AAA CLOs - The Top of the Waterfall

BMO AAA CLO ETF

ZAAA.F	ZAAA	ZAAA.U
Hedged Units Risk Rating: Low[1]	CAD Units Risk Rating: Low to Medium[1]	USD Units Risk Rating: Low[1]

Management Fee: 0.20%

Smart Income Starts at the Top!

What are collateralized loan obligations (CLO)?

CLOs are securitized[2] products backed by a diverse portfolio of senior secured loans to businesses. The CLO portfolio is comprised primarily of ~200-300 first lien senior secured loans across industries. CLOs are funded by layers of debt (called tranches) 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 AAA being the most-senior and therefore the most stable with priority access to interest and principal payments.

BMO AAA CLO ETF holds a diversified basket of the most senior and highest rated AAA CLO tranches.

BMO AAA CLO ETF Benefits

Underlying CLOs provide attractive cashflow

CLOs often provide higher yields compared to traditional investment grade bonds.[3] The BMO AAA CLO ETF has a monthly distribution frequency*

Diversification

CLO ETFs provide exposure to a distinct asset class that is less correlated with traditional fixed-income securities, enhancing portfolio diversification.

Access to Institutional-Grade Investments

ETFs allow investors access to AAA CLOs, a market historically dominated by institutional investors.

Floating Rate

CLO tranches have a floating interest rate tied to bench-marks of overnight rates which reset periodically making them an effective hedge against the movement of interest rates.

Low Default Rates

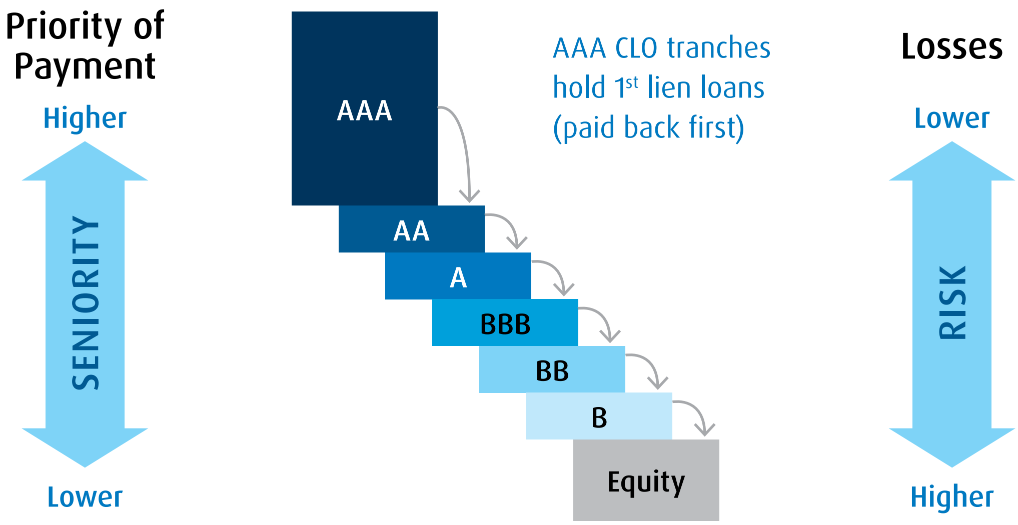
There have historically been zero defaults on AAA tranches through the 30-year history of CLOs.[3]

Liquidity and Transparency

ETFs offer a more liquid way to invest in CLOs compared to purchasing individual tranches directly, which can be illiquid and complex. ETFs also provide daily pricing and greater transparency.

First to get paid, last to take loss. Smart income starts at the top!

The AAA CLO tranches represent the most senior, stable, and highest-rated portion of the capital stack. They receive first priority in cash flow distributions and are historically known for resilience.



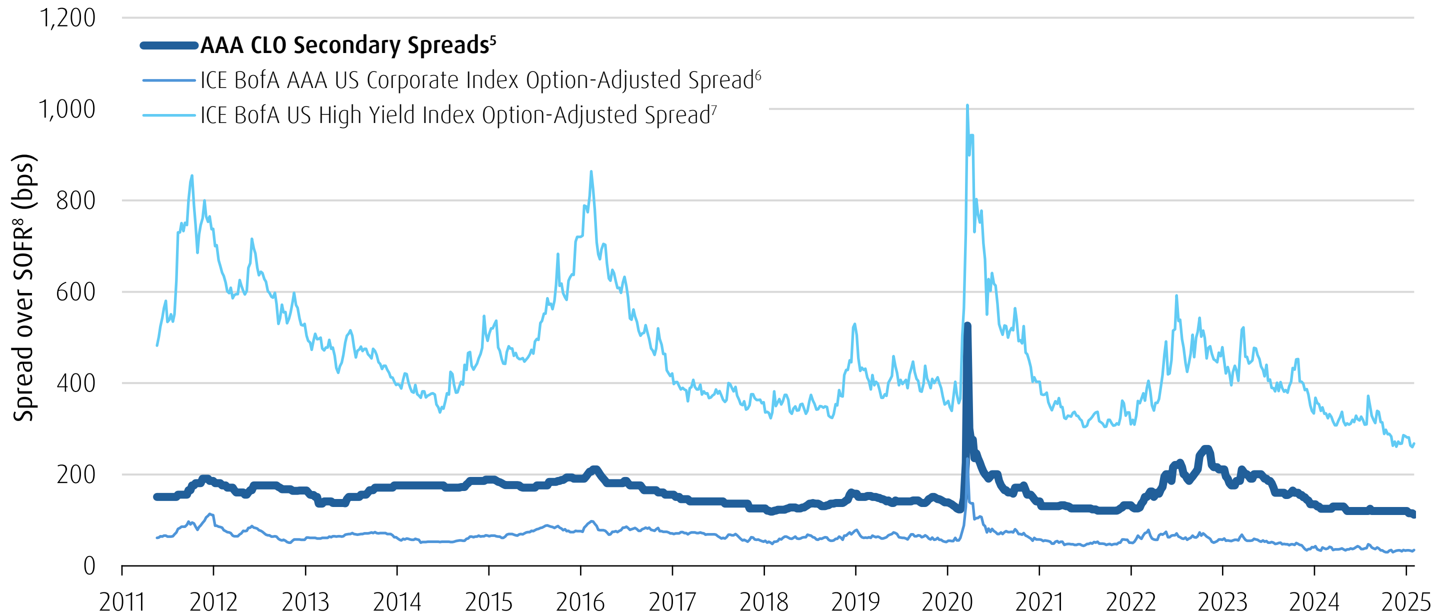
AAA CLOs have shown to have an attractive yield compared to other fixed income instruments

Source: Bloomberg, JP Morgan, as of December 31, 2024. Indices used to represent asset classes: 1-3 Yr gov/cr. (Bloomberg 1-3 Year U.S. Gov/Credit Index), AAA CLOs (JP Morgan AAA CLO Index), Agg (Bloomberg U.S. Aggregate Bond Index), High yield (Bloomberg U.S. Corporate High Yield Index), IG corporates (Bloomberg U.S. Corporate Investment Grade Index), Money markets (3-Month Treasury Bill), and U.S. treasuries (Bloomberg U.S. Treasuries Index).

Historical Spreads[4]

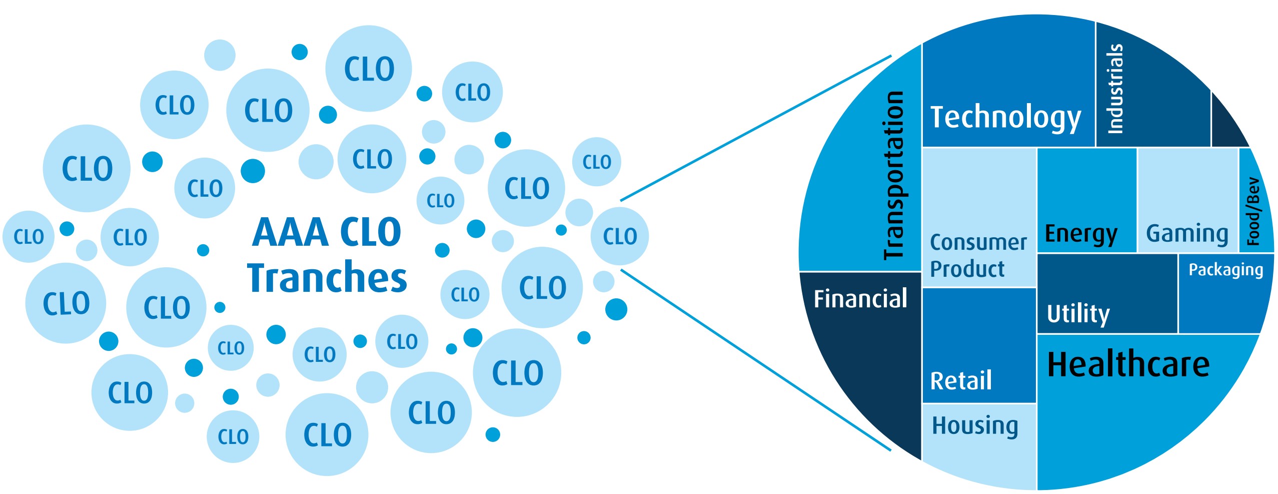
Due to the mechanics of securitization and overcollateralization of the CLO AAA tranche, this graph illustrates that CLO AAAs carried less credit risk than U.S high yield and has offered more attractive yields than AAA corporate bonds over time.

Spreads of AAA CLO, AAA Corp[6], and HY[7]



Source: J.P. Morgan for secondary AAA CLO spread.
Source: Ice Data Indices, LLC, ICE BofA AAA US Corporate Index Option-Adjusted Spread [BAMLC0A1CAAA], retrieved from FRED, Federal Reserve Bank of St. Louis.

A well diversified portfolio of AAA CLOs



BMO AAA CLO ETF

BMO AAA CLO ETF holds a diversified portfolio of AAA CLO tranches, thus diversifying across managers and sectors.

AAA CLO

Each CLO has diversification requirements across loan industry and geography to maintain its rating profile.

CLOs historically had low default rates

Over the 30 year history of CLOs, there have been zero defaults on AAA-rated tranches. CLOs as a whole have consistently demonstrated low default rates across the rating spectrum, comparing favourably to traditional corporate debt.*

Original Rating Category	CLO	Corporate	
		5 Year	10 Year
AAA	**0.00%**	0.42%	0.83%
AA	0.03%	0.41%	0.96%
A	0.15%	0.64%	1.65%
BBB	0.30%	1.79%	3.93%
BB	1.26%	7.26%	13.35%
B	3.36%	17.48%	24.79%

* Source: Bloomberg, as of December 31, 2024. Past default rates are not indicative of future default rates.

Differences between collateralized debt obligations (CDOs)[9] vs collateralized loan obligations (CLOs)

CDOs and CLOs may sound alike however, they are quite different. CDOs often included risky assets such as subprime mortgages and were a big part of the 2008 Great Financial Crisis (GFC). CLOs, on the other hand, continued to perform well during the GFC due to their focus on corporate loans and active management.[10]

Attribute	CDOs[9]	CLOs
Asset	Subprime mortgages	First lien on senior secured, unsecured, subordinated and corporate loans.
Correlation[11]	**High:** Portfolio value driven by U.S. home prices and homeowner behavior	**Low:** Portfolios include diverse borrowers across many different industries
Active Management	**No:** Selected by investment banks, originators and mortgage specialists; asset pool unchanged after issuance	**Yes:** Selected and actively managed by asset managers with capital at risk; underperforming loans can be traded out
Creditworthiness	Underlying mortgages were often made to borrowers with low incomes and few assets	Loans made to well-known companies with financial statements evaluated by credit professionals
Monitoring	**No:** Information regarding credit quality only provided at time of borrowing	**Yes:** Detailed financial statements provided quarterly and annually
Volatility	High: Prices declined during the GC and never fully recovered	CLOs have remained resilient even during market downturns
Losses	All junior tranches of RMBS CDOs suffered significant impairments during the GFC	There have been **zero defaults/losses on AAA tranches**

Experienced portfolio management team

With over 70 fixed income ETFs and 40 billion in fixed income ETF assets under management, BMO Global Asset Management (BMO GAM) is the largest fixed income ETF provider in Canada with a history of democratizing hard to access asset classes such as preferred shares and mortgage back securities for investors.[12]

BMO GAM brings over 30 years of portfolio management experience in originating, structuring, and investing across credit assets.

Our Experts

Mark Jarosz
Head of Private Credit

Mark joined BMO Global Asset Management in 2023 and serves as Head of Private Credit. Mark brings over 20 years' experience in originating, structuring and investing across credit assets. Prior to joining BMO GAM, Mark was with CPP Investments where he served as a member of the Private Credit investments team and was head of the credit investment committee for Antares. He began his career at Coventree where he spent 10 years in Structured Credit.

Matt Montemurro
Head of Fixed Income & Equity Index ETFs

Matt is currently the Head of Fixed Income and Equity Index ETFs. In his role, Matt, and his team, are responsible for all index tracking mandates, both equity and fixed income, managed by BMO Global Asset Management. Matt joined BMO in 2009 and joined the BMO ETF portfolio management team in 2012.

MacKenzie Bier
Associate Portfolio Manager, Structured Solutions

MacKenzie is an Associate Portfolio Manager on the Structured Solutions team, that focuses on developing novel products and providing bespoke derivatives and credit solutions to institutional and retail clients. She is a member of the Women in Securitization (WiS®)

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[1] All investments involve risk. The value of the BMO AAA CLO ETF can go down as well as up and you could lose money. The risk of the BMO AAA CLO 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 the BMO AAA CLO 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 a BMO AAA CLO ETF's returns, see the BMO AAA CLO ETF's simplified prospectus.

[2] **Securitized:** The process of pooling financial assets together to create new securities that can be sold to investors.

[3] Source: Bloomberg, as of December 31, 2024. Past default rates do not guarantee future default rates.

[4] **Credit Spreads:** The difference in yield between a risk-free asset and a corporate bond. It represents the risk premium investors demand for taking on the additional credit risk. Credit spreads widen when investors perceive a higher risk of default or economic uncertainty. This can occur during periods of economic contractions, rising interest rates or market volatility. Conversely credit spreads tighten when there is confidence in the economy and risk of default is low.

[5] **AAA CLO secondary spreads:** The difference between the yield (return) of a traded, secondary market AAA-rated collateralized loan obligation (CLO) and a risk-free benchmark, typically a government bond. In simpler terms, it's the additional return an investor receives for taking on the credit risk of the CLO, which is backed by a pool of leveraged loans.

[6] **ICE BofA AAA US Corporate Index Option-Adjusted Spread (OAS):** The difference between the yield of a hypothetical AAA-rated corporate bond index and a benchmark yield curve, typically the US Treasury yield curve, according to Trading Economics and Capital Economics. It reflects the additional yield investors demand for holding corporate debt with embedded options, like call or put features.

[7] **ICE BofA High Yield Index Option-Adjusted Spread (OAS):** A measure of the additional yield investors demand for holding high-yield bonds (those with a credit rating below investment grade) compared to a risk-free benchmark, like Treasury securities. It reflects the credit risk and option-related risk embedded in the high-yield bond.

[8] **Secured Overnight Financing Rate (SOFR):** A benchmark interest rate for dollar-denominated derivatives and loans.

[9] **Collateralized Debt Obligation (CDO):** A structured financial product where a bank or other entity pools together various types of debt, like mortgages, bonds, and loans, and repackages them into tranches, or classes of securities, based on their risk level.

[10] Source: Bloomberg, as of March 31, 2025.

[11] **Correlation:** A statistical measure of how two securities move in relation to one another. Positive correlation indicates similar movements, up or down together, while negative correlation indicates opposite movements (when one rises, the other falls).

[12] Source: BMO Global Asset Management, March 31st 2025.

CLOs are floating- or fixed-rate debt securities issued in different tranches, with varying degrees of risk, by 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 herein 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.

*Distributions are not guaranteed and are subject to change and/or elimination

The portfolio holdings are subject to change without notice and only represent a small percentage of portfolio holdings. They are not recommendations to buy or sell any particular security.

BMO Global Asset Management is a brand name that comprises BMO Asset Management Inc. and BMO Investments Inc.

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 ETFs 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 the BMO ETFs, please see the specific risks set out in the BMO ETF's 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 guaran- teed 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.

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