

# Weighted average life divides CLO industry

Creditflux's second CLO Census reveals stark differences of opinion on weighted average life and par-flush for US CLOs. But there is a clear consensus on which bank is best at CLO execution

by Tom Davidson

The CLO market is, to a large extent, standardised, but that does not stop divisions opening up whenever participants discuss how it should operate. Following on from the successful launch of Creditflux's CLO Census last year, we once again surveyed stakeholders and found that valuations provoked the biggest differences in opinion.

We asked only CLO investors and traders about the weighted average life assumptions they make for new CLO investments, and the results reveal a complete lack of consensus in the market. Around a third of CLO holders use the reinvestment date plus one year for their weighted average life expectation, but a quarter prefer to go all the way out to maturity – and 15% use the end of the reinvestment period.

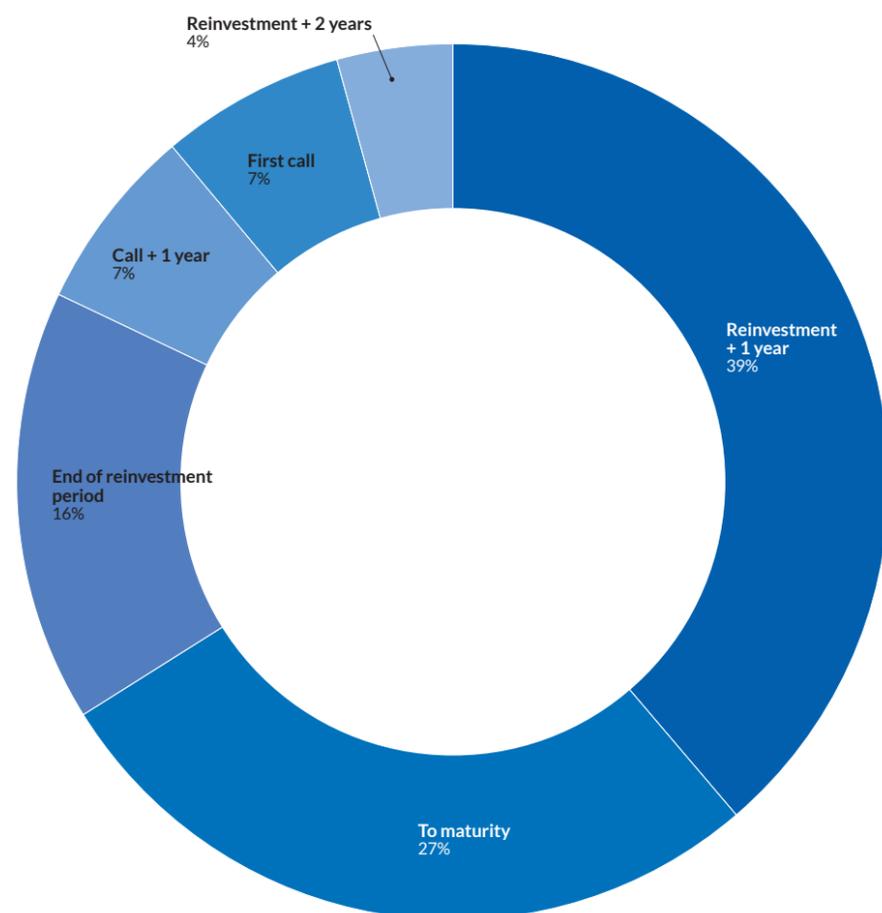
Several respondents wrote that they use more complicated probability path calculations. According to one CLO investor at a hedge fund: "The ability to reset the deal after the non-call period is factored into the price, but with a less than 100% likelihood of that happening. It is impossible to know with certainty where primary spreads will be going forward, so it is imprudent to price in 100% of the benefit of a repricing."

## Par flush features are being hidden

The question on par-flush mechanisms for US deals also drew a mixed response. 32% of the market believe that par-flush is only acceptable on the first payment date; 22% were fine with its use up to the third payment date; and 17% chose any payment date. Commenters noted that they were most concerned about the way par-flush features were hidden in the docs.

We also asked investors and managers for their views on the best CLO arranger. Citi was the clear favourite, coming out on top for best execution on US and European deals and for pricing transparency.

## What weighted average life do you assume for new CLO investments?



**The best reinvestment period depends on the non-call period – we would rather take 2y/5y than 5y/7y**  
CLO, CLO manager

**Lack of standardisation will eventually lead to uneven performance and another bout of extreme volatility**  
Senior PM, pension fund

GENERAL	
<b>What is the biggest current risk for CLO investments?</b>	
Weakening loan documentation	59%
Tightening loan spreads	28%
Retail names	7%
Weakening CLO documentation	6%
<b>What is the best recent innovation in the CLO market?</b>	
CLO reissues	63%
Emergence of a term curve	25%
Infrastructure CLOs	7%
ESG CLOs	5%
<b>When is a par-flush acceptable for a US CLO?</b>	
At first payment date only	32%
On a reset	24%
Up to third payment date	22%
Any payment date	17%
Never	5%

PRIMARY	
<b>Do you intend to issue European retention-compliant US deals?</b>	
Yes	30%
No	40%
Maybe	30%
<b>Which arranger achieves the best execution on new US CLOs?</b>	
1 Citi	32%
2 Morgan Stanley	14%
3 JP Morgan	11%
<b>Which arranger achieves the best execution on new European CLOs?</b>	
1 Citi	35%
2 Barclays	14%
3 Credit Suisse	12%
<b>Which law firm provides the best service to CLO managers?</b>	
1 Milbank	32%
2 Dechert	22%
3 Winston & Strawn	10%
<b>Which law firm provides the best service to CLO arrangers?</b>	
1 Cadwalader	50%
2 Paul Hastings	17%
3 Ashurst	8%
<b>What should the CLO reinvestment period for a new US deal be?</b>	
<4 years	6%
4 years	22%
5 years	51%
6 years	11%
>6 years	11%

# 40%

of respondents plan to hold to maturity the CLO investments they made to comply with risk retention

## Preparing the survey

The CLO Census was open to all market participants. We asked respondents to indicate if they were a CLO manager, investor, arranger or service provider and asked certain questions only to the appropriate group. 42% of respondents identified as CLO managers and 29% as CLO investors or traders. The winner of the draw for a pair of Bose Quiet Comfort 35 headphones is based at a US CLO management firm and wishes to remain anonymous.

SECONDARY	
<b>What do you plan to do with CLO investments made to comply with risk retention?</b>	
Hold to maturity	40%
Sell opportunistically over the long term	25%
Have yet to decide	21%
Sell in the next six months	13%
<b>Which firm is most willing to make a secondary market in US CLOs?</b>	
1 Nomura	24%
2 Citi	18%
3 Deutsche Bank	16%
<b>Which firm is most willing to make a secondary market in European CLOs?</b>	
1 Barclays	21%
2= Citi	18%
2= JP Morgan	18%

**We can now access latest investor reports from SOME managers on Intex and CLO-i – but ALL managers should make their reports available in a timely manner. There really isn't anything to hide**  
PM, insurance company

**We often see sneaky flush features hidden in the docs**  
CLO trader, asset manager