Collateralized Loan Obligations (CLOs)

April 2022

ASSET MANAGEMENT | FACT SHEET

Conning believes that CLOs are a compelling asset class for insurers in today's market. As floating-rate securities, they offer income protection in varying market environments while also minimizing duration. At the same time, CLO securities (i.e., tranches) typically offer higher yields than similarly rated corporate bonds and other structured products. The asset class also provides strong capital preservation through structural protections and investor-oriented covenants.

Historically, the CLO structure has proven to be extremely resilient through multiple market cycles. In fact there has never been a default in the AAA and AA -rated CLO debt tranches.[1] Negative correlation to U.S. Treasury Bonds and low correlations to U.S. investment grade corporate bonds and equities present valuable diversification benefits. CLOs also offer an opportunity to access debt issuers that do not participate in the high-yield bond markets.

How CLOs Work

The CLO collateral manager purchases a portfolio of loans (typically 150-300) using the proceeds from the sale of CLO tranches (debt & equity). The interest earned from the loan collateral pool is used to pay the coupon to the CLO liabilities. The residual cash flow, after paying the interest on the CLO liabilities and all expenses, is distributed to the holders of the CLO equity. Notably, loan portfolio losses are first absorbed by these equity investors. CLOs are typically rated by S&P, Moody's and / or Fitch.

Benefits of Investing in CLOs

- **Attractive Yields** – Opportunity for incremental yield pick-up relative to similarly rated corporate bonds and other structured securities
- **Low Historical Defaults** – CLO tranches have demonstrated low historical default rates
- **Floating Rate** – Coupons float over SOFR/LIBOR, which benefits investors in periods of rising short term interest rates
- **Portfolio Diversification** – Low correlations to IG corporate credits and equites and negative correlation to U.S. Treasury Bonds

Team

Andrew Gordon
Octagon, CEO
38 years of experience

Gretchen Lam, CFA
Octagon, Senior Portfolio Manager
23 years of experience

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Octagon, Portfolio Manager
18 years of experience

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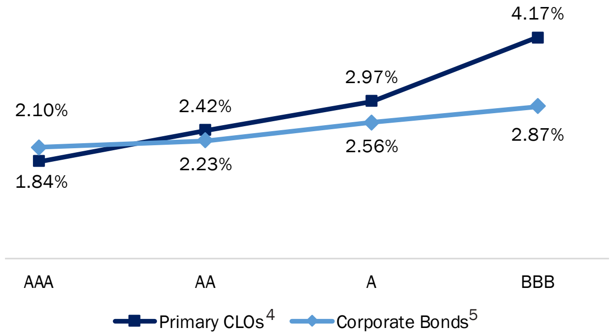
Average Comparative Yield of U.S. CLOs and Equally Rated U.S. Corporate Bonds[2,3]



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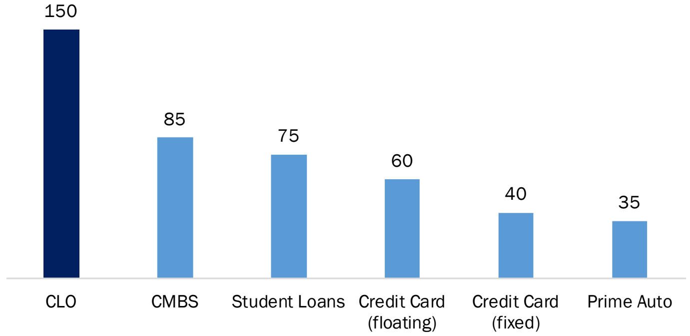
Comparative AAA Asset Class Spreads[6] (3-5 Yr) (bps)



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Conning / Octagon Advantage

In 2016, Conning acquired a majority stake in Octagon Credit Investors, LLC ("Octagon"), and as such, gained expertise in CLOs, bank loans, high yield bonds, and structured credit investments. Octagon has focused solely on credit since its inception in 1994 and has managed CLOs since 1999, one of the original investors in the asset class. Over the years, Octagon has gained substantial expertise in structuring, managing, and investing in CLOs over multiple credit cycles.

Asset Class Expertise

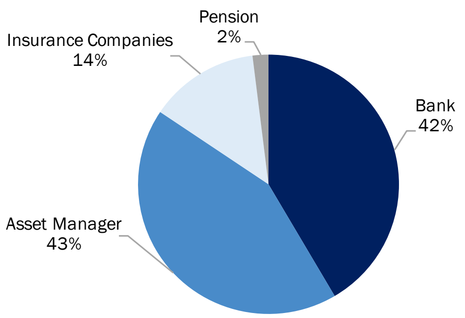
- Team depth & focus
- Credit research expertise
- Loan-level insight
- Collateral manager due diligence
- Deal structure expertise

Enhanced Portfolio Management

- Active oversight / management
- Deep knowledge of market technicals
- Long-standing market relationships
- Strong access to trade flows
- Systems and infrastructure

Insurance companies are active participants in the CLO market

Primary CLO AAA Purchases[7]
November 2021



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Octagon Credit Investors $31.0B AuM[8]		
Bank Loans	Structured Credit	Multi-Asset Class Credit
$28.1B	$1.2B	$1.8B

CLOs vs Asset-Backed Security Collateralized Debt Obligations (ABS CDOs)[9]

	CLOs	ABS CDOs
Underlying Collateral	Non-Investment Grade Corporate Loans	Mezzanine Tranches & High Grade ABS Tranches
Transparency	Transparent - monthly trustee reports allow underlying loans to be analyzed and priced frequently	Opaque - monthly trustee reports allow identification of underlying ABS tranches but not the ultimate underlying assets
Managed vs. Static	Actively managed portfolio of corporate loans	Managed portfolio of tranches of static securitizations
Correlation Among Underlying Assets[10]	Low	High
Sector Diversification	High - Top industry limited to 12-15% of the portfoio	Low - Tied to the performance of the real estate sector

Considerations for Insurers

Ratings
CLOs are rated by at least one major rating agency (i.e., S&P, Moody's, Fitch).

Pricing
CLOs are typically priced at least monthly.[11] Pricing sources include IHS Markit, IDC (Interactive Data Corp.), and Pricing Direct (JPM).

Accounting Classification
Rated CLO tranches are debt securities. Holders may elect to classify as trading, available-for-sale (AFS), or held-to-maturity (HTM). U.S. insurers report individual CLO holdings on Schedule D, Part 1 of the NAIC annual statement; CLO SPVs are typically offshore (e.g., Cayman) entities and may be subject to limitations applicable to foreign country allocations.

Trade / Settlement Conventions
Standard three-day settlement for secondary market purchases. Primary market purchases settle trade date plus three to four weeks with economics starting on settlement date.

Regulatory Capital Treatment
Highly-rated CLO tranches (i.e., AAA, AA, A) are considered NAIC 1-rated assets and benefit from the most favorable statutory capital charges.

Taxation
AAA, AA, A, and BBB CLO tranches are debt for U.S. tax purposes and are taxed similarly to other debt instruments such as corporate bonds or asset-backed securities.

Investment Guidelines
Insurers should review applicability under existing guidelines and, if not permitted, investment committee approval may be required prior to investing in the asset class. For example, investment guidelines may have broad limitations on securitized asset classes, or limitations applicable to foreign country allocations.

CLO Risk Factors (Include Are But Not Limited To)

Structure - CLOs often involve risks that differ from those associated with other types of debt instruments. The complex structure of the security may produce unexpected investment results not based on default or recovery statistics. Rating agencies may downgrade their original ratings of CLO debt tranches. Majority equity holders retain the right to call or refinance/reprice a CLO, creating cash flow variability for minority equity and debt holders.

Liquidity - CLOs may be difficult to value and may constitute illiquid investments. Valuation of structured credit products is provided by third parties, based on models, indicative quotes, and estimates of value, in addition to historical trades. There is inherent difficulty in valuing these assets, and there can be no assurances the assets can be disposed of or liquidated at the valuations established, or that published returns will be achieved.

Default - During periods of economic uncertainty and recession, the incidence of modifications and restructurings of investments may increase, resulting in impairments to the underlying asset value and reduced "subordination" to the CLO liabilities.

Regulatory - CLOs are susceptible to changing regulations, influencing eligibility of certain investments, risk retention requirements, and other factors that can influence availability and liquidity.

LIBOR – CLO debt and bank syndicated loans historically used LIBOR as an interest rate benchmark, which is currently being phased out, with new instruments being issued with an alternative rate and all existing instruments tied to LIBOR required to transition by June 30, 2023. Replacement of LIBOR could adversely affect the market value or liquidity of CLO securities and/or loans, and pose tangential risk for markets and assets that do not rely directly on LIBOR. On July 29, 2021, the Alternative Reference Rates Committee formally recommended CME Group's forward-looking Term SOFR rate as the replacement rate for U.S. dollar LIBOR, however, there is uncertainty with respect to replacement of LIBOR with proposed alternative reference rates, and it is possible that different markets might adopt different rates, resulting in multiple rates at the same time and a potential mismatch between CLO securities and underlying collateral, the effects of which are uncertain at this time, and could include increased volatility or illiquidity. In addition, operational and technology challenges during the transition from LIBOR as well as inconsistent communication from issuers could result in delayed investment analyses and reduced investment opportunities.

General Market & Economic Conditions - Changing economic, political, regulatory or market conditions, interest rates, general levels of economic activity, the price of securities and debt instruments and participation by other investors in financial markets may affect the value of CLOs and all other asset classes.

About Conning

Conning (www.conning.com) is a leading investment management firm with a long history of serving the insurance industry. Conning supports institutional investors, including pension plans, with investment solutions and asset management offerings, risk modeling software, and industry research. Founded in 1912, Conning has investment centers in Asia, Europe and North America.

Organization

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Disclosures and Footnotes

1. Past performance is not a guarantee of future results.

2. Source: ©2022 J.P. Morgan Chase & Co. ("J.P. Morgan") - all rights reserved. Information has been obtained from sources believed to be reliable, but J.P. Morgan does not warrant its completeness or accuracy. The Index is used with permission. The Index may not be copied, used or distributed without J.P. Morgan's prior written approval. MorganMarkets analysis conducted 4/17/2022.

3. For Corporate Bonds, average calculated based on daily data for the period 1/3/2022 to 3/31/2022. For CLOs, spot spreads used as of 4/1/2022.

4. Yield calculated by adding spread to 3-month SOFR for the respective tranche for primary (i.e., new issue) USD CLOs. Primary CLO spreads represent newly issued USD CLO market pricing levels broken out into six original rating classes (AAA, AA, A, BBB, BB, B).

5. Portfolio yield for J.P. Morgan U.S. Liquid Index ("JULI") investment grade corporate bond index is shown. Includes only securities with maturities of 3-5 years and excludes emerging market bonds.

6. Source: Courtesy J.P. Morgan Chase & Co., Copyright 2022. Credit Card (fixed and floating) and CMBS data based on 5-year spreads. Prime Auto and Student Loans data based on 3-year spreads (5-year spreads not reported). As of April 1, 2022.

7. Source: ©2022 Citigroup, Inc., Citi Research. Percentages may not foot due to rounding.

8. As of March 31, 2022, Octagon Credit Investors, LLC total AUM. May not foot due to rounding.

9. Provided for illustrative purposes only. Information presented above does not capture all characteristics or risk of investing in CLOs or ABS CDOs.

10. Correlation of underlying assets is intended to convey a measure of diversification of the underlying assets of the respective product, based on Octagon's assessment of the ultimate risk of loss for the underlying assets of the respective product.

11. Daily pricing is available, although vendors typically charge additional fees for this service.

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