



The CLO Investor

Brief insights into trends and news shaping CLO investing

Issue No. 7, November 2025

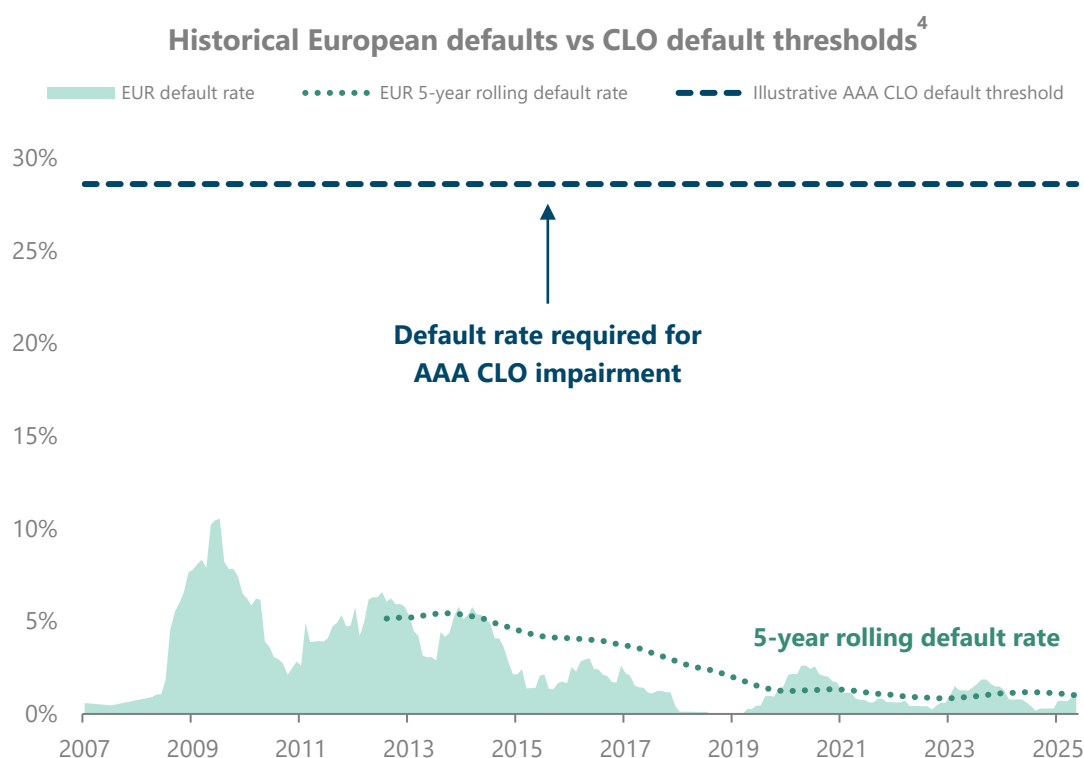
What does it take to break a AAA CLO?

Over the first half of October, we observed an uptick of volatility in the loan markets. From the 30th of September to 14th October, the Morningstar European Leveraged Loan Index (or “ELLI”) was down 1.07%.¹ While global markets were also down over the same period, the move has coincided with negative loan related headlines, for example: the swift bankruptcy of the First Brands Group.² The auto parts manufacturer, which issued broadly syndicated loans and additional trade financing, filed for bankruptcy in September after questions were raised about the quantity of debt it was carrying. High profile figures in the traditional and alternative banking systems have also exchanged pointed remarks about the episode.³

Amongst all this noise, we think it is always helpful to go back to fundamentals. Fundamentals should always anchor one’s view and aid effective decision making. Given the headlines, what are the implications?

First, how does a decline in loan prices impact CLOs? The short answer is it doesn’t. CLOs are non-mark to market structures; thus, they are not forced sellers in falling markets and can often take advantages of dips given the locked in financing structure. There are cases where certain CCC loan prices can impact a CLO’s cashflows, but there are mechanisms built to protect debtholders against a deterioration in fundamental risk exposure and do not involve any forced selling of the underlying loans. See [“Busting the CLO CCC Myth”](#) for more details.

With the decline in loan prices not necessarily being an issue, what about defaults? Defaults do impact CLOs, but they first affect the equity tranche as the most junior part of the capital structure. To gauge their broader impact, one must assess the magnitude and severity of defaults to determine whether more senior debt tranches will be affected. Moreover, all else equal, the default of single loan (like First Brands) will not cause a fundamental issue for debt holders. CLOs by design are diversified and cannot hold outsized exposures in any credit. We observe typical average individual position sizes in European CLOs of 0.5-1.0% and the documentation will contain hard limits on a single obligor exposure. In other words, multiple defaults are required to fundamentally impact CLO debt - not just one. This raises the question: how many defaults does it take to break a AAA CLO?



Sources: Fair Oaks Capital, Intex and Pitchbook LCD as at 31-Oct-25

Simply put, the threshold is remarkably high. It would require close to 30% of the loan pool defaulting every single year (accounting for a recovery of 70%) for the approximate 5-year life of a CLO AAA before it would take a principal impairment.⁴ To put this in perspective, loan defaults only briefly reached 10% even during the depths of the 2008-2009 financial crisis, while the rolling 5-year default rate was considerably lower. This illustrates the substantial protection embedded in the CLO structure and is why AAA CLOs have a robust fundamental track record (see [“What do Macy’s, Kodak and General Motors have in common?”](#) for more details).

Amongst the volatility and headlines, keeping a firm grasp on the fundamentals is key to navigating the markets. For AAA CLOs specifically, we see a robust fundamental case.

Should you have any queries, please do not hesitate to contact us.



Endnotes

1. Bloomberg & Fair Oaks data as at 17-Oct-25.
2. Financial Times, "[Investors warn on leveraged loan risks after First Brands collapse](#)", 17-Oct-25.
3. Financial Times, "[Top US financiers sound alarm on lending standards](#)", 15-Oct-25.
4. Fair Oaks Capital, Intex and Pitchbook LCD. European Leveraged Loan Index default rate by principal amount as at 31-Oct-25. Default threshold is the calculated annual default rate required during the entire remaining life of the deal to achieve a principal impairment. Analysis of recent CLO primary investment made by Fair Oaks Capital as at 30-Sep-25. For illustrative purposes only.

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