



Fixed Income Research

CLO and Structured Credit: Understanding the Risk/Return Landscape

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Executive Summary

Structured credit—encompassing collateralized loan obligations (CLOs), commercial mortgage-backed securities (CMBS), and asset-backed securities (ABS)—represents one of the most analytically demanding and potentially rewarding segments of the fixed income universe. Each sub-sector is built on a common architectural principle: a pool of heterogeneous assets is isolated in a bankruptcy-remote special purpose vehicle, cashflows are tranching by seniority into rated securities, and credit enhancement protects senior investors through subordination, excess spread, and in some cases reserve accounts or guarantees. The complexity of that structure, however, varies dramatically across instruments—from the relatively transparent master trust mechanics of credit card ABS to the multi-layered reinvestment and overcollateralization dynamics of broadly syndicated loan CLOs.

This report provides institutional investors with a technically rigorous overview of the structured credit landscape as of March 2026, covering CLO mechanics and tranche-level analysis, CMBS structure types and current sector differentiation, and ABS subsector fundamentals. It concludes with a relative value framework comparing structured credit to vanilla investment-grade and high-yield corporate bonds on a spread, duration, and risk-adjusted basis.

The current environment is characterized by tight spreads at the senior end of most structured credit capital stacks—CLO AAA new-issue spreads near SOFR+125 basis points represent multi-year lows relative to history—alongside a more bifurcated picture in subordinate tranches and in CMBS, where office-sector distress has pushed conduit BBB- spreads above 450 basis points. The ABS market presents perhaps the most idiosyncratic landscape: prime auto and credit card AAA spreads remain historically narrow, while rising auto loan delinquencies (now approaching the 2010 GFC-era peak at 5.2% for 90+ day serious delinquencies) and credit card charge-off normalization introduce meaningful sector selection risk in the subordinate tranches.

Key Conclusions

- CLO AAA tranches remain structurally superior to equivalent-rated corporate bonds on a yield, duration, and historical loss basis; however, the spread premium has compressed to near-cycle tight, making entry timing critical.
- CMBS must be approached on a structure-by-structure basis: conduit diversified-pool AAA offers modest pickup over IG corporates with manageable complexity; office SASB and subordinate conduit tranches require deep fundamental underwriting given a 16%+ office delinquency rate.
- Consumer ABS (auto, credit card) at senior tranches provides short-duration carry at minimal credit risk, but subordinate ABS in auto and unsecured consumer faces meaningful stress from cumulative delinquency normalization.
- CLO BB and CMBS BBB- currently offer the most compelling spread compensation for credit risk on an absolute basis, but require sophisticated manager selection and ongoing surveillance.
- For institutional investors constrained to investment grade, a barbell of CLO AAA/AA and conduit CMBS AAA provides superior carry versus equivalent IG corporate exposure with materially shorter duration.

Structured Credit Market Snapshot: Current Spreads and Yields

The table below summarizes current approximate spreads, all-in yields, and key risk factors across the principal structured credit instruments covered in this report. All-in yields are approximations based on prevailing reference rates as of late March 2026: SOFR at approximately 3.65% (effective fed funds rate) and the 10-year Treasury at approximately 4.27%.

Instrument	Rating	Spread (S+)	All-In Yield	Duration	Key Risk
BSL CLO AAA (new issue)	AAA	S+125 bps	~4.90%*	~0.25 yrs	Spread widening; refi risk
BSL CLO AA (new issue)	AA	S+175 bps	~5.40%*	~0.25 yrs	Reinvestment; collateral drift
BSL CLO A (new issue)	A	S+240 bps	~6.05%*	~0.25 yrs	Mezz subordination compression
BSL CLO BBB (new issue)	BBB	S+340 bps	~7.05%*	~0.25 yrs	OC test breach; manager quality
BSL CLO BB (new issue)	BB	S+575 bps	~9.40%*	~0.25 yrs	Elevated default correlation
CLO Equity	NR	Residual	15–20%+ IRR	~0.25 yrs	Manager skill; arb compression
Conduit CMBS AAA (A-S)	AAA	~S+78 bps	~4.43%†	~5.0 yrs	CRE fundamentals; extension
Conduit CMBS AA	AA	~S+145 bps	~5.10%†	~5.0 yrs	Subordinate tranche losses
Conduit CMBS BBB-	BBB-	~S+450 bps	~8.15%†	~5.0 yrs	Office distress; CDR spikes
SASB CMBS AAA (multifamily)	AAA	~S+108 bps	~4.73%†	~3.0 yrs	Single-asset concentration
SASB CMBS AAA (office)	AAA	~S+145–177 bps	~5.10–5.42%†	~3.0 yrs	Work-from-home; lease rollover
CRE CLO AAA (managed)	AAA	~S+150 bps	~5.15%†	~0.25 yrs	Transitional collateral; refi
Prime Auto ABS AAA (2–3yr)	AAA	~T+30 bps	~4.27%†	~1.5 yrs	Prepayment; used car prices
Subprime Auto ABS AAA	AAA	~T+60 bps	~4.57%†	~1.0 yr	Higher CDR; excess spread
Credit Card ABS AAA (3yr)	AAA	~T+35 bps	~4.32%†	~2.0 yrs	Charge-off normalization
Student Loan ABS AAA (gov-gtd)	AAA	~T+40 bps	~4.37%†	~3.0 yrs	Prepayment; policy risk
Equipment ABS AAA	AAA	~T+45 bps	~4.42%†	~2.0 yrs	Industrial demand cycles

**CLO floating-rate yields based on SOFR ~3.65% + stated spread. †Fixed-rate ABS/CMBS yields based on prevailing Treasury reference point at relevant maturity. Spreads are indicative new-issue levels; secondary market may differ. Source: CREFC, PitchBook LCD, AAM, industry estimates.23wsz*

CLO Mechanics and Capital Structure

Structure and Lifecycle

A collateralized loan obligation is a structured finance vehicle that issues multiple tranches of rated debt and unrated equity, using the proceeds to purchase a diversified portfolio of broadly syndicated leveraged loans (BSL CLOs) or, in the case of middle-market CLOs, privately originated senior secured loans. The CLO is managed by a collateral manager, who actively buys and sells loans within defined eligibility criteria during the reinvestment period—typically four to five years from closing. After the reinvestment period ends, principal proceeds amortize the liabilities sequentially from the most senior tranche downward.

The CLO lifecycle has three phases: (1) the ramp-up period, during which the manager purchases the initial loan portfolio from the CLO's warehouse line; (2) the reinvestment period, during which the manager can actively trade and reinvest principal proceeds; and (3) the post-reinvestment amortization period. CLOs also typically include a non-call period—commonly the first two years—during which the equity holders cannot force a refinancing or reset of the liability stack. Resets and refinancings, which reprice the CLO liabilities at current spread levels while resetting the reinvestment period, have been a defining feature of the 2024–2025 market: approximately \$422 billion in CLOs entered or will soon exit their non-call periods in 2026, creating significant reset and refinancing activity.

Waterfall and Overcollateralization Tests

The CLO waterfall governs the distribution of interest and principal proceeds among the tranches. Interest proceeds flow in order of seniority: senior management fees, then AAA interest, AA interest, and so on down the capital stack. Critically, the waterfall contains coverage tests—overcollateralization (OC) tests and interest coverage (IC) tests—that, if breached, divert cashflows away from junior tranches and accelerate repayment of senior notes.

The OC test for a given tranche compares the par value of the loan portfolio (adjusted for defaulted loan haircuts) to the outstanding balance of all notes at that tranche's level and above. For a BBB OC test, this ratio must exceed a defined trigger level—commonly 108%–112%—or interest payments to the BB and equity tranches are diverted to pay down the AAA. This structural feature is the primary mechanism that protects senior investors from collateral deterioration: before a AAA investor experiences even a dollar of principal loss, defaults must be severe enough to exhaust all subordinate tranches and simultaneously breach every OC trigger.

Tranche	Rating	% of Stack	Sub'n Below	Typical Spread	Priority	Key Structural Feature
AAA	AAA	~65%	~35%	S+120–135	1st	Senior OC test; most protected from losses
AA	AA	~10%	~25%	S+170–185	2nd	Second OC test; still IG; minimal historical impairment
A	A	~8%	~17%	S+230–255	3rd	IG rated; interest diversion before principal risk
BBB	BBB	~6%	~11%	S+330–360	4th	First non-IG tranche; most sensitive to CDR spikes
BB	BB	~5%	~6%	S+550–600	5th	HY rated; equity-like vol; manager skill key driver
B	B	~1%	~5%	S+750+	6th	Near equity; thin subordination; high risk/reward
Equity	NR	~5%	N/A	Residual IRR	Last	Unrated; receives excess spread after all fees paid

Source: Illustrative BSL CLO capital structure. Spreads are approximate 2026 new-issue levels per PitchBook LCD / Morgan Stanley consensus. Subordination levels are representative for post-GFC vintage CLOs.

Collateral Quality Tests and Eligibility Criteria

Beyond coverage tests, CLOs are governed by a suite of collateral quality tests that constrain the manager's portfolio construction: maximum weighted average rating factor (WARF), minimum weighted average spread (WAS), maximum concentration in any single obligor or industry, maximum Caa-rated and CCC-rated loan buckets (typically 7.5%–10%), and minimum weighted average recovery rate (WARR). These tests serve as guardrails preventing the manager from migrating the collateral pool toward lower quality in search of higher coupon without corresponding capital structure adjustments.

The CCC bucket is particularly important to monitor in the current environment. When CCC-rated loans exceed the prescribed threshold, excess CCC holdings are marked to market (rather than carried at par) in the OC test calculation, mechanically compressing OC ratios even without actual defaults. Given recent leveraged loan credit dispersion—certain sectors with elevated interest burden are experiencing distress even without a broad recession—CCC bucket utilization warrants ongoing surveillance for CLO investors in the mezzanine tranches.

The CLO Arbitrage and Equity Returns

The CLO equity tranche earns the residual cashflow after all rated debt is serviced and fees are paid. Its return is a function of the arbitrage between the weighted average spread on the loan portfolio and the weighted average cost of the CLO liabilities. With BSL CLO AAA liabilities at SOFR+125 and leveraged loans averaging approximately SOFR+350–400 basis points, the gross arbitrage—before fees and defaults—is approximately 125–175 basis points on a dollar-weighted basis, spread across a leveraged capital structure where equity represents only 5%–6% of the deal. This leverage amplifies returns (and losses) dramatically at the equity level.

The current environment presents a mixed picture for CLO equity. On the positive side, AAA liability costs remain near post-GFC lows, providing historically favorable financing for equity investors. On

the negative side, bank loan spreads are at the 10th historical percentile, with 63% of loans trading above par as of early 2025, compressing the asset side of the arb. The net CLO arbitrage is therefore tighter than the liability cost metric alone would suggest. Equity IRR targets of 15%–20% require either continued tight liability spreads, active management of the loan portfolio toward higher-spread reinvestments as loans prepay at par, or both.

Current Market Conditions and Issuance

The U.S. CLO market enters 2026 on historically high volumes. New BSL and middle-market issuance reached approximately \$203 billion in 2025, a consecutive record year. Consensus forecasts for 2026 call for issuance in the \$185–\$220 billion range, supported by continued M&A loan supply and the large wave of non-call period exits. The dominant theme for 2026 supply is the reset and refinancing pipeline: approximately \$422 billion in outstanding CLOs exit their non-call periods, and managers are incentivized to refinance at current tight liability spreads.

Spread levels at the senior end have tightened materially relative to the 2022–2023 stress period. AAA new-issue spreads for Tier 1 managers average approximately SOFR+122–125 basis points, versus peaks above SOFR+200 during late 2022. The widest 2026 year-end forecasts from sell-side dealers (Deutsche Bank, JPMorgan) project AAA spreads near SOFR+130–135—modest widening from current levels driven by the reset supply wave and potential ETF outflows if rate hike fears suppress demand for floating-rate products. The growth of CLO ETFs (AUM expanding from \$6.3 billion in December 2023 to over \$30 billion by mid-2025) introduces a new technical dynamic: ETF inflows have disproportionately compressed AAA spreads, but outflows during risk-off episodes could create temporary dislocation.

Commercial Mortgage-Backed Securities (CMBS)

Structure Types and Key Distinctions

The CMBS market is not monolithic. Institutional investors must navigate at least four structurally distinct product types—conduit/fusion deals, single-asset single-borrower (SASB) transactions, agency CMBS, and CRE CLOs—each with different collateral profiles, subordination mechanics, and risk drivers. The market recorded approximately \$162 billion in private-label CMBS issuance in 2025, a record, with 2026 KBRA projections calling for \$183 billion in new issuance.

Structure	Collateral	AAA Spread	BBB- Spread	Avg Loan Count	Primary Risk
Conduit / Fusion	Diversified multi-property, multi-borrower	~S+78 (A-S)	~S+450	50–150+ loans	Pool diversity vs. vintage underwriting quality
SASB — Multifamily	Single asset or portfolio; stabilized	~S+108	N/A (typically AAA only)	1–5 assets	Rent growth; cap rate compression; refinancing
SASB — Office	Single class-A tower or portfolio	~S+145–177	N/A	1–3 assets	Tenant lease rollover; remote work secular shift

SASB — Industrial/Data Center	Single logistics or hyperscale asset	~S+90–115	N/A	1–5 assets	Tenant concentration; power capacity; CapEx
CRE CLO (managed)	Transitional bridge loans; value-add	~S+145–155	~S+350–365	20–50 loans	Loan extension; property business plan execution
CRE CLO (static)	Fixed pool; shorter WAL	~S+140–150	~S+340–355	15–40 loans	No reinvestment; faster amortization
Agency CMBS (Freddie K)	GSE-guaranteed multifamily	~S+55–70	N/A (gov-backed)	Diversified pools	Prepayment (yield maintenance provisions)

Source: CREFC (March 2026 data), KBRA, Altus Group. Spreads are indicative new-issue levels as of mid-March 2026. †Fixed-rate yields based on 10-year Treasury at ~4.27% or 5-year Treasury at ~4.10% as applicable.

Conduit / Fusion CMBS

The classic conduit transaction pools 50–150+ commercial mortgage loans across multiple borrowers and property types, securitized into a sequential-pay capital structure with typically ten-year fixed-rate balloon loans as collateral. The diversification of the collateral pool provides the primary basis for the AAA rating at the senior end, supplemented by substantial subordination—typically 20%–30% credit enhancement for the senior-most A1/A2 bond, and approximately 10%–15% for the A-S (junior AAA) tranche.

The A-S tranche is the critical junction point in conduit analysis: it is the last AAA-rated bond in the payment waterfall, with significantly less credit enhancement than the super-senior A1/A2 bonds, and its spread—currently approximately S+78 basis points—reflects the market's aggregate view of conduit pool credit quality and the adequacy of subordination. Below the A-S, the AM (A-minus) tranche is typically rated AA, and spreads widen substantially through the subordinate structure to the BBB- first-loss piece.

The BBB- tranche (also called the first-loss piece or 'B-piece') deserves particular attention in the current environment. Conduit BBB- spreads near S+450 basis points reflect the elevated distress in the conduit universe, particularly from office loans. The overall CMBS delinquency rate stands above 7.0%, with office CMBS delinquencies at approximately 16%—driven by the structural impairment in office demand from remote and hybrid work arrangements. Post-2021 multifamily loans underwritten at peak rent growth assumptions also show stress, with a meaningful proportion of 2023-vintage conduit multifamily already in special servicing. B-piece buyers are typically specialized CRE credit funds that conduct loan-by-loan underwriting of the entire conduit pool; vanilla institutional investors rarely hold conduit BBB- outside of diversified structured credit mandates.

Single-Asset Single-Borrower (SASB) CMBS

SASB transactions securitize a single large commercial real estate loan—or a small portfolio of cross-collateralized loans—against one or a few properties. The structure fundamentally changes the credit analysis: because there is no pool diversification, the investor's return depends entirely on the performance of a single asset and borrower. This concentration risk is reflected in wider spreads at equivalent rating levels compared to conduit AAA, but the transparency of a single-asset analysis also allows investors to form stronger views.

The composition of SASB issuance tells an important story about where institutional capital is flowing in CRE. Office SASB, despite the sector's secular headwinds, accounted for approximately \$25.7 billion of new issuance in 2025, with \$17.2 billion concentrated in Manhattan. This reflects an important bifurcation: trophy-quality Class A office in gateway markets—particularly Midtown Manhattan, Uptown Dallas, and select San Francisco submarkets—is finding abundant financing at competitive spreads, while commodity suburban office remains essentially uninvestable in the SASB market. Data center SASB issuance more than tripled from 2024 to 2025, reaching \$10.7 billion, and is expected to continue growing as hyperscale tenant demand drives development.

Multifamily SASB, backed by agency GSE guarantees or strong institutional sponsorship in stabilized apartment portfolios, currently prices at approximately S+108 basis points for AAA tranches—representing among the tightest spreads in the CMBS universe. Industrial and logistics SASB, supported by strong e-commerce and supply chain demand, similarly prices near S+90–115 basis points at the AAA level. The fundamental risk in both sectors is refinancing: with ten-year balloon loans maturing into a higher-rate environment, even well-performing collateral may face extension risk if cap rates have moved adversely relative to underwritten debt yield assumptions.

Agency CMBS

Agency CMBS—primarily Freddie Mac K-series and Fannie Mae DUS transactions—are backed by the implicit or explicit credit support of the GSEs and represent the most credit-risk-free segment of the CMBS market. Freddie K-series transactions feature a diversified pool of multifamily loans with a first-loss guarantee from the GSE; the guaranteed senior certificates (typically representing 90%+ of the deal) carry an effective U.S. government credit backstop. Spreads for agency CMBS AAA range from approximately S+55–70 basis points, offering a modest premium over super-senior conduit CMBS while eliminating credit risk. The primary risk is prepayment, but Freddie K transactions include yield maintenance provisions that disincentivize prepayment during the loan term, making extension risk the more relevant concern in a rising-rate environment.

CRE CLO

The CRE CLO applies the CLO structure to commercial real estate bridge loans rather than leveraged corporate loans. The collateral consists of floating-rate, short-maturity (typically 2–5 year) transitional loans against value-add or development properties—assets that do not qualify for fixed-rate conduit financing because they are not yet stabilized. CRE CLOs may be static (fixed pool at closing) or managed (the manager can reinvest within eligibility criteria during the reinvestment period).

CRE CLO AAA spreads currently stand at approximately S+145–155 basis points for managed deals—meaningfully wider than conduit CMBS AAA and roughly in line with BSL CLO AAA—reflecting the transitional nature of the collateral and the construction/business-plan execution risk inherent in bridge lending. The wider spread reflects real structural risk: unlike a conduit loan against a stabilized office tower, a CRE CLO loan may be against a multifamily building undergoing renovation with occupancy at 40%. If the business plan fails and the property cannot be stabilized, the bridge loan itself becomes at risk. CRE CLO investors must therefore analyze not just the legal structure but the sponsor's track record, the property's market, and the adequacy of the business plan. YTD 2026 private-label CMBS and CRE CLO issuance totaled approximately \$39.7 billion as of mid-March, running roughly in line with the prior year's pace.

Asset-Backed Securities (ABS)

The ABS market encompasses a broad universe of instruments backed by consumer and commercial receivables—auto loans, credit card balances, student loans, equipment leases, aircraft, and increasingly, more esoteric collateral such as data center power agreements and BNPL receivables. The fundamental appeal of ABS at the senior end is the combination of high structural credit quality (AAA with significant subordination and excess spread), short weighted average life (most ABS amortize within 1–4 years), and yield premium over equivalent-maturity Treasuries or agency securities. The short duration also provides natural protection against interest rate risk—a feature that has made ABS a favored holding for bank treasury portfolios and insurance general accounts.

ABS Sector	Collateral	AAA Spread (approx.)	Avg WAL	Fixed/Float	Key Underwriting Considerations
Prime Auto Loan	New/used vehicle loans, prime FICO 720+	T+25–35 bps	1.5–2.0 yrs	Fixed	CDR, CNL, used vehicle residuals; subrogation
Subprime Auto Loan	Used vehicles, FICO 580–660	T+55–70 bps	1.0–1.5 yrs	Fixed	Higher CDR tolerance; excess spread coverage; servicer quality
Credit Card	Revolving trust; master trust structure	T+30–40 bps	2.0–3.0 yrs	Fixed	Charge-off rate; payment rate; yield; seasoning of accounts
Student Loan (gov-gtd)	FFELP loans; gov principal guarantee	T+35–45 bps	3.0–5.0 yrs	Float (SOFR)	Basis risk (SOFR vs. 91-day T-bill); CPR; policy/IBR risk
Student Loan (private)	Private; no gov guarantee	T+80–120 bps	3.0–6.0 yrs	Fixed/Float	School quality; default rate; no sovereign backstop
Equipment ABS	Heavy equip, machinery, fleet vehicles	T+40–55 bps	2.0–3.0 yrs	Fixed	Obligor diversification; residual value; sector exposure
Aircraft ABS	Commercial aircraft; airline obligors	T+110–180 bps	3.0–5.0 yrs	Fixed	Airline creditworthiness; remarketing; air traffic demand
Consumer Installment / BNPL	Unsecured personal loans, BNPL pools	T+120–200 bps	0.5–1.5 yrs	Fixed	Thin credit enhancement; vintage seasoning; FICO dispersion

Source: AAM 2026 Fixed Income Outlook, New York Fed Household Debt and Credit Report (Q4 2025), TransUnion. Spreads are approximate senior tranche levels; subordinate tranches price significantly wider. WAL = weighted average life.

Auto ABS

Auto ABS remains one of the most liquid and well-understood segments of the structured credit market, with over \$181 billion in new auto loans originated in Q4 2025 alone providing a continuous supply of securitizable collateral. The key credit metrics are the cumulative net loss (CNL) rate, the conditional default rate (CDR), and the monthly payment rate—the speed at which principal is repaid. Prime auto ABS, backed by borrowers with FICO scores typically above 720, historically experience

CNLs well below 1% through the cycle; subordination levels at the AAA are sized conservatively around 5%–10%, providing substantial protection.

The credit picture for the broader auto loan market is more nuanced. Serious delinquency (90+ days past due) across all auto loans has reached 5.2% as of late 2025, approaching the GFC-era peak of 5.3%, though the subprime composition of today's \$1.66 trillion market and the secured nature of the collateral (vehicles can be repossessed) makes the comparison imperfect. Crucially, ABS structures insulate senior investors from pool-level delinquency through multiple layers of protection: excess spread (the difference between the portfolio yield and the cost of the ABS liabilities) absorbs losses before subordination is even touched. In prime auto ABS with excess spread of 200–400 basis points annually, substantial deterioration in CDRs can be absorbed without principal impairment to the AAA. Subprime auto ABS warrants greater caution: higher CDRs, thinner excess spread, and faster collateral amortization all compress the time available for credit enhancement to build.

Sector selection within auto ABS has become more important than it was in the low-default environment of 2021–2022. In the current environment, we favor prime issuers with seasoned portfolios and tight FICO overlays, and mid-prime issuers with demonstrated loss experience across cycles. We are cautious on deep subprime collateral—particularly pools with significant concentration in used vehicles purchased at 2021–2022 peak prices, where residual values have partially corrected—and on servicers with limited track record managing elevated delinquency environments.

Credit Card ABS

Credit card ABS uses a master trust structure, which differs fundamentally from the static pool structure of auto ABS. In a credit card master trust, new receivables are continuously added to the trust as existing balances revolve and are paid down. The trust issues multiple series of notes, each with its own maturity and credit enhancement, against the same underlying pool of accounts. The key performance metrics are the portfolio yield (gross interest income), the monthly payment rate (MPR—how quickly cardholders pay down balances), and the monthly charge-off rate (net credit losses as a percentage of outstanding balances).

Credit card ABS has shown a divergent performance picture in 2025–2026. Aggregate credit card delinquency has moderated from its 2024 peak, partly reflecting the natural charge-off dynamic: severely delinquent accounts are eventually charged off and removed from the denominator. The 90+ day serious delinquency transition rate for credit cards was approximately 7.1% as of Q4 2025—comparable to early Great Recession levels—reflecting genuine stress among lower-income and revolving-dependent cardholders. However, the structural protections in investment-grade credit card ABS are substantial: most AAA-rated series carry 15%–25% credit enhancement, and the early amortization trigger—which converts the revolving trust into an amortizing structure if charge-offs breach a defined threshold—provides a structural safety valve. AAA-rated credit card ABS has not experienced principal impairment in its history. Sector selection focus for institutional investors should center on the credit quality of the account pool, the diversity of the issuer's cardholder base, and the conservativeness of the trust's trigger levels.

Student Loan ABS

Student loan ABS divides cleanly into two categories with radically different risk profiles. Government-guaranteed FFELP (Federal Family Education Loan Program) loans—the legacy program that preceded direct federal lending—carry a principal guarantee from the U.S. Department of Education, effectively making FFELP ABS a quasi-sovereign instrument. Credit risk on FFELP ABS is minimal; the dominant risk is basis risk between the floating-rate liabilities (indexed to SOFR) and the floating-rate assets (indexed to the 91-day Treasury bill), as well as prepayment from income-based repayment (IBR) and other government programs. Private student loan ABS, backed by loans with no government guarantee, is a true credit product: the borrower's income, employment prospects, school quality, and repayment history all matter. Student loan delinquency across the

federal portfolio has remained elevated at 9.6% serious delinquency following the resumption of payment reporting post-pandemic, though the FFELP ABS pools are largely insulated from this by the government guarantee.

Equipment and Other ABS

Equipment ABS—backed by leases and loans against heavy machinery, construction equipment, agricultural equipment, and commercial vehicles—offers moderately wider spreads than prime auto ABS (T+40–55 basis points at the AAA) with similar structural protections. The key differentiator is obligor diversification: equipment ABS pools typically contain hundreds or thousands of underlying leases across industries, providing granular diversification. The primary collateral risk is residual value on operating leases and the creditworthiness of the equipment lessees, many of which are small-to-mid-size businesses with limited public credit data. Aircraft ABS, though structurally similar to equipment ABS, carries materially wider spreads (T+110–180 at AAA) reflecting the concentration in airline obligors and the volatile remarketing value of commercial aircraft. Consumer installment and BNPL ABS—a newer and rapidly growing segment—demands particular caution: thin credit enhancement, short asset lives, and limited vintage performance data make this the highest-risk segment of the ABS universe for structured credit investors.

Relative Value: Structured Credit vs. Investment-Grade and High-Yield Corporates

The fundamental relative value argument for structured credit rests on three pillars: spread premium for equivalent ratings, duration advantage (particularly for floating-rate CLOs and short-WAL ABS), and structural protections absent in vanilla corporate bonds. The table below positions key structured credit instruments against comparable-rated corporate bond benchmarks.

Asset Class	Rating	Approx. OAS / Spread	Duration	RV Observation vs. IG Corps
IG Corp AAA (index avg)	AAA	~S+50 bps	~7.0 yrs	Baseline; longer duration; no structural protection
IG Corp BBB (index avg)	BBB	~S+115 bps	~7.0 yrs	Baseline; sector/issuer credit risk; no waterfall
CLO AAA (BSL new issue)	AAA	~S+125 bps	~0.25 yrs	+75 bps pickup; zero duration; historical zero losses
CLO AA (BSL new issue)	AA	~S+175 bps	~0.25 yrs	+125 bps pickup vs. IG AA; structural leverage benefit
CLO BBB (BSL new issue)	BBB	~S+340 bps	~0.25 yrs	+225 bps pickup vs. IG BBB; subordination buffer; active mgmt
Conduit CMBS AAA (A-S)	AAA	~S+78 bps	~5.0 yrs	+28 bps vs. IG AAA; CRE collateral; higher complexity premium
Prime Auto ABS AAA	AAA	~T+30 bps	~1.5 yrs	Tight but short WAL; convexity from amortization; liquidity

Credit Card ABS AAA	AAA	~T+35 bps	~2.0 yrs	Master trust; early amortization trigger adds optionality risk
HY Corp BB (index avg)	BB	~S+270 bps	~4.0 yrs	Comparable to CLO BB at much wider spread; duration risk
CLO BB (BSL new issue)	BB	~S+575 bps	~0.25 yrs	+305 bps vs. HY BB; floating; structural subordination buffer

Source: IG/HY corporate spreads based on ICE BofA index OAS (approximate late-March 2026 levels). Structured credit spreads per prior tables. Duration figures are approximate; corporate bond durations reflect index averages. RV observations are qualitative.

The Case for CLO Senior Tranches

The relative value argument for CLO AAA and AA tranches over equivalent-rated corporate bonds is among the most durable in fixed income. At SOFR+125 basis points for AAA, CLO senior notes offer approximately 75 basis points of spread pickup over AAA corporate bonds—with materially shorter duration (0.25 years versus ~7 years), floating-rate coupon (eliminating interest rate risk), and the benefit of a structural waterfall with active collateral management. The historical track record reinforces the argument: no AAA or AA CLO tranche has experienced a principal impairment since the post-GFC era of more conservative structural design. This record holds through the 2020 COVID shock, which involved the sudden suspension of leveraged buyout activity and significant leveraged loan price dislocations.

The primary risk to the relative value thesis at the senior end is technical rather than fundamental. ETF inflows have been a dominant driver of AAA CLO spread compression since 2023; if rate hike fears or a broader risk-off episode prompt ETF outflows, AAA spreads could widen 20–40 basis points rapidly—not because credit quality has deteriorated, but because the marginal buyer has become price-sensitive. Investors with longer time horizons and the ability to hold through spread volatility can treat such episodes as buying opportunities; managers with mark-to-market mandates face temporary drawdown risk.

The Case for Subordinate CLO Tranches

For investors willing to accept high-yield equivalent risk in exchange for dramatically superior structural protection, CLO BB tranches present a compelling argument. At SOFR+575 basis points, CLO BB notes offer approximately 305 basis points of spread premium over comparably-rated HY corporate BB bonds—with zero duration risk (floating rate), active management of the underlying collateral pool, and meaningful subordination from the equity and B tranches before the BB is at risk of principal impairment. The CLO BB investor does not face the binary event risk of a single corporate issuer defaulting; instead, the tranche is exposed to aggregate default correlation across 100–250 leveraged loans. In a moderate default environment, the structural excess spread at the BB level—generated by the difference between loan spreads and the cost of senior liabilities—absorbs losses before principal is touched.

The risks are real and require expertise to underwrite. CLO BB performance is highly dependent on manager quality: active reinvestment decisions, CCC bucket management, and obligor selection all materially affect BB outcomes across the CLO universe. In a severe credit cycle—similar to 2008–2009—CLO BB tranches can experience significant principal impairment, particularly in older vintage CLOs with looser structural covenants (so-called 'covenant-lite' CLOs) and higher leverage ratios. Current vintage CLOs benefit from post-GFC structural improvements, including higher subordination requirements and more conservative trigger levels.

CMBS vs. Corporate Bonds

Conduit CMBS AAA (A-S) offers approximately 28 basis points of spread pickup over IG AAA corporate bonds at a duration of approximately 5 years—a relatively modest premium that reflects both the structural protection of the conduit pool's credit enhancement and the growing market sophistication around conduit analysis. The pickup has compressed from the 2022–2023 period when CRE distress was more acute and CMBS spreads were materially wider. For investors seeking more meaningful spread pickup within investment-grade constraints, CRE CLO AAA (S+145–155) and conduit CMBS AA (S+145) offer approximately 95–125 basis points of pickup over IG corporate equivalents, with the caveat that both instruments require deeper CRE credit analysis.

CMBS BBB- stands in a category of its own: at S+450 basis points in conduit deals, it is approaching the spread of high-yield corporate debt but with CRE-specific risks (office distress, maturity wall, cap rate sensitivity) that require specialized underwriting. Institutional investors who approach CMBS BBB- as a generic high-yield alternative without rigorous loan-level analysis are accepting risks they may not fully appreciate. The recommendation for most institutional mandates is to remain at or above the A tranche in conduit CMBS, and to seek B-piece exposure only through specialized managers with deep loan-level underwriting capability.

ABS vs. Short-Duration Alternatives

Short-WAL consumer ABS (prime auto, credit card) competes most directly with short-duration Treasuries, agency debt, and money market alternatives. At T+30–40 basis points for prime AAA tranches with 1.5–2.5 year WAL, consumer ABS offers modest but consistent pickup over equivalent-maturity Treasuries while maintaining near-sovereign credit quality at the senior level. The amortizing nature of auto ABS and the prepayment variability of credit card trusts introduce modest uncertainty around actual WAL relative to stated projections—but for investors managing to a target liquidity profile rather than a precise maturity date, this variability is manageable. Bank treasury portfolios and insurance general accounts have historically been the dominant buyers of senior consumer ABS for precisely this reason: high credit quality, short duration, and a carry premium over agency alternatives that accrues predictably across market cycles.

Key Risks and Institutional Considerations

Structural Complexity and Operational Risk

Structured credit instruments require ongoing monitoring that vanilla corporate bonds do not. A CLO investor must track the performance of 100–250 underlying leveraged loans, monitor coverage test ratios, assess manager trading activity, and evaluate collateral quality test compliance. A CMBS investor must track property-level occupancy, DSCR trends, servicer watchlist additions, and special servicing events for each loan in the pool. This operational complexity is a genuine risk: investors who enter structured credit markets without adequate analytical infrastructure—surveillance systems, legal document expertise, and direct line of communication with trustees and servicers—risk being the last to know when subordinate tranche protection is being eroded.

Liquidity Risk

Structured credit securities are less liquid than comparably-rated corporate bonds, particularly in stress environments. CLO AAA tranches from established managers trade with reasonable two-way liquidity in normal markets; CLO BB and CMBS subordinate tranches can gap significantly in bid-ask spreads during risk-off episodes, as seen during the 2020 COVID shock and the 2022 rate spike.

Investors must size positions consistent with their true liquidity horizon—the period over which they can hold through spread volatility without being forced sellers—rather than the theoretical liquidity implied by daily NAV calculations. The growth of CLO ETFs has improved AAA liquidity but simultaneously introduced a new source of technical volatility driven by retail flow dynamics.

Manager and Servicer Risk

CLO equity and subordinate tranche returns are meaningfully differentiated by manager quality. Academic and practitioner analysis consistently shows that top-quartile CLO managers outperform bottom-quartile managers by 100–300 basis points annually in equity IRR, with the differential materializing primarily through better loan selection, more disciplined CCC management, and superior reinvestment timing. Similarly, CMBS servicer quality directly affects recovery rates on distressed loans: special servicers with active CRE workout capabilities, strong legal resources, and aligned incentive structures (owning the first-loss B-piece, for example) systematically achieve better recoveries than passive trustees. Institutional investors accessing structured credit should conduct formal manager due diligence—reviewing historical track records across CLO vintages, analyzing manager trading behavior in prior stress cycles, and assessing the alignment of interests between manager and investor.

Regulatory Capital Treatment

For bank investors subject to Basel III risk-based capital requirements, structured credit instruments carry nuanced capital treatment that materially affects the economics of holding them. CLO AAA tranches held by banks under the standardized approach receive risk weightings that vary based on regulatory optionality; the Advanced Internal Ratings-Based (AIRB) approach allows banks to use their own risk models for non-securitization exposures but imposes the Supervisory Formula Approach or Simplified Supervisory Formula Approach (SSFA) for securitization tranches, which can produce punitive capital charges for subordinate tranches. Insurance investors should assess NAIC risk-based capital charges, which have become more granular for CLO holdings following the NAIC's CLO modeling initiative. Pension funds operating under ERISA must assess whether structured credit investments constitute eligible plan assets and whether any fiduciary duty concerns arise from complexity-related risks.

Conclusion and Positioning Framework

Structured credit is not a homogeneous asset class, and the most common mistake institutional investors make is treating it as one. CLO AAA tranches, prime auto ABS, government-guaranteed student loan ABS, and agency CMBS represent fundamentally different risk/return propositions than CLO equity, conduit CMBS BBB-, or BNPL ABS—even though all are labeled 'structured credit.' The technical sophistication required to navigate the universe is high, but so is the potential reward for investors who invest in that capability.

The current opportunity set, as of March 2026, is most compelling in the following areas. CLO AAA and AA tranches offer a structurally superior alternative to equivalent-rated corporate bonds, with a meaningful spread premium, zero duration, and the best historical loss track record of any fixed income instrument at those rating levels. The spread premium has compressed from 2022–2023 peaks, but the fundamental relative value thesis remains intact. Investors with tolerance for spread volatility can add CLO BB exposure selectively, favoring managers with demonstrated performance across the 2020 and 2022 stress periods and deals with robust OC test headroom.

In CMBS, the most attractive risk-adjusted exposure is in conduit AAA and agency CMBS, where structural protections are strongest and the CRE distress affecting subordinate tranches is most

insulated. Data center and industrial SASB AAA offers differentiated exposure to secular growth themes with strong tenant credit quality. Office SASB requires loan-by-loan fundamental analysis; conduit BBB- requires B-piece buyer-level due diligence and should not be sized as a generic yield enhancement allocation.

In ABS, prime auto and credit card AAA remain appropriate short-duration holdings for institutional investors managing to a conservative risk mandate. Equipment ABS offers incremental spread pickup with manageable complexity. The caution flags are in deep subprime auto collateral, BNPL, and private student loan ABS—all of which require bottom-up underwriting of collateral performance in a consumer credit environment that has deteriorated from pandemic lows.

For the institutional investor new to structured credit, the practical starting point is CLO AAA/AA and agency CMBS—products where the structural protections are most robust, the analytical framework is well-established, and liquidity is most reliable. As analytical infrastructure matures, selective extension into CLO BBB and high-quality conduit CMBS AA provides additional carry with manageable incremental risk. Subordinate tranches, CLO equity, and CMBS B-piece should be accessed through specialized managers with direct underwriting capability, not allocated as passive portfolio exposures.

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