

AAA CLOs and the search for efficient income

Insights from Invesco Insurance CLO Breakfast Roundtable | September 2026

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The key question isn't whether CLOs are complex, but whether the structure, collateral and implementation are understood well enough to use them appropriately."

Key takeaways

- Insurers are seeking more income without materially increasing capital consumption, balance-sheet volatility, or liquidity risk.
- AAA collateralised loan obligations (CLOs) typically combine floating-rate income, structural protection, and diversification, but remain underrepresented on European insurance balance sheets.
- Regulatory reform, improving liquidity, and broader implementation options are reopening the strategic case for senior CLO exposure.
- Governance, operational readiness, and legacy perceptions remain important barriers to adoption.

Why insurers are taking a fresh look at structured credit

The insurance industry continues to face a difficult balancing act. Investment teams are being asked to enhance portfolio income while preserving capital, managing volatility, maintaining liquidity, and meeting increasingly complex regulatory, and accounting requirements.

Against this backdrop, collateralised loan obligations (CLOs) are moving back into focus. At a recent Invesco roundtable, insurers, Lloyd's market participants, consultants, and industry representatives discussed how the AAA CLO market has evolved, how regulation is changing, and whether senior CLOs could play a larger role in insurance portfolios. The conversation was framed around the question: Can senior CLO exposure improve overall portfolio efficiency while remaining consistent with an insurer's liabilities, governance framework, accounting basis, and tolerance for mark-to-market volatility? Here are the key takeaways from the roundtable.

Different starting points, common constraints

The portfolio problem rather than the asset class kicked off the roundtable. Across life and non-life markets, insurers are looking for ways to:

- Increase income without materially increasing credit risk
- Improve capital efficiency
- Reduce sensitivity to interest-rate volatility
- Maintain liquidity through stressed markets
- Meet return objectives within fixed income allocations

A recurring observation was that the objective is not simply to add risk — it's to identify exposures capable of improving overall portfolio efficiency. For non-life and surplus portfolios, the appeal of short-spread duration, floating rate income can be particularly relevant. For life insurers, the case may be more selective, especially when matching adjustment eligibility and operational requirements shape implementation. Senior tranches, particularly AAA and AA, were viewed as the more natural entry point for insurers seeking a defensive exposure. Lower-rated tranches were recognised as having materially different credit, liquidity and capital characteristics.

Why CLOs are back on the agenda

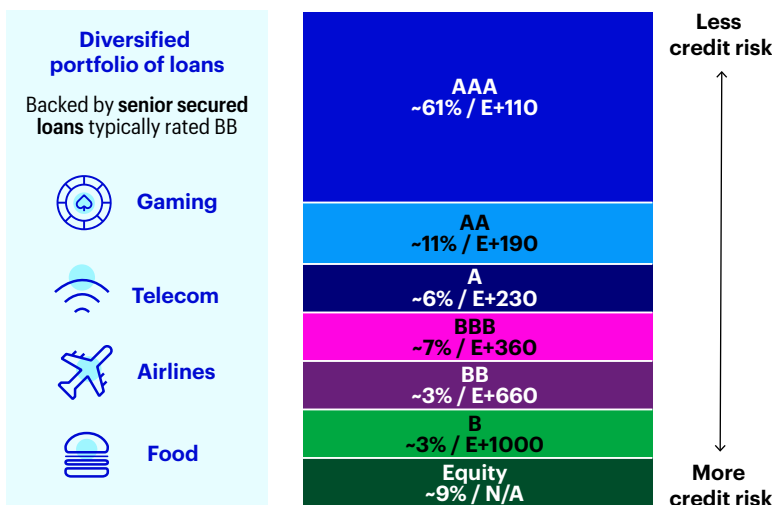
The global CLO market is now a large and established part of the credit landscape, spanning US and European issuance. Yet structured credit remains a relatively small allocation for many European insurers, reflecting historically punitive capital treatment and the long shadow of the 2008 Global Financial Crisis.

Roundtable participants stressed that the senior CLO market shouldn't be viewed through the same lens as pre-crisis structured products. Post-crisis structures generally featured stronger collateralisation, more consistent portfolio tests, and mechanisms that redirect cash flows when collateral performance deteriorates. Risk-retention frameworks have also reinforced alignment in the European market.

What are CLO (collateralized loan obligation) notes?

Debt security that represents rated securitizations of a pool of senior secured loans

Illustrative US dollar (USD) CLO structure



- CLOs are **diversified pools of loans** selected by loan managers, and then structured into tranches of debt (**CLO notes**)
- Each tranche has a **different risk/return profile** based on its priority claim on the cash flows
- The flow of payments is referred to as the **"cash flow waterfall"**
- Equity tranches earn the residual income after debt is paid

Source: Invesco. For illustrative purposes only. CLO capital structures not drawn to precise scale. A credit rating is an assessment provided by a nationally recognized statistical rating organization (NRSRO) of the creditworthiness of an issuer with respect to debt obligations, including specific securities, money market instruments or other debts. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest); ratings are subject to change without notice.

Understanding the senior CLO proposition

A CLO typically holds a diversified portfolio of senior secured, floating-rate corporate loans. Cash flows are distributed sequentially through a capital structure: Senior tranches receive payments before mezzanine debt and equity. This priority of payments, together with over-collateralisation and interest-coverage tests, is central to the protection of AAA investors.

The collateral manager can actively manage the loan portfolio during the reinvestment period, subject to transaction limits and tests. If performance weakens and a coverage test is breached, cash that would otherwise flow to junior tranches can be redirected to repay senior debt or improve the collateral position. Participants described this as an important "self-healing" feature of the structure.

Four reasons insurers are reconsidering AAA CLOs

1. Relative income

Senior CLOs can provide a spread premium relative to many conventional, similarly rated fixed income assets. For insurers, the potential attraction isn't just a higher yield, but additional income alongside substantial structural subordination.

2. Floating-rate exposure

CLO debt is predominantly floating rate. This limits interest-rate duration and can complement portfolios dominated by fixed-rate corporate or government bonds. The core exposure is more closely linked to credit conditions and spread movements than to changes in underlying government bond yields.

3. Structural resilience

The depth of protection beneath senior tranches is important. Diversification across borrowers, payment seniority, collateral coverage and cash-flow diversion tests mean that severe and sustained collateral deterioration would be required before losses reach the top of the structure. This doesn't eliminate risk: AAA tranches can still be downgraded, experience mark-to-market volatility, or suffer losses in extreme scenarios.

4. Portfolio diversification

Because AAA CLOs are floating rate and are primarily exposed to credit spread risk, they can behave differently from duration-heavy fixed income. Reallocating a measured portion of cash, Treasury bills, or short-dated investment-grade credit may improve portfolio income and, depending on the starting portfolio, risk-adjusted outcomes.

Regulation may be reaching a turning point

Regulatory treatment has been one of the largest constraints on European insurance demand. The roundtable highlighted a material reduction in the illustrative EU standard-formula capital charge for senior AAA securitisations, from 12.5% to 2.7% per unit of spread duration. The benefit is concentrated in senior tranches, while mezzanine exposures remain more heavily penalised.

The UK hasn't replicated the same calibration. However, participants noted that Solvency UK developments have made some aspects of implementation easier. The potential use of structured assets within matching adjustment portfolios where cash flows can meet the relevant requirements was one. The practical implications will remain insurer-specific and will depend on regulatory status, internal-model treatment, liabilities, and governance.

Implementation: segregated mandate, ETF, or fund?

Implementation was a central theme. Larger insurers may prefer a segregated mandate that allows customised constraints, dedicated reporting, tailored currency management and greater portfolio control. AAA CLO ETFs are becoming a practical entry point, offering immediate diversification, operational simplicity, intraday tradability, and efficient access. They may also be used tactically while a longer-term mandate is built. Segregated-mandate structures and ETFs serve different requirements and can be complementary.

Participants cautioned against deploying an entire allocation into a single new-issue vintage. A diversified portfolio should consider manager, transaction, and vintage exposure, as well as the balance between primary and secondary market opportunities. Underwriting capability matters: Investors need expertise in both the CLO structure and the underlying leveraged-loan market.

Capital efficiency for EU and UK balance sheets

The -78% cut is the EU standard-formula recalibration; the UK reaches the same place via internal models, the Matching Adjustment and Highly Predictable cash-flows

-78%

AAA senior non-STs spread-risk charge
(EU standard formula)

12.5% → 2.7%
applying from 30 Jan 2027

- **What is STS?**

Senior charges now track underlying quality. CLOs — previously among the most penalised assets as they cannot qualify for STS — gain the deepest relief, while the seniority ladder is preserved (mezzanine stays materially higher).

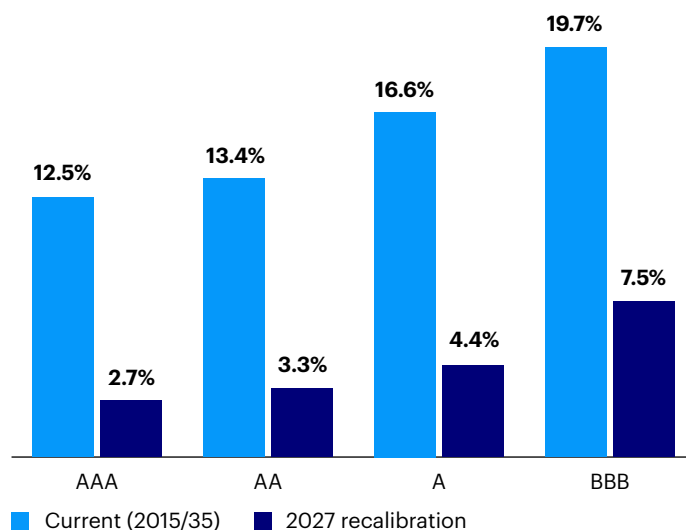
- **Levelling the field vs. internal models**

Internal-model insurers — including Lloyd's syndicates — already hold senior AAA CLOs at risk-reflective capital; capital was never their barrier. The 2027 recalibration extends this to EU standard-formula firms. The UK has not mirrored the cut in its standard formula, but the direction of travel is aligned.

- **Solvency UK and the Matching Adjustment**

In the UK the benefit runs through the Matching Adjustment: senior CLOs are already used in MA portfolios via fixed-cash-flow structures, and the Highly Predictable framework broadens eligibility further (HP capped at 10% of MA benefit).

Standard-formula Spread SCR factor (%) per year of spread duration — senior non-STs securitisations



Source: Delegated Reg (EU) 2015/35 (current); securitisation recalibration under Delegated Reg (EU) 2026/269, applying 30 Jan 2027. PRA / Solvency UK reforms. Invesco analysis. Illustrative — not investment advice.

Liquidity: improved, but not equivalent to cash

The panel discussed the meaningful improvement in AAA CLO liquidity over the past decade. Broader dealer participation, portfolio auctions, and the growth of ETFs have expanded the available routes to trade. Existing investors reported being able to transact when required, including during periods of market stress.

AAA CLOs shouldn't be treated as a direct cash substitute, however. In a risk-off environment, prices may fall as spreads widen even when ultimate credit impairment remains remote. The key distinction is between mark-to-market volatility and permanent loss. Investors should size allocations with this liquidity profile in mind and recognise that execution conditions can deteriorate in stressed markets.

Remaining barrier may be perception

Several participants argued that the largest remaining obstacle is the legacy association between CLOs and the 2008 Global Financial Crisis. The complexity of the structure can reinforce the perception that complexity itself equals risk. The discussion suggested a more useful approach: Understand the collateral, the cash-flow waterfall, the structural tests, and the circumstances under which losses could reach each tranche.

Governance remains critical. Investment committees and boards need a clear explanation of the role the allocation is intended to play, the risks being introduced, how liquidity will be managed, and why the selected implementation route is appropriate. Specialist manager selection and transparent reporting are essential to sustaining that confidence.

Looking ahead

The roundtable concluded that AAA CLOs are moving from a specialist discussion towards a more established portfolio construction tool. Regulatory reform, increased market depth, and new access vehicles have strengthened the case for further consideration, especially for insurers seeking high-quality floating-rate income and diversification.

Adoption is likely to remain gradual and insurer-specific. But the direction of travel is clear. For firms able to address governance, accounting, regulatory, and operational requirements, senior CLOs are increasingly part of the strategic fixed income conversation rather than an asset class to overlook.

Investment risks

For complete information on risks, refer to the legal documents. The value of investments, and any income from them, will fluctuate. This may partly be the result of changes in exchange rates. Investors may not get back the full amount invested.

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