PEMBERTON

CLO Insights Series

The Importance of Portfolio Optimisation in CLOs

March 2026

This article explores the critical role of portfolio optimisation throughout the lifecycle of a Collateralised Loan Obligation (CLO).

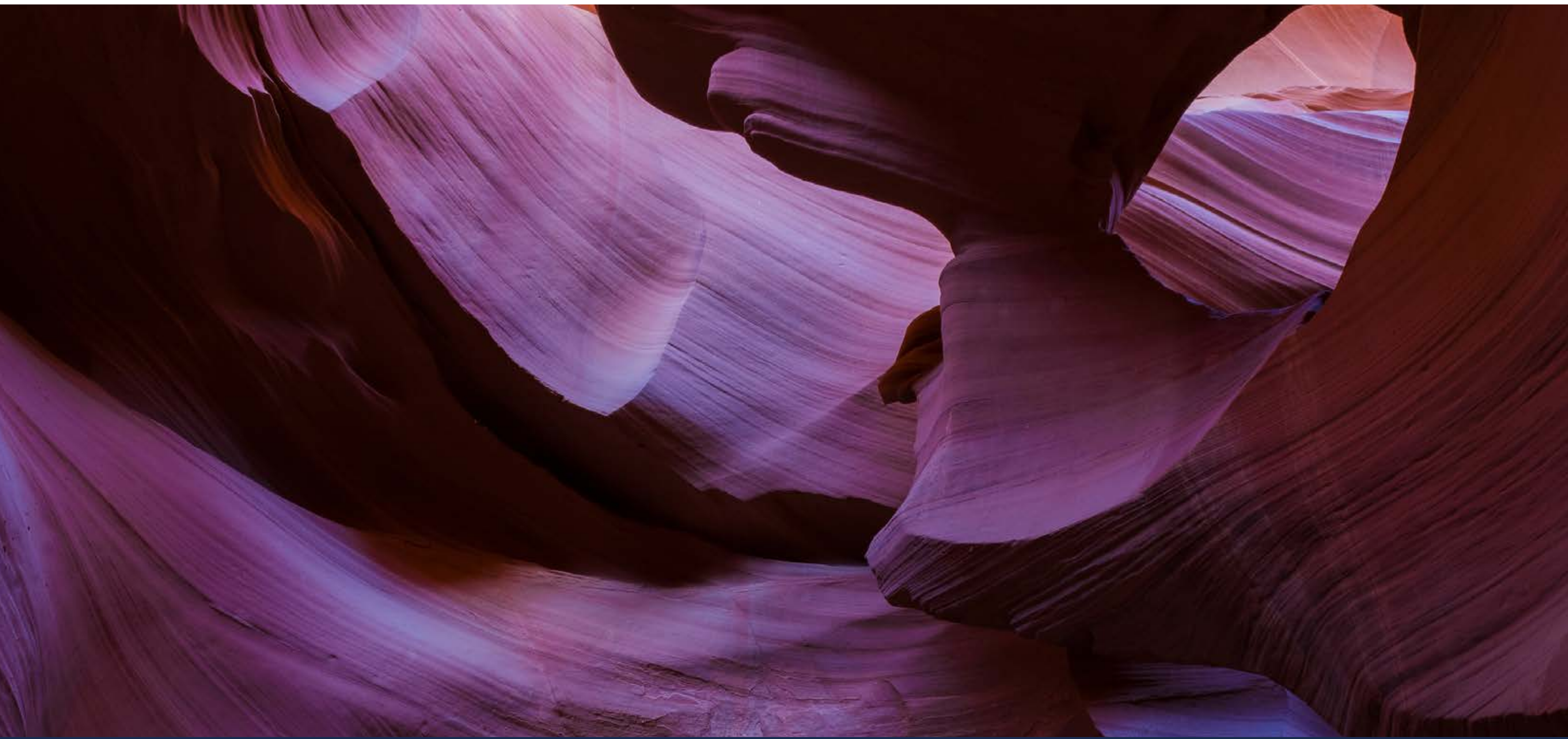
CLO portfolios typically consist of over 100 underlying leveraged loans, which are primarily first-lien loans to companies backed by private equity sponsors. These loans are generally tradeable in the secondary market giving the CLO manager scope to make changes to the portfolio. While CLOs are also permitted to invest in other instruments, such as unsecured loans or bonds, these exposures are typically capped.

Once the initial loan ramp-up is complete, the focus shifts to active portfolio management – aimed at optimising the portfolio for the benefit of all noteholders.

Optimisation can involve a variety of objectives, such as building par, adding diversity, increasing the weighted average spread (e.g., replacing loans paying E+350 with those paying E+400), and managing risk. The objective is to improve the resilience of the CLO portfolio by improving risk-adjusted returns while simultaneously controlling downside risk. Accordingly, during both the ramp-up period and the reinvestment period, CLO managers actively trade assets - subject to eligibility criteria and portfolio tests. Although the ability to optimise is more limited following the reinvestment period, certain amendments and trades may still be permitted under specific circumstances.

Other reasons for a CLO manager to make changes to the portfolio may include in response to changing geo-political conditions or macroeconomic forecasts - reducing exposure to countries or sectors expected to underperform and increasing investment in others with more favourable outlooks.

However, portfolio optimisation is not straightforward as assets are not homogeneous and there are some costs involved.



Different borrowers have different attributes including spreads, credit ratings, or recovery expectations, which need to fit into the overall CLO constraints including:

- **Eligibility Criteria:** which must be satisfied for each asset at the time of acquisition
- **Portfolio Profile Tests:** designed to mitigate portfolio concentration risk such as single obligor limits, fixed-rate asset caps, and CCC bucket restrictions
- **Collateral Quality Tests:** mainly driven by the rating agencies, including the Weighted Average Rating Factor (WARF), Weighted Average Spread (WAS), Weighted Average Life (WAL), and Diversity Score
- **Coverage Tests:** such as Overcollateralisation (OC) and Interest Coverage (IC) ratios, designed to ensure that the par value and interest proceeds of the portfolio is sufficient to cover payments due on the rated notes

These tests are designed to protect the CLO noteholders. If not satisfied, they either result in the early paydown of some of the CLO notes or prevent the CLO manager from any reinvestment that makes the test failure worse than it already is (often called maintain-or-improve tests).

Conclusion

Ultimately, the CLO manager has a fiduciary responsibility to manage capital on behalf of investors in accordance with its Standard of Care. Through active management, the CLO manager aims to optimise the CLO portfolio by enhancing yield while preserving value and managing risk for the benefit of investors at all levels of the capital structure.

Produced in association with Weil, Gotshal & Manges (London) LLP.

Contact Us

Rob Reynolds

Managing Director
Head of CLO
Pemberton Capital Advisors LLP
rob.reynolds@pembertonam.com
T: 020 3841 8358
M: +44 (0)770 6338 302

Liam Tyce, CFA

Director
CLO
Pemberton Capital Advisors LLP
liam.tyce@pembertonam.com
T: +44 (0)20 3148 5069
M: +44 (0)773 2495 964

Disclaimer

This document is intended only for the person to whom it has been delivered and is solely for discussion / information purposes.

Any third-party information (including any statements of opinion and/or belief) contained herein is provided by Pemberton Capital Advisors LLP ("we", "our" or "us") and has not been independently verified.

Statements of opinion, market or performance information and any forecasts or estimates contained in this document are prepared on the basis of assumptions and conclusions reached and are believed to be reasonable by us at the time.

No representation, warranty, assurance or undertaking (express or implied) is given (and can therefore not be relied upon as such), and no responsibility or liability is or will be accepted by us or any of our affiliates or our respective officers, employees or agents as to the adequacy, accuracy, completeness or reasonableness of the information, statements and opinions expressed in this document. Any opinions expressed in this document do not constitute legal, tax or investment advice and can therefore not be relied upon as such. Please consult your own legal or tax advisor concerning such matters.

The information contained in this document (which does not purport to be comprehensive) is believed to be accurate only at the date of this document and does not imply that the information herein is correct at any time subsequent to the date hereof and such information is subject to change at any time without notice. The views expressed herein are subject to change based on market and other conditions and we give no undertaking to update the information, to reflect actual events, circumstances or changes in expectations or to provide additional information after its distribution, even in the event that the information becomes materially inaccurate.

The recipient acknowledges and agrees that no person has, nor is held out as having, any authority to give any statement, warranty, representation, assurance or undertaking on our behalf. No part of this document may be reproduced in any manner without our written permission.

This document has been prepared and issued by Pemberton Capital Advisors LLP. Pemberton Capital Advisors LLP is authorised and regulated by the Financial Conduct Authority ("FCA") and entered on the FCA Register with the firm reference number 561640 and is registered in England and Wales at 5 Howick Place, London SW1P 1WG, United Kingdom. Registered with the US. Securities and Exchange Commission as an investment adviser under the U.S. Investment Advisers Act of 1940 with CRD No. 282621 and SEC File No. 801-107757. Tel: +44(0) 207 993 9300.

The information in this document does not constitute legal or other professional advice of Weil, Gotshal & Manges (London) LLP.

www.pembertonam.com