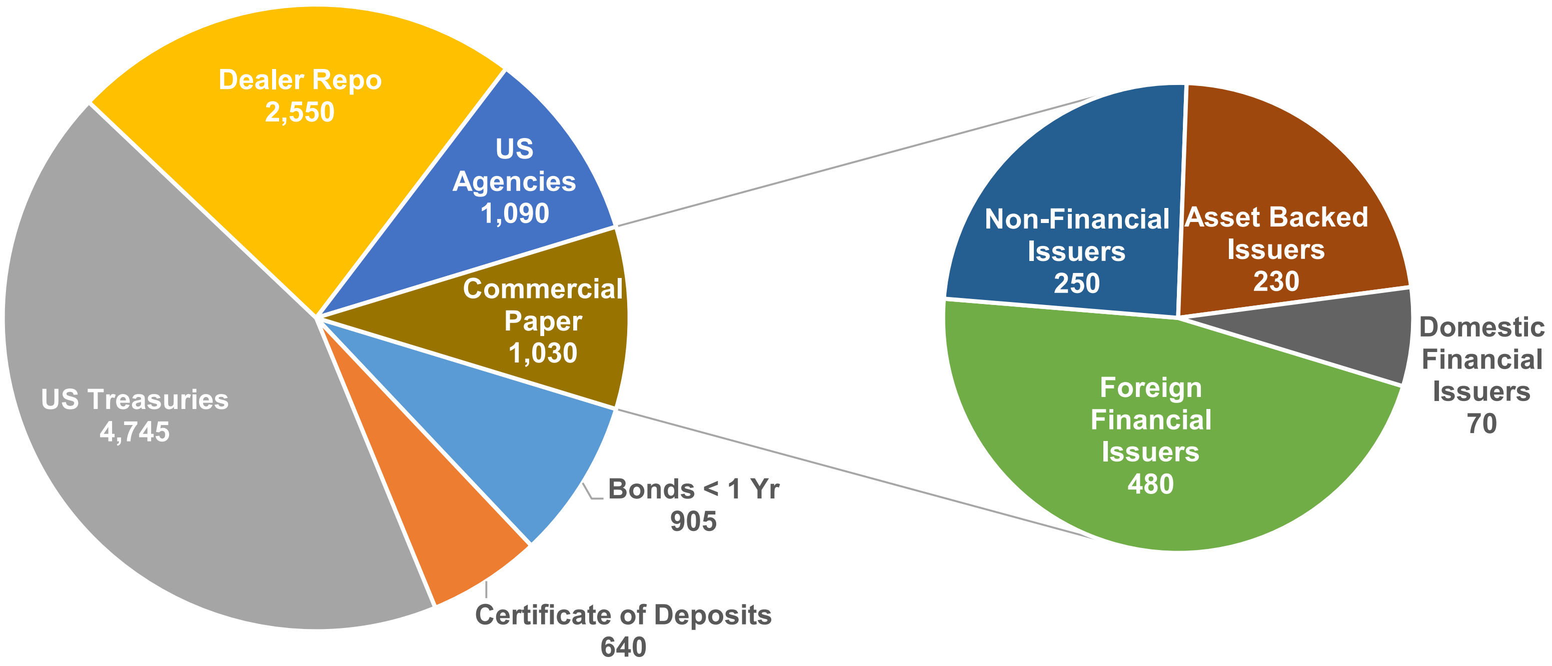
NATIONAL ASSOCIATION OF STATE TREASURERS

Qualified Institutional Buyers: How Can You Qualify and What Are the Benefits?

Moderator:
Hon. Steve McCoy, State Treasurer, GA

Speakers:
Laurie Brignac, Head of Global Liquidity Portfolio Management, Invesco
Marty Margolis, Chief Investment Officer, PFM Asset Management LLC
David Stockton, Partner, Kilpatrick Townsend & Stockton LLP

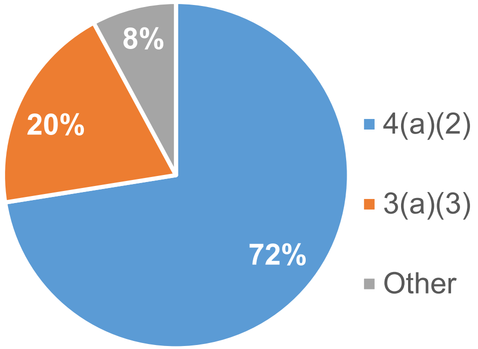
Supply in the money markets is estimated to be over $10 trillion USD



*Estimate based on JP Morgan Forecasts 12/31/18; Source: JP Morgan, Federal Reserve, Bloomberg

Commercial paper is an important investment and funding tool

Commercial Paper Outstanding By Type



**Estimate based on JP Morgan commercial paper issuance outstanding as of 11/30/18*

Understanding the Terminology

- **3(a)(3)**- this section of the Securities Act allows issuance without registration if the following criteria are met:
  - No maturity greater than 9 months
  - Must be used for qualifying purposes
  - Must meet several other criteria
- **4(a)2**- this section of the Securities Act which allows issuance without registration if the security is deemed to be "restricted" (commonly called private placements)
- **144(a)**- refers to section 230.144A of the Securities Act which defines qualified institutional buyer who can purchase private placement securities

FAQs

Why do issuers favor issuing private placement 4(a)(2) commercial paper?

- More flexibility and fewer restrictions- besides the requirement for the security to be restricted, there are no other criteria if issuing using the 4(a)(2) exemption; particularly no maturity limit and no restrictions on the use of proceeds.

Why are these securities only offered to qualified buyers?

- QIBs are viewed as having more resources and more access to information and can make sound investment decisions despite the lack of information due to the unregistered nature of these securities.

What are the benefits of buying private placements for QIBs?

- Access to more supply, increased investment options, and higher spreads (higher yields) in certain markets are some of the benefits.

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LEGAL ISSUES SURROUNDING LGIPs QUALIFYING AS A QIB

January 24, 2019

PRESENTED BY:
David A. Stockton
Kilpatrick Townsend & Stockton LLP

The Problem – SEC Regulations Defining a QIB and an Accredited Investor Don't Address LGIPs Directly

- The closest category for a QIB is a "corporation, partnership, Massachusetts or similar business trust"
    - ➢Accredited Investor definition also includes a "trust"
- "Business Trust" definition not precise, varies by state
- Result is uncertainty

SEC Has Provided Helpful Guidance

- LLCs aren't named in the definitions either, but have been recognized by SEC as qualifying as a QIB and an Accredited Investor
- Two SEC no-action letters directly addressed LGIPs and found that they qualify as a QIB and an Accredited Investor
  - College Savings Plan Network (January 12, 2016)
  - Alaska Permanent Fund (July 14, 2011)

Factors Cited by SEC as Supporting Qualification as a QIB and an Accredited Investor

- Sophisticated and experienced institutional investor, able to protect itself
- Employs a dedicated, fulltime staff of investment professionals
- Publishes annual audited financial statements
- Has directors or trustees with authority and fiduciary duties normally associated with such positions in traditional corporations or trusts

Factors Cited by SEC as Supporting Qualification as a QIB and an Accredited Investor (continued)

- A sovereign wealth fund analogous to a business trust or partnership
- Described as a “body corporate” or “trust” in its enabling statutes

Certifying that LGIP Qualifies as a QIB or an Accredited Investor – Alternative Levels of Support

Alternatives are:

- Secure your own SEC no-action letter – best support possible, but expensive and time consuming, and often not necessary
- Advice from qualified legal expert
  - Written opinion, or
  - Oral advice – but nothing in the file to evidence the advice
- Wing it – not advisable

Downside of Being Wrong

- Being excluded from the offering, or causing a busted offering exemption – very remote
- More realistic possibility – getting criticized for inadequate basis for your certification, which could come up in
  - Routine or special audit
  - Unrelated review or investigation
- Could result in reputational harm in the marketplace if it became known

LGIPs, QIBs and Accredited Investors: An Investor Perspective

Presented by:

Marty Margolis, CIO

PFM Asset Management LLC

January 24, 2019

Investor Status[1] & Considerations

- **Diversification: QIB or Accredited Investor status can provide access to a broader universe of money market and high quality, investment grade debt instruments**
  - Commercial paper issued under Section 4(a)(2) of the 1933 Securities Act
  - Bank obligation issued under Section 3(a)(2) of the 1933 Securities Act
  - Private placements—so called 144A obligations*
  - 42%[2] of investment grade issuers offer securities under Rule 144A/Section 3(a)(2).
    - Sectors such as insurance and banking are heavily represented in the 144A/3(a)(2) market.
- **Liquidity vs. yield**
  - **In the Commercial Paper (CP) market:**
    - 4(a)(2) paper is as liquid as 3(a)(3) paper of the same credit quality.
    - Both typically trade at similar levels and high quality CP can add incremental yield of 20-30[3] basis points (bps) over U.S. Treasuries.

1) Qualified Institutional Buyers (QIB) are required to have minimum assets of $25 million; Institutional Accredited Investors are required to have minimum net worth of $5 million.
2) PFM analysis based on ICE BAML U.S. Investment Grade Corporate Index. 144A and 3(a)(2) status from Bloomberg. As of 01/11/19.
3) PFM estimates based on A1/P1 rated commercial paper , as of 01/11/19.

Investor Status & Considerations (Cont'd)

- **In the Banking sector:**
  - Banks tend to be highly rated and frequent issuers.
  - Negotiable CDs and bank notes can be good investment options for LGIPs.
  - 3(a)(2) exemption allows issuers to avoid costly, redundant filings.
  - All U.S. unsecured bank level issuance are part of a 3(a)(2) program.
  - Bank level issuance has recently increased due to changes at the FDIC, tax reform, and new rating methodologies that provided uplifts to U.S. deposit and senior bank debt ratings.
- **In the Corporate bond market:**
  - 144A securities generally have reduced liquidity compared to those registered with the SEC.
  - As a result, 144A investment grade bonds can offer incremental yield spread over those registered. PFM analysis suggests 144A bonds add 7bps[1] of yield spread per year of duration on average.

1) PFM analysis compares issuers that issue both 144A and registered securities in the ICE BAML U.S. Investment Grade Corporate Index. 144A bonds have an average option-adjusted spread (OAS) of 158bps and duration of 5.9 years (27bps/year), which compares with registered securities with OAS of 155bps and duration of 7.8 years (20bps/year). 144A status from Bloomberg. As of 01/11/19.

3(a)(3) vs. 4(a)(2)
U.S. Commercial Paper Programs

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

Source: Morrison & Foerster LLP

Commercial Paper Market Statistics

- Current outstanding U.S. commercial paper (CP) is $1.055 billion.
- The Federal Reserve does not report total market outstanding broken out by exemption type.
- Active U.S. CP dealers have recently reported that 4(a)(2) exemption commercial paper represents 70% or more of total outstanding.
- All newly launched corporate CP programs that have come to the market since 2016 have used the 4(a)(2) exemption with only one exception.
- Asset Backed Commercial Paper (ABCP) programs are typically 4(a)(2).
  - ABCP represents around 25% of the CP market even though outstanding have shrunk from its pre-financial crisis peak volume of $1.2 trillion in August 2007 down to approximately $250 billion outstanding today.

Source: Federal Reserve, as of 01/09/19.

Current U.S. Commercial Paper Market

Commercial Paper Outstandings as of January 9th, 2019 (Source: Federal Reserve)				
	O/S ($bn)	Δ WoW ($bn)	Δ YTD	Δ Since Peak (Aug. '07)
Total	1,055	+57	+2%	(52%)
ABCP	254	+1	+2%	(79%)
Corporates	259	+27	+4%	+30%
Tier-2	77	+5	(5%)	(10%)
Financials	541	+30	+2%	(30%)

Indicative Offered-side Trading Levels as of January 14th, 2019*						
	Overnight	1-Week	2-Week	1-Month	2-Month	3-Month
Tier-1 Domestic Industrial	2.38 - 2.43	2.40 - 2.45	2.43 - 2.48	2.48 - 2.53	2.53 - 2.58	2.60 - 2.68
Tier-1 Foreign Industrial	2.39 - 2.44	2.42 - 2.47	2.45 - 2.50	2.51 - 2.56	2.57 - 2.62	2.65 - 2.73
Tier-2	2.60 - 2.70	2.70 - 2.75	2.75 - 2.83	2.90 - 3.00	3.00 - 3.10	3.05 - 3.20
Tier-3	2.80 - 3.00	2.90 - 3.05	3.00 - 3.15	3.15 - 3.25	3.25 - 3.45	3.50 - 3.75
ABCP	2.42 - 2.50	2.45 - 2.55	2.50 - 2.60	2.55 - 2.65	2.65 - 2.70	2.73 - 2.80
Banks	2.35 - 2.40	2.40 - 2.45	2.45 - 2.50	2.50 - 2.55	2.58 - 2.68	2.70 - 2.80
LIBOR	2.39	2.41	-	2.51	2.65	2.79

*Source: Discount rates in (%) as quoted by BofA Merrill Lynch. *All pricing is issuer specific, please inquire for additional detail.*

Note on color coding: green/red indicate that yields are lower/higher week-over-week from the issuer's perspective.

3(a)(2) Bank Obligations vs. 144A Corporate Offerings

	Section 3(a)(2)	Rule 144A
Required issuer:	Need a US state or federal licensed bank as issuer or as guarantor	Can be bank or non-bank
Foreign entities:	Only US branches of foreign banks that are regulated by NY State Department of Financial Services (NYDFS) or by the Office of the Comptroller of the Currency (OCC)	Can be US or foreign
Permitted offerees:	All investors, which means that there is a broader market. Generally, sales only to institutional “accredited investors”	Only to QIBs
Exemptions from the Securities Act:	Section 3(a)(2)	Section 4(a)(2) / Rule 144A
Basis for exemption:	Banks are highly regulated and provide adequate disclosure to investors. Also subject to various capital requirements that increase likelihood that holders will receive timely payments of principal and interest	QIBs are not in need of the protections of the prospectus requirements of the Securities Act
FINRA filing requirement:	Subject to filing requirement and payment of filing fee (but an investment grade exemption is available)	Not subject to FINRA filing
Other notes:	Eligible for bond indices. Subject to TRACE reporting	Most are eligible for bond indices. Subject to TRACE reporting

Source: Morrison & Foerster LLP, as of 02/16/17.

Breakdown of Corporate Market by Industry and 144A Status

Industry	% Outstanding		# of Unique Tickers		
	144A/3(a)(2)	Non-144A	144A/3(a)(2)	Non-144A	144A/3(a)(2) %
Automotive	34%	66%	14	13	58%
Banking	32%	68%	98	61	60%
Basic Industry	43%	57%	48	61	49%
Capital Goods	14%	86%	13	50	22%
Consumer Goods	24%	76%	30	47	43%
Energy	22%	78%	68	72	53%
Financial Services	26%	74%	24	36	40%
Healthcare	9%	91%	11	88	12%
Insurance	40%	60%	44	64	46%
Leisure	24%	76%	1	7	13%
Media	7%	93%	4	16	21%
Real Estate	9%	91%	12	61	16%
Retail	4%	96%	8	33	20%
Services	22%	78%	8	38	14%
Technology	7%	93%	5	54	8%
Telecommunications	8%	92%	10	14	43%
Transportation	23%	77%	19	15	56%
Utility	27%	73%	66	56	65%
Total	**22%**	**78%**	**480**	**780**	**42%**

PFM analysis based on ICE BAML U.S. Investment Grade Corporate Index. 144A and 3(a)(2) status from Bloomberg. As of 01/11/19.

Questions?