BMO AAA CLO ETF
Frequently Asked Questions

How can I invest in BMO AAA CLO ETF?

- BMO AAA CLO ETF – CAD Units (Cboe CA: **ZAAA**)
- BMO AAA CLO ETF – Hedged Units (Cboe CA: **ZAAA.F**)
- BMO AAA CLO ETF – USD Units (Cboe CA: **ZAAA.U**)

What is a Collateralized Loan Obligation (CLO)?

CLOs^ are securitized portfolios backed by a diverse pool of loans to businesses. The CLO portfolio is comprised primarily of below investment grade corporate loans, which may include domestic and foreign senior secured loans,^ senior unsecured loans and subordinate corporate loans. CLOs are funded by layers of debt of varying seniority (also known as tranches).

The principal and interest received from the portfolio of senior secured loans is distributed according to a cash flow waterfall. The debt obligations have varying seniority in the cash flow waterfall, with residual cash flows being distributed to the CLO's equity holders. Due to credit enhancements, priority of cash flows, diversification, active management and other risk protections, priority tranches earn investment grade ratings. The highest-ranking tranche achieves the AAA^ rating.

How is the BMO AAA CLO ETF structured?

BMO AAA CLO ETF is an actively managed fund that will hold primarily AAA tranches issued by CLO issuers outside of Canada. CLO issuers will generally be required to adhere to certain diversification rules to mitigate against the risk of concentrated defaults within a given industry or sector.

What are the advantages of accessing CLOs through an exchange traded fund that invests in CLOs (CLO ETF) and why BMO ETFs?

The CLO ETF structure offers a liquid, accessible format to invest in CLOs compared to purchasing individual tranches directly, which can be complex and limited to institutional investors. ETFs also provide daily pricing and greater transparency. CLO ETFs generally have lower management fees compared to alternative methods of investing in CLOs, such as private funds. Finally, ETFs allow investors access to CLOs, a market historically accessible only to institutional investors.

The BMO GAM team of experts brings over 20 years of portfolio management experience in originating, structuring and investing across credit assets. BMO ETFs is the largest fixed income ETF issuer in Canada with over 70 fixed income ETFs and over 40 billion in assets under management within them[1]. Along with fixed income, the BMO GAM team also has experience in structured credit, private credit, and restructuring.

What are the benefits of having CLO exposure in your portfolio?

Underlying CLOs Offer Attractive Cashflow

CLOs often provide higher yields compared to traditional Investment Grade bonds due to the credit risk of the underlying leveraged loans which are not investment grade[2].

Active Portfolio Management

CLOs are not index tracking funds; they are actively managed investment vehicles. Although CLOs have strict covenants regarding portfolio diversification, credit quality and other metrics by which managers must abide, there is substantial discretion to reinvest collateral proceeds. A manager can, among other things, buy, sell and substitute loans in the underlying asset portfolio. A manager's ability to assess credit and quickly respond to changes in markets can significantly impact the performance of a CLO's portfolio.

Diversification

Specific covenants are incorporated into the transaction documents to regulate the type of loans that managers may acquire, including the requirement for managers to construct a diversified portfolio. The typical CLO is diversified across a wide range of industries and borrowers. It is common to have more than 200 individual companies in a single CLO. Generally, only a small percentage of the assets (typically 2%) may be invested in the loans of any individual borrower. These limitations on portfolio composition mitigate outsized exposure to any single borrower or industry and restrict the purchase of lower credit quality loans.

Floating Rate feature

CLO tranches may have either a fixed interest rate or a floating interest rate tied to benchmarks, such as the Secured Overnight Financing Rate (SOFR)^ for United States dollars. CLOs with floating rates allow investors to have short duration in their portfolios.

Zero Default Rates

Historically, there have been zero defaults on AAA tranches through the 30-year plus history of CLOs.[2]

What are the risks associated with an investment in of BMO AAA CLO ETF?

Investing in BMO AAA CLO ETF involves several risks, primarily stemming from the nature of the underlying CLOs and the market they are traded in. For more information about the risk rating and specific risks that can affect the BMO AAA CLO ETF's returns, see the BMO AAA CLO ETFs' simplified prospectus.

What is the difference between CLOs and CDOs?

CDOs are not the same as CLOs.

CDOs, or Collateralized Debt Obligations, are issued by special purpose issuers that do not limit their investments to ordinary corporate loans. CDOs are vehicles backed by subprime mortgages, which suffered in the Great Financial Crisis and never fully recovered. [1]

CLOs, on the other hand, are comprised primarily of first lien senior secured loans, although there may be small allowances for second lien loans and unsecured debt. CLOs are funded by layers of debt of varying seniority and equity. The principal and interest received from the portfolio of senior secured loans is distributed according to a cash flow waterfall. The debt obligations have varying seniority in the cash flow waterfall, with residual cash flows being distributed to the CLO's equity holders. For the economics of a CLO transaction to work, the interest income from the loan portfolio must exceed the interest expense of the debt obligations, with the CLO's equity investors receiving the excess interest. Furthermore, CLOs are actively managed, so CLO managers can trade in and out of the underlying leverages loans if they change their market view.

How often will BMO AAA CLO ETF make distributions?

BMO AAA CLO ETF expects to make monthly distributions. To the extent that the expenses of BMO AAA CLO ETF exceed the income generated by BMO AAA CLO ETF in any given month, it is not expected that a monthly distribution will be paid.

How long have CLOs been around and how large is the CLO market?

CLOs have been part of the securitized products market since the late 1980s. Historically, most AAA CLOs were privately sold to large institutional investors such as banks, insurance companies, and asset management companies.

CLOs performed well through the financial crisis of 2009, with low default rates and attractive risk-adjusted equity returns[3]. Even through the credit market turmoil, defaults on pre-crisis CLOs were minimal across all rating categories, and no CLO debt that was initially rated AAA has ever defaulted[4]. Although pre-crisis CLO performance was strong through the financial crisis, post-crisis CLOs are characterized by even more robust structures. Structural improvements relative to their pre-crisis counterparts include: (i) substantially more credit enhancement for each rated debt tranche, resulting in lower leverage, (ii) stricter limits on the portfolio composition, and (iii) more restrictive covenants protecting investors.

The CLO market has grown impressively, reaching about $1.5 trillion in assets. [1] The AAA segment of the market is around 60% of the overall market[5]. This growth demonstrates the CLO market's emerging significance and liquidity and highlights CLOs as a compelling option for investors seeking diversification and growth.

^Definitions:

CLOs: CLOs are floating- or fixed-rate debt securities issued in different tranches, with varying degrees of risk, by entities typically organized as trusts or other special purpose vehicles ("CLO Issuers") and backed by an underlying portfolio consisting primarily of below investment grade corporate loans. The BMO ETF pursues its investment objective by investing, under normal circumstances, at least 85% of its net assets in CLOs that, at the time of purchase, are rated AAA or the equivalent by a nationally recognized statistical rating organization

AAA: refers to the order of payments, should there be any defaults, and does not represent the ratings of the underlying loans within the CLO. If there are loan defaults or the CLO Issuer's collateral otherwise underperforms, scheduled payments to senior tranches take precedence over those of mezzanine tranches (a tranche or tranches subordinated to the senior tranche), and scheduled payments to mezzanine tranches take precedence over those to subordinated/equity tranches. The riskiest portion is the "Equity" tranche, which bears the first losses and is expected to bear all or the bulk of defaults from the corporate loans held by the CLO Issuer serves to protect the other, more senior tranches from default.

Secured Overnight Financing Rate (SOFR): a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities.

Disclaimers

[1] Source: Bloomberg March 31, 2025. All investments involve risk. The value of an ETF can go down as well as up and you could lose money. The risk of an ETF is rated based on the volatility of the ETF's returns using the standardized risk classification methodology mandated by the Canadian Securities Administrators. Historical volatility doesn't tell you how volatile an ETF will be in the future. An ETF with a risk rating of "low" can still lose money. For more information about the risk rating and specific risks that can affect an ETF's returns, see the BMO ETFs' simplified prospectus. 1[st]

This communication is for information purposes only. The information contained herein is not, and should not be construed as, investment, tax or legal advice to any party. Particular investments and/or trading strategies should be evaluated relative to an investor's investment objectives and professional advice should be obtained with respect to any circumstance.

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Commissions, management fees and expenses all may be associated with investments in exchange traded funds. Please read the ETF Facts or prospectus of the BMO ETF before investing. Exchange traded funds are not guaranteed, their values change frequently and past performance may not be repeated.

For a summary of the risks of an investment in BMO AAA CLO ETF, please see the specific risks set out in the prospectus. BMO ETFs trade like stocks, fluctuate in market value and may trade at a discount to their net asset value, which may increase the risk of loss. Distributions are not guaranteed and are subject to change and/or elimination.

BMO ETFs are managed by BMO Asset Management Inc., which is an investment fund manager and a portfolio manager, and a separate legal entity from Bank of Montreal.

[1] Source: BMO GAM, March 31, 2025
[2] Source: Bloomberg March 31, 2025
[3] Source: Bloomberg December 31, 2024
[4] Source: Bloomberg December 31, 2024
[5] Source: Bank of America, December 31, 2024