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More CRT Planned Amid Basel Wait

Banks continue to explore capital-relief trades amid what is expected to be an extended wait for clarity on a final update to the **Bank for International Settlements'** Basel 3 rules.

Market professionals say issuance of notes transferring risk from loans that banks hold on their balance sheets is running at roughly the same level as during the first quarter of 2024. There have been two such transactions so far this year, from Huntington Bank and U.S. Bank, both issued via the Rule-144A market. Several more private deals are in the works.

At least one would transfer risk on commercial real estate debt. Some banks also are exploring deals linked to credit card receivables.

Hopes are running high that the **Trump Administration** will cast aside the Basel 3 Endgame plan that was proposed in July 2023 by the **Federal Reserve,** the **Office of the Comptroller of the Currency** and the **FDIC,** though many think this is unlikely to happen before 2026.

The proposed plan would have sharply increased capital exposures for the largest banks, potentially encouraging more capital-relief trades. It also would have limited their abilities to use cash or synthetic securitizations to reduce capital-reserve requirements.

A reproposal is expected to result in rules that are more capital neutral. While this could be viewed as reducing the need for such trades, market pros nevertheless expect them to remain attractive to banks.

"Many of the trades that have been done by large banks to date were not necessarily executed because those banks were capital constrained," said **Jed Miller,** a partner at **Cadwalader.** Instead, they were intended as a proofs of concept or to optimize regulatory capital.

And some smaller banks that would not be subject to the Endgame rules because they have less than $100 million of assets also have conducted synthetic securitizations.

Another use case for banks is managing the capital they must hold against a specific asset class in which they have more concentrated exposure, according to **Carleton Goss,** a partner at **Hunton.**

Hunton regularly hears from investment bankers who have come up with twists on an old idea and want to vet it from a regulatory perspective. "I view that as healthy," Goss said.

A reproposed Basel 3 Endgame plan also could benefit banks by providing more clarity on acceptable structures for risk-transfer deals. The transactions are unsecured notes with payments that are tied to the performance of reference pools of assets on bank balance sheets. By convincing investors to forfeit principal and interest if losses on the referenced assets reach certain levels, banks reduce the amounts of capital they must hold against them.

The **Federal Reserve** prefers that such notes be issued via special-purpose vehicles that use proceeds to collateralize a guarantee. However, this structure is unattractive to banks because it could require them to register with the **Commodity Futures Trading Commission** as commodity pool operators — a designation that would heft a host of regulatory and reporting requirements, and costs, on the institutions.

Banks prefer to issue unsecured notes directly, at least for deals referencing consumer loans. The downside to such transactions is that the institutions first must request what is known as a reservation of authority from the Fed, making it difficult to time transactions when market conditions are favorable. Moreover, the Fed to date has limited banks to using directly issued notes to transfer risk on only up to $20 billion of exposures.

The hope is that, once a new group of banking regulators is in place and can focus on capital, they may allow banks to directly issue credit-linked notes without the need for a reservation of authority.

"When and if the Trump Administration and new bank regulators speak, we expect that it will be a win or tie," another attorney said. "We don't expect a loss." ❖