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## HOW TO FUTURE-PROOF YOUR CLO STRATEGY

After several years of robust growth, the market for Collateralized Loan Obligations (CLOs) has not escaped the challenges of the current economic environment.

Building on a record year in 2018, CLO issuance carried strong momentum into 2019, which continued throughout the year. However, the coronavirus pandemic combined with new developments in the regulatory space have been impacting both issuers and managers in 2020, with issuance for the first six months dropping by around 50% compared to the previous year.

### Hunting for experienced support

In light of current market conditions, CLO managers are increasingly looking to reduce costs while maintaining high standards of excellence for the more administrative

components of operations. As a result, many managers are turning to outsource service providers – which can be a cost-effective solution for time- and budget-conscious managers. However, the knowledge and skillsets required to handle the operational components of issuance and management tend to be rare in the market, and it can be difficult for fund managers to find experienced professionals who not only understand loans, CLOs and their covenants – but also how to monitor them.

The operational part of the role of a CLO manager encompasses a unique and varied skillset – from dealing with clients, regulators, ratings agencies, managing liquidity, allocations, internal reporting and monitoring pipelines.



## Did you know...

Experienced professionals in this field are not only rare, but tend to be expensive.



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Many of these tasks must be done in a timely manner, and it is imperative that all requirements under the CLO governing documents are met and followed.

“As recently as 10 years ago, there weren’t many options when it came to reputable outsource service providers,” notes Matt Jerrell, Managing Director of Alter Domus – a fully integrated service provider dedicated to servicing clients’ alternative investment strategies in international environments. “While there is a fair amount of relatively niche processes for CLO managers to juggle, many of these are recurring and quite clearly defined. Therefore, it makes sense to offload them onto a firm that regularly handles these types of operations for clients.”

A former CLO manager himself, Jerrell takes a practical approach towards outsourcing of back and middle office functions. He explains, “Good people in this field are not only rare, but tend to be expensive as well. Outsource service providers with global coverage offer the benefit of established teams of experienced professionals throughout the US, Europe and Asia... typically in lower cost locations than where managers sit. These teams not only benefit from working with a wide variety of clients applying a range of different strategies, but can also leverage this experience when working with other clients in the same sector.”

## Ensuring compliance through specialized IT systems

Due to the particular nature of CLOs, managers need to demonstrate to regulators that their operations meet specific criteria in terms of technology and eligibility – a level of compliance not found in average funds. At the same time, some of the outdated communication practices still prevalent amongst underlying assets can make it challenging for managers to meet tight and frequent reporting timelines.

“While there is a certain amount of nuance between deals, there are also many similarities as all CLOs

are assessed by a handful of rating agencies. For first time or start-up managers, it’s crucial to quickly gain awareness of operational best practice – or to partner with a firm that offers it,” says Jerrell. “Working with an external service provider gives managers the flexibility to scale their service level as required, from half an FTE to an international team, all supported by the pooled knowledge and resources of an experienced global network.”

“Another major requirement these days is the need for a strong technology platform,” adds Randall Reider, Director of Business Development at Alter Domus. “To ensure compliance with rating agencies’ operational reviews, it’s important that fund managers choose partners with technology experience specific to the CLO sector. Providers that work with these types of funds on a day-to-day basis are more cognisant to the technology issues faced by CLOs.”

## Striking balance between the right partner and fair price

Outsourcing provides a variable cost solution to what is normally considered a fixed cost – giving clients the flexibility to scale their service levels as they grow, while focusing on their core business. Reider continues, “With support and resources available around the world, global service providers offer a 24-hour support model that can significantly speed up time of delivery. This presents a distinct advantage that most start-up managers will find challenging to match in-house.”

“With many CLO managers dealing with the impact of changes to the ratings of their underlying assets, it’s becoming more challenging for them to source appropriate investments,” summarises Jerrell. “Working with the right outsource service provider gives managers the freedom to concentrate on managing their portfolios, while leaving more routine daily operations and reporting in the hands of a highly experienced, professional and specialised team.”