How Unrated Asset-Backed Finance Can Unlock Value

Unrated asset-backed finance (ABF) refers to credit investments backed by hard assets or contractual income streams that have not been evaluated by a credit rating agency. Unrated ABF is sometimes misunderstood as risky given that it typically offers higher yield potential. In reality, such yields often reflect compensation for complexity and illiquidity in a market segment that remains underfunded and overlooked. Diversified, well-structured portfolios may deliver income-rich returns with thoughtfully managed risk by utilizing unrated ABF loans.

Mapping the ABF landscape

The ABF universe spans a wide spectrum, but the market can be thought of as comprising three segments:

1. **Investment Grade (Rated)**
   The primary option for insurers and other regulatory capital–focused investors. Generally considered lower risk, with a lower spread, and increasingly crowded.

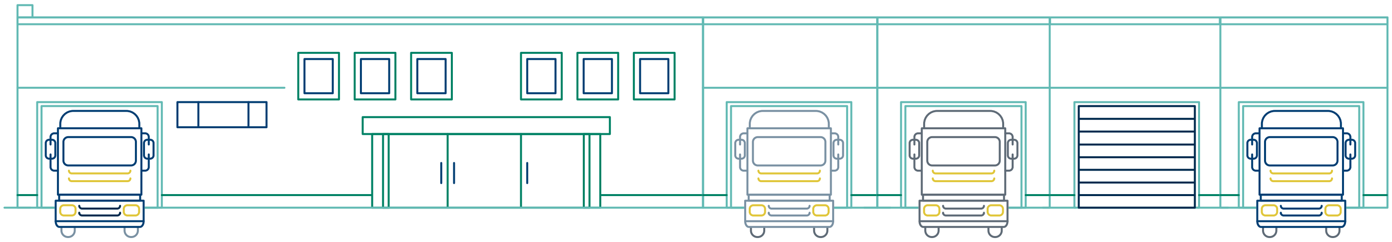
2. **Opportunistic**
   Where distress and complexity may drive higher returns but also carry higher risk.

3. **Core**
   The overlooked middle ground. Attractive, high-quality pools of contractual assets, which can either be rated or unrated. Some core structures don't always meet rating agency criteria; e.g., loans with shorter maturities or delayed-draw features, or collateral formats that fall outside standard models. However, these characteristics don't necessarily reflect weaker credit quality.

'Unrated' doesn't necessarily mean riskier

Much of the capital in ABF still flows to rated investments, as insurers and insurance-affiliated managers typically require ratings. By contrast, banks have pulled back from unrated lending because these transactions demand intensive, bespoke due diligence on diverse pools of underlying assets, along with ongoing monitoring, which many balance sheet lenders are not equipped to provide. Combined with rising regulatory capital requirements, this has left the unrated core segment underpenetrated and underserved.

Diversification does not guarantee a profit or protect against loss.



"Unrated" is often misunderstood as "riskier." In reality, it more often reflects structural features that rigid ratings models cannot accommodate for non-risk-based reasons, including:

1. **Shorter tenor:** e.g., a two-year warehouse facility against longer-tenor loans.
2. **Variable funding:** Facilities structured to let borrowers draw and repay as needed; e.g., revolving or delayed-draw loans. These require ongoing origination and monitoring because the composition of the underlying asset pool can shift over time.
3. **Nonstandard formats:** Transactions that fall outside the fixed assumptions used by rating agencies; e.g., maturities that don't fit a standardized template, cash flows that are less predictable or amortize irregularly, or collateral types that are diverse or harder to model.

In all these cases, the absence of a rating says little about the underlying asset quality. What it does mean is that borrowers are willing to pay a premium—of potentially 160+ basis points above corporate direct lending[1]—for flexible, bespoke capital. That spread premium can represent an overpayment for comparative credit risk.

The case for core, unrated ABF

Today, a compelling risk/return dynamic appears in the core, unrated segment. Banks, once dominant here, are pulling back, and insurers—bound by rating sensitivity—cannot fill the gap. This creates a relatively less crowded market where capable managers may provide bespoke, flexible capital and negotiate meaningful protections.

That's not to say that there aren't opportunities in rated ABF—it's a large addressable market. However, it is more crowded and spreads are tighter, making it less compelling from a relative value perspective today.

We believe that having a long history in opportunistic ABF provides an advantageous foundation for evaluating complex collateral, aligning incentives and anticipating sector trends. In today's environment, that experience can be applied to core unrated ABF, which typically features simpler structures and higher-quality asset pools than opportunistic ABF. In other words, the pivot is toward a segment that is less complex but more resilient, and still an underpenetrated area of the market.

[1] Based on Oaktree's observations. Higher spreads typically reflect higher credit risk and do not guarantee higher actual returns. Material differences between ABF and corporate private credit include investment objectives, risk profiles, liquidity, costs and expenses, and structural protections. ABF investments may involve higher complexity, lower liquidity and different risk-mitigation features compared with corporate private credit. Past spread advantages do not guarantee future results, and actual returns may differ due to these and other factors. Comparative spread advantages may not persist over time, and spread potential does not ensure actual performance outcomes. Investment decisions should not be based solely on spread comparisons between different strategies.

Manager discipline makes the difference

In a market where many managers either crowd into rated deals or chase the higher-risk opportunistic trades in hopes of yield bumps, experienced managers may distinguish themselves from their peers by their ability to underwrite complexity, structure protections, and—most importantly—walk away from the wrong deals, leveraging their deep institutional knowledge.

Key capabilities we believe investors should look for in a manager include:

- **Extensive ABF experience.** Skill across cycles provides the foundation to underwrite diverse collateral types and identify attractive relative value opportunities.
- **Opportunistic credit expertise.** This adds another layer of skill and discipline, enabling managers not only to find attractive opportunities but also to avoid "losers" that could impair performance. Deep sector expertise across sectors such as consumer, equipment, digital infrastructure and transportation serves as the basis for understanding collateral and originator incentives.
- **Structuring skills.** Experience that includes rigorous analytics, creative financing approaches, flexibility and negotiation enables managers to provide bespoke financing solutions where banks are no longer active.
- **A disciplined approach to risk mitigation.** Experience using tools such as strict collateral standards, cash reserves and performance triggers that tighten controls if asset quality weakens, along with limits on how much can be borrowed (tied to the value of the underlying assets), can help manage risk. Sourcing scale comes from broad originator networks and relationships, while selectivity comes from the discipline to only commit to the best opportunities.
- **A reputation as a preferred partner.** Look for managers offering flexible capital solutions when traditional channels can't deliver.

Capturing the unrated opportunity

The essence of the unrated ABF opportunity is about borrowers paying a premium for capital that rating-sensitive lenders cannot provide. That premium represents an overpayment for comparable credit risk.

We believe that skilled managers with scale, structuring expertise and flexibility may be well-positioned to capture this opportunity. At the same time, discipline is critical to protect against downside scenarios. For investors, unrated core ABF can serve as a compelling component of a diversified credit portfolio, offering the potential for income-rich returns with thoughtfully managed risk in a part of the market where relatively few other managers currently compete.

IMPORTANT DISCLOSURES

All investing involves risk. The value of an investment will fluctuate over time, and an investor may gain or lose money or the entire investment. **Past performance is no guarantee of future results.**

As an asset class, private credit consists of a large variety of different debt instruments. While each has its own risk and return profile, private credit assets generally have increased risk of default, due to their typical opportunistic focus on companies with limited funding options, in comparison with their public equivalents. Because private credit usually involves lending to below-investment-grade or non-rated issuers, yield on private credit assets is increased in return for taking on increased risk.

RISKS TO CONSIDER

Investing involves risk. Principal loss is possible. There can be no assurance that the strategy will achieve its investment objective. The strategy will be subject to greater levels of credit risk, call risk and liquidity risk than funds that do not invest in such securities. Generally, lower-rated or unrated securities of equivalent credit quality offer a higher return potential than higher-rated securities but involve greater volatility of price and greater risk of loss of income and principal, including the possibility of a default or bankruptcy of the issuers of such securities. An investment in the securities of financially distressed issuers can involve substantial risks. These securities may present a substantial risk of default or may be in default at the time of investment. The strategy currently intends to use leverage to seek to achieve its investment objective. Leverage creates risks that may adversely affect the return for the holders of common stock. Exposure to investments in commercial real estate, transportation, healthcare loans, and royalty-backed credit and other asset-backed lending, including distressed loans, may also subject the strategy to greater volatility than investments in traditional securities.

Investments in distressed loans are subject to the risks associated with below-investment-grade securities. In addition, when a strategy focuses its investments in certain sectors of the economy, its performance may be driven largely by sector performance and could fluctuate more widely than if the fund were invested more evenly across sectors. The investment strategy may not produce the intended results.

The opinions expressed herein are the current opinions of Brookfield, including its subsidiaries and affiliates, and are subject to change without notice. Brookfield, including its subsidiaries and affiliates, assumes no responsibility to update such information or to notify clients of any changes. Any outlooks, forecasts or portfolio weightings presented herein are as of the date appearing on this material only and are also subject to change without notice. Past performance is not indicative of future performance, and the value of investments and the income derived from those investments can fluctuate.

The information contained herein is for educational and informational purposes only and does not constitute, and should not be construed as, an offer to sell, or a solicitation of an offer to buy, any securities or related financial instruments. This commentary discusses broad market, industry or sector trends, or other general economic or market conditions, and is being provided on a confidential basis. Further, this communication does not constitute and should not be construed as a recommendation or testimonial for any securities, related financial instruments, products or services.

FORWARD-LOOKING STATEMENTS

The information herein contains, includes or is based on forward-looking statements within the meaning of the federal securities laws, specifically Section 21E of the Securities Exchange Act of 1934, as amended, and Canadian securities laws. Forward-looking statements include all statements, other than statements of historical fact, that address future activities, events or developments, including, without limitation, business or investment strategy or measures to implement strategy, competitive strengths, goals, expansion and growth of our business, plans, prospects and references to our future success. You can identify these statements by the fact that they do not relate strictly to historical or current facts. Words such as “anticipate,” “estimate,” “expect,” “project,” “intend,” “plan,” “believe” and other similar words are intended to identify these forward-looking statements. Forward-looking statements can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. Many such factors will be important in determining our actual future results or outcomes. Consequently, no forward-looking statement can be guaranteed. Our actual results or outcomes may vary materially. Given these uncertainties, you should not place undue reliance on these forward-looking statements.

The case study discussions are provided for informational purposes only and are intended to illustrate the investment process. They do not constitute a recommendation or investment advice and should not be used as the basis for any investment decision. This is not a representation that an investment in the securities described was or will be profitable.

This communication is not intended to provide an overview of the terms applicable to any products sponsored by Brookfield Corporation and its affiliates (together, “Brookfield”).

The information and views herein are subject to change without notice. Some of the information provided herein has been prepared based on Brookfield’s internal research, and certain information is based on various assumptions made by Brookfield, any of which may prove to be incorrect. Brookfield may not have verified (and disclaims any obligation to verify) the accuracy or completeness of any information included herein, including information that has been provided by third parties, and you cannot rely on Brookfield as having verified any of the information.

The information provided herein reflects Brookfield’s perspectives and beliefs as of the date of this commentary.

Contact Us

brookfieldoaktree.com

+1 855-777-8001

Follow us on LinkedIn

Brookfield | OAKTREE
WEALTH SOLUTIONS

ID B810442

00499