SCI

Middle Market CLO Awards

2022

Lake Shore CLO Platform: Balanced Management Throughout the Structure

First Eagle Investments

Our team has managed CLOs in a variety of market environments since 1999, using a multi-dimensional approach to credit investing, combined with proactive, opportunistic trading.

Our dedication to the CLO business is clear from our commitment to credit research and performance, as well as through information transparency and investor access to the portfolio management team.

We are grateful to be part of the CLO community and thank our partners for their continued support.

AT A GLANCE

- $21B in assets across direct lending and tradable credit
- 50+ investment professionals primarily focused on credit markets
- Top 15 CLO manager by AUM

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Lake Shore MM CLO IV

Innovation of the Year

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November 2022

What a time to launch SCI's Middle Market CLO Awards! The market has had to face and overcome a plethora of challenges throughout the awards year of 1 October 2021 to 30 September 2022.

The time period began with participants having to deal with the continuing boom of 2021's record year for the sector and to differentiate themselves through innovation and consistent excellence of service. By the end of February, after the invasion of Ukraine, it was a very different landscape – with volatile conditions from a variety of drivers persisting all the way to the end of 3Q22, making it challenging to get even the most straightforward of deals done.

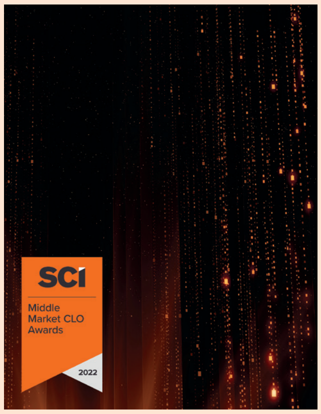
To ensure the MM CLO market continued to function as well as it could in such difficult times, issuers, managers, investors, arrangers, lawyers and service providers all had to stand up to be counted. As the Roll of Honour for the awards on page 4 demonstrates, there were plenty of firms willing to do just that. Our congratulations to the deserving winners, as well as to the MM CLO market as a whole, for its many achievements over the last 12 months.

We would like to thank everyone who submitted a nomination for the awards and extend our thanks and appreciation to our awards advisory board – comprising: Reginald Fernandez & Christopher Gilbert of Natixis; Mark Fontanilla of Mark Fontanilla & Co; Milen Shikov of AIG Asset Management (US); and Daniel Wohlberg of Eagle Point Credit Management (each of whom was recused from judging an award that they could be nominated for) – for its invaluable input. Final selections for the awards were made by the SCI editorial team, based on the pitches we received, colour from other market participants and our own independent reporting.

Looking to the next 12 months, the only certainty appears to be uncertainty as macro concerns weigh heavy on all markets. Nevertheless, it seems likely that the MM CLO sector will once again meet the challenges ahead with equanimity and resolution.

All the best for the year ahead,

Mark Pelham
Director



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DEAL OF THE YEAR
WINNER: GOLUB CAPITAL PARTNERS CLO 18(M)-R2

A second reset of a middle market CLO upsized for a second time to now stand at over US$1.2bn would be notable enough. But GC Investment Management's Golub Capital Partners CLO 18(M)-R2, arranged by SMBC Nikko, was also successfully priced while the market was still coming to terms with a new benchmark and amid heightened market volatility following the invasion of Ukraine only a month earlier and is SCI's middle market CLO Deal of the Year.

The deal was originally issued in March 2014 totalling US$453.4m and previously refinanced in October 2017, when it was increased to US$898.5m. The previous iteration of notes were repaid in full on 18(M)-R2's 21 April 2022 refinancing date.

Alan George, Managing Director, Head of Structured Products at Golub Capital, recalls: "The deal was done in March and there was still quite a bit of fact-finding that needed to be done in terms of where the CLO market was going to be in a post-Libor world."

He continues: "We needed to navigate and problem-solve to get the deal done. You had people still trying to figure out what the bid-ask was going to be on new CLO formation, while worrying about the impact of geo-political factors over the longer term. All the while, liabilities were also becoming more expensive."

Despite the somewhat significant widening of liabilities at that point in time, Golub Capital took the decision to act. "As we typically do, we continue to issue through volatile periods and we, of course, work closely with our investors," George says.

CLO 18(M)-R2

Class	Size (US$m)	Fitch	S&P	WAL	CE (%)	Coupon
A-1-R2	684.00	AAA	AAA	5.2	43.0	SOFR+178
A-2a-2	24.00	NR	AAA	6.5	40.0	SOFR+195
A-2b-2	12.00	NR	AAA	6.5	40.0	4.30%
B-R2	96.00	NR	AA	6.8	32.0	SOFR+220
C-R2	96.00	NR	A	7.3	24.0	SOFR+315
D-R2	72.00	NR	BBB-	7.9	18.0	SOFR+385
Sub	219.85					
Total	1203.85					

Priced: 25 March 2022

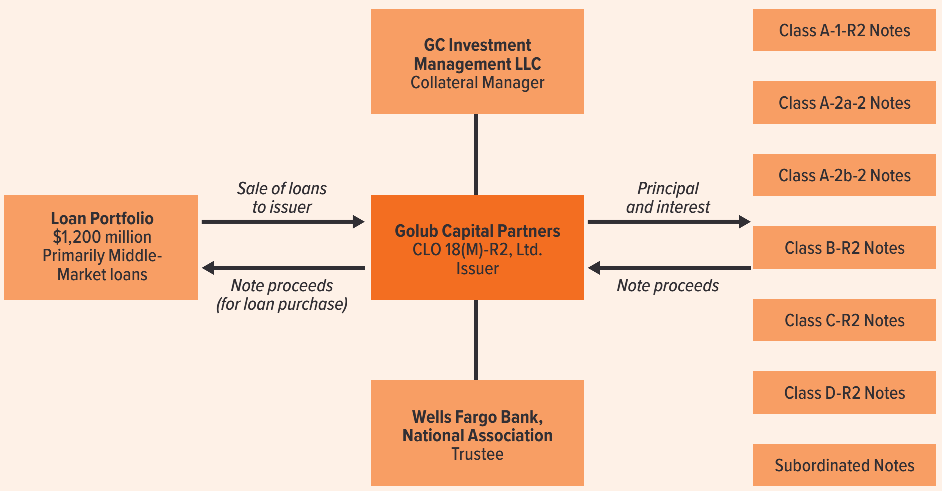
Settled: 21 April 2022

Non-call end: 25 April 2024

Re-investment period end: 25 April 2026

Source: Golub Capital

Transaction structure



Source: Golub Capital

INDENTURE INFO

S&P notes that 18(M)-R2 was issued via a supplemental indenture, which outlines the terms of the replacement notes. That supplemental indenture highlights impacts of the reset, including:

- The replacement class A-1-R2, A-2a-2, B-R2, C-R2, and D-R2 notes will be issued at a spread over three-month secured overnight financing rate (SOFR), which will replace the spread over three-month LIBOR on the original notes.
- The class A-R notes will be replaced by the class A-1-R2, A-2a-2, and A-2b-2 notes.
- The stated maturity will be extended by 5.5 years.
- The reinvestment period will be extended by 4.5 years.
- The non-call period will be extended until April 2024.
- The weighted average life test will be extended to eight years from the refinance date.

INNOVATION OF THE YEAR
WINNER: LAKE SHORE MM CLO IV

Priced on the very first day of our awards year, 1 October 2021, First Eagle Alternative Credit's Lake Shore MM CLO IV, led the way in so many other respects. Our innovation of the year not only provided an innovative structure subsequently duplicated by other managers, but took the unusual step of syndicating, via arranger Wells Fargo, such a tailored product, while seeking to encourage insurance companies further into the middle market space.

"Lake Shore IV was designed to meet insurers desire for yield through middle market exposure while offering ratings from a major agency like S&P," says Michael Herzig, senior md, head of business development, at First Eagle Alternative Credit (FEAC). "In recent years, partnerships between private credit managers and insurers have given way to outright M&A activity between the two groups. CLOs and direct lending products are among the most actionable examples, and thus, we see Middle Market CLOs are a natural intersection of these two trends."

FEAC has a long history of working closely with insurance company investors both in direct lending via private funds, rated insurance feeders, SMAs with ratings, and so on; as well as through its own BSL and MM CLOs. It took things a step further with Lake Shore IV, which featured an updated MM CLO structure designed to appeal to insurers.

Lake Shore IV used a more comprehensive X note as opposed to the historically more common "Fat BBB" tranche. This was done to guard against some scepticism over the validity of the latter. Utilising an X note, which is used very frequently in BSL CLOs, was seen as a simpler solution and one that provided more capital efficiency faster, amortisation and a cheaper cost of funding; thereby increasing the deal structure's efficiency and therefore attractiveness to investors.

The deal uses "turbo" amortisations of mezzanine tranches in an effort to shorten duration and provide greater stability. Herzig explains: "There is often an argument to be made that perhaps turboing down your highest cost of debt is a good use of proceeds in the vehicle. Once money leaves to the equity it doesn't really help the mezzanine in the structure, but if you take some of that money to amortise the junior, most expensive debt you're helping the structure overall – it increases cash flow, takes a little bit of risk out of the structure and it effectively delevers the deal."

Lake Shore MM CLO IV

Class	Size (US$m)	S&P	Par sub	Coupon	DM	Price
X	25	AAA		L+118	118	100
A	287.5	AAA	43%	L+153	153	100
B	50	AA	33%	L+190	190	100
C	45	A	25%	L+265	265	100
D	41.25	BBB-	18%	L+350	350	100
E	33.125	BB-	11%	L+800	800	100
Equity	62.5	NR				
Total	544.375					

Priced: 1 October 2021

Settled: 29 October 2021

Non-call period: 1.96 years

Re-investment period: 3.96 years

Stated maturity: 17 October 2033

Source: First Eagle Alternative Credit

He continues: "The insurance companies who were the target audience for this deal have a similar focus on balance in their CLOs, where they are as concerned about mezz security as they are about high equity returns. That fits with our experience in that the deals that perform the best over time don't wring every free dollar out and instead use excess par or excess capital or early excess returns to reinforce the vehicle, and it's something we and investors really like about this structure. Overall, we want a good experience for the senior, the mezzanine and the equity investors; not one of those is more important than the others – the balance among them is absolutely critical for us in our CLO business."

Lake Shore IV was also the first of this style of MM CLO to carry S&P ratings through the mezzanine. "Many insurance companies are rating sensitive and there has been an evolving set of creative solutions for achieving ratings on alternative assets," Herzig notes. "US insurers have a pre-determined list of nationally recognised credit ratings organisations, but for non-US insurers, it usually has to be either Moody's, S&P or Fitch and that's something we wanted the structure to facilitate."

Tailored MM CLO Investments such as Lake Shore IV are not typically syndicated and are usually structured for a single investor, but the deal was syndicated to a number of insurance companies, including the equity. The Lake Shore MM CLO platform is all third-party equity investor led, which is not the traditional norm for MM CLOs.

Syndication was a key element to the deal, according to Herzig. "We wanted to take what was cutting edge technology developed by and with one of our key insurance clients and spread it around to a number of different insurance companies," he says. "At the same time, unlike a BSL deal when most of the ramping can be done after pricing MM CLOs typically have assets in place before pricing so have to be warehoused and the warehouse hurdle for a lot of insurers is a really tough one – it is long and not very capital efficient."

To overcome this, FEAC utilised one insurance company to provide the majority of the warehousing and then was able to bring other firms in, in a minority role, to co-invest. "Through syndication and this process, we were able to offer these insurance companies access to a deal that they probably wouldn't be able to do themselves, because it is quite a large capital commitment," says Herzig.

Demand for Lake Shore IV overall was significant resulting in an upsize to US$544m, much larger than any prior Lake Shore MM CLO. As Herzig concludes: "The structure proved so popular that it has since been used numerous times by managers ranging from Blackrock to Mass Mutual to Maranon; but First Eagle Alternative Credit's Lake Shore IV was first."

ISSUER OF THE YEAR
WINNER: OWL ROCK, A DIVISION OF BLUE OWL

Owl Rock, a division of Blue Owl Capital, is recognised in this year's SCI Middle Market CLO Awards for continuing to grow its platform and remaining an active issuer in challenging market conditions. For closing four MM CLOs during the awards period, three of which were issued after the Russian invasion of Ukraine, the firm has won the Issuer of the Year category.

The transactions comprise: a refinancing of Parliament Funding II in November 2021; a refinancing of Owl Rock CLO V in March; and Owl Rock CLO VII and VIII in June and September respectively. "CLOs are important in enabling us to finance our funds: they provide stable term financing, price attractively and tap into a differentiated investor base relative to our other sources of debt financing. We made a strategic decision to enter the CLO market early on, because we understood the value of the form of financing and recognised that it would take time to develop a brand and attract an investor base," says Jerry DeVito, head of structured products and portfolio finance at the Owl Rock division of Blue Owl.

The firm has 11 MM CLOs outstanding, representing approximately US$5bn in total capitalisation as of issuance date, with a roster of over 60 CLO investors participating across the Owl Rock platform. Following its debut issuance in 2019, the firm now operates three CLO verticals: one has exposure to diversified direct lending, via the Owl Rock moniker; another has exposure to first lien/lower leveraged loans via the Parliament Funding moniker; and the other has exposure to technology/enterprise software loans via the Owl Rock Technology Finance Corp moniker.

Jerry DeVito, Owl Rock division of Blue Owl

> "OUR ABILITY TO NAVIGATE THE CURRENT CHALLENGING MARKET IS SUPPORTED BY OUR TRACK RECORD AND OUR TRANSPARENCY WITH INVESTORS REGARDING THE UNDERLYING ASSETS"

Founded by Doug Ostrover (formerly of GSO), Marc Lipschultz (KKR) and Craig Packer (Goldman Sachs) in 2015, Owl Rock's thesis is to target the upper middle market, which sits between the broadly syndicated and traditional middle market loan segments. "Historically, there has been less competition in the upper middle market space, due in part to the required scale to accommodate larger transactions. In order to be relevant to private equity clients, you need scale – in other words, a large capital base and plentiful access to financing," confirms DeVito.

He continues: "For example, our first BDC – Owl Rock Capital Corporation – launched with US$5.5bn equity and is about 1x levered, which translates into US$11bn or more of investing power. Across Owl Rock Funds, we had approximately US$56bn of AUM, as of 30 June 2022."

DeVito notes that the Covid-19 crisis marked the first real test for the Owl Rock CLO platform, with the firm still able to attract financing. "Our ability to navigate the current challenging market is supported by our track record and our transparency with investors regarding the underlying assets. Investors are being more selective and spending more time reviewing portfolios and performance, while gravitating towards the regular issuers. In this sense, we are helped by the nature of our portfolios: many investors accept our thesis that upper middle market companies tend to be less risky than traditional middle market firms."

Although spreads have widened across the CLO market generally, there is still capital to deploy and significant demand for MM CLO paper, according to DeVito. "We're sensitive to spreads, but we also recognise that if funding spreads have widened, our asset spreads are also likely to have widened. We want to minimise funding costs, but because we manage permanent capital and long-duration vehicles, we seek to maintain a certain level of leverage to generate an expected return," he says.

He adds: "Consequently, we sometimes change up what we issue – sometimes only triple-A and double-A notes; sometimes deeper in the capital structure – depending on the cost of financing, financing alternatives available and the market environment at the time. We're not trying to time the market and we believe our investors understand this."

Looking ahead, Owl Rock expects to continue executing on its plan – which is to increase capital under management and provide relevant solutions for its clients. "Dislocation in public markets and banks slowing capital commitments to leveraged lending has provided more opportunities for us. We anticipate continuing to be a regular CLO issuer when the market is available and remain optimistic about the middle market CLO product. With a growing market and more regular issuance, more data and performance information is and will become available, which we believe will increase demand as a reliable way for investors to deploy capital – all of which provides the framework for investors to become more and more comfortable with the asset class," observes DeVito.

He concludes: "The Owl Rock platform is not arbitrage-driven in the traditional CLO sense – we need access to the CLO market as a funding source; it's not a stand-alone transaction based on relative market parameters at a point in time."

MANAGER OF THE YEAR
WINNER: GOLUB CAPITAL

Manager of the Year was perhaps the toughest category at this year's middle market CLO awards to judge, with a number of likely candidates. However, with a combination of consistent investment performance in a challenging market and strong issuance activity, Golub Capital is our worthy winner.

In terms of investment performance, the manager's is remarkable in its unremarkability in such a volatile environment. "Things have been quite stable for us over the year. Obviously, that's changing to an extent now with rising inflation, interest expense and other factors that are impacting the leveraged loan market more broadly. But for us, performance has been quite good," says Alan George, Managing Director, Head of Structured Products at Golub Capital.

He continues: "Our portfolio companies continue to grow top line revenue and are operating well through this current period of volatility. Defaults have been very, very low. This is consistent with what we've seen from Golub Capital over the last 15 years."

At the same time, Golub Capital issued and managed six new MM CLOs in the awards period from 1 October 2021 to 30 September 2022, one more than its nearest competitor. They comprised four new issues and two resets *(see table)*.

Alan George, Golub Capital

Golub Capital MM CLOs

Pricing date	Name	Size (US$M)	Deal type	Arranger	Pool
28-Sep-22	Golub Capital Partners Short Duration 2022-1	706.5/€70	New issue	Morgan Stanley/NW	Static
31-May-22	Golub Capital Partners CLO 61(M)	701.75	New issue	Natixis	Managed
25-Mar-22	Golub Capital Partners 18(M)-R2	1,203.85	Reset	SMBC Nikko	Managed
15-Feb-22	Golub Capital Partners 30(M)-R	674.4	Reset	Greensledge	Managed
15-Dec-21	Golub Capital Partners CLO 59(M)	1,052.73	New issue	Wells Fargo	Managed
23-Nov-21	Golub Capital Partners CLO 57(M)	1,003.45	New issue	Morgan Stanley	Managed

Source: Golub Capital

"OUR PORTFOLIO COMPANIES CONTINUE TO GROW TOP LINE REVENUE AND ARE OPERATING WELL THROUGH THIS CURRENT PERIOD OF VOLATILITY"

Among those deals is Golub Capital Partners 18(M)-R2, SCI's Transaction of the Year *(see page 5)*. But, overall, George views all six deals as part of a greater whole. "Each deal is a little nuanced in terms of the investor base and the documents that those investors require, so we balance our CLO liabilities across investor constructs," he says. "They were all very good transactions in the typical middle market structures that we've issued over the years."

That all-encompassing approach is in essence how Golub Capital seeks to differentiate itself. George explains: "One of the ways we differentiate ourselves is by having the type of fund construct where all the equity is owned by our private funds and so all the debt, assets and equity are consolidated onto one balance sheet. It allows us to functionally manage our portfolio across our various leverage facilities and enables us to optimise our portfolio within the constraints of our financings."

As a result, Golub Capital can take a proactive approach across all its facilities to align the interests of the debt holders with the equity holders. "We're able to better manage risk because we are not selling third-party equity and filling up one CLO with some outsize risk relative to our other products," says George.

He believes this approach is key for investors. "When you're buying CLO bonds, you have to understand fundamentally how the manager is prepared to manage that securitisation and what kind of controls and levers they can pull to operate through times of volatility."

INVESTOR OF THE YEAR
WINNER: CalPERS

The largest public pension plan in the US – the US$495bn California Public Employee's Retirement System (CalPERS) – has long been a CLO investor and has been involved with middle market CLOs since 2018. However, what caught our attention was market participants' reports of the fund's increased buying activity at the top of the MM CLO stack from the beginning of 2022 and its public announcement of a new asset allocation strategy at the end of 2021. That, combined with the reassurance of the US$495bn behemoth's strong and long-term presence in a market dealing with difficult times, makes CalPERS a clear choice for SCI's MM CLO Investor of the Year.

"Middle market CLOs is actually part of our broader CLO strategy," explains Justina Wang, investment manager at CalPERS. "We constantly evaluate opportunities that align with CalPERS Core Values across different asset classes, and middle market is a part of that."

CalPERS has established itself in the market as a chiefly relationship-centric investor, prioritising collaboration and longevity in deals. "Why so many managers like to work with us is because we view our investment as a partnership," says Wang. "We work together with the managers through all aspects of the deal – from the assets, right through to the document negotiations."

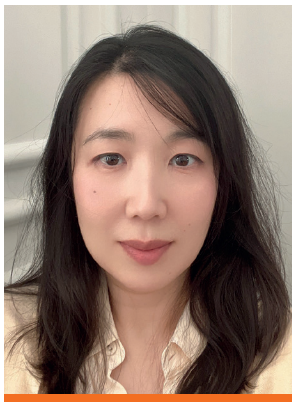
CalPERS appreciates the impact that the expected recession may have on the middle market space, but also considers it an opportunity to see greater manager differentiation as they weather the wider macroeconomic difficulties. Indeed, prior to investment, CalPERS dedicates a lot of time to understanding the value of managers.

"One of the key components of our MM CLO strategy is that we really view our work with managers as long-term partnerships," Wang says. "Given our selected manager's track record and expertise – as well as the resilience of CLOs seen in the past through different credit cycles, and the structural protections embedded in the CLO structure – I believe our portfolio should fare through this economic downturn okay."

"ONE OF THE KEY COMPONENTS OF OUR MM CLO STRATEGY IS THAT WE REALLY VIEW OUR WORK WITH MANAGERS AS LONG-TERM PARTNERSHIPS"

CalPERS has strengthened its MM CLO business triumphantly in the last 12 months as it has refocused its wider CLO strategy. Nevertheless, CalPERS' steadfast commitment to establishing relationships with managers has continued through this refocus.

Wang explains: "We keep a dialogue open with the managers – even after the CLO transaction has closed – which means we can continue to talk and, if the right opportunity presents itself, then we are not afraid of moving forward with it. We've learned a lot over the past year – both deal-wise, market dynamic-wise and industry-wise. We really have an appreciation for the managers and how they are willing to help us understand the credit selection process."



Justina Wang, CalPERS

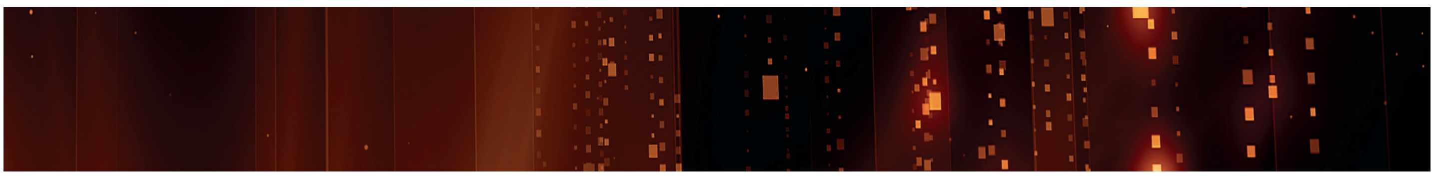
On 15 November 2021, the CalPERS Board of Administration announced that it had selected a new asset allocation mix that will guide the fund's investment portfolio for the next four years, while at the same time retaining the current 6.8% target it assumes those investments will earn over the long term. The board also approved adding 5% leverage to increase diversification.

The decision concluded a nearly yearlong comprehensive review of the pension system's investment portfolio and actuarial liabilities. Known as the Asset Liability Management (ALM) process, the board conducts the evaluation every four years.

As part of the ALM process, led by CalPERS' investment, actuarial and financial offices, the board examined different investment portfolios and their potential impact to the CalPERS fund. Each portfolio presented a different mix of assets and corresponding rate of expected return and risk volatility.

Ultimately, the board selected the portfolio with expected volatility of 12.1% and a return of 6.8%. The discount rate has been at 6.8% since July, when a strong double-digit fiscal year investment return automatically triggered a reduction under the Funding Risk Mitigation Policy.

The new asset allocation incorporated a shift towards alternative assets, which would include CLOs. It included a projected increase in private debt investment from 0% to 5% – representing approximately US$25bn. The new asset allocation took effect from 1 July 2022.



ARRANGER OF THE YEAR
WINNER: NATIXIS

With 18 middle market CLOs arranged during the awards year, 1 October 2021 to 30 September 2022, Natixis is our Arranger of the Year. The firm's achievement of leading nearly double the number of deals as their nearest rival is borne out of a sector-focused approach.

Christopher Gilbert who is responsible for managing the CLO banking team at Natixis, with a team of 12 bankers and four specialised syndicate professionals says they are really dedicated to the MM CLO sector. "This business is not an add-on to an ABS, leveraged finance or cash management business, this is the front, centre and core of our business and a primary pillar for Natixis," he says.

Gilbert explains that winning this award is a team effort and he is pleased that his team's work has received recognition within the market. "We are thrilled to receive this award – there is a great deal of focus, professionalism, dedication, a great deal of work from the team. It is very gratifying to see this recognised – I'm proud of what the team has done and it is nice to see some recognition of our accomplishments and the skill that we bring to the market."

Natixis has been involved in the sector since the group was formed in 2003. That 19 years of experience allows it to be well-placed to deal with investors, CLO managers and other MM CLO participants.

Gilbert adds: "We have a detailed track record of many managers' performance. We have extensive experience placing these transactions, and we have a long-term dialogue with investors. We know who is interested in this space and in many cases, we have helped them carry out their initial due diligence as they get up to speed on this market."

Christopher Gilbert, Natixis

"THE BUSINESS IS VERY WELL-ALIGNED AROUND MM CLOS, AND WE WILL BE WELL-POSITIONED TO ADDRESS THE MARKET WHERE OTHER PLAYERS' COMMITMENT TO THIS SPACE WILL BE TESTED"

Experts at the organisation explain that deep connectivity with managers and investors is the key to their success. A combination of knowledge, a focus on syndicating positions and distribution as opposed to just lending helps them to be distinguishable players in the MM CLO sector.

"When you have been doing this for many repeat clients for such a long time, there is a level of trust and understanding that translates into long term partnerships. In addition, this leads to private transactions often from the same issuers," notes Reginald Fernandez, GSCS credit trader and CLO specialist at Natixis.

However, Gilbert explains that despite being successful in winning this award there have been challenges along the way. Like broader markets, things have been difficult since late-February and early-March due to the macroeconomic conditions, such as interest-rates, tightening monetary supply, currency fluctuations and the Ukraine disruption.

"The market has been tough – there has been a reduction in the number of active investors and the obvious widening of pricing since late-Feb to early-March," he says. "This is not unique to the CLO market but is seen across asset classes."

During the first part of that period, the market saw a lot of transactions with a great deal of pent-up supply and people with middle market portfolios that wanted to finance in the CLO markets, and there was a lot of money that needed to be deployed in this market.

Gilbert says: "We have been focused on what we do – since the market turned in the first quarter, the environment has been challenging and most deal takes longer. However, we have been successful in placing deals – eight of these deals were completed since the end of Feb. We have remained active during a difficult period. It's having that deep understanding of our client's needs."

Reginald Fernandez, Natixis

Gilbert adds that as we head into a period where people are worried about fundamentals, worried about how credit markets progress and react to the current macro events the increased protection CLOs has given people some comfort. "The experienced manager who issues these – their deep experience is very important; these people can handle complexities."

Looking ahead, Gilbert says he is keen for his team to continue to display their abilities in the market, and he says that it will be interesting if the market goes into a tricky period, as he is confident that Natixis will emerge as one of the even more dominant players within the market. He observes: "The business is very well-aligned around MM CLOs, and we will be well-positioned to address the market where other players' commitment to this space will be tested."

Fernandez mirrors this view and is confident that the CLO middle market team will be able to address the possible hurdles that could lie ahead. He concludes: "We have been in the market a while; we anticipate more headwinds given the macro backdrop but are confident of working through them and coming out stronger."

LAW FIRM OF THE YEAR
WINNER: ALLEN & OVERY

Allen & Overy wins Law Firm of the Year in this year's SCI Middle Market CLO Awards, as the practice is recognised for its accomplishments as a leading legal advisor in the MM CLO sector. Allen & Overy boasts a renowned team, well placed to offer advice on a wide range of sophisticated securitisation transactions and which possesses extensive CLO expertise.

> "WE AIM TO STRIKE A BALANCE BETWEEN STRONGLY ADVOCATING FOR OUR CLIENTS AND ALSO BEING ATTUNED TO THE COMMERCIAL DRIVERS IN A DEAL IN OUR UNDERSTANDING OF ALL PARTIES"

Allen & Overy has received abundant praise for its MM CLO practice. The practice focuses on representing underwriters, asset managers, administrative agents and debt and equity investors in CLOs, with clear expertise on the middle market sector. It acts as a central partner to leading investment banks and collateral managers in the public widely distributed and private MM CLO space, representing lenders and borrowers in structured loan facilities, CLO warehouse facilities, risk retention financings and a variety of other asset backed securities transactions. Sitting within the wider structured finance practice, the team is widely recognised by commentators and industry leaders as a dominant force in the industry.

"A fundamental aspect which differentiates Allen & Overy in this market is that we act equally vigorously for both arrangers and managers," notes partner Lawrence Berkovich. "This gives us a more comprehensive market understanding to arrive at a compromise that is beneficial to all parties."

Such vision and value is further emphasised by partner Nicholas Robinson: "We take a broad view of the market, both from both the bank and manager's side and also from the perspective of advising parties to securities issuances in the capital markets and in the private structured loan markets. We aim to strike a balance between strongly advocating for our clients and also being attuned to the commercial drivers in a deal in our understanding of all parties."

Lawrence Berkovich, Allen & Overy

Looking back at the past twelve months and its defining moments, the team highlights its comprehensive approach and market authority on EU risk retention compliance matters.

"There is not a particular or specific deal I would highlight," views Robinson. "A significant number of our clients are leading European financial institutions, therefore we advise on deals which have to comply with EU securitisation regulations. To be able to truly be on top of those developments and leading the market on such aspects is clearly a highlight for us."

He adds: "We have also been focusing extensively on warehouse lending and long-term financings. We formulate a certain flexibility for the managers to operate in the current environment and which is acceptable to the bank's credit."

Despite the turbulent macroeconomic backdrop and uncertainty hampering capital markets, steady appetite from CLOs has meant that volatility in this segment of market has been less pronounced. With demand for private debt running high, direct lending is becoming increasingly more competitive.

"Given the current environment, traditional banks are tightening up their lending to middle market companies and alternative direct lenders see an opportunity to further expand their market share," notes Berkovich. "One of the reasons we are particularly keen to participate and be so involved in this market is to partner with direct lenders in helping them take advantage of such opportunities because most MM CLOs are not arbitrage vehicles, but products designed to help direct lenders finance their business."

Nicholas Robinson, Allen & Overy

Robinson further expands on this trend: "We are clearly experiencing a move to private credit deals. From a private credit perspective, there are still a lot of healthy sectors where you can look to develop businesses. And with less LBO activity given the current market constraints, direct lenders are looking to use CLOs to leverage their portfolios."

Unsurprisingly, the outlook for the coming year is uncertain as loans and structures will experience idiosyncratic stresses from the current challenges of rising rates and geopolitical conflict. However, given MM CLOs are a financing product, such a stressful environment is likely to accelerate consolidation of private-credit lenders and MM CLO managers. In what are challenging times, the MM CLO market could experience fewer headwinds than other asset classes.

Berkovich concludes: "Generally the number of new BSL CLOs has been stable, however what is interesting to me is that we are receiving on our desk just as many new MM CLO and structured loan facility mandates. This suggests that private-credit lenders have already begun to take advantage of new opportunities."

Proud to be selected as "Law Firm of the Year" for the SCI Middle Market CLO Awards 2022

Allen & Overy is a global law firm, helping the world's leading businesses to grow, innovate and thrive. For almost a century, we have built a reputation for our commitment to think ahead and bring original solutions to our clients' most complex legal and commercial challenges.

We have deep expertise throughout the securitization spectrum. We are widely recognized for our work on many of the most innovative and complex securitization and asset finance transactions brought to market and, most importantly, providing clients with commercially viable structures in the increasingly regulated international markets.

We advise a range of parties on these transactions, including arrangers, managers and anchor debt and equity investors in capital markets CLOs, CLO warehouses, and bespoke private loan financing facilities in the middle market, broadly syndicated, and project and energy loan spaces.

"Allen & Overy's pragmatism is one of their greatest strengths – they measure their legal advice by anticipating business needs, clearly explaining the practical risks and legal issues."

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SERVICE PROVIDER OF THE YEAR
WINNER: U.S. BANK

U.S. Bank doesn't merely have a narrow lead over its chief competitors in the provision of custody and trust services to middle market CLO managers: it has opened up a yawning gulf. For the 12 months ending September 30 2022 U.S. Bank claims a 60.9% market share.

> "WHAT MADE US SUCCESSFUL IN THE OVERALL MARKET HAS MADE US SUCCESSFUL IN THE MIDDLE MARKET AREA"

The bank has been prominent in this business since the MM CLO market began really taking off in 2017, and its market share has not dropped below 50% since then. Moreover, it has been dealing with the underlying asset class – middle market loans – around 15 years.

U.S. Bank's eminence is due to a number of factors. In a business like corporate trust and custody, experience and history count for a lot. The parent institution, US Bancorp, is the fifth largest bank in the country. It operates under the second-oldest continuous national charter, granted in 1863, and has assets of close to $575bn. It is considered a systemically important bank by the Financial Stability Board.

This pedigree is important, and the bank's management has made it clear that it is considers the provision of CLO services to be central to the model. "U.S. Bank has made a significant commitment to this business over the years, in people and in technology. It is supported at the highest levels of the bank. It is part of wealth management and investment services, one of the core revenue-generating businesses lines, and we've made a significant number of acquisitions in this space over the last 30 years," says Joe Nardi, US CLO business head.

Indeed, U.S. Bank global corporate trust and custody business has bolstered its operations by no less than 26 significant acquisitions in the last 30 years, dating back to 2Q 1992. For example, at the beginning of 2021, US Bancorp bought MUFG Union Bank for $8bn, gaining the debt servicing and securities custody services alongside an additional 190,000 small business customers.

Joe Nardi, U.S. Bank

The CLO custody business remains generally labour intensive. However, U.S. Bank's scale has allowed it to invest heavily in automated processes and this means it can devote more scale and staff resources to the middle market CLO custody business – which is even more labour intensive. "We've been able to shift resources to this asset class. There is a lot of picking up the phone, punching in numbers and chasing people about where this or that wire transaction went," says David Keys, head of CDO relationship management. Some 800 staff is currently employed in the overall CLO business.

The firm operates a third-party vendor platform from Deloitte for trustee services and custodianship, but has it has been customised to suit the specific needs of U.S. Bank in the MM CLO business. "Our continuous investment in technology sets us apart," says Nardi.

Of course, all manner of whizzy technology counts for naught without experienced staff. This is a complex business, and the firm has acquired and kept people that understand it. This also means that the barriers to entry are high; it is difficult to imagine a competitor dethroning U.S. Bank without equivalent levels of expertise and knowledge.

It got it into MM CLOs at the same time its clients did, and the business has developed as the market has developed. "We want to serve our global clients and as they evolved with the market, we wanted to make sure we could partner with them. As they developed the middle market space, we grew with them," explains Keys.

There is no typical U.S. Bank MM CLO client, he adds. "The roster spans from the largest established managers to the small niche players that only play in the middle market space."

The experience and understanding it had of the overall CLO market was an invaluable

David Keys, U.S. Bank

underpinning of its development of the middle market business. It already knew how to manage loans and it applied this, with requisite tweaks and adjustments, to this new area. The firm has been in the MM CLO space for as long as there has been a MM CLO space.

"We've been at the forefront of this market from the beginning. What made us successful in the overall market has made us successful in the middle market area," says Nardi.

Its scale also allows it to be competitive with fees. Although fees have stabilised in the last year or two, there has been gradual fee compression from the earliest days of the market and U.S. Bank's size and sophistication means that it can offer competitive rates. If it did not, it would not be able to maintain such a lead over its rivals.

Despite the seismic shifts in the global economy which have become apparent in the past year, the performance of the MM CLO business has been surprisingly robust and issue pipeline appears impressive.

"We're in a period of disruption right now, but we expect activity to pick up again in 2023," concludes Nardi.