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# Reg Cap Recap

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

SEER CAPITAL

**April 15, 2025**

## Reg Cap Fundamental Credit Trends

The Reg Cap sector spans a variety of reference assets and, of course, the performance of those assets varies among originators. Assets originated by banks to their clients for the banks' balance sheets have generally outperformed assets in generic credit indices. Further, investors impose selection criteria and originators, when selecting assets for a reference pool, are motivated to help ensure the success of their Reg Cap program on the most attractive terms.

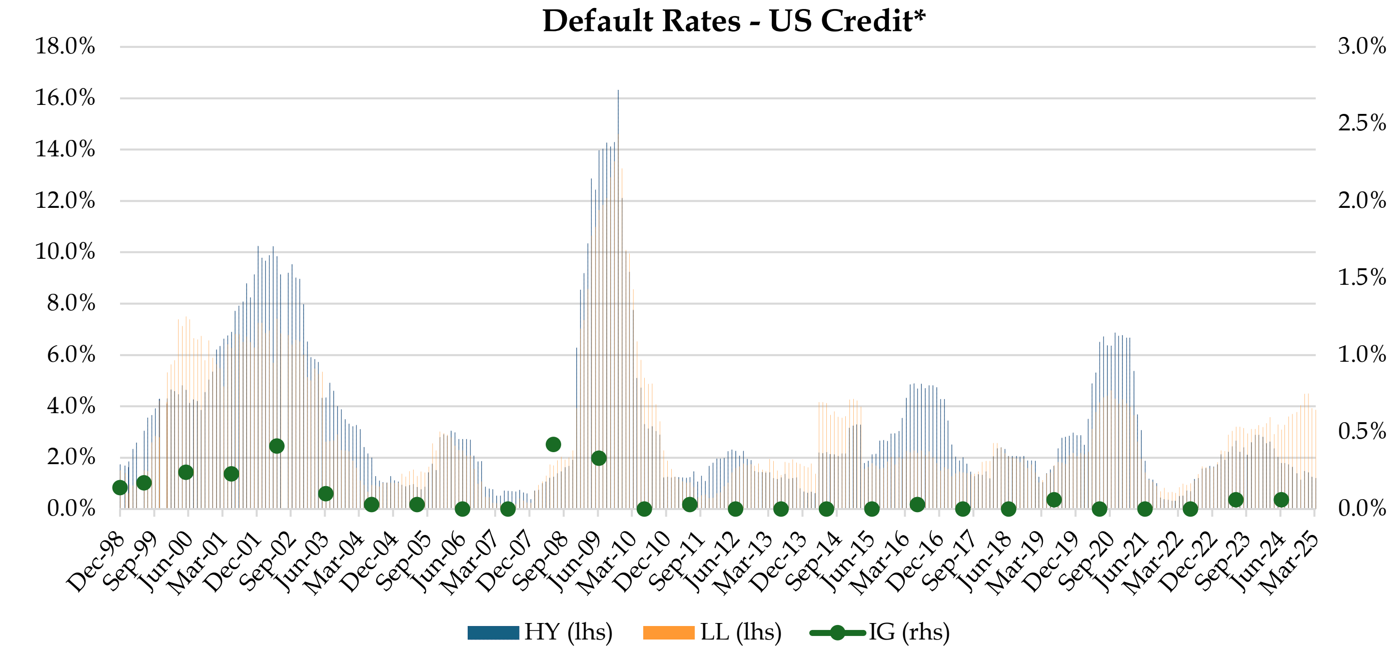
That said, we find it useful and important to track broad trends in asset performance in addition to deal-specific surveillance (which is non-public). Across 42 investments that we own and track, referencing corporate, SME, middle market, consumer, and auto loans in Europe, North America, and Asia, we are seeing continued strong credit performance almost across-the-board, with just a few positions that we are monitoring more carefully due to slightly higher negative credit migration and/or default trends.

The indices we look at as broadly representative of some of the most common reference assets include: US Corporate Debt, including Investment Grade, High Yield and Leveraged Loans; European Investment Grade Debt and High Yield; and US Prime auto loans. We would expect most reference asset pools to significantly outperform these publicly available benchmarks. The following is a brief update on current credit trends for each.

**US High Yield and Leveraged Loans**

Most corporate credits in referenced pools are investment-grade quality. Defaults of investment grade obligors are rare. While Investment Grade ("IG") defaults have been only a small fraction of the defaults in leveraged credit (i.e. US High Yield "HY"[1] bonds and Leveraged Loans "LL"), there is a strong correlation (~75%). Therefore, it is useful to track the (far more numerous) default activity in HY and LL as a possible bellwether for IG. Current default performance in HY and LL continues to be consistent with very low or no IG defaults.

Default/distressed exchange activity rose MOM in March, on the heels of a February that saw the lightest activity since December 2022. There were three payment defaults and four distressed transactions in March totaling $4.6bn. This still compares favorably to an average $7.1bn of volume affected per month across 2023/24. The trailing 12-mo. par-weighted US high-yield bond and loan default rates decreased 5bp and 7bp MOM to 1.20% and 3.86%, respectively. HY default rates are now at a 2.5yr low and LL default rates are now 66 bp below January's 4.5yr high. The 25-year average leveraged loan annual default rate is 3.0%, and analysts' baseline expectation has been that LL defaults would mean reverting to that level over the next year, while HY defaults would essentially maintain their current level. While baseline assumptions have not changed, the recent policy volatility and hence market volatility has raised recession risk considerably.




*Source: Standard & Poor's, JPMorgan Research, as of March 31, 2025.*
** HY and LL on a trailing 12-month basis, dollar-weighted. Includes distressed exchanges. IG on an annual basis.*

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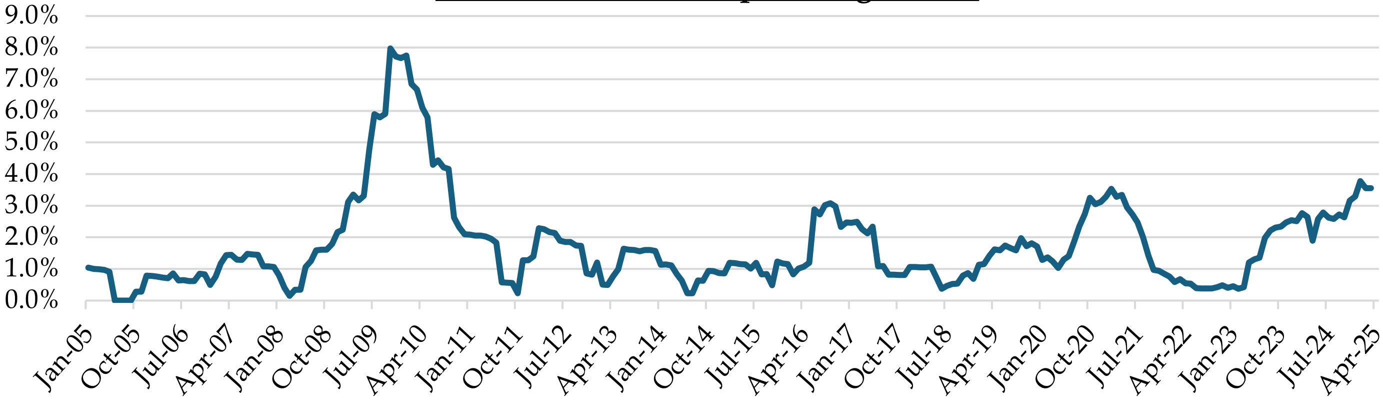
## Reg Cap Fundamental Credit Trends (Cont.)

**European High Yield**

Historically, IG defaults in Europe have also been very low, with no defaults at all in most years. Our European HY default data goes back to 2005. Since 2005, the default rate for IG in Europe has been zero in every year but two; in both 2008 and 2009 the IG default rate was 11bp per annum. Again, as with the US market, with so little default activity in IG, we turn to the HY market as a bellwether.

There were no European High Yield defaults in March, leaving the trailing-12mo. default rate 3.55%, which is up 26bp YOY. Meanwhile, the amount of distressed paper (defined as bonds trading at a spread of >= 1000bp) in European HY, rose nearly 100bp MOM to 5%, which is right in the middle of the range we have seen in the past half year. Several of these distressed bonds are well-known restructuring candidates in the coming quarters, which will put upward pressure on default rates for at least the next 12-18 months. Trump's trade war is a sea change and may well usher in a new default cycle. Goods exporters are the most vulnerable, but cyclical issuers more broadly could be vulnerable if recession ensues.

**Default Rates - European High Yield**

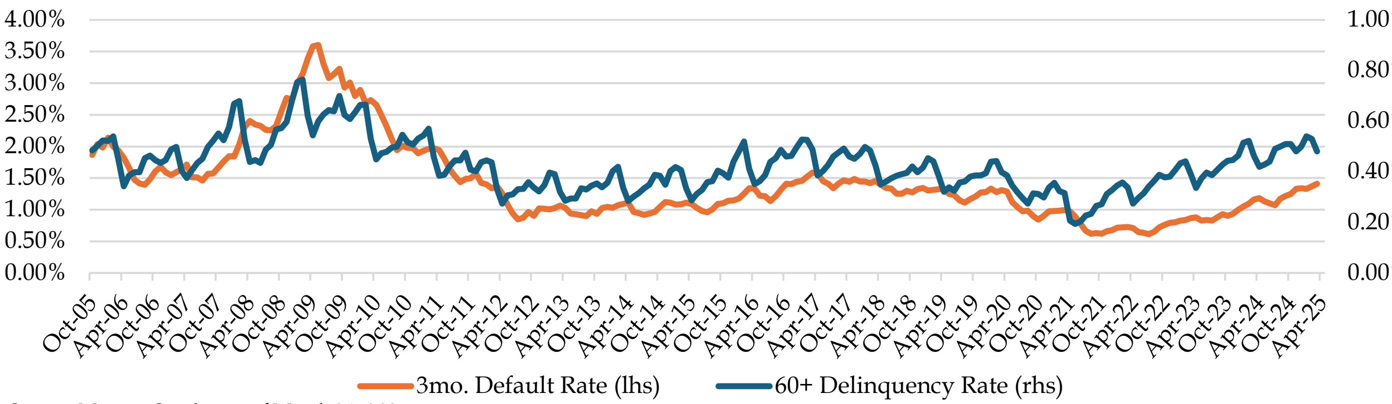



*Source: JPMorgan Research, as of March 2025. Trailing 12-month basis, dollar-weighted. Excludes Banks/Insurers.*

**US Prime Auto Loans**

The 60+ delinquency rate for securitized US Prime Auto Loans fell 5bp MOM in March, to 48bp, showing modest seasonal improvement, as expected. The 3-month default rate is 141bp (up 4bp MOM). This leaves both delinquencies and defaults elevated vs. their 5-year averages (42bp and 99bp). Using the last 20 years of data, prime auto delinquencies are in the 73rd percentile. Losses are only in the 62nd percentile, as more delinquent consumers are curing. Generally, prime auto loan performance remains within the bands of normal expectations while subprime performance metrics have seen more significant deterioration. (Reg Cap deals backed by auto loans have been exclusively prime quality, to our knowledge.) Like any risk asset, auto loan portfolios are likely to see some credit deterioration in a recession scenario - and that deterioration will be orders of magnitude higher in subprime. At the same time, new tariffs are likely to result in higher used car prices, which could positively impact auto loan defaults and recovery rates.

**Delinquency and Default Rates - U.S. Prime Auto Loans**




*Source: Morgan Stanley, as of March 31, 2025*

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## Reg Cap News

**Issuance News:**

***BBVA Triples Size of ESG-Linked Risk Transfer With PGGM*** (Bloomberg News, aka "BN,", 4/2/25)
BBVA is tripling the size of the loan portfolio linked to its new Reg Cap (aka "SRT") deal with Dutch pension fund manager PGGM and Swedish pension group Alecta. The reference portfolio will include €6 billion of corporate loans with both European and US obligors. More than 30% of the portfolio will be linked to ESG indicators. The deal will adjust BBVA's cost of capital based on some of these companies' progress toward sustainability goals, including emissions, water efficiency and diversity. BBVA has a business unit dedicated to ESG transactions.

***Third Coast Bank Announces Securitization of $200 Million Commercial Real Estate Loan in a Transaction Sponsored by EJF Capital LLC (***PR Newswire 4/7/25)
Texas' Third Coast Bank originated a $200 mn revolving commercial real estate loan secured by interests in a portfolio of eleven Residential Master Planned Communities under development in several Texas markets. Third Coast created participation interests in the mortgage loan, selling the junior interest to an investor in a deal akin to a Reg Cap transaction while retaining the senior portion of the risk. Third Coast noted that the transaction "will reduce the bank's risk-weighted assets" and improve the diversity of the Bank's on-balance sheet loan portfolio while reducing the bank's concentration to commercial real estate. At Seer we are looking forward to continued growth in the use of Reg Cap and similar tools by regional banks to manage their capital and balance sheets.

***ABN Amro, EIB Enter Risk-Sharing Pact on €1 billion Dutch Loans*** (BN, 4/9/25)
ABN Amro Bank and the EIB Group are entering into a Reg Cap deal on a reference portfolio of €1 billion of existing SME loans. The European Investment Fund and the European Investment Bank will guarantee a portfolio of Dutch SME loans. In turn ABN Amro commits to providing up to €1.2 billion in new financing at favorable rates to SMEs. The purpose is both to support economic growth and encourage environmental sustainability projects in the Netherlands. Amro says it expects to realize a risk-weighted assets reduction of around €650 million from the transaction. In other news reports, Abn Amro also reported that their CET1 ratio would rise ~7bp post transaction.

***UniCredit Plans New SRT Amid Choppy Markets, Banco BPM Takeover*** (BN, 4/14/25 )
Italy's UniCredit is working on a RegCap/SRT transaction linked to a €1.2 bn pool of factoring contracts. European banks are reportedly taking steps to shore up capital in anticipation of a possible economic slowdown in the wake of drastic changes in tariff policies. A recent *Bloomberg Intelligence* article estimated that European banks may need "to set aside as much as €100 billion for loan-loss provisions through 2026." Moreover, UniCredit's takeover bid for rival Banco BPM would also require additional capital. UniCredit recently completed a RegCap deal tied to a pool of Romanian loans and a second deal linked to a portfolio of German corporate loans.

**Reg Cap News:**

***Cadwalader Capital Call Securitization Conference*** (New York, 4/3/25)
We participated in the Cadwalader Capital Call Securitization Conference on April 3, where a standing room only crowd tore themselves away from the red ink and tariff news to learn about a growing market. The conference dealt with a variety of new ways lenders can finance capital calls, each of which will lend additional liquidity to this product. We joined a panel on Synthetic and Other Non-Cash Securitizations, where we offered our perspective on Reg Cap to an audience largely unfamiliar with the product. Reg Cap is an attractive way for investors to gain exposure to various lending products, including capital call facilities, in partnership with leading banks. Reg Cap is a vital tool banks can use for capital management, limit relief, and establishing market pricing for illiquid risks. Banks work carefully with Reg Cap investors to select portfolios that are likely to outperform from a credit perspective, ensuring that this market remains efficient. The Reg Cap investor base will continue to grow, particularly in the US, where regulatory hurdles currently limit distribution in some cases. Reg Cap will continue to play an important role in bringing additional capital and liquidity to the market for capital calls and other lending products.

***Banks warned against dodging capital rules through risk transfers*** (London Financial News, 4/9/25)
The Bank of England has warned banks that they must still meet capital requirements, even as they increasingly use significant risk transfers to offload credit risk to third parties. The use of SRTs has grown as capital requirements were raised post-GFC . While SRTs help banks reduce risk and free up capital, the BoE raised concerns that some lenders are using these transactions to "artificially" lower their capital obligations. The BoE cited issues around liquid assets in particular, saying that "the repackaging of illiquid assets into a tradeable format, is not, without appropriate supporting evidence, sufficient to justify regulatory capitalisation under trading book rules." It emphasized the importance of assessing the . Other global regulators, like the IMF and ECB, have also recently expressed concerns around SRTs. Meanwhile the ECB has also announced a trial fast-track approval process for Reg Cap transactions.

## Reg Cap News (Cont.)

***UK's PRA flags 'imprudent approach' in SRT financing*** (IFR News, 4/10/25)
***UPDATE - UK's PRA flags 'imprudent approach' in SRT financing*** (IFR News, 4/11/25)
The UK's Prudential Regulatory Authority (PRA) has sent a warning letter to bank CFOs, criticizing some banks for taking an "imprudent" approach to financing Significant Risk Transfer (SRT) transactions. The PRA argued that securities financing of transactions backed by illiquid collateral should instead be covered by the rules for the banking book and not the trading book. The PRA is especially concerned that marked-to-model valuations using liquid proxies, may understate the real risks of illiquid SRT reference assets. The PRA has asked the banks to review and justify their capital treatment of SRT assets, and report back by June 11. There is concern in the market that some smaller banks might reconsider their involvement in providing SRT leverage.

The leading players in financing Reg Cap include the UK's NatWest, Nomura, and Morgan Stanley while Barclays, Standard Chartered, and BNP Paribas are also active. While the PRA may simply be asking banks to more fully document that SRTs are liquid enough for inclusion in their trading book, there is concern that some smaller players who currently finance SRT might reconsider. Whether or not SRTs can be considered liquid enough to be eligible as trading-book instruments is a complex question, primarily because SRT investors are "fundamentally buy-and-hold." However, one participant notes that when secondary sales do come up, the bid list usually draws "significant interest… and clears at reasonable levels in a short timeframe" (i.e., SRTs are liquid). The most active banks likely have enough data to substantiate this and thus justify trading book treatment. However, smaller players may not be able to demonstrate SRT market liquidity as easily.

Perhaps, most importantly, is what the PRA did ***not*** say, which is that the financing of SRTs was a concern in and of itself. By contrast, as the article notes, some critics claim that financing SRT is imprudent because it "reintroduces risk into the banking system that should have been transferred out." The PRA letter does not express concern over financing SRTs per se, but rather says: "You can do it as long as you are doing it according to the rule book.'"

At Seer, we continue to believe that Reg Cap leverage helps banks achieve optimal execution and distribution of Reg Cap transactions, supporting cost effective lending to businesses and consumers. Historically, in times of stress, Reg Cap has traded at better levels than other structured credit assets, supported by a dedicated investor base with conviction in the product. See our further thoughts on Reg Cap leverage here: https://seercap.com/wp-content/uploads/2025/01/Reg-Cap-Leverage-Clearing-Misconceptions.pdf

***UK Lenders Fret Over Risk Transfer market after BofE Warning*** **(FT.com, 4/14/25)**
After the Bank of England set a 2-month deadline for bankers to respond to questions about the liquidity risks in SRT repo, market players are trying to assess how widespread the BoE's worries are. The BoE's new scrutiny could increase financing costs for SRT investors, possibly pushing out new issue spreads or even slowing the growth of the RegCap market.

While entities like the IMF have questioned the appropriateness of bank financing for bank Reg Cap issuance (though to the best of our knowledge financing is never by the same bank issuing the SRT), the BoE appears to have a much narrower concern. The BoE is questioning how banks classify the financing they provide on SRT via repurchase agreements to investors. Some banks assign financing for SRT to their trading book, which allows them to allocate less capital than if that risk were in their banking book. According to the article, the US Federal Reserve and the European Central Bank do not share the BoE's concern. For its part, the ECB introduced a fast track approval process for SRTs and appears very supportive of the market.

***Tariff wars*** (RTRA Intelligence, 4/9/25)
While the primary market has been very strong in the last few years, secondary trading in Reg Cap has been relatively quiet since the COVID-19 crisis. For the first time in years there is a pick up in secondary offerings, though actual trading is stalled due to pricing disagreements and geopolitical uncertainty. Margin calls and portfolio adjustments may be leading some holders to offer bonds out. Some investors view the current market as a long-overdue correction of too-tight spreads. Most of the offerings have been deals from traditional, programmatic issuers and involved common reference assets such as corporate and SME loans. One key concern of course, is how the new tariffs, especially those on EU and UK goods, will impact corporate defaults. Growing trade tensions and economic slowdown may push default rates higher. While some sectors like autos and metals are most directly at risk, indirect effects on supply chains and financing are impossible to quantify at this stage. At Seer we saw significant volume of Reg Cap paper offered for bid in the immediate aftermath of "Liberation Day", however very little traded—we are aware of only one late 2024 vintage transaction changing hands just below par. Generally, bid prices were a few points back of where they would have been prior to Liberation Day, as bidders priced in liquidity premia, assumed some level of distress among sellers, and or recalibrated their models assuming an uptick in defaults. Sellers were generally sticky on price. Increased secondary activity

## Banking Industry News

***Big Banks Hurtle Toward Worst Two-Day Drop Since Pandemic Start*** (BN, 4/4/25)
Shares of major Wall Street banks have fallen sharply, with some of the biggest drops since March 2020, following China's escalation of its trade war with the US. Morgan Stanley, Goldman Sachs, and Citigroup all saw drops of around 10%, while the KBW Bank Index lost more than 15% and JPMorgan was off 6%. Regional lenders such as First Horizon Corp. and Western Alliance Bancorp were both off over 11%. Despite US banks having limited direct exposure to tariffs, their links to impacted industries, the economy, interest rates, and capital markets all contributed to the decline. The banking sector has now officially entered a bear market, having fallen 20% from February highs on growing recession concerns. As equity capital becomes more expensive, tools like Reg Cap only become more important to banks.

***Credit Fear Gauges Soar Most Since Banking Meltdown in 2023*** (BN, 4/4/25)
Credit risk gauges are spiking as investors try to digest what Bank of America analysts call "the biggest shock to global trade in modern times," President Trump's tariffs. The Markit CDX North American Investment Grade Index, the most active CDS contract in the world, jumped as much as 8.5 basis points to 75.7 basis points a day after US junk-rated bonds widened 45 basis point to 386 basis points, echoing the early days of the COVID crises. Junk bonds are of course particularly sensitive to economic conditions. The levies, if implemented, may push the US and global economy into recession this year, the analysts wrote. "Everyone is stunned by what is happening," one researcher is quoted as saying. "The consequences generally speaking for the credit market is that inflation is likely to be back, and revenues expectations adjusted downward at issuer level," he added. Some analysts are now estimating a 50% chance of a recession.

***UBS Sees Bond Spreads Widening to Levels Last Seen in 2020*** (BN, 4/7/25)
The tariffs have shaken credit markets, with credit-default swap gauges surging sharply in both the US and Europe. UBS strategists predict that the impact of the new US tariffs regime will push corporate-bond spreads to levels not seen since the early part of the pandemic. UBS forecasts that by mid-2025, corporate-bond spreads could widen to 160-170 basis points for high-grade bonds and 600-650 basis points for junk bonds. UBS analysts anticipate a mild recession. The strategists also assume that most of the tariffs will stay in place for about nine months, but there is an upside risk if tariff retaliation is more moderate and negotiations lead to tariff reductions. Sectors that typically underperform in recessionary conditions, according to UBS, include CCC-rated bonds, and those in communications, consumer cyclicals, transport, and basic materials. The subsequent suspension of most of the tariffs for 90 days created some relief in markets, but uncertainty and volatility are likely to persist.

***Treasury's Bessent: Regulators 'Hard at Work' on Leverage Ratio Reform*** **(BPI.com, 4/12/25)**
In recent remarks at a conference and in a media interview, Treasury Secretary Bessent laid out his views on banking regulation, including:

1. The need to reform the Supplementary Leverage Ratio (SLR), which limits banks' ability to support the Treasury market, noting that post-crisis rules pushed banks to hold "excess reserves."
2. A critique of Basel framework in favor of a domestic, independent approach to regulation, tailored to U.S. needs.
3. Calling for a stronger focus on material financial risks in bank oversight vs' so-called"reputational risk.".
4. Reevaluating liquidity regulations, emphasizing that liquidity buffers should be available for use, not treated as untouchable minimums.

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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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