News

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More supply, and US banks to join the party, say conference speakers

While 2022 was a record year in the global SRT market, with $20bn of issuance and some $140bn of assets referenced, 2023 will be even bigger, said speakers at the IMN Credit Risk Transfer conference in New York this week.

Though the jury is still out on whether the US will join the issuance bonanza, there is increasing optimism that things are about to change here too as tier one banks try out new structures to please the regulators.

Various factors have conspired to make the regulatory capital relief market look even better this year. Firstly, banks can't turn to the equity market. A lot are trading at a discount to book value. "The equity market is closed so this is a good opportunity for the CRT market," explained a speaker in New York.

At the same time, higher interest rates have created mark to market pressure for longer duration assets while also increasing competition for bank deposits. The recent demise of First Republic, to be added to the swelling roster of banks that have failed in 2023, shows the urgent need for many regional banks to de-risk.

A recent report by Seer Capital suggests that there will be perhaps $25-30bn of CRT issuance this year, with 65-70 individual deals referencing over $170bn of assets.

"The SRT market has grown dramatically in recent years, with an increasing number of banks globally looking to avail themselves of the many benefits, including risk relief, capital relief, and demonstrating ability to distribute risk. The recent bank turmoil, with the failures of SVB and Signature Bank and the rescues of CS and First Republic, will stimulate further growth in the US, in Europe, and further afield," Terry Lanson, an md and portfolio manager at Seer Capital, told SCI.

Whether the US will come to the party remains the big question. While regional banks have been able to issue reg cap deals, and in the last year or so PacWest, Western Alliance and, most recently Merchants Bank of Indiana, have done so, the tier one market, which is subject to much keener regulatory oversight, has been on hold since the end of 2021.

However, recent market talk indicates that JP Morgan, which has a bigger regulatory capital burden than most, is about to bring an SPV deal to test the waters. Speakers at the conference suggested that the credit linked note structure, preferred by US banks for logistic and accounting reasons, does not conform to the stipulations of Reg Q rules.

"We understand that the regulators have no philosophical objections to CRT deals, but they must adhere to Reg Q. So there is a clear path forward," said another speaker on Monday. The clear path forward would seem to involve the use of an SPV.

Moreover, the recent turmoil in the banking market has made investors a little more wary of assuming counterparty risk, and the use of SPV immunizes investors from that direct exposure. Thus SPVs should make the reg cap market more attractive to a broader range of buyers, and bring more issuers into the fold.

There are likely to be changes in the way SRT deals are structured as well, as investors will seek higher rewards and less risk. Tranches will be thicker, higher quality assets referenced and replenishment periods will be shorter with tighter criteria, predicts the Seer Capital report.

Yields at the end of last year regularly reached mid-teens, as spreads had widened 200-300bp over the course of the year while SOFR rates had also increased sharply. To prevent levels rising even further, banks will look to reference less risky assets as well as using more risk-averse structures.

As the report notes, despite the bad publicity surrounding bank names, the market is moving in favour of investors, with wider spreads, more conservative structures and more carefully selected portfolios. Smaller banks will stay in the game by paying wider spreads and implementing buffers to insulate investors still further.

And US banks should not find themselves locked out of the SRT party.

"The banking turmoil finally creates the 'use case' that US regulators have been waiting for to pave the way for the widespread adoption of the SRT product as a way for US banks, both large and small, to remove risk from their balance sheets and distribute it among sophisticated investors. We expect the US market to come on line imminently and drive exponential growth in the market," predicts Terry Lanson.

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