Winning With CLOs

Melissa Ricco, co-head of Barings' Structured Credit Investment Team, said that the opportunity in collateralized loan obligations for insurance investors remains compelling. "Insurers with access to experienced CLO investment managers with robust underwriting capabilities are well positioned to capitalize on these opportunities," she said. Following are excerpts from an interview.

BARINGS

Melissa Ricco
Co-Head, Structured Credit Investment Team
Barings

"There's never been a default of an AAA-rated tranche in its 30 year plus history, and defaults in the rest of the capital stack have been relatively minor compared to their corporate counterparts."

Visit the Issues & Answers section at *bestsreview.ambest.com* to watch an interview with Melissa Ricco.

What are CLOs?

A CLO is an actively managed securitized product backed by a highly diversified pool of leveraged loans. CLOs provide an efficient, scalable way to invest in floating rate loans while offering structural protection and have historically performed well through multiple credit cycles. CLOs have been around since the 1990s and have now matured into a market worth more than $1.3 trillion with an actively traded secondary market.

Why have CLOs been one of the fastest-growing asset classes for insurance companies?

CLOs offer diversification by providing exposure to a broad range of leverage loans, typically involving 150-250 borrowers and across 15-20 industries. This diversity helps mitigate risk, as the performance of the CLO is not overly dependent on any single borrower. Additionally, the structural features of CLOs provide further risk mitigation by redirecting cash flows from lower rated tranches to more senior rated tranches if the underlying portfolio's credit quality weakens. Lastly, the perceived complexity of the asset class offers the potential for higher spreads on a like for like basis in credit rating and regulatory capital.

How do regulatory changes impact the investment in CLOs by insurance companies?

Regulatory changes, particularly those from the National Association of Insurance Commissioners, NAIC, can significantly impact CLO investments by insurance companies. For instance, recent NAIC initiatives have aimed to revise capital requirements for CLO investments, potentially altering the risk based capital, or RBC, factors for these assets, depending on what part of the capital stack an investor is in. This, of course, could affect the demand for CLO investments, making it crucial for insurers to stay informed and adapt their strategies accordingly.

What does it take to win in this asset class?

Most important is partnering with an experienced team that has strong access to the market and a commitment to underwriting. Barings has a long, consistent track record across multiple market cycles and is well positioned to navigate different market conditions. Given the complexity and specialization of CLOs, a dedicated team is key to capitalizing on opportunities in the asset class. Second, managers with longstanding and active participation in the CLO ecosystem can often negotiate favorable terms for their clients, including allocations to coveted new-issue CLO tranches, early first looks at primary and secondary market investment opportunities, and strong trade execution. Also very important, an effective CLO manager should employ rigorous, bottoms-up fundamental credit analysis. CLO teams with investment managers that have a broad public and private fixed income team can leverage the firm's wider research and market insights. For CLO tranche investors, it's critical to have the resources to better understand the impact, the quality and relative value of potential investments.

Share this edition at ***https://bestsreview.ambest.com/issuesanswersarchive.html***.