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Reg Cap Recap

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

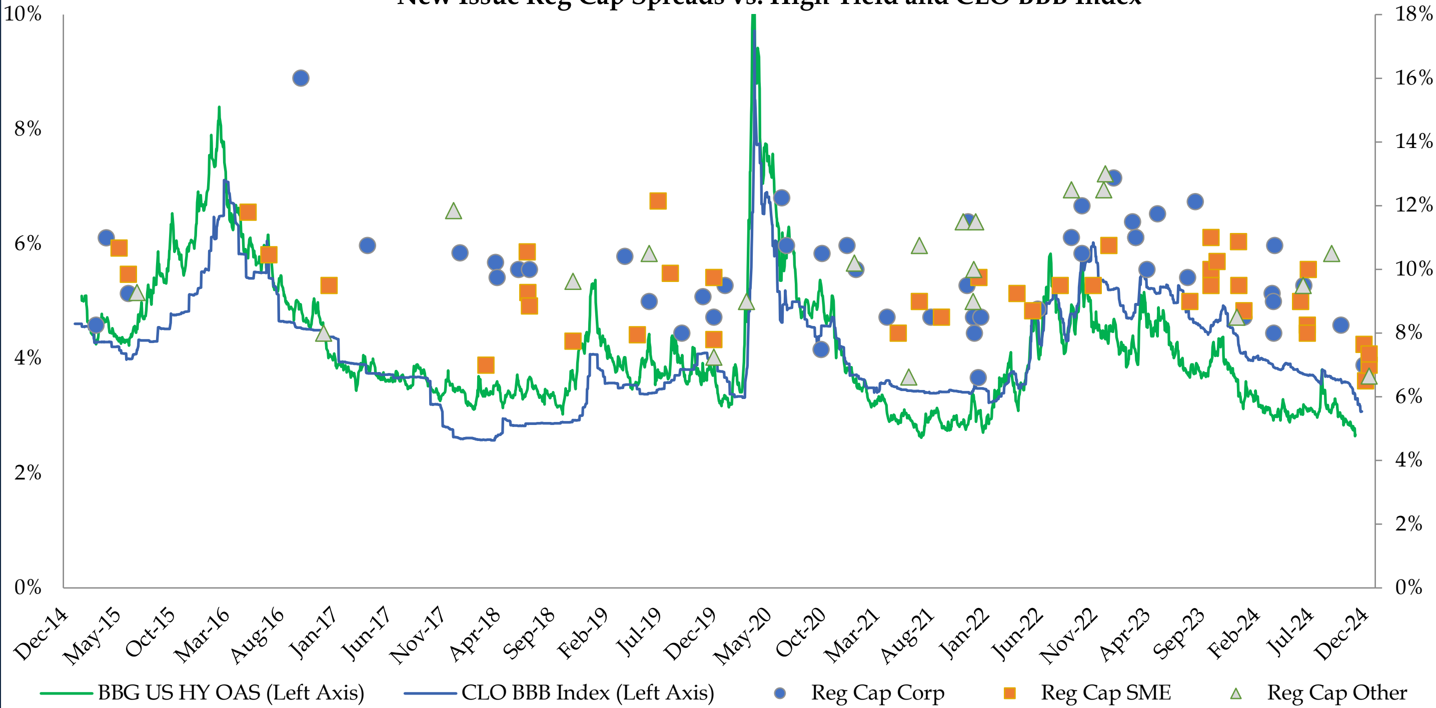
December 3, 2024

SEER CAPITAL

Reg Cap Spread Trends

Reg Cap spreads for new issue ranged from 650 to 900bps over the past couple months, around 100bps tighter than 1H2024 prints, while HY spreads tightened by 21 basis points during November and the BBB CLO index tightened by 31 basis points.

New Issue Reg Cap Spreads vs. High Yield and CLO BBB Index *



** 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 Dec. 2, 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]
Dec-24	650	SME	Spain	No	EUR	2.8	No
Nov-24	665	Auto	Sweden	No	SEK	12	No
Nov-24	750	Auto	US	No	USD	3	No
Nov-24	750	Auto	US	No	USD	4	No
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

The dust is beginning to settle on what will surely go down as a record quarter in terms of Reg Cap issuance volume, as well as in range of geographies, asset classes, and issuers represented. Total 2024 issuance volume will eclipse the EUR 30 billion figure projected by one market participant. Global banks are under increasing pressure to optimize use of their limited balance sheets and demonstrate ability to transfer risk. Regulatory changes, including the implementation of new Basel standards including the Output Floor, which sets minimum RWA at a percentage of the standardized approach, are creating additional capital pressures.

Demand was more than sufficient to absorb the 4Q supply. The cat is out of the bag among investors and allocators on the favorable historical performance and attractive risk reward profiles offered by Reg Cap. Traditional Reg Cap investors, whom we have been working alongside for the past 10+ years, have raised significant amounts of capital, while new entrants, especially large fund managers looking to deploy capital raised for private credit, have entered the space. Repeat benchmark deals from established issuers are seeing bids 100+ basis points tighter than comparables from earlier in 2024.

We expect more of the same in 2025. An increasing range of global banks are adopting Reg Cap, while a lot of banks are talking about expanding the use of the product (a number of these appear in the news section below). Investor demand for a wider range of asset classes at tighter spreads will provide additional propulsion to the flywheel. On the US side, 2024 has been spotty, with a few large banks completing bilateral trades with large asset managers at tight spreads and a handful of regional banks joining the fray. We anticipate the market to grow more gradually than many had hoped, as remaining regulatory uncertainty will take time to resolve and smaller banks, in particular, will require time to complete their first deals.

Reg Cap News

New Issue News

Santander Markets at Least a Dozen SRTs in Move to Boost Profits (Bloomberg News, 11/21/24)
Banco Santander SA is seeking to sell over a dozen Reg Cap deals linked to more than $21 billion of loans out of its global operations in the US, Germany, the UK and Mexico. Issuance plans include at least one unfunded deal, with (very high quality) investors providing guarantees, rather than buying credit-linked notes. The wave of transactions is part of Santander's push to free up capital and boost profitability and is part of what their CEO refers to as "changing completely the model of the bank." According to a recent presentation, Santander pays about 9% for Reg capital relief and reinvests at a yield of ~23%, on average. Reg Cap has also allowed them to increase their Common Equity Tier 1 ratio 20bp so far this year.

AIB Considers Selling More SRTs After Completing €1 Billion Deal (BN, 11/25/24)
Irish bank AIB recently completed a Reg Cap transaction tied to a portfolio of ~$1bn of corporate loans, boosting AIB's Common Equity Tier 1 ratio 20bp. The bank is also examining future issuances, and calls Reg Cap a "welcome addition" to their capital management tools.

PGGM Invests In ESG-Linked Risk Transfer Deal with BBVA Loans (BN, 11/25/24)
The Dutch pension fund manager PGGM is investing in a significant risk transfer linked to ~$2 billion in loans from Spain's BBVA SA. The portfolio is made up of loans to large corporate clients across the US, Spain and other European markets. The deal adjusts the cost of capital based on borrowers' progress toward ESG goals, a means of incentivizing BBVA's clients to adopt more sustainable business practices, as urged by the EU.

Blackstone Buys into Santander's $1 Billion Loan Portfolio (BN, 11/26/24)
Blackstone Inc. has bought interests in a portfolio of infrastructure loans from Banco Santander SA worth $1 billion The loans finance assets in digital infrastructure such as data centers, as well as other areas such as renewables and transportation. Santander has moved close to €40bn of risk-weighted assets off its books YTD, up from ~€30 billion in the whole of 2023. Other banks are also selling Reg Cap lined to infrastructure loans, with ABN Amro Bank NV planning a deal linked to ~ €3 billion of infrastructure loans.

Lloyds Plans SRT Tied to £1 Billion of UK Restructured Mortgages (BN, 12/3/24)
Lloyds is bringing a Reg Cap transaction linked to ~$1.3bn of UK modified mortgages. These home loans are "mostly performing" but are subject to high regulatory capital charges because they were previously delinquent and have since been modified. Lloyds' core equity tier 1 ratio is down 30bp YOY; this new Reg Cap issuance should boost equity for the bank.

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Reg Cap News (continued)

Reg Cap News

BofA targets regional banks to expand risk transfer market (The Financial Times, 11/21/24)
Bank of America is drawing up plans to structure risk transfer deals for smaller banks, a move that could "turbocharge" issuance next year. European banks have been using SRTs for more than a decade and many large US banks entered the market this year, after US regulators opened the door. However, smaller, regional banks have been slower to become involved, partly because of the extensive due diligence involved. BofA has been exploring ways to structure Reg Cap deals for US regional banks and smaller players in Europe. BofA has also been in talks with rating agencies, investigating the possibility that a portion of Reg Cap deals could be rated investment-grade. BofA's plans could also lead to a more standardized model for Reg Cap issuance, making the process easier and more efficient. At Seer we are looking forward to the development of the US regional bank SRT market, and we think efforts by BofA and others to pitch the product to banks and work with them to structure and place deals will be very helpful.

Goldman, Morgan Stanley, BofA Scrutinize SRT Buyers' Leverage (BN, 11/21/24)
Another negative article about Reg Cap from Bloomberg News—this one presenting what we believe is a one-sided and uninformed view of the use of leverage against SRT/Reg Cap deals. The article reports that banks are newly asking investors whether they intend to use leverage to finance the purchase of SRT deals. Ostensibly this is in reaction to rumblings that leverage provided by banks for the purchase of SRT investments effectively keeps the risk in the banking system, potentially undermining the benefits of the tool from the point of view of regulators.

In reality, banks issuing Reg Cap have nearly always required all investors to sign a subscription agreement or representation letter when they invest in the transaction, and the letter requires them to inform the issuer if and when they obtain repo financing. Also, ironically, many issuing banks also provide financing to investors for deals issued by other banks. At least one of the 3 banks named in the article as allegedly "scrutinizing" buyers' use of leverage to finance its own deals is a prominent provider of financing to buyers of other banks' deals.

Bloomberg does rightly point out that adding leverage is more common in the US than elsewhere, because tranche sizes are typically thicker in the US market (due to US capital regulations requiring a relatively high 12.5% of risk to be placed in most deals for the issuing bank to obtain optimal capital treatment on the retained senior). By issuing thicker tranches, US deals create a different risk/return profile than the bulk of the SRT market. Investors often choose to employ leverage to increase returns on such deals.

Finally, the article notes that some Reg Cap deals are financed with NAV loans, especially by private equity firms. The article omits the essential point that NAV loans and other forms of term financing generally do not require the borrowers to post margin if the market value of the position declines, eliminating the mismatch risk inherent in short term / mark-to-market financing.

Banking Industry News

ABS and CLOs May See Record Volumes in 2025, Deutsche Bank Says (BN, 11/20/24)
The primary thrust of this article is, as the headline suggests, this year's heavy issuance in securitized products. DB further suggests that 2025 may be a record as well. The article also includes DB's thoughts on SRT. DB expects that banks will continue to tap the Reg Cap market for balance sheet optimization, given that SRT investor yields are below banks' cost of capital.

Barr Plans to Serve Full Term as Fed's Top Bank Cop (BN, 11/20/24)
Michael Barr, the Federal Reserve's top regulator, said he plans to serve his entire term (i.e. through July 2026), regardless of whether or not the President-elect, who is notoriously anti-regulation, sought to fire him. Barr's comments echoed similar comments from Chair Powell; Powell's term expires in May 2026, but his board post does not end until January 2028.

Biden Bank Regulators Punt Big-Ticket Rulemakings to Trump (Law360.com, 11/20/24)
Biden administration banking regulators have formally stated that they don't plan to move forward on efforts to strengthen banks' requirements for capital, liquidity and long-term debt before the President-elect takes office.

The Basics of Nonbank Financial Institutions (https://tellerwindow.newyorkfed.org/, 11/21/24)
This article from the New York Fed discusses the significance of NBFI (Nonbank Financial Institutions) to the US financial system. NBFIs, which are outside of the banking system per se, have grown rapidly in recent decades and are now "collectively much larger than U.S. banks." The Fed estimates that NBFIs have over $100 trillion in assets –three times larger than the U.S. banking system. Notably, for data reasons, this figure excludes private funds, which are likely another $23bn. NBFIs include investment funds, pension funds, insurers, government-sponsored enterprises, and financial broker-dealers, mortgage originators and servicers, real estate investment trusts, central counterparties, securitization vehicles, nonbank consumer lenders that offer auto loans, credit cards, or student loans, fintech companies, and principal trading firms (PTFs). NBFIs are "increasingly important in providing credit" both to other financial institutions and to the real economy—businesses and individuals. "NBFIs now originate 67 percent of all U.S. residential mortgages, up from 39 percent in 2008."

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Reg Cap News (continued)

The report notes that NBFIs make up the majority of the U.S. financial sector and play an increasingly important role in U.S. financial markets and the economy, begging the question about appropriate regulation.

Big Banks Bet Trump Will Make the Best of Times Even Better (BN, 11/22/24)
"A lot of bankers, they're, like, dancing in the street," JPMorgan's CEO Dimon told CEOs at a global summit last month. "They've had successive years and years of regulations, a lot of which stymied credit. One of Trump's platforms was reduced regulation, after all." The article goes on to point out that, despite banks' complaints about onerous regulations, the largest US banks have been enjoying record profits and shares of the top 3 US banks "hit their highest price ever in the weeks before this November's election." Regulators' proposals to increase bank capital buffers were the long-coming outgrowth of the 2007-08 crisis, aka the Basel III Endgame. With Trump returning to office, Citigroup Inc. CEO Fraser said she anticipates that those tighter capital regulations will be significantly eased, if not dropped. At the same time, a new administration more favorably disposed to M&A, combined with easing interest rates, augurs well for a pickup in their investment-banking businesses. We still expect the US Reg Cap market to develop in spite of the reduced likelihood of higher capital requirements on the largest banks. Large banks globally issue Reg Cap to optimize capital deployment, demonstrate liquidity and pricing for lending, and manage concentrations and risks. US banks will adopt the product to advance these objectives, in keeping with their global peers. Regional banks in the US continue to face capital and business challenges in the aftermath of SVB and will adopt Reg Cap to help address these challenges.

Credit Is So Hot That Traders Are Building Shorts (BN, 11/23/24)
With spreads in US junk bonds now about 30 basis points above their all-time lows (which was pre-GFC), investors are increasingly thinking "that it's time to buy downside protection." YOY, corporate bond shorts have risen 25%, while longs are up only 10.6%. Shorts are now the equivalent of 7.3% of longs, up from 6.4% a year ago. While US economic growth has been above expectations, there is considerable policy uncertainty. Policies on tariffs and immigration could be inflationary, US fiscal policy is on an "unsustainable path", and economic growth in both Germany and China has been disappointing.

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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