ARTICLE

CLOs, Par Flush and the updated Volcker rule: An emerging opportunity?

The market for collateralized loan obligations (CLOs) may get a boost from 2020 updates to the Volcker Rule. Slated to roll out in October, this update will allow for a five percent “bond bucket” and loosen restrictions on banks’ participation. Par Flush may gain new importance with this change.

WHAT IS PAR FLUSH?

In a typical CLO, the cash from borrower payments goes first to the highest-rated bonds tied to the deal. Later payments flow down the waterfall, with equity holders getting paid last.

Par Flush changes the CLO waterfall structure, enabling the portfolio manager to make payments to equity holders in front of the bonds. The amount of these early equity-holder payments is typically capped at one percent of the deal size. Issuers usually retain trading gains in the CLO to cover defaults and maintain a layer of security for the bondholders. There is also one crucial provision: payments must come from the principal in buying and selling the loans in the portfolio, not from interest payments.

OPPORTUNITY KNOCKS?

Some investors anticipate substantial demand for CLOs post-pandemic. The Volcker Rule update may also attract equity investment from banks. Par Flush is one of many considerations as investors weigh their options.

See how Broadridge Portfolio Management for CLOs can automatically track principal and interest proceeds, equity and note holder distributions and bond bucket allocations.

Schedule a demo of our Asset Management Solutions here.

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