Corporate Capital Trust II

SPECIAL REPORT

THE DEBT MARKET

Private Credit Investing and the Middle-Market Opportunity

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Our special report discusses today's lending and financial regulatory environment and its combined impact on the middle market and private credit investments.

Private businesses have been a staple of the U.S. economy for centuries. These companies not only provide much needed goods and services, but help to fuel the national economy through the creation of jobs. In the United States alone, the nearly 200,000 businesses comprising the country's middle market employed roughly 48 million people by the end of June 2016.[1] However, today's middle market is being greatly affected by a shortage of commercial banks able to provide sources of capital, a trend that has accelerated since the Great Recession of 2008.

As the flow of credit tightens in many U.S. banks, alternative lenders are playing a larger role in providing financing to middle-market companies. This special report will discuss some of the key trends in today's commercial banking environment that have created a lending gap in the middle-market business sector, as well as comment on the constraints arising from complex financial regulations. In addition, the report will discuss the opportunities alternative lenders are generating for income-seeking investors and summarize some of the benefits and risks of private credit investments, with a special emphasis on non-traded business development companies (BDCs).

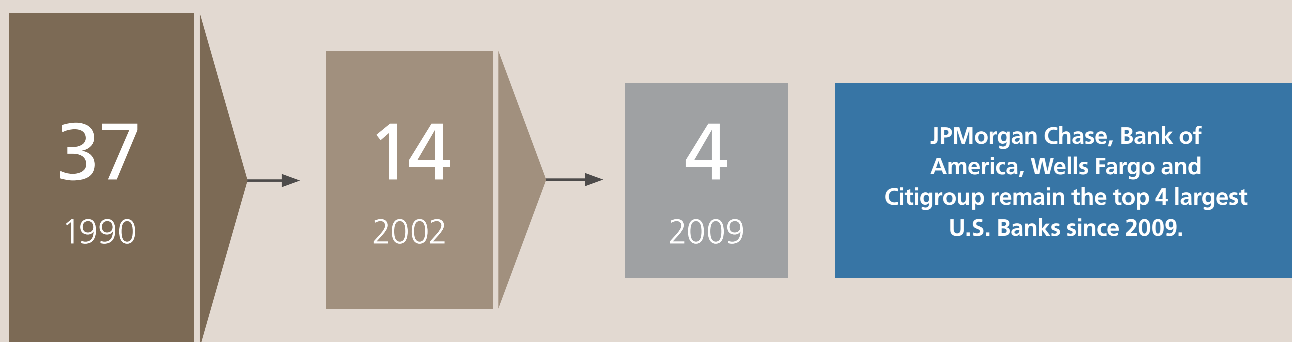
Today's Regulatory Environment

Many analysts and economists describe today's lending environment as the "perfect credit storm." In spite of historically low interest rates, many U.S. banks are hesitant to extend certain types of loans. Compounding the issue is the consolidation in the banking industry over the last two decades (refer to Figure 1 below), as well as the increased number of complex banking regulations, which are leading to even tighter lending policies on the banking side. As a result, there is currently high demand for credit from the private business sector, especially among middle-market companies that do not meet all the qualifications to obtain low-cost, traditional financing.

COMPLEX (AND COSTLY) FINANCIAL REGULATIONS

As financial markets have become progressively more complex, financial regulations have followed. Table 1 on the next page summarizes the key regulations impacting today's banking and lending industry. Of these rules, three have had a prominent

FIGURE 1. CONSOLIDATIONS OF THE FOUR LARGEST U.S. BANKS



SOURCES: "How Banks Got Too Big to Fail," *Mother Jones*, January/February 2010. "The 10 Biggest Banks in America," *The Motley Fool*, Jan. 27, 2016. "America's Top 10 Biggest Banks," *Bankrate,* accessed May 10, 2016.

impact on the financial services industry — the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Volcker Rule and Basel III.

DODD-FRANK ACT. Since its inception in 2010, the Dodd-Frank Act has changed the U.S. financial regulatory environment, affecting almost every part of the nation's financial services industry. The aim of the bill is to prevent the recurrence of events causing the 2008 financial crisis by improving accountability and stability in the financial system.

The precise impact of the 849-page Act still remains unclear, which is creating an uncertain lending environment for banks. The Act requires federal agencies to write 390 rules to put the Act's provisions into effect. As of July 2016, 271 rulemaking deadlines have passed and, of those, 210 of the provisions have final rules in place. Rules are still pending or nonexistent for 61 of the rule-making requirements.[2]

VOLCKER RULE. The Volcker Rule restricts U.S. banks from making certain kinds of speculative investments that do not benefit their customers. Proposed by former Federal Reserve Chairman Paul Volcker, the Rule particularly limits banks' abilities to own or sponsor hedge funds or private equity funds that may create a material conflict of interest, expose the institution to high-risk assets or trading strategies, or create instability within the bank.[3]

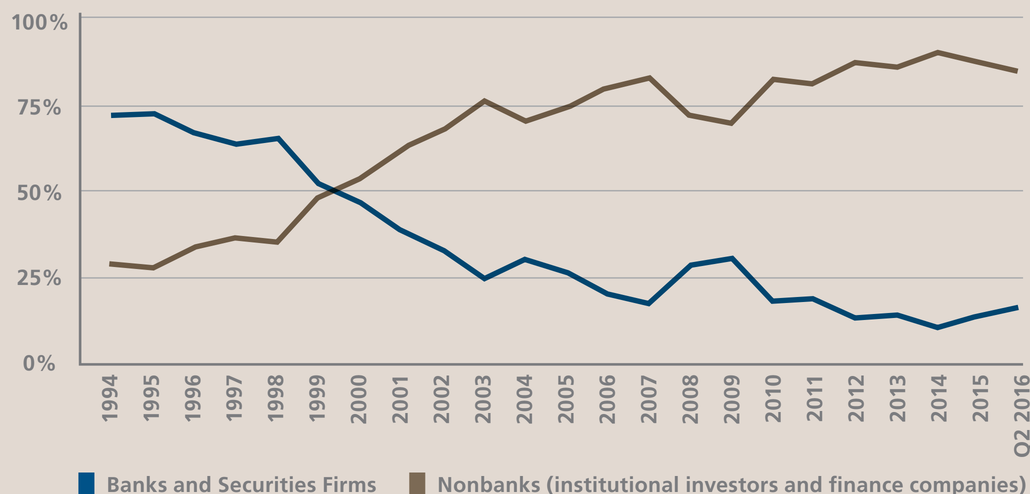
BASEL III. Basel III, also known as the Third Basel Accord, is a comprehensive set of reform measures aimed at strengthening the regulation, supervision and risk management of the banking sector.[4] In particular, and

TABLE 1. SUMMARY OF FINANCIAL REGULATIONS IMPACTING THE BANKING AND LENDING INDUSTRY

Regulation	Timeframe	Detail
Basel III	Effective April 2014	New capital requirements state banks must reserve more equity capital against leveraged loans — systemically important financial institutions (SIFIs) would be required to hold equity capital worth 6 percent of total assets.
Interagency Guidance on Leveraged Lending	Guidance effective May 2013	Establishes minimum lending standards and changes in leveraged loan transactions for financial institutions. In particular, the guidance outlines underwriting, valuation, pipeline management and risk rating standards, among others, for leveraged transactions.
SIFI	Ongoing	Once a financial institution is placed under SIFI status, it falls under the Federal Reserve's "enhanced prudential" supervision, thus increasing the entity's operational requirements and costs.
Volcker Rule	Effective April 2014	The Volcker Rule prohibits banks from performing certain investment activities in their own accounts. More specifically, the rule limits the ability of banks to own or sponsor hedge funds or private equity funds.
Risk Retention Rules	Effective October 2014	These rules state that sponsors of collateralized loan obligations are required to retain a 5 percent interest in the loan on their own balance sheets.
House Rule 3868 *of the Small Business Credit Availability Act*	Not yet effective	This rule amends the Investment Company Act of 1940 to allow BDCs to own or acquire securities or other interests in the business of a registered investment advisor or an advisor to an investment company.

SOURCES: "Fed and FDIC Agree 6% Leverage Ratio for U.S. SIFIs," *Central Banking*, July 10, 2013. "Rules and Regulations," *Federal Register*, April 14, 2014. *Description: Guidance on Leveraged Lending*, OCC, March 22, 2013. *Interagency Guidance on Leveraged Lending*, Federal Reserve System, FDIC and OCC, March 21, 2013. *SIFI Designation and Its Potential Impact on Nonbank Financial Companies*, Deloitte Center for Regulatory Strategies, 2013. "Volcker Rule," *Investopedia*, accessed March 16, 2016. *Credit Risk Retention*, OCC, Oct. 22, 2014. *H.R.3868 — Small Business Credit Availability Act*, Library of Congress, April 19, 2016.

FIGURE 2. PRIMARY MARKET FOR HIGHLY LEVERAGED LOANS



Note: Data excludes left and right agent commitments (including administrative, syndication and documentation agent, as well as arranger). Nonbanks include: institutional investors, insurance companies and finance companies.
SOURCE: S&P LCD Middle Market Quarterly Review, Q2 2016.

Financing to middle-market businesses from commercial banks has decreased since the late 1990s. Consequently, the growing middle-market lending space is increasingly being served by alternative lenders such as institutional investors and private finance companies.

among other measures, the Accord will require banks to hold a leverage ratio of at least 3 percent. In the United States, this requirement is higher — 6 percent for eight systemically important financial institutions (SIFIs) and 5 percent for their insured bank holding companies.[5] As a result, many U.S. banks have decreased the amount of lending, as evident in Figure 2 above.

FEWER BANKS MAKING FEWER LOANS

The U.S. banking industry has witnessed unprecedented consolidation through mergers and acquisitions in recent years. Since 1990, the number of banks in the United States has decreased considerably — from 37 to 14 by the end of 2002 and to four by 2009 (refer to Figure 1 on page 2). Starting in 2009, the top four spots have been occupied by the same large banking institutions — J.P. Morgan Chase, Bank of America, Wells Fargo and Citigroup.[6,7]

These bank consolidations have reduced the number of commercial banking sources for U.S. companies, especially middle-market businesses. In addition, the number of new commercial banks, as reported by the Federal Deposit Insurance Corporation (FDIC), has declined (refer to Figure 3 on the next page). According to March 2016 data from the FDIC, only 14 new commercial banks have come into the marketplace since 2010, the same year the Dodd-Frank Act was enacted.

THE BOTTOM LINE. The heightened level of regulatory oversight and scrutiny has made banks more hesitant about extending certain types of credit, due to lack of clarity on the ultimate outcome of many financial regulations. Also, banks need to maintain higher amounts of capital on balance sheets to offset loan investments. While overall interest rates remain far lower than historical averages, the combined impact of bank consolidations, lower levels of new commercial bank formations since 2010 and regulatory uncertainty are reducing available credit from U.S. banks.

The Impact on the Middle Market

The "perfect credit storm" described in the previous section has contributed to the creation of a lending gap in the U.S. middle market.

THE MIDDLE MARKET DEFINED

As mentioned earlier, today's middle market consists of nearly 200,000 businesses. While it represents just 3 percent of all U.S. companies, the middle market accounts for one-third of the country's private sector gross domestic product (GDP) and jobs.[8] By the end of June 2016, middle-market companies employed 47.9 million people, as well as added 2.2 million jobs through the Great Recession across major industry sectors and U.S. geographies. Globally, if the middle market were a country, it would be considered the third largest economy.[1]

The middle market can be defined in terms of revenue or EBITDA.[9] According to the National Center for the Middle Market, this sector of the economy consists of businesses with revenues between US$10 million and US$1 billion.[1] In terms of EBITDA, an overview by Sankaty Advisors defines the middle market as those companies with EBITDAs ranging from less than US$10 million to more than US$75 million.[10]

Therefore, the middle market can be divided as follows:

Type	Revenue[1]	EBITDA[10]
Lower Middle Market (Small Cap)	$10 million to < $50 million	< $10 million
Middle Market	$50 million to $100 million	$10 million to $75 million
Upper Middle Market	> $100 million to $1 billion	> $75 million

THE LENDING GAP

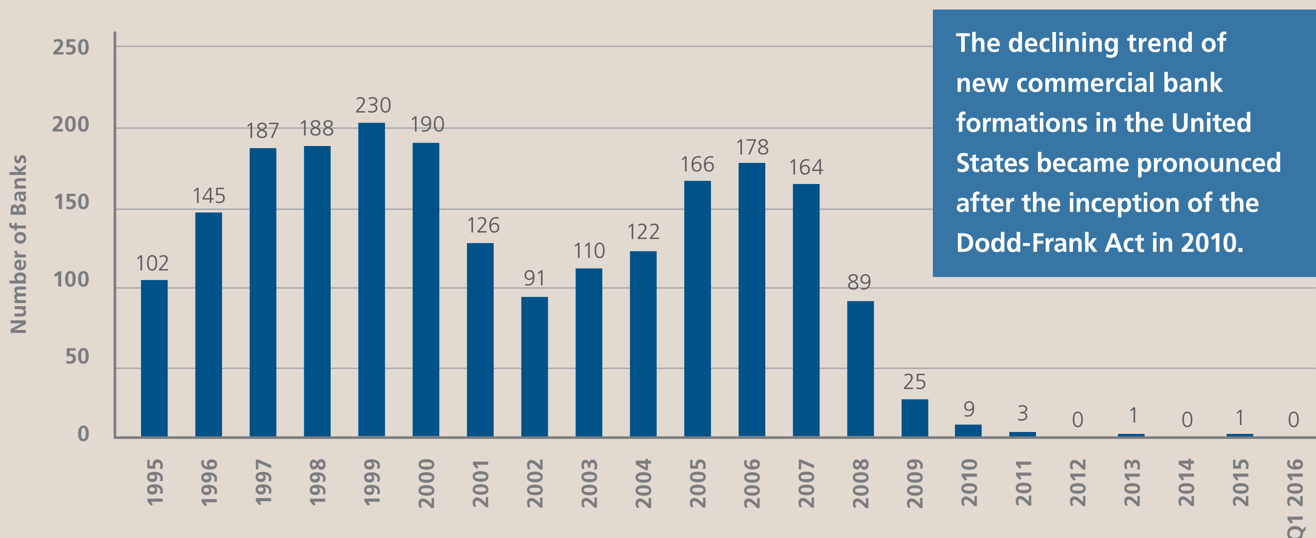
When private middle-market companies require capital to expand or manage their operations, they typically do not have access to the public markets to issue stocks or bonds. Due to this lack of access, they are more reliant on alternative sources of capital, including private credit. As Figure 4 on page 6 illustrates, the financing needs of the middle market have continued to increase since the late 1990s, peaking twice since then: in 2008, at the height of the Great Recession, and in 2014. The decrease in large and commercial banks, which reached a low in 2014, coupled with the decrease in the leveraged loan market have contributed to a heightened need for financing in middle-market businesses since 2014. With that said, there is no assurance this lending gap or demand for middle-market financing will remain at these levels or will not reverse itself in the future.

Market Opportunities

The growing demand for credit among middle-market companies is increasingly being served by alternative lenders, who now make up a majority of the leveraged loan market.[11] (Refer to Figure 2 on page 4 and "What Are Leveraged Loans?" on page 8 for more information.)

As part of this demand, alternative lenders are providing investment opportunities for income-oriented investors

FIGURE 3. NEW BANK FORMATIONS IN THE UNITED STATES (1995–2016)



SOURCE: "Historical Trends," *Statistics at-a-Glance*, FDIC, March 31, 2016.

seeking current return and lower correlation with public bonds.

ALTERNATIVE LENDERS

A variety of alternative lenders exist in today's market that can provide much-needed financing to middle-market companies. Examples include business development companies (BDCs), private equity firms, hedge funds and insurance companies. Following is a description of each.

BDCs, created in the 1980s, were designed to help facilitate the flow of capital to small and mid-sized private American companies — BDCs must have at least 70 percent of its total assets invested in U.S. businesses. A BDC can provide retail investors with exposure to the private equity and private credit markets, which until recently have been primarily accessed by institutional investors such as pension funds and endowments.

The **PRIVATE EQUITY** market has strengthened since the 1970s. Private equity firms with a credit platform provide capital to companies to fund new technology, make acquisitions and enhance and solidify a balance sheet. Due to their equity experience, many private equity firms are in a good position to provide credit to middle-market companies in need of capital. Funds, which are provided by institutional and individual investors, can also be used to engage in buyouts of public companies.[12]

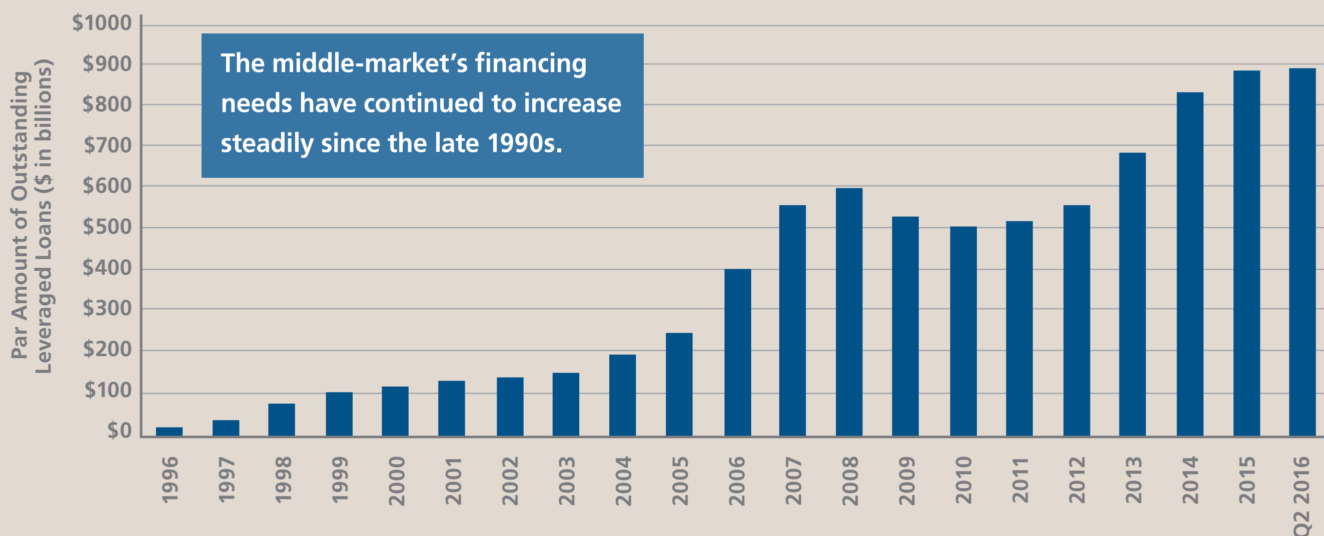
LIQUID VS. ILLIQUID INVESTMENTS

Besides providing much-needed capital to middle-market companies, hedge funds and BDCs also serve as investment vehicles. When investing in these types of products, it is important to note their level of liquidity.

Non-traded BDCs and other direct lending funds are highly illiquid. While investors may not be able to easily redeem their shares in a non-traded BDC, for instance, there is also no pressure for the investment to lock in losses by selling in a down cycle. Investors should carefully consider the benefits and risks of each investment vehicle before buying shares in a product.

HEDGE FUNDS are managed portfolios that use advanced investment strategies, such as leveraged, long, short and derivative positions, in both domestic and international markets with the goal of generating high returns for its accredited and sophisticated investors. A type of pooled fund, they are most often set up as private investment limited partnerships with a high minimum investment to participate.[13]

FIGURE 4. MIDDLE-MARKET FINANCING NEEDS



Note: There is no assurance that this lending gap or demand for middle-market financing will remain at these levels or will not reverse itself in the future.
SOURCE: S&P LCD Middle Market Quarterly Review, Q2 2016.

Finally, **INSURANCE COMPANIES** are also playing a role in the financing of private companies. Many insurance companies have hired former bankers to take advantage of today's middle-market lending gap to deploy the capital themselves. As many insurance companies can hold premiums on products such as life insurance policies for decades before paying benefits, the premiums are often invested in portfolios that may include financing business ventures through private loans and bonds.

Private Credit as an Investment

For some individual investors, companies that extend credit to private American businesses have become an attractive investment option. Some individuals find these investments complementary to other income-seeking assets in their portfolio, particularly investors who are willing to accept higher illiquidity in return for the potential of a higher rate of return. It is important to note that investments in private credit companies may be considered speculative and involve a high degree of risk. Investors also should review the fees and expenses in the prospectus, as there are substantial costs associated with investing in private credit companies.

In addition, investing in companies that provide financing to private businesses indirectly helps fuel the economy. By investing in a security that takes investment dollars and provides capital, investors are indirectly lending to U.S. middle-market businesses.

Finally, private businesses in other parts of the world are experiencing the same financing restraints. In Europe, for instance, financial regulations and other factors have contributed to decreased levels of financing to middle-market companies from traditional lending sources like commercial banks.

HOW LOANS TO PRIVATE COMPANIES WORK

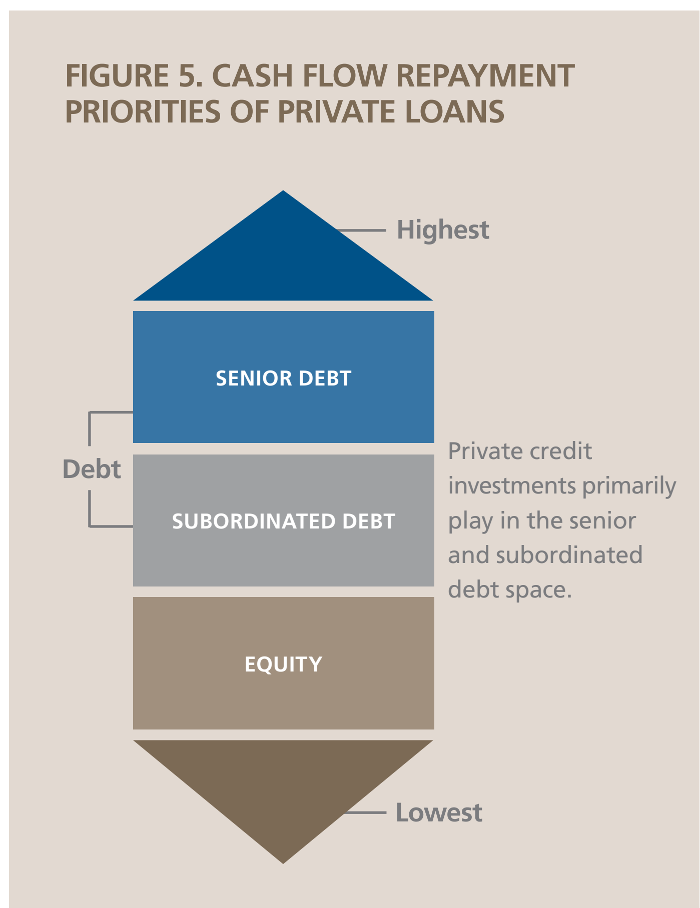
With the different sources of nonbank lending available to middle-market companies, it is important to understand how private credit works, especially when considering investing in a company in the private credit space.

LOANS AS INVESTMENTS. Similar to when a bank makes a loan to a private company, an alternative lender has a contractual agreement (called a credit agreement) stipulating all the terms of the loan, including covenants, the repayment schedule and interest rate terms, to name a few.

There are two ways that alternative lenders can build a loan portfolio. The first is originating the loans by working directly with the borrower, just like a bank would, and negotiating the terms of the credit agreement, including pricing, covenants and maturity date. The alternative lender also negotiates whether the loan has a fixed rate or floating rate based on a benchmark rate, the most common of which is the London Interbank Offered Rate (LIBOR).

The second way to build a loan portfolio is to purchase loans on an active securities exchange or secondary market. The secondary market allows third parties to buy and sell loans that have already been originated. Typically, loans traded on the secondary market are called *syndicated loans* in that they are divided into smaller pieces, which are purchased and sold similarly to how a share of stock in a company is traded in the stock market or a piece of a syndicated bond is traded in the bond market. The ability to understand, carefully source and underwrite these loans is an important part of the lending and portfolio construction processes because, often, these loans are made to companies that are noninvestment grade or have little to no public credit history, which increases the risk of repayment.

FIGURE 5. CASH FLOW REPAYMENT PRIORITIES OF PRIVATE LOANS



SENIOR VS. SUBORDINATED DEBT. Private loans are primarily structured as either *senior* or *subordinated* debt. Senior debt ranks first in claims on assets or earnings, while subordinated debt ranks below senior debt in priority, but may have a higher return to reflect this increased risk (refer to Figure 5 on page 7). Equity has the last priority on repayments, but comes with the highest return expectations. Regardless of the investment's position in the capital stack and the loan's contractual agreement, there is always the risk that the company will default on a loan.

It is important to understand that investments in senior debt are not necessarily more protected than those including subordinated debt. Although senior debt

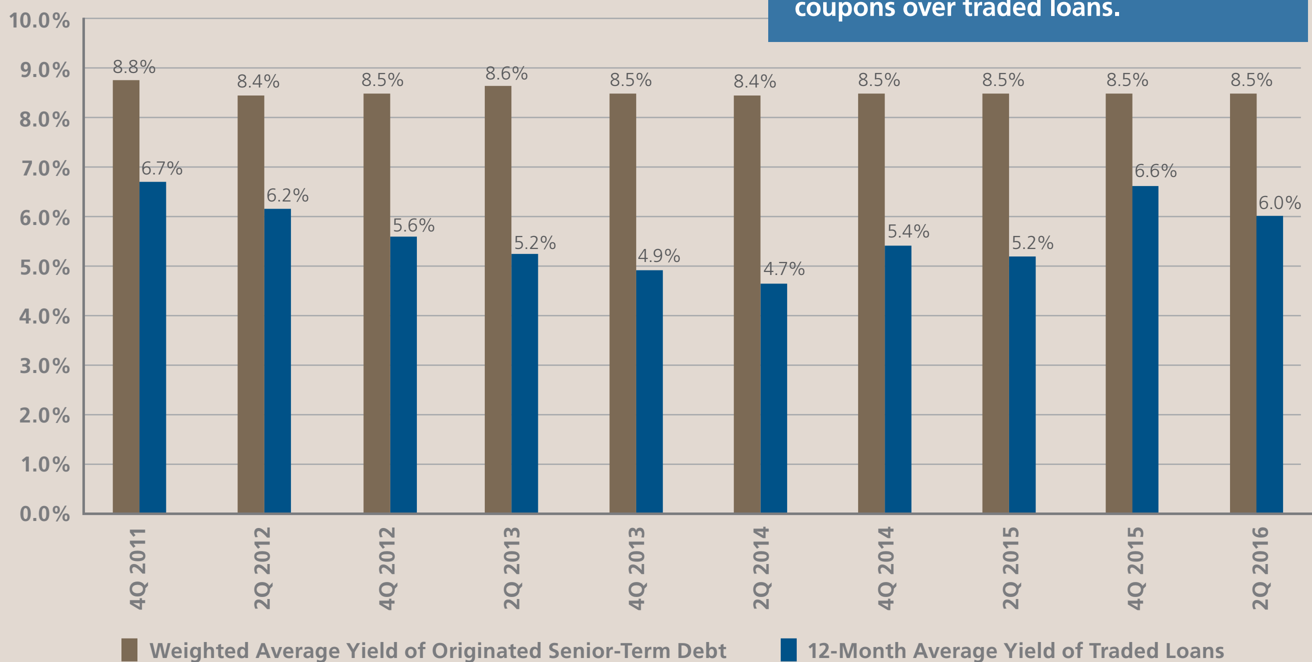
WHAT ARE LEVERAGED LOANS?

In this document, *leveraged loans* are defined as a commercial loan extended to a company that is already heavily indebted. Leveraged loans are considered to be riskier than other loans and, because of this, the lender can negotiate higher interest rates to offset that risk.

Most companies use debt to finance operations. By doing so, the company increases its leverage because it can invest in business operations without diluting its equity. While leverage helps the investor and the firm, it comes with greater risk. This is because leverage magnifies both gains and losses.

FIGURE 6. AVERAGE COUPON COMPARISONS OF ORIGINATED VS. TRADED LOANS

On average, coupons on originated loans have remained above 200 bps since the last quarter of 2011, resulting in higher coupons over traded loans.



Originated loans are not available in all investment portfolios.

Note: Past performance is not a guarantee of future results. This information is for illustrative purposes only. The indexes represent investment offerings that are materially dissimilar to non-traded BDCs in regards to a non-traded BDC's higher fees/expense structure, higher risk level, time horizon, illiquidity options and more. BDCs must obtain exemptive relief from U.S. Securities and Exchange Commission to co-invest in originated loans. Weighted Average All-In Coupon represents the weighted average of the yields of all loans included in the respective portfolios. Weighted Average All-In Coupon does not represent realized or unrealized performance of KKR Lending Partners LP (KKRLP) or KKR Mezzanine Partners I LP (KKRMP), and is not an indication of how KKRLP or KKRMP would have performed in the past or will perform in the future. It is presented to demonstrate the illiquidity premiums available on originated financings and is not meant to predict or project performance of any investment strategy or fund. Yield information does not reflect the deduction of management fees, carried interest, custody charges, withholding taxes and other indirect expenses that would reduce performance.
SOURCES: Cumulative weighted average all-in cash yield for all transactions completed in KKRLP and KKRMP, June 30, 2016. S&P LSTA, All Loans Index Yields and BAML Global HY Index Yields, Bloomberg, June 30, 2016.

has priority claims on assets and earnings if a company defaults on its loan payments, it is important to consider the entire underwriting of the investment. For instance, a senior, first-lien loan given to a local business with an average credit score may carry a higher risk of default than a subordinated loan made to a national retail chain with an above average credit record.

BENEFITS OF INVESTING IN PRIVATE CREDIT

Besides the benefits associated with a loan's contractual return and repayment priority, as mentioned previously, private credit investments may offer three additional benefits discussed below.

ILLIQUIDITY PREMIUM. Private credit investments are considered illiquid, because investors are unable to easily redeem shares in these kinds of products, if at all. However, for investors who can withstand high periods of illiquidity, these investments may provide what many have termed an "illiquidity premium." As Figure 6 on page 8 shows, coupons on originated loans (i.e., loans not available via the secondary credit market) remain above 200 basis points (bps), possibly resulting in higher coupons over traded loans. Not all investments have access to originated loans. As a result, it may be worth determining if an investment has this objective.

HISTORICALLY REDUCED PRICE FLUCTUATION. Private credit investments merit consideration for investors seeking to diversify their portfolios with investments that are not as sensitive to the intraday price fluctuation associated with the stock market. Historically, private credit investments have been less prone to the wide price swings seen in traded stocks. The introduction of such investments into a portfolio also may increase overall diversification.

LOWER HISTORICAL CORRELATION. Private credit has historically shown lower long-term correlation to more liquid and traditional income-oriented investments, like public bonds (refer to Table 2 below). Assets with lower correlation have returns that don't move together with respect to changing economic and market conditions. As one investment's value declines, the less correlated asset is less likely to also decline to the same degree. In addition to increasing portfolio diversification, adding somewhat less correlated assets may mitigate swings in portfolio returns.

RISK FACTORS

Benefits aside, acting as a lender to private companies is not without risk. Some of the risks include the potential for default, limited liquidity and the lack of independent credit ratings to assist in the evaluation of the private company.

TABLE 2. ASSET CLASS CORRELATIONS (2010–2015)

	Private credit	Public bonds	Domestic stocks	International stocks	Emerging-market stocks	Private equity	Direct real estate
Private credit	1.00						
Public bonds	-0.11	1.00					
Domestic stocks	0.74	-0.47	1.00				
International stocks	0.77	-0.38	0.85	1.00			
Emerging-market stocks	0.84	-0.22	0.79	0.92	1.00		
Private equity	0.84	-0.39	0.77	0.79	0.80	1.00	
Direct real estate	-0.40	-0.07	-0.38	-0.42	-0.36	-0.16	1.00

Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. The information, data, analyses and opinions contained herein do not constitute investment advice offered by Morningstar and are provided solely for informational purposes. © Morningstar. All Rights Reserved.
SOURCE: Morningstar, 2016. (Refer to "Morningstar Chart Dataset Information" for additional content on this chart.)

POTENTIAL DEFAULT. Loans come with the risk that the borrower may not meet the legal obligation of debt repayment. Higher interest rates are generally charged to compensate for this risk. Lenders may also place the private company in bankruptcy in the event of default to reclaim some or all of the loan balance. To mitigate the risk of default, alternative lenders may choose to focus on making loans to more established companies with a history of healthy positive cash flows. Understanding the underwriting experience of a fund's management team is crucial to ensuring loans are given to companies with a strong track record of credit performance, although all lending involves risk.

LIMITED LIQUIDITY. When a loan is made, the funds are repaid over a contractually set period of time, making these investments less liquid. In response, a private credit portfolio may include multiple loans with different maturity dates that impact cash availability. As a result, investments in private credit typically offer limited liquidity for investors. Certain investments may have redemption or repurchase programs that can be suspended, modified or terminated at any time.

LACK OF INDEPENDENT CREDIT RATINGS. Independent services like Standard & Poor's and Moody's often provide ratings on the credit quality of publicly traded debt, but such ratings are less likely to be available for the below investment-grade private credit that is often in a portfolio. This scenario places extra importance on the ability of a lender to assess the creditworthiness of a private company. With that said, many private companies have no intention of accessing the public markets and are, therefore, never rated.

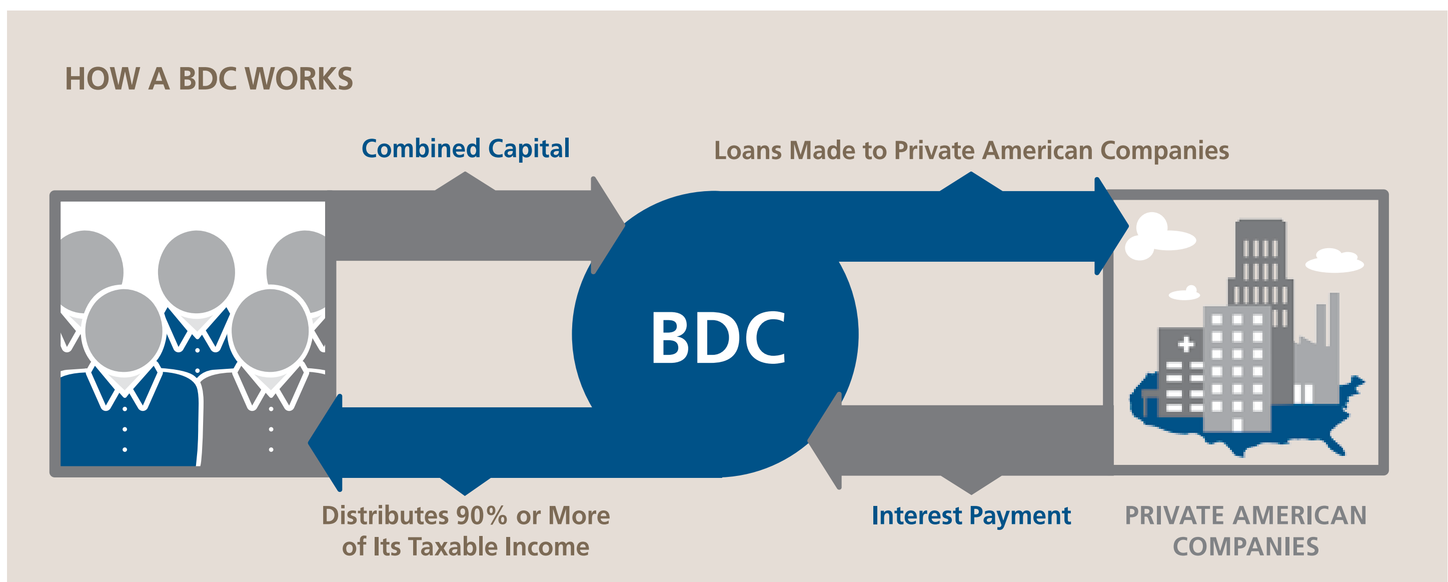
What Are BDCs?

Registered with the U.S. Securities and Exchange Commission and regulated under the U.S. Investment Company Act of 1940, BDCs offer individual investors access to private debt — an asset class that typically has only been available to high-net-worth and institutional investors. BDCs are closed-end funds that invest at least 70 percent of their assets in the debt (via loans) or equity of private U.S. companies, with the goal of generating income, capital growth or both. (Refer to the illustration on this page to understand how BDCs work.)

While traded BDCs may provide investors the benefit of higher liquidity, their share values are influenced by general market sentiment and have higher correlation to the traded markets. Non-traded BDCs, on the other hand, seek to provide diversification outside the traded market (refer to Traded and Non-Traded BDCs comparison table). These types of investments are less liquid than their traded counterparts, but have the potential to align the fund structure with the characteristics of the asset class in which they participate. As a result, non-traded BDCs may provide the diversification benefits of lower correlation to the traded market that are frequently associated with alternative investments.

HOW BDCS WORK

All BDCs combine the capital of many investors to finance a portfolio of businesses. These companies, in turn, intend to make dividend or interest payments to the BDC, whose objective is to pass qualifying income to its investors through distributions. BDCs must distribute 90 percent or more of their taxable income to qualify as a regulated



investment company under the Internal Revenue Code of 1986 and eliminate corporate income tax. In addition, the BDC's distributions allow for similar regulation, transparency and tax treatment as mutual funds.

STRUCTURE BENEFITS, RISKS AND SUITABILITY

Despite some structural similarities to mutual funds, non-traded BDCs are not traded on an exchange, have higher fee structures and are valued less frequently. As with any asset class, it is important for investors to understand the potential benefits and risks of non-traded BDCs.

POTENTIAL BENEFITS

- Investment access to private U.S. companies.
- Potential for higher income.
- May provide diversification in portfolios comprised of traditional assets.
- Form-1099 tax reporting.
- Leverage limited to 50 percent of total assets.

POTENTIAL RISKS

- Redemption that is subject to suspension, modification and termination at any time.
- No guarantee of distributions or that distribution rates will be sustained or paid from earnings.
- Liquidation at less than the original amount invested.
- Higher risk profile than that of traditional investments.
- Limited operating history and reliance on the investment's advisor, which may cause conflicts of interest.
- Use of leverage may increase risk of loss.

SUITABILITY STANDARDS

Finally, non-traded BDCs are not suitable for all investors. Suitability standards generally require an investor to have either a net worth of at least US$250,000 or a net worth and an annual gross income of at least US$70,000, although some states require higher standards. An investment is only suitable for investors who are comfortable with the illiquid nature of this vehicle. Additional suitability requirements are relative to the investment strategy and should be discussed with a financial advisor.

TABLE 3. TRADED AND NON-TRADED BDCs

While the investment strategies of traded and non-traded BDCs may be similar, key differences exist between the two:

	Traded	Non-Traded
Capital Raise	Issue new shares in intermittent periods	Sold on a continuous, best efforts offering for a fixed amount of shares over a specified period of time
Returns	Besides distributions, returns are based on the value of the underlying assets and market sentiment	Besides distributions, returns are tied to the change in value of the underlying assets
Volatility	Share prices are affected by daily fluctuations in the market, limiting the correlation between net asset value (NAV) and price	Share prices are calculated based on the value of the underlying assets
Liquidity	Liquid; shares can be continuously bought and sold	Illiquid; shares have limited liquidity, if any, and redemption options are restricted and subject to change
Suitability	General; suitability standards are determined by each financial advisor for each individual investor	Investors must meet minimum income and net worth requirements among other qualifications

Note: Distributions are not guaranteed in frequency or amount. Distributions paid from sources other than cash from operations are not sustainable over the long-term, and can reduce the funds available to investors and for portfolio acquisition.

STRUCTURE OF NON-TRADED BDCs

	Non-Traded BDCs
Underlying investment in private American companies	✓
SEC registered (public offering)	✓
SEC reporting (public reporting of financial statements)	✓
Tax reporting on Form-1099	✓
Distribute 90% or more of their income to eliminate corporate tax	✓
Must meet asset and diversification tests under the Investment Company Act of 1940	✓
Comply with Sarbanes-Oxley	✓

In Brief

Despite historically low interest rates, access to credit for middle-market companies remains limited due to the lower number of larger banking institutions, the uncertainty in the financial regulatory environment and bank lending expenses. When you consider today's credit market landscape, it is not hard to see why alternative lenders are playing such a prominent role as a source of financing to many middle-market businesses. Alternative lenders such as hedge funds, pension funds and traded and non-traded private credit companies are filling this gap and assuming a larger share of the middle-market lending space.

Today's credit alternatives are also presenting an opportunity for income-oriented investors seeking the possibility of higher returns and lower correlation with public bonds, and those who can withstand longer periods of illiquidity and higher risk. These investors should work with their financial advisor to investigate whether investments in a company or fund that provides credit to middle-market businesses fits within their financial objectives.

Corporate Capital Trust II is a non-traded BDC that invests primarily in the debt of privately owned American companies and intends to provide shareholders with monthly income and, to a lesser extent, capital appreciation.* Alternative investments, including non-traded BDCs, may provide diversification in portfolios comprised of traditional assets and potentially mitigate the impact of rising interest rates.

To learn more about Corporate Capital Trust II, investors are encouraged to contact their financial advisor. Financial advisors are invited to contact the managing dealer of Corporate Capital Trust II, CNL Securities, member FINRA/SIPC, at **866-650-0650** or visit **corporatecapitaltrustii.com**.

* There is no assurance that this objective will be met. Distributions are not guaranteed in frequency or amount. Since inception, distributions have been supported by the advisors in the form of fee waivers and/or operating expense support waivers, and are not estimated to be a return of capital or supported by borrowed funds. Distributions exceed earnings and are not based on the investment performance; there can be no assurance that distributions will be sustained at current levels or at all. Future distributions may be paid from fee waivers or deferrals, offering expense support waivers, offering proceeds, borrowings and/or cash from operations. Corporate Capital Trust II typically is obligated to repay the advisors over several years, reducing future distributions and potentially diluting value for shareholders entering the fund at a later date.

RISK FACTORS

- Investing in Corporate Capital Trust II may be considered speculative and involves a high degree of risk, including the risk of a substantial loss of investment. Other risks include no operating history, reliance on the advisors of the company, conflicts of interest, payment of substantial fees to the advisors of the company and its affiliates, limited liquidity, and liquidation at less than the original amount invested. This is not intended for short-term investing and requires investors to meet the minimum suitability standards. Investors must review the fees and expenses in the prospectus as there are substantial costs associated with this offering.
- This is a new company and is subject to all of the business risks and uncertainties associated with any business without an operating history, including the risk that it will not achieve its investment objective and that the value of its common stock could decline substantially. In addition, Corporate Capital Trust II has not identified specific investments that it will make with the proceeds of this offering. As a result, this may be deemed to be a *blind pool* offering, and investors will not have the opportunity to evaluate historical data or assess any investments prior to purchasing shares of common stock.
- The investment strategy of Corporate Capital Trust II is focused primarily on investing in privately held companies, which may present certain challenges, including extending loans to those with potentially low credit quality and a lack of publicly available information.
- Leverage can increase expenses, add interest rate risk and may also magnify performance volatility.
- Distributions are not guaranteed in frequency or amount. Since inception, distributions have been supported by the advisors in the form of fee waivers and/or operating expense support waivers, and are not estimated to be a return of capital or supported by borrowed funds. Distributions exceed earnings and are not based on the investment performance, and there can be no assurance that distributions will be sustained at current levels, or at all. Future distributions may be paid from fee waivers or deferrals, offering expense support waivers, offering proceeds, borrowings and/or cash from operations. Corporate Capital Trust II typically is obligated to repay the advisors over several years, reducing future distributions and potentially diluting value for shareholders entering the fund at a later date.
- An investment in Corporate Capital Trust II is illiquid, which means there is a limited ability to sell shares, thus investors may not be able to sell until a liquidity event. The board of trustees must consider liquidity options on or before five years after the completion of the offering. It is neither intended that Corporate Capital Trust II be listed on an exchange during the offering period, nor is it expected that a secondary market in the shares will develop. If investors are able to sell their shares, they will likely receive less than their purchase price.
- The board of trustees for Corporate Capital Trust II may, but is not required to, implement a share repurchase program. The share repurchase program is expected to be limited to 2.5 percent of the weighted average number of shares outstanding in any quarter. The program may be suspended, modified or terminated by the board of trustees at any time. Any repurchase of shares pursuant to the share repurchase program will be at a price per share that is less than the current public offering price in effect on the date that Corporate Capital Trust II initiates the repurchase offer.
- The quarterly share repurchase price is expected to be based on net asset value and is subject to a contingent deferred sales charge (CDSC) if redeemed within four years of purchase.
- Read the prospectus, including the Risk Factors section, for full details.

Corporate Capital Trust II is not available to residents of Massachusetts. Selling firms are reminded that offering-specific communications must be accompanied or preceded by a prospectus. Neither the U.S. Securities and Exchange Commission, the attorney general of the state of New York nor any other regulatory agency has passed on or endorsed the merits of this offering. Any representation to the contrary is a criminal offense.

This is not an offer. Securities can be offered by the prospectus only, which should accompany or precede this material. Since investing in Corporate Capital Trust II is not suitable for all investors, the prospectus should be read carefully by an investor before investing. Investors are advised to consider the investment objectives, risks, charges and expenses before investing. The prospectus, which is available at sec.gov and corporatecapitaltrustii.com, and may be obtained by calling 866-650-0650, contains this and other information about Corporate Capital Trust II.

REFERENCES AND ENDNOTES

[1] *2Q 2016 Middle Market Indicator*, National Center for the Middle Market, June 2016. The data cited from this report is not adjusted for purchasing power parity.

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[3] "Volcker Rule," *Investopedia*, accessed March 16, 2016.

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[6] "How Banks Got Too Big to Fail," *Mother Jones*, January/February 2010.

[7] "The 10 Biggest Banks in America," *The Motley Fool*, Jan. 27, 2016.

[8] *From Awareness to Impact: 2015 Annual Report*, National Center for The Middle Market, 2015.

[9] EBITDA stands for *earnings before interest, tax depreciation and amortization*, not to be confused with EBIDA (or *earnings before interest, depreciation and amortization*).

[10] *Middle Market Overview*, Sankaty Advisors, May 2013.

[11] There is no guarantee this trend will continue.

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MORNINGSTAR CHART DATASET INFORMATION (2010–2015)

Asset-Class Correlations: Government bonds are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest, while returns in stocks, direct real estate, private credit, private equity and real estate investment trusts (REITs) are not guaranteed. Direct real estate trades in a private asset market, which is different in structure and function compared to the publicly traded REIT market. Direct real estate differs from non-traded REITs in many ways, as it does not incorporate brokerage fees, take into account market valuation in the event of public offering or reflect liquidity constraints. Real estate investment options are subject to certain risks, such as risks associated with general and local economic conditions, interest rate fluctuation, credit risks, liquidity risks and corporate structure. International investments involve special risks, such as fluctuations in currency, foreign taxation, economic and political risks, liquidity risks, and differences in accounting and financial standards. Emerging-market investments are riskier than developed market investments.

About the Data: The data assumes reinvestment of all income and does not account for taxes or transaction costs. An investment cannot be made directly in an index.

- **Direct real estate** is represented by the Transactions-Based Index of Institutional Commercial Property Investment Performance (TBI) from the MIT Center for Real Estate in 2010 and the NCREIF Transaction Based Index (NTBI), thereafter. The performance of direct real estate represented by the TBI is based on the research from the MIT Center for Real Estate, which draws from the NCREIF property transaction database. The performance of direct real estate represented by the NTBI is based on properties that were in the NCREIF Property Index (NPI) and were sold that quarter. The NTBI methodology is a simpler, average price based version of the TBI (MIT) that does not require regression modeling.
- **International stocks** are represented by the Morgan Stanley Capital International Europe, Australasia and Far East (EAFE®) Index, and emerging-market stocks by the Morgan Stanley Capital International Emerging Markets Index.
- **Public bonds** are represented by the Barclays U.S. Aggregate Bond Index.
- **Private credit** is represented by an equally weighted composite, consisting of 50 percent Credit Suisse Leveraged Loan Index and 50 percent Bank of America-Merrill Lynch U.S. High-Yield Master II Index.
- **Private equity** is represented by the Cambridge Associates U.S. Private Equity Index. Correlations are based on quarterly data.

Disclaimer: The underlying index series and weightings used to represent the private debt composite and the 2010 start date were requested by CNL Financial Group. Asset class correlations are based on correlation analyses of quarterly returns.

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