

The Half-Full Glass and Those Who Observe It

After allowing a few days for reflection following the Barcelona ABS Conference, and after gathering feedback from a number of participants who travelled to the Ciudad Condal, I have taken considerable interest in the various perspectives shared with me across several of the key topics discussed during the event. I have selected a few areas where my involvement is more direct and where I hope I can provide a valuable way to look at them.

I chose not to attend this year's conference, primarily because I was busy with distressed credit situations and the evolving methodology of measuring the risk profile of banking-sector balance sheets. In addition, I did not view the conference agenda as sufficiently differentiated from previous editions or compelling enough to warrant participation. That said, the growing importance of significant risk transfer (SRT) transactions has rightly attracted considerable attention from originators, arrangers, investors, and market participants seeking innovative capital management solutions.

From my perspective, the continued growth of the SRT market is being driven primarily by originating banks rather than by a broadening base of new end investors. Several factors help explain this dynamic, including the relative novelty of the asset class for certain financial institutions, the structural and legal complexity involved in executing these transactions, the significant analytical and operational resources required to extract and analyze the assets and, perhaps most importantly, the ability of originating banks to achieve capital relief while continuing to originate and replenish the underlying asset pools (not only corporate credits but also the retail segment). In effect, SRTs provide banks with a mechanism to transfer risk without relinquishing client relationships or franchise-generating activities. That said, investor demand remains strong, as demonstrated by the consistent oversubscription of many transactions in primary market and tight spreads in secondary. This continued appetite suggests that investors increasingly view SRTs as an attractive source of risk-adjusted returns, offering exposure to diversified (and difficult to source) credit portfolios within a regulatory framework that remains supportive of risk-transfer structures and balance-sheet optimisation initiatives.

The sentiment surrounding the CLO market appeared noticeably more cautious based on discussions with conference attendees. I have previously

highlighted the challenges currently facing collateral managers, many of whom continue to assess new CLO issuance opportunities through the lens of historical arbitrage frameworks that are increasingly difficult to reconcile with a leveraged loan market pricing broadly around Euribor +300 bps. While asset spreads compressed, liability costs have not tightened to the levels many portfolio managers had anticipated, limiting arbitrage and constraining equity economics. As a result, for the subordinated notes, the traditional CLO value proposition has become more difficult to replicate than in previous cycles. Managers are being forced to navigate a market characterised by tighter margins on the asset side with dangerous idiosyncratic risk, greater sensitivity to funding costs, and a narrower range of structures capable of generating attractive returns for equity investors. This dynamic continues to place pressure on CLO issuance economics and has contributed to a more selective and challenging environment than that experienced in recent years.

I will not repeat points I have previously raised regarding tranche pricing dynamics, relative value considerations across the capital structure, expected CLO equity returns, the risk-return characteristics of equity investment, or the embedded tail risks that continue to reside within certain portfolios, particularly those linked to specific vintages and credit platforms.

Both the US and European CLO markets continue to be supported by robust technicals, strong fund inflows, and persistent demand for structured credit risk. Yet, the market will eventually need to confront a reality that periods of strong technical support tend to obscure: not all vintages are created equal, and the differences in underwriting credit risk, spread environments, and portfolio construction will ultimately manifest themselves in performance especially when the asset pools approach the end of reinvestment period of the vehicles. The consequences of those differences extend well beyond a single financial year and may increasingly manifest themselves through divergent credit portfolio profiles, liability performances, and equity distributions over multiple years. I gave already some indications regarding previous vintages: 2006, 2007, 2016, 2017, 2020, 2022.

With respect to CLO portfolio performance, the market has undoubtedly become more discerning in its assessment of manager quality. Nevertheless, manager tiering remains far from punitive for those who underperform and in my view often exhibits a degree of inconsistency across transactions, vintages, and credit platforms. This limited (and difficult to evaluate) differentiation is further compounded by several factors, including manager-retained positions, the limited liquidity of some CLO tranches, the complexity associated with assessing the existing and latent risk in reset transactions, and the challenges involved in analysing collateral pools that are approaching—or have already passed—their reinvestment periods.

Can CLOs still be issued with economics that are attractive for equity investors? The answer is probably yes, but increasingly on a selective rather than broad-based basis. The number of CLO transactions capable of delivering compelling risk-adjusted returns has narrowed, as arbitrage remains constrained and competition for (good) assets continues to intensify. The ELLI index, when correctly interpreted, provides for Europe a useful reference point for developing a granular understanding of prevailing market conditions and associated portfolio manager behavior within industry groups.

At the same time, many newly issued CLO portfolios display a striking degree of homogeneity, not only in terms of collateral composition but also with respect to capital structure design, liability management strategies, and portfolio construction frameworks. Against this backdrop, genuine differentiation among managers has become increasingly difficult to identify. Investors continue to hear familiar narratives centered on "bottom-up credit selection", "disciplined investment processes", and "rigorous fundamental analysis"—all of which are important but hardly unique. The real challenge for managers is no longer articulating these principles but demonstrating a repeatable ability to generate alpha when this is possible, preserve value (rating agencies call it credit support) through credit cycles and periods of increased volatility, and construct portfolios that are meaningfully differentiated from the broader market.

I think it is still possible a different approach to CLO asset pools and capital stack that could potentially hold up better through periods of stress and market fluctuations. CLOs may be a "commodity" in 2026 (and probably since many years), but even commodities can be differentiated—much like bread, where ingredients, process, and craftsmanship still matter.

On a separate and final note what I find considerably more interesting are several structural developments that are reshaping in my opinion, the broader credit landscape. These include the increasingly interconnected relationship between private credit and public-market—a trend I discussed extensively with several credit platforms as early as 2019–2020 but they did not believe—the growing feasibility of issuing portfolios backed by multiple asset classes through ABS-style structures, and the progressive alignment of fund finance and structured finance through innovative feeder mechanics. As I am involved in certain transactions in this area, I will avoid going into further detail and keep my focus deliberately high level.

Collectively, these developments carry significant implications for market structure, liquidity creation, risk-transfer mechanisms, capital efficiency, and the broader evolution of leveraged finance. They also continue to blur the

traditional boundaries between banking, private credit, public market, asset management, and structured finance. As these trends accelerate, they will increasingly influence how risk is originated, retained, distributed, financed, and monitored across the financial system. Accordingly, they warrant close and continuous scrutiny from investors, issuers, and, where supervised entities are involved, regulatory and supervisory authorities alike. The long-term consequences may extend well beyond product innovation, ultimately shaping market resilience or volatility, capital allocation, and the transmission of risk across both public and private credit markets.

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