY A BANK

Unconditional liability of the bank

SPECIFIED AMOUNT
ON A SPECIFIED DATE

Final Maturities are typically within six months

PRIMARILY USED IN
INTERNATIONAL TRADE

Draft holder may hold the acceptance until maturity
and receive the face value, or sell it at a discount

RATINGS SHOULD BE CONSIDERED
PRIOR TO PURCHASE

Allows parties unfamiliar with each other to substitute
the bank's creditworthiness for the debtor's



Statutory Requirements

135.14 (B) (7)

Up to 40% of interim moneys available for investment in either commercial paper or banker's acceptances

135.35 (8)

Up to 40% of county's total average portfolio in either commercial paper or banker's acceptances

No investment shall be made unless the treasurer, governing board, or investment authority has completed additional training specific to these types of investments.

The type and amount of additional training shall be approved by the treasurer of state and may be conducted by or provided under the supervision of the treasurer of state.

At Time of Purchase		40% Combined	5% per Issuer
Active Funds	\$5,000,000		
Interim Funds	\$20,000,000	\$8,000,000	\$1,000,000
Inactive Funds	\$0		
Total Funds	\$25,000,000		

Invested		40% Combined	5% per Issuer
Periods 1–8	\$24,000,000		
Periods 9–10	\$100,000,000		
Periods 11–12	\$44,000,000		
Average	\$40,000,000	\$16,000,000	\$2,000,000

135.142 : Board of Education Investment of Interim Moneys

The Treasurer shall prepare annually and submit to the Board, the Superintendent of Public Instruction, and the Auditor of State, on or before August 31st, a report containing:

- List of each investment made in commercial paper and banker's acceptances
- Income earned from such investments
- Fees and commissions paid in connection with the investments and any other information required by the Board, Superintendent, and the Auditor of State.

Ask your service provider to supply this information to assist you with this requirement.

Commercial Paper Statutory Requirements

Commercial Paper notes issued by an entity that is defined in division (D) of section 1705.01 or division (K) of section 1706.01 of the Revised Code and that has assets exceeding five hundred million dollars, to which notes all of the following apply:

- The notes are **rated** at the time of purchase in the highest classification established by at least two nationally recognized standard rating services.
- The aggregate value of the notes does not exceed ten per cent of the aggregate value of the outstanding commercial paper of the issuing corporation.
- The notes mature not later than **two hundred seventy days** after purchase.
- The investment in commercial paper notes of a single issuer shall not exceed in the aggregate **five per cent** of interim moneys available for investment at the time of purchase.



Commercial Paper Issuer Example

Issuer: Toyota Motor Credit Corp



Ratings: S&P A-1+; Moody's P-1;

Program Type: (CP) U.S. CP

Reg Type: 3 (a) 3

Program Size: Unlimited

Banker's acceptances of banks that are insured by the **Federal Deposit Insurance Corporation** and that mature not later than **one hundred eighty days** after purchase.





Types of Commercial Paper

Types of Commercial Paper

CP in the United States is issued pursuant to the exemption from registration under various sections of the Securities Act of 1933:

Section 3(a)3	Section 3(a)2	Section 4(a)2/ 144A Private Placement
Most Common in Market	Available for Bank obligations both direct and via Letter of Credit (LOC)	Exempt from registration
Issued 270 days or less	Issued 270 days or less	No limit on issuing terms; however, generally programs are limited to one year
Used for current transactions only	Issuer can gain improved rating through Bank LOC	No limit on use of proceeds
	The Obligation of the LOC Bank to investor is irrevocable and unconditional	Can be issued as asset backed or floating rate note

INVESTOR SOPHISTICATION TESTS

ACCREDITED INVESTOR

- Client investments \$5 million or more
- If client investments less than \$5 million, then permissible types of commercial paper exclude 4(a)2 (private placements)

QUALIFIED INSTITUTIONAL BUYER (QIB)

- Client investments \$100 million or more
- No limitation on permissible types of commercial paper

RULE APPLIES TO THE INVESTOR NOT THE INVESTMENT ADVISOR



CERTIFICATE OF RULE 144A QUALIFIED INSTITUTIONAL BUYER AND SECTION 3(C)(7) QUALIFIED PURCHASER

Revised 12/2011

Fax: 212.577.4506

E-Mail: compliancemanager@dealogic.com

I. The undersigned certifies that it is familiar with Rule 144A under the Securities Act of 1933, agrees that persons selling securities to the undersigned in reliance upon Rule 144A may rely on the information contained in this certificate and represents and warrants that:

- (i) * It is a Qualified Institutional Buyer ("QIB") (as described in [Annex A](#) hereto) of the following type:
_____ [Insert type of institution as it appears in bold in [Annex A](#) hereto (e.g., insurance company, investment adviser, etc.)]
- (ii) * as of _____, 20____ [Insert a specific date that is on or after the close of undersigned's most recent fiscal year], the undersigned owned or invested on a discretionary basis \$ _____ million (Insert a specific dollar amount.) of "eligible securities" (as set forth in [Annex A](#));
- (iii) if the amount specified in clause (ii) above is less than US\$100 million but not less than US\$10 million the undersigned is a dealer registered under Section 15 of the Securities Exchange Act of 1934 (the "Exchange Act");
- (iv) if the amount specified in clause (ii) above is less than US\$10 million, the undersigned is a dealer registered pursuant to Section 15 of the Exchange Act acting in a riskless principal transaction on behalf of a QIB;
- (v) if the undersigned decides to purchase Rule 144A securities for the accounts of others, it will purchase Rule 144A securities only for accounts that independently qualify as QIBs as defined in Rule 144A;
- (vi) ** if the undersigned is an investment advisor acting for one or more registered investment companies that are part of a family of investment companies (as defined in Rule 144A) that in the aggregate owns or invests on a discretionary basis at least \$100 million of "eligible securities" (as set forth in [Annex A](#)), or if the undersigned is itself a registered investment company that is part of such a family of investment companies, as of _____, 20____ [Insert a specific date that is on or after the close of the most recent fiscal year of each such registered investment company], the family of investment companies in the aggregate owned or invested on a discretionary basis the following amount of "eligible securities" (as set forth in [Annex A](#)) [check one] ☐ \$100 million or more but under \$1 billion, ☐ \$1 billion or more but under \$10 billion, ☐ \$10 billion or more; and
- (vii) * the undersigned's current fiscal year ends on _____, 20_____.

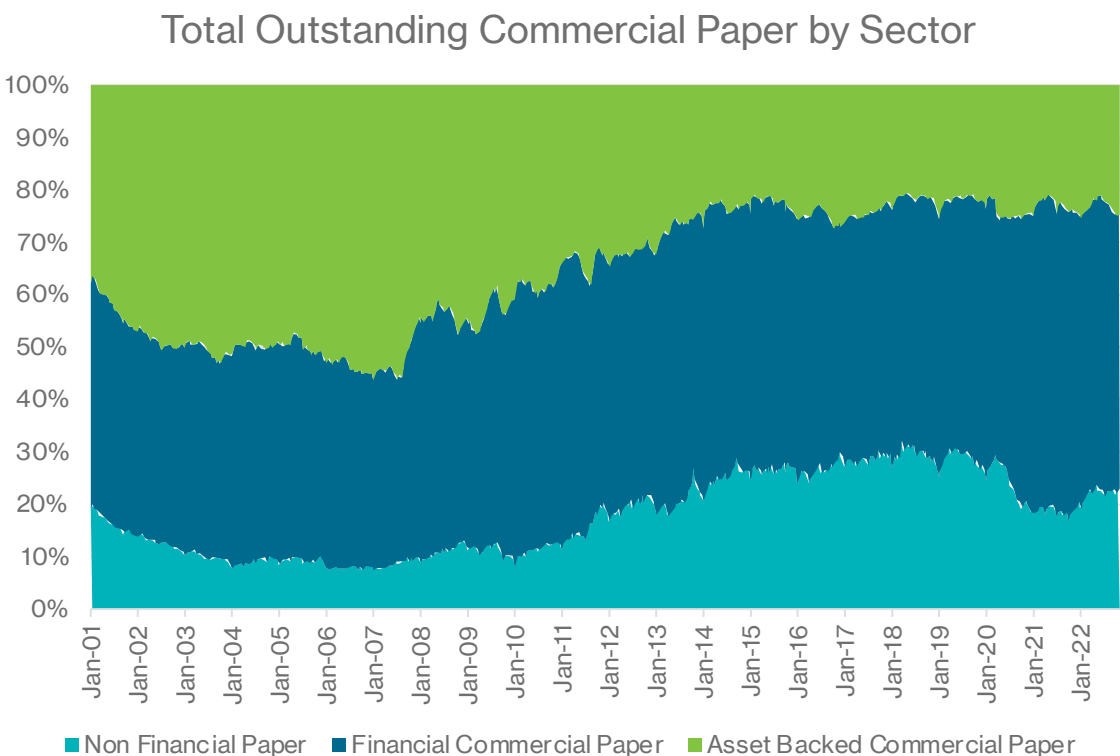
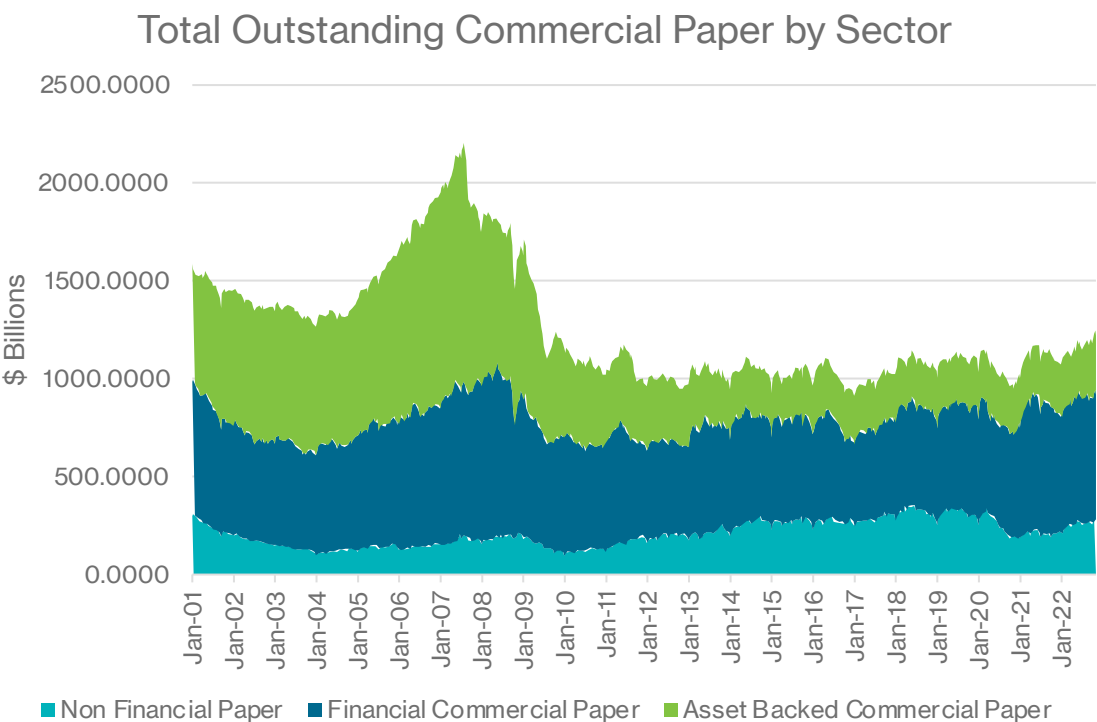
Issuer Examples

Issuer Name	S&P ST Rating	Moody's ST Rating	Fitch ST Rating	Country Code	Regulation
BARCLAYS BANK PLC NY	A-1	P-1	F1	United States	4(2)
BNP PARIBAS NY BRANCH	A-1	P-1	F1+	United States	3(a)3
BNP PARIBAS	A-1	P-1	F1+	France	4(2)
BOFA SECURITIES INC	A-1	NR	F1+	United States	4(2)
CANADIAN IMPERIAL HLDS	A-1	P-1	F1+	United States	4(2)
CHEVRON CORP	A-1+	P-1	NR	United States	4(2)
CISCO SYSTEMS INC	A-1+	P-1	NR	United States	4(2)
CITIGROUP GLOBAL MARKETS	A-1	P-1	F1	United States	4(2)
COCA-COLA CO	A-1	P-1	F1	United States	3(a)3
COCA-COLA CO	A-1	P-1	F1	United States	4(2)
INTEL CORPORATION	A-1	P-1	F1	United States	4(2)
JOHN DEERE CAPITAL CORP	A-1	P-1	NR	United States	3(a)3
JOHN DEERE CAPITAL CORP	A-1	P-1	NR	United States	4(2)
JOHNSON & JOHNSON	A-1+	P-1	NR	United States	4(2)
JP MORGAN SECURITIES LLC	A-1	P-1	F1+	United States	3(a)3
JP MORGAN SECURITIES LLC	A-1	P-1	F1+	United States	4(2)
ROYAL BANK OF CANADA	A-1+	P-1	NR	Canada	3(a)3
ROYAL BANK OF CANADA	A-1+	P-1	NR	United States	4(2)
SOCIETE GENERALE NORTH AMERICA	A-1	P-1	F1	France	4(2)
SANTANDER UK PLC	A-1	P-1	F1	Great Britain	3(a)3

Non-Financials



Commercial Paper by Sector



SOURCE: FRED ST. LOUIS DATABASE

Commercial Paper Offering Types

Direct Offer of Commercial Paper (DOCP)

- Can purchase directly from the Issuing program
- Usually requires larger minimum orders

Dealer Commercial Paper Offerings

- Purchase through a Broker/Dealer
- Can be Primary or Secondary Issuance
- Minimum order size depends on the Issuers program rules





Investment Considerations

Asset-Liability Method

- Short-Term Cash Flow Management

“Laddered” or “barbell” portfolio

Liquidity Percentage Method

- To provide liquidity for daily operations

May be used for diversification in your “core” investment portfolio to balance longer maturities

Credit Risk
Considerations
(A1/P1)

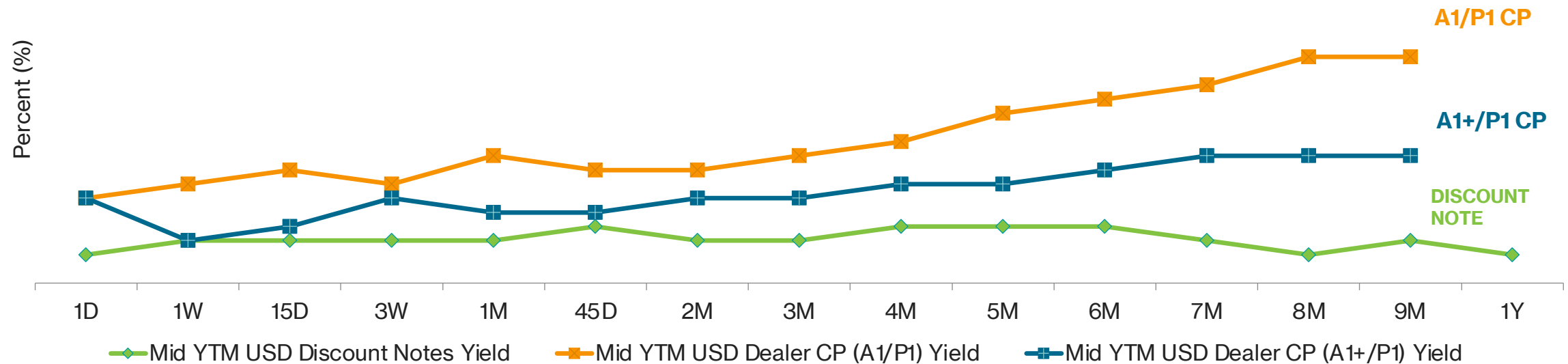
Yield comparisons
should be evaluated versus
other alternatives

If utilizing a broker/dealer,
compare to more than
one offering

Secondary Market –
Excessive “mark-ups”

Yield Spreads

- Always evaluate Yields to determine quality of asset type versus risk premium being placed
- Liquidity can play a role in certain assets offering higher yields across different environments and scenarios



SOURCE: BLOOMBERG. YIELD SPREADS SHOWN ARE FOR ILLUSTRATIVE PURPOSES ONLY.

PRICE CALCULATION

$$\text{Price} = 100 - (\text{Days to maturity}/360 \times \text{Discount Rate})$$

$$270/360 \times 1.67 = 1.2525$$

$$\text{Price} = 100 - 1.2525 = 98.7475$$

$$\text{Cost} = 1,000,000 \times .987475 = \$987,475.00$$

Third-Party Custodian

- Securities held in public entity's account at bank trust department
- Public entity controls account
- Securities held in public entity's name
- Written custodial agreement
- **GFOA best practice**

Broker or Bank acting as Broker

- Securities held in brokerage account
- Broker controls account
- Securities not held in public entity's name
- Safekeeping cost bundled with other services



Credit Rating Agencies

Nationally Recognized Statistical Rating Organizations (NRSROs)

- There are nine NRSROs. The most recognizable are:
 - Standard & Poor's
 - Moody's Investor Service
 - Fitch Ratings Service

PURPOSE

- Credit rating agencies provide a detailed and independent credit opinion
- Credit ratings are a rank of that agency's opinion on a particular issuer
- Credit rating agencies also provide other in-depth analyses on CP issuers

Credit Rating

- A score assigned to an issuer by a credit rating agency to indicate how likely a debt will be repaid
- The rating reflects the general creditworthiness of a company, city, or country that issues debt

CREDIT RATING CATEGORIES

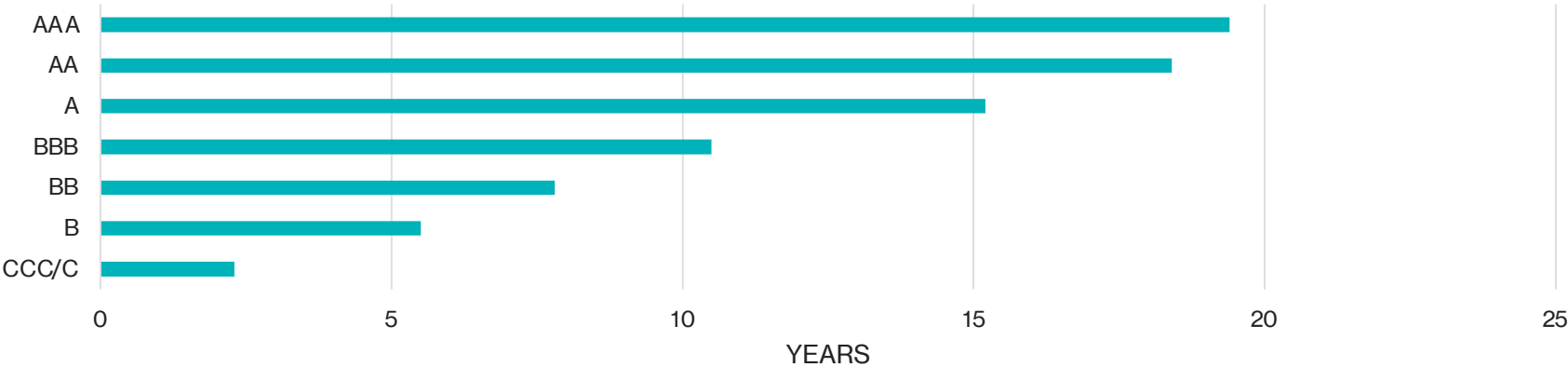
- **Long-Term Ratings**
 - Investment Grade (also known as High Grade, Non-Speculative Grade)
 - Non-Investment Grade (also known as High Yield, Speculative Grade)
- **Short-Term Ratings**
 - Tier 1 (also known as First Tier)
 - Tier 2 (also known as Second Tier)

Ratings Matrix

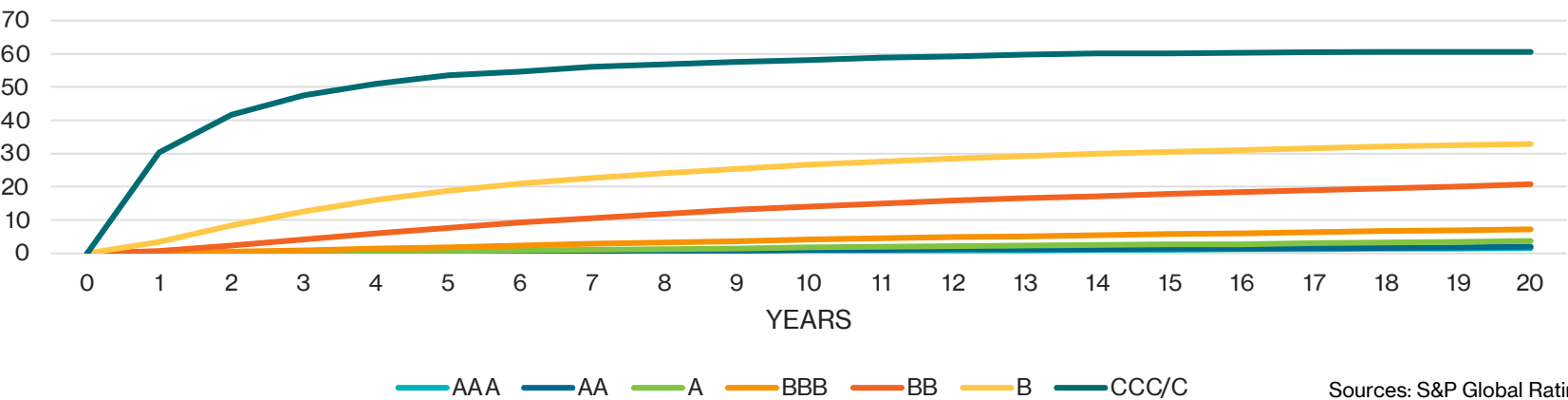
RATING DESCRIPTION		MOODY'S		S&P		FITCH	
		LONG-TERM	SHORT-TERM	LONG-TERM	SHORT-TERM	LONG-TERM	SHORT-TERM
INVESTMENT GRADE	FIRST TIER	Aaa	P-1	AAA	A-1+	AAA	F-1+
		Aa1		AA+		AA+	
		Aa2		AA		AA	
		Aa3		AA-		AA-	
		A1		A+	A-1	A+	F-1
		A2		A		A	
	SECOND TIER	A3	P-2	A-	A-2	A-	F-2
		Baa1		BBB+		BBB+	
	THIRD TIER	Baa2	P-3	BBB	A-3	BBB	F-3
		Baa3		BBB-		BBB-	

U.S. Corporate Default Summary

Average Time To Default From Original Rating (1981-2020)



U.S. Corporate Average Cumulative Default Rates By Rating (1981-2020)



Sources: S&P Global Ratings Research and S&P Global Market Intelligence's CreditPro®.



Credit Research Process



Purpose of Fundamental Analysis



More granular view of a company's credit risk than credit ratings convey



Understand key credit factors upholding an issuer's financial position



Apply stressed scenarios to evaluate debt service coverage in adverse situations

Credit Review Process



Credit Report Components

BUSINESS

RISK

FINANCIAL

RISK

HYBRID

RISK

LIQUIDITY

RISK

From the Commercial Paper Issuer

Company Filings (10-Ks, 10-Qs, Annual Reports, Quarterly Reports, etc.)

Press Releases

Offering Circular/Term Sheet

Investor Presentations

Alternative Sources

News outlets/Media

Broker/Dealer Research

Industry News Sources

Credit Rating Agency Reports

Conclusion

- Investing in Commercial Paper can benefit your portfolio through safety, liquidity, and yield
- Continuously familiarize yourself with the Commercial Paper environment to navigate the marketplace
- Have a due diligence process in place to monitor Commercial Paper issuers
- Obtaining your Commercial Paper and Banker's Acceptances Certification will increase your ability to enhance returns back to taxpayers



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Any rates and yields shown are for illustrative purposes only. Any securities shown are for illustrative purposes only and should not be assumed to be eligible investments for your entity. You should review any investment's eligibility based on Ohio Revised Code and your entity's investment policy.

Past performance does not guarantee future results. Opinions and forecasts are all subject to change at any time, based on market and other conditions, and should not be construed as a recommendation of any specific security. Investing in securities involves inherent risks, including the risk that you can lose the value of your investment. There is no assurance that the investment process will consistently lead to successful results. The investment return and principal value of an investment will fluctuate so an investor's shares or units, when redeemed, may be worth more or less than their original cost.

**Meeder Investment
Management**

6125 Memorial Drive
Dublin, OH 43017

866.633.3371

MeederInvestment.com



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