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WHITE PAPER

Alternative Income:
The Role of CLO Investments in a Low-yield Environment

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- Unforeseen increases in operating and capital expenses
- Lack of availability of due diligence information
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- Risk that a fund will not achieve its investment objectives if it does not raise sufficient capital
- A fund may not be a diversified investment fund for purposes of the 1940 Act.

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A new generation of public funds is now enabling more individual investors to participate in CLO investments.

With rates at their current levels, most of today's fixed-income portfolios are concentrated in instruments with low yields. This situation is presenting serious challenges for income-oriented investors. Many are yearning for a broader range of investment options that could more effectively address their long-term goals for income generation and better position them for varying scenarios in which interest rates either remain stable or increase in the future. For these reasons, investors are increasingly willing to consider fundamental changes in the allocation of their income-oriented investments—even if it requires them to look beyond traditional fixed-income alternatives.

Collateralized loan obligations (CLOs) are special purpose vehicles that hold diversified pools of 100 to 200-plus corporate debt positions. CLOs are emerging as a uniquely compelling alternative for income-oriented investors. CLOs that invest in senior secured bank loans (SSLs) have historically provided attractive current income while buffering fixed-income portfolios from market volatility[1] and the risks associated with rising interest rates. Although SSLs are typically issued to borrowers with credit ratings below investment grade, SSLs have provided positive cash yields in all years since 1997, and only one year of negative returns in 2008.[2] This is due to several factors including the senior position of SSLs in the capital structure, which gives them repayment priority ahead of all other debt obligations, and first liens against corporate assets. As a result, SSLs have had historically low default rates[3] with high recovery rates.[4]

CLO investments traditionally have been available only to institutions and high-net-worth investors. However, a new generation of public fund offerings is now providing a wider range of individual investors with the opportunity to participate in CLO investments. Actively managed CLOs enable investors to access the expertise of high-quality managers with expertise in analyzing the creditworthiness of borrowers, monitoring current market interest rates for non-investment-grade credit, and forecasting how a business is likely to perform during the next downturn. Due to the particular features of SSLs, including interest rates that periodically recalibrate rather than remaining fixed, CLO investors can be better-positioned for varying scenarios in which interest rates either remain stable or increase in the years to come.

Although investments in CLOs offer potential benefits, these investments are not without risk. Potential investors would be wise to seek the assistance of a financial professional in carefully evaluating these risks as well as their individual suitability for any specific investment program.

CLOs provide an alternative allocation strategy for income-oriented investors seeking higher yields.

The Intensifying Search for Yield

Investors attach far greater importance to income-generating products today than they did five years ago, according to Legg Mason's "Global Income Survey Summary Report," published in March 2013.

The survey results demonstrate that there is a substantial gap in expectations between what investors want from their income investments and what they actually receive. Investors' income expectations are not being met by the yield they are achieving with traditional income investments which typically include:

- Certificates of deposit (CDs)
- Annuities
- Bonds
- Cash
- Investments in real assets

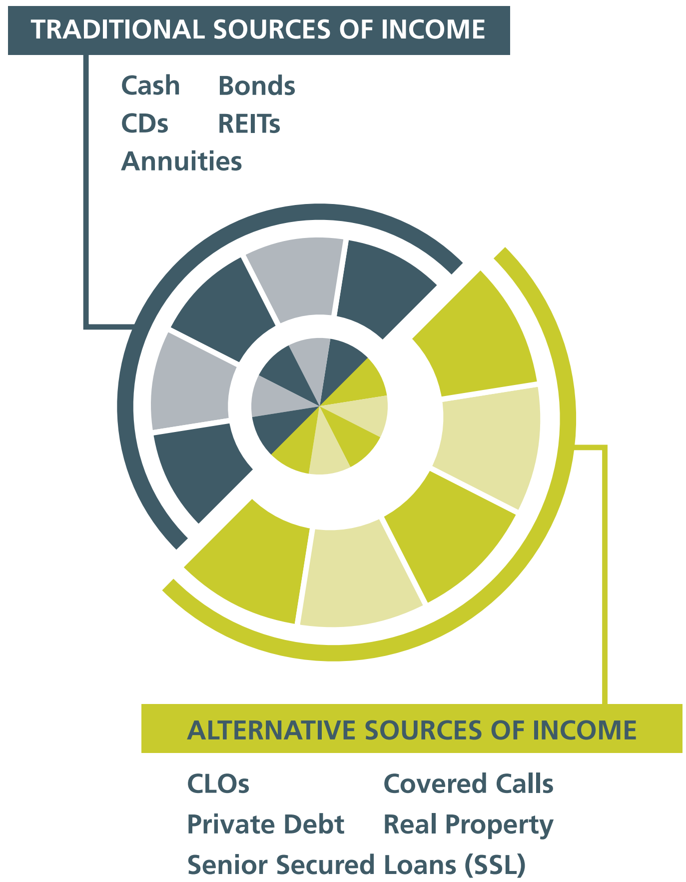
Faced with numerous challenges, from their own risk aversion to macro issues like volatility and inflation, investors are hungry for more information about income investing. They also want to receive more ideas from financial advisors about innovative ways to:

- Optimize income in a low-rate environment
- Protect wealth
- Maintain their current lifestyle in retirement
- Enhance their peace of mind through investments with lower underlying volatility (as compared to equity investments)
- Manage risks such as market volatility and inflation through investments with low correlation characteristics

CLO Investments:

A Compelling Alternative for Income-oriented Investors Seeking Higher Yield

In today's rising interest rate environment, investments in CLOs provide an alternative allocation strategy for income-oriented investors who are seeking higher yields than can be achieved via traditional fixed-income investments.



Traditional fixed-income securities pay investors a fixed rate of interest, which is also known as a coupon, for the duration of the investment. Fixed-rate investments provide the most benefit for investors when interest rates fall and the coupon on the note exceeds current market interest rates. But if interest rates rise, the coupon will remain fixed, perhaps at a level lower than market interest rates. As a result, a coupon-bearing instrument paying an interest rate lower than the market interest rate will decline in value.

CLOs performed very well during the recent financial crisis, experiencing virtually no defaults during that time. This level of performance surpasses that of investment-grade bonds.[7]

The Inverse Relationship of Fixed-rate Bond Prices and Interest Rates

If Interest Rates Rise — If Interest Rates Fall

Non-correlated Relationship of SSL Principal Values and Interest Rates

If interest Rates Rise, Fall or Remain Stable
{ No Direct Impact on SSL Principal Values}

When compared with most fixed-rate debt instruments, the market values of SSLs held by CLOs are more sensitive to the underlying credit quality of the issuing corporation than the current interest rate market. Because the frequent resetting of the interest rates paid by the borrowing corporation reduces interest rate risk, the market value of SSLs tends to fluctuate more with the market's appetite for risk than with shifts in interest rates.[5]

CLOs holding SSLs can provide a higher return than other fixed-income investments due to their floating interest rates and the higher interest rates provided by investments in loans that are not investment grade. However, investor payouts can be reduced by operational and administrative costs, which generally constitute 0.15% to 0.20% of the assets of the CLO. Some of the best-known brand names in the United States are associated with companies that do not issue investment-grade debt. Examples of such companies (as of December 2015) include H. J. Heinz Company, Dell Computer Corporation, Burger King Corporation, and The Hertz Corporation. Only a small percentage of American companies issue debt that is classified as investment grade.[6]

The interest rates for SSLs generally "float," or move in relationship to a reference rate such as LIBOR (London Interbank Offered Rate), which resets every 30 to 90 days. Floating interest rates potentially provide investors with protection from interest rate and inflation risk. Because their yield rises and falls with changes in the LIBOR rate, floating-rate loans are relatively less sensitive to interest rate movements than other fixed-income investments.

Strong Historical Performance of CLO Investments

Over the past 16 years, there have been impairments on less than 1.5% of CLO notes, and most were cured with no losses to note holders. In addition, CLOs performed very well during the recent financial crisis, experiencing virtually no defaults during that time. This level of performance surpasses that of investment-gradebonds.[7]

CLOs are structured to make allowances for a certain level of default in their underlying portfolio of loans. As long as their loans continue to perform and pay off as scheduled, within planned allowances, movements in the market prices of the loans are largely irrelevant and will not derail the CLO's investment performance.[8]

Low historical default rates

Recent rates of default on senior secured bank loans tracked by the S&P/LSTA Leveraged Loan Index have been below the average historical level. The trailing 12-month default rate by principal amount on senior secured bank loans was 1.54% at the end of 2015, according to the S&P Capital IQ LCD.[9]

High historical recovery rates

SSLs are secured by a first lien on the borrower's assets, and the lender has the first priority for repayment. For these reasons, SSLs generally have a higher recovery rate after default than borrowings further down the capital stack. Since 1987, the average annual recovery rate on defaulted SSLs has been 80.2%, as compared to 63.0% for senior secured bonds, 48.8% for senior unsecured bonds, and 28.2% for subordinated bonds.[10]

The recovery rates for senior secured bonds, senior unsecured bonds and other subordinated bonds are lower than the recovery rate for SSLs because they have a subordinated position in a corporation's capital structure, and therefore, a lower priority for repayment. For this reason, funds that invest in the bonds described above assume higher repayment risk than CLOs that invest in SSLs.

The Value Proposition for CLO Investments

Investments in CLOs that hold SSLs now are providing individual investors with access to an investment strategy that previously has been available only to institutions and high-net-worth investors.

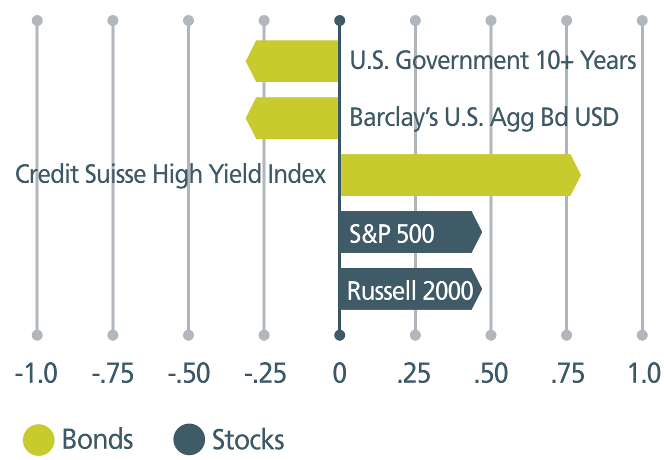
SSLs typically are loans to large- and mid-size businesses that are secured by a first lien on the cash flow and assets of the corporation. Collateral assets are often:

- Cash and cash flow
- Accounts receivable
- Property/physical plants
- Equipment
- Intangibles such as intellectual property
- Subsidiary stock

SSLs are corporate loans, as opposed to loans to individual borrowers. Unlike various forms of collateralized debt obligations (CDOs) linked to residential real estate, CLOs also have no exposure to commercial or residential mortgages, sub-prime debt or consumer-based debt. In this way, CLOs are very different from the varied versions of CDOs that were prominent features of the sub-prime mortgage challenges that resulted in the financial crisis of 2008–2009.

Corporate debt positions, including SSLs, are originated by commercial banks. The originating bank, or another financial institution such as an investment bank, then acts as an arranger or syndicator and sells loans, or portions of loans, to institutional investors including banks, insurance and securities companies, private equity investors, and funds that hold debt investments including CLOs, mutual funds, and hedge funds. The corporate debt positions, including SSLs, are bought and sold at the dealer desks of underwriting investment banks in an "over the counter" direct transaction between a seller and a buyer.

Correlations Between Credit Suisse Leveraged Loan Index and Various Assets: 1/1/2011–12/31/2015



CLOs that invest in SSLs have historically provided attractive current income while buffering fixed-income portfolios from market volatility and the risks associated with rising interest rates.[1]

The senior secured bank loans held by CLOs have unique features that potentially benefit investors, including:

- priority in repayment (due to senior position in the capital structure);
- floating interest rates based on a reference rate such as LIBOR. A specified rate of additional interest (known as the spread over LIBOR, which is expressed in terms of basis points that represent fractional portions of a percentage point) is added to compensate the lender for the level of credit risk assumed;
- security provided by a first lien on the borrower's collateral (which often improves the recovery rate in the case of a default);
- minimal correlation with other fixed-income asset classes, negative correlation with U.S. Treasury notes,[11] and low correlation with equity and real estate asset classes. Investments with low correlation, or negative correlation, to other asset classes can stabilize a portfolio during periods of high volatility in the public bond and equity markets; and
- documented lower rates of default and higher recovery rates after default than unsecured corporate bonds.

The Importance of Active Management

One factor that previously has inhibited individual investment in senior secured bank loans is that this investment strategy requires careful and skillful analysis of pertinent fundamentals that must be executed loan-by-loan. Few individual investors have access to data about pertinent fundamentals and the expertise required to analyze the creditworthiness of a corporate borrower.

However, CLOs give investors access to a professional advisor (called the CLO manager or the collateral manager) that employs a team of credit professionals who regularly research companies serving various industries and gather data that can be used as benchmarks to calibrate risk and reward. Investors should seek CLO managers with expertise in analyzing the creditworthiness of borrowers, monitoring current market interest rates for non-investment-grade credit, and forecasting how a business is likely to perform during the next downturn. Investors also should look for managers with experience in actively managing multiple CLO investments.

CLO managers also execute stress tests for various investment scenarios to help ensure that capital will be preserved while attractive yields are generated.

Static CLOs employ a passive "buy and hold" management strategy that maintains the same pool of loans throughout the life of the CLO. As loans are paid off, the value of the pool declines. On the other hand, actively managed CLOs have dynamic loan pools because the portfolio manager actively buys and sells assets in an attempt to maximize return. Therefore, the makeup of the loan pool can vary over time, within certain limitations. Because actively managed CLOs require a higher level of involvement from the CLO manager than static CLOs, their management fees can be correspondingly higher.

Risk Management in CLOs

Although investments in CLOs offer potential benefits, these investments are not without risk. The discussion below outlines major risks associated with CLO investments as well as methods and features that are commonly employed by CLOs to manage or mitigate these risks.

Credit risk and default risk

Most companies that are borrowers on senior secured bank loans are rated below investment grade, which means they have a higher risk of defaulting than investment-grade companies. CLOs and associated lenders often seek to mitigate credit risk by incorporating restrictive financial covenants, such as ratios of equity to debt; cash flow or income to debt, or total debt to assets or cash flow. These covenants provide benchmarks that allow a lender to monitor the financial health of a borrower and take protective steps if a borrower's financial position deteriorates before an actual payment default occurs.

In addition, most non-investment-grade loans of recent vintage are capitalized with more equity and less leverage than before the 2008–2009 financial crisis. In the wake of the recession, many surviving businesses have more attractive cash-flow profiles because they have reduced their operational costs and are now more hardened for the next economic downturn. Concentration limits also can help control over-exposure to a single borrower, loan class, or industry.

Duration risk

The duration of an investment influences how its value could be affected by interest rate changes; in general, a longer duration represents increased risk. A fixed-rate coupon is, by definition, subject to interest-rate risk because its rate does not change if interest rates rise. In addition, the market price of a fixed-rate bond moves in the opposite direction of changes in interest rates. For example, if interest rates rise, the market price of a fixed-rate bond will fall; the income it produces would be indirectly offset by a decline in its value if the investor were to sell the bond.

In contrast to many fixed-income investments, the SSLs held by a CLO represent very minimal duration risk because floating interest rates (which reset every 30 to 90 days) potentially enable the CLO investor to benefit from upside potential if market interest rates rise. Unlike fixed-rate investments, the principal values of SSLs remain primarily unaffected by interest rate changes.

In an environment of rising interest rates, CLO investors can potentially achieve yields that keep pace with the rising trajectory of interest rates while reducing volatility by limiting their portfolio's exposure to the price declines that would typically be associated with fixed-rate investments.

Recovery risk

The nominal value of a loan (also known as the par value or face amount) may not be fully recovered in the event that the borrower defaults. In the case of SSLs, recovery risk is mitigated by:

- the loan's senior (or first-priority) position in the borrowing company's capital stack, which means that this loan would be the first to be repaid in the event of a default, and
- the security provided by a first lien on the borrower's collateral assets.

Reinvestment risk

As loans in the CLO's portfolio of assets are amortized or sold, reinvested proceeds may result in lower yields due to lower interest rates at the time of reinvestment. Reinvestment risk can be mitigated by certain practices of the CLO manager, such as selecting loans with LIBOR floors (minimum interest rates) and a longer maturity profile. When compared to most fixed-income bonds with low coupons and extended maturities, bank loans are more likely to perform well in most scenarios where interest rates are rising.

Liquidity risk

Liquidity in the secondary markets (which exists on the dealer desks of underwriting investment banks) is especially a concern during periods of economic downturn.

The degree of investment liquidity is also dependent on the liquidity provided by the vehicle used to invest in CLOs. Some investment vehicles are illiquid, and transaction costs also can affect liquidity.

CLOs generally employ a valuation process that does not require their assets and liabilities to be "marked to market," or periodically repriced on their balance sheets to reflect value fluctuations in a particular market. Therefore, a CLO's performance is driven primarily by the underlying fundamentals of the loans, rather than market value changes.

As a result, CLOs can be better equipped to withstand market disruptions. The CLO manager has extensive latitude to hold assets during a downturn and potentially increase overall yield as market prices on loans create a buying opportunity.

Match funding of the CLO's assets and liabilities ensures that the interest rates on both will move in tandem.

Structure and Payment Process of a CLO

Structure

A CLO is structured like a corporate balance sheet with similar components. Those components are:

Assets:

Typically a portfolio of 100 to 200 bank loans made to large- or medium-size corporations. SSLs in a CLO are often rated as "B" or "BB" (which is below investment grade) by an independent rating agency such as Moody's, Standard & Poor's, or Fitch. The SSLs generate cash flow in the form of contractual principal and interest payments.

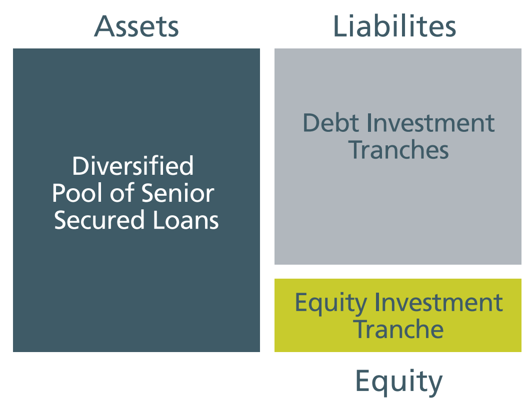
Liabilities:

Debt issued by the CLO (which is structured in rated classes called tranches) pays floating LIBOR-based interest rates. The debt is sold to institutional investors, generating proceeds that are used to acquire assets (the CLO's portfolio of loans).

Both the CLO's assets and liabilities feature floating interest rates referenced to LIBOR, and therefore, are considered to be "match funded." Match funding of the CLO's assets and liabilities ensures that the interest rates on both will move in tandem as the LIBOR rate recalibrates. As a result, it is not necessary for the CLO manager to accurately forecast LIBOR rate movements in order to maintain a spread sufficient to provide a targeted rate of return for investors. Liabilities typically represent 90% of the CLO's capital structure.

Debt tranches are independently rated in a range from "AAA," which occupies the senior position in the liabilities structure and represents the lowest risk, and therefore, a lower rate of return, to "BB" or lower, which represents debt with higher levels of risk, and therefore, a higher rate of return.

CLO Assets, Liabilities and Equity



Equity:

The equity tranche receives any excess cash after the operational expenses, administrative expenses, and debt service obligations of the CLO have been paid. Equity often represents 10% of the CLO's capital structure.

Equity tranche investors control decisions related to the timing and methodology of the ultimate liquidation or disposition of the CLO's assets. (The life cycle of a CLO usually does not exceed 10 years.)

Because investors in the equity tranche assume more repayment risk, they have the potential to achieve higher returns. CLOs are typically structured to target a mid-teens percentage annual return for equity investors.[12]

The CLO Payment Process

CLO Payment Process

1. Principal and interest payments from the underlying loan portfolio flow into the CLO in the form of cash.

2. Through a payment process known as "the waterfall," payments on liabilities are made in a prioritized order based on seniority in the CLO's capital structure.

3. Operational and administrative costs for the CLO are paid first, in the form of a senior fee which is generally 0.15% to 0.20% of the assets of the CLO.

4. Interest payments on issued debt are then made by the CLO. The highest rated (AAA) debt tranches are paid before the next-highest debt tranche, and so on until all of the debt service obligations have been paid by the CLO.

5. Tranches with a lower priority for repayment receive a higher spread over LIBOR to compensate those investors for assuming a higher level of risk. Higher-priority tranches pay a lower interest rate that reflects their lower level of risk.

6. CLO managers are required to maintain the quality and diversity of the CLO's loan portfolio in accordance with the terms of the offering, as defined by a contract between the CLO (which is the debt issuer) and the trustee known as an indenture. For example, a particular CLO's indenture could require that no more than 2% of the principal amount of the CLO's loan portfolio can involve a single borrowing entity, and no more than 10% can involve borrowers in a single industry.

7. The waterfall payment process is impacted by the results of various mandated tests the CLO manager must perform before each tranche is paid. These tests include over-collateralization tests, weighted average ratings factor tests, interest coverage tests, and weighted average life tests, among others. An independent trustee selected by the CLO manager verifies the results of these tests.

8. If the income earned on the portfolio is below some predefined amount, or if the par or face value of the loan pool, after deductions for defaulted assets and lower-rated assets in excess of certain limits, falls below a specified ratio of the liabilities, cash flow which would have been paid to investors in junior tranches is used instead to redeem the senior notes, or to buy more loans until such tests are once again in compliance.

9. These cash flow diversions constitute a "self-healing" process that is designed to provide further loss protection for investors in the senior tranches.

10. Any remaining funds are distributed to the equity tranche after a subordinate fee to the CLO Manager in the amount of 0.30% to 0.35% of the assets of the CLO.

11. In this fashion, CLOs classified as arbitrage CLOs make money based on the difference between the interest rate they earn on the underlying loan assets and the interest rates they pay to those who have invested in the bonds issued by the CLO.

Conclusion

For the reasons outlined above, the historical long-term profile of the senior secured loan market suggests stability of income, low correlation with other fixed-income sectors, and solid performance in a rising-rate environment. Investors who are willing to look beyond traditional fixed-income investments are likely to find that CLOs offer a compelling value proposition that addresses the significant gap in expectations between what they want from their income investments and what they actually receive.

CLO investments are not without risk, including limitations on liquidity and with significant operational and administrative costs. Suitability must be carefully evaluated for any investor considering an investment in a specific investment program. For suitable investors, CLO investments offer a full menu of options with varied combinations of risk and return that suit diverse investment objectives. By investing in CLOs, investors can potentially generate attractive current income while buffering fixed-income portfolios from market volatility and the risks associated with flat or rising interest rates. In today's low-yield environment, CLO investments should be considered as a core component of diversified, income-oriented portfolios.

Endnotes

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5. Loan Syndications and Trading Association (LSTA), *Advertising Supplement: Pensions & Investments*. "How to Invest in the Senior Secured Loan Market," February 2013, pg. 8.

6. Glenn Yago and Susanne Trimbath, *Beyond Junk Bonds: Expanding High-Yield Markets* (Oxford University Press, 2003). The authors estimate that only 800 (and thus, less than 5 percent) of the 22,000 U.S. companies with sales in excess of $35 million issue debt that is classified as investment grade.

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12. Stephen Foley, Financial Times. "CLO Issuance Near Record 2007 Levels," March 25, 2013.

Glossary of Terms

The following glossary defines pertinent terms as they are used in this document and in the context of CLOs. These terms are broadly used elsewhere to describe a diverse range of financial services and investment programs, and therefore, may have differing meanings when used in other contexts.

Active management	One of two major styles of portfolio management, active management strategies feature an entity that acts as a portfolio manager and relies on analytical research, forecasts, and the organization's judgment and experience to make investment decisions on what assets to buy, hold, and sell in an attempt to maximize return. In a passively managed or "buy and hold" portfolio, stocks or bonds are bought and held for a comparatively longer duration, and market forces exert the primary impact on return.
Arbitrage	In a CLO, arbitrage is the differential (or spread) between the floating interest rates paid by the SSLs in the CLO's asset portfolio and the floating interest rates paid by the CLO on the debt it issues.
Arranger/syndicator	In the case of a CLO, the arranger or syndicator is the investment bank or financial institution that creates and underwrites the CLO.
Basis points (bps)	A single basis point is one hundredth of a percentage point. Basis points are primarily used to express differences in interest rates.
Bond	A bond is a type of debt instrument issued by a corporate or government entity that enables the issuer to borrow money from investors for a defined term in exchange for interest payments at a fixed rate. Bonds are issued by companies, municipalities, states, and U.S. and foreign governments to finance a variety of projects and activities. Bonds are commonly referred to as fixed-income securities or investments and are a major investment asset class.
Bond ratings	Bond ratings help close the information gap between lenders and borrowers by providing independent opinions of creditworthiness. Typically, bond ratings are expressed as letter grades that range from 'AAA' (the highest rating) to 'D' to communicate the rating agency's opinion of the relative level of credit risk.
Collateralized debt obligation (CDO)	CDOs are a broad category of special purpose vehicles created and underwritten by investment banks to repackage debt instruments into a product that can be sold to investors. The collateral for CDO securities is the promised repayment of the borrowings in the CDO's asset portfolio. CLOs are a specialized subset within the broader class of CDOs.
Collateralized loan obligation (CLO)	CLOs are special purpose vehicles that hold diversified pools of corporate debt positions.
Coupon	A coupon is the negotiated interest rate paid to investors who have purchased a debt instrument such as a bond.

Creditworthiness of borrower	Creditworthiness is an assessment of an entity's current and future ability and inclination to honor its debt obligations which is usually conducted by a potential creditor, an investment bank, or an independent ratings agency. Creditworthiness is assessed via a complex (and often proprietary) method of analyzing a range of factors that include the entity's credit history, credit rating, and general character, among others.
Default rate	In the case of a CLO, the default rate is the rate at which corporate debt positions in its asset portfolio fail to meet their debt obligations per the terms of the loan agreement.
Equity investment	Equity investments represent an ownership interest in the entity issuing the security.
Equity tranche	In a CLO, investments in the equity tranche represent an ownership interest in the CLO which confers rights to direct certain aspects of the CLO. Due to its position at the end of the payment waterfall, the equity tranche typically represents a higher repayment risk for investors, and thus a potentially higher rate of return.
Financial covenants	Financial covenants are conditions that the lender requires of the borrower with the goal of reducing default risk. Via covenants outlined in a loan agreement, the borrowing company promises to limit specified actions that have the potential to significantly impact its financial health. The borrower typically agrees to maintain specific level ranges for certain balance sheet components or ratios.
Fixed-income investments	Fixed-income investments generally involve a class of assets that provide investors with payments at a fixed rate of interest. Traditional fixed-income investments include certificates of deposit, annuities, bonds, cash, and investments in real assets.
Floating interest rate	Floating interest rates move in relationship to a reference rate such as LIBOR, which resets every 30 to 90 days. In contrast to fixed-income investments that provide payments at a fixed rate of return, investments with floating interest rates potentially enable investors to capture upside potential when interest rates rise during the duration of the investment.
Indenture	A CLO indenture is a contract between the CLO and the trustee that defines and governs the terms under which the CLO will operate including (but not limited to): provisions for active or passive management; characteristics of loans eligible for acquisition by the CLO; collateral quality tests; concentration limitations; coverage tests; priority of payments; conditions to reinvestment; events of default; manager replacement provisions; call provisions; provisions for amending the indenture; and reporting requirements.

Investment-grade credit/ non-investment-grade credit	Ratings agencies have adapted two classes that categorize at a high level the general creditworthiness of borrowing entities. Those with investment-grade credit have been rated with a higher level of creditworthiness than entities with credit that is not investment grade.
Leverage	Leverage involves the use of borrowed capital to finance an investment.
Liabilities	Liabilities are a balance sheet component consisting of the debt obligations of an entity expressed as amounts owed to lenders or debt investors.
LIBOR	London Interbank Offered Rate (LIBOR) is the interest rate at which banks can borrow from each other in the international interbank market. Considered to be a significant benchmark rate, LIBOR is widely used as a reference rate that provides a basis for calculating interest rate payments payable on debt instruments.
LIBOR floor	Debt instruments can include terms intended to limit volatility and provide a degree of downside protection from floating interest rates referenced to LIBOR by defining a LIBOR floor, which is a minimum interest rate that will be paid to investors even if LIBOR rates go below the established minimum.
Loan maturity	Loan agreements include a maturity date, which is the date upon which the loan becomes due for repayment. If the borrower fails to repay in full the principal and interest due to the lender by the maturity date of a loan agreement, this constitutes an event of default.
Mark-to-market vehicles	Investment programs classified as mark-to-market vehicles are periodically required to use a form of accounting that reflects the fair market value of the program's assets and liabilities based on their current market price. Fair value accounting has been a part of Generally Accepted Accounting Principles (GAAP) in the United States since the early 1990s.
Par value/face value	The par value or face value of a loan is its principal amount as established in the loan agreement.
Primary market for CLOs	The primary market for CLOs is focused on the origination of senior secured bank loans by a commercial bank or another financial institution that first acts as an arranger or syndicator and then sells the resulting loans, or portions of loans, to institutional investors, private equity investors, and funds that hold debt investments including CLOs, mutual funds, and hedge funds.
Rating agency	Rating agencies are firms that help close the information gap between lenders and borrowers by providing independent opinions of the creditworthiness of borrowing entities and the debt securities issued by them. Major rating agencies include Moody's, Standard & Poor's, and Fitch.
Recovery rate	The recovery rate reflects the percentage of the nominal value (par value) of loans that is successfully recovered after a borrower defaults.

Repayment priority	The level of seniority that a security has in the capital structure of a borrowing entity establishes its repayment priority, which is invoked upon the borrowing entity's default or bankruptcy. Senior loans are at the top of the capital structure and are repaid first, before subordinated debt or equity investors are repaid.
Secondary market for SSLs	The secondary market for SSLs is focused buying and selling of SSLs at the dealer desks of underwriting investment banks after their origination in an "over the counter" direct transaction between a seller and buyer.
Senior secured bank loan (SSL)	SSLs are debt instruments that occupy the most senior position at the top of the borrowing entity's capital structure and have the highest priority for repayment. They are secured by a first lien on the assets of the borrower which serve as collateral for the loan.
Special purpose vehicle (SPV)	A special purpose vehicle (or special purpose entity) is organized for the purpose of acquiring and financing specified assets.
Spread	In general terms, spread is the difference between two interest rates or rates of yield. Spreads are typically expressed in basis points. One hundred basis points equal one percentage point.
Spread over LIBOR	The interest rates paid to investors in various tranches of bonds issued by a CLO are often expressed in terms of the difference (or spread) between the referenced LIBOR rate and the rate received by investors, such as LIBOR plus a specified number of basis points.
Tranche	Bonds issued by the CLO are segmented or sliced into rated debt classes called tranches. The tranches have differing risk and return profiles based on their repayment priority in the CLO's capital structure.
Volatility	Volatility is a representation of the pace at which securities prices move higher or lower, and how widely they swing. Volatility has been exhaustively studied, measured, and described as a significant factor in the performance of varied asset classes.
Waterfall	The waterfall describes the payment process that governs how principal and interest payments on the loans in the CLO's asset portfolio are dispersed to pay the CLO's liabilities. Repayment of various liabilities is made in a prioritized order based on their seniority in the CLO's capital structure. After the operational, administrative expenses, and debt service obligations of the CLO have been paid, in that order, the equity tranche receives any excess cash.
Yield / income	Yield is the income returned on an investment, which is usually expressed annually as a percentage rate based on the investment's cost and its current market value.

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