

ANNALY CREDIT OPPORTUNITIES MANAGEMENT LLC

Form ADV, Part 2A

March 15, 2019

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**Item 1 - Cover Page**

**ANNALY CREDIT OPPORTUNITIES MANAGEMENT LLC**

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NEW YORK, NY 10036

212-696-0100

This brochure provides information about the qualifications and business practices of our firm, Annaly Credit Opportunities Management LLC (the “Advisor”). If you have any questions about the contents of this brochure, please contact us at 212-696-0100.

The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (“SEC” or the “Commission”) or by any state securities authority. Additional information about us is available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

We are an investment adviser registered with the SEC. Registration of an investment adviser does not imply any level of skill or training. The oral and written communications of an adviser provide you with information to aid in your determination to hire or retain an adviser.

When we use the term “we” “us” and “our” in this brochure, we are referring to the Advisor. In addition, any reference to “our employees” or “our officers” means officers and employees of the Advisor.

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**Item 2 - Material Changes**

This March 2019 annual update to the brochure contains the following material changes to the Adviser's initial brochure filed on December 6, 2018:

- Item 4 is amended to reflect that as of February 28, 2019 the Advisor has regulatory assets under management in excess of \$100 million.

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#### **Item 4 - Advisory Business**

##### **FIRM DESCRIPTION**

The Advisor was formed in Delaware in 2017, and is registered with the SEC. The Advisor is an indirect, wholly-owned subsidiary of Annaly Capital Management, Inc. (NYSE: NLY), a publicly-traded real estate investment trust ("Annaly").

##### **SERVICES PROVIDED**

The business of the Advisor primarily consists of (i) advising private investment funds and co-investment vehicles ("Managed Funds" and each, a "Managed Fund") focused on middle market credit opportunities and (ii) serving as the collateral manager for portfolios of certain collateralized loan obligations ("CLOs"). Such Managed Funds and CLOs are referred to in this brochure as "Clients," collectively, and each, a "Client."

The Advisor's investment advisory services to the Managed Funds are principally focused on commercial lending and investment, including originating, investing in and managing commercial debt-related investments, including senior loans, subordinated debt, mezzanine loans, and related investments. The Advisor's advice to the Managed Funds is generally limited to middle market lending investments, and is tailored to the specific investment objectives and restrictions of each Managed Fund.

The Advisor's services as collateral manager of CLOs are principally focused on managing the CLOs to generate sufficient returns to meet the CLOs' payment obligations and to optimize the returns for investors. As part of these services, the Advisor manages, maintains and reports on the assets, investments securities related to the CLOs throughout their lifecycles.

The services provided by the Advisor to the Managed Funds and the CLOs are subject to the organizational documents, Management Agreements (as defined herein), offering materials or other related documents ("Governing Documents") of each Client.

##### **MANAGEMENT AGREEMENTS**

The Advisor manages assets in the Managed Funds pursuant to investment management agreements ("IMAs") and the assets in the CLOs pursuant to collateral management

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agreements (together with IMAs, "Management Agreements"). Fees and investment guidelines for Clients are outlined in the Management Agreements and Governing Documents applicable to any specific Client. While the Advisor often follows its own defined strategies, the Clients are permitted to impose restrictions on investing in certain securities or types of securities, which must be detailed in writing.

The Advisor is not permitted to assign (within the meaning of the Investment Advisers Act of 1940, as amended (the "Advisers Act")) a Management Agreement without consent from the applicable Client. Subject to the applicable Governing Documents, a Client or the Advisor may be permitted to terminate the corresponding Management Agreement at-will upon advance written notice. Fees will be charged through the date service is terminated.

The Advisor's Form ADV became effective on December 6, 2018, at which time the Advisor expected that it would manage in excess of \$100 million in assets for Clients within 120 days of such date.

As of February 28, 2019, the Advisor managed \$857,333,261 in assets for Clients on a discretionary basis, and \$0 in assets for Clients on a non-discretionary basis.

## **Item 5 - Fees and Compensation**

### **FEE SCHEDULE**

All fees are subject to negotiation.

The types and amounts of, and the related limitations and restrictions on, fees charged by the Advisor are set forth in each Client's respective Management Agreement; and the fees and expenses related to Clients are fully specified in the respective Governing Documents for each Client.

The Advisor typically bills fees on a monthly or quarterly basis in arrears. The Clients may also elect to be billed directly for fees or to authorize the Advisor to debit fees directly from the Clients' accounts. Fees charged to Managed Funds may be prorated for each capital contribution and withdrawal made during the applicable calendar month; fees charged to CLOs may be prorated for each equity issuance and repurchase made during the applicable calendar month. Accounts initiated or terminated during a calendar quarter are charged a

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prorated fee. Upon termination of any account, any prepaid, unearned fees will be promptly refunded, and any earned, unpaid fees will be due and payable.

The Advisor's fees are exclusive of brokerage commissions, transaction fees and costs (including broken deal costs), and other management related costs and expenses which shall be incurred by Clients. Client expenses may include (i) administration, legal, auditing, consulting, banking, custody, regulatory, compliance, reporting (including securities filings related to the Client) and accounting expenses; (ii) tax expenses and expenses related to a Client's financial statements, tax returns, tax estimates and filings (including, without limitation, expenses related to the foregoing incurred to allow a Client or its affiliate(s) to comply with non-U.S. and U.S. federal, local and state laws and regulations (including all expenses incurred with respect to filing the Form PF and Form D as well as to comply with the requirements of the Alternative Investment Fund Managers Directive, as implemented in any relevant jurisdiction (and including any secondary legislation, rules and/or associated guidance)); (iii) expenses associated with the identification, investigation, acquisition, holding, structuring, organizing, financing, refinancing, restructuring, winding up, liquidation, dissolution and disposition of the Client's assets; (iv) all costs incurred in connection with the organization, management, operation, and dissolution, liquidation and final winding up of any blocker subsidiaries; (v) expenses incurred in connection with valuing a Client's assets, including, without limitation, third party valuation services; (vi) expenses attributable to any proposed investment that is ultimately not made by a Client (including expenses that may have been allocable to third-party co-investors had such transactions been consummated); (vii) all costs of leverage incurred by a Client and other similar fees and expenses, all interest on borrowed funds (if any), and other expenses relating to the financing or refinancing of any indebtedness of, guarantees or other obligations of the Client; (viii) expenses incurred in connection with the obtaining and maintaining of insurance policies by or on behalf of a Client, its general partner and the Advisor (including directors and officers, errors and omissions liability and other insurance); (x) extraordinary expenses of a Client (such as fees or expenses incurred in litigation or in respect of indemnification obligations); (xi) expenses of the Advisor Board (as defined herein) of a Client; (xi) any taxes, fees and other governmental charges levied against a Client; (xii) any loan servicing fees (*e.g.*, structuring and/or underwriting and arrangement fees from loan syndication activities, administrative loan agency fees and investment advisory fees) whether such fees are paid to a third party or to Annaly, or an entity affiliated with Annaly; and (xiii) organizational expenses of a Client. Such costs and expenses are exclusive of and in addition to the Advisor's fees, and the Advisor does not

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receive any portion of these costs and expenses. Clients are permitted to engage in any recommended transaction with the broker-dealer of their choosing, including broker-dealers or agents that are not affiliated with the Advisor.

In particular with respect to the Managed Funds, Annaly will generate fees in connection with the origination or acquisition of loans or other assets or the holding of a loan or asset, including commitment fees, unused facility fees, prepayment premiums, amendment fees, and other similar fees, payments or compensation. Annaly will, subject to the applicable Governing Documents, allocate to the Managed Funds the portion of these fees attributable to the loans held by the Managed Fund. In addition, Annaly may generate fees in respect of loans when it is the lead arranger of such loans, including structuring and/or underwriting and arrangement fees from loan syndication activities, administrative loan agency fees, and investment advisory fees. Such fees will be retained by Annaly and will not offset the fees paid by, or otherwise shared with, the Managed Funds.

The Advisor is compensated for providing services to CLOs in the form of a market rate collateral management fee based on the total value of the CLO's assets. Total fees are based on the asset value of the CLO and are payable monthly in arrears. These fees are qualified by the CLO's respective transaction documents, and may be waived by the Advisor based on the terms and conditions therein. The Advisor expects to waive its entitlement to its fees for CLOs for so long as the Advisor or an affiliate thereof provides collateral management and investment advice to both the CLO and to Annaly. If the Advisor's fees are not waived, such fees are allocated and paid in accordance with the designated "Priority of Payments" or waterfall payments.

In addition, the CLO pays, or reimburses the Advisor (or its relevant affiliate), for its proportional cost of certain out of pocket expenses including, for example, expenses and costs incurred in effecting or directing purchases and sales of loans and eligible investments, negotiating with borrowers under the loans as to proposed modifications or waivers, taking action or advising any trustees with respect to the CLO's exercise of any rights or remedies in connection with the loans and consulting with and providing certain nationally recognized statistical rating organizations with any information in connection with maintenance of the ratings of any of the securities issued by the CLO. Expense allocation is undertaken per the terms of the CLO's respective transactional documents.

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### **Item 6 - Performance-Based Fees and Side-By-Side Management**

Arrangements for performance-based fees (fees based on a share of capital gains on or capital appreciation of the assets of a Client), if any, are negotiated with each Client on an individualized basis and will in all cases be in compliance with Section 205(a)(1) of the Advisers Act in accordance with the available exemptions thereunder, including the exemption set forth in Rule 205-3. Currently, we have arrangements for performance-based compensation for Managed Funds but not for any CLOs.

Generally, the payment of performance-based compensation for a Managed Fund will be subject to a specified “hurdle” rate. When measuring a Managed Fund’s assets for the calculation of performance-based fees, the Advisor may include realized and unrealized capital gains and losses. Performance based fee arrangements may create an incentive for us to recommend investments that may be riskier or more speculative than those that would be recommended under a different fee arrangement. Such fee arrangements also create an incentive to favor higher fee paying accounts over other accounts in the allocation of investment opportunities.

In addition, for investors in certain Managed Funds, the Advisor may grant certain preferential terms to such investors, including a waiver or reduction of management fees or carried interest or other performance-based fees, a blended management fee, or carried interest rates that are lower than those applicable to the Managed Funds in which such investors invest.

The Advisor seeks to treat all Clients in a fair and equitable manner over time and will act in a matter that it believes to be in the best interests of the Clients. Accordingly, the Advisor has various procedures designed and implemented to ensure that the Clients are treated fairly and in accordance with our fiduciary obligations.

### **Item 7 - Types of Clients**

The Advisor provides investment advice to the Managed Funds and other pooled investment vehicles and collateral management services to CLOs and other structured vehicles. Investors in Clients are comprised of government and private pension funds, sovereign wealth funds, endowments, foundations, family offices, investment companies, insurance companies, private corporations and high net worth individuals.



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Generally, investors participating in the Managed Funds and CLOs are required to meet certain suitability and net worth qualifications, such as being (1) an “accredited investor” within the meaning of Rule 501 of Regulation D under the Securities Act of 1933, as amended (the “Securities Act”) and “qualified purchaser” as defined in Section 2(a)(51) of the Investment Company Act of 1940, as amended (the “Investment Company Act”), (2) a “knowledgeable employee” within the meaning of Rule 3c-5 of the Investment Company Act, or (3) a non-U.S. person, depending on the eligibility requirements of the specific Client.

The minimum investment in each Managed Fund or CLO is stated in the applicable Governing Documents. The Advisor may waive this minimum in its discretion.

**Item 8 - Methods of Analysis, Investment Strategies and Risk of Loss****INVESTMENT STRATEGIES; METHODS OF ANALYSIS***Managed Funds*

The Advisor’s objective for the Managed Funds is to generate high current income with a focus on preservation of capital by investing in senior secured loans to middle market companies located in the United States. To achieve this, the Advisor will primarily invest in customized debt financing to middle market companies. Specifically, the Managed Funds will invest across first lien loans (inclusive of unitranche loans), and second lien loans within the middle market.

The Advisor intends to leverage long-established partnerships with U.S. based private equity sponsors and intermediaries to source attractive financing opportunities that comply with the Advisor’s disciplined underwriting process. In addition, Annaly’s direct origination platform provides the Advisor with access to each borrower’s management team’s experience, enhances the Advisor’s due diligence of each borrower, and should allow significant input into each borrower’s capital structure, including potentially direct negotiation of transaction pricing and terms. The Advisor believes the benefits of working with private equity sponsors include corporate governance, incremental due diligence, extensive monitoring, and operational expertise. The cornerstone of the Advisor’s strategy is the robust corporate governance advantages that flow to debt providers with private

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equity ownership at a speed enabling such ownership structures to react quickly and comprehensively in adverse scenarios.

The Advisor will manage the Managed Funds' portfolios by employing the following principles:

- Large hold positions in each transaction
- Disciplined underwriting policy
- Maximize risk-adjusted returns by optimizing place in the capital structure
- Fundamental credit analysis
- Relationship-oriented investment
- Buy and hold strategy
- Rigorous portfolio management
- Quantitative risk ratings assessment throughout investment cycle

In addition, a unique attribute of the Advisor's strategy is Annaly's co-investment in all assets of certain of the Managed Funds. Investments which the Advisor has determined meet the investment objectives and criteria of such Managed Funds will be made by such Managed Funds and Annaly in accordance with the joint investment policy ("Allocation Policy") between the Advisor and Annaly Management Company LLC ("AMCO"), the external manager to Annaly.

#### *CLOs*

The Advisor utilizes a sizable asset portfolio, a strong platform and an experienced team in order to provide its Clients with sound collateral and loan obligation management. Loans are allocated to each CLO in accordance with the Governing Documents of such CLO.

The Annaly brand has an established presence in the structured finance market and the Advisor's securitization team has extensive experience in the negotiation of the purchase and sale of securities and assets. The Advisor's securitization team has worked to develop its own suite of proprietary models and analytical tools which facilitate the efficient monitoring of its Clients' investments. The Advisor's legal team further analyzes all aspects of the portfolios and investment choices such that a balanced, well-rounded decision making process is utilized on behalf of the Clients.

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**RISK OF LOSS***Managed Funds*

Identifying investment opportunities and managing those investments can be difficult. There can be no assurance that any Client account managed by the Advisor will be able to make and realize any particular investment or generate returns. Investing involves a risk of loss that investors in one or more Clients should be prepared to bear. Investors should carefully consider, among other factors, the following risks involved with the Advisor's investment strategies and methods of analysis. Please refer to the Governing Documents for the applicable Client for more complete and detailed information regarding its investment strategies and methods of analysis, and the corresponding risks associated with those investment strategies and analysis.

- *General Business Risks.* The Managed Fund's investment portfolio will consist primarily of senior secured debt obligations and other securities that have significant risks as a result of business, financial, market or legal uncertainties. Such investments involve business and financial risks that can result in substantial losses and investors may lose their entire investment in a Managed Fund.
- *Market Conditions.* There can be no assurance that the market will be liquid. For example, from mid-2007 through 2009, liquidity in the market for leveraged bank loans constricted significantly, resulting in a dramatic decline in the market price for many of these assets. There can be no assurance that another such liquidity crisis will not occur. Illiquidity in the market may adversely affect the Fund's ability to dispose of assets on favorable terms, or at all.

The credit markets experienced an unprecedented degree of dislocation during the credit crisis from 2007 through 2009. The Managed Funds' strategies carries significant risk of substantial loss if future market dislocations occur or if market conditions are adversely affected by other events, such as the failure of significant financial institutions or private equity or hedge funds, dislocations in other investment markets, or extrinsic events.

- *Middle Market Loan Risks.* A non-investment grade or unrated middle market loan is generally considered speculative in nature and may experience defaults for a variety

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of reasons. A middle-market loan may become subject to either substantial workout negotiations or a restructuring, which may entail, among other things, a substantial reduction in the interest rate, a substantial write-down of principal, deferral of payment, payments-in-kind of interest, and a substantial change in the terms, conditions and covenants with respect to such loan. In addition, such negotiations or restructuring may be quite extensive, protracted and costly over time, and therefore may result in substantial uncertainty with respect to the ultimate recovery on such loan. The liquidity of a loan in default will be limited, and to the extent that a defaulted loan is sold, it is highly unlikely that the proceeds from such sale will be equal to the amount of unpaid principal and interest thereon. There can be no assurance as to the levels of defaults and/or recoveries that may be experienced on middle market loans and an increase in default levels or a decrease in recoveries could adversely affect the returns of the Managed Funds.

Non-investment grade or unrated loans to middle market businesses may carry more inherent risks than non-investment grade loans to larger, publicly traded entities. For example, middle market loan obligors generally are not publicly traded entities and have significantly less publicly available information about them compared to publicly traded entities. These middle market companies generally have more limited access to capital and higher financing costs, may be in a weaker financial position, may need more capital to expand or compete, and may be unable to obtain financing from their respective private equity sponsors, public capital markets or from traditional sources, such as commercial banks. Middle market loan obligors may be highly leveraged which may cause them to be more likely to be unable to meet their obligations in an economic downturn, a period of rising interest rates, a contraction of the leveraged loan market or a period of fluctuating exchange rates (in respect of those obligors located outside of the U.S.). Middle market businesses typically have narrower product lines and smaller market shares than large businesses. Therefore, they tend to be more vulnerable to competitors' actions and market conditions, as well as general economic downturns. Middle market businesses may have more difficulties implementing enterprise resource plans and may face greater challenges integrating acquisitions than large businesses. These businesses may also experience substantial variations in operating results. Typically, the success of a middle market company also depends on the management talents and efforts of one or two persons or a small group of persons. The death, disability or resignation of one or more of these persons could

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have a material adverse impact on such middle market company and its ability to repay its obligations. A deterioration in a middle market obligor's financial condition and prospects may cause it to fail to satisfy net income, cash flow and other coverage tests typically imposed by lenders and may be accompanied by deterioration in the collateral securing a Managed Fund's investments. Such deterioration may impair the ability of such obligor to obtain refinancing, force it to seek to have its middle market loan restructured or result in a defaulted middle market loan.

- *Leveraged Investments.* The portfolio borrowers in which a Managed Fund will invest may be highly leveraged, thereby increasing the credit risk inherent in each investment. Leverage often imposes restrictive financial and operating covenants on a company, in addition to the burden of debt service, and may impair its ability to finance future operations and capital needs. In addition, this leverage could accelerate and magnify declines in the value of a Managed Fund's investments in the leveraged portfolio borrowers in a down market. In the event any portfolio borrower cannot generate adequate cash flow to meet debt service, the Fund may suffer a partial or total loss of capital invested in the portfolio borrower, which could adversely affect the returns of a Managed Fund. Furthermore, the companies in which a Managed Fund will invest generally will not be rated by a credit rating agency.
- *Non-Controlling Investments.* The Managed Funds will principally hold debt obligations and other non-controlling interests in portfolio borrowers and, therefore, each Managed Fund will have a limited ability to protect its position through the operation of such portfolio borrowers. Although Advisor will monitor the performance of each investment, it will be the responsibility of a portfolio borrower's management to operate the portfolio borrower on a day-to-day basis. There can be no assurance that the management of a Managed Fund's portfolio borrowers will operate a company successfully.
- *Credit and Interest Rate Risks of Debt Securities.* Debt portfolios are subject to credit and interest rate risk. "Credit risk" refers to the likelihood that an issuer will default in the payment of principal and/or interest on an instrument. Financial strength and solvency of an issuer are the primary factors influencing credit risk. In addition, subordination, lack or inadequacy of collateral or credit enhancement for a debt

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instrument may affect its credit risk. Credit risk may change over the life of an instrument and securities which are rated by rating agencies are often reviewed and may be subject to downgrade. "Interest rate risk" refers to the risk associated with market changes in interest rates. Interest rate changes may affect the value of a debt instrument indirectly (especially in the case of fixed rate securities) and directly (especially in the case of instruments whose rates are adjustable). In general, rising interest rates will negatively impact the price of a fixed rate debt instrument and falling interest rates will have a positive effect on price. Adjustable rate instruments also react to interest rate changes in a similar manner although generally to a lesser degree (depending, however, on the characteristics of the reset terms, including the index chosen, frequency of reset and reset caps or floors, among other factors). Interest rate sensitivity is generally more pronounced and less predictable in instruments with uncertain payment or prepayment schedules.

- *Lender Liability Considerations and Equitable Subordination.* In recent years, a number of judicial decisions in the United States have upheld the right of borrowers to sue lending institutions on the basis of various evolving legal theories ("lender liability"). Generally, lender liability is founded upon the premise that an institutional lender has violated a duty (whether implied or contractual) of good faith and fair dealing owed to the borrower or has assumed a degree of control over the borrower resulting in creation of a fiduciary duty owed to the borrower or its other creditors or shareholders. Because of the nature of certain of a Managed Fund's investments, the Managed Fund could be subject to allegations of lender liability.
- *Projections.* Projected operating results of a company in which a Managed Fund invests normally will be based primarily on financial projections prepared by each company's management. In all cases, projections are only estimates of future results that are based upon assumptions made at the time the projections are developed. There can be no assurance that the results set forth in the projections will be attained, and actual results may be significantly different from the projections. Also, general economic factors, which are not predictable, can have a material effect on the reliability of projections.
- *Risks Associated with Bankruptcy Cases.* There are a number of significant risks inherent in the bankruptcy process. Many of the events within a bankruptcy case

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are adversarial and often beyond the control of the creditors. While creditors generally are afforded an opportunity to object to significant actions, there can be no assurance that a bankruptcy court would not approve actions which may be contrary to the interests of a Managed Fund. Furthermore, there are instances where creditors and equity holders lose their ranking and priority such as when they take over management and functional operating control of a debtor. In those cases where a Managed Fund, by virtue of such action, or by virtue of its investment in an issuer in which one or more other Annaly Vehicles has a controlling equity interest is found to exercise "domination and control" of a debtor, a Managed Fund may lose its priority if the debtor can demonstrate that its business was adversely impacted or other creditors and equity holders were harmed by the Managed Fund.

A bankruptcy filing may have an adverse effect on a company, as the company may lose its market position and key employees and otherwise become incapable of restoring itself as a viable entity. If for this or any other reason the proceeding is converted to a liquidation, the liquidation value of the company may not equal the liquidation value that was believed to exist at the time of the investment. In addition, the duration of a bankruptcy proceeding is difficult to predict and the administrative costs in connection with a bankruptcy proceeding are frequently high. A creditor's return on investment can be adversely affected by delays while the plan of reorganization is being negotiated, approved by the creditors and confirmed by the bankruptcy court and until it ultimately becomes effective. Administrative costs will be paid out of the debtor's estate prior to any return to creditors (other than out of assets or proceeds thereof, which are subject to valid and enforceable liens and other security interests) and equity holders. In addition, certain claims that have priority by law over the claims of certain creditors (*e.g.*, claims for taxes) may be quite high. U.S. bankruptcy law permits the classification of "substantially similar" claims in determining the classification of claims in a reorganization for the purpose of voting on a plan of reorganization. Because the standard for classification is vague, there exists a significant risk that the Managed Fund's influence with respect to a class of securities can be lost by the inflation of the number and the amount of claims in the class.

Troubled company and other asset-based investments require active monitoring and may, at times, require participation in business strategy, bankruptcy or reorganization proceedings by the General Partner or the Investment Manager. To

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the extent that the Advisor becomes involved in such proceedings, a Managed Fund may have a more active participation in the affairs of the issuer than that assumed generally by an investor. The Advisor or an affiliate, on behalf of a Managed Fund, may elect to serve on creditors' committees or other groups to facilitate preservation or enhancement of the Managed Fund's positions as a creditor. A member of any such committee or groups may owe certain obligations generally to all parties similarly situated that the committee represents. If the Advisor nor an affiliate concludes that its obligation owed to the other parties as a committee or group member conflict with its duties owed to a Managed Fund, it will resign from that committee or group, and the Managed Fund may not realize the benefits, if any, of participation on the committee or group. In addition, if a Managed Fund is represented on a committee or group, it may be restricted or prohibited under applicable law from disposing of its investments in such company while it continues to be represented on such committee or group.

- *Fraudulent Conveyance and Preference Considerations.* There is a risk that a Managed Fund's purchase of its investments may be subject to various federal and state laws enacted for the protection of creditors, by virtue of the Managed Fund's role as a creditor with respect to the borrowers under such investments. Furthermore, there is a risk that payments on an investment may be determined to be avoidable, either as fraudulent conveyances or preferences, in which case such payments can be recaptured either by a Managed Fund, as the initial recipient of such payments, or from subsequent transferees of such payments, including investors.
- *Event-Driven Special Situations.* The Managed Funds' strategies may, from time to time, involve investments in "event-driven" special situations such as recapitalizations, spinoffs, corporate and financial restructurings, litigation or other catalyst-oriented situations. The Advisor believes these types of investments often have less downside risk relative to their current valuations. The Managed Funds could, however, be incorrect in its assessment of the downside risk associated with an investment, thus resulting in a significant loss. Such investments are often difficult to analyze. The Managed Funds' risk management strategies cannot fully insulate the Managed Fund from the risks inherent in their planned activities. Moreover, in certain situations, the Managed Fund may be unable to, or may choose



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not to, implement risk management strategies because of the costs involved or other relevant circumstances.

- *Borrower Fraud.* Of paramount concern in originating loans is the possibility of material misrepresentation or omission on the part of borrowers or guarantors. Such inaccuracy or incompleteness may adversely affect the valuation of the collateral underlying the loans or may adversely affect the ability of the Managed Fund to perfect or effectuate a lien on the collateral securing the loan. The Advisor will rely upon the accuracy and completeness of representations made by borrowers to the extent reasonable, but cannot guarantee such accuracy or completeness.

#### *CLOs*

While the Advisor has access to skilled underwriting, securitization and legal teams covering the full breadth of the investment process, there are standard risks inherent to the management of vehicles such as CLOs. Any collateral debt and loan obligation securities are subject to credit, liquidity and interest rate risks, and some will be subject to timing risks. Please refer to the Governing Documents for the applicable Client for more complete and detailed information regarding its investment strategies and methods of analysis, and the corresponding risks associated with those investment strategies and analysis.

- *Terms of Governing Indentures.* The ability of CLOs to make distributions or pay dividends will depend on the extent to which payments are made on their portfolio assets and, among other things, on the terms and conditions of the indentures governing the relevant CLO securities. For example, tests based on overcollateralization, interest coverage or other financial ratios may restrict the ability of certain classes of CLO securities to receive cash flow from these investments. Also, such vehicles may take actions that prioritize distributions to certain classes of securities and delay distributions to other classes of securities in order to preserve ratings. Holders of the more senior debt tranches of such a vehicle will often receive current payments of principal and interest at times when the factors enumerated above preclude payments and distributions to some or all of the more junior debt and equity tranches of such CLO. In addition, a decline in the credit quality of an asset due to poor operating results of the relevant borrower or issuer, declines in the value of the collateral supporting such asset and increases in

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defaults, among other things, may force such vehicles to sell certain assets at a loss, reducing their earnings and, in turn, cash potentially available for payment or distribution.

- *Subordinated Interests.* Certain Annaly affiliates may invest in a significant portion of the subordinated debt or preferred equity tranche, commonly known as the “equity,” of a CLO, whose investment portfolio is managed by the Advisor or its affiliates. Annaly affiliates may also invest in various tranches of more senior debt securities issued by CLOs managed by the Advisor or its affiliates. Investing in CLOs or financing vehicles sponsored by the Advisor or its affiliates would result in certain conflicts of interest.

The CLO securities held by certain Annaly affiliates may be subordinate to other CLO securities issued by such CLO and to other creditors of such CLO. To the extent that any losses are incurred by the CLO in respect of any collateral, such losses will be borne first by the holders of the CLO equity, and next by the most junior tranches of CLO debt. The subordination of the more junior tranches of CLO securities makes such CLO securities leveraged investments in the assets of the relevant CLO. Use of leverage is a speculative investment technique and involves certain risks to investors. Although the use of leverage generally magnifies CLO equity’s opportunities for gain, it also magnifies risk of loss as well as financing expenses. Returns on any holding of a CLO security will depend on the amount of such leverage and on changes in interest rates, delinquencies and losses on the underlying assets. As a result, Annaly affiliates may receive payments in respect of any investment in a CLO security that are, in the aggregate, less than the original amount of its investment in such CLO security.

- *Financial Condition of Obligors.* The market value of the collateral debt and loan obligations generally will fluctuate with, among other things, the financial condition of the obligors or issuers of the collateral debt and loans, the credit quality of the underlying asset or pool of assets securing any collateral debt or loan obligation, the remaining term to maturity, general economic conditions, the condition of certain financial markets, political events, developments or trends in any particular industry and changes in prevailing interest rates. The Advisor does not have or hold any liability or obligation to the investors as to the amount or value of, or a decrease in the value of, the collateral debt or loan obligations from time to time. In the event

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that a debt or loan obligation becomes troubled, the Advisor may either sell or retain the affected asset. However, there can be no assurance as to the timing of the sale of the affected asset, or if there will be any market for such asset or as to the rates of recovery on such affected asset.

- *Financial Condition of Underlying Properties.* The CLOs we manage are similar in certain respects to commercial mortgage-backed securities ("CMBS") and subject investors to many of the same risks. Collateral underlying CMBS generally consists of commercial mortgage loans secured by income producing property, such as regional malls, other retail space, office buildings, industrial or warehouse properties, hotels, rental apartments, nursing homes, senior living centers and self-storage properties.

Performance of a commercial mortgage loan depends primarily on the net income generated by the underlying mortgaged property. The market value of a commercial property similarly depends on its income-generating ability. As a result, income generation will affect both the likelihood of default and the severity of losses with respect to a commercial mortgage loan. Any decrease in income or value of the commercial real estate underlying a CLO could result in cash flow delays and losses on the CLO.

- *Participation Interests.* We may invest our CLOs in loans acquired through participations. In purchasing participations, there will usually be a contractual relationship only with the selling institution, and not the borrower. There generally will not be any right to directly enforce compliance by the borrower with the terms of the loan agreement, nor any rights of set-off against the borrower, nor will it have the right to object to certain changes to the loan agreement agreed to by the selling institution. Our CLOs may not directly benefit from the collateral supporting the related secured loan and may not be subject to any rights of setoff the borrower has against the selling institution. In addition, in the event of the insolvency of the selling institution, under the laws of the United States and the states thereof, our CLOs may be treated as general creditors of such selling institution, and may not have any exclusive or senior claim with respect to the selling institution's interest in, or the collateral with respect to, the secured loan. Consequently, CLOs may be subject to the credit risk of the selling institution as well as of the borrower.

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**Item 9 - Disciplinary Information**

Registered investment advisers are required to disclose all material facts regarding any legal or disciplinary events that would be material to your evaluation of us or the integrity of our management. At least annually, our employees are required to certify if they have any matters that require disclosure. We have no matters that require disclosure.

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## **Item 10 - Other Financial Industry Activities and Affiliations**

### **RELATED PERSONS**

#### *Managed Funds*

We have relationships with, and may utilize, suggest or recommend our own services or those of entities which are related to us and are affiliates of Annaly in connection with our activities. The particular services involved will depend on the types of services offered by affiliates of Annaly. Certain of our trading, advisory and other activity for the Client may be delegated to Annaly affiliates at our discretion. These arrangements will generally involve sharing or joint compensation related to each entity's responsibilities for the Client, subject to the requirements of applicable law.

#### Business Relationship with Annaly Management Company LLC

AMCO is a registered investment advisor and serves as the external investment manager for Annaly. The Advisor is an indirect wholly-owned subsidiary of Annaly. In accordance with the Allocation Policy, the Advisor will manage investments for the Managed Funds alongside AMCO, which shall manage investments for Annaly. In the future, the Advisor may also manage investments for other accounts, in which Annaly may or may not have a beneficial interest.

The Advisor's personnel may also provide other services to Annaly, and AMCO's personnel, including finance, accounting, legal and other employees, may provide services to the Advisor in relation to the Managed Funds and their respective investments.

These arrangements may create conflicts of interest, as discussed below and in the Governing Documents for the Managed Funds, but this conflict of interest may also arise in ways not contemplated in this brochure or the applicable Governing Documents. In general, however, the Advisor and AMCO address conflicts of interest arising from this business relationship through the Allocation Policy, the Governing Documents of the Managing Funds and by adhering to the requirements of the Advisers Act and other applicable law.

- *Conflicts Related to Multiple Legal Duties.* The Advisor has a fiduciary duty under the Advisers Act to act in the best interest of the Managed Funds. AMCO has a fiduciary

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duty under the Advisers Act to act in the best interests of Annaly. The directors, officers and employees of Annaly, the parent of the Advisor, have a duty under Maryland law to act in the best interest of Annaly's shareholders. There may be instances where these duties are in conflict and present a conflict of interest to the Advisor's duties to the Managed Funds.

- *Conflicts Related to Allocation of Investment Opportunities.* There may be a conflict of interest in the allocation of investment opportunities among the Managed Funds, Annaly, and the other investment vehicles permitted by the Governing Documents of the Managed Funds ("Annaly Vehicles"). The many investment activities by the Advisor, AMCO, and their affiliates may present conflicts of interest in determining how much, if any, of certain investment opportunities to offer to the Managed Funds. The Advisor intends to address such conflicts through the Allocation Policy.

Further, because Annaly generally will co-invest in the same investment opportunities that the Advisor identifies for the Managed Funds in accordance with the Allocation Policy, we must ensure that the investment opportunities are appropriate for both Annaly and the Managed Funds, which could create a conflict of interest. The type and characteristics of investments that are desirable to Annaly may change over time and are outside of the control of the Advisor. If a type or characteristic of a particular investment is not desirable to Annaly at any given time, the Managed Funds may not have the opportunity to invest in such investments even though they otherwise meets Annaly's investment criteria and objectives.

- *Conflicts Relating to Other Annaly Vehicles.* The Advisor, AMCO, or their affiliates manage, or may manage, funds other than the Managed Funds, Annaly, the CLOs, or the Annaly Vehicles, which invest in assets eligible for purchase by the Managed Funds, and the Managed Funds may or may not participate in such investments. There may be a conflict of interest in the allocation of investment opportunities among the Managed Funds, Annaly, and the Annaly Vehicles, which are generally expected to be allocated pursuant to the Allocation Policy, as amended from time to time to account for new Annaly Vehicles. In certain circumstances, the Managed Funds may invest in portfolio borrowers in which Annaly and/or an Annaly Vehicle has invested in another part of the portfolio borrower's capital structure, which may result in potential conflicts of interest, particularly in the case of financial distress of the portfolio borrower.

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The Managed Funds may invest, directly or indirectly, in investments in which Annaly and/or an Annaly Vehicle (i) have an investment, (ii) are contemplating an investment, or (iii) have decided not to invest. In addition, Annaly and/or the Annaly Vehicles may invest, directly or indirectly, in investments in which the Funds (i) have an investment, (ii) are contemplating an investment, or (iii) have decided not to invest. Without limiting the foregoing, investors should be aware that the Managed Funds may have conflicting interests in negotiating the terms of an investment and investing in a company if Annaly and/or one or more other Annaly Vehicles have or propose to make an investment in the same issuer, particularly where Annaly and/or such Annaly Vehicle(s) have a controlling interest in the issuer. Such negotiated terms may include, but are not limited to, the collateral, if any, pledged to secure the issuer's obligations, the interest rates to be paid on the issuer's debt securities, the characterization of the issuer's securities (whether as preferred stock or subordinated debt), the amount and nature of equity securities (if any) attached to debt, the fees and expenses to be charged to or by the Managed Funds, and the nature of the covenants running in favor of the Managed Funds.

The Advisor will typically notify a Managed Fund's advisor board (or equivalent committee of investor representatives) ("Advisor Board"), prior to causing a Managed Fund to purchase an investment from Annaly and/or an Annaly Vehicle, receive an investment by transfer from Annaly and/or an Annaly Vehicle, or sell or transfer to Annaly and/or an Annaly Vehicle an investment made by the Managed Funds; provided, however, that a Managed Funds shall not be required to notify its Advisor Board prior to purchasing an investment or receiving an investment by transfer from Annaly and/or an Annaly Vehicle or selling or transferring an investment to Annaly and/or an Annaly Vehicle if (i) such transaction is effected pursuant to an order of a court of competent jurisdiction, (ii) such transaction occurs shortly after the investment was originally made by the Funds, Annaly and/or the Annaly Vehicle, as the case may be, for consideration equal to the purchase price paid by such person, fair market value or cost plus interest, (iii) if one or more third parties unaffiliated with a Managed Fund, Annaly, and their respective affiliates participates in the transaction on the same terms and conditions as the Managed Funds, or (iv) the Managed Funds purchase an investment or receives an investment by transfer from Annaly and/or an Annaly Vehicle at least 30 days after the investment was originally made by Annaly and/or the Annaly Vehicle

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(i.e., after the investment has been “seasoned”) for consideration equal to the fair market value.

- *Conflicts Relating to Multiple Investors in Investments.* Further conflicts may arise once Managed Funds have made an investment in a company in which Annaly and/or another Annaly Vehicle has also invested. For example, questions may arise as to whether payment obligations and covenants should be enforced, modified or waived, or whether debt should be refinanced. Decisions about what action should be taken in a troubled situation, including whether or not to enforce claims, whether or not to advocate or initiate a restructuring or liquidation inside or outside of bankruptcy, and the terms of any work-out or restructuring, raise conflicts of interest. If additional capital is necessary as a result of financial or other difficulties, or to finance growth or other opportunities, the Funds, Annaly and/or other Annaly Vehicles may or may not provide such additional capital, and if provided, the participating Funds, Annaly and/or each other participating Annaly Vehicle will supply such additional capital in such amounts, if any, as determined by the Advisor, AMCO, and/or the relevant managers of the other Annaly Vehicles in their sole discretion. The Advisor, AMCO, and/or each manager of the other Annaly Vehicles will resolve all such conflicts by considering in good faith the investment objectives of the Managed Funds, Annaly and such other Annaly Vehicles as a whole, rather than the investment, tax or other objectives of any one investment entity separately in good faith, subject in certain cases to approval by the advisory boards or investment committees of the participating investment vehicles.
- *Conflicts Related to Non-Public Information.* From time to time, the Advisor, AMCO and/or one or more of their affiliates may come into possession of material non-public information, and such information may limit the ability of the Managed Funds to buy and sell investments, even if such information was obtained in the context of the investment activities of Annaly and/or other Annaly Vehicles.

#### *CLOs*

There may be conflicts of interest related to our affiliations with other companies in the Annaly group that may increase risk to the CLO. The mortgage portfolio in which the CLO and Annaly invest are originated, underwritten and serviced by various affiliates of Annaly. In addition, the Advisor selects the specific pool of commercial real estate-



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related loans that are included in a CLO based on, among other things, whether such mortgage assets satisfy the eligibility criteria set forth in the Governing Documents for such CLO. In order to address these and other related-party conflicts, the Advisory Committee (as defined below) will review conflicted transactions.

AMCO will devote such time as it deems necessary to conduct the business affairs of the CLO and Annaly in an appropriate manner. However, the managers, directors, officers, employees and other personnel of AMCO and Annaly may have conflicts between their duties to the CLO and Annaly and their duties to, and interests in, AMCO.

#### **Item 11 - Code of Business Conduct and Ethics**

We have adopted a Code of Business Conduct and Ethics (the "Code") for all of our supervised persons describing our high standard of business conduct, and fiduciary duty to Clients. The Code is available to Clients or potentials Clients upon request and includes standards of business conduct, avoiding conflicts of interest, a prohibition on insider trading, and personal securities trading procedures, among other things. Our employees must acknowledge the terms of the Code annually, or as amended.

Unless permitted by the Chief Compliance Officer, our supervised persons are prohibited from trading and investing in securities issued by Clients, as well as in mortgage backed securities and derivatives of mortgage backed securities. We maintain a Restricted List of securities in which there is a conflict or non-public information known about an issuer of securities. Our employees are prohibited from trading and investing in securities on the Restricted List unless permitted by the Chief Compliance Officer. For compliance purposes, the supervised persons are required to report their transactions quarterly, have their accounts monitored electronically by Schwab Compliance Technologies (formerly Compliance11), or are required to have duplicate confirmations and account statements delivered to us for review if not electronically submitted.

The Code is designed to assure that the personal securities transactions, activities and interests of our employees will not interfere with (i) making decisions in the best interest of the Clients, and (ii) implementing such decisions while, at the same time, allowing employees to invest for their own accounts. Under the Code certain classes of securities have been designated as exempt transactions, based upon a determination that these would materially not interfere with the best interests of the Clients. In addition, the Code

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requires pre-clearance of many transactions. Nonetheless, because the Code in some circumstances would permit employees to invest in the same securities as the Client, the possibility exists employees might benefit from market activity by a Client in a security held by an employee. Employee trading is continually monitored under the Code through Schwab Compliance Technologies (formerly Compliance11) and the review of employee account confirmations and statements, in a reasonable effort to prevent conflicts of interest between us and our Client.

Clients or prospective Clients may request a copy of the Code by contacting the Chief Compliance Officer at 212-696-0100.

ACOM recommends the purchase or sale of certain assets from Annaly. This is done in a manner that is consistent with the best interests of the Client, applicable law, and the governing, advisory, and other documents related to each respective Client.

#### *Principal Transactions Involving CLOs*

Our compliance policy establishes a set of guidelines for entering into principal transactions between the CLO, or any future Client, and the proprietary accounts of our affiliates. An advisory committee ("Advisory Committee") is required to consent to transactions between the CLO and AMCO or any of its affiliates (each a "Restricted Transaction"). Following the receipt of notice of a Restricted Transaction, the Advisory Committee is required to determine whether the Restricted Transaction is on terms substantially as favorable to the CLO as would be the case if such transaction were not a Restricted Transaction. The Advisory Committee is required to determine that the purchase price in respect of such Restricted Transaction is equal to the fair market value of such mortgage loan. In certain circumstances, the Advisory Committee will be required to determine whether the mortgage loan satisfies the applicable eligibility criteria applicable to it. Each of the foregoing determinations must be made by the Advisory Committee and evidenced in writing.

The Advisory Committee will include an independent member. The independent member of the Advisory Committee will serve on, and attend meetings of, the Advisory Committee, consider actions to be taken with respect to Restricted Transactions and take such actions as may be necessary or advisable in connection therewith.

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Advisory Committee consent will not be required in certain pre-determined circumstances including credit risk/defaulted obligation cash purchases and sales of assets in connection with a redemption of the CLO's notes pursuant to their indenture, in each case subject to purchase prices specified in the transaction documents of the notes' offering.

*Principal Transactions Involving Managed Funds*

The Advisor Board of each Managed Fund is required to consent to transactions between such Managed Fund and ACOM or any of its affiliates, including any principal transactions, subject to the Governing Documents of such Managed Fund. In the future, we may establish certain guidelines in our compliance policy for entering into principal transactions between a Managed Fund, or any future Client, and the proprietary accounts of our affiliates.

**Item 12 - Brokerage Practices**

With respect to the Managed Funds, generally, the Advisor does not use broker-dealers for Client transactions.

With respect to CLOs, the issuer with respect to a CLO will retain broker-dealers to place the offered CLO notes with investors.

**Item 13 - Review of Accounts**

The Advisor will monitor all portfolio investments on behalf of each Client on an ongoing basis. Accounts with little or no activity may be reviewed on a less frequent basis, but no less frequently than monthly where there is activity. Reviews of accounts are performed in the context of each Client's (i) adherence to the investment objectives and guidelines set forth in such Client's Governing Documents and (ii) investment performance. Reviewers include Portfolio Managers, Vice Presidents, Assistant Vice Presidents, and accounting personnel, as well as external independent auditors. Reviewers are instructed to confirm the accuracy of the account position, performance, and alignment with account objectives.

The Advisor provides reports to investors in the Clients as required by the applicable Governing Documents for such Clients, or otherwise agreed with a Client or an investor in a Client. The Governing Documents of certain Clients sometimes require quarterly and annual financial statements to be distributed to the Client's investors, and the Advisor also typically provides written investor letters with respect to a Client and its performance. The

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Advisor distributes tax information on Schedule K-1 to investors, where applicable, and provides certain other reports and analyses to investors and potential investors upon requests.

With respect to CLOs, the related servicer and special servicer prepare period statements regarding the collateral assets, and the related note administrator prepares period statements regarding distributions to noteholders.

**Item 14 - Client Referrals and Other Compensation**

The Advisor will not receive economic benefits from non-Clients for providing investment advice or other advisory services to Clients.

The Advisor will not compensate third parties for Client referrals.

**Item 15 - Custody**

The Advisor will be deemed to have custody of certain Client assets, which will be administered in compliance with applicable rules and regulations. Clients generally undergo audits by independent accountants, which are hired by the Clients and all reports are disclosed to investors in that Client.

**Item 16 - Investment Discretion**

The Advisor will receive discretionary authority in writing from certain Clients at the outset of an advisory relationship to select the identity and amount of securities to be bought or sold. In all cases, however, such discretion is to be exercised in a manner consistent with the stated investment objectives for the particular Client account.

When selecting securities and determining the amounts to invest, the Advisor observe the investment policies, limitations, and restrictions of each Client. The Advisor's authority to trade securities may also be limited by certain federal securities and tax laws that require diversification of investments, and favor the holding of investments once made. Investment guidelines and restrictions must be provided to the Advisor in writing.

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**Item 17 - Voting Client Securities**

As a matter of policy and practice, the Advisor generally will not vote proxies on behalf of Clients. Each Client retains the responsibility for receiving and voting proxies for any and all securities maintained in its portfolios. The Advisor may provide advice to Clients regarding its voting of proxies.

In very limited instances, a Client may elect in writing to have us engage in the voting of proxies or making decisions relating to other proposed actions on Client securities on its behalf. The Advisor has adopted policies and procedures relating to voting proxies and other corporate actions that are designed reasonably to ensure that we vote proxies in the best interest of our Client where requested, including notice to the Client of any potential or actual conflict of interest that may arise. Clients may request a copy of our Corporate Action and Proxy Voting Policy, as well as a history of votes on its behalf by making a written request to the Chief Compliance Officer at the address set forth on the first page of this form.

**Item 18 - Financial Information**

Registered investment advisers are required in this Item to provide you with certain financial information or disclosures about their respective financial condition. The Advisor has no financial commitment that impairs our ability to meet contractual and fiduciary commitments to the Client, and have not been the subject of a bankruptcy proceeding.