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The composition of CLO managers is changing, so management styles may drift

The US CLO market has come a long way from the relatively obscure, niche structured product it was a few years ago. New CLO collateral manager entrants seem to pop up monthly. This is not surprising considering that CLO platforms provide a steady stream of income and an ability to scale up AUM in a historically resilient asset class.

While we are seeing many financial institutions create their own platforms organically, we are also seeing a significant number of mergers and acquisitions. Since March, there have been at least five major announcements — including Carlyle's acquisition of CBAM to become the largest US CLO collateral manager.

New CLO strategies are welcome as we seek out fresh investment opportunities, but not all new CLO management platforms will perform well. As CLO collateral managers acquire others, they must digest differentiated portfolios and integrate teams — and investors cannot be sure those platforms will continue to provide the same returns.

CLOs are melting ice cubes without resets

Arguably the most vital factor in any CLO collateral manager's business relates to capital formation and equity following. For new entrants, a strategic equity partnership or internal capital 'treasure chest' are vital in demonstrating future relevance to the market. Without a pathway to numerous CLO transactions, many CLO debt and equity investors won't even pick up the pen.

Without an active reset program, a CLO platform is a constantly melting ice cube, so collateral

the breadth of your triple A-rated note pipeline. New entrants must understand that growing their triple A following will be important in convincing early triple A investors that the platform will be able to provide returns and liquidity in the future.

Established CLO collateral managers with access to a broad smattering of global bank investors and domestic insurance companies have significantly outperformed in issuance over the past few years. But some CLO collateral managers in 2022 with multiple billions in AUM remain without a good triple A path today.

Keep investors in the loop

It may be counter-intuitive to think of rigidity as a positive attribute, but CLO collateral manager combinations or new entrants can allow style drift. This can be due to market opportunity, the continued revolving door of human resources or not having the necessary building blocks to accomplish stated goals. Regardless, an investor's expectation will always be for a CLO collateral manager to be as they represented themselves in the pitchbook.

The failure to do so is more prevalent today due to the changing landscape. Established collateral managers may adapt due to past experience. If this fits within their established investment goals, it may be acceptable — so long as they communicate with investors. However, wholesale movements into risk areas after internal changes, or even without, should sound an alarm that past performance may not be indicative of future results. This is why an understanding of



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managers' capital must be flexible. They must also be able to issue CLOs in a range of market environments.

Among established CLO collateral managers, the best find ways to procure long-term, third-party equity partnerships, as well as internal sources of co-investment, by ensuring investors see the manager has skin in the game.

Less discussed, but equally crucial to platform sustainability, is CLO senior debt distribution. The ability to reassure investors you can sustain issuance and provide future refinancing activities for both equity and mezzanine tranches hinges on

personnel retention plans is essential.

Moreover, with CLOs now being a more mainstream product, we see entrants to the market with little to no actual CLO management experience — and even some which have little to no experience investing in senior secured loans.

Perhaps their analysts understand credit well, but without a team to manage the dynamics of the CLO structure, we expect such managers will struggle to put into action what they pitch.