



*DBRS Criteria: Commercial Paper
Liquidity Support Criteria
for Corporate Non-Bank Issuers*

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Insight beyond the rating.

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TABLE OF CONTENTS

Introduction	4
Bank Lines	4
Alternative Liquidity Sources	5
Liquidity Support and the Strength of Issuers	5
Haircutting	6
Issuer Responsibilities	6
Ratings Impact	6
Parent Guarantees	7
Global Standard	7
Extendable Commercial Paper	7
Issuer Strength	7
Provincial Governments	7
Pension Funds	7



INTRODUCTION

Commercial paper is typically issued by only the most highly rated corporate entities. DBRS commercial paper ratings are a reflection of the overall credit strength of the issuer, with particular focus on the shorter term as it fundamentally relates to an issuer's ability to fulfill its near-term obligations in a timely manner.

Commercial paper markets are by nature confidence-sensitive and, while disruptions are infrequent, there is a very real risk that the normal orderly rolling of maturing paper may be prevented by exogenous market events or by matters more specific to the issuer. Such an occurrence could lead to an unexpected and sudden default scenario for both the issuer and the investor. To address this risk, it is critical that all issuers have appropriate liquidity back-up in place such that maturing commercial paper can be repaid in the event that there is an inability to roll or issue more commercial paper.

With few exceptions, the DBRS standard is that issuers should have 100% liquidity back-up in place for their commercial paper programs. DBRS recognizes that there are a variety of liquidity back-ups that can be acceptable for this purpose, including cash and securities. In practice, however, there are several meaningful considerations that add complexity in terms of relying on back-up in the form of cash and securities and, as such, the vast majority of commercial paper issuers rely on bank lines for their commercial paper liquidity back-up. As discussed herein, DBRS only gives consideration to bank lines that are committed.

Regardless of the type of liquidity back-up, it is important that it is structured in such a way that there is always coverage available for maturing commercial paper. In the case of bank lines, DBRS expects that same-day liquidity availability will equal or exceed the maximum amount of commercial paper that comes due on any day, allowing for all "peaks" that may occur over time.

The remainder of this criteria will review a number of key areas in more detail. For details on the DBRS approach to liquidity support where applicable in the Structured Finance area, refer to Legal Criteria for Canadian Structured Finance.

BANK LINES

Where bank lines are used for liquidity back-up, DBRS generally expects issuers to maintain liquidity through a combination of unused capacity under committed bank facilities and any other acceptable liquidity sources, such that there is full liquidity support for outstanding commercial paper at any time. DBRS also expects that this liquidity support will include same-day availability equal to the maximum amount of commercial paper maturing on any day.

DBRS gives very little credit for demand facilities or any other types of uncommitted bank lines. The committed bank facilities should extend to or beyond the maximum tenor of any commercial paper that could be issued under the program. For example, in the case of one-year lines (364-day facilities), issuers typically have buffers in place so that the lines are not immediately cancelled should a renewal not be achievable; as a result, coverage is not suddenly disrupted in these circumstances.

While DBRS standards do not require that all bank lines are same day, this is recognized as the most robust form of liquidity support. The preferential situation is one in which the bank line is dedicated to the commercial paper program, but in many cases, general purpose bank lines or swing lines may be acceptable alternatives. This would occur if DBRS was satisfied that there is the intent and ability to maintain full liquidity support and that the lines would be available at the necessary level when and if needed.



Bank lines may include a variety of covenants, representations, warranties and conditions precedent to draw that may cause the bank line to be limited or unavailable. Facilities that do not contain these types of provisions – or contain limited provisions such as ones that apply only to drawings that increase outstandings – will be viewed more favourably by DBRS. Because bank lines are in place primarily to deal with commercial paper issues caused by market disruptions, DBRS does not take a favourable view of bank lines that include any requirements to produce evidence of a market disruption.

The Banking Group

In assessing bank facilities as back-up liquidity for commercial paper, DBRS considers the strength of the banks providing the back-up facility. DBRS would generally expect a group of banks with average credit strength in the R-1 range if the issuer program were to achieve that rating. It may be acceptable to have some banks with a lower rating in the group, but the proportion would be expected to be relatively minor, and consideration would be given to the mix within the context of other issues such as the size of the program, other liquidity sources and the length and quality of the back-up facilities themselves.

ALTERNATIVE LIQUIDITY SOURCES

While liquidity is mainly provided by bank lines, there may be other satisfactory forms of both external and internal sources which may vary from issuer to issuer. The list of potential options includes cash, short-term investments, a close relationship with an associated issuer or parent, and government assistance or other third-party relationships. Any dependence on these sources of liquidity back-up would require consideration of the nature of the issuer's business, the size of the program, the seasonality of borrowing needs and any upcoming maturity of longer-term debt obligations that must also be met by the issuer.

The complication in relying on these types of sources for liquidity back-up is that it is imperative that they adequately provide cash in a known amount and in an immediate time frame. It is appropriate that there is a high burden of proof that these expectations can be met and the onus is on the issuer to demonstrate this. For securities, they must be sold to receive cash and as such, the speed of sale and "haircuts" for potential value fluctuations would be considerations. Credit for securities would also likely necessitate specific classification, the assurance that no encumbrances were in existence and that the pool of "acceptable securities" would be limited to those with both very high ratings and very active secondary markets, such as highly rated sovereigns. In the case of cash, DBRS would typically request confirmation of the availability of cash for back-up liquidity purposes and that it was located in a jurisdiction and location where it could be accessed on a timely basis.

When considering alternative liquidity sources, it should be noted that: (1) Some situations may require additional conservatism if support was to be depended on in the context of same-day availability; (2) Considerations vary with the strength of the issuer; and (3) Giving credit for the availability of any liquidity source (bank lines or other) is always at the discretion of DBRS.

LIQUIDITY SUPPORT AND THE STRENGTH OF ISSUERS

In most cases, the size of total liquidity support should at least equal the size of the commercial paper program. As a general rule, there are virtually no exceptions to the standard for 100% liquidity support for programs rated R-1 (low) or lower and, notwithstanding the fact that certain stronger rated entities have more consistent access for refinancing at competitive terms with more alternatives, it is still relatively rare that even a strong borrower can operate with clearly qualified liquidity support of less than 100%. There may be circumstances where a gap is acceptable due to guarantees/support from other entities or where the issuer agrees to restrict the usage of its commercial paper program. In the case of very highly rated entities, DBRS may also consider a liquidity support facility that is smaller than the size of the com-



mercial paper program, recognizing positive factors such as the issuer's credit strength, stronger investor ties, funding diversification and access to capital markets. In general, these issuers have deeper and wider resources to adjust and deal with unforeseen liquidity issues, which often occur when markets are volatile. This occurs on a limited basis, however, and, with the exception of certain governments and pension funds (see below), it would be a rare occurrence for even an R-1 (middle) or an R-1 (high) issuer to have less than 75% liquidity support.

HAIRCUTTING

When securities are established as part of liquidity support, DBRS will establish haircuts as recognition that the immediate sale of such may require the acceptance of a lower price, acknowledging that challenging market conditions may exist at the time of sale. The degree of the haircut required for securities would consider the following factors:

- Credit strength and potential for change.
- Market liquidity in challenging markets.
- Restrictive elements, including encumbrances, immediate taxes, and where the securities are held.
- An assessment of whether securities are clearly in excess of operating needs and expected to remain so.
- Currency risk.
- The propensity for interest rate risk (including duration of the securities).

Even in the case of AAA-rated sovereign government securities that score well on all of the aforementioned considerations, DBRS would require some haircut and as a general rule, issuers with greater reliance on securities as part of their liquidity support package would also likely receive less credit (a higher haircut). For securities other than AAA-rated sovereigns, even if very highly rated, DBRS would be even more focused on the ability to sell quickly and what this would mean for pricing. In short, situations are treated on a case-by-case basis. The bar is high and securities that miss on any consideration in a meaningful way are, in many cases, simply viewed as ineligible to receive liquidity support credit.

ISSUER RESPONSIBILITIES

Each issuer bears the responsibility to ensure that it has sufficient liquidity to meet all maturities as they come due and to take appropriate actions when there are indications of stress. In providing ratings, DBRS will review these plans to consider compliance and acceptability but DBRS does not perform the role of auditor nor does it monitor issuers' commercial paper position on a daily basis. As an example, consider the case where an issuer begins to experience stress in its commercial paper program in the form of higher pricing, reduced length of maturity and, perhaps, even loss of certain buyers. Should these changes be material, DBRS would expect that the issuer in question would take appropriate steps to ensure that there was no deterioration in the ability of liquidity back-up to cover all commercial paper maturities. In a very negative situation, it may be necessary for the issuer to take actions such as selling securities or drawing down its bank lines to ensure that same-day coverage can be fully maintained.

RATINGS IMPACT

There will be cases where DBRS may provide a commercial paper rating when liquidity support is adequate but not as robust as desired for the rating that would normally correspond to the long-term evaluation of the company. In such cases, there is flexibility in the DBRS rating scales such that a commercial paper rating for an issuer can be lower than the long-term rating would normally dictate. For example, the DBRS policy with respect to ratings mapping denotes that in most cases, an A (low) issuer would be able to obtain a rating of R-1 (low), but the policy does specifically provide for the ability to assign an R-2 (high) rating, noting that this would occur if DBRS had meaningful concerns about either



the liquidity support or liquidity strength of an issuer. In some cases, however, a lack of adequate back-up liquidity support may be significant enough to cause DBRS to simply decline the opportunity to assign a short-term rating.

PARENT GUARANTEES

There are cases where a domestic borrower may issue based on a guarantee from a foreign parent. In such cases, liquidity back-up may be based on resources of the parent and not the subsidiary, providing that all potential timing issues (such as different time zones or statutory holidays) are acceptably dealt with.

GLOBAL STANDARD

Issuers with commercial paper programs in more than one jurisdiction are expected to meet the DBRS requirements on a consolidated basis and provide same-day availability support to all maturities in all jurisdictions, regardless of the geographic location of the liquidity. In jurisdictions where a subsidiary issuer operates the commercial paper program and the commercial paper is not based on that issuer's standalone financials, the subsidiary issuer must have evidence of support from the parent issuer (an irrevocable, unconditional guarantee being the most common) and show that there is same-day availability support, regardless of the geographic location of the liquidity.

EXTENDABLE COMMERCIAL PAPER

It should be noted that in the case of extendible commercial notes (ECNs), the liquidity back-up is essentially provided by the investor and as such, DBRS does not require separate liquidity support for these programs. It should also be noted that at this time, ECNs are no longer widely used in the markets and DBRS does not expect this to change in the foreseeable future.

ISSUER STRENGTH

When discussing bank lines, it is important to remember that an issuer's rating reflects the overall strength of the issuer. While bank lines are expected to fulfill their support role when market disruptions occur, they are not established as legal guarantees. Even the strongest and most diversified bank back-up facility cannot improve the rating of an issuer. The latter requires an unconditional guarantee or a similar agreement that effectively transfers the debt obligation to a higher-rated supportive issuer. For this reason, the rating on an R-1 (low) issuer with bank lines of R-1 (middle) strength remains an R-1 (low) rating.

PROVINCIAL GOVERNMENTS

As a general rule, DBRS expects provincial governments to have back-up facilities (cash and marketable securities, including bank lines) sufficient to cover the average of its cumulative ten business days of maturities (commercial paper and term debt maturities). The less stringent standard for provincial governments relative to all other borrowing entities is due to its strong ability to issue both short-term and long-term debt.

PENSION FUNDS

By their nature, most pension funds have an exceptionally high degree of liquidity, with large bases of unencumbered high-quality securities that can be monetized through reposessions or asset sales very quickly.



For pension funds, DBRS defines “highly liquid assets” as unencumbered debt securities of any duration issued or guaranteed by sovereign governments rated AAA. For Canadian pension funds, DBRS will also consider any debt issued or guaranteed by one of the Canadian provinces for inclusion within the highly liquid asset definition. If DBRS does not rate a sovereign, it will still be acceptable for inclusion within the definition of highly liquid assets if the debt has been rated AAA (or the equivalent rating) by at least one publicly available Nationally Recognized Statistical Rating Organization or External Credit Assessment Institution. However, DBRS reserves the right not to rely on other agencies in this way if their risk opinions, methodologies, or sector outlooks are meaningfully inconsistent with the views of DBRS.

When a pension fund is a commercial paper issuer, DBRS will assess the need for bank line support on a case-by-case basis, by considering the following issues:

- The level of liquidity on the balance sheet relative to the size of the commercial paper program. As a general rule, the fair value of highly liquid assets should, at all times, be at least 1.5 times the size of the maximum authorized limit for the commercial paper program.
- The rating given to the pension fund (higher-rated entities generally have better ability to access the market in a stressed environment). In most cases, DBRS is only satisfied with relying on balance sheet liquidity for support when the rating of the pension fund in question is R-1 (high).
- Whether the commercial program is of such a large size that some bank line support would be prudent, notwithstanding the level of liquid assets maintained by the pension fund.
- Whether the issuing organization is aware of the importance of supporting its commercial paper program and is highly likely to access its sources of liquidity.
- Whether the fair value of highly liquid assets on the issuer’s balance sheet demonstrates high volatility.
- Whether there are any special circumstances that could add liquidity stress that should be taken into consideration, such as pension payment holidays or actuarial considerations.
- Where there are concerns with any of these areas, DBRS standards may include the maintenance of available bank lines to cover 15% of outstanding commercial paper, which should provide enough coverage 3/23 (13%) of average outstandings or three business days maturities (assuming even maturities over a given 30-day period). More significant concerns will necessitate a higher level of bank line coverage.

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