

CLOs Explained

April 2026

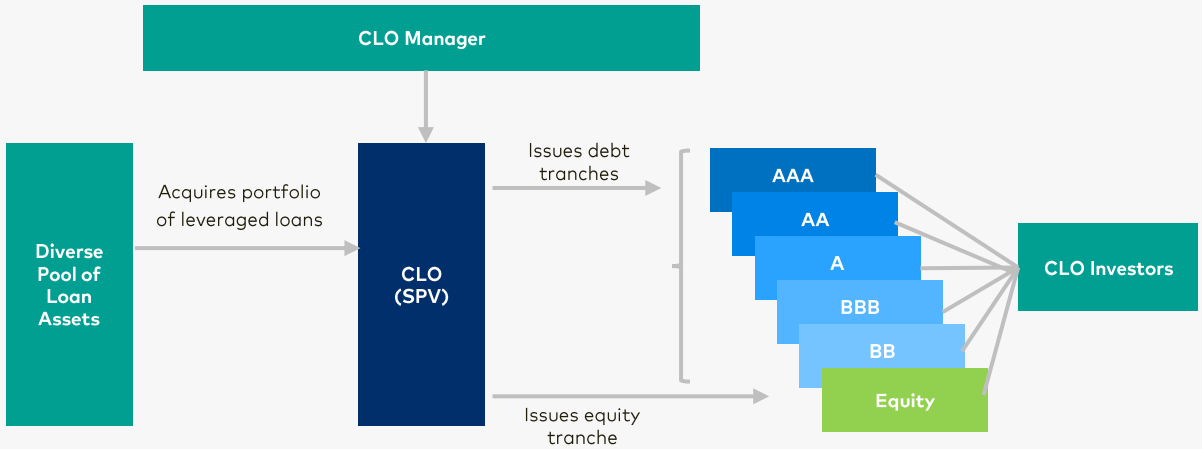
1. What is a CLO?

Collateralized Loan Obligations ("CLOs") are structured finance vehicles that raise money from investors by issuing various tranches of securities. The sale of these CLO securities fund the purchase of a diverse pool of underlying corporate Broadly Syndicated Bank Loans ("BSLs") which collateralizes a CLO. The underlying loans in a BSL CLO are actively managed by the CLO manager, like an investment fund.

2. How does a CLO work?

- A CLO issues two types of tranches – debt and equity – to fund the purchase of underlying loans. Each tranche represents varying levels of risk and return to meet the needs of different investors.
- CLO tranches are formed through the securitization process – the creation of asset-backed securities. This process starts with the establishment of a special purpose vehicle ("SPV"). The SPV serves two purposes: 1.) to act as the "issuer" of CLO tranches to investors to finance the acquisition of loan assets; and 2.) To provide a home for the acquired loans, which are held by the CLO and actively traded by the CLO manager. The CLO tranches issued to investors are asset-backed securities, which are secured by the underlying loans that are purchased by the CLO.
- Debt tranches are issued with ratings typically ranging from AAA to BB. These ratings depend on the amount of subordination or the hierarchy of repayment of each tranche. Higher rated tranches are first in line to receive cash flows from the loans (and accordingly are the least risky), while lower rated tranches are last in line (and accordingly are the most risky).
- The "equity" tranche (or "Subordinate Notes") is usually held by a combination of the CLO manager and third-party investors.

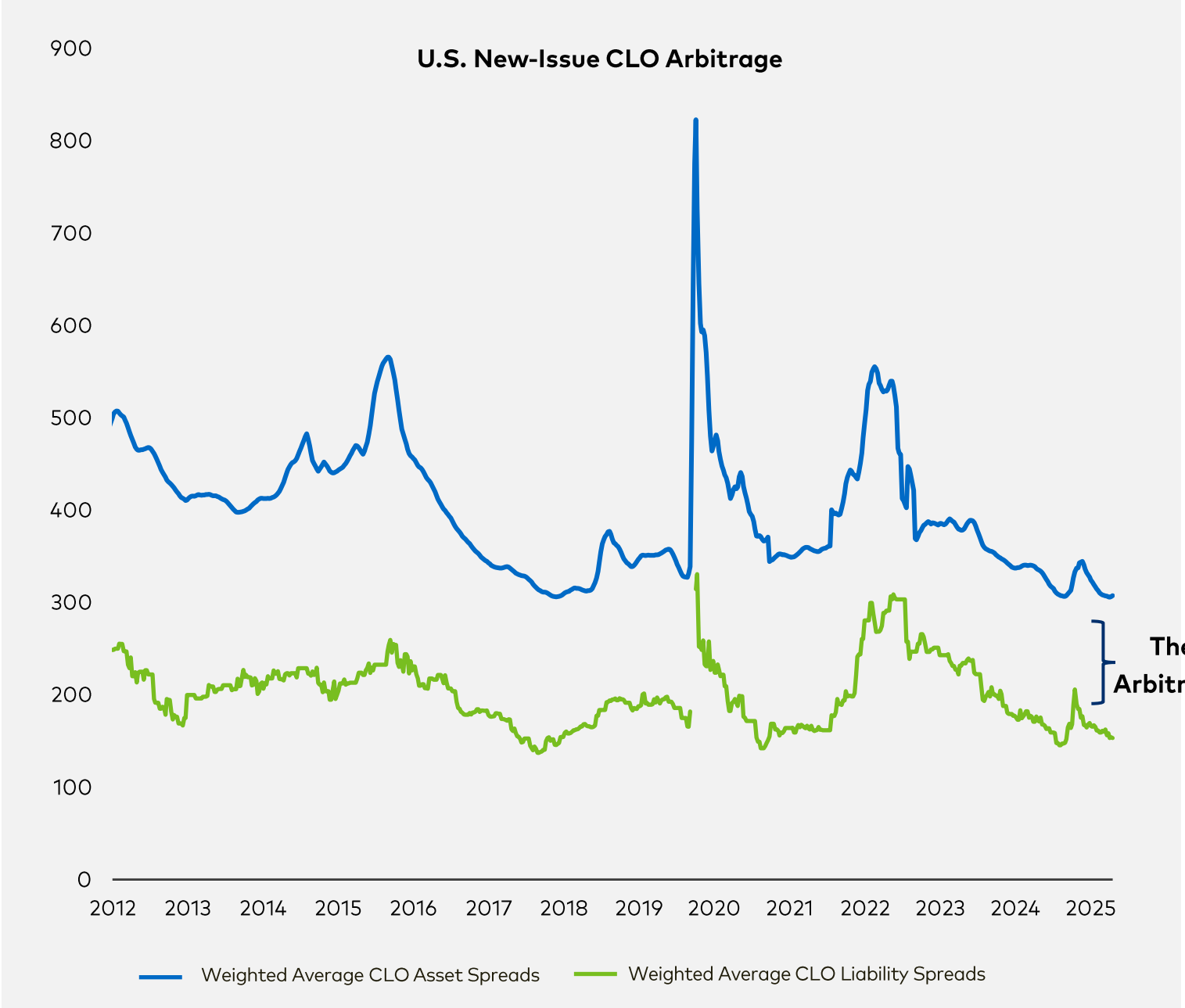
CLO Securitization



3. How does a CLO generate returns for investors?

- CLOs aim to **capture cash flow arbitrage** - the excess spread between the interest and principal received on the loan portfolio (assets) held by the CLO, on the one hand, and the payments due to the investors of the various CLO debt tranches (liabilities), on the other.

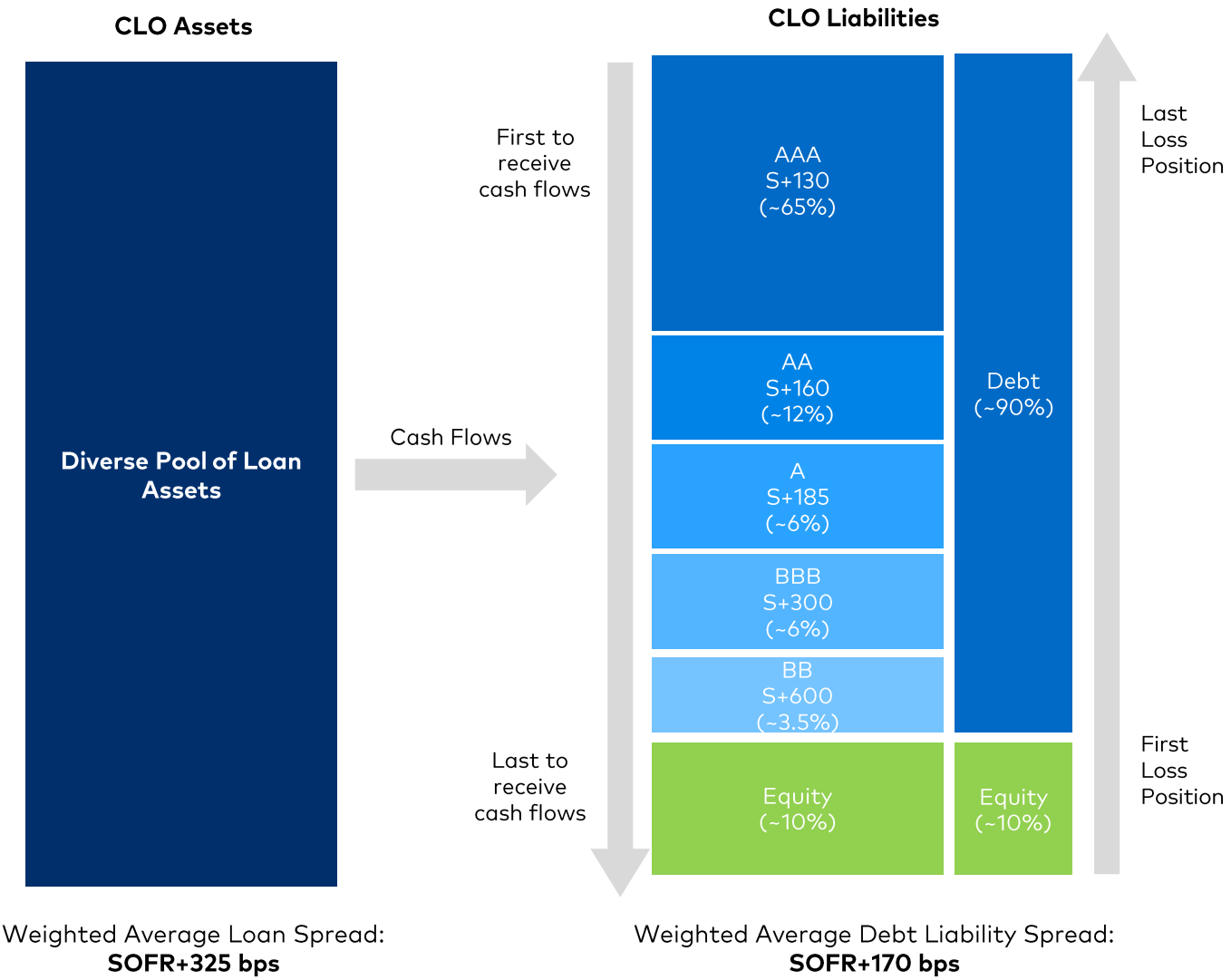
- Any excess cash remaining after all CLO liabilities are paid (i.e., all CLO expenses plus all coupon and principal payments on the debt tranches) belongs to the CLO Equity investors. This is known as the "Arb" or "Arbitrage" and represents the return to CLO Equity investors.



Source: Source: BofA Global Research, LCD as of June 2024. There is a short break in reported data in late March 2020 due to the COVID-19 Pandemic.

4. How do CLOs capture this "Arb"?

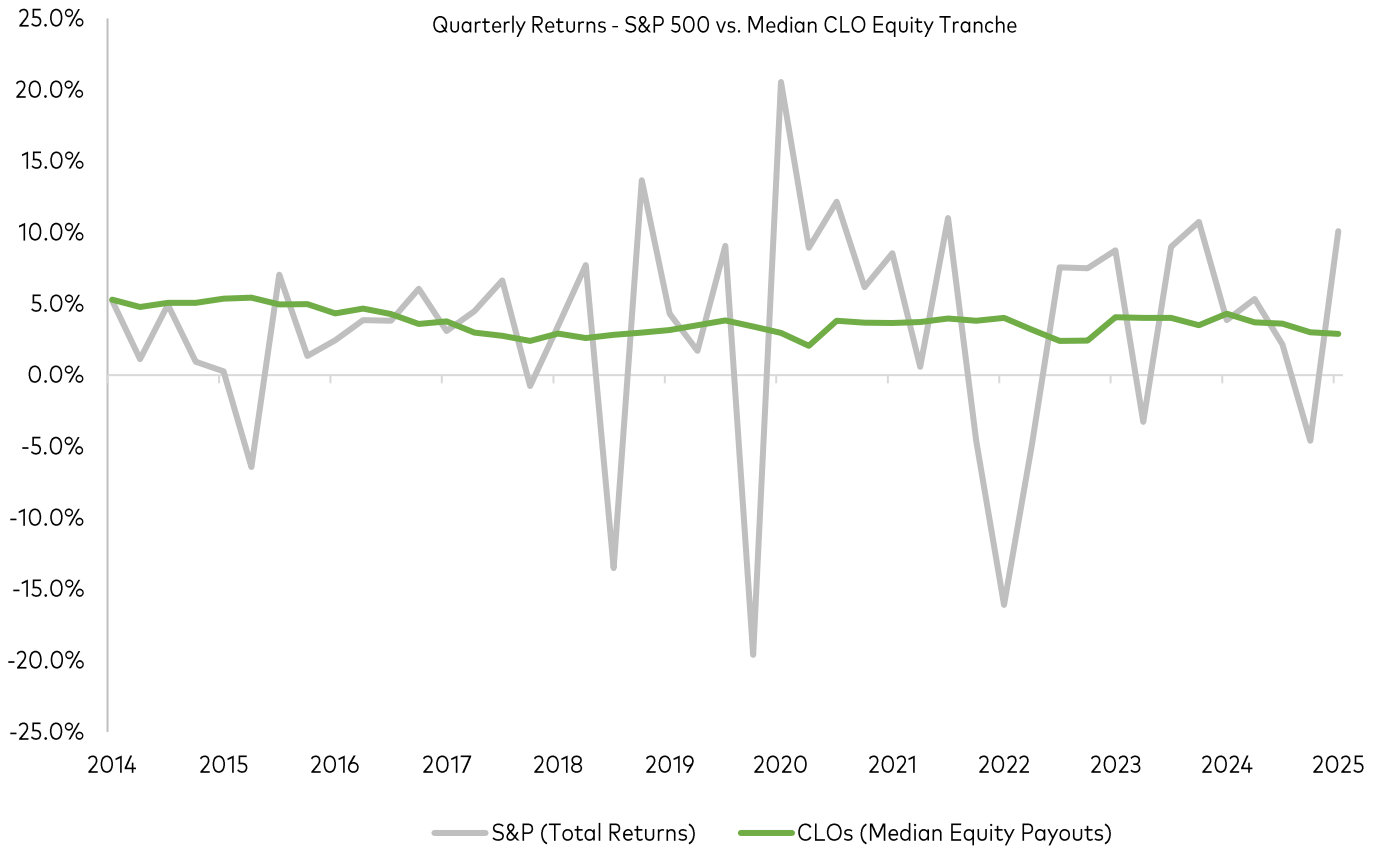
- Below is an example of how the capital structure of a CLO aims to capture the funding gap, or "arb", between CLO assets and CLO labilities (the gap seen in the graphic on page 2).
- CLOs receive income from the diverse pool of loans held in the SPV (left hand side) and subsequently distribute income to CLO Debt investors (right hand side) according to the CLO's cash flow waterfall. The cash flows through a waterfall, or priority of payments - the most senior tranches are paid first, followed by junior tranches.
- If, after fees and credit losses are accounted for, the income received by the CLO is greater than the income distributed to CLO Debt investors, any leftover cash is then distributed to CLO Equity investors. Notably, CLO Equity returns are typically magnified by the use of leverage, with CLO loan-to-values typically around 90%, reflecting the ratio of CLO Debt to CLO Equity within a CLO's capital structure.
- In today's market, a CLO earns more on its underlying pool of loans than it pays to finance them (roughly a ~1.5% spread). This difference, which is passed to CLO Equity investors as quarterly income, has historically resulted in average annual returns on CLO Equity in the mid-teens.
- While the cost of CLO Debt remains fixed over the three-month short-term rate, the Weighted Average Spread ("WAS") of the underlying loan pool within a CLO will move higher or lower during the CLO's lifecycle as a result of active management by the collateral manager.



Past performance is not indicative of future results. Actual performance results for a CLO equity tranche, which may not achieve this level of return, will vary.

5. How has CLO Equity Performed Historically?

CLO Equity has typically provided double-digit annual returns, with less volatility vs. public equity markets.

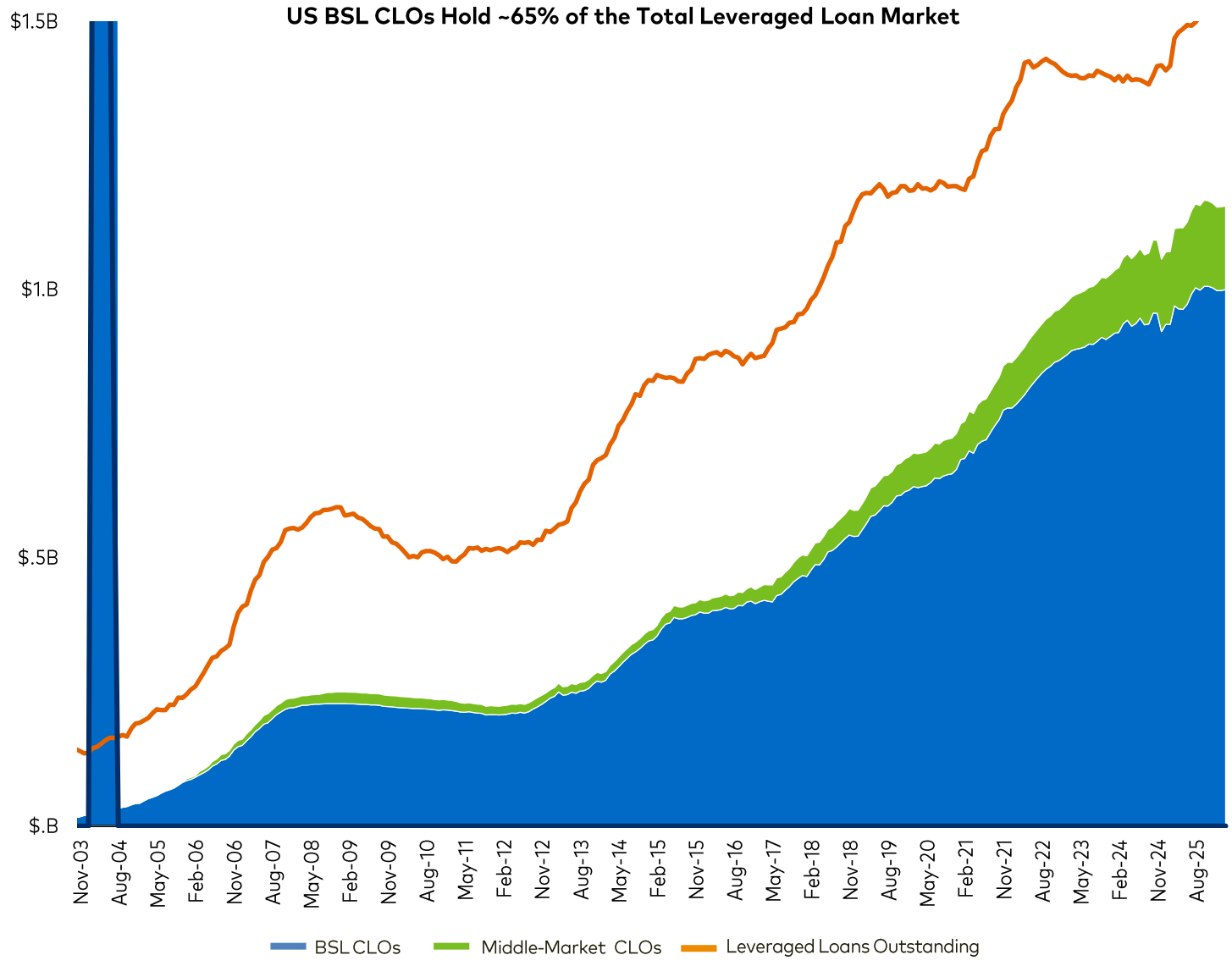


Year	S&P 500	CLO Equity	+ / - CLO Equity
2025	18%	16%	-2%
2024	23%	16%	-7%
2023	26%	14%	-12%
2022	-18%	13%	31%
2021	29%	15%	-14%
2020	18%	12%	-7%
2019	31%	13%	-19%
2018	-4%	10%	15%
2017	22%	12%	-10%
2016	12%	17%	5%
2015	1%	19%	17%
2014	14%	18%	4%
2013	32%	17%	-16%

Source: Bloomberg Finance LP, Intex, Markit, Deutsche Bank as of December 31st , 2025 CLO universe represented by all outstanding CLOs. The S&P 500 Index, which is maintained by S&P Dow Jones Indices, is a market capitalization weighted index that measures 500 common equities that are generally representative of the U.S. stock market. **Past performance is not indicative of future results.**

6. Where do the loans come from that are held in CLOs?

- The underlying collateral held in a CLO typically comprises 200-300 individual leveraged loans across various sectors and borrowers in the United States.
- The leveraged loan market consists predominantly of loans issued by non-investment grade U.S. corporate companies that are typically senior secured, floating rate, and callable. These loans, which are known as Broadly Syndicated Loans ("BSLs"), get their name by the way they are issued and sold to investors - through a bank's syndication desk. BSLs typically have a deep and liquid secondary market.
- There is a growing area of the leveraged loan market, known as the "middle-market" or "private credit", in which loans are issued to smaller companies and often directly from a lender to a company (i.e., as a direct loan with no broad syndication). These types of loans, which are used to collateralize "middle market" CLOs, in the aggregate are approximately 10% the size of the BSL market. CLOs backed by "middle market" or "private credit" are loans originated directly by the lender and are less likely to be traded within a CLO.
- The leveraged loan market currently has ~US$1.4 trillion loan outstanding, with over 50% of issuances exceeding US$1.0 billion in size, primarily coming from larger corporations.



Source: BofA Global Research, Intex, LCD, as of March 2026.

7. How does a CLO mitigate risk?

CLOs have embedded structural protections to promote diversity and risk management...

Diversification	• Exposure to various industry sectors and borrowers via 200-300 underlying loans, which drives a manager's Diversity Score – a quantification of sector and issuer diversification (higher number implies more diversity).
Locked-Up Capital	• Non-mark-to-market vehicle; when loan prices decline, CLOs are not forced sellers. • Ability to buy loans at discounts during market dislocations when others are selling. • Ability to refi/reset CLO liabilities, which provides optionality for the equity tranche by reducing the overall cost of financing for the CLO.
Active Management	• BSL CLO managers have the ability to 1.) sell credits to mitigate losses; and 2.) purchase assets to take advantage of relative value opportunities. • Any gains from secondary trading of the loan collateral can increase credit support • Constant focus on maintaining sufficient risk mitigation
Risk Measurements	• Trigger-based **collateral** and **performance** tests force redirected cashflows • Interest Coverage Tests, Overcollateralization Tests, and Weighted Average Risk Factor (WARF), Weighted Average Spread (WAS), 2nd Lien Limits, and CCC Limits • Repayment of CLO debt tranches may be required using cash interest

...and 2.0 CLOs, which emerged following the Great Financial Crisis of 2008, offer even more structural advantages, which helps preserve capital and generate attractive returns

Enhanced Structural Protections

	Pre-Crisis 1.0 CLOs	Post-Crisis 2.0 CLOs
Leverage	12.0x	10.0x
AAA Par Subordination	26.0%	35.0%
BB Par Subordination	5.6%	8.4%
Permitted Collateral	15-20% Non-Senior Secured Loans (Structured Finance, Synthetic etc.)	5-10% Non-Senior Secured Loans
Refinancing Capabilities	None	Permitted
Weighted Average Default Rate (Across All Debt Tranches)	0.9%	0.2%

Source: Wells Fargo Research, JPMorgan, Guggenheim Investments, S&P Global Ratings Credit Research & Insights and S&P Global Market Intelligence's CreditPro®. CLO tranche default rate as of December 31, 2025. The economic environment that brought the Global Financial Crisis differs from today's economic environment.

8. CLOs, CDOs – what's the difference? Are they the same?

- CLOs are not CDOs. CDO stands for Collateralized *Debt* Obligation – the key word being "debt", which is a catch-all term for various types of debt.

- The primary difference between CDOs and CLOs is the underlying collateral. As noted, CDOs can contain various forms of debt, such as consumer credit card loans, auto loans, mortgage-backed securities and even other CDOs ("CDOs Squared"). On the other hand, CLO collateral is made up of broadly syndicated *loans* from varying corporate issuers across a range of industry sectors.

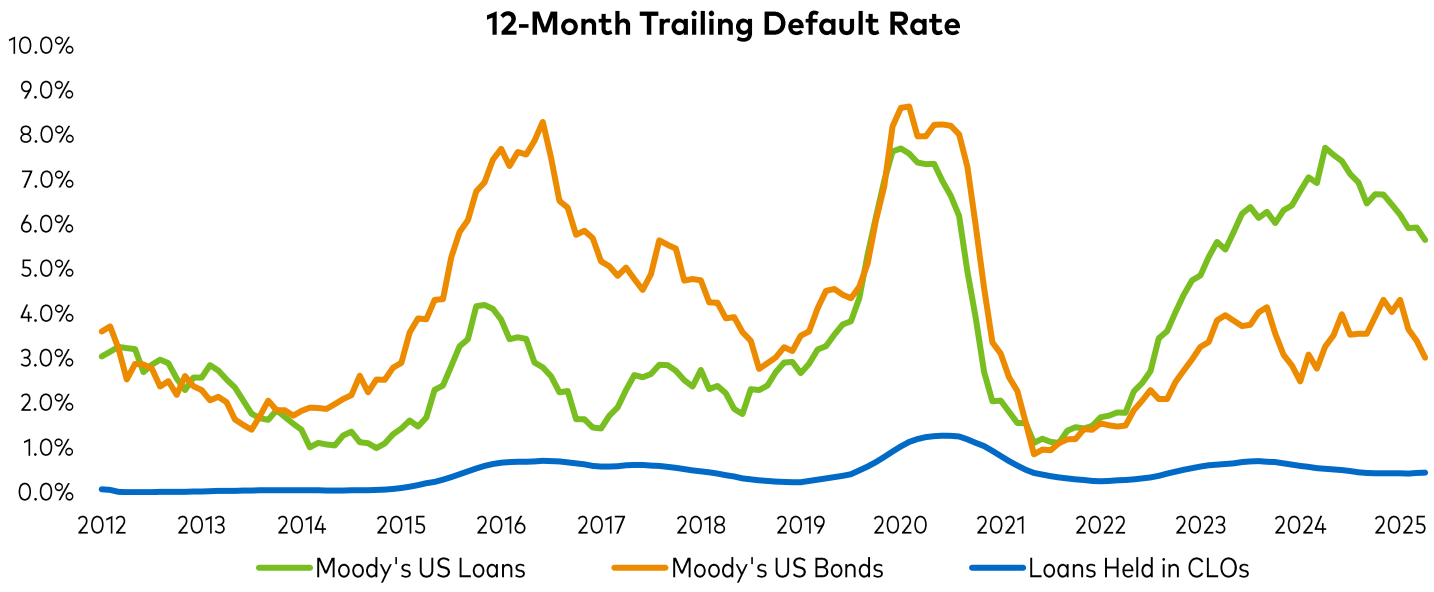
- One misconception is that CLOs are highly risky and played a significant role in the 2008 Global Financial Crisis. This confusion stems from similar names and structural features. However, the CDOs that contributed to the 2008 financial crisis were largely backed by a single asset class, subprime mortgages, resulting in highly correlated collateral that deteriorated simultaneously when the housing bubble burst. Additionally, sub-prime CDOs were largely synthetic CDOs using Credit Default Swaps of Asset-Backed Securities, which magnified outcomes. The underlying collateral protection for these CDOs was very different than the collateral (i.e., broadly syndicated loans) underlying CLOs during the financial crisis and today. Such CLOs are collateralized by bank loans held in the SPV and do not utilize synthetics or CDS of ABS.

- The result – AAA CLO tranches have yet to default, and the weighted average default rate of all CLO tranches issued is below 1% - with CLOs issued post-GFC well below that level.

	Default %	
Orig. Rating Category	**Pre-GFC CLOs (CLO 1.0)**	**Post GFC CLOs (CLO 2.0)**
AAA	0.0%	0.0%
AA	0.2%	0.0%
A	0.6%	0.0%
BBB	1.1%	0.0%
BB	3.9%	0.6%
B	10.7%	2.8%
Total	**0.9%**	**0.1%**

CLO tranche default counts as of December 31, 2025. Source: S&P Global Ratings Credit Research & Insights and S&P Global Market Intelligence's CreditPro®.

CLO default rates are a direct result of the underlying loans held in the CLO, which default rates have remained lower than high yield bonds. Furthermore, low historical CLO default rates have been primarily due to the active management, diversification, and structural protections offered by CLOs.



Sources: PitchBook LCD, Moody's, Intex, Deutsche Bank as of April 2026.

9. Why do investors overlook the asset class?

1. CLOs are a relatively new asset class with only 25+ years of history. They are mainly tailored to major institutional investors such as insurance companies, pension funds, banks, and hedge funds. While CLOs were smaller and more opaque pre-Great Financial Crisis, today's CLO market has grown into a healthy, thriving and transparent market. More recently CLO ETFs and mutual funds have provided non-institutional investors listed product allowing them to participate in CLO investing.

2. The perceived complexity and often misunderstood risks and rewards associated with investing in CLOs have deterred investors. That has provided a spread premium versus the High Yield and Leverage Loan markets.

3. As CLO tranches are private securities, average investors typically do not have easy access to them. In particular, investing in CLO debt tranches oftentimes requires partnering with sophisticated institutions that have structuring and trading expertise coupled with analytical resources.

10. What makes CLOs particularly attractive to investors?



11. Why CLO Equity?

Exposure to Senior Secured Loans	Underlying loans held by CLOs are senior and secured instruments – which have historically exhibited low defaults and relatively high recovery rates
Insulated from Interest Rate Volatility	Underlying loans held by CLOs are floating rate – mitigating adverse impact from any continued increases in interest rates
Highly Diversified Portfolios in Large Established Corporates	CLO portfolios typically consist of over 200 broadly syndicated loans across varied sectors, providing investors with diversification benefits
Attractive Return Potential	Attractive return potential given the spread between the underlying loans and the cost of senior tranches in the CLO. Active portfolio management provides for ongoing risk mitigation and the ability to capture attractive returns during periods of market volatility
Transparency	CLO reporting offers detailed transparency to investors, including details of underlying exposures and portfolio-level metrics
Locked-In Financing	CLOs can capture market dislocations. Furthermore, CLO Equity owns call rights after a short Non-Call Period that creates optionality for reducing overall financing cost via "refinancing" and "resetting" of the outstanding CLO debt liabilities in part or whole.

Disclosures:

For Market Sounding Purposes Only.

Investing in CLOs is not without risk, including the possible loss of principal. As with other securities, CLOs are subject to credit, liquidity, and mark-to-market risk, and the basic architecture of CLOs requires that investors must understand the waterfall mechanisms and protections as well as the terms, conditions, and credit profile of the underlying loan collateral. The content contained herein is not intended to be and should not be construed as legal or tax advice and/or a legal opinion. Always consult a financial, tax and/or legal professional regarding your specific situation. An investor in any CLO should carefully read the applicable disclosure document, such as an offering memorandum, before investing.

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