

Basel Revisions Dim CRT Outlook

U.S. regulators' planned rollback of their implementation plan for the final update to the **Bank for International Settlements'** Basel 3 rules likely will lead to a reduction in risk-transfer transactions from banks.

As originally proposed by the **Federal Reserve**, the **FDIC** and the **Office of the Comptroller of the Currency** in June 2023, the required capital reserves for banks with more than \$250 billion of assets would have risen by 19%. But Fed vice chair for supervision **Michael Barr** said on Sept. 10 that the plan now is to implement a 9% increase.

Banks with \$100 billion to \$250 billion of assets, meanwhile, would see their required set-asides rise by 3% to 4% after accounting for unrealized gains and losses on their securities portfolios. But otherwise, they are no longer in the scope of the proposal.

The upshot is that both sets of institutions still will face added capital constraints under the repropounded measure, but not as severely as they would have under the original plan. That means they'll have less incentive to reduce their exposures to various assets via risk-transfer offerings — although market participants expect a smaller supply of deals to continue flowing from banks of all sizes.

The thinking is that risk-transfer structures, typically encompassing notes that have performance linked to a referenced asset pool, still offer an attractive way to manage capital. "There are plenty of proofs of concept, and enormous investor appetite," one attorney said.

Big banks including **Citigroup**, **Goldman Sachs** and **JPMorgan Chase** were the first in the U.S. to employ such transactions as a means of shedding credit risk tied to corporate loans, mortgages and subscription lines of credit, even before the Federal Reserve started [approving](#) them in 2023.

Since then, numerous banks with less than \$250 billion of assets, including **Ally Financial**, **Huntington National Bank** and **U.S. Bank**, also have conducted transactions that reduce their exposures to auto loans — thus cutting the amounts of capital they have to reserve against those assets (see article on Page 1).

"Banks may still need to do — or want to do — CRT, but there will just be less supply," said **Carleton Goss**, a partner at Hunton Andrews.

Goss believes the dollar volume of risk-transfer transactions could be 40% to 50% lower under the revised controls than it would have been under the original version of the so-called Basel 3 Endgame plan. "We'll probably see a reduction more on the volume of assets referenced in transactions, as opposed to

the number of transactions," he said.

Banks' capital-reserve requirements aren't the only factor that will determine risk-transfer issuance levels, however, as a revised proposal also likely will include changes to proposed risk weights for various assets. Barr indicated that mortgages might receive more favorable treatment than under the original proposal, for example, potentially lessening their appeal as reference assets for risk-transfer transactions.

JPMorgan has been among the most active issuers of risk-transfer notes referencing mortgages, most recently in the form of an Aug. 26 transaction linked to the performance of a pool of adjustable-rate loans.

Additionally, banks won't be able to formulate their strategies until they see how the repropounded rules treat set-asides for securitized assets. The original proposal would have doubled a calculation known as the P factor that large banks use in determining their set-asides, making synthetic securitizations of most assets challenging or even unviable.

While market participants expect some relief on that front, any increase for the biggest banks could make risk-transfer strategies relatively more attractive for banks with less than \$250 billion of assets because they would not be subject to such calculations, **Clifford Chance** counsel **Young Kim** said.

The extended rulemaking timeline also could create a window for banks to complete transactions, said Clifford Chance partner **Jeff Berman**.

As for banks with less than \$100 million of assets, industry professionals see no change in appetite to conduct risk-transfer offerings. That's because those institutions are not affected under the original proposal or the revised plan.

Indeed, some banks and law firms see such operations as a potentially large source of deals because they are both numerous and capital constrained.

Two regional banks, **Valley National Bank** of Morristown, N.J. and **Pinnacle Financial Partners** of Nashville, recently [obtained](#) capital relief by entering credit-default swap transactions. Valley National's deal, completed in June, involved a \$1.5 billion pool of auto loans, while Pinnacle's, also completed in the second quarter, was tied to a \$1.7 billion pool of residential mortgages.

In both cases, the swaps originally were provided by a money center bank with the expectation that the institution would be replaced at some point by a special-purpose vehicle that would sell credit-linked notes and use proceeds to collateralize the guarantee. ❖

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