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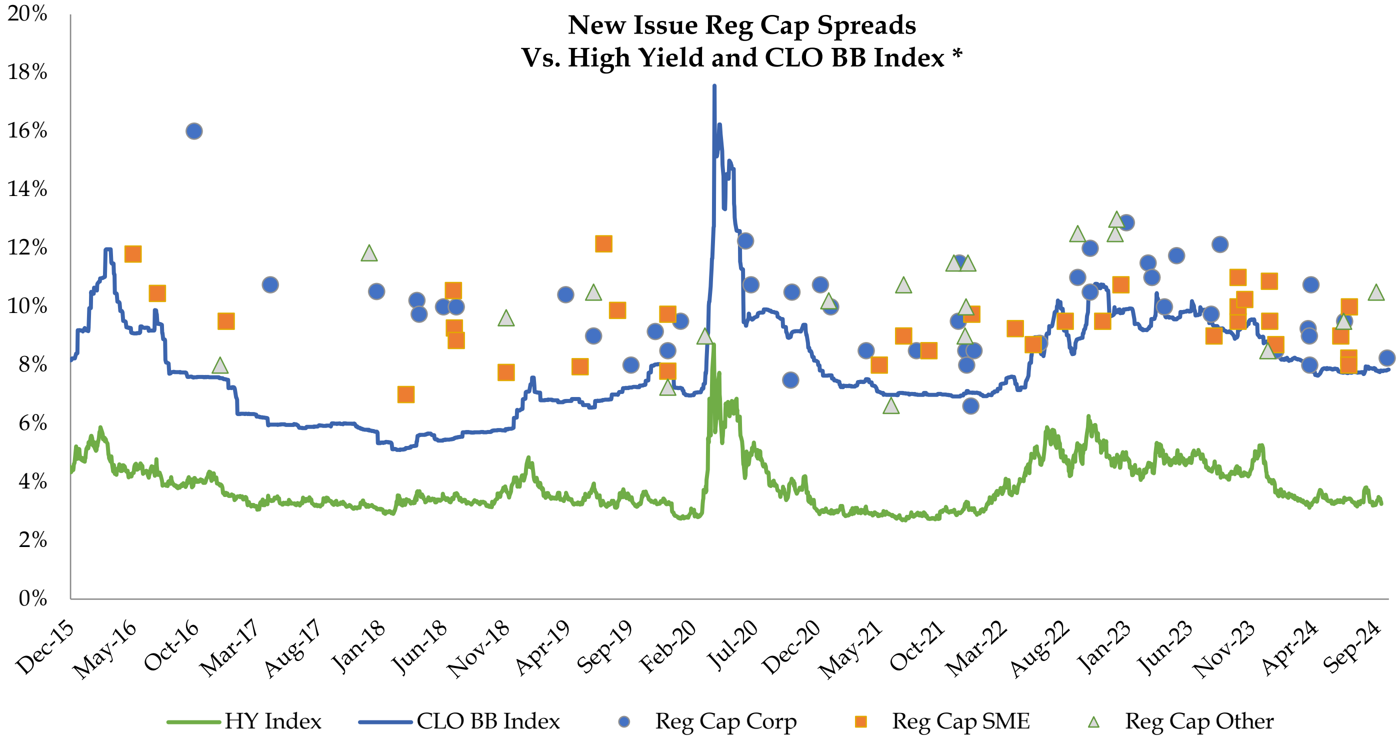
Reg Cap Recap

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

October 1, 2024

Reg Cap Spread Trends

Reg Cap spreads for new issue ranged from 800 to 1000 bps over the past couple months, marginally tighter than recent prints, while HY spreads tightened by 5 basis points during September and the BB CLO index widened by 4 basis points.



** Source: Seer Capital Research / Bloomberg. Reflects selected first and second loss tranches but excludes mezzanine and thick (i.e. 0-12.5%) tranches. As of Oct. 1, 2024.*

Recent New Issue Activity

The following is a representative listing of recent new issue activity.

		ASSET			PORTFOLIO SIZE		
Closing Date	Spread (bp) [1]	Type	Jurisdiction [2]	Disclosure [3]	Currency	Amount (bn)	First Loss [4]
Sep-24	825	Corporate	Global	Yes	USD	4.5	Yes
Sep-24	1050	Lev Loans	Global	Yes	USD	3	Yes
Jul-24	795	Jumbo Mortgages	US	No	USD	1.73	Yes
Jun-24	1000	SME	UK	No	GBP	1.68	No
Jun-24	800	SME	Portugal	No	EUR	1.635	No
Jun-24	825	SME	Spain	No	EUR	1.16	No
Jun-24	950	Lev Loan	Global	No	USD	1.5	No
Jun-24	950	Corporate	UK	Yes	GBP	1.35	Yes
Jun-24	900	SME	Germany	No	EUR	2.562	No
Jun-24	825	Auto	US	No	USD	4	No
Jun-24	875	Auto	US	No	USD	2.3	No
Jun-24	825	Auto	US	No	USD	2.5	No

[1] *Spread to SOFR*
[2] *Asset jurisdiction and issuer jurisdiction may vary*
[3] *Disclosure of obligors in the reference pool of assets by name*
[4] *Indicates whether the Reg Cap issue is in the first loss position*

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Market Commentary

After a relatively quiet 3rd quarter, we are busy at work on a heavy 4Q pipeline, which includes a number of transactions backed by granular pools of corporate and consumer loan assets, which we like because (i) we can model them using a statistical approach based on historical performance of similar assets, (ii) we avoid idiosyncratic risk of one or two large defaults, and (iii) we see less competition from traditional corporate credit/CLO investors. We have seen some spread pressures in Reg Cap, as well as other credit assets, and we expect 4th quarter supply to price in the high single digits, slightly inside of previous years.

Attention remains focused on US regulators, who provided hope of some resolution on the Basel Endgame, then dashed that hope. On September 10, Fed Vice-Chair for Supervision Michael Barr made a speech outlining adjustments to the original Basel Endgame proposal from July 2023, including a 9% overall increase in capital required for large banks vs 19% in the initial proposal. But the Fed, the OCC, and the FDIC need to agree on the final capital rules, and it was subsequently reported that three of the five commissioners of the FDIC oppose the revised proposal, so back to the drawing board pending the November election. Clarity on the Basel Endgame will stimulate more US banks to come off the sidelines and get to work on Reg Cap issuance.

Reg Cap News

IACPM Research Principles and Practices in CPM 2023 White Paper (iacpm.org, 11/23)
The International Association of Credit Portfolio Managers (IACPM) recently publicly released its 2023 Principles and Practices in CPM Survey. The report noted that the regulatory capital ratio "is now the top binding constraint at banks globally" and as a result meeting capital targets as a priority is now second only to revenue generation. Discipline at origination remains the most important credit risk management tool. However, over the past two years, the use of so-called "back-end" or market tools to manage credit, including credit risk insurance, loan sales, financial guarantees, and Reg Cap issuance have all grown and that growth is expected to continue at banks both large and small. Due to jurisdictional differences in regulatory treatment, Reg Cap is still far more common in Europe, although the reports notes that it has been growing in North America.

Fed's Relaxed Bank-Capital Plan Faces Bipartisan FDIC Pushback (Bloomberg News, 9/20/24)
When the Fed, FDIC and Office of the Comptroller of the Currency unveiled their original plan for bank capital requirements in July 2023, the industry responded with a "fierce" lobbying campaign. Earlier this month, regulators cut their proposal from a 19% capital hike (for the US's eight "systemically important" banks) down to 9%. Fed Chair Powell is now hoping to finalize the new rules in the first half of 2025, but other regulators are less sanguine. At least three of five FDIC directors oppose the latest overhaul, with one calling it a "giveaway," others arguing a full re-proposal is needed, and tentative plans to hold an open meeting on the issue now scuttled. Industry reaction to the Fed's less onerous proposal was also unenthusiastic. Morgan Stanley's Co-President "...wasn't sure the changes would be sufficient" and Bank of America CEO said the proposal was an example of "show them death and they'll take despair."

NatWest Plans Risk Transfer Tied to £1.4 Billion of Loans (BN, 9/23/24)
NatWest plans to issue a significant risk transfer linked to a portfolio of about £1.4 billion ($1.9 billion) of corporate loans. The size of the SRT is expected to be around £101 million. The article also noted that NatWest has recently added several bankers to its SRT desk.

Inaugural Regional Bank CRT Seminar (SCI conference, 9/24/24)
Key takeaways from this industry conference include:

- US regional banks are gingerly wading into the Reg Cap market. Many smaller banks are reluctant to bear the annual premium, and put off by deal complexities, the need to obtain buy-in of necessary stakeholders, and the need to coordinate internal resources. Exacerbating this is the fact that US banks, particularly smaller banks, tend to view Reg Cap as "one off," whereas in Europe many banks have established programs, and view it as a regular capital management tool. Some US regionals may wish to use Reg Cap to reduce commercial real estate concentrations, which are a considerable part of their assets and currently underperforming.
- Regulatory issues still mired in uncertainty. Consensus around the latest "Basel Endgame" proposal for the US appears elusive, compounded further by the risk that, should we have a new administration next year, they might scrap the existing proposal entirely.
- Spread tightening may have run its course. Heavy cross-over buying has increased demand and tightened spreads. A lot of demand comes from undeployed capital for private credit, and cross-over buying of corporate deals. As the market develops and we see more issuance linked to other asset classes, crossover buying should ebb. Meanwhile, the recent spread tightening makes Reg Cap marginally more attractive for issuers, potentially adding supply.

UK to Make Bank SRT Deals Cheaper with Securitizations Revamp (BN, 9/27/24)
UK financial regulators are set to make it easier for banks to do "unfunded" deals, where banks use insurance to cover potential loan losses. Unfunded deals allow banks to transfer the risk on a portfolio to a third-party investor such as an insurer. These deals are fairly common on the continent, with quasi-governmental entities such as the European Investment Bank and public development funds providing the protection. Since unfunded Reg Cap deals entail the risk that the "insurer" might be unable to honor their commitment to

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Reg Cap News (continued)

cover losses, only the highest quality counterparties will suffice for capital relief.

UBS Chair Warns Against Big Increase in Capital Requirements (USNews.com, 9/28/24)
The Chair of UBS recently warned that the Swiss government's plans to raise bank capital requirements, coming on the heels of Credit Suisse's collapse last year and in the context of worldwide changes under Basel III, might threaten Switzerland's role as a global financial center. Details on the Swiss proposal were not available, although Finance Minister Keller-Sutter was quoted as saying that an additional $15 billion to $25 billion in capital was "plausible" for UBS. Like their US counterparts, UBS argues that "excessive" capital requirements would damage competitiveness and raise costs for customers. UBS--with a balance sheet twice the size of annual Swiss economic output--is a prime example of "too big to fail."

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.

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