

ABC of Regulatory Capital

April 2024



**Regulatory
Capital is a bank
risk sharing
strategy that
can provide
attractive and
stable income**

Market context

Global credit to the private sector from banks is four times larger than the global non-financial corporate bond market¹

Much of the bank loan universe has not traditionally been available to investors

How has the market landscape changed?

- **Changes to banking regulation have been significant** over the last 15 years
- Banks have had to improve their **capital buffers** to better withstand future financial turmoil
- This could affect both their day-to-day business and profitability
- Initially, banks had limited options – raise equity (potentially expensive and dilutive to shareholders) or reduce lending capacity (risk of losing market share)

What are Regulatory Capital Relief trades?

- To **improve capital positions**, banks can **share credit risk** of **core high quality loans** through a securitisation process, and **pay coupons to investors**
- A way for **banks to partner with investors like Manulife | CQS Investment Management (IM)** to meet their required capital ratios
- **Structure beneficial** to investors like Manulife | CQS IM
 - Issuing **banks remain invested**; banks **keep the most senior tranches**
 - **Assets remain on bank balance sheets** (aligns interests)
- 5–20% of collateral exposure must remain unhedged by the bank in compliance with regulation
- **Banks continue to service the loans**; servicing departments walled off from information about risk reduction
- This is **not an arbitrage or loss mitigation strategy**
- Expect ongoing growth and development in the space as regulatory capital requirements increase; with 25% income expected in 2024, \$6-7bn in the US alone²
- **Evolved as a niche option to a widely adopted tool for balance sheet optimisation**
 - Growing number of bank participants

Outperformance during periods of stress

- **Strong source of stability over various crises** Global Financial Crisis (GFC) 2008-2009, sovereign crisis 2012-2013, oil crisis 2016, Covid-19³
- **Low correlation to wider equity and credit markets**. E.g., during the GFC, Moody's corporate losses were more than 3%, whereas European Bank Loan charge offs peaked at around 1%.³
- During Covid-19, Regulatory Capital recovered its modest mark-to-market losses quickly and outperformed high yield and European banks more broadly
- **Consistently low credit losses**, even during these periods of crisis⁴
- Regulatory Capital loans have consistently exhibited low default rates; quality of collateral³

Source: Manulife | CQS IM analysis.

¹ International Capital Market Association (ICMA). ² Structured Credit Investor. ³ Moody's Annual Defaults Study as at December 2021. ⁴ Manulife | CQS IM observations of historical performance in RCR markets.



We have been
in this market
for 10 years and
invested upwards
of \$1.8 billion

Potential Investor benefits

- **Stable and attractive income**—quarterly underlying asset coupons (8–14% p.a.)
- **High quality collateral**¹—important to help mitigate default risk
- **Floating rate**—helps to mitigate interest rate risk, complementary to other floating rate assets in portfolios
- **Low volatility**—volatility reduced through stability and regularity of income (natural hedge against backdrop of uncertainty)
- **Low correlation**—regular and diversified cash flows; low correlation to public markets²
- **Diversification**—wide range of underlying sectors³

Structure

- Investor agrees on tranche structure and asset selection
- Senior tranche (10–100%) is retained by the bank
- Risk on junior tranche transferred to Special Purpose Vehicle (SPV)
- SPV issues notes to Investor
- Investor receives quarterly coupons of premium
- Collateral account compensates bank for final losses on selected portfolio
- Deal pricing driven by regulation not economics—attractive for investors

Why Manulife | CQS Investment Management?

- Specialist management is required for investing in this space
- **Active in the space since 2014**
- Invested c. \$1.8bn in the asset class with consistent performance
 - Better credit loss outcomes than the broader Regulatory Capital market
- **Highly disciplined process**—less than 0.05% cumulative credit losses since inception³
- **Rigorous selection process**—only investing in 30% of reviewed transactions
- **Strong sourcing relationships**—we are a key partner with many issuers
 - We can transact quickly and with certainty of execution
- **Scale and access to drive structures** (we can participate in size)
 - We can drive competitive terms, specific structural and collateral requirements
- **Experience to select deals** backed by high quality pools of loans—**primarily secured and Investment Grade**
- **Leverage wider Manulife | CQS IM credit platform** (research, loans, securitised credit)

Source: Manulife | CQS IM analysis as at 30 September 2023.

1 Underlying asset credit quality, where visible, is rated Investment Grade (BBB). **2** Manulife | CQS IM observations of historical performance in Regulatory Capital markets. **3** Diversification does not guarantee a profit nor protect against loss in any market. **4** Final Credit loss as percentage of tranche: 0.048% since inception of the Strategy in 2014. This document includes historic returns and past performance is not a reliable indicator of future results. The value of investments can go down as well as up.

Important Information

This document has been issued by:

Manulife | CQS Investment Management which is a trading name of CQS (UK) LLP, authorised and regulated by the UK Financial Conduct Authority, and/or CQS (US), LLC which is a registered investment adviser with the US Securities and Exchange Commission. The term “CQS” or “Manulife | CQS Investment Management” as used herein may include one or both of CQS (UK) LLP and CQS (US), LLC. The information is intended solely for sophisticated investors who are (a) professional investors as defined in Article 4 of the European Directive 2011/61/EU or (b) accredited investors (within the meaning given to such term in Regulation D under the U.S. Securities Act of 1933, as amended) and qualified purchasers (within the meaning given to such term in Section 2(a)(51) of the U.S. Investment Company Act 1940, as amended). This document is not intended for distribution to, or use by, the public or any person or entity in any jurisdiction where such use is prohibited by law or regulation.

Manulife | CQS Investment Management is a subsidiary of Manulife Investment Management (Europe) Limited.

This document is also issued by:

Australia: Manulife Investment Management (Hong Kong) Limited. **Canada:** Manulife Investment Management Distributors Inc. and in Ontario only, John Hancock Investment Management Distributors LLC. **European Economic Area:** Manulife Investment Management (Ireland) Ltd. which is authorised and regulated by the Central Bank of Ireland. **Hong Kong:** Manulife Investment Management (Hong Kong) Limited. **Japan:** Manulife Investment Management (Japan) Limited. **Singapore:** Manulife Investment Management (Singapore) Pte. Ltd. (Company Registration No. 200709952G) **South Korea:** Manulife Investment Management (Hong Kong) Limited. **Switzerland:** Manulife IM (Switzerland) LLC. **Taiwan:** Manulife Investment Management (Taiwan) Co. Ltd. **United Kingdom:** Manulife Investment Management (Europe) Ltd. which is authorised and regulated by the Financial Conduct Authority. **United States:** John Hancock Investment Management Distributors LLC Member FINRA, SIPC, Listed MSRB.

About Manulife Investment Management

Manulife Investment Management is the brand for the global wealth and asset management segment of Manulife Financial Corporation. Our mission is to make decisions easier and lives better by empowering investors for a better tomorrow. Serving more than 17 million individuals, institutions, and retirement plan members, we believe our global reach, complementary businesses, and the strength of our parent company position us to help investors capitalize on today's emerging global trends. We provide our clients access to public and private investment solutions across equities, fixed income, multi-asset, alternative, and sustainability-linked strategies, such as natural capital, to help them make more informed financial decisions and achieve their investment objectives. Not all offerings are available in all jurisdictions. For additional information, please visit manulifeim.com.

This material has not been reviewed by, is not registered with any securities or other regulatory authority, and may, where appropriate, be distributed by the following Manulife entities in their respective jurisdictions. Additional information about Manulife Investment Management may be found at manulifeim.com/institutional

This document is a marketing communication prepared for general information purposes only and has not been delivered for registration in any jurisdiction nor has its content been reviewed by any regulatory authority in any jurisdiction. The information contained herein does not constitute: (i) a binding legal agreement; (ii) legal, regulatory, tax, accounting or other advice; (iii) an offer, recommendation or solicitation to buy or sell shares or interests in any fund or investment vehicle managed or advised by CQS (a “CQS Fund”) or any other security, commodity, financial instrument, or derivative; or (iv) an offer to enter into any other transaction whatsoever (each a “Transaction”). Any decision to enter into a Transaction should be based on your own independent investigation of the Transaction and appraisal of the risks, benefits and appropriateness of such Transaction in light of your circumstances. Any decision to enter into any Transaction should be based on the terms described in the relevant offering memorandum, prospectus or similar offering document, subscription document, key investor information document (where applicable), and constitutional documents and/or any other relevant document as appropriate (together, the “Offering Documents”). Any Transaction will be subject to the terms set out in the Offering Documents and all applicable laws and regulations. The Offering Documents supersede this document and any information contained herein. The Offering Documents for CQS UCITS range of funds is available here (<https://www.cqscapital.com/ucits-funds>) in English (US persons will not be eligible to invest in CQS managed UCITS funds save to the extent set out in the relevant Offering Document). A copy of CQS' Complaints Policy, which sets out a summary of investors' rights, is available here (<https://www.cqscapital.com/site-services/regulatory-disclosures>) in English. CQS may terminate the arrangements for marketing or distribution of any CQS Fund at any time

Nothing contained herein shall give rise to a partnership, joint venture or any fiduciary or equitable duties. The information contained herein is provided on a non reliance basis, not warranted as to completeness or accuracy, and is subject to change without notice. Any information contained herein relating to any non affiliated third party is the sole responsibility of such third party and has not been independently verified by CQS. The accuracy of data from third party vendors is not guaranteed. If such information is not accurate, some of the conclusions reached or statements made may be adversely affected. CQS nor Manulife Investment Management are not liable for any decisions made or action taken by you or others based on the contents of this document and neither CQS, Manulife Investment Management nor any of their directors, officers, employees or representatives accept any liability whatsoever for any errors or omissions or any loss howsoever arising from the use of this document.

Information contained in this document should not be viewed as indicative of future results as past performance of any Transaction is not indicative of future results. Any investment in a CQS Fund or any of its affiliates involves a high degree of risk, including the risk of loss of the entire amount invested. The value of investments can go down as well as up. Don't invest unless you're prepared to lose all the money you invest. This is a high risk investment and you are unlikely to be protected if something goes wrong. Future performance is subject to taxation which depends on the personal situation of each investor and which may change in the future. Investments may lead to a financial loss if no guarantee on the capital is in place. An investment in any CQS Fund will involve a number of material risks which include, without limitation, risks associated with adverse market developments, currency and exchange rate risks, risk of counterparty or issuer default, and risk of illiquidity. Any assumptions, assessments, targets (including target returns and volatility targets), statements or other such views expressed herein (collectively “Statements”) regarding future events and circumstances or that are forward looking in nature constitute CQS' subjective views or beliefs and involve inherent risk and uncertainties beyond CQS' control. Any indices included in this document are for illustrative purposes only and are not representative of CQS Funds in terms of either composition or risk (including volatility and other risk related factors). Unless stated to the contrary CQS Funds are not managed to a specific index.

The information contained herein is confidential and may be legally privileged and is intended for the exclusive use of the intended recipient(s) to which the document has been provided. In accepting receipt of the information transmitted you agree that you and/or your affiliates, partners, directors, officers and employees, as applicable, will keep all information strictly confidential. Any review, retransmission, dissemination or other use of, or taking of any action in reliance upon, this information is prohibited. Any distribution or reproduction of this document is not authorized and prohibited without the express written consent of Manulife Investment Management, CQS, or any of its affiliates. Unless otherwise stated to the contrary herein, CQS owns all intellectual property rights in this document.

CQS is a founder of the Standards Board for Alternative Investments (“SBAI”) which was formed to act as custodian of the alternative investment managers’ industry best practice standards (the “Standards”). By applying the Standards, managers commit to adopt the “comply or explain” approach described in the Standards. CQS is a signatory of the UN Principles for Responsible Investment and a supporter and participant of certain other responsible investment related industry associations.

Distribution in the European Economic Area and the UK:

In relation to each member state of the EEA and the UK (each a “Relevant State”) which has implemented the Alternative Investment Fund Managers Directive (Directive (2011/61/EU) (the “AIFMD”)/as AIFMD forms part of local law of the Relevant State, this document may only be distributed and Shares may only be offered or placed in a Relevant State to the extent that: (1) the Fund is permitted to be marketed to professional investors in the Relevant State in accordance with AIFMD (as implemented into the local law/regulation / as it forms part of local law of the Relevant State); or (2) this document may otherwise be lawfully distributed and the Shares may otherwise be lawfully offered or placed in that Relevant State (including at the initiative of the investor).

The data and information presented is directed solely at persons who are Professional Investors in accordance with the Markets in Financial Instruments Directive (2004/39/EC) as transposed into the relevant jurisdiction. Further, the information and data presented does not constitute, and is not intended to constitute, “marketing” as defined in the Alternative Investment Fund Managers Directive.

Information required, to the extent applicable, for Distribution of Foreign Collective Investment Schemes to Qualified Investors in Switzerland:

The representative in Switzerland is FundRock Switzerland SA, Route de Cité-Ouest 2, 1196 Gland, Switzerland. The paying agent in Switzerland is Banque Cantonale de Genève, Case Postale 2251, 1211 Genève 2, Switzerland. The Prospectus, the Articles of Association and [annual and semi-annual report, if any] [annual financial statements] can be obtained free of charge from the representative in Switzerland. With regards to the Shares offered in Switzerland, the place of performance is the registered office of the representative and the place of jurisdiction is at the registered office of the representative or at the registered office or place of residence of the investor.

For investors domiciled in Australia:

Manulife Investment Management (Hong Kong) Limited (“Manulife IM (HK)”) is exempt from the requirement to hold an Australian financial services license under the Corporations Act in respect of the financial services being offered in this material. Manulife IM (HK) is regulated by the Securities and Futures Commission of Hong Kong (“SFC”) under Hong Kong laws, which differ from Australian laws. This presentation is directed at wholesale investors only.

For investors domiciled in Hong Kong:

This material is provided to Professional Investors, as defined in the Hong Kong Securities and Futures Ordinance and the Securities and Futures (Professional Investor) Rules, in Hong Kong only. It is not intended for and should not be distributed to, or relied upon, by members of the public or retail investors. This material has not been reviewed by the Securities and Futures Commission (SFC).

For investors domiciled in Japan:

Interests in the Fund described in this document (the “Interests”) are a security set forth in Article 2(2)(vi) of the Financial Instruments and Exchange Act (Act No. 25 of 1948, as amended, the “FIEA”). As no public offering of the Interests is being made to investors / residents in Japan in accordance with Article 2(3)(iii) of the FIEA, no securities registration statement pursuant to Article 4(1) of the FIEA has been made or will be made in respect to the offering of the Interests in Japan. *A limited partner who acquired the Interests may not sell, assign, encumber, pledge, hypothecate, mortgage, exchange, give away or otherwise dispose of or transfer all or any of the Interests (collectively, the “Transfer”) unless the general partner of the Fund has consented to the Transfer in writing, which consent may be withheld in the general partner’s sole discretion, and the Transfer otherwise complies with the requirements under the limited partnership agreement. [* Applicable to fund in form of limited partnership] Neither the Fund nor any of its affiliates is or will be registered as a “Financial Instruments Business Operator” pursuant to the FIEA. Neither the Financial Services Agency of Japan nor the Kanto Local Finance Bureau has passed upon the accuracy or adequacy of this document or otherwise approved or authorized the offering of the Interests to investors resident in Japan.

For investors domiciled in Singapore:

This material is intended for Accredited Investors and Institutional Investors as defined in the Securities and Futures Act.

For investors domiciled in South Korea:

This material is intended for Qualified Professional Investors under the Financial Investment Services and Capital Market Act (“FSCMA”). Manulife Investment Management does not make any representation with respect to the eligibility of any recipient of these materials to acquire any interest in any security under the laws of Korea, including, without limitation, the Foreign Exchange Transaction Act and Regulations thereunder. An interest may not be offered, sold or delivered directly or indirectly, or offered, sold or delivered to any person for re-offering or resale, directly or indirectly, in Korea or to any resident of Korea, except in compliance with the FSCMA and any other applicable laws and regulations. The term “resident of Korea” means any natural person having his place of domicile or residence in Korea, or any corporation or other entity organized under the laws of Korea or having its main office in Korea.

For investors domiciled in Taiwan:

Past performance of the fund manager does not guarantee a minimum return of the fund. In addition to exercising the duty of care of a good administrator, the fund manager shall not be responsible for profits or losses of the fund, nor guarantee any minimum return. Before subscription, investors shall fully read the prospectus of the fund carefully. The economic trend forecast referred to herein does not inevitably represent the performance of the fund or actual assets allocation of the fund. The fund is not protected by protections such as deposit insurance, insurance guarantee fund and other protection mechanism. Risks are inherent in investments of the fund, and the maximum loss may be total amount of the investment. Where any dispute occurs due to transaction of the fund, a complaint may be filed to Securities Investment Trust and Consulting Association of the R.O.C. or Financial Ombudsman Institution. Ref. No. 110-Jin-Kuan-Tou-Shin-Shin-Tz-001 “Manulife Investment Management (Taiwan) Co., Limited operates and manages independently.

CQS (UK) LLP
4th Floor, One Strand,
London WC2N 5HR, United Kingdom
T: +44 (0) 20 7201 6900

CQS (US), LLC
152 West 57th Street, 40th Floor, New York, NY
10019, US
T: +1 212 259 2900

CQSClientService@cqsm.com
cqs.com