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Reg Cap Recap

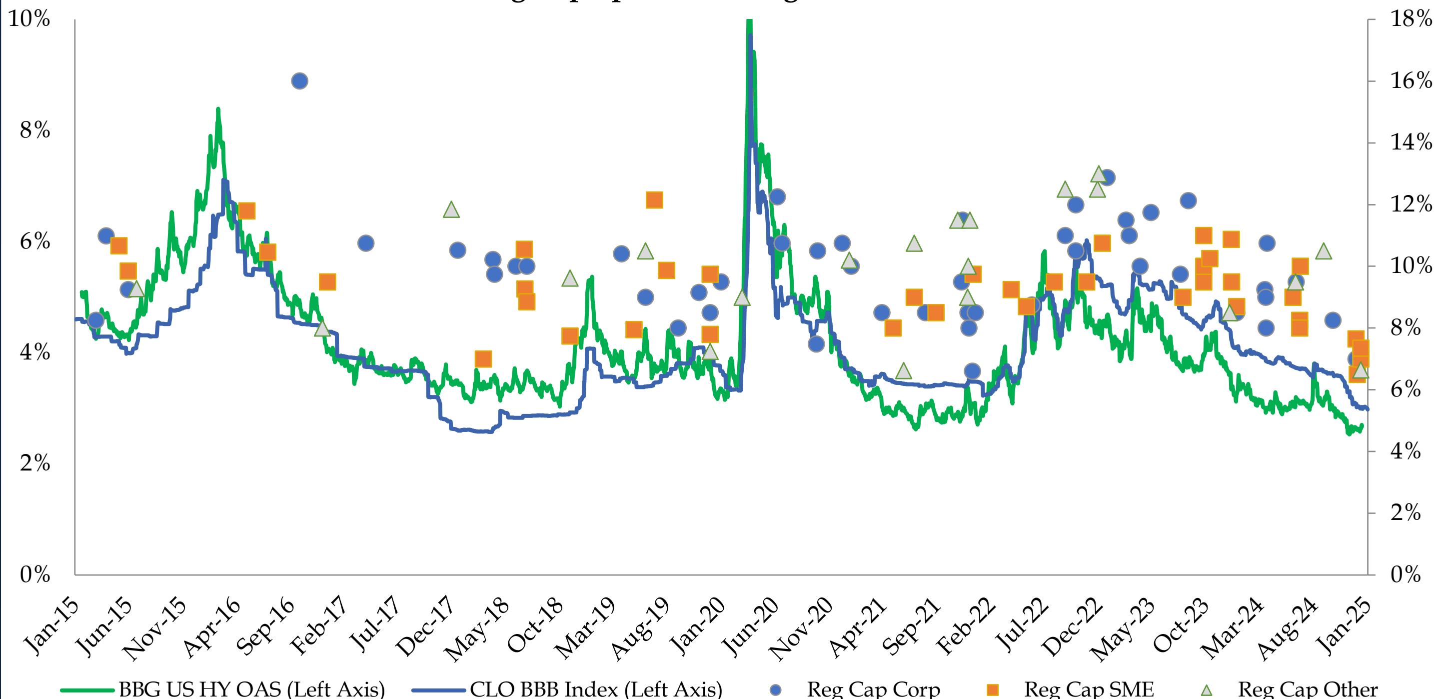
A bimonthly update on the Regulatory Capital Relief/Significant Risk Transfer sector

January 7, 2025

SEER CAPITAL

Reg Cap Spread Trends

Reg Cap spreads for new issue ranged from 650 to 900bps over the past few months, around 100bps tighter than 1H2024 prints, while HY spreads widened by 10 basis points during December and the BBB CLO index tightened by 10 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 Jan. 3, 2025.*

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	765	SME	Germany	No	EUR	3.1	No
Dec-24	700	Corporate	Global	Yes	EUR	6.4	Yes
Dec-24	700	SME	Spain	No	EUR	2.2	No
Dec-24	735	SME	UK	No	GBP	1.6	Yes
Dec-24	840	Auto	US	No	USD	2.6	No
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

[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

Happy New Year, we wish all a happy, healthy, and successful 2025. The Reg Cap market sprinted to the finish in 2024, with 4Q issuance from all corners of the market, capping what was surely a record year. Banks of all sizes in Europe, North America, and further afield are under increasing pressure to optimize use of their limited balance sheets and demonstrate ability to transfer risk. Business and regulatory factors are driving banks to reference a wider range of assets, especially consumer loans.

On the demand side, 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, are exploring the market. Benchmark deals from established issuers are seeing bids 100+ basis points tighter than comparables from early 2024. Given the level of demand, it is essential to have established relationships and a strong market position to access the market effectively. For more, see our latest market research here: https://seercap.com/wp-content/uploads/2024/12/Reg-Cap-Inexperienced-Players-Need-Not-Apply.pdf

We look forward to more of the same in 2025. An increasing range of global banks are adopting Reg Cap, while several others are planning to expand their use of the product. Investor demand for a wider range of asset classes at tighter spreads will provide additional propulsion to the flywheel. If there was any disappointment in the Reg Cap market in 2024, it was slower than anticipated growth in US, where a few large banks completed bilateral trades with large asset managers at tight spreads and a handful of regional banks joined the fray. We anticipate continued steady growth in 2025, 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

New Issue calendar was light due to holiday period. But in the credit markets:

How Low Can Spreads Go? (Bloomberg Credit Weekly, 1/4/25)

While complaining that corporate-bond valuations are in "nosebleed territory," at the same time money managers do not see spreads widening out anytime soon. Investors are more focused on yield than spreads, and by the standards of recent decades, yields are attractive. With leverage, the carry investors can earn is especially attractive, even if bond prices seem unlikely to provide market gains or may even be vulnerable to weakening a bit. Moreover, index durations have shortened, and the credit quality of bond indices has improved (e.g., increasingly, HG indices have less BBBs, and HY indices have more BBs). The article claims that "(it) will take a significant shift in momentum to upend risk premiums… a combination of deteriorating fundamentals and weakening technical dynamics …which is not our base case for the coming year."

Asset-Backed Fundamentals Positive Despite Tighter Spreads (Bloomberg News, 1/6/25)

Spreads on Bloomberg's US Aggregate ABS index (option-adjusted) tightened from 68bp to 44bp over 2024. We start 2025 with ABS spreads 9bp inside the decade average for the index, 55bp. Even so, the author expects spreads to be stable or tighten further in 2025, citing: economic data that continues to surprise to the upside, robust investor demand, falling inflation's positive impact on credit, and overall strong fundamentals.

Reg Cap News

Inside Wall Street's booming $1tn 'synthetic risk transfer' phenomenon (The Financial Times, 12/20/24)

This article begins with an anecdote speculating about how Reg Cap issuer Deutsche Bank was insulated from a recent default, losing less than $20mn when the German financial services company Wirecard "went belly up," possibly because of risk DB laid off in Reg Cap transactions. The article covers the mechanisms of Reg Cap as well as "...how long has it been going on, why has it recently exploded, and just how dangerous is this phenomenon — if at all?"

The article points out that, when a bank issues a Reg Cap translation, "it looks like a leaner, meaner and better bank." Europe regulators have been very supportive of Reg Cap, "enshrining" it in the EU's regulatory framework and laying out detailed guidelines for the product. The European Banking Authority "recognizes that credit risk transfer techniques can significantly reduce credit risk to which institutions are exposed and … can be an effective risk management tool." Partly as a result, European banks now account for roughly two-thirds of global Reg Cap issuance. The European Systemic Risk Board says that "the importance of the SRT securitization market for European banks and the European economy cannot be overstated".

US banking regulators have been slower and less full-throated in their embrace of Reg Cap. It was not until 2023 that the Federal Reserve "posted a seemingly innocuous legal interpretation … a de facto Fed blessing for the capital relief that SRTs can offer." Some expect that US issuance will eventually exceed that of Europe. The article points out that, while European banks tend to use Reg Cap to free up lending capacity, in the US, where banking is more fragmented, many regional banks are looking to Reg Cap to reduce "exposure to long duration fixed rate assets… (and) manage the risk of deposit flight, " particularly in the wake of the Silicon Valley Bank failure.

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Reg Cap News (continued)

Even with the regulatory outlook turning more lenient post-election, US banks "will continue to seek out ways to de-risk and optimize their balance sheets." SRTs allow banks to "improve capital ratios without diluting shareholders" and thus are attractive tools for banks, even without draconian capital requirements.

The article goes on to discuss the commonly cited concern that, by providing leverage for investors who buy Reg Cap, banks may be creating interconnections that undermine the benefit of Reg Cap to the financial system. Then the author points out some solid counterarguments, e.g. "Even if many SRT investors nowadays use leverage to juice returns, they're still a lot less leveraged than banks are. And if they go bust then the fallout is much smaller. …Most of all, it's still a modest market."

SRT record on cards despite slow US market (International Financing Review, 12/20/24)
Investors are preparing to bid on the first significant risk transfer trades of 2025, on the heels of record issuance in 2024. Seer's Terry Lanson was quoted in the article, noting that "We looked at over 30 deals this year, which is more than we've ever looked at" in a given year. Estimates on issuance vary in this rather opaque sector. For example, the International Association of Credit Portfolio Managers claims banks placed about €18.2bn of risk in 2023, while one major player put the figure for 2023 at about US$24bn. It is widely agreed that 2024 was higher than both those estimates, even with US banks not quite as active as expected.

For some perspective on the US bank market, Lanson offered: "If you look at the European market, it's very healthy…A growing number of banks are issuing and different banks in different jurisdictions are looking at different asset classes. But that market has been developing for 15 years. The US market has been developing for less than 15 months. Everybody was expecting huge growth, but it's going to take more than 15 months."

In the US, regulatory issues affect the structures issuers can use, capital requirements are still up in the air, and new issuers need to expend "the time and effort required to get a program up and running." JP Morgan, Citi, Morgan Stanley, Goldman Sachs and US Bank and several regional banks have done Reg Cap issuance since the Fed gave the go-ahead in 2023, but many smaller players have yet to do a deal.

Meanwhile in Europe, new banks continue to enter the market and existing issuers "have broadened the range of assets they securitize." Greece's Attica Bank recently completed its first synthetic securitization, referencing loans to small and medium-sized companies and large corporates. Repeat-issuer Santander added new asset classes to its issuance platform in 2024, including Austrian auto loans. Broadly speaking, Reg Cap issuance has historically been focused on loans to corporations but consumer loans, especially auto loans, are gaining in popularity.

Santander's €60 Billion in Asset Shifts Is Set to Slow Next Year (BN, 12/19/24)
Banco Santander, one of Europe's most active Reg Cap issuers, moved ~€60 billion in risk-weighted assets off its balance sheet in 2024, taking advantage of excellent market conditions for the product. For 2025, the bank expects that number to drop to ~€40 billion. Santander has a team of 50 around the globe that allows them to do Reg Cap across jurisdictions and asset types. It is reported that capital relief trades helped Santander increase pretax profits by ~€800 mn in 2024. Banking analysts are quoted as saying "there's now an improved outlook for the lender, partly thanks to its use of SRTs," which has helped the bank shore up its capital base — historically skimpier than its peers.

Santander's expectation is that conditions for issuance may not be as favorable in 2025, as other issuers ramp up, and European regulators speed up, the Reg Cap process this year. With the additional supply, issuance may become more costly. There is also a "potential headwind" from intensifying regulatory scrutiny. Of this, ECB banking supervision head Buch said "securitization can be a useful instrument to move risks to the part of the financial system where they can be better borne than on banks' balance sheets," but "we need to make sure that there is no spill-back effect on the banking sector."

<u>Banking Industry News</u>
A Federal Reserve Regulator Who Deserves the Boot (The Wall Street Journal, 12/17/24)
This editorial suggests that "Trump would send a useful message by removing Michael Barr as Vice Chair for Supervision." After speculation that President-elect Trump might seek to oust Fed Chair Jerome Powell, which Trump denied, this editorial offers "... if Mr. Trump is looking for an alternative: Michael Barr as Fed Vice Chair for Supervision. Federal law lets the President remove members of the Federal Reserve Board "for cause," and the author argues that Barr's "mishandling" of his role would constitute cause.

BofA's Moynihan Says Regulators Need 'Sober Look' at Bank Rules (BN, 12/17/24)
Bank of America's CEO said regulators need to "re-assess and relax" banking regulations, stating that higher capital requirements make it harder for firms "to spend money and lend." Moynihan argues for "bringing that regulation back in the middle, and for the good of the industry, getting it to settle someplace so we can build a model around it." Banking executives have argued that proposals to hike capital

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Reg Cap News (continued)

requirements would "harm the economy and low-income borrowers most of all," an argument to which Republican lawmakers have been more receptive. Under the new administration, bankers are hopeful that the pendulum is swinging their way, with lighter regulation on several fronts.

BPI Holiday Highlights **(**Bank Policy Institute at linkedin.com, 12/21/24)
In this discussion the BPI explains how synthetic risk transfers, "allow banks to manage their lending and balance sheets more efficiently by transferring the credit risk of loans to investors while keeping loans on their books." The BPI goes on to argue that bank capital requirements "significantly exceed the underlying risk of certain loans and other assets, and that allowing banks to issue Reg Cap deals can increase credit availability."

Barr to Step Down as Fed's Top Bank Cop in Surprise Reversal (BN, 1/6/25)
Barr Didn't Want Legal Battle for Fed Job, Even If He Could Win (BN, 1/6/25)
Reversing an earlier pledge to stay on in his role, banking regulator Barr announced he would step down as Vice Chair for Supervision (a term set to end in July 2026) at the end of February, apparently bowing to pressures from Republicans who feel he has been too heavy-handed and signs of a messy battle to replace him. Barr also expressed concern that staying on would distract from the work of the institution. Barr will continue to serve as a member of the Fed's Board of Governors.

Barr's departure clouds the future of US regulators' landmark proposals to force the country's largest banks to hold more capital, a response both to recent crises (the 2023 failure of Silicon Valley Bank) as well as part of a years-long effort to strengthen the financial system post-GFC. Originally, regulators were calling for a 19% capital increase for the largest US banks — that ask was scaled back to a 9% increase last Fall.

Barr to Step Down as Vice Chair for Supervision and Forthcoming Stress Testing NPR **(**Royal Bank of Canada Regulatory Update, 1/6/25)
In the wake of Barr's departure, this author argues that the most likely scenario is that FRB Governor Michelle Bowman (a Trump appointee) will become the next Vice Chair for Supervision. Bowman has been critical of Barr and is considered pro-banking. Further, the author argues that the Basel Endgame re-proposal will likely be "significantly delayed and meaningfully watered down" or "dropped altogether."

On a separate matter, the same update discusses a recent press release from the Fed providing "notice of a forthcoming notice of proposed rulemaking" (an "NPR") regarding bank stress testing. The rationale for this release is to "address the framework of administrative law… and the evolving legal landscape." Specifically, this refers to the Supreme Court's decision to overturn the "Chevron Doctrine," which has held that federal courts should defer to the relevant regulatory agencies for interpretations of federal statutes. The press release stated the "Board plans to take immediate steps to reduce the volatility of the results and begin to improve model transparency."

Lastly, the update disclosed that the Bank Policy Institute, American Bankers Association and others filed a lawsuit against the FRB challenging the "opaque aspects of the stress testing framework" under Federal law.

Citi Leads US Financials' 2025 Debt Maturities Citi's Big Burden as $393 Billion of Sector Debt Matures in 2025 (BN, 1/6/25)
The banking sector has a combined $393 billion of debt due in 2025. Specifically, Citigroup, Wells Fargo, JPMorgan Chase and BofA face the most erosion of so-called "TLAC-eligible" debt in 2025, which they will likely choose to replace. TLAC stands for "Total Loss-Absorbing Capacity." The TLAC standard was implemented in January 2019 and includes several characteristics that allow debt issuance to count toward TLAC requirements. TLAC-ineligible operating-company debt is less costly for banks to issue.

Michael Barr resigns US Federal Reserve Vice Chair for Supervision (RTRA Intelligence 1/6/25)
With the new administration now able to appoint its own Federal Reserve Vice Chair for Supervision, the future for banking regulation will depend on whether any new appointee can sway the majority of the Federal Reserve to agree on any proposals. Other banking regulatory entities, such as the OCC, FDIC and CFPB, are likely to be Republican-controlled, but the Fed will still have a 4-3 Democratic majority (albeit with Powell, a Republican, heading it). In addition to the open question on capital requirements is the more arcane "P factor." The P factor refers to the treatment of senior tranches retained when a bank issues a Reg Cap transaction. The higher the P factor, the thicker the tranches must be. Current regulation "effectively imposes a premium capital charge on SRT transactions. putting US banks at a clear disadvantage."

The article includes comment from Seer's Lanson, who concludes: "with the new administration, we expect the regulatory environment to be generally constructive for banks. We don't think finalizing the Basel Endgame will be a priority, so it could take quite some time. In the meantime, we continue to foresee steady growth in US SRT issuance, stemming from increasing adoption by regional and large banks."

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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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