CalFIT®

Local Government Investment Pool
Educational Series
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Asset Backed Commercial Paper

A diversifying investment requiring a high degree of research and due diligence

Introduction

Commercial paper is a foundational short-term financing instrument used by corporations, financial institutions, and structured-finance vehicles. In institutional cash portfolios, commercial paper often serves as a credit allocation that can diversify government-only exposures and modestly enhance yield. Asset backed commercial paper (ABCP) is a specific subset of the market that introduces securitization features into the commercial paper format. As of July 2026, there was $1,453.5 billion of commercial paper outstanding of which $492.1 billion was ABCP.[1]

The key distinction is that traditional commercial paper is generally unsecured and depends primarily on the issuer's credit. ABCP, by contrast, is issued through a special purpose vehicle (SPV) and is backed by specified assets. ABCP as typically issued by a bankruptcy remote SPV or conduit and supported by collateral, liquidity mechanisms, and credit support features. LGIP investment policies or information statements often distinguish section 3(a)(3) commercial paper from more complex privately placed section 4(a)(2) asset backed structures because liquidity, transparency, and complexity differ materially across the instrument types.

Commercial Paper vs. ABCP

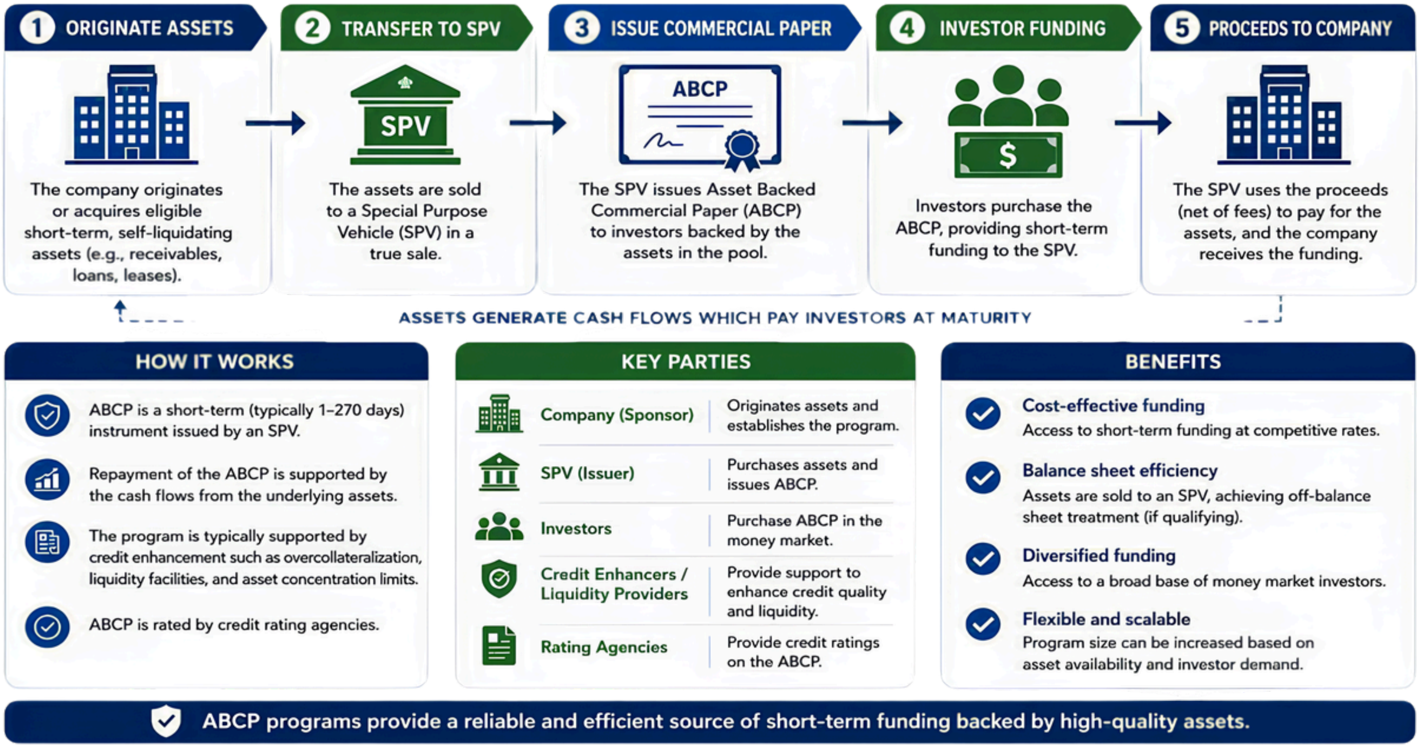
Feature	Traditional Commercial Paper	Asset Backed Commercial Paper
Issuer	Operating company, bank, or finance company	Special purpose vehicle / conduit sponsored by a bank, asset manager, or finance company
Primary repayment source	Issuer's liquidity and balance sheet	Liquidity facility, maturing asset cash flows, collateral, or refinancing of maturing paper
Collateral	Generally unsecured	Backed by receivables, securities, or asset backed interests
Structure	Relatively straightforward promissory note	Securitization-style conduit with legal isolation and support agreements
Key risk lens	Issuer credit and liquidity	Structure, sponsor, liquidity provider, collateral, rollover risk, and documentation
LGIP use case	Core credit allocation and liquidity enhancement	Selective yield enhancement and diversification within policy limits

[1] Source: https://www.sifma.org/research/statistics/us-money-market-instruments-statistics

Basic ABCP Structure

The core ABCP transaction begins with financial assets. These may include trade receivables, credit card receivables, auto loans, equipment leases, or asset backed securities. The assets or interests in the assets are sold to or financed through a conduit. The conduit issues short-term paper to investors and uses proceeds to finance the asset purchase or lending arrangement. The conduit is typically designed to be bankruptcy remote, meaning it is legally isolated for insolvency purposes from the sponsor, seller, or intermediate SPV. Regulatory language describing eligible ABCP conduits specifically references bankruptcy remoteness or equivalent insolvency isolation and defines ABCP as paper with maturity not exceeding 397 days at issuance.

Asset Backed Commercial Paper Program



Credit Support and Liquidity Support

ABCP programs generally rely on two distinct forms of support. Credit support mitigates losses caused by poor asset performance. In the instance in which newly issued paper cannot be sold to refinance maturing paper liquidity support helps ensure timely repayment at ABCP maturity. Credit and liquidity support can be program wide or specific to underlying deals. A purchaser of ABCP must gain an understanding of credit support mechanisms such as overcollateralization, excess spread, and cash reserve accounts and liquidity support mechanisms such as bank-provided purchase or financing agreements.

Credit Support

- Overcollateralization: assets pledged exceed the amount of ABCP outstanding.
- Excess spread: asset income exceeds program funding costs and can absorb losses.
- Cash reserve accounts: dedicated reserve accounts can absorb losses.

- Subordination: junior interests absorb losses before senior ABCP investors.
- Letters of Credit
- Surety Bonds

Liquidity Support

Liquidity support is critical because ABCP maturities are short while the assets may be longer dated or less liquid. Federal Reserve materials state that ABCP programs are typically supported by liquidity facilities that are commitments to lend to, or purchase assets from, ABCP programs if funds are needed to repay maturing commercial paper.

Maturity Transformation and Rollover Risk

A defining risk of ABCP is maturity rollover. ABCP may mature in days or months, while the assets supporting the program may pay over a longer period. The conduit must therefore refinance maturing ABCP by issuing new paper or drawing on support facilities.

For LGIP investors, this means the analysis should not stop at the collateral pool. It must also evaluate the liquidity provider, conditions to drawing support, documentation terms, and the market's confidence in the sponsor and program. For those LGIPs that are rated, the rating agencies may also impose holdings restrictions to ensure issuer and sector diversification.

Risk Framework for LGIP Investors

Risk	Description	Due diligence focus
Asset performance risk	Deterioration in receivables or securities backing the conduit.	Collateral reporting, excess spread, subordination, delinquency and loss levels/trends, diversification.
Liquidity risk	Inability to issue new ABCP or sell assets at fair value when paper matures.	Liquidity facility coverage, provider rating, draw conditions, tenor matching.
Sponsor risk	Sponsor weakness can reduce investor confidence or affect program administration.	Sponsor ratings, capitalization, funding access, reputation, program history.
Structural risk	Weak documents or complex collateral mechanics can impair protections.	Legal opinions, bankruptcy remoteness, eligible asset criteria, trigger events.
Market risk	Spread widening can affect market value and tradability.	Spread history, dealer support, maturity ladder, stress test assumptions.
Concentration risk	Large exposure to one sponsor, conduit, sector, or asset type.	Issuer limits, sponsor-family limits, asset-sector caps, maturity caps.

Lessons from Market Stress

In the years leading up to the 2008 financial crisis banking and non-banking institutions created a number of ABCP structures. Many of these structures deviated from traditional conduits. Some didn't provide adequate liquidity or credit support and included assets with lower credit scores and less liquidity. This combination proved to be very damaging. Several Structured Investment Vehicle (SIV) programs experienced credit issues and others were absorbed onto the sponsor's balance sheet. Many extendible ABCP programs exercised their extension options, creating liquidity challenges for investors. The good news is that after the crisis many of these flawed structures quickly disappeared.

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

The lesson for LGIPs is that liquidity stress is not limited to default risk. Even high-quality short-term instruments can experience market value pressure if investors withdraw concurrently and dealers or buyers pull back. Therefore, ABCP exposure should be evaluated through combined scenarios: rate shock, spread widening, large redemptions, and impaired rollover capacity.

Conclusion

Asset backed commercial paper is a sophisticated money market instrument that blends commercial paper issuance with securitization, credit enhancement, and liquidity support. For LGIPs, ABCP can provide diversification and incremental yield, but it should be used only within a disciplined risk-management framework. The key evaluation questions are not simply "What is the rating?" or "What is the yield?" They are: "Who is the sponsor?" "How is the conduit structured?" "Who provides liquidity?" "What assets support the program?" "What happens if the market refuses to roll the paper?" "And how does the allocation fit the pool's liquidity and fiduciary objectives?"

When ABCP is conservatively selected, diversified, and monitored, it can be beneficial to an LGIP. When structure, liquidity, or sponsor risk is poorly understood, it can become a source of complexity and stress. The most prudent approach for LGIP managers is to treat ABCP as a structured credit instrument that requires ongoing due diligence, exposure limits, liquidity tiering, and stress testing.

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