Seer Capital Management LP
1177 Avenue of the Americas, 4th Floor
New York, NY 10036
(212) 850-9068
www.seercap.com

Reg Cap: Inexperienced Players Need Not Apply

December 2024

Reg Cap currently offers few attractive opportunities for investors who lack experience and relationships in the market

At a recent allocators' conference focused on private credit, a senior representative of a large global private equity firm dismissed Reg Cap, saying there are no barriers to entry and spreads are too tight. In a sense he is correct, large investors new to Reg Cap who wish to deploy a significant amount of capital can access a few large, on-the-run transactions from primarily US banks by competing on price alone. Paradoxically, these investors aren't aware of the majority of Reg Cap transactions, which are more attractive, reference a broader range of assets, and are placed by repeat issuers among a select group of specialized investors with whom they have developed partnerships over many years.

A key theme of the allocators' conference was the contrast between large and small investors. Large players in private credit are seen as "beta" investors, competing for and participating in the same mega-deals. Large investors offer scale and a wide range of products, but smaller investors can be more nimble and access alpha from unique opportunities. One conference participant drew a contrast between "asset collectors" and "asset selectors".

Reg Cap investors with specialized knowledge and relationships can gain exposure to attractive lending product alongside banks

Reg Cap offers nimble private credit investors the opportunity to participate alongside banks in core lending originated for the banks' balance sheets to key clients. Banks issue Reg Cap for capital relief and balance sheet management more than for risk management, so they are motivated to select assets where the capital treatment diverges from the risk profile. This allows them to achieve capital relief at the most effective cost. Investors gain exposure to lending product that they would find difficult to replicate elsewhere. For more on bank motivations and alignment of interest in Reg Cap see: https://seercap.com/wp-content/uploads/2024/07/Reg-Cap-A-Better-Way-for-Private-Credit-to-Partner-With-Banks.pdf.

Below is a non-exhaustive list of assets to which Reg Cap investors can gain exposure alongside banks. Investors need expertise beyond corporate credit / high yield to analyze many of these.

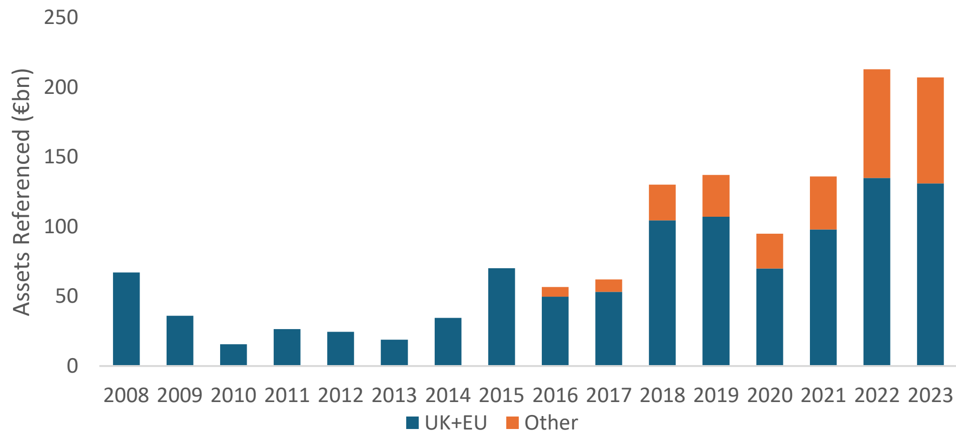
Agricultural Loans	Emerging Market Loans	Project Finance Loans
Auto Leases	Large Corporate– IG	Residential Mortgages
Auto Loans	Large Corporate– Crossover	Resi Mortgages-- High LTV
Capital Call Facilities	Large Corporate-- Disclosed Names	Small Ticket CRE Loans
Commercial Real Estate Loans	Leveraged Loans	SME Loans-- Mid Cap
Consumer Loans	Non-Performing Loans	SME Loans-- Small Cap
Counterparty Exposures	Object Finance Loans	Trade Finance

US Market: Democratization of Reg Cap?

The Reg Cap market in Europe has been developing since the Financial Crisis, and over that time a clear and transparent regulatory framework has evolved. The framework enables most large banks to issue transactions periodically for capital relief, balance sheet optimization, and portfolio management. Large US banks were effectively excluded from Reg Cap due to regulatory uncertainty until the Federal Reserve published FAQ in September, 2023 clarifying the treatment.

Seer Capital Management LP
1177 Avenue of the Americas, 4th Floor
New York, NY 10036
(212) 850-9068
www.seercap.com

Figure 1: Reg Cap Issuance History by Region



Source: IACPM. Note: Other comprises primarily Asia and Canada in 2022 and prior and US in 2023. Further breakdown unavailable.

For more on the inception of the US Reg Cap market see: https://seercap.com/wp-content/uploads/2024/07/Regulatory-Clarification-Opens-US-Reg-Cap-Market-web.pdf.

The initial wave of US Reg Cap issuance has reflected pent-up supply of on the run assets issued to large investors at tight pricing

The Fed FAQ released a wave of pent-up supply, which consisted primarily of leading banks executing large transactions designed for maximum efficiency. These referenced on-the-run assets such as investment grade corporate loans or subscription lines, placed with large investors who have expertise in corporate credit and can allocate several hundred million dollars to a single deal. JP Morgan sold more than $2 billion of notes referencing investment grade corporate loans in separate bilateral deals with a handful of investors in late 2023. Citi, which has historically issued mostly large corporate transactions under the Terra program but paused for regulatory reasons, rekindled the program with a similarly high minimum investment size. Morgan Stanley, Goldman Sachs, and US Bank have also tapped large investors for on-the-run assets. These transactions have priced at very tight spreads, in some cases below 5%. A few regional banks have issued deals, including several referencing auto loans, which have been placed with crossover ABS buyers at tight spreads.

Expediency as well as legal and regulatory considerations have pointed US banks toward large bilateral transactions, but selected legal and regulatory adjustments would pave the way for broader distribution on the European model. See Appendix for legal and regulatory considerations influencing the development of the US market.

Different Syndication Approaches

According to an old stereotype, European business is conducted based on relationships, while Americans are more transactional. But we are convinced that in time, US banks will invest resources to (i) overcome the regulatory and legal hurdles to syndicating deals and (ii) pursue relationships with a range of specialized, dedicated Reg Cap investors.

Large banks and experienced Reg Cap investors invest heavily in mutually beneficial partnerships

Most global Reg Cap issuers syndicate transactions among a club of investors, which can range from a handful to 20+, depending on the issuer, transaction size, and type. Many issuers work assiduously with investors to ensure their availability on a repeat basis under different market conditions. On the other side, investors undertake detailed due diligence of banks, particularly for first-time Reg Cap deals (see page 5.) Regulators are concerned about "flowback risk," i.e. the risk that, when a Reg Cap transaction matures, the issuer is unable to issue a replacement transaction, and the assets flow back onto the bank's balance sheet, forcing reduction in lending. Banks with a stable group of repeat Reg Cap investors limit this risk.

Figure 2: Large Reg Cap Issuers and Preferred Placement Method

		Total Assets	Assets Referenced (USD mm)			
Bank	**Country**	**(USD mm)**	**2023**	**2022**	**2021**	**Placement***
Barclays PLC	GB	1,881	59.0	58.1	61.8	B
Banco Santander SA	ES	1,984	51.0	41.3	38.2	C
BNP Paribas SA	FR	2,861	46.3	42.0	42.1	C
Bank of Montreal	CA	1,017	45.4	31.0	10.0	C
UBS Group AG	CH	1,717	37.8	0.0	0.0	B
JPMorgan Chase & Co	US	3,875	35.5	0.0	2.4	B
Societe Generale SA	FR	1,716	30.7	19.1	17.7	C
Deutsche Bank AG	DE	1,449	29.7	21.6	23.1	C
Intesa Sanpaolo SpA	IT	1,064	24.1	24.9	21.2	C
Citigroup Inc	US	2,412	20.9	30.4	30.9	B
Nordea Bank Abp	FI	645	15.7	7.5	5.7	C
Lloyds Banking Group PLC	GB	1,122	15.7	14.4	17.4	C
Credit Agricole SA	FR	2,417	15.3	17.3	14.7	C
Commerzbank AG	DE	571	14.1	11.9	11.6	C
Raiffeisen	AT	219	13.7	10.5	9.2	C
UniCredit SpA	IT	867	12.8	12.2	4.7	C
HSBC Holdings PLC	GB	3,039	10.7	10.4	7.5	C
Others			84.8	100.6	97.0	
Total			563.2	453.3	415.1	

* B=Bilateral, C=Club (some banks listed as Club issue bilateral deals periodically under certain circumstances)

Source: Bloomberg, Seer Capital Research. Total Assets are as at 12/31/23. Assets referenced are total assets referenced by the Bank in outstanding Reg Cap deals as at the end of each year.

Most large Reg Cap issuers place transactions primarily, if not exclusively, among clubs of investors. This includes the largest European banks, HSBC, BNP Paribas, and Credit Agricole, which are marginally smaller than JP Morgan but larger than Citi in terms of assets. Barclays is a notable exception, offering exposure to a relatively standard portfolio, structure, and documentation in bilateral slugs of $100 million and more. The longtime leader of Barclays' program is an ambassador for Reg Cap and his program, working to establish partnerships with a wide range of investors globally. The bank prefers bilateral transactions to facilitate negotiation of post-closing adjustments to structure and terms, which it occasionally requires for regulatory or internal reasons.

Santander, in contrast, reviews capital management on a book-by-book basis, issuing separate Reg Cap transactions referencing Portuguese SME loans, UK CRE loans, Scandinavian auto loans, etc. to select groups of investors with appetite for each risk profile. Bloomberg reported that the bank was working on 7 transactions referencing a total of more than €20 billion of loans during the 4th quarter of 2024. Santander cultivates relationships with targeted groups of Reg Cap investors for different risk profiles.

Opportunities in the Current Market

Seer's experience in the 4th quarter of 2024 is indicative of the ability of experienced, targeted investors to access attractive market opportunities. The 4th quarter is always busiest, as banks seek capital relief for their year-end financials.

Seer's experience analyzing 11 Reg Cap transactions in 4Q 2024 is illustrative of the need for relationships and specialized skills to access the market

Coming into the quarter we had invested in 77 Reg Cap deals with 23 different bank issuance partners since 2010, focusing on transactions referencing granular portfolios which we analyze using a statistical approach based on historical performance. We analyzed 11 transactions this quarter—many more were issued, but based on our longstanding presence in the market, issuers know which are likely to fit us. We would have seen few, if any of these transactions if not for our experience and market position. As usual our hit rate for the quarter was less than 50%, as many transactions that appear to suit our criteria ultimately fall out on due diligence and/or price.

Overview of transactions analyzed by Seer in 4Q 2024:

Number of Transactions	11
Repeat Issuers	10
Repeat Programs	7
Previous Seer Partners	9
Large Corporate	2
Borrowers Disclosed	1
>$400mm Issuance	1

We agree with our friend from the allocator conference that there can be low barriers to entry in Reg Cap investing. But that applies mostly to transactions referencing disclosed portfolios of corporate obligors, which tend to be the largest and easiest to analyze. Even the one such transaction we saw this quarter was issued by a bank that prefers to distribute among a limited club of familiar Reg Cap investors. All the other 10 transactions had significantly higher barriers to entry, requiring existing relationship with the issuer and specific knowledge of the asset class.

Several of our key issuance partners have recently told us that, in the face of many new investors professing interest in Reg Cap, they are showing deals to a narrower range of counterparties and prioritizing investors who have participated in their Reg Cap programs in the past. This makes the process more efficient for issuers, who face fewer investor questions but retain certainty of execution at competitive pricing, and investors, who are assured of reasonable allocation if they put in the work. We have an extensive, yet targeted list of points to address in our due diligence.

Seer Capital Management LP
1177 Avenue of the Americas, 4th Floor
New York, NY 10036
(212) 850-9068
www.seercap.com

Seer Reg Cap Due Diligence Checklist:

Item	Description
The Bank	• Past Reg Cap issuance and commitment to Reg Cap as a key capital management tool • Size and financial strength of the bank • Transaction structure / credit exposure to the bank
Lending Program	• Strength of lending program and market presence • Bank commitment to the product and market • Origination, servicing, and workout processes
Assets / History	• Process for selecting the reference portfolio • Detailed review of historical performance of similar assets of the bank for a period of 7-10 years • Detailed review of performance of past Reg Cap transactions completed by the bank

Reg Cap issuers achieve effective execution with optimal return on effort by showing transactions to a targeted handful of experienced investors

Issuers lament that many new investors seeking to enter the market submit questions and requests unlike any they have seen in the past, reflecting a less than complete understanding of the product. A Reg Cap professional at one prolific issuer complained that several times he had to explain to his boss why he was unwilling to work with large investors who are key clients of the bank but not experienced in Reg Cap. Ultimately the bank's overarching objective is to execute Reg Cap transactions efficiently and consistently over market cycles.

At Seer we think our investment process is broadly consistent with other experienced Reg Cap investors, although we focus more on quantitative details around performance history, given our heavily statistical approach to risk. The hurdle for us to become comfortable with a new issuer is high, requiring several meetings, discussions, and information requests. Issuers have expressed appreciation that, even when our requests are extensive, they are informed by detailed knowledge of Reg Cap transaction processes, risks, and market history. Once we have onboarded a new issuer and program, repeat transactions are much more straightforward, requiring only updates to historical performance data and qualitative factors that have changed.

The opening of the US Reg Cap market has brought significant attention from allocators, investors, and reporters. In the meantime, good markets and bad, popular or not, Seer continues to leverage our experience and relationships to source, analyze, and gain exposure to portfolios of attractive off-the-run assets in partnership with banks, earning attractive risk-adjusted returns for our investors.

Seer Capital Management LP
1177 Avenue of the Americas, 4th Floor
New York, NY 10036
(212) 850-9068
www.seercap.com

Appendix: US Legal and Regulatory Considerations for Reg Cap Issuers

Regulation	Description	Result / Workaround
Fed FAQ	Direct CLNs require Fed Reservation of Authority and are subject to a cap of the lower of $20 billion of assets referenced and the bank's total equity capital	Banks prefer to issue SPV deals where possible
CFTC Rules	SPVs for deals referencing certain consumer assets may need to register as Commodity Pool Operators (CPO), creating burdensome reporting requirements	Consumer assets are typically issued via direct CLN, although service providers may be able to assume CPO reporting requirements
Collins Amendment to Dodd Frank Act	US banks are constrained by the standardized approach	Banks must issue thick tranches, generally detaching at 12.5%, to obtain optimal capital treatment for the retained senior tranche
Volcker Rule	Conflict of interest rules restrict banks from controlling SPVs set up to issue Reg Cap deals	Several external law firms active in Reg Cap have outlined processes under which banks can syndicate SPV deals, but many banks take the view that the SPV must be set up for only one investor
Bank Capital Regulations	US banks cannot purchase protection from insurance companies directly in Reg Cap deals. By contrast, insurers often have a strong bid for mezzanine risk in European Reg Cap deals	Insurance companies are working on structures to invest in Reg Cap, and changes to the capital regulations are under discussion. In the meantime banks must place thick tranches with cash investors