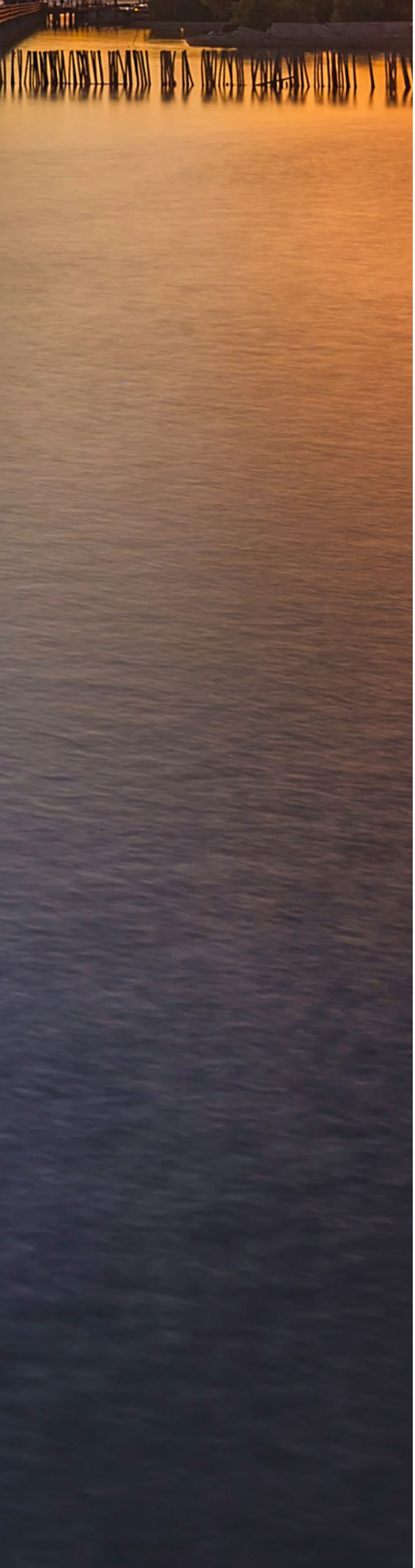
CLO MARKET REMAINS ROBUST,

BUT QUESTIONS PERSIST ABOUT ITS LONG-TERM OUTLOOK

INTERVIEW WITH GREG MYERS



In an endless hunt for yield, fund managers are eyeing the CLO market as an attractive opportunity – and it is easier than ever for them to access it

When the pandemic first hit early last year, financial markets plunged amid unprecedented turmoil.

But despite the chaos all around, one niche area of the securitised debt market remained remarkably robust throughout.

Ever since, collateralised loan obligations (CLOs) – instruments backed by corporate loans – have held up well and remain a popular choice for asset managers seeking to diversify their portfolios.

With a CLO, the investor receives scheduled debt payments from the underlying loans, assuming most of the risk in the event that the borrower defaults.

In exchange for taking on the default risk, the investor gains increased diversity and the prospect for better-than-average returns.

So, what is the outlook for the CLO market over the next 12 months? How has the pandemic, which has badly affected the creditworthiness of many businesses, impacted the sector? Above all, are CLOs, which have traditionally been viewed as a relatively obscure area of investment, moving further into the mainstream?

ENDLESS HUNT FOR YIELD

In a world of low interest rates and an endless hunt for yield, the CLO market offers one reliable way to access higher returns.

Moreover, Greg Myers, global head of debt capital markets at Alter Domus, a fully integrated provider of fund administration, debt capital markets and corporate services backed by Permira, believes it is now easier than ever for asset managers to launch CLO funds because of innovations in the kind of managed services they can now access.

"What we can do for a manager is not only the loan administration and assistance, trade settlement, etc, but we can also become an extension of their back and their middle office, where we are tracking the entire portfolio, as it relates to all of the tests and limitations that are contained within the indenture for that DLL," he says. "So, we are the ones that are reconciling with the trustee. We are the ones that are verifying all the cash accounts, the allocations, the cashflow waterfalls – all on behalf of the manager. We have the systems and the staff and everybody to support it."

Alter Domus is already supplying such services for about 20 firms including some of the world's biggest asset managers.

STRIPPING OUT COST AND COMPLEXITY

Myers says this outsourced approach strips out much of the cost and complexity involved in starting and managing a CLO fund, especially for new market entrants who are trying to evaluate the market opportunity and what will be involved.

"You need less office space. You don't need much HR staff to manage. You don't have to worry about redundancies, vacation, illness or anything like that."

He says managed services of the kind offered by Alter Domus are attractive for asset managers who are asking basic questions: "Do I want to buy a system? Do I want to hire a bunch of staff? I don't know how successful our CLOs will be in the market and how well they'll be received."

Myers adds that the hiring market in this area is extremely tough.

"If you were to launch a CLO, you would need to hire a couple of back office people that have experience, probably an analyst, an investment professional that understands all the math and everything else that goes into that CLO management. It becomes a pretty expensive endeavour."

"It's so hard to hire. It's so hard to maintain all the systems internally, and if you can find the right service provider that can provide you with the staff and the systems and maybe pass those costs off to the deal, as opposed to the management company, it just makes sense."

He continues: "Often the fees for our services get covered by the CLO itself, so it can become a really efficient model."

Myers says he remains confident that demand for CLOs will remain robust over the coming years.

"I think the market is still going to remain strong," says Myers. "The structuring of portfolios and the availability of assets that go into the portfolios continues to be good."

Last month, it emerged New York hedge fund Diameter Capital was raising USD250 million from a group of investors to invest in CLOs.

In the US, total issuance of CLOs this year is currently about USD70bn, according to figures from S&P Global Market. That represents a record with the total market now worth about USD770bn outstanding, according to Citi.

LONG-TERM OUTLOOK REMAINS UNCLEAR

Either way, questions persist about the impact of the pandemic on the long-term outlook for the sector.

In the past, regulators had expressed concern that they could pave the way for a new financial crisis because they had made it easier for companies to access risky lending.

Supporters of CLOs say this criticism is unfair and after Covid the model has been proven to be resilient.

Myers says it is still unclear how the market will play out.

He says: "Going into Covid, the underwriting rules for broadly syndicated debt had become a little bit more lax. It felt like covenant light deals were becoming a bit more prevalent."

He remains an optimist about the future of the CLO market, but believes that asset managers need to be aware of the risks of another economic shock on the sector.

Myers says: "What's going to happen to all these corporate borrowers that are held in all these CLOs post-Covid? There is so much government stimulus in the market that is going to affect economies globally so what impact is that going to have on those borrowers? How are those borrowers going to perform, and other than selling the assets out of the CLO, how is that going to impact performance?"

Against this background, it's crucial that asset managers take the right precautions, he concludes.

"Managers need to have the correct infrastructure. They need to have the right systems, the right oversight and compliance infrastructure to be able to ride out any kind of post-Covid economic impact to their portfolio." ■

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> **Greg Myers, Global Head Of Debt Capital Markets, Alter Domus**

GREG MYERS

GLOBAL HEAD OF DEBT CAPITAL MARKETS, ALTER DOMUS

Greg Myers is responsible for shaping Alter Domus' strategy for lenders and debt fund managers globally and overseeing business relationship management for Alter Domus' North America fund administration group.

As an experienced financial executive, Greg has over 15 years of broad-based financial services expertise. Previously, Greg managed the Specialty Bank Loans team within LaSalle Bank's Global Securities and Trust Services group and acted as an equity options market maker at the Chicago Board of Options Exchange. He additionally worked as a financial analyst and Y2K consultant with other financial institutions.