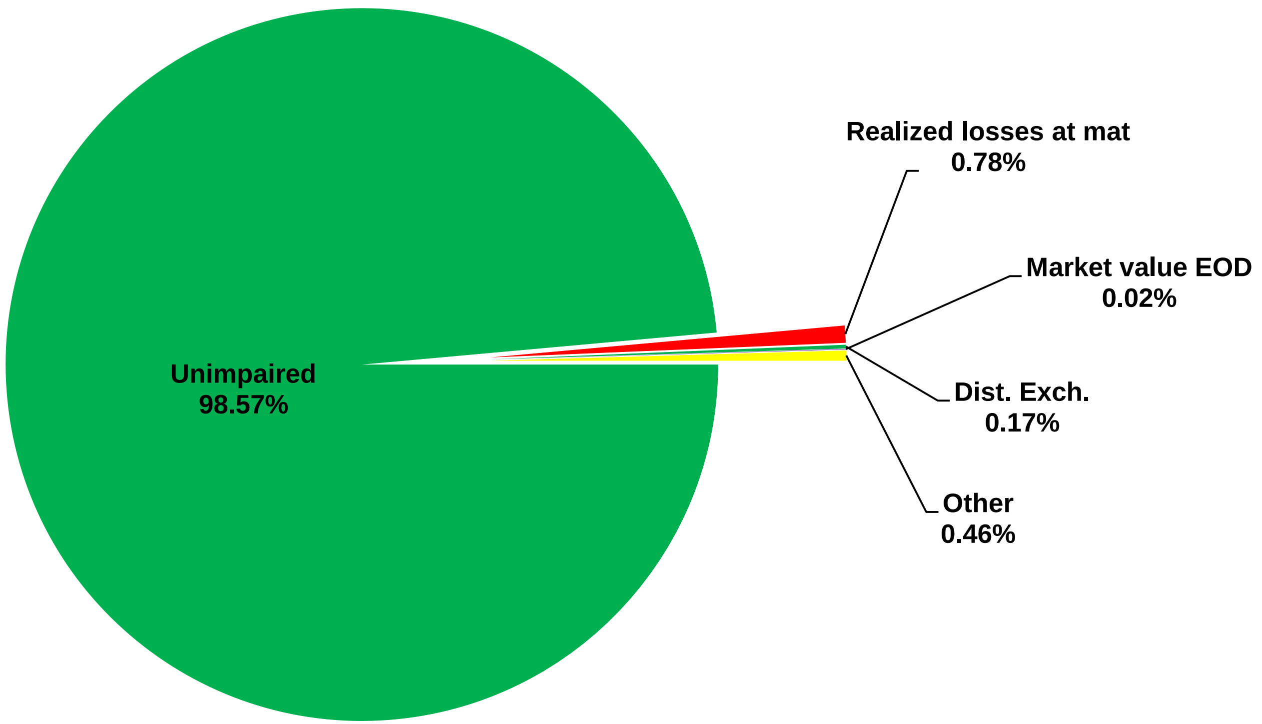
Risk Retention for CLOs

LSTA Contacts
Bram Smith, Executive Director – LSTA, bsmith@lsta.org
Meredith Coffey, EVP- LSTA, mcoffey@lsta.org
Elliot Ganz, General Counsel – LSTA, eganz@lsta.org

Performance: CLO note impairments have been all but non-existent

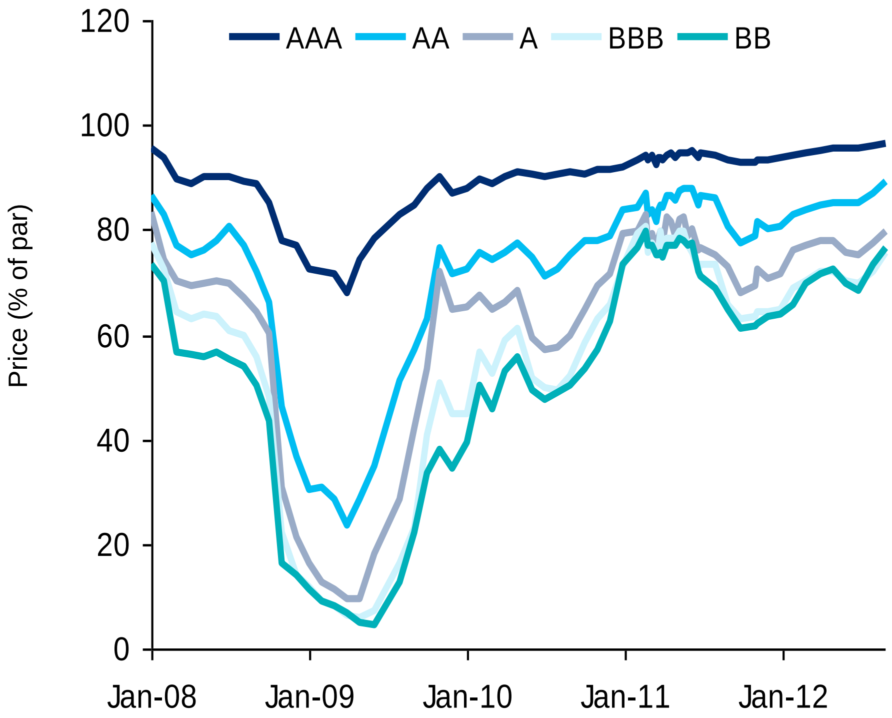
Cumulative impairment rate from Jan 1996 to May 2012



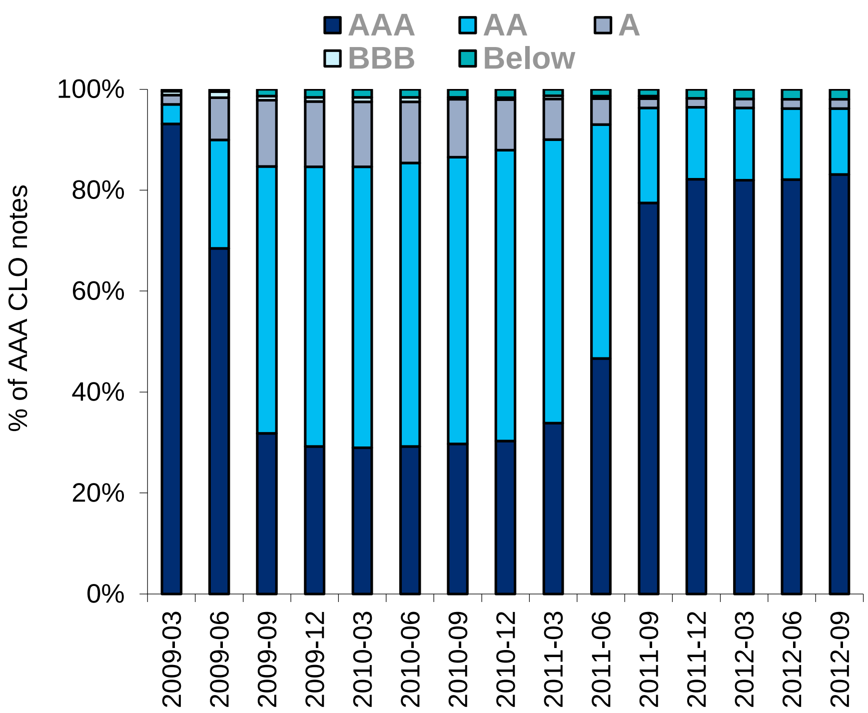
Source: Moody's Investors Service

Performance: CLO prices and ratings recover

CLO 1.0 secondary prices recover

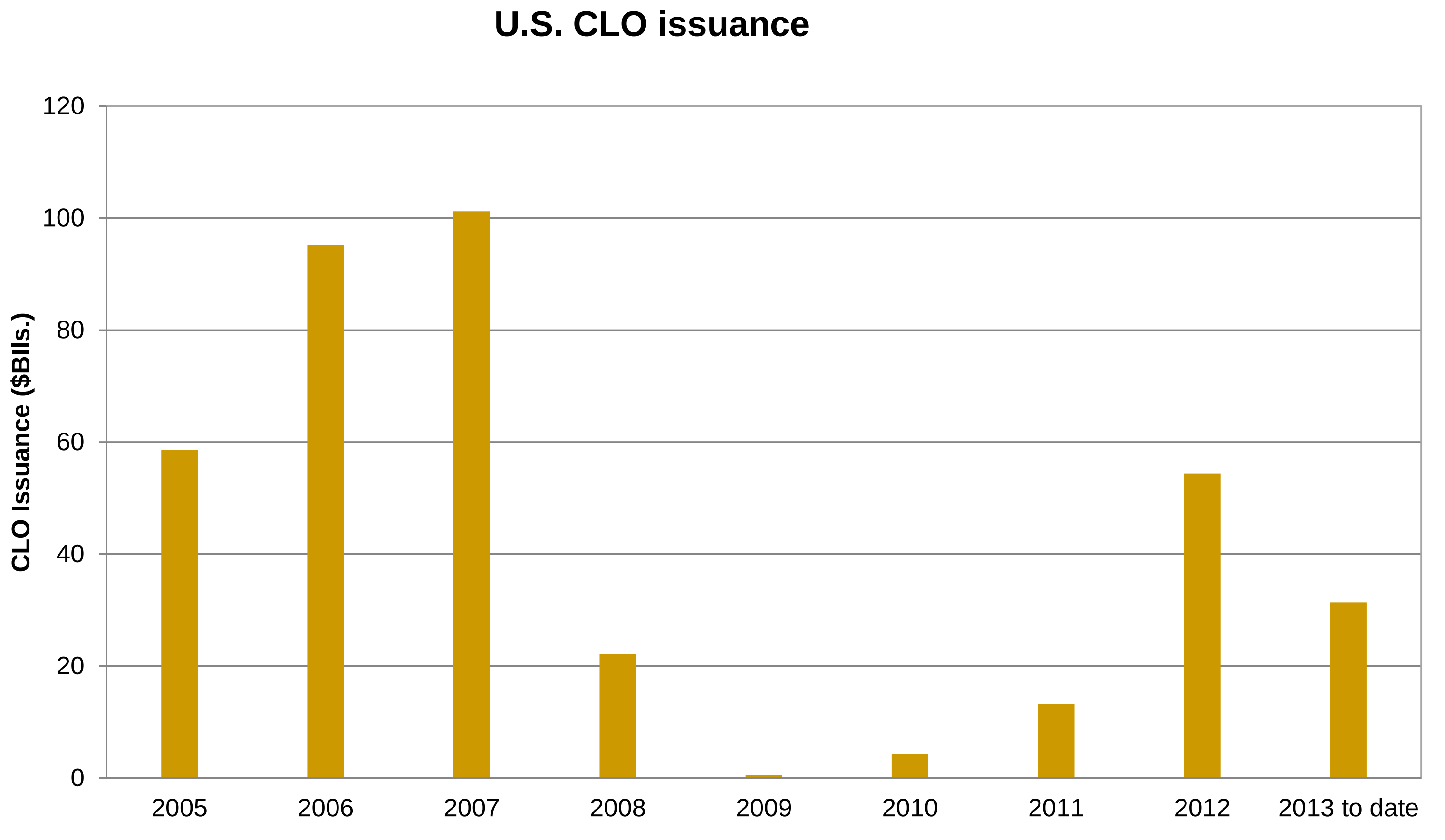


CLO AAA notes downgraded, but recover



Source: Citi Research, Moody's

Performance: Because CLOs performed, satisfying investors, CLO issuance has returned materially



Source: Thomson Reuters LPC

It is simply not feasible for managers to hold 5% of the face value of open market CLOs

- **While CLO issuance has returned, the imposition of a 5% FV retention on the CLO manager will hamstring the market**
- **CLO managers are simply managing the portfolio**
- **CLO managers have no balance sheets that the assets were on …then shifted off of**
- **CLO managers have very limited balance sheets generally**
- **CLO managers earn an annual fee of approximately 50 bps per year to manage a CLO (with the potential of a performance based incentive fee)**
- **The present value of that 50 bps for a 10 year CLO is *well less than 5% of the face value of the CLO***
- **The proposed rule would require managers to invest *well more than* all of their income from the CLO simply for the right to manage the CLO**
- **It's simply not economically viable**

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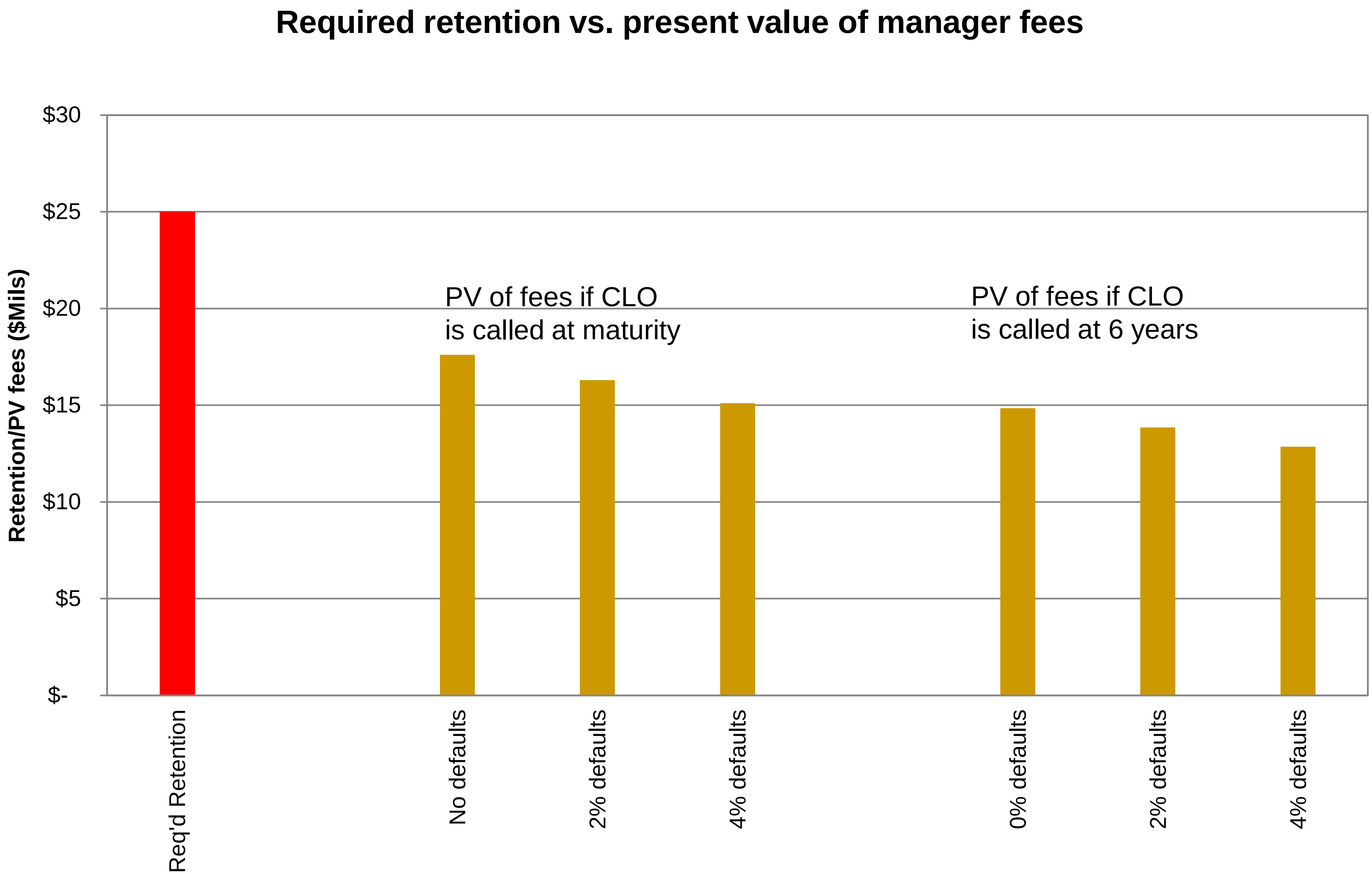
Manager fees wouldn't even cover required retention

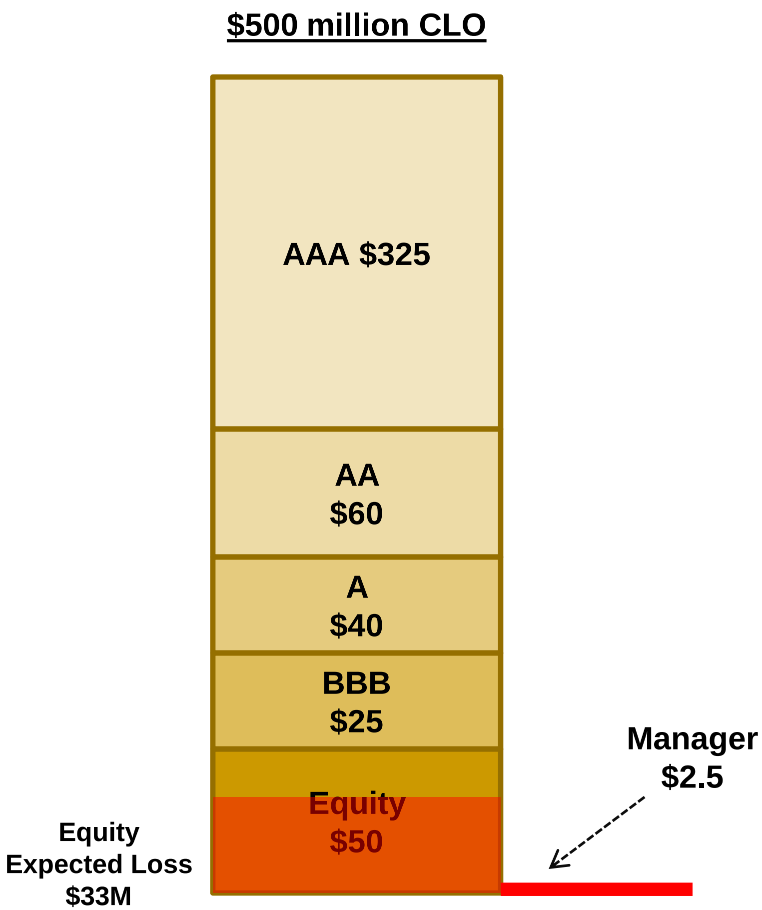


Source: CLO Model Calculations

LSTA's April 2013 Proposal

- **The Proposed Retention Rule would require managers to purchase $25 million of equity for a new $500 million CLO**
- **CLO managers simply cannot comply with this requirement; $25 million could be nearly *twice what they earn for managing a CLO***
- **LSTA's risk retention proposal has very real skin in the game, but should be feasible for most managers**
  - **CLO manager purchases 5% of the equity of the CLO out of pocket**
  - **Senior, sub and fee stream are replaced by ownership of Class M Unfunded Notes that create a similar income stream**
- **The equity purchase alone is nearly 5% of the credit risk, because the vast majority of the credit risk resides in the first loss position**
- **In addition, holding Class M Unfunded Notes gives the manager another 5% of the credit risk because the Notes are weighted toward the bottom of the capital stack**

Example of $500M CLO with manager equity retention



Manager purchases 5% of equity

- Manager must contribute $2.5 million of equity in LSTA's' Proposal
- The manager's equity contribution equates to 14-20% of the manager's full compensation for managing the CLO… just to do his job
- This is the first loss position in the CLO
- Based on historical loan performance, the manager's expected loss is $1.65 million
- This is a very serious commitment from the manager

LSTA's Framework for Class M Notes

Current Structure & Fee Stream

CF	• Senior Management Fee (15 bps)
CF	• AAA Note Payments
CF	• AA Note Payments
CF	• A Note Payments
CF	• BBB Note Payments
CF	• BB Note Payments
CF	• Subordinate Mgt Fee (35 bps)
CF	• Equity
CF	• Incentive Fee (20% after equity earns 12% IRR)

Proposed Structure & Income Stream

CF	• AAA Note Payments & AAA Class M Note Interest (15 bps equivalent)
CF	• AA Note Payments & AA Class M Note Interest (1 bp equivalent)
CF	• A Note Payments & A Class M Note Interest (1 bp equivalent)
CF	• BBB Note Payments & BBB Class M Note Interest (1 bp equivalent)
CF	• BB Note Payments & BB Class M Note Interest (1 bp equivalent)
CF	• Subordinate Class M Note Interest (31 bps equivalent)
CF	• Equity
CF	• Class M Incentive Note Payment (equivalent to 20% share after equity earns 12% IRR)