

Europe: where is the structured credit market, beginning of March?

Recent geopolitical developments have prompted investors to pause and reassess their investment strategies for 2026. Heightened volatility across parts of the credit markets—and the resulting mark-to-market pressure on several credit portfolios—has led many investors to revisit risk pricing and reconsider capital allocation decisions.

In contrast, the Significant Risk Transfer (SRT) market has remained broadly insulated from these dynamics. SRT transactions, which enable banks to reduce the capital charge on loan portfolios by transferring a portion of the associated credit risk to investors, have continued to demonstrate resilience despite broader market volatility. The relative stability reflects both the structural characteristics of the transactions and the nature of the investor base. From a bank perspective, SRTs are primarily executed to optimize balance sheets by reducing risk-weighted assets (RWAs) and strengthening capital ratios—objectives that remain unchanged through market cycles. On the demand side, the investor base tends to be concentrated, long-term oriented, and typically adopts a hold-to-maturity approach, which helps limit secondary market volatility.

The characteristics of the underlying reference pools have also contributed to the market's stability. Portfolios referencing granular exposures to mid-sized and small corporate loans, residential mortgages, unsecured consumer lending, commercial real estate, auto loans, and project finance have so far remained largely insulated from the current macro and geopolitical backdrop, which has instead weighed more heavily on several industrial sectors. While some minor corrections cannot be ruled out, overall asset performance has remained stable.

Primary market activity, although somewhat reduced, has remained constructive. Recent SRT transactions have continued to attract solid investor interest, with deals generally well covered and pricing holding firm at final terms.

The same cannot be said for the other dominant pillar of structured credit: CLOs. The asset class was already grappling with rising idiosyncratic risk, and it now faces additional layers of uncertainty: the AI that begins to challenge segments of the technology and software ecosystem—two sectors that represent a meaningful share of the leveraged loan universe, and the elevated threat of persistent high oil and energy prices.

Against this backdrop, the resilience of many CLO portfolios is increasingly open to question. Without singling out specific managers or vintages, the recent tightening in CLO liability spreads has been difficult to reconcile with the deterioration in underlying asset pool quality and fundamentals. Loan prices have drifted lower (ELLI at 95 down from 96,70 in January), MVOC tests have weakened (average 2%), yet liability spreads continued for some time to compress taking the WACC around 180 bps. The disconnect was striking. BBBs inside 300 bps and BBs inside 480 offered negligible value. I do not need to comment on the Bs.

In practice, the tightening was less a reflection of improving credit quality than a “mechanical response” to the steady erosion of asset margins that has been underway for roughly the past fifteen months in the leveraged loan and bond markets. As spreads across the high yield market tightened, CLO liabilities compressed as well, largely in an attempt to preserve the arbitrage and the economics of new issuance. Many portfolios ended up carrying weighted average spreads in the 325–340 bps range, often on loans sourced with difficulties in primary issuance or purchased in the secondary market at elevated prices. Par creation and excess spread distribution became impossible tasks and subordinated equity investors realized the painful reality of tight arbitrage in the cash flow distributions and in the first low coupons following the unwinding of the warehouse line.

In a number of cases, asset pools are visibly deteriorating and NAVs are under pressure (they were 55-60 in the Q3 2025 for reinvestment deals; discover where NAVs stand today and for certain platforms in particular). Managers are now facing the far more difficult moment: cleaning up portfolios, rotating out of low-margin loans, and stabilizing structural tests that are starting to bite and to freeze portfolio activity. Par destruction is inevitable and not priced in my view. I remain critical of how many portfolios were ramped and managed (the consequences are well known and the market knows this). Still, volatility creates opportunities. The current dislocation allows for meaningful adjustments to the risk-return profile of several CLO vehicles (as long as the CLOs are managing the tests with informed judgment....).

For investors in CLO liabilities—many of whom, as I wrote, chased paper at unsustainably tight levels earlier this year and again around mid-February—the

recent repricing finally opens more interesting entry points. Certain tranches now offer attractive convexity. My bias remains toward vintages that are close to, or already beyond, the reinvestment period, as well as longer-dated vehicles that were printed at exceptionally tight levels and offer the notes room to improvement. The remaining part of vintages must be studied case by case. AAAs at 130 bps look attractive despite they could go a little wider.

2026 will be a revealing year for the market—and an even more revealing one for portfolio managers, many of whom remain stubbornly attached to investment frameworks increasingly misaligned with today's credit environment: the most challenging since the Great Financial Crisis, as I have repeatedly highlighted.

Not to overstate it, the geopolitical events have added fuel to the fire, but the flames were already burning the house well before.

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