Seer Capital Management LP
1177 Avenue of the Americas, 4th Floor
New York, NY 10036
212 850-9035
investorrelations@seercap.com
www.seercap.com

Reg Cap Recap

A biweekly update on the Regulatory Capital Relief/Significant Risk Transfer sector

July 23, 2024

Reg Cap Fundamental Credit Trends

The RegCap sector spans a variety of reference assets and, of course, the performance of those assets varies among originators. Assets originated by banks to their clients for their own balance sheets generally outperform assets in generic credit indices. Further, investors impose selection criteria and originators tend to "cherry pick" assets for Reg Cap deals to help ensure the success of their RegCap program on the most attractive terms.

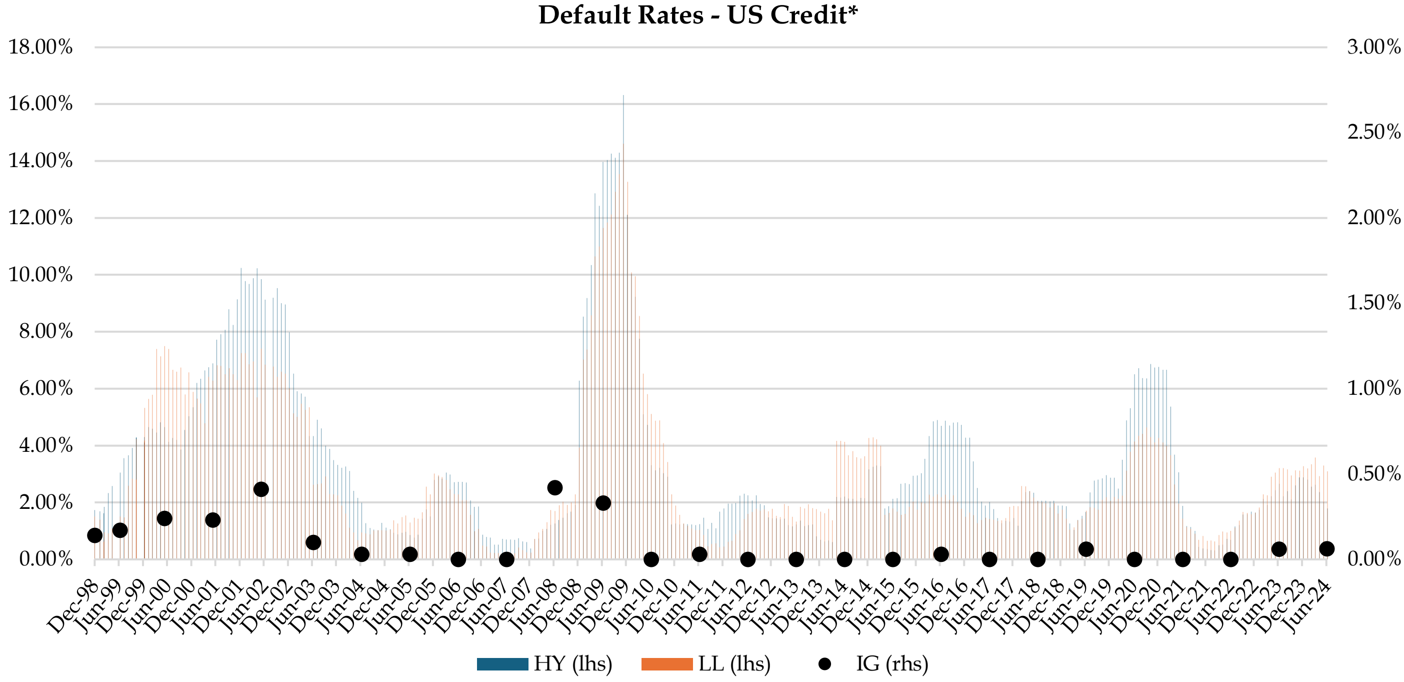
That said, we find it useful and important to track broad trends in asset performance in addition to deal-specific surveillance (which is non-public). Across 32 deals that we own and track, referencing corporate, SME, middle market, consumer, and auto loans in Europe, North America, and Asia, we are seeing continued strong credit performance almost across-the-board, with just a few positions that we are monitoring more carefully due to slightly higher negative credit migration and/or default trends.

The indices we look at as broadly representative of some of the most common reference assets include: US Corporate Debt, including Investment Grade, High yield and Leveraged Loans; European Investment Grade Debt and High Yield; and US Prime auto loans. We would expect most reference asset pools to significantly outperform these publicly available benchmarks. The following is a brief update on current credit trends for each.

US High Yield and Leveraged Loans

Most corporate credits in referenced pools are investment grade quality. Defaults of investment grade obligors are rare. While Investment Grade ("IG") defaults have been only a small fraction of the defaults in leveraged credit (i.e. US High Yield "HY" bonds and Leveraged Loans "LL"), there is a strong correlation (~75%). Therefore, it is useful to track the (far more numerous) default activity in HY and LL as a possible bellwether for IG.

The trailing 12-mo. default rate for HY and LL is 1.79% and 3.10%, respectively. YOY, HY defaults are down 88bp and LL are down 22bp. HY defaults are significantly below their historical average (3.39%) while LL default rates are essentially at their historical average (3.01%). Despite a reasonably supportive macro backdrop, defaults are biased to drift up. The distressed universe of loans (i.e. trading below $80) is at 5.9% and the distressed universe of bonds (trading at spreads at or above 1000bp) is at 7.6%. While these distressed buckets have shrunk over the past year, they still suggest that default rates are biased to increase, with some forecasts showing a peak in 2025 at ~3% for HY and ~4% for LL. These levels are consistent with very low to no IG defaults.



Source: Standard & Poor's, JPMorgan Research, as of June 2024.
** HY and LL on a trailing 12-month basis, dollar-weighted. Includes distressed exchanges. IG on an annual basis.*

.

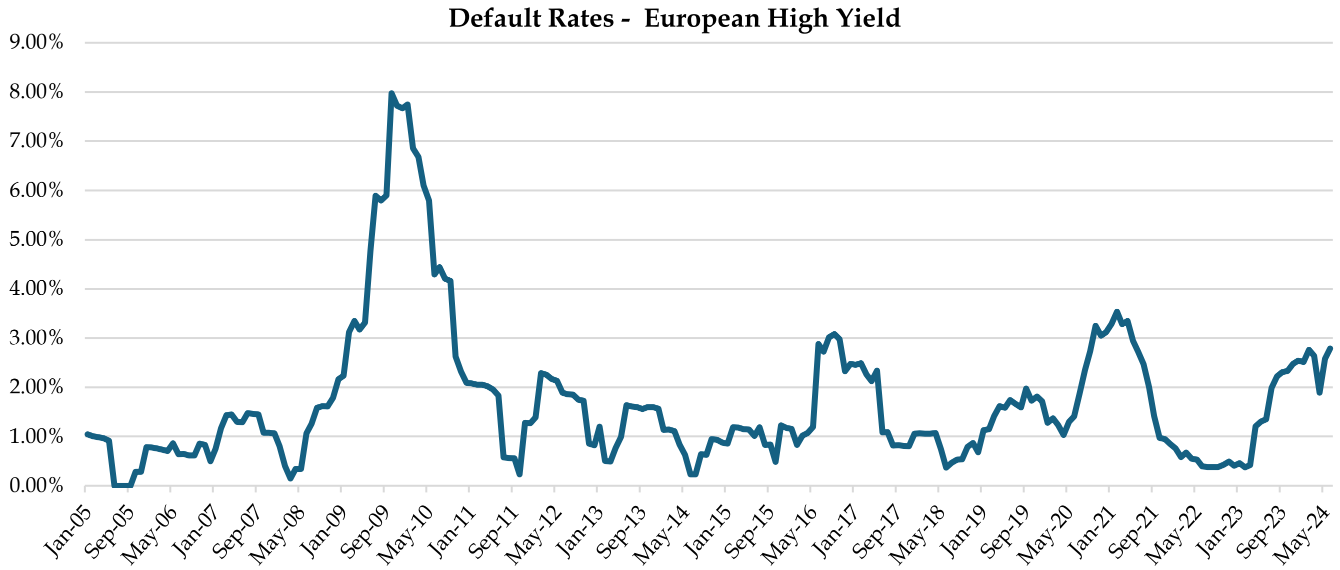
Seer Capital Management LP
1177 Avenue of the Americas, 4th Floor
New York, NY 10036
212 850-9035
investorrelations@seercap.com
www.seercap.com

Reg Cap Fundamental Credit Trends (Cont.)

European High Yield

Historically, IG defaults in Europe have also been very low, with no defaults at all in most years. Our European HY default data goes back to 2005. Since 2005, the default rate for IG in Europe was zero in every year but two; in both 2008 and 2009 the IG default rate was 11bp.

As of June 2024, the trailing 12-mo. default rate for European HY is 2.79%, up 144bps YOY and ~100bps above average. The increase reflects slowed growth and higher debt service burdens. The consensus forecast for the EU is constructive, with GDP growth expected to rise from 0.9% in 2024 to 1.7% in 2025. However, the distressed bucket in HY (bonds trading with a spread of 1000bps or more), while falling, remains relatively high at 7.7%. For that reason, defaults are likely to remain at today's somewhat elevated levels until that can clear. Again, these levels are consistent with very low levels of IG default if not nil.



Source: JPMorgan Research, as of June 2024. Trailing 12-month basis, dollar-weighted. Excludes Banks/Insurers.

The ECB publishes a bank lending survey ("BLS") quarterly. The survey details the net percentage of banks that report a tightening of standards, by region and product, as shown below. A positive number means more banks report tightening than easing. The July 2024 report shows a small net tightening of credit standards for loans to enterprises, with only Italy showing a modest loosening Trends in lending standards were mixed in residential mortgage lending, with Germany and Spain tightening while the rest of the regions loosened credit, especially in France. Lastly, credit standards for consumer credit tightened moderately. Banks reported that risk perceptions were largely unchanged, with lower risk tolerance the main driver behind the (quite modest) QOQ tightening. The survey also indicated that banks expect the third quarter to bring a modest net tightening for loans to firms and unchanged credit standards for loans to households. This relative stability in lending standards is constructive for growth and credit performance.

Latest BLS results for the largest Euro area countries (net percentages of banks reporting a tightening of credit standards):

Country	Enterprises			House Purchase			Consumer Credit		
	Credit Standards			Credit Standards			Credit Standards		
	Q1 24	Q2 24	Avg.	Q1 24	Q2 24	Avg.	Q1 24	Q2 24	Avg.
Euro area	3	3	9	-6	-6	6	9	6	5
Germany	6	3	4	7	7	4	14	7	1
Spain	0	0	9	0	10	14	17	17	11
France	0	8	7	-22	-33	4	8	0	0
Italy	0	-9	12	0	-9	1	15	8	5

Source: European Central Bank

Seer Capital Management LP
1177 Avenue of the Americas, 4th Floor
New York, NY 10036
212 850-9035
investorrelations@seercap.com
www.seercap.com

Reg Cap Recap

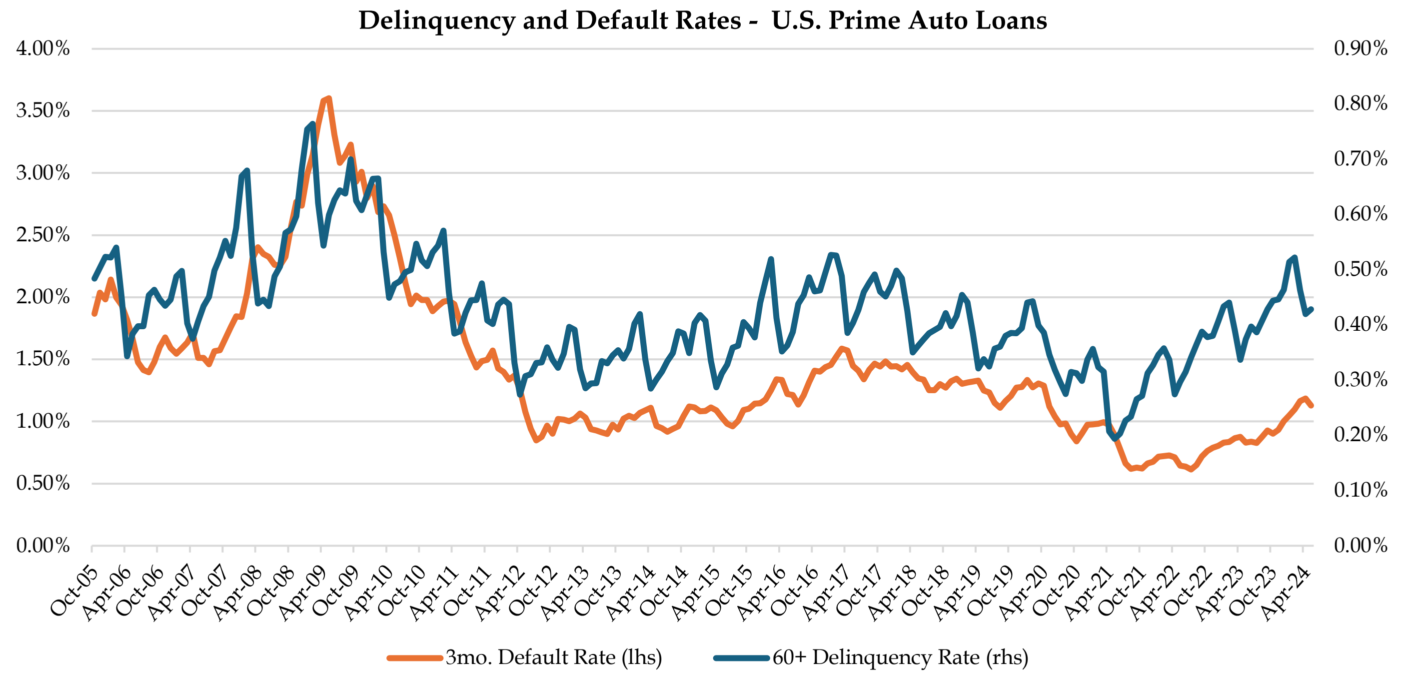
July 23, 2024

SEER CAPITAL

Reg Cap Fundamental Credit Trends (Cont.)

US Prime Auto Loans

As of the end of May (the most recent data available), the 60+ delinquency rate for securitized US prime auto loans was 43bps, up 5bps YOY. The 3-month default rate is 113bps. This leaves delinquencies on par with their long run average (42bps), but with fewer delinquencies rolling into defaults, 3mo default rates are significantly below their long run average of 143bps. Unlike corporate credit, which suffered during the pandemic, consumer credit losses hit new lows in 2020/2021, as consumers benefited from stimulus payments and a spike in used car prices. The current period represents a normalization. With unemployment still low, the outlook is for auto loan delinquencies to flatten out at close to today's levels.



Source: BofA, as of May 2024.

Reg Cap News

Issuance News:

Intesa Plans SRT Deals Tied to at Least €4.5 Billion of Loans (Bloomberg News aka "BN," 7/1/24). Milan-based Intesa Sanpaolo is working on three Reg Cap (aka "SRT") deals, tied to €4.5 billion ($4.8 billion) of loans. The proposed deals include issuances referencing €1.3 billion of leveraged loans, €1.2 billion of commercial real estate loans, and ~€2 billion of large corporate loans. Intesa hopes to complete all three transactions in the second half of the year.

Credit Agricole Readies SRTs Tied to Up to $10 Billion of Loans (BN, 7/9/24). Credit Agricole is planning as many as three new Reg Cap issues, potentially totaling $10bn: $4bn in EM debt under its Marco Polo shelf; $5.4 bn in large corporate loans under its Cedar shelf; and a third issue referencing as-yet-unspecified debt up to €1 billion.

BNP Paribas Eyes SRT Deal Linked to Up to €12 Billion of Loans (BN, 7/10/24). BNP Paribas is contemplating a new Reg Cap issue under their Resonance program. The issue will be linked to a blind pool of up to €12 billion in corporate loans for which Paribas plans to sell between €400 million and €650 million of protection. Preliminary pricing is 750bp over Euribor. The article also noted that Paribas is considering a Reg Cap structure known as "unfunded credit protection," whereby an insurer guarantees the notes. It was also noted that Deutsche Bank, Banco Santander, UniCredit and Intesa Sanpaolo are all also planning to tap the Reg Cap market in the coming months.

Irish Bank AIB Considers Debut SRT Tied to €1 Billion of Loans (BN, 7/12/24). AIB was nationalized in the wake of the GFC. As the Irish state continues to reduce its stake and the bank prepares to become independent, AIB is contemplating issuing its first Reg Cap deal.

Seer Capital Management LP
1177 Avenue of the Americas, 4th Floor
New York, NY 10036
212 850-9035
investorrelations@seercap.com
www.seercap.com

SEER CAPITAL

Reg Cap News (Cont.)

Plans for their debut issuance involve a €1 billion ($1.1 billion) pool of corporate loans, slated to be done by year end. AIB also disclosed plans for a second Reg Cap deal in early 2025, referencing mortgages, and hopefully regular issuance thereafter.

Bawag Eyes Significant Risk Transfer Tied to €1 Billion of Loans (BN, 7/17/24). Austria's Bawag Group is considering issuing a Reg Cap deal referencing a €1 billion ($1.1 billion) pool of consumer loans. Bawag recently agreed to acquire **Barclays** Plc's German/Austrian consumer finance business. The purchase is expected to reduce Bawags' regulatory capital (specifically their Common Equity Tier 1 ratio) by ~140bp. Reducing the bank's risk-weighted assets via Reg Cap issuance would help offset the hit to capital caused by the acquisition.

Other News:

Powell Says Regulators Are Near a Revamped Bank-Capital Plan (BN, 7/9/24). Federal Reserve Chair Jerome Powell said US regulators are close to agreeing to changes to plans forcing big banks to hold significantly more capital, after a successful pushback from the industry. Some estimated the biggest US lenders would have needed to hold as much as 19% more capital under the original plan. While less onerous capital requirements may take some of the pressure off banks, we believe that issuers have seen the wisdom of having a RegCap program as part of their arsenal to optimize performance, and expect continued growth regardless of the outcome here.

Powell Supports Basel Endgame Re-Proposal (Morgan Stanley Research, 7/9/24). In testimony to the Senate Banking Committee. Fed Chair Jerome Powell indicated his support for revising the new "Basel Endgame" bank capital requirements. MS's base case assumes the new proposal will be released Fall 2024 with a final rule in Spring 2025, and adoption not until 2026 at the earliest. Of course, a change in the administration and the possibility of new regulatory appointments could derail the process.

Risk Transfer Deals Are on Path to Hit Record High (BN, 7/11/24). According to this article, global Reg Cap issuance reached a record $9.5 billion in the first half of 2024 up 32% from 2023 1H, which was also a record. With a robust pipeline of deals , full year issuance could reach $30bn, vs $24bn in 2023. European banks issuers comprised 71% of YTD volume, with US banks comprising 25%. The growth in issuance has been matched by growing demand as new investors enter the market.

Goldman challenges Fed's demand to hold more capital after stress test (The Financial Times, 7/14/24). Goldman Sachs lodged an appeal with the Fed challenging the results of the most recent "stress test," and hence the associated new capital requirements. The Fed's stress results showed GS losing more than $40bn from loans in its most severe stress case. Goldman is typically subject to particularly high capital requirements due to its large trading business. The Fed has allowed banks to file appeals since 2020, but none of those (8) appeals succeeded, including a prior one filed by GS.

Goldman Sachs, facing capital buffer increase, will pare buybacks (American Banker, 7/15/24). In a recent earnings call, GS noted that they are facing a "higher than expected Stress Capital Buffer requirement." As a result, they plan to cut back on buyback activity this quarter. The planned increase for GS, to be effective October 1, is a 90+bp jump from ~5.5% to ~6.4. GS, like others, continues to challenge the sizing of the SCB. Higher SCB, which is a component of overall minimum capital ratio, is a likely impetus for GS and other large US banks to issue Reg Cap.

U.S. Bank Usage of SRT Deals to Increase; Could Weigh on Assessment of Capital (Fitch Ratings 7/16/2024). Fitch Ratings expressed caution over "too heavy of a reliance" by banks on capital relief transactions. The rating agency allowed that Reg Cap should generally be neutral from a ratings standpoint, but that banks may come under scrutiny if Fitch believes Reg Cap programs are leaned on to drive capital returns or increase leverage, or if the costs of Reg Cap deals are "outsized" relative to the actual amount of risk being transferred. Fitch posited that, even with more muted proposals now on the drawing board, they expect many larger regional banks will face higher capital requirements and choose to issue Reg Cap. Fitch also joined the voices of others in urging regulators to focus on whether the junior risk is fully exiting the banking system, especially if banks are financing non-banks' Reg Cap portfolios. It is somewhat surprising that Fitch has concerns about the use of Reg Cap by US banks, given that it is widely used by so many banks in Europe and elsewhere.

Default Cycles: US Corporate High Yield 3Q (Bloomberg Intelligence, 7/17/2024). Even as bankruptcies in the HY index have been declining, the US Chapter 11 Bankruptcy filings were up sharply in the first half , i.e. +61% YOY. This reflects particular stress among smaller businesses (which are unlikely to be in an index). Despite these broader signs of stress, the HY market is pricing in lower defaults. Current HY spread levels imply default rates will contract as much as another 30bp this year.

Seer Capital Management LP
1177 Avenue of the Americas, 4th Floor
New York, NY 10036
212 850-9035
investorrelations@seercap.com
www.seercap.com

Reg Cap Recap

July 23, 2024

Reg Cap News (Cont.)

Investment Grade Fundamentals: 1Q24 (Bloomberg Intelligence, 7/17/2024). Credit quality for the Bloomberg US Corporate Bond Index shows signs of deterioration. The 1Q earnings season shows rising leverage, for the sixth quarter in row. Interest coverage dropped to 6.7x as of 1Q, down from 9.1x in 3Q22.–Over the same period, debt-to adjusted Ebitda rose to 3.51x from ~3.25x. Meanwhile, at both Moody's and S&P, the upgrade-to-downgrade ratio is even at ~1x.

About Seer

Seer Capital Management LP is a diversified, credit-focused investment firm founded by Phil Weingord in 2008 that primarily invests in structured credit and loans. We allocate capital opportunistically across all major asset classes within structured credit in the U.S. and Europe, including: bank regulatory capital risk transfer (SRT), residential and commercial mortgages, syndicated and SME loans, and a variety of consumer loans (personal, auto, credit card, student, housing). These investments are executed through active trading in both legacy and new issue securitizations, purchase and securitization of whole loans, and direct lending joint ventures.

Seer Capital believes it is well positioned to capitalize on opportunities in structured credit as a result of our highly experienced senior investment team, which has on average more than two decades of experience working in structured credit.

For more information about Reg Cap or this publication, contact:

Abhayad Kamat
Managing Director
Head of Business Development
212 850-9035
akamat@seercap.com

Terry Lanson
Managing Director
Reg Cap Portfolio Manager
212 850-9005
tlanson@seercap.com

IMPORTANT DISCLAIMERS

Seer Capital Management has prepared this Reg Cap Update using information gathered from third parties as well as its own independent research, all of which it believes to be accurate as of the date hereof. While this memorandum represents our current thinking, future events could lead to a change in our opinion, and there can be no guarantee that the opinions expressed herein will be borne out by the market or underlying asset performance.
No offering of any investment product managed by Seer Capital Management is intended hereby.