

Understanding Commercial Paper

The commercial paper (CP) market has evolved over time, originating as a short-term funding mechanism for large, non-financial corporations and has since developed into a systematically important financing segment of the global economy. It has been argued that the evolution of the CP market has enabled the U.S. economy to function more efficiently.

What is Commercial Paper?

CP is essentially an unsecured promissory note issued by a financial or non-financial entity for a specific dollar amount and maturity date; it is issued for short maturities, typically averaging 30 days to maturity but could range up to 270 days.

- The CP structure applies to paper that does not involve a public offering and is generally sold only to accredited investors either directly or using a dealer.
- CP provides slightly higher yields relative to Treasury Bills with the same maturities because of the moderate counterparty risk inherent in CP as T-bills are backed by the full faith and credit of the U.S. government.

The TrustIndiana Approach

CP is backed by the full faith and credit of the issuer. As such, the TrustIndiana credit team performs a fundamental credit analysis of each CP issuer to evaluate its capacity to repay its debt.

- Only CP that is rated A-1+/P-1 or A-1/P-1 from S&P Global and Moody's is considered.
- Both top-down and bottom-up analysis is conducted to evaluate the riskiness of a CP investment. This includes closely monitoring the macroeconomic conditions on the region(s) where the company operates, following industry and sector trends, and conducting company-specific and peer comparison analyses.
- TrustIndiana aims to stay ahead of rating migration risk from rating agencies and focuses on uncovering potential opportunities in the market while avoiding unnecessary risks.
- Exposure to a single CP issuer is limited to 5% of total TrustIndiana assets under management. Additional concentration limits may also be imposed.

Commercial paper benefits short-term investors by providing a safe, liquid alternative with enhanced returns. CP positively contributes to the economy as it facilitates growth by bridging short-term capital needs. When CP is properly utilized and evaluated, a sound credit process, like the one at TrustIndiana, can eliminate much of the risk.

For more on commercial paper, please visit www.trustindiana.in.gov/understanding-commercial-paper to request a copy of our white paper, "Commercial Paper Demystified."

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