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Reg Cap Recap

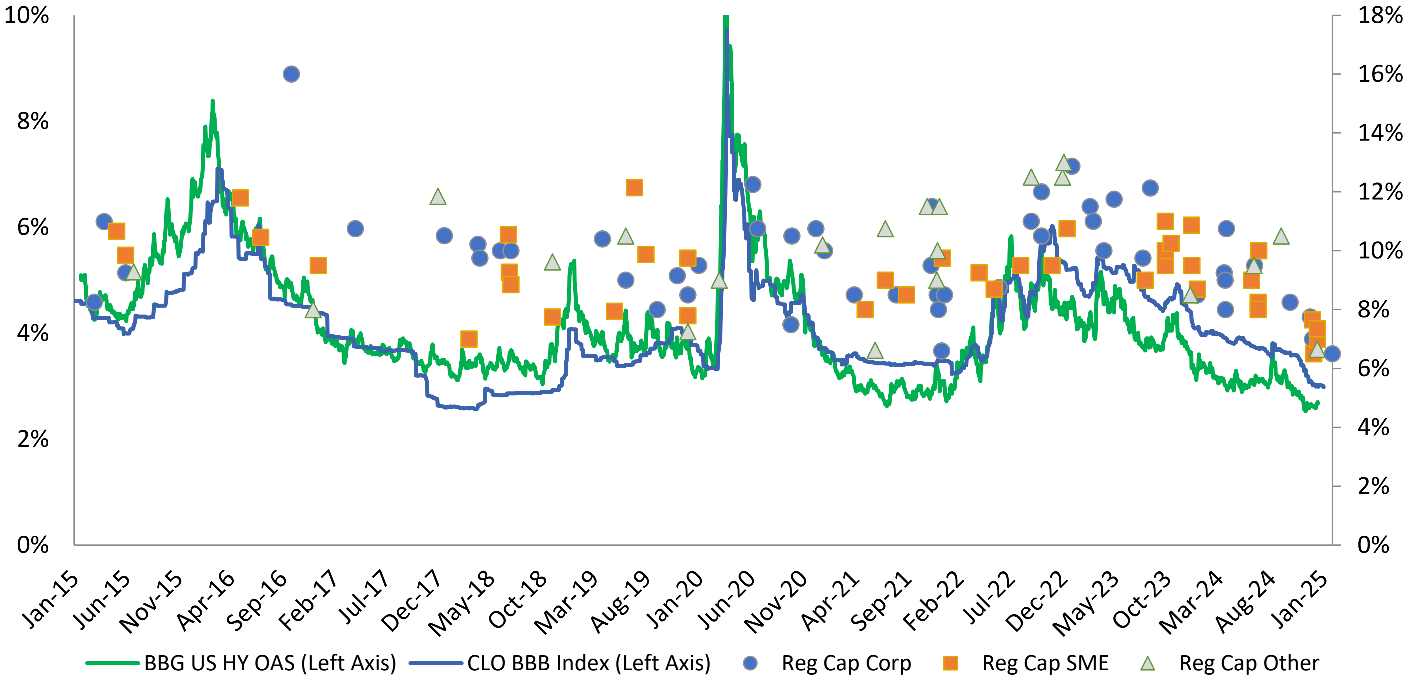
A bimonthly update on the Regulatory Capital Relief/Significant Risk Transfer sector

February 4, 2025

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 tightened by 16 basis points during January.

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 Feb. 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]
Jan-25	650	Corporate	Canada	Yes	USD	7.0	Yes
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

The Reg Cap market is off to a fast start in 2025, which is unusual, as activity is usually more concentrated around the end of the first half and year end. Anticipated lighter regulation globally is expected to trigger a pickup in bank M&A activity, which is driving some of the early issuance. The theme of 2025 will be pressure on banks globally to optimize use of balance sheet and demonstrate ability to transfer risk, for which they will issue Reg Cap referencing an increasingly wide range of assets. Today's tighter spreads make Reg Cap issuance relatively more attractive, so will beget more supply.

Benchmark deals from established issuers are seeing bids 100+ basis points tighter than comparables from early 2024. Traditional Reg Cap investors, whom we have been working alongside for the past 10+ years, continue to look to deploy the significant amount of capital they have raised. There may be less opportunity for new entrants, as many issuers are restricting distribution to experienced Reg Cap investors with whom they have built relationships over time. For more, see our latest market research here: https://seercap.com/wp-content/uploads/2024/12/Reg-Cap-Inexperienced-Players-Need-Not-Apply.pdf

The US market could supply significant additional growth. After a regulatory change in late 2023 triggered much anticipation, market development has been uneven, as regulatory uncertainty persists. We expect gradual market growth over time, as has happened in Europe, as regulators and the industry harmonize and adoption spreads among banks.

Reg Cap News

New Issue News

Austrian Lender Bawag Plans SRT Tied to €2.4 Billion of Loans (Bloomberg News aka BN.com, 1/21/25)
Bawag Group is set to launch a Reg Cap deal linked to a portfolio of about €2.4 billion ($2.5 billion) of Austrian mortgage loans, the first of three Reg Cap deals planned for this year. Bawag's CEO has said the bank needs to absorb recent acquisitions that will grow its balance sheet by 35%. Bawag is also considering two further Reg Cap deals this year, including one linked to a portfolio of mortgage loans in the Netherlands.

BNP Plans SRT Tied to €800 Million of Leveraged, Corporate Loans (BN.com, 1/31/25)
BNP Paribas SA is offering a Reg Cap (aka "SRT") deal linked to a ~ €800 million ($830 million) portfolio of leveraged and corporate loans. Among current transactions, Italy's Banco BPM is marketing two Reg Cap linked to loan portfolios worth about €4.5bn, Vienna-based Bawag Group is planning a deal linked to a portfolio of about €2.4 billion of loans, and Deutsche Bank AG is working on a Reg Cap deal referencing ~€2 billion of loans to German mid-cap companies.

Reg Cap News

SRT market expects further growth after banner year (9fin.com, 1/21/25)
The SRT (Significant Risk Transfer, aka "Reg Cap") market saw record issuance in 2024, reaching $29 billion by some estimates, with strong momentum continuing into 2025. European banks, including the UK, continued to drive growth in 2024 and accounted for 71% of issuance. Tight spreads have encouraged banks to issue deals while demand remains high. However, investors anticipate further supply growth which could lead to more attractive pricing for them (e.g. wider spreads) if supply and demand become better balanced. After a heavy influx of new investors into the Reg Cap sector last year, that trend has ebbed. Not many new participants have entered the space recently, perhaps in part because issuance growth in 2024 was somewhat less than expected. Though Europe remains the dominant market, 2024 also brought increasing participation from Nordic banks and Latin America, supported by institutions like the IFC. The U.S. market has grown but has yet to reach its full potential.

The use of leverage on deals has come under regulatory scrutiny from the Fed, IMF and ECB. Though immediate regulatory action seems unlikely, banks have begun self-policing by asking investors to disclose whether they are using leverage. The article claims that "Given the relative concentration of lenders, just a few large providers pulling out of the market has the potential to completely change the equilibrium."

UK regulators have started examining the issue of unfunded participation in Reg Cap, typically done with insurers as investors. Unfunded Reg Cap transactions are disallowed in the US and rare everywhere else; the International Association of Credit Portfolio Managers (IACPM) estimated that insurers provided unfunded protection on only about 5% of Reg Cap done in 2024.

Innovation continues with structural adjustments such as variable notional issuance (some banks are now issuing transactions that allow them to increase the notional at a later date), bespoke amortization features, and expansion into new asset classes, including subscription lines and mortgages. 2025 is expected to bring further growth, geographic expansion, and structural evolution in the market.

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Reg Cap News (continued)

Inside Wall Street's 'SRT' phenomenon (ft.com, 1/22/25)
In this interview the editor of the Financial Times' "Alphaville" blog, Robin Wigglesworth, discusses the attractiveness of Reg Cap in a post-financial crisis world where banks are required to hold more capital. Key points from the interview include:

1. The growing popularity of Reg Cap (herein "SRTs") as the sector has evolved from a "wonky niche" to become a meaningful part of the financial system. European banks, regulated more strictly than their U.S. counterparts, have needed to adopt SRTs more widely, with over $1 trillion in SRT assets since 2016.
2. Pros of SRTs:
   - Banks reduce their capital requirements, and investors get a decent return by taking on some risk.
   - European regulators, including the European Central Bank, endorse SRTs, seeing them as a way to safely transfer risk out of banks and into the market.
3. Concerns and Risks:
   - A particular concern is "recycling risk," where the debt doesn't fully leave the bank but is instead "recycled" back into the system through loans to investment funds used to leverage their SRT purchases. We don't believe this concern is warranted. Banks that finance SRT transactions issued by other banks transform the risk by requiring a combination of cash collateral, mark to market requirements, and recourse to other assets. We explore this issue more fully here: https://seercap.com/wp-content/uploads/2025/01/Reg-Cap-Leverage-Clearing-Misconceptions.pdf
   - Another worry is the lack of transparency in SRT markets, making it difficult to track the details of individual deals, which could lead to hidden risks. As we have said before, we believe that regulators and seasoned investors have the needed data; it simply is not public.
   - There is a risk that the banks, believing they have transferred risk, will face massive exposure if their SRT structures break down during a downturn. We believe this risk is greatly ameliorated by the fact that RegCap deals are almost always pre-funded.
4. SRTs have, so far, been relatively successful, and a "win-win" for issuers and investors.
   - "We haven't really seen any examples of an SRT going bad."
   - "They're working pretty much as advertised. …there's a reason why regulators have blessed this. "
   - The European Central Bank, "which is pretty hardcore — it does not mess around, it does not want banks to do stupid things — have looked at these things and have blessed them, saying this is genuinely actually (sic) a good thing."
5. Conclusion
   - SRTs can make the financial system safer by transferring risk away from banks and into the hands of investors willing to bear it. SRTs are likely to remain a part of the financial system. The fact that SRT are "potentially hazardous if misused or if the financial system becomes too opaque or interconnected;" is not unique to this sector and is the reason for the regulatory supervision that exists.

SRTs soar (RTRAIntelligence.com, 1/28/25)
Synthetic securitization issuance broke all-time records last year with total tranche notional hitting US$29 bn by some estimates, up 20% YOY. Tight pricing was and remains the dominant theme along with the emergence of new opportunities such as consumer and auto loans as well as residential mortgages. Capital efficiency remains an important driver but it's clear that the post 2008 crisis trend of regulatory tightening is shifting towards a focus on competitiveness. 2024 was a year where EU bank stocks rallied and generated meaningful amounts of capital so now their price-to-book and capital ratios are looking in good shape and lenders have been paying dividends.

Reg Cap spreads tightened over 2024, in line with the broader tightening in the wider credit markets. The future of spreads will likely depend on macro volatility (impacting credit spread generally) and, within Reg Cap, the extent to which supply and demand might better sync in 2025.

According to RTRA, 2024 Reg Cap issuance includes 46 corporate trades, 28 SMEs and Midcaps and 31 consumer and auto SRTs. The jump in consumer and auto loans was driven largely by the US market. These loans are attractive reference assets because they have had very robust credit performance and are highly granular, yet they have hefty capital requirements under US capital regulations. Reg Cap issuance for this asset class is therefore highly efficient for issuers. Commercial real estate has staged a comeback in Reg Cap pools, with one trade in 2024 from Intesa Sanpaolo and three in the pipeline from Frost Bank, Merchants Bank of Indiana and Bank of Montreal.

2024 was also a year for structural innovations, such as "re-tranching." Re-tranching allows investors to boost returns by slicing a tranche into thinner slices, one of which is retained and the rest rated and placed with other investors. Re-tranching is best applied to very granular asset classes that rating agencies understand well, such as consumer and auto loans.

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Reg Cap News (continued)

Banking Industry News

TD Eyes Selling $9 Billion of Mortgages as It Faces Asset Cap (BN.com, 1/21/25)
Toronto-Dominion Bank is looking to sell about $9 billion of residential mortgage loans as the Canadian lender adjusts its balance sheet to comply with a new cap imposed by US regulators, part of a plea agreement reached last year for its role in failing to prevent money laundering. In October, TD agreed to pay almost $3.1 billion in fines and other penalties and have assets at its two US retail banking units capped as part of a guilty plea. The bank is looking to reduce assets by selling as much as $50 billion of lower-yielding investments.

Banks Could Be Hurt By a Leverage Ban in SRTs, Hedge Fund Says (BN.com, 1/21/25)
This article discusses our recent research piece on leverage and RegCap referenced on page 3. Some of our arguments that were covered in the article include:

1. Banning the use of leverage in significant risk transfers could have a knock-on impact on the cost of credit for consumers and businesses. The use of leverage allows more money managers to compete for the deals, benefiting issuers.
2. "Various parties have raised concerns about reg cap financing based on the claim that reg cap risks must leave the banking system entirely…These critics are off the mark in our view" because the leverage providers manage the risk of an SRT investor defaulting through measures including collateral and mark-to-market margin calls.
3. Investors in European SRTs have less need for leverage because banks are allowed to split deals into junior and mezzanine portions, so the riskiest tranches typically price at higher yields. In the US, by contrast, some banks interpret the rules as meaning the use of tranching is not allowed. Clarifying this would allow issuers to create tranches that meet the risk/return needs of investors without having to use leverage.

Pinto Says Direct Lending to Small Businesses Merits Attention (BN.com, 1/22/25)
JPMorgan Chase & Co. Chief Operating Officer Daniel Pinto, speaking at Davos, said private credit's financing of small businesses "warrants attention," given the rapid growth in a sector that has not been tested by recession "There is a lot of direct lending going into the smaller side of middle markets," Pinto said, as funds step in to fill gaps left by banks after the 2008 financial crisis. However, he also noted that "Banks, we've been lending for 200 years. We are in an amazing position to compete and we offer to them not just the loan" but an array of products. Pinto also notes that JPMorgan also has several partnerships with asset managers to allow them to participate in loan origination, as many funds are getting large inflows and not finding enough good assets, per Pinto.

BOE Capital Adviser Says AT1s Should Be Ditched If Rules Change (BN.com, 1/23/25)
Additional Tier 1 bonds should not be part of banks' capital stack… if and when the Bank of England decides to overhaul its rules, an adviser at the central bank specializing in regulatory capital said at a private industry event. A representative for the Bank of England, meanwhile, said that the bank has no plans to remove AT1 bonds from the capital stack. The role of AT1 bonds in banks' capital stacks has attracted some scrutiny in recent years. First introduced after the financial crisis to ensure bondholders take losses first when a bank is in trouble, the AT1 market was jolted about two years ago during the SVB collapse, when nearly $17 bn of Credit Suisse AT1 bonds were rendered worthless as part of the government-brokered takeover by UBS. Issuing AT1 debt allows banks to bolster capital at a cost that is more attractive than issuing shares. While Australia's regulators, for one, subsequently decided to phase out AT1s, the AT1 market in Europe has largely bounced back from the Credit Suisse debacle. European banks issued the securities at a rapid pace last year, well received by investors.

European Banks' Upbeat Outlook Paves Way for IPOs, Stake Sales (BN.com, 1/23/25)
A bullish outlook for banking stocks is making it an opportune time for European governments to offload their stakes, vestiges of rescue plans from the GFC. Countries from Ireland to Iceland are evaluating IPOs to unwind crisis-era investments in banks and using proceeds to strengthen public finances. The pipeline for government sales includes Iceland's resumption of plans to exit its 42.5% stake in Islandsbanki, Ireland's sell down of its stake in AIB Group, and Hungary's exit from MBH Bank. This trend follows a wave of government disposals last year in Greece, Germany and Italy.

How Trump Could Free Up $139 Billion Surplus at Big US Banks (Bloomberg Intelligence, 1/23/25)
According to this article, the eight US-based G-SIBs are holding $139 billion in surplus Common Equity Tier 1 (CET1) capital, presumably in preparation for more stringent capital requirements to come. However, with a change in the regulatory regime under the Trump administration, it is now broadly expected that Basel III Endgame proposals will be paused and/or watered down.

If the original Basel Endgame proposal were enforced, it would likely wipe out surplus capital at most big US lenders. However, if capital requirement increases were watered down to 50% of the original proposal, for example, most big banks would maintain pro forma capital surpluses. (Goldman Sachs and Morgan Stanley may still have pro forma capital deficits even under that scenario). Among top banks, JPMorgan may have the most surplus, followed by BofA, Citi and Wells). Share buybacks have been muted for some time in order to build capital ahead of potential full implementation of Basel III Endgame's new requirements, but this may be about to change.

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And the Pendulum Swings, Again . . . Changes in U.S. Banking Regulation (rbccm.com, 1/24/25)
RBC Capital Market recently published a report on the state of banking regulation in the US with the change in administration. Some senior bank regulators recently made speeches and statements in which they highlighted several priorities and objectives. These comments signal "the beginning of a new direction." Some common themes include:

Basel III Endgame Re-Proposal
- Tailoring regulations based on size, risk, and business model is essential.
- Review regulations to support economic growth while maintaining resilience.
- Basel III Endgame proposal should start from a capital-neutral position and incorporate all feedback.

Supervisory Approach Shift
- Greater emphasis on substantive financial risks rather than process and formality.
- A more balanced approach to maintaining safety and soundness while ensuring access to banking services.
- Improve supervisory appeals process.
- Revise M&A approval policies for efficiency.
- Enhance readiness for large bank failures based on 2023 lessons

Bessent Freezes Most CFPB Work Upon Taking Control of Agency (Bloomberg Law, 2/3/25)
Newly-appointed Treasury Secretary Scott Bessent has shut down operations inside the Consumer Financial Protection Bureau in his new role as acting director. Bessent ordered the CFPB to stop all rulemaking, communications, litigation, and other activities. Only activities authorized by Bessent or required by law can move forward at this time. Elon Musk, head of the Department of Government Efficiency has called to "Delete CFPB" on social media. The future of CFPB is uncertain. Some Republicans want to see a consumer watchdog to protect everyday Americans from debanking and potential abuses from lending giants. Others want to eliminate the agency, which has been controversial since it was launched during the GFC, on the grounds that it "lacks accountability and may be duplicative in its mission."

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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