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Hedging alternatives eyed

JPM said to be exploring alternative risk transfer structures

JP Morgan is believed to be exploring alternative risk transfer structures given the persisting uncertainty in the US around the regulatory treatment of synthetic securitisations. However, market sources believe that the impasse is expected to be resolved this year amid the incorporation of Basel IV into the US regulatory framework.

According to sources, the US lender is exploring CDS and SPV structures as alternative wrappers to the CLN format as well as old school cash structures such as the one that was executed by Customers Bank last year (SCI 12 October 2022).

US regulators raised issues about the direct CLN structure in 2022 (SCI 19 August 2022), but the same sources qualify without detail that the discussions are technical in nature and can be resolved through simple contractual changes.

The regulatory impasse has dramatically reduced US issuance. Indeed, according to SCI data, the US CRT market grew from US$128.96m in 2019 to US$2bn in 2021 in total tranche notional terms. However, last year that figure was more than halved (US$705m).

The US regional banks such as Western Alliance, PacWest and Customers Bank breathed some life into the market last year, given the more fragmented regulatory architecture in the United States (see SCI's capital relief trades database).

The resolution of the regulatory challenges is particularly salient due to all the capital management challenges that US banks began encountering last year.

Share buybacks for instance had to be suspended in some cases to meet higher bank capital requirements, amid what a Seer Capital report called a “double whammy” of higher RWAs and a higher required capital ratio due to adjustments in capital regulation.

The challenge here is twofold according to the Seer Capital report. First, RWAs ascribed to derivative counterparty exposures increased significantly at the beginning of 2022 based on the required adoption of the Standardized Approach for Counterparty Credit Risk (“SA-CCR”).

US banks are subject to the Collins Amendment to the Dodd Frank Act, requiring them to calculate RWAs based on the higher of the standardized approach and the IRB approach. The adoption of the SA-CCR boosts standardized RWAs versus IRB RWAs.

Second, minimum CET1 ratios set by the Federal Reserve Board include a base requirement plus bank specific buffers determined based on criteria including size and performance in stress tests. Hence, stress capital buffers (“SCB”) for US banks can be adjusted depending on their performance in these tests.

Consequently, the capital regime renders risk transfer technology and especially programmatic issuance an essential tool in managing higher and more volatile capital requirements.

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