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Structural Overview

The structures used for both CBOs and CLOs are similar to traditional ABS structures. The issuing vehicle is usually a stand-alone, special purpose vehicle (SPV) or trust which purchases a pool of assets through the issuance of various tranches of debt and a portion of equity. Recent CLO/CBA transactions have used a master trust structure which permits the issuance of multiple series out of a single vehicle (similar to credit card master trusts).

Like credit card ABS, many CBO and CLO transactions include a “revolving period” during which collections on the collateral are reinvested in new assets. This is followed by an “amortization period” in which bond principal is repaid, either sequentially or in a single bullet payment. In certain structures, there is also a “ramp-up” period during which the initial collateral is purchased by the trust (this is similar to the “prefunding period” for ABS transactions).

Each transaction specifies an asset manager (similar to an ABS servicer), who is assigned the responsibility of actively managing the portfolio, subject to specific constraints. For CLO’s the asset manager is often an affiliate of the seller. For CBOs, the asset manager is usually a third-party asset management company, selected based on its track record for managing the asset classes in the collateral pool. The asset manager will frequently own a portion of the equity tranche, thus providing a continuing incentive to manage the collateral diligently. (Similarly, in most ABS, the issuer/servicer effectively owns the equity tranche through its rights to excess spread).

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