

## INSURANCE SOLUTIONS

# Ready, Steady, CLO: Solvency II Reform & the Case for AAA CLOs

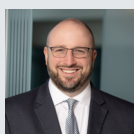
### INSIGHTS

From January 2027, Solvency II capital charges on senior (AAA) CLO tranches will fall materially, improving capital efficiency. This reform creates a timely opportunity for European insurers to enhance public fixed income returns and strengthen portfolio risk profiles.



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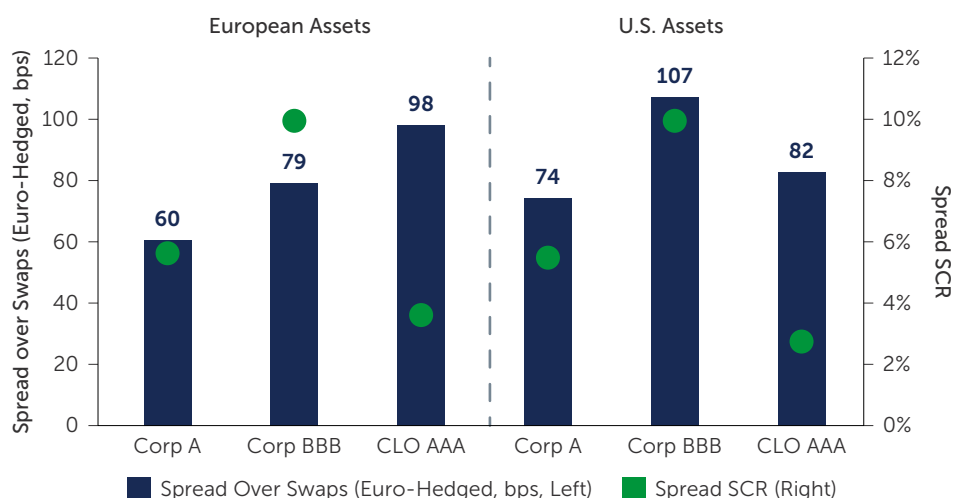
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Senior CLO tranches are a staple investment for North American insurers and are gaining traction globally, supported by liquidity and structural features that can improve a portfolio’s risk and return profile.

European insurers, by contrast, have historically been less active in this asset class, largely due to the high Solvency II Standard Formula Spread SCR charges applied to non-STS securitized assets. That dynamic is set to change. From 30 January 2027, senior (AAA) CLO tranches will benefit from a significant reduction in capital charges, materially increasing their capital efficiency. With these changes on the horizon, European insurers now have a unique opportunity to potentially enhance public fixed income returns and improve portfolio risk profiles through one of the more efficient asset classes in credit markets.

**Figure 1: AAA CLO Tranches May Become More Capital-Efficient than Investment Grade Corporate Bonds<sup>1</sup>**



Sources: ICE Bof; JP Morgan Markets; EIOPA; European Commission. As at February 27, 2026. Based on the following indices: ICE BofA 1–10 Year A Euro Corporate Index, ICE BofA 1–10 Year BBB Euro Corporate Index, J.P. Morgan European CLOIE AAA Index, ICE BofA 1–10 Year A U.S. Corporate Index, ICE BofA 1–10 Year BBB U.S. Corporate Index, J.P. Morgan Post-Crisis CLOIE AAA Index. CLO spreads are discount margins to worst. Corporate spreads are asset swap spreads. Barings’ interpretation of Solvency II. Based on proposed amendments post January 2027. Spread risk capital calculated using spread duration for corporate bonds, and modified duration for CLO tranches.

## What is a CLO?

A CLO is an actively managed, securitized product collateralized by a highly diversified pool of leveraged loans. CLOs provide an efficient, scalable way to invest in floating-rate loans while offering structural protections that have historically performed well through multiple credit cycles.

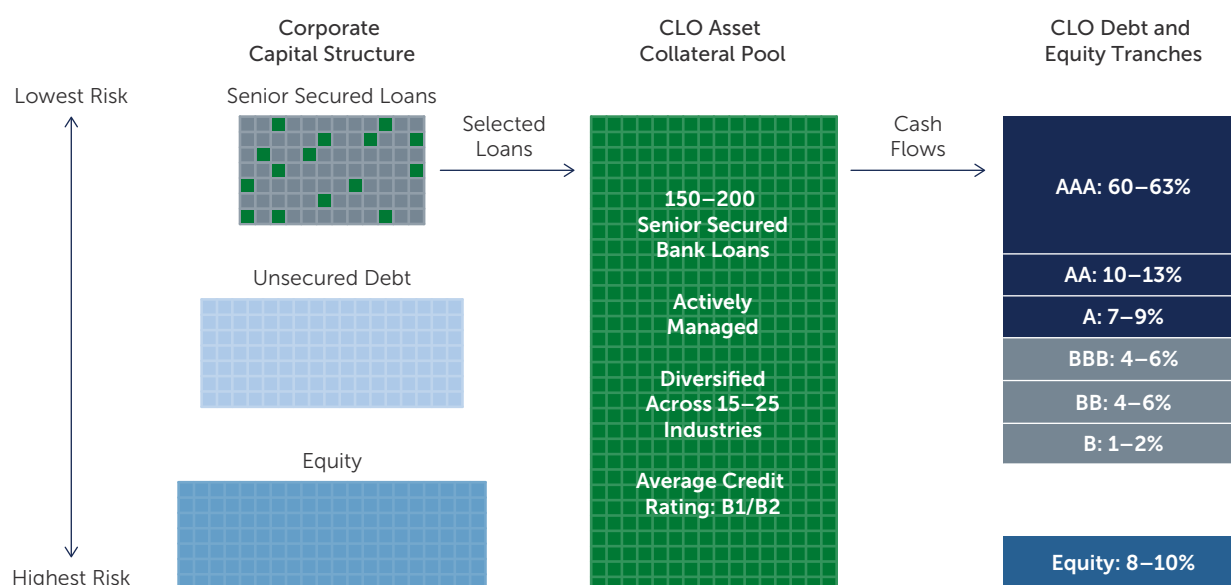
1. For comparability between U.S. and European corporate markets, and between corporate bonds and CLO tranches, all corporate bond indices are 1-10 year maturity.

At a high level, CLOs can be thought of as vehicles that raise capital from debt and equity investors to purchase a diversified pool of senior secured, first-lien corporate loans, (the assets). These assets are funded through a series of debt obligations (the liabilities), which are issued in distinct “tranches” that re-distribute credit risk by offering varying levels of subordination, credit enhancement and structural protections.

A typical CLO structure combines five or more debt tranches, ranging from the most senior, AAA tranche down to the most junior and highest-yielding debt tranche, typically rated BB- (or single-B in European CLOs). Like the underlying loans, CLO tranches are floating-rate instruments and generally pay coupons on a quarterly basis.

After paying off expenses and liabilities, a residual unrated “CLO Equity” tranche captures the excess spread (returns) that the assets generate. As the equity tranche is leveraged exposure to the underlying leveraged loans, it is the riskiest piece of the CLO structure. However, it can also be the most lucrative.

**Figure 2: Typical CLO Structure**



Source: Barings.

## Range of Flavors

The largest portion of the \$1.4 trillion global CLO market is the **U.S. broadly syndicated loan (BSL) CLO** market. At approximately \$1 trillion<sup>2</sup> in size, these CLOs are backed by highly diversified pools of 200-300+ leveraged loans to large, well-known borrowers. These are typically companies with EBITDA above \$100 million, such as United Airlines, Virgin Media and Burger King.

2. Source: BofA. As of February 13, 2026.

The underlying loans are typically sub-investment grade and rated by a major credit rating agency, such as S&P, Moody's or Fitch, with weighted average ratings generally between B and B-. These loans are distributed across a broad, 100+ syndicated lender group, supporting both liquidity and tradability.

When investing in securitized assets, European insurers must ensure that the investments comply with European risk retention, disclosure and other regulatory requirements. As a result, only about a quarter of the U.S. BSL CLO market is currently accessible to European investors.

The **European CLO** market has also been growing. With a market size of approximately €300 billion, it reflects a more concentrated underlying loan market than its U.S. counterpart. As a result, European CLO portfolios typically hold 150–200 obligors, compared with 200–300+ in U.S. CLOs. To offset this smaller and slightly less diverse underlying asset pool, senior and mezzanine tranches of European CLOs generally feature increased subordination, and over-collateralization test triggers are typically set at more conservative thresholds.

*“Alongside their favorable default history, high-grade, particularly AAA, CLO tranches have exhibited relatively low historical volatility, broadly in line with single-A and BBB corporate bonds.”*

The smaller underlying loan universe also contributes to slightly lower liquidity in European secondary loan and CLO markets, meaning trading depth and execution speed can be more limited during periods of volatility. Even so, the market's growth trajectory has been notably strong, with European CLO issuance expanding more rapidly than the U.S. in recent years. As issuers and investors increasingly operate across both regions, we expect this trend to continue.

Finally, as European CLOs comply with European risk retention requirements, this represents a sizable portion of the CLO market that is accessible to European investors.

**Private Credit CLOs**, also sometimes referred to as middle market CLOs, represent another growing segment of the structured credit market. These structures are typically backed by more concentrated pools of loans to mid-sized companies with EBITDA values between \$15 and \$75 million. In recent years, however, the market has also seen the emergence of private large-cap CLOs, which include higher-EBITDA companies within the private credit universe.

The underlying loans in private credit CLOs are typically unrated or privately rated and are syndicated to smaller lending groups, which tends to limit liquid and secondary market activity. In exchange, middle market loans often offer greater control to lenders through tightened credit agreements and more covenants. These covenants allow lenders to engage earlier with company management teams when signs of distress emerge, which can ultimately lead to improved recovery rates. Many of these loans are also backed by private equity sponsors, who may provide additional support during periods of stress through documentation amendments and/or capital infusions, offering further protection for lenders. Finally, because these loans are directly originated, regulations require CLO managers to hold 5% of the deal notional, reinforcing alignment through “skin in the game”.

While private credit CLOs have historically been concentrated in the U.S., a European private credit CLO market is beginning to emerge. At the same time, CLO structures are increasingly being used to access other areas of private fixed income including infrastructure and real estate debt, through **Infrastructure CLOs** and **Commercial Real Estate CLOs**.

## AT A GLANCE

Metric	Euro BSL CLO	U.S. BSL CLO	Private Credit CLO
Market Size	~€300 Billion	~\$1 Trillion	~\$150 Million
Average Tranche Subordination	AAA 38%, BB 10%	AAA 36%, BB 8%	AAA 42%, BBB 18%
Average AAA Coupon	3m EURIBOR + 125 bps	3m SOFR + 125 bps	SOFR + 150 bps
Average Rating of Underlying	B	B	B-
CCC Bucket Limit	7.5%	7.5%	17.5%
Number of Obligors	150–200+	200–300+	50–100
Average Loan Position Size	~0.50%	~0.30%	~1%

\*Note: Figures are illustrative and not indicative of expected pricing levels. Nothing in this document is intended as a recommendation to buy or sell any security, or an offer to buy or sell any security.

## Risks & Rewards: CLO Tranche Investment for Insurers

### REDUCED DEFAULT RISK

Supported by diversified collateral pools, active management and structural protection, senior and high-grade CLO tranches exhibit strong risk efficiency. Consistent with this, CLO debt tranches have historically experienced significantly lower default rates than similarly rated corporate loans. Notably, since their inception, no AAA CLO tranche has ever defaulted (**Figure 3**).

Figure 3: S&P U.S. CLO Tranche Default History

Rating	CLO 1.0			CLO 2.0		
	Number of Original Ratings	Number of Defaults	Currently Rated	Number of Original Ratings	Number of Defaults	Currently Rated
AAA	1,541	0	0	5,965	0	2,388
AA	616	1	0	4,455	0	1,647
A	790	5	0	3,762	0	1,427

Source: S&P Global Ratings. As of December 31, 2025. Source: S&P. CLO history based on period 1996–Q4, 2025. Corporate history based on period 1994–Q1 2024.

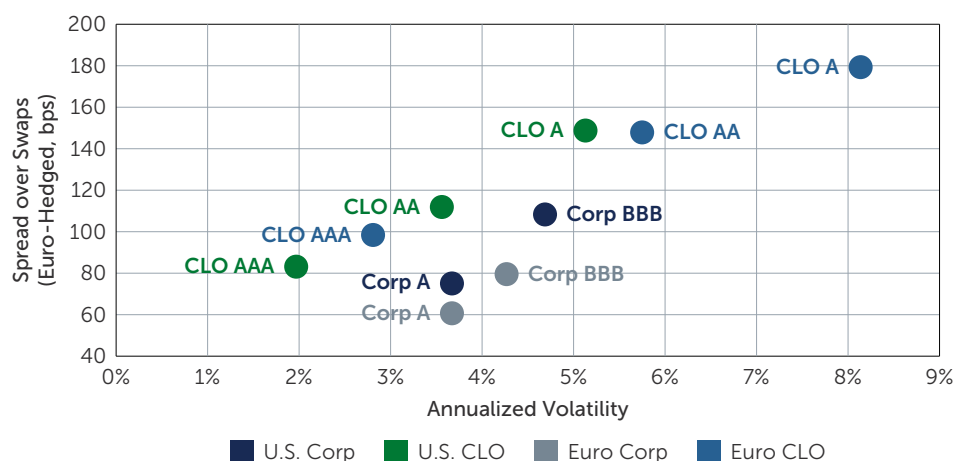
Rating	CLO 1.0			CLO 2.0		
	Number of Original Ratings	Number of Defaults	Currently Rated	Number of Original Ratings	Number of Defaults	Currently Rated
AAA	481	0	0	846	0	495
AA	227	0	0	917	0	648
A	249	0	0	594	0	406

Source: S&P Global Ratings. As of March 31, 2024.

### IMPROVED RISK EFFICIENCY

Alongside their favorable default history, high-grade, particularly AAA, CLO tranches have exhibited relatively low historical volatility, broadly in line with single-A and BBB corporate bonds.

Figure 4: Current Spreads vs. Historical Volatility<sup>3</sup>



Sources: ICE BofA; JP Morgan Markets; Refinitiv. As at February 27, 2026. Based on the following indices: J.P. Morgan Post-Crisis CLOIE AAA/AA/A Indices, ICE BofA 1-10 Year A U.S. Corporate Index, ICE BofA 1-10 Year BBB U.S. Corporate Index, J.P. Morgan European CLOIE AAA/AA/A Indices, ICE BofA 1-10 Year A Euro Corporate Index, ICE BofA 1-10 Year BBB Euro Corporate Index. CLO spreads are discount margins to worst. Corporate spreads are asset swap spreads. Spreads shown are in Euro-hedged terms over EURIBOR. Volatility based on returns calculated using index data from January 31, 2012 to February 27, 2026. European CLO series extended back to prior to January 31, 2018 based on EUR-hedged returns of U.S. CLOIE series.

3. For comparability between U.S. and European corporate markets, and between corporate bonds and CLO tranches, all corporate bond indices are 1-10 year maturity.

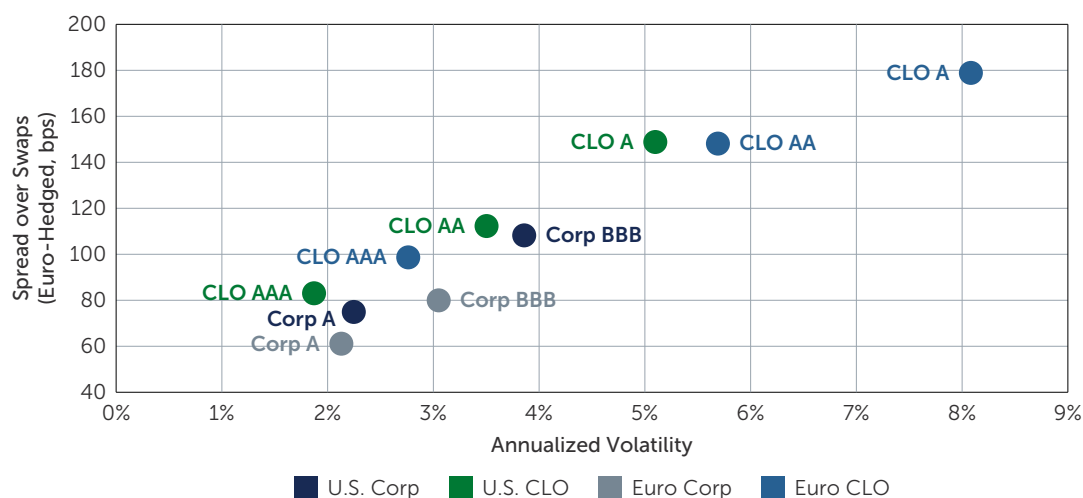
At the index level, U.S. AAA CLO tranches are currently priced at spreads close to those of single-A U.S. corporate bonds. For European insurers, relative value appears even more compelling given tight corporate spreads and a historically smaller European CLO investor base. These dynamics may evolve following Solvency II reforms, as spreads could conceivably tighten with increased demand from European insurers.

### SPREADS VS. RATES

Part of the relative stability of AAA and AA CLO returns reflects the floating-rate nature of CLO tranches, which mirrors the floating-rate characteristics of their underlying collateral. As a result, CLO tranches are less exposed to rising interest rates than fixed-rate corporates, as was observed during the sharp rate increases in 2022–2023.

For a more like-for-like comparison, spread return volatilities can be assessed excluding the interest rate component. Under this framework, high-grade CLO tranches continue to display similar levels of historical volatility as single-A and BBB corporate bonds.

**Figure 5: Current Spreads vs. Historical Spread Return Volatility**



Sources: ICE BofA; JP Morgan Markets. As at February 27, 2026. Based on the following indices: J.P. Morgan Post-Crisis CLOIE AAA/AA/A Indices, ICE BofA 1–10 Year A U.S. Corporate Index, ICE BofA 1–10 Year BBB U.S. Corporate Index, J.P. Morgan European CLOIE AAA/AA/A Indices, ICE BofA 1-10 Year A Euro Corporate Index, ICE BofA 1-10 Year BBB Euro Corporate Index. Spreads as at February 27, 2026. CLO spreads are discount margins to worst. Corporate spreads are asset swap spreads. Volatility based on returns calculated using index data from January 31, 2012 to February 27, 2026. European CLO series extended back to prior to January 31, 2018 based on EUR-hedged returns of U.S. CLOIE series. For comparability between U.S. and European corporate markets, and between corporate bonds and CLO tranches, all corporate bond indices are 1-10 year maturity.

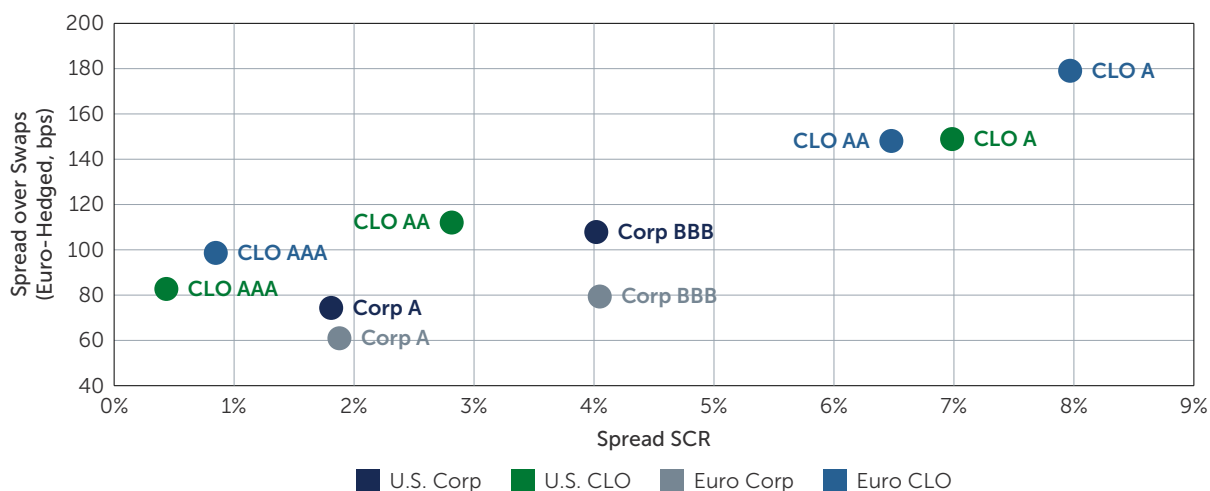
Historically, the interest rate and credit spread components of fixed-rate instruments have tended to diversify one another, helping to moderate volatility during periods of spread widening. That relationship was challenged in 2022, when spreads and rates rose sharply at the same time. For insurers with net duration exposure, for example those holding fixed-rate assets in surplus portfolios, this environment resulted in a “double-whammy” of mark-to-market losses. By contrast, floating-rate instruments would have been relatively more resilient as surplus assets in such conditions.

For liability-backing portfolios, on the other hand, interest rate exposure remains essential. In this context, CLOs can be incorporated alongside an interest rate overlay, such as Treasury forwards or futures or interest rate swaps, to hedge liability duration while retaining exposure to CLO spreads.

### ENHANCING CAPITAL EFFICIENCY

Under the revised Solvency II framework, spread risk capital requirements are set to decline across both Simple, Transparent and Standardised (STS) and non-STS securitized assets, bringing the capital treatment of CLO tranches closer to their underlying economic reality. Senior tranches, in particular, are expected to benefit from a meaningful improvement in capital efficiency.

Figure 6: Current Spreads vs. Solvency II Spread Risk Capital Post-Reform



Sources: ICE BofA; JP Morgan Markets; EIOPA; European Commission. As at February 27, 2026. Based on the following indices: J.P. Morgan Post-Crisis CLOIE AAA/AA/A Indices, ICE BofA 1-10 Year A U.S. Corporate Index, ICE BofA 1-10 Year BBB U.S. Corporate Index, J.P. Morgan European CLOIE AAA/AA/A Indices, ICE BofA 1-10 Year A Euro Corporate Index, ICE BofA 1-10 Year BBB Euro Corporate Index. CLO spreads are discount margins to worst. Corporate spreads are asset swap spreads. Barings’ interpretation of Solvency II. Based on proposed amendments post January 2027. Spread risk capital calculated using spread duration for corporate bonds, and modified duration for CLO tranches.

### MIND THE CONVEXITY

For fixed income investors, top line duration and capital efficiency are not the full story. Part of the excess return associated with CLO tranches, relative to more traditional fixed income assets, comes from the embedded call option within CLO debt. When market conditions are favorable, equity holders have the ability to refinance or reset the structure, and debt holders earn a premium for bearing this uncertainty.

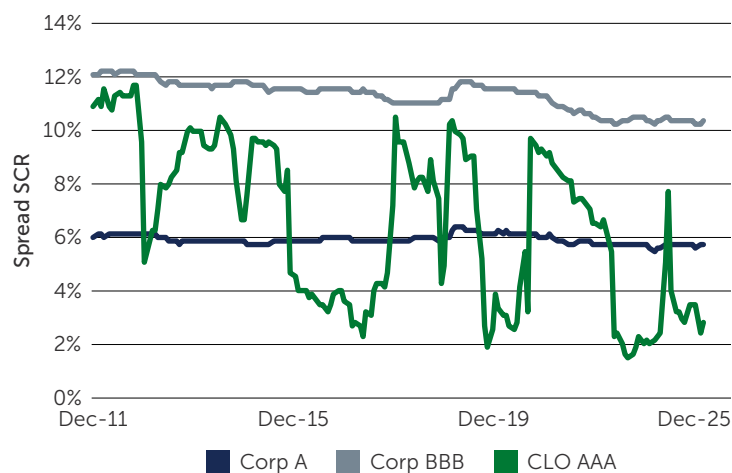
That embedded call option, however, also introduces risks. When credit spreads widen, CLO debt is less likely to be called, which can increase spread duration, and in turn, spread sensitivity. Beyond the economic volatility this may create, an increase in spread duration can also translate into higher Standard Formula Solvency Capital Requirement (SCR) charges during periods of market stress, potentially reinforcing pro-cyclical behavior from some Solvency II insurers.

As expected, this effect is considerably less pronounced for senior (AAA) tranches, for two key reasons:

- 1. Economic factors:** AAA spreads have historically been the least volatile in the CLO capital stack, and the cost of financing is lowest for the CLO equity owner, making spread durations and asset values least volatile.
- 2. Capital treatment:** As senior instruments, AAA tranches are subject to a much lower multiplier when calculating spread SCR, reducing the capital impact of changes in spread duration relative to non-senior tranches.

Taken together, these factors mean that the effect of negative convexity on AAA tranches is relatively limited. When the new Solvency II charges are applied retrospectively to the U.S. CLOIE index (which has longer history than the Euro CLOIE index), capital charges remain broadly comparable to those of investment grade corporate bonds since index inception:

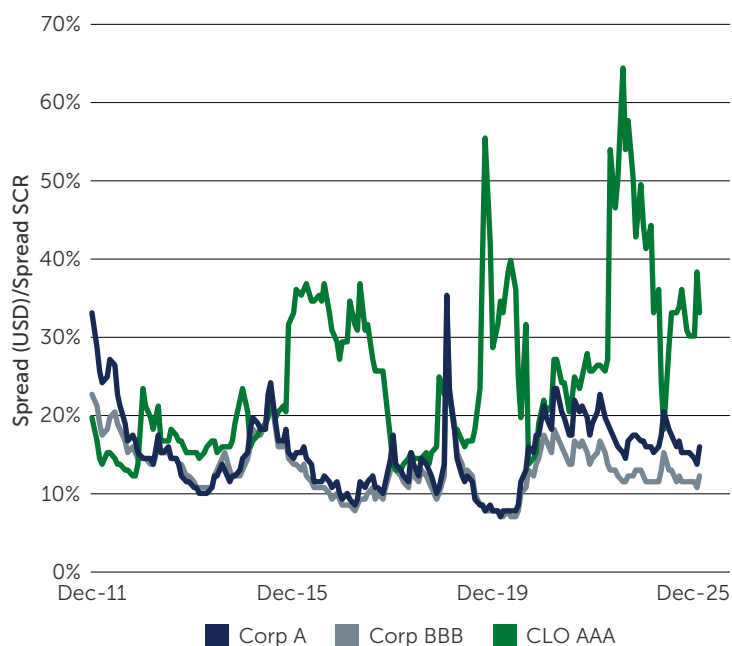
**Figure 7: Spread SCR Over Time (Retrospective)**



Source: ICE BofA, JP Morgan Markets, EIOPA, European Commission. As at February 27, 2026. Based on the following indices: ICE BofA 1-10 Year A US Corporate Index, ICE BofA 1-10 Year BBB US Corporate Index, J.P. Morgan Post-Crisis CLOIE AAA Index. CLO spreads are discount margins to worst. Corporate spreads are asset swap spreads. Barings' interpretation of Solvency II. Based on proposed amendments post January 2027. Spread risk capital calculated using spread duration for corporate bonds, and modified duration for CLO tranches. For illustrative purposes only. Nothing in this document is intended as a recommendation to buy or sell any security, or an offer to buy or sell any security.

Combining this with historical spread levels, we see that AAA CLO tranches would have remained more capital-efficient than corporate bonds for the vast majority of time.

**Figure 8: Capital Efficiency Over Time (Retrospective)**



Source: ICE BofA, JP Morgan Markets, EIOPA, European Commission. As at February 27, 2026. Based on the following indices: ICE BofA 1-10 Year A US Corporate Index, ICE BofA 1-10 Year BBB US Corporate Index, J.P. Morgan Post-Crisis CLOIE AAA Index. CLO spreads are discount margins to worst. Corporate spreads are asset swap spreads. Barings' interpretation of Solvency II. Based on proposed amendments post January 2027. Spread risk capital calculated using spread duration for corporate bonds, and modified duration for CLO tranches. For illustrative purposes only. Nothing in this document is intended as a recommendation to buy or sell any security, or an offer to buy or sell any security.

Similar patterns can be seen for the Euro CLOIE series, since its index inception in December 2017.

In short, asset characteristics can evolve across market environments, and for CLO tranches, capital efficiency can vary as market conditions change. However, historical data suggests that under the new Solvency II framework, AAA CLO tranches would have remained capital efficient across a range of past market environments, with capital charges staying relatively stable through time. This stability supports their role as a steady and value-accretive component of insurers' liquid portfolios.

**FROM THEORY TO PRACTICE**

Putting these elements together, what might adding AAA CLO tranches to a European corporate portfolio look like in practice?

Beyond lower volatility at an asset level, incorporating CLO tranche exposure into a traditional public fixed income portfolio can also provide diversification benefits. Using euro-denominated assets as an example, CLO tranches exhibit lower correlation with IG corporate bonds than IG corporate bonds exhibit with each other.

**Figure 9: Euro Asset Correlations**

Correlations	Corp A	Corp BBB	CLO AAA	CLO AA	CLO A
Corp A	100%	97%	58%	56%	59%
Corp BBB	97%	100%	63%	62%	65%
CLO AAA	58%	63%	100%	96%	93%
CLO AA	56%	62%	96%	100%	95%
CLO A	59%	65%	93%	95%	100%

Source: ICE BofA, JP Morgan Markets. As at February 27, 2026. Based on the following indices: ICE BofA 1-10 Year A Euro Corporate Index, ICE BofA 1-10 Year BBB Euro Corporate Index, J.P. Morgan European CLOIE AAA/AA/A Indices. Correlations based on returns calculated using index data from January 31, 2012 to February 27, 2026. European CLO series extended back to prior to January 31, 2018 based on EUR-hedged returns of U.S. CLOIE series. Barings' interpretation of Solvency II. Based on proposed amendments post January 2027. Spread risk capital calculated using spread duration for corporate bonds, and modified duration for CLO tranches. For illustrative purposes only. Nothing in this document is intended as a recommendation to buy or sell any security, or an offer to buy or sell any security.

As noted earlier, part of this effect reflects the floating-rate nature of CLO tranches. In a surplus portfolio, or portfolios backing short-dated liabilities where there is some flexibility around target duration, this characteristic can meaningfully enhance diversification within corporate allocations, improving both economic and capital efficiency.

**Figure 10: Strawman Portfolio Allocations**

Allocation	Corp Only	Corp + CLO AAA + Interest Rate Overlay
Corp A	60%	51%
Corp BBB	40%	34%
CLO AAA	0%	15%
<b>Key Statistics</b>		
Spread (bps)	68	72 ▲
Ann. Vol.	3.89%	3.59%
Spread SCR	7.51%	6.95%
Duration	4.07	3.50
<b>Portfolio Efficiency</b>		
Spread/Vol.	17.4%	20.1% ▲
Spread/Spread SCR	9.0%	10.4% ▲

Source: ICE BofA, JP Morgan Markets. As at February 27, 2026. Based on the following indices: ICE BofA 1-10 Year A Euro Corporate Index, ICE BofA 1-10 Year BBB Euro Corporate Index, J.P. Morgan European CLOIE AAA Index. Spreads as at February 27, 2026. CLO spreads are discount margins to worst. Corporate spreads are asset swap spreads. Volatility based on returns calculated using index data from January 31, 2012 to February 27, 2026. European CLO series extended back to prior to January 31, 2018 based on EUR-hedged returns of U.S. CLOIE series. Barings' interpretation of Solvency II. Based on proposed amendments post January 2027. Spread risk capital calculated using spread duration for corporate bonds, and modified duration for CLO tranches. For illustrative purposes only. Nothing in this document is intended as a recommendation to buy or sell any security, or an offer to buy or sell any security.

*“Investors need broad access to primary and secondary European, U.S. and Private credit CLO markets. Each region offers its own balance of spread, collateral depth, liquidity and deal structure.”*

In portfolios where duration is required, CLO exposure can be paired with an interest rate overlay to maintain interest rate exposure. In this case, the portfolio can continue to hedge liability duration while potentially benefiting from an uplift in return and efficiency.

**Figure 11: Strawman Portfolio Allocations**

Allocation	Corp Only	Corp + CLO AAA
Corp A	60%	51%
Corp BBB	40%	34%
CLO AAA	0%	15%
Key Statistics		
Spread (bps)	68	72 ▲
Ann. Vol.	3.89%	3.59%
Spread SCR	7.51%	6.95%
Duration	4.07	4.07
Portfolio Efficiency		
Spread/Vol.	17.4%	18.6% ▲
Spread/Spread SCR	9.0%	10.4% ▲

Source: ICE BofA, JP Morgan Markets. As at February 27, 2026. Based on the following indices: ICE BofA 1-10 Year A Euro Corporate Index, ICE BofA 1-10 Year BBB Euro Corporate Index, J.P. Morgan European CLOIE AAA Index. Spreads as at February 27, 2026. CLO spreads are discount margins to worst. Corporate spreads are asset swap spreads. Volatility based on returns calculated using index data from January 31, 2012 to February 27, 2026. European CLO series extended back to prior to January 31, 2018 based on EUR-hedged returns of U.S. CLOIE series. Barings’ interpretation of Solvency II. Based on proposed amendments post January 2027. Spread risk capital calculated using spread duration for corporate bonds, and modified duration for CLO tranches.

## Finding Value

As regulatory changes come into effect, AAA CLO tranches are increasingly being considered as a complement to European insurers’ existing investment

grade allocations. For AAA-focused investors, alpha generation is bolstered by access to the widest possible opportunity set, and a deep understanding of how markets and collateral managers behave.

In other words, investors need broad access to primary and secondary European, U.S. and Private credit CLO markets. Each region offers its own balance of spread, collateral depth, liquidity and deal structure. Relative value between them, on a currency-hedged basis, can shift over time in response to macro conditions, supply and demand dynamics and underlying loan performance.

European BSL CLOs represent a smaller universe that is largely aligned with European risk retention rules, offering a clean and straightforward investible set for European insurers. In contrast, the U.S. BSL CLO market is larger and more liquid, supported by deeper secondary markets and a wider borrower base. Private credit CLO tranches typically trade at a premium to BSL CLO tranches, providing exposure to private credit while maintaining a moderate level of liquidity, particularly at senior tranches. A flexible strategy that allocates across these segments, alongside opportunistic exposure to areas like infrastructure and commercial real estate (CRE) CLOs, can further expand the potential sources of excess return and diversification.

Finally, because spreads are tightest at the AAA level relative to the rest of the CLO capital structure, market presence can be a meaningful differentiator. Investors with long-standing participation in the CLO market often benefit from earlier visibility into new issues, better access to secondary opportunities and more consistent execution. These advantages can support stronger access to high-quality AAA tranches when supply is constrained or demand is elevated.

## Key Takeaways

CLO tranche investment offers diversified exposure to corporate credit with structural protections that have proved resilient through multiple credit cycles. For insurers, these features help balance the pursuit of incremental yield pick-up with the objectives of capital preservation and liquidity management.

For European Solvency II insurers, the upcoming regulatory reform materially changes the calculus for senior tranches. A meaningful reduction in capital charges brings the regulatory treatment of AAA CLOs closer to the underlying risk of the asset, removing a key historical barrier to participation. This shift allows European insurers to evaluate the asset class more directly on its economic merits: collateral quality, structural protections and relative value across regions and collateral types. With a clear understanding of these dynamics, insurers can incorporate AAA CLOs as a complementary component with their existing public asset portfolios.

### Barings' CLO Platform

Barings is one of the larger, more established and innovative players in the CLO Market



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