# CLO (COLLATERALIZED LOAN OBLIGATION) - OVERVIEW

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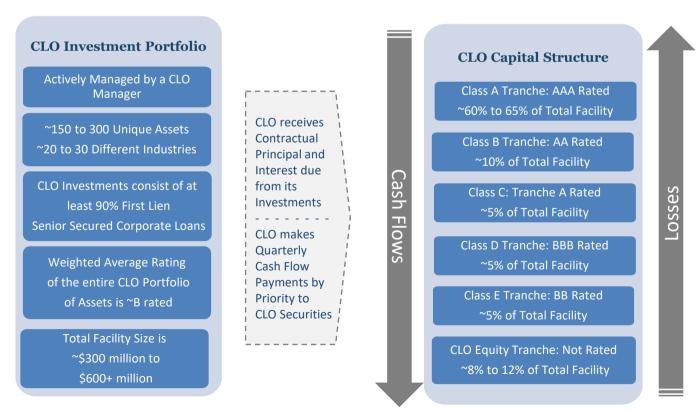
### WHAT IS A CLO?

## A Collateralized Loan Obligation ("CLO") structure is a securitization vehicle.

- Collateral is primarily floating rate, first lien senior secured loans (at least 90%), and broadly syndicated.
- Credit ratings for the collateral assets are typically rated BB+ through B-, with a weighted average portfolio rating of approximately B.

CLOs issue several debt tranches and equity and use the proceeds to build a diversified portfolio of assets, which is actively managed by a CLO manager.

- CLOs are typically \$300 million to \$600+ million in size.
- Debt tranches are rated AAA through BB (with a single B tranche on occasion).
- Quarterly payments are made per a "waterfall" mechanism defined in the CLO indenture, with the AAA debt tranches having first payment priority, followed by the AA debt tranche and so on. Any potential collateral losses are incurred in reverse order, with the equity absorbing such losses first, and if such losses exceed the equity outstanding, followed by the junior debt and so on.



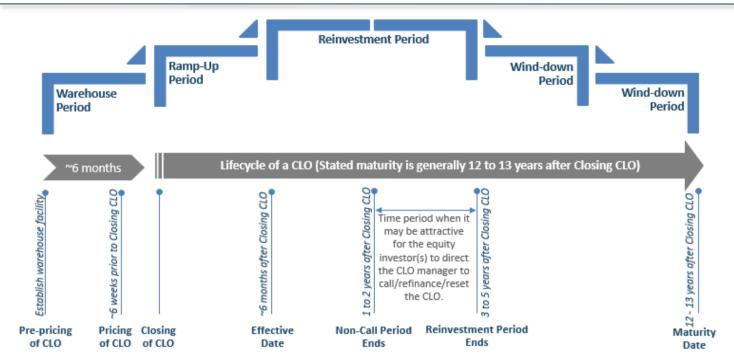
The CLO investment portfolio and CLO capital structure are for illustrative purposes only. An actual CLO may vary substantially from the
above example. All references to CLOs in this presentation are intended to be with respect to CLOs which invest in broadly syndicated
leveraged loan. CLOs which invest in middle market loans are excluded in this primer.

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### LIFECYCLE OF A CLO



The above Lifecycle of a CLO is for illustrative purposes only. The actual Lifecycle of a CLO may vary substantially from the above illustration. Prior to the Ramp-up Period, a warehouse facility may be established by the CLO manager to invest in corporate loans which will eventually be sold to the CLO on the Closing Date.

#### CHARACTERISTICS OF CLOS

- Structural protections for debt tranches include quarterly overcollateralization ("OC") and interest coverage ("IC") tests. Should an OC or IC test fail, a "self-curing" mechanism per the CLO indenture either partially or fully diverts interest payments from the junior tranche alongside any applicable diverted reinvestment principal proceeds to pay down the most senior debt tranche outstanding in order of priority (AAA, AA and so on) or purchases additional collateral, until the test(s) is in compliance. The AAA and AA tranches (the "Senior Notes" of the CLO) are not subject to the OC or IC tests and therefore are not subject to any interest and/or principal payment diversion.
- Floating rate interest payments provide a hedge against duration/interest rate risk.
- The collateral manager provides active management of a diversified portfolio, subject to ongoing concentration limits and collateral quality test covenants per the CLO indenture.
- Transparency due to comprehensive and monthly reporting requirements, rating agency monitoring and trustee oversight.
- Since the establishment of the CLO market in the 1990's no U.S. AAA CLO tranche has defaulted and there has been one technical default of an AA tranche (with no loss of principal or interest due to the AA investors). As of September 30, 2024, there have been five defaults of an A tranche, nine defaults of a BBB tranche and thirty-two defaults of a BB tranche.<sup>1</sup>
- The debt benefit from the overcollateralization of the CLO structure as there are more collateral assets held in the CLO than the total amount of debt outstanding at closing.

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### **CLO MARKET HISTORY & GROWTH DRIVERS**

- The CLO market was established in the early 1990s. There have been two distinct periods of CLOs.
  - Primary deals issued from the 1990s to the Great Financial Crisis (GFC), around 2009, are referred to as CLO 1.0.
  - CLO 2.0/3.0 deals were issued after the GFC; these CLO transactions generally have stronger covenants and higher quality collateral portfolios.
- The U.S. CLO market has grown to ~\$1.0 trillion as of year-end 2023, from ~\$600 billion over the past five years.
- The anticipated growth of the leveraged loan market (~\$1.4 trillion as of 12/31/23) should result in a corresponding increase in CLOs. CLOs represent the largest investor group (~70%) in the leveraged loan market.
- Institutional and retail investor interest is expected to continue to expand given the risk adjusted returns and low default rates of CLO debt and equity tranches.
- Establishment (in June 2022) of an electronic trading platform (by Octaura Holdings, created by seven major CLO banks) will provide better market execution and trading information.

#### **CLO MANAGERS**

- There are approximately 150 U.S. CLO managers.
- The top 50 CLO managers are private equity credit affiliates, hedge funds, insurance companies and traditional asset management firms.
- $\sim$ 35 CLO managers have more than \$10 billion of CLO assets under management.
- Some of the largest U.S. CLO managers include:
  - Blackstone, Octagon Credit Investors, Carlyle, PGIM, Ares Management, Neuberger Berman, Apollo Global Management and KKR.

### IMPORTANT RISK DISCLOSURES

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