Basel Committee
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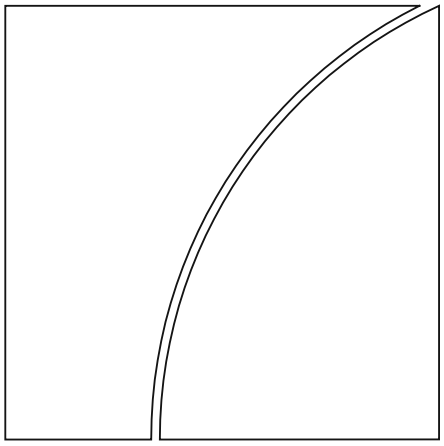

Synthetic risk transfers

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Executive summary

Synthetic risk transfer (SRT) transactions involve transferring all or a portion of the credit risk of a pool of assets to a counterparty while the bank retains ownership of the underlying assets. The investor base in SRTs is dominated by private investment funds, such as credit funds and hedge funds, pension funds and insurance companies. In some jurisdictions, public sector entities also play an important role as SRT investors. SRT transactions are usually fully funded: investors provide high-quality collateral upfront for the full amount of credit protection to mitigate counterparty credit risk. While the complexity of SRTs continues to evolve and there are limitations to the transparency of the market, in general the SRT structures in use today are less complex than those used prior to the Great Financial Crisis (GFC).

Capital and credit risk management are the main motivations for banks to engage in SRTs. Investors are attracted to SRTs because these transactions give access to loans originated by banks in accordance with bank lending standards, while not requiring the investor to take ownership, fund or service the loan pool. Some SRT investors seek enhanced returns by leveraging their SRT positions in the repo market, in which banks provide the necessary secured finance. SRT transactions are privately placed, often on a bilateral basis, and are not always rated by external agencies.

The economic importance of SRT markets has grown rapidly over the last decade, and SRT investors have become an important source of capital relief for corporate credit risk (Section 3).

- Assets protected by SRTs as a percentage of consolidated total assets of banks in individual jurisdictions range between 0.9 and 1.8% with an average of about 1.1%. The SRT market is dominated by large banks, although smaller banks have recently become more active.
- Corporate loans are the largest asset class protected by SRTs; 12% of the corporate book of an average large and medium-sized European bank benefits from SRT protection, with a wide dispersion as some outlier banks receive protection for more than a third of the corporate book.
- There is a wide range among individual banks for the capital relief provided by SRT transactions.

Regulatory and supervisory reforms implemented since the GFC make SRTs simpler and result in more scrutiny relative to credit risk transfer transactions in use before the GFC. Some jurisdictions and market participants are of the view that blind spots related to disclosure and SRT financing activities remain (Section 4).

- The Basel Framework sets out requirements for the recognition of synthetic securitisations for risk-based capital purposes.
- Beyond the requirements in the Basel Framework, individual jurisdictions often implement explicit criteria for the amount of risk that must be transferred, complemented with case-by-case supervisory assessments.
- Supervisors may restrict the extent of capital relief, or not recognise it altogether, when they determine that capital relief is not commensurate with the actual risk transfer or does not comfortably fit under their capital regulations.
- Supervisors are in the early stages of understanding banks' SRT financing activities and determining appropriate prudential approaches to address associated risks. Data on the scale of such financing activities are not available, and some supervisors have expressed concerns about insufficiently prudent practices by banks in this space.
- Disclosure of SRT activities and their impact on bank capital remains limited.

Risks associated with SRT use are acknowledged and, to some extent, actively managed by market participants, but they merit continued monitoring as SRT markets continue to grow (Section 5).

- SRTs provide an additional source of risk-bearing capacity but they may need to be replaced with new transactions if the bank intends to continue lending beyond the maturity date of the SRT.
- High dependence on SRTs may make banks' supply of credit more dependent on non-bank financial intermediaries (NBFIs) and expose banks to spillovers from the NBFI sector; this could potentially increase the procyclicality of aggregate credit provision, as SRT investors may be less willing or less able to provide protection in downturns. Use of unfunded SRTs and reliance on NBFIs providing protection to banks on short-term market financing may exacerbate procyclical effects.
- Banks mitigate these risks by spacing out SRT maturities and matching the maturity of SRT protection to that of the underlying loans, using a diversified pool of protection providers, and limiting the use of unfunded SRTs. Investors mitigate these risks with due diligence and by monitoring banks' origination and credit risk management practices. However, the efficacy of risk mitigants has not yet been tested by large-scale credit losses and SRT markets are opaque to regulators and participants.
- Bank-provided financing of SRTs reduces the extent of risk transfer from the banking sector to the NBFI sector and exposes banks to credit and counterparty risk, underpinned by illiquid and hard-to-value collateral.
- Supervisors who monitor the risk of banks' dependence on SRT transactions have been or could consider assessing a range of metrics, including the overall capital relief, scale of SRT use versus relevant loan portfolios, cost and maturities of SRTs.

Introduction

This report investigates: (i) the range of synthetic risk transfer (SRT) structures and the risks they pose; (ii) the market for SRTs, including analysis of market size, participants and trends; and (iii) the approaches to SRTs taken by supervisors across jurisdictions. Synthetic risk transfers are a subset of a broader type of financial transactions, *significant* risk transfers,[1] which share the acronym SRT. However, this report will focus on synthetic risk transfers.

1. What are synthetic risk transfers?

Banks can use securitisations to manage credit risk from loans held on their balance sheets and/or reduce regulatory capital requirements by transferring this credit risk to third parties. Securitisations can be "traditional" or "synthetic".[2] While there are a range of terms used to refer to synthetic securitisation products, this report will generically refer to them as synthetic risk transfers or SRTs.

Box A

Differences between pre-GFC credit risk transfer and SRTs in use today

The use of credit risk transfer (CRT) – including both traditional and synthetic structures – grew rapidly in the leadup to the 2008–09 Great Financial Crisis (GFC). Market discipline eroded as banks engaged in increasingly complex instruments to achieve capital relief and a diverse and global investor base failed to understand the risks in the underlying reference portfolios. As losses emerged and market turmoil spread, some banks felt pressure to bring assets back to their balance sheets or extend credit to off-balance sheet entities who were credit protection providers in the CRT transactions, despite not having contractual obligations to do so.①

Post-GFC reforms included measures to address the shortcomings in CRT that had contributed to the crisis. These measures included requirements for risk retention, revised requirements for both traditional and synthetic securitisation structures and enhanced supervisory scrutiny. While the complexity of SRTs continues to evolve and there are limitations to the transparency of the market, in general the SRT structures in use today are less complex than those used prior to the GFC.

① The Joint Forum, *Credit risk transfer: developments from 2005 to 2007*, July 2008, www.bis.org/publ/joint21.htm.

1.1 Synthetic versus traditional securitisation structures

In a traditional securitisation, a bank transfers ownership of assets off its balance sheet to a special purpose entity (SPE), which issues securities based on the cash flows from these assets. Traditional securitisations transfer credit risk from the originating bank to purchasers of the securities issued by the SPE,[3] while the underlying securitised assets are often serviced by the originator (ie the bank which initially extended the loan).

Conversely, synthetic securitisations involve transferring all or a portion of the credit risk to a counterparty while the bank retains ownership of the underlying assets. This risk transfer is most often

[1] Significant risk transfer transactions, a term used in some jurisdictions including the euro area and the United Kingdom, refers to transactions that result in capital relief for the associated exposures either via traditional (cash) securitisation or synthetic securitisation. Accordingly, not all significant risk transfers are considered synthetic risk transfers.

[2] Traditional and synthetic securitisations are defined in chapter CRE40 of the Basel Framework.

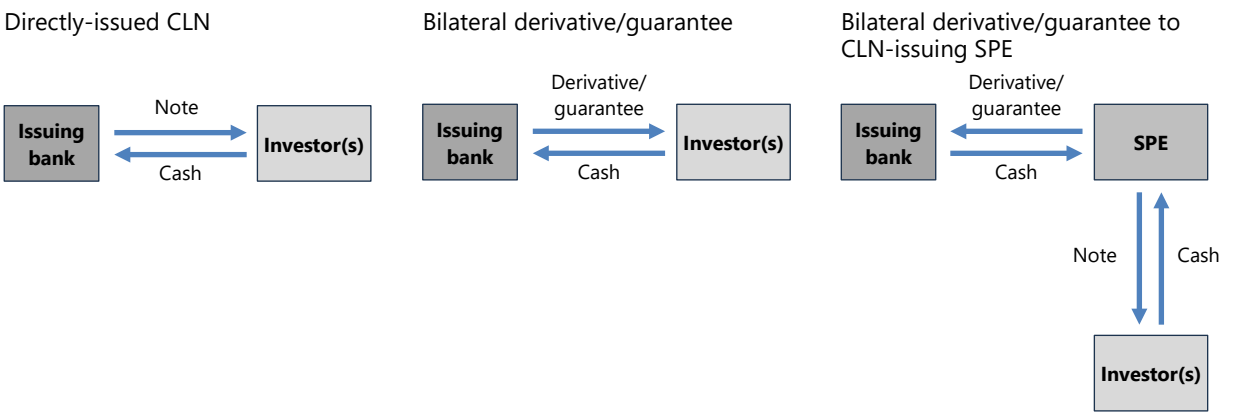
[3] In some instances, banks may repurchase some of the securities that are issued by the SPE.

applied to pools of assets but can be applied to specific loans. Depending on the SRT structure, cashflows are exchanged at different periods over the lifecycle of the product (see Section 3.3).

1.2 SRT structures

Synthetic risk transfers can take a variety of forms. In some cases, the bank may directly interface with the protection provider. Examples of this include SRTs in the form of directly issued credit-linked notes (CLNs) that the bank sells to investors or bilateral derivatives (eg credit default swap) or guarantees with a protection provider. In other cases, an SPE may issue CLNs to investors with the proceeds used to provide protection to the bank via a derivative or guarantee. While each of these structures may result in identical capital relief, banks may prefer one structure over another based on relative financial or operational costs given the nature of the portfolio, depth of investor base or other factors. For example, it may be easier for a bank to structure an SRT for a more complex portfolio as a derivative with a single sophisticated counterparty, whereas a less complex portfolio may be easier to package as a CLN for a wider investor base.

Typical SRT transaction structures — Graph 1



Source: Basel Committee on Banking Supervision.

1.3 Tranching

The Basel Framework indicates that synthetic securitisation structures must feature at least two tranches that reflect different degrees of credit risk in the underlying pool of exposures.[4] Accordingly, SRTs can achieve risk transfer by obtaining credit protection at a mezzanine level between a first loss tranche and a senior loss tranche of the exposure (ie a three-tranche transaction) or credit protection can begin with the first loss layer of the portfolio (ie a two-tranche transaction).

The choice between a two- and a three-tranche transaction can be motivated by the capital relief achievable relative to the cost of the protection provided, as well as by jurisdiction-specific requirements for risk retention and the recognition of risk transfer.[5] See Section 2.1 for more detail on capital relief under two- and three-tier structures.

[4] See CRE 40.3.

[5] Jurisdiction-specific differences that can motivate a bank's choice of tranche structure are addressed in Section 3.3.

1.4 Funding and counterparty risk

Synthetic SRTs for which the protection provider delivers proceeds from the sale of the notes or cash collateral in the full amount of the credit protection are called funded structures. The availability of cash proceeds or collateral mitigates the bank's counterparty credit risk exposure to the protection provider.

Partially funded or unfunded SRTs may be subject to margin requirements, but do not feature up-front delivery of cash proceeds or collateral to cover the full amount of protection provided. These transactions may be more common when the investor/protection provider has a strong credit rating (eg an insurer or development bank) as the capital relief for unfunded SRTs in some jurisdictions is contingent on protection providers carrying a strong credit rating or being a counterparty type that would result in a low risk weight. Partially funded or unfunded SRTs may be less expensive for a bank issuer, but may result in less regulatory capital benefit compared with an equivalent fully funded transaction, as the bank would need to allocate capital to account for the counterparty risk of the protection provider.

2. Motivations of market participants

The SRT ecosystem is composed of bank issuers and protection providers, along with a range of other participants. The motivation of investors is relatively straightforward: attractive risk-adjusted returns. For bank issuers, however, there is a heterogenous and non-mutually exclusive suite of potential motivations for undertaking SRTs.

2.1 Bank issuers

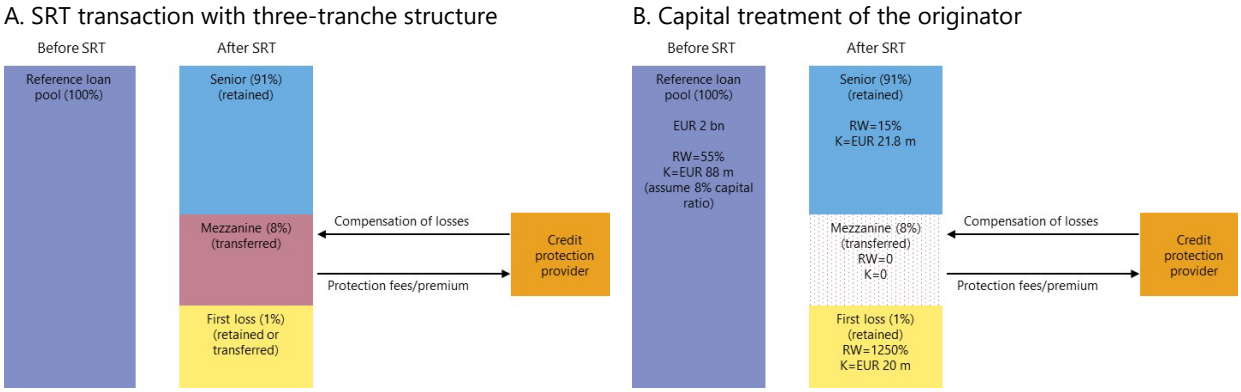
Though SRT markets vary across regions (see Section 3), the overarching motivations of SRT issuers generally involve capital optimisation and/or risk management, including but not limited to balance sheet optimisation. How SRTs are used to achieve these goals is influenced by domestic regulatory features.

Banks view SRTs as particularly advantageous for loan portfolios that incur regulatory capital requirements that they deem higher than their economic capital needs. Graph 2 provides a stylised example of the capital relief that can be achieved via a funded three-tranche structure. The illustration assumes a €2 billion portfolio of loans that receives a 55% risk weight prior to use of an SRT. The SRT-issuing bank in the example retains the risk of losses on the first 1% of the reference portfolio (ie the first loss tranche). In exchange for protection fees or a premium, the credit protection provider agrees to compensate the bank for losses on the next 8% of the portfolio (ie the mezzanine tranche).[6] The bank retains the risk of losses on the senior tranche, which represents the remaining 91% of the portfolio. In this example, as the mezzanine tranche is fully funded, the bank is no longer required to hold any capital for the mezzanine tranche for which risk was transferred. Compared to the pre-SRT structure for which the bank would face a €88 million capital requirement, the SRT would allow the bank to face a €41.8 million capital requirement associated with the retained tranches of the portfolio (ie a 52.5% reduction in the portfolio's capital requirement).[7]

[6] In some jurisdictions, SRT issuers (or other eligible parties) are subject to risk retention requirements. For example, in the European Union and the United Kingdom, eligible parties (most commonly SRT issuers) must retain, on an ongoing basis, a material net economic interest of not less than 5% of the transaction portfolio or total tranche size.

[7] The calculations assume an 8% capital requirement and the protection provider fully collateralises the mezzanine tranche. In practice, banks would face much higher capital targets, which would lead to an even greater capital relief in absolute terms.

Stylised example of an SRT transaction and associated capital relief Graph 2



Note: K represents the capital requirement for the portfolio based on the risk weight (RW) associated with the tranche and an 8% capital ratio requirement. The RW of the senior retained tranche decreases with the thickness of the first loss and mezzanine tranches but must not be less than 15% (CRE44.26).

Source: Basel Committee on Banking Supervision.

When banks achieve capital relief, they can redirect capital for other purposes, including repurchases or distributions to shareholders, additional lending or other strategic initiatives.[8] In some cases, banks reallocate capital from lower-return business segments to those with higher returns. When the capital relief from an SRT outweighs its cost, firms can achieve a higher return on capital.[9]

Credit risk management considerations can also be important factors in bank issuers' decision-making process. In some cases, banks have issued SRTs without the primary object of obtaining capital relief.[10] Instead, many bank issuers consider SRTs as part of a broader toolkit to actively manage credit risk alongside credit insurance, loan sales and traditional securitisation. For example, SRTs can be used to reduce risk exposure to a specific sector or asset class, or counterparty relative to a bank's established concentration risk limits in those areas, thereby increasing lending capacity to that sector or asset class without breaching risk limits. Another benefit often cited by issuers is the ability to mitigate risk at the portfolio level rather than just at the individual borrower level. This is particularly useful for managing illiquid or difficult-to-sell assets. Moreover, because SRTs do not require asset sales, they allow banks to retain customer relationships and avoid realising mark-to-market losses.

2.2 Protection providers (SRT investors) – motivations and considerations

Some investors are attracted to SRTs for their ability to provide exposure to the credit risk of products or entities that they may be less able to otherwise access,[11] as well as for diversification benefits and operational efficiency purposes. By participating in SRT transactions, these protection providers can access loan portfolios underwritten to the bank issuer's standards while avoiding expenses associated with loan

8 In some transactions, particularly those conducted with supranational entities, the freed-up capital is designated for specific activities (eg "green" or SME lending in European Investment Bank or European Investment Fund transactions).

9 The key economic advantage of SRT for the originator is that it reduces the amount of capital held against credit exposures. Even if the cost of protection is comparable to the bank's own cost of equity, capital relief can lead to a higher return on equity held against the protected loan pool.

10 In some instances, SRT structures used by a bank may not qualify for capital relief under local capital requirements or the bank may engage in the SRT prior to confirming supervisory approval to recognise associated capital relief for the transaction.

11 Although traditional securitisations also provide access to the credit risk of a portfolio, in some jurisdictions SRTs can allow for exposure to a wider range of underlying products or entities for which traditional securitisation markets are less well-established. In Europe, where the underlying of traditional securitisations are predominately mortgages and auto loans, SRT can facilitate access to other types of underlying credit exposures.

origination and servicing. For other SRT investors (eg some pension funds in the European Union), it is an alternative to buying bank's equity. The protection provider is then effectively investing in the lending activity of the bank without taking exposure to other risk factors affecting bank equity values. Additionally, SRTs can be structured to contain embedded leverage allowing investors to enhance their returns in comparison to buying loan portfolios outright.

The potential for attractive risk/return profiles and diversification of credit exposures is a key motivation for protection providers. For instance, SRTs may include loans to borrowers that do not have access to capital markets. Investors also value the structural features of SRTs, such as the tranching of credit risk to achieve risk-return profiles different from those available in public markets, the ability to share losses with the originating banks and the benefit to loss recoveries from the involvement of issuing banks' workout teams.

While some investors specialise primarily in SRTs, others invest in SRTs alongside other forms of credit investing such as collateralised loan obligations (CLOs) or CDS. While some SRTs are issued using a CDS (see Section 1), the underlying exposure of a traditional CDS is typically a single reference entity, rather than a tranched pool of loans, and its returns are determined by the credit spread of the entity, rather than by the performance of the loan portfolio and the specific tranche to which the investor is exposed. Moreover, unlike CDS, some SRTs allow investors to benefit from the bank's credit underwriting standards and avoid the settlement risk of a CDS associated with a credit event.[12] Some insurance companies note the flexibility to use SRTs to either enhance investment income by investing in CLNs or to generate insurance income via guarantees on the liability side of their balance sheet. Supranational investors such as business development banks and public development funds note that investing in SRTs can support broader policy goals, such as the development of securitisation markets in lesser developed but desirable segments of economies and to incentivise bank lending to SMEs and environmental sustainability and energy efficiency projects.

2.3 Leverage/funding providers

SRT investors may seek to further enhance returns by using leverage to fund their investments. For example, leverage could be achieved via an SRT repo transaction, in which an investor pledges a purchased CLN as collateral to borrow funds from a financing bank (usually different from the SRT originating bank). The investor typically pays a premium above a risk-free rate to compensate the financing bank for the risk of the leverage financing transaction. The investor often can only borrow a fraction of the value of the CLN (Graph 3) subject to the haircut terms with the financing bank. Overall, SRT financing transactions can lead to the investor having both the leverage from the tranche structures and the financial leverage offered by the funding providers.

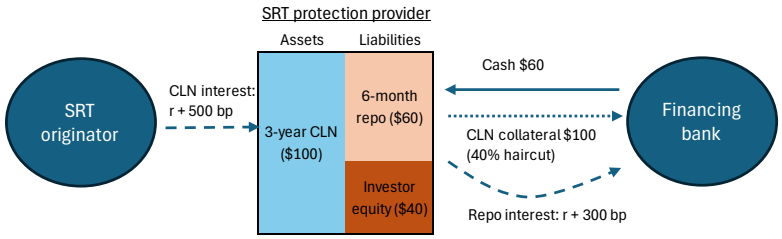
The incentives to seek leverage may depend on the SRT structure; higher credit quality of the underlying assets and thicker protected tranches imply a lower coupon paid to investors and could be associated with a greater incentive to use more leverage. SRT investors' appetite for leverage is often constrained by the collateral haircut requirements and higher funding cost from the lender. The funding providers, especially when they are banks, will have to consider the capital and liquidity requirements for repo transactions with potentially more complex and more opaque underlying assets that already have embedded leverage in the SRT structure, which may constrain their appetite to finance SRTs.

Ongoing visibility into SRT financing is a challenge across jurisdictions. While reliable data on SRT financing are scarce, there is anecdotal evidence that supervisory scrutiny of SRT financing may have discouraged some banks from proactively offering financing to SRT investors or led to increased public

[12] CDS are settled at auction and the cheapest-to-deliver obligation may not be perfectly aligned with the credit exposure that an investor might have intended to take.

disclosure of SRT financing. Some banks reportedly also ask investors to disclose any plans to finance SRTs.[13]

Stylised example of SRT financing with a repo transaction Graph 3



r denotes the risk-free interest rate for a given maturity. Solid lines indicate lending; dotted lines indicate collateral flows and dashed lines indicate interest flows. Transaction parameters are broadly aligned with market practices suggested by market intelligence.

Source: Basel Committee on Banking Supervision.

2.4 Other participants

Rating agencies

The involvement of external credit assessment institutions (ECAIs, or rating agencies) varies across jurisdictions. Many banks determine their capital requirements using either the securitisation internal ratings-based approach (SEC-IRBA) or the securitisation standardised approach (SEC-SA), neither of which depend on external ratings. Consequently, external ratings are not necessary to issue SRTs in such cases. Additionally, where banks issue bilateral SRTs, structures and issuances are marketed to potential investors that do not rely on external ratings.

In many cases, rated SRTs are more desirable because the rated tranches generally attract more investors (ie a higher number of bids from a more diverse pool of potential buyers), which results in lower costs for the originating banks relative to unrated tranches. In other cases, ratings of SRT issuances can be used to create more tranches and optimise the capital requirements of the retained tranches by using the securitisation external ratings-based approach (SEC-ERBA) instead, which does rely on external ratings.

When rating agencies assess SRT instruments, they use frameworks similar to those used for traditional securitisations but adjust the rating analysis to capture differences in SRTs due to the synthetic nature of the structures, such as the absence of true sale, the possibility to mix funded and unfunded elements and other critical analytical considerations relevant to synthetic structures.[14] For example, the credit quality of the reference asset portfolio and operational criteria assessment are important factors for both traditional securitisations and synthetic securitisations. However, for synthetic securitisations, factors related to credit event definitions and CDS/guarantee agreement rights and counterparty credit risk analysis are also important dimensions.

Ratings agencies also consider a bank's SRT issuance in bank rating analyses. For a bank that issues SRTs, rating agencies examine whether or not SRTs reduced the bank's risk, improved its financial position or benefited capital calculation. They would also examine how a bank decides to use the risk reduction and capital improvement gained from the SRTs (eg to reallocate capital to new opportunities

[13] See E Duarte and A Schuetze, "Deutsche Bank raises bar for SRT leverage amid ECB inquiry", *Bloomberg*, 7 February 2025, www.bloomberg.com/news/articles/2025-02-07/deutsche-bank-raises-bar-for-srt-leverage-amid-ecb-inquiry.

[14] For directly issued CLNs in the United States, rating agencies also take into consideration the credit quality of the issuing bank.

and grow, or to pay shareholders). At the same time, over-reliance on SRTs can have a negative credit rating impact on the bank.

Special purpose entities

SPEs can be used in SRT transactions to provide bankruptcy remoteness, ensuring that the collateral provided by the protection provider is protected even if the originating bank faces financial difficulties. For unfunded transactions using CDS or guarantees, SPEs can ensure the reference assets protected by these contracts are legally separate from the originating bank's balance sheet; for funded transactions, use of an SPE may be required to achieve reductions in capital requirements in some jurisdictions.

Advisory banks and verification agents

Other participants include advisory banks that earn fees from advising clients on capital optimisation, risk analytics, benchmarking and/or deal structuring techniques in SRT transactions. Advisory banks may also earn additional revenue from cross-selling (eg by matching a bank with a credit insurer to cover the mezzanine tranche or with a swap counterparty for an unfunded transaction).

SRT investors may engage verification agents to ensure the integrity of loss claims and compliance with predefined loss triggers. These verification agents are typically legally accountable and independent third parties such as an independent accounting practice or the calculation agent or management company for the securitisation. In the European Union, originators may use a verification agent, who needs to be authorised by the competent authority, to assess the compliance of securitisations with the "simple, transparent and standardised" (STS) criteria.[15]

3. SRT market overview

3.1 Market volumes

The SRT markets have been particularly vibrant in the European Union, United States, United Kingdom and Canada. Other jurisdictions, including Japan, Sweden and South Africa, have seen limited transaction activity.

SRT issuance volumes have increased substantially in several jurisdictions in recent years (Graph 4). In the European Union, the annual volume of new SRT transactions (measured by the value of reference assets) has more than tripled from 2016 to 2024. The extension in the European Union of the STS securitisation criteria to synthetic securitisations in 2021 may have contributed to the recent increase in SRT activity.[16] In the United States, SRTs are not a recent phenomenon as they have been a core part of the US agency mortgage markets since 2013 (see Box B). More recently, increased regulatory clarity on the treatment of capital for bank-issued SRTs provided by the Federal Reserve in 2023 has catalysed a steep increase in activity for US bank-issued SRTs.[17] In the United Kingdom, SRT issuance has risen consistently over the past decade. The total value of protected assets in Canada, the euro area, the United States and the United Kingdom is estimated at about EUR 750 billion, or 1.1% of total bank assets;

[15] See Articles 27(2) and 28 of the EU Securitisation Regulation for details.

[16] The change was introduced in the European Union in April 2021 via changes to the EU Securitisation Regulation. The STS criteria are the EU implementation of the Basel Committee's simple, transparent and comparable (STC) securitisation criteria. Securitisation exposures meeting those criteria are eligible for a preferential prudential treatment. The Basel Framework only allows traditional securitisations to qualify for the STC treatment. See CRE40 of the Basel Framework for more details.

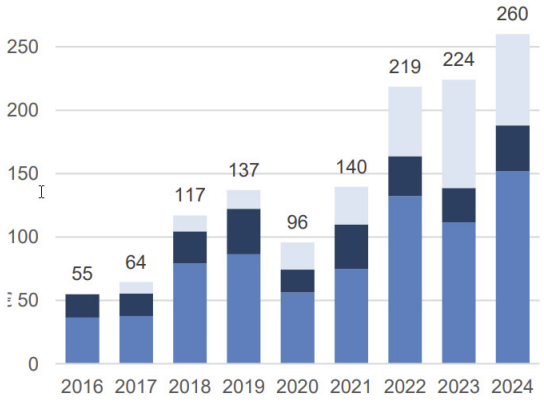
[17] Federal Reserve, *Frequently asked questions about Regulation Q*, September 2023, www.federalreserve.gov/supervisionreg/legalinterpretations/reg-q-frequently-asked-questions.htm.

individual jurisdictions range between 0.9 and 1.8%. Although SRT markets have been increasingly active, the weight of SRT as a source of risk-bearing capacity trails that of additional Tier 1 hybrid capital.[18]

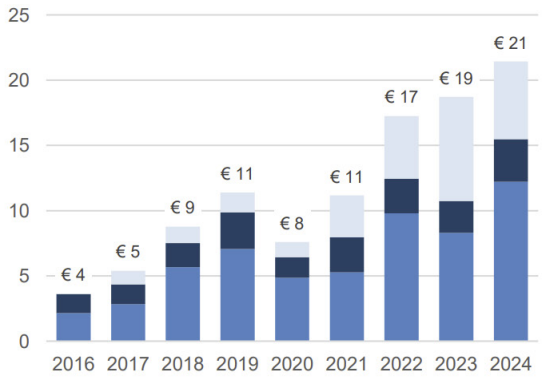
Bank SRT issuance at inception

In billions of euros — Graph 4

A. Underlying pool size



B. Protected tranches



European Union (EU) excl. UK | Europe outside the EU incl. UK | Other Regions incl North America

Protected tranche volume does not include placed senior tranche volume. Activity in the European Union is almost exclusively concentrated in the euro area countries. Other regions include South/Latin America, Asia, multi-country (same region), unknown. Data do not include US agency CRTs.

Source: IACPM, *Global SRT Bank Survey 2016–2024*, iacpm.org, reproduced with permission of IACPM.

Historically, large and complex banks, led by global systemically important banks (G-SIBs), dominated the issuance of SRTs. Issuance has been highly concentrated. Over the last few years, smaller banks have increasingly adopted SRTs. These include regional US banks and US subsidiaries of foreign banks, banks located in smaller EU countries and, recently, interest from smaller UK issuers.

Corporate loans are the largest asset type included in bank-issued transactions. Broadly, banks indicate that the use of SRT for corporate loans results from the rather high regulatory capital requirements these loans attract, relative to the economic capital. The asset mix in the United States is more diverse than in other jurisdictions: corporate loans account for the largest share of SRT pools, followed by capital call facilities,[19] with a substantial amount of the remainder accounted for by auto loans and residential mortgages. In the euro area, approximately 75% of SRT volumes reference corporate loans, with the remainder split between SME, commercial real estate, consumer and mortgage lending.[20] Working capital facilities account for a larger share of SRT pools relative to aggregate euro area loan books, while commercial mortgages and general-purpose loans are underrepresented. In the United Kingdom, corporate loans account for the largest share of referenced assets but other asset classes such as leveraged loans and project finance are also referenced in the deals; recent years have seen an increase in retail exposures such as auto and, more recently, consumer loans.

[18] For example, euro area banks, which are the most active users of SRT, issued EUR 30 billion of additional Tier 1 securities in 2024, 2.5 times as much as the volume of protected SRT tranches (see Graph 4.B).

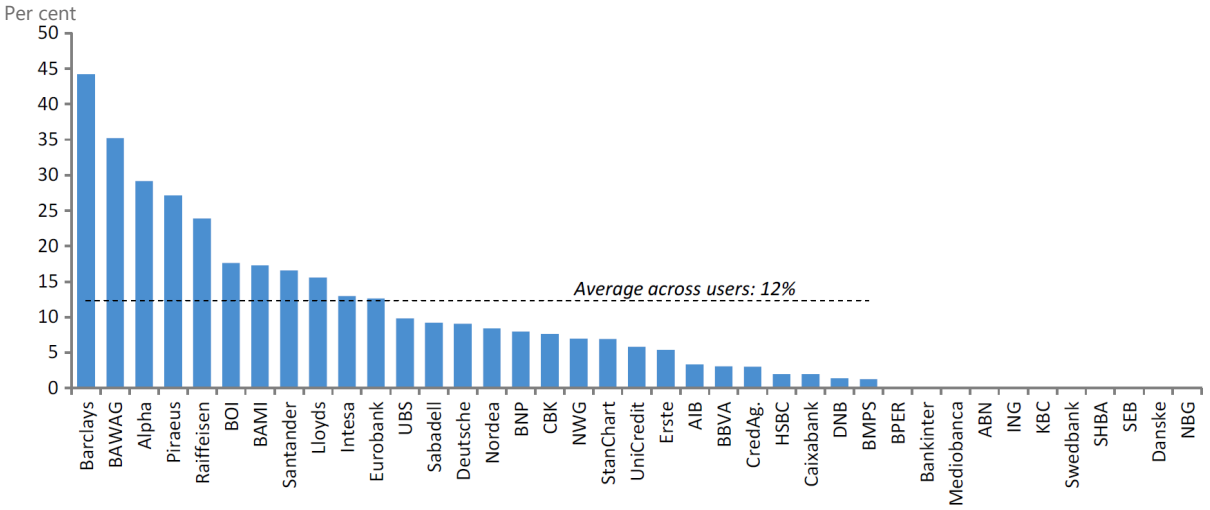
[19] The prominence of capital call facilities in SRT deals is likely due to their high capital requirement relative to historical loss rates, coupled with banks' desire not to disrupt relationships with the facility holders – typically large private equity clients.

[20] European Systemic Risk Board, *Unveiling the impact of STS on-balance-sheet securitisation on EU financial stability*, May 2025, p 26, panel A, www.esrb.europa.eu/pub/pdf/reports/esrb.report202505_syntheticSTSsecuritisation.en.pdf?6c3885349149fe9b6edb268d98d24490.

SRT markets have become an important source of risk-bearing capacity for banks. Section 4.1 provides more details on conditions for recognition of risk transfer. SRT transactions protect a sizeable and increasing share of banks' corporate loan books, although usage varies across banks and jurisdictions. For example, at the end of 2024, the average listed bank in the European Union, the United Kingdom and Switzerland used SRTs to cover about 12% of its corporate loan book (Graph 5), and several banks protected more than a quarter of their corporate exposure. The corresponding capital relief is estimated to amount to 47 basis points of their CET1 ratio for the average bank (Graph 6).[21] However, many banks, including some G-SIBs, have not issued material volumes of SRTs to date.

SRT protection as a share of banks' corporate loan books

European Union, United Kingdom and Swiss listed banks, Q4 2024, in percent of exposure at default — Graph 5

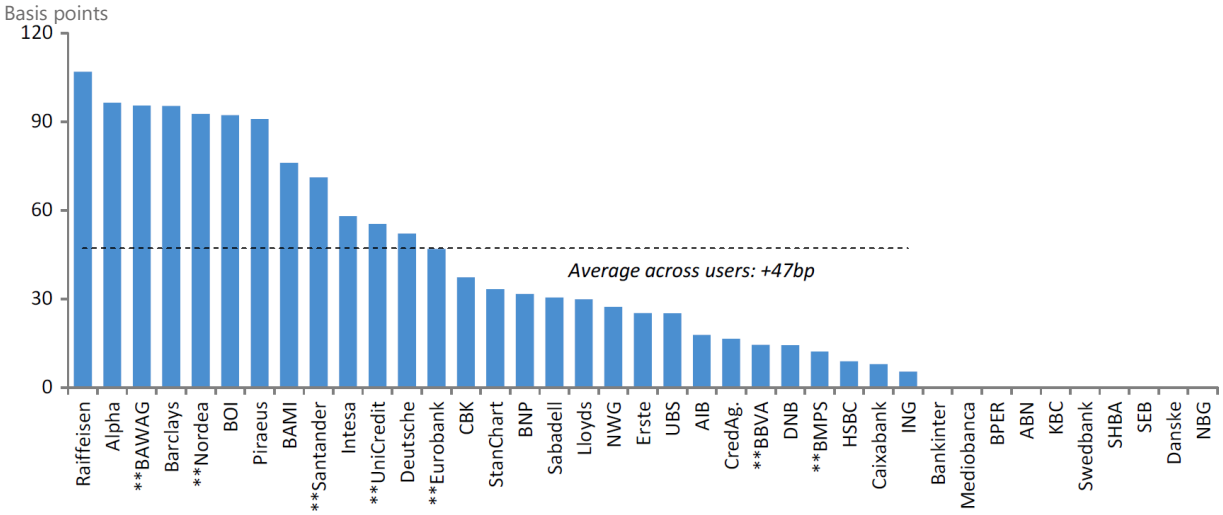


Source: C Cant, L Li and M Evison, *European banks – SRT growth continues*, Autonomous Research, June 2025, p 4, chart 6. Reproduced with permission of the authors.

[21] C Cant, L Li and M Evison, *European banks – SRT growth continues*, Autonomous Research, June 2025, p 4.

Estimated CET1 benefit from SRT

European Union, United Kingdom and Swiss listed banks, Q4 2024 Graph 6



Estimates assume a pre-SRT risk weight of 50% and 85% exposure retention. ** Banks where more than 25% of SRT exposure relates to retail books.

Source: C Cant, L Li and M Evison, *European banks – SRT growth continues*, Autonomous Research, June 2025, p 4, chart 7. Reproduced with permission of the authors.

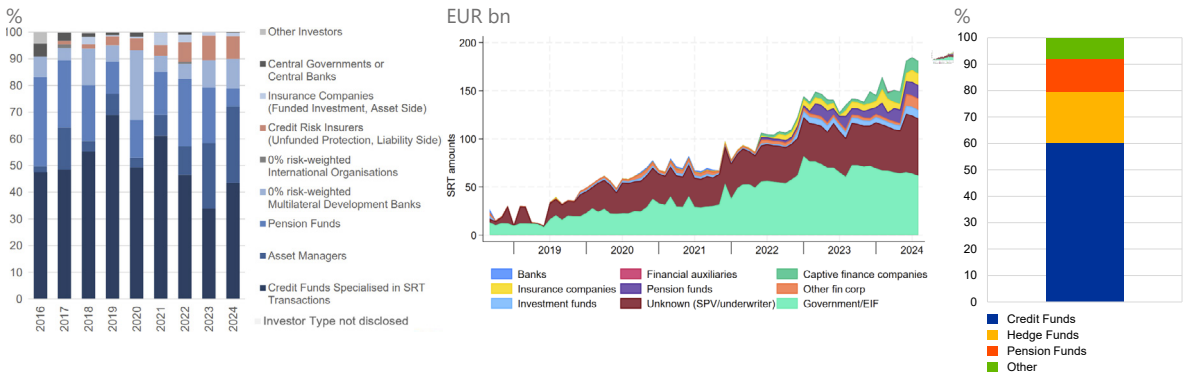
3.2 SRT investors

SRTs are traded in private markets and therefore public disclosures on investor composition are limited. Available supervisory information and market intelligence show there are a broad range of investor types in SRTs globally, in the euro area and the United Kingdom (Graph 7). A large majority of investors are NBFIs, including private credit funds, investment/mutual funds, hedge funds, pension funds, sovereign wealth funds, regional and international development banks and insurance and reinsurance companies. These investors often operate globally, with significant cross-jurisdictional holdings. For example, approximately one third of euro area SRTs involve foreign investors, predominantly US-based. Securities holdings data show that non-euro area-based investors hold a majority of CLNs issued by euro area banks. However, there are data gaps relating to investors in CLNs issued via an SPV, which account for a large part of the euro area SRT market. SRT transactions are executed privately, involving one or a small number of specialised investors.

There are also notable regional differences in the composition of SRT investors. In the euro area, public sector entities, such as development banks, make up a large group of protection providers. Investment funds – often specialised credit funds – are the largest group of private investors, often taking exposure to SRT by investing in CLNs (Graph 7). In the United Kingdom, credit funds held a 60% share over the last two years.

SRT investor profiles by jurisdiction Graph 7

A. Global (2024) B. Euro area (2019–2024) C. United Kingdom (2023–2024)



EIF = European Investment Fund.

Categories on all panels are aligned with the respective reporting schemes and a reconciliation of these categories is not possible. Credit funds and hedge funds, reported separately in Graph 7.C, are included under investment funds, other financial corporations as well as "unknown (SPV/underwriter)" in Graph 7.B. Graph 7.B: SPVs represent CLN structures in which the risk is transferred via a guarantee or CDS to an SPV, which issues notes to investors. The ultimate investors in these CLNs are not known. A recent paper estimates that credit funds and asset managers hold 75% of these assets (see F Gonzalez and C Morar Triandafil, "The European significant risk transfer securitisation market", *European Systemic Risk Board Occasional Paper Series* no 23, 2023, www.esrb.europa.eu/pub/pdf/occasional/esrb.op23~07d5c3eef2.en.pdf).

Sources: IACPM, *Global SRT bank survey 2016–2024*, iacpm.org, reproduced with permission of IACPM; A Osberghaus and G Schepens, *Synthetic, but how much risk transfer?*, working paper, 17 October 2025, p 67, based on European Central Bank AnaCredit data, reproduced with permission of the authors, www.bis.org/events/251209_tiifm_cfp_osberghaus_paper.pdf; Bank of England Prudential Regulation Authority.

3.3 Typical SRT structures

A large majority of SRTs are funded. For example, 85–90% of transactions in the United States are funded. Similarly, most euro area SRTs are funded, except for transactions protected by public sector entities and some transactions protected by credit insurers. The SRT programmes offered by the public sector entities enable issuers to transfer credit risk to the public sector and transform the underlying exposures into exposure to a multilateral development bank, which carries a zero risk weight.[22] All UK transactions to date have been funded.

Transaction type

Funded SRTs in the euro area, the United Kingdom and Canada have typically used an SPV, although the share of transactions using an SPV has fallen from about two thirds in 2019 to 15% in 2024. The originating bank transfers credit risk via guarantees to an SPV, which then sells CLNs to investors, who assume the risk associated with the mezzanine tranche of the portfolio. The SPV holds the proceeds from selling the notes in deposits or eligible investments (low-risk fixed income assets) and retains these as collateral against potential defaults among the reference assets. This structure protects the investors from the originator's credit risk. Increasingly frequently, CLNs are issued directly by the originating bank.

SRTs in the United States are more typically structured as CDS, including indirectly issued CLNs, followed by directly issued CLNs. The CDS market in the United States is larger than the size of the directly issued CLN market, in part because the CDS structures satisfy the criteria for capital relief under US

[22] European Union regulations require that unfunded synthetic securitisations be protected by a zero risk weight party to qualify for the STS label.

regulations,[23] while directly issued CLNs require additional regulatory approval for capital relief.[24] In a CDS transaction (that is not an indirectly issued CLN) which is negotiated bilaterally as an over-the-counter derivative, the investor base is generally limited to larger institutions. By contrast, CLNs, which are issued as a form of unsecured bank debt can provide broader capital market access to a broader set of investors. The cost of protection via directly issued CLNs can vary depending on the creditworthiness of the bank, because the CLN investors can be exposed to the credit risk of both the reference portfolio and of the issuing bank.

Tranche structure

The choice of a specific tranche structure in a given transaction can be driven by differences in conditions for the recognition of risk transfer and investor preferences.

In the euro area, three-tranche structures with a retained first-loss piece are more common. The first-loss piece usually amounts to between 0.5 and 1.5% of the reference portfolio, slightly above the expected losses on the portfolios which, on average, range between 0.4% and 1%. Typically, the attachment point for the senior tranche is set to between 7 and 9%. In the United Kingdom, 78% of SRTs use a two-tranche structure, with 22% featuring three tranches. The attachment points are similar to those used in the euro area.

Unlike in the United Kingdom and the euro area, SRT coverage in the United States and in Canada generally applies to first losses.[25] The typical two-tranche US SRT reduces the risk-weighted assets (RWA) of a reference portfolio by 60 to 80%. This is accomplished by purchasing protection on the first 12.5% of portfolio losses which will reduce the risk weight for this portion of the reference portfolio to 0% (if fully funded and with no relevant mismatch adjustment).[26] The risk weight of the remaining senior tranche retained by the issuing bank then typically falls from the risk weight of the underlying securitised exposures to the lowest allowed risk weight of 20%.

Maturity

Standard SRT transaction maturities vary by region but generally align with the maturity of the underlying exposures. In the European Union, a typical SRT transaction has an original maturity of two to four years, which is broadly aligned with the average maturity of the underlying asset pools.[27] In the United Kingdom, original maturities vary – typically they are between three and five years – in accordance with the profiles of the underlying assets. In the United States, maturities also depend on the underlying assets – corporate or auto loans can have maturities that typically range from three to seven years, while transactions for residential mortgages can have significantly longer maturities.

[23] A bank may recognise a CDS that meets the eligibility criteria, but capital relief depends on whether the CDS is collateralised or sold by a counterparty that receives a risk weight lower than that of the reference exposure.

[24] The bank-issued CLN requires approval because it is not a credit derivative or guarantee, necessary to meet the requirements for capital relief under the US capital rule, and does not use a qualifying credit risk mitigant described in the operational requirements under the US capital rule. In approvals that have been granted by the Federal Reserve for US bank holding companies to recognise the regulatory capital benefit of directly-issued CLNs, the capital benefit has been limited to the lower of 100% of the bank holding company's total capital or USD 20 billion in reference loans.

[25] In some instances, US banks have opted to retain a thin layer first loss tranche for some SRTs in order to control the cost at which investors are willing to provide protection.

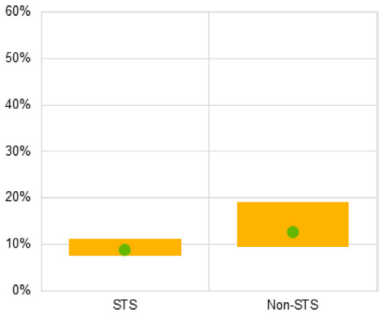
[26] The protected first-loss tranche may be split into two or more sub-tranches to meet the risk-return expectations of specific investors.

[27] European Banking Authority, *Risk assessment report of the European Banking Authority,* June 2025, Box 3, www.eba.europa.eu/sites/default/files/2025-06/93431cb8-4877-4325-82f9-0a41ba71e45a/Risk%20Assessment%20Report%20Spring%202025.pdf.

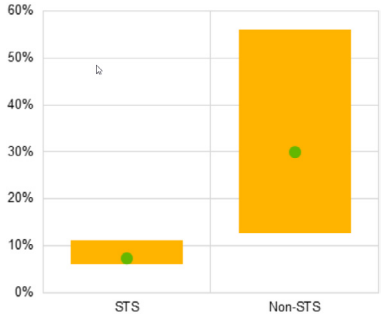
Financial parameters of SRT transactions in the euro area Graph 8

A. Senior tranche attachment point (2024)

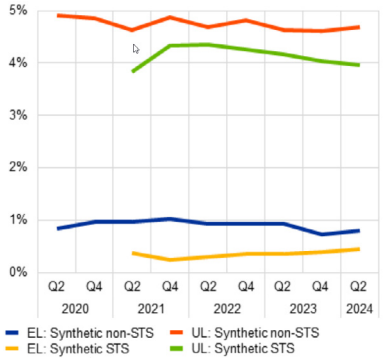
Three-tranche structures



Two-tranche structures



B. Expected and unexpected losses on the loan portfolios protected by SRT in the euro area



STS = simple, transparent and standardised, EL = expected loss, UL = unexpected loss.

Graph 8.A: dot = median, bar = interquartile range.

Sources: European Central Bank supervisory reporting (Graph 8.A and Graph 8.B), European Systemic Risk Board, *Unveiling the impact of STS on-balance-sheet securitisation on EU financial stability*, May 2025, p 44, www.esrb.europa.eu/pub/pdf/reports/esrb.report202505_syntheticSTSsecuritisation.en.pdf?6c3885349149fe9b6edb268d98d24490.

3.4 Funding of SRTs

Data on the scale of SRT financing are scarce, posing challenges for ongoing monitoring. Repo financing appears to be the principal way through which protection providers can obtain leverage in SRTs (see Section 2.3). In the United Kingdom, supervisory engagement with a subset of large internationally active banks prior to publication by the UK Prudential Regulation Authority (PRA) of its April 2025 "Dear CFO" letter identified that SRT financing was associated with approximately 10% of the outstanding global SRT market.[28] Supervisory and market intelligence suggest that the extent of repo financing of SRTs by euro area banks is limited, with only a few large banks being actively involved.[29] In the United States, in addition to repo, there are cases in which large asset managers have secured term loans backed by SRT collateral, but this appears to be less common than repo. Supervisors are not aware of banks financing own-originated SRTs, although a recent survey reported that one bank may be providing such financing.[30]

The terms of repo financing of SRTs consider the risk profile of CLN collateral. SRT financing is typically short-dated (three to 12 months) relative to the maturity of the underlying SRT assets. Haircuts on CLN collateral across jurisdictions have been reported to lie between 26 and 55%. Market contacts suggest haircuts are driven by the high credit risk of the CLNs. In the United Kingdom, the PRA has observed that for certain financing portfolios banks have adopted an imprudent approach associated with

28 Bank of England Prudential Regulation Authority, *Significant risk transfer financing: prudential expectations*, 9 April 2025, www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2025/significant-risk-transfer-financing-prudential-expectations-letter.pdf.

29 For a subsample of SRT protection providers which receive funding from euro area banks, Osberghaus and Schepens find that the total outstanding credit from euro area banks to these protection providers increased around the date when the protection providers entered into an SRT transaction. This indicates that protection providers are indeed using leverage from banks. See A Osberghaus and G Schepens, *Synthetic, but how much risk transfer?*, working paper, 17 October 2025, www.bis.org/events/251209_tiifm_cfp_osberghaus_paper.pdf.

30 Moody's, *SRTs to support bank capital despite concentration and regulatory scrutiny*, 6 May 2025, events.moodys.com/banks-europe-srts-to-support-bank-capital-despite-concentration-and-regulatory-scrutiny. See also Annex 1.

the recognition of collateral for regulatory capital purposes, resulting in a potential undercapitalisation of the risks, as communicated publicly in the April 2025 Dear CFO letter. In response, the PRA has undertaken targeted supervisory work with relevant firms to mitigate risks associated with this.

Box B

US government-sponsored enterprises credit risk transfer programmes

US agency credit risk transfer (CRT) programmes, initiated by government-sponsored enterprises (GSEs), primarily Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), represent a form of synthetic risk transfer. They are designed to shift a portion of mortgage credit risk from the GSEs to private investors without transferring the actual underlying mortgage assets.

CRT securities were created in 2013 to transfer a portion of the risk associated with credit losses within pools of conventional residential mortgage loans from the GSEs to the private sector. Unlike agency mortgage-backed securities (MBS), full repayment of the original principal balance of the CRT securities is not guaranteed by the GSEs. Rather, "credit risk transfer" is achieved by writing down the outstanding principal balance of the CRT securities if credit losses on the related loans exceed a certain threshold. By reducing the amount that they are obligated to repay to holders of CRT securities, Fannie Mae and Freddie Mac can offset credit losses on the related loans. Since their inception in 2013, the GSE CRT programmes have transferred credit risk on roughly USD 6.7 trillion of unpaid principal balance through the end of 2023.

GSE CRTs have attracted a broad range of institutional investors, including insurance companies, hedge funds, pension funds and asset managers. These protection providers improve liquidity and reduce execution costs for GSEs by offering customised risk-return profiles and absorbing a significant portion of credit losses. Investor demand supports ongoing issuance despite market volatility.

GSE CRTs follow synthetic risk transfer structures with a senior-subordinate tranche hierarchy, where GSEs retain senior tranches and most of the first-loss tranches. Credit risk for mezzanine tranches, covering elevated unexpected losses, is sold to private investors, with the GSEs typically retaining a 5% vertical slice of each mezzanine tranche.

The GSEs fund themselves through MBS issuance, and CRT serves as risk transfer overlay. Protection providers fund CRT exposures through capital allocations rather than leverage. GSE CRT investors are compensated through spread premiums for absorbing default risks.

The Federal Housing Finance Agency (FHFA), the regulatory supervisor of the GSEs, publishes annual reports detailing CRT issuance, performance and compliance. Performance data show substantial investor-absorbed losses during stressed periods, confirming the resilience of the programme and the effectiveness of CRT's capital relief and loss-sharing in supporting FHFA's capital and stress testing objectives.

Sources: Fannie Mae, Connecticut Avenue Securities transactions, capitalmarkets.fanniemae.com/credit-risk-transfer/single-family-credit-risk-transfer/connecticut-avenue-securities/connecticut-avenue-securities-transactions; Fannie Mae, "Connecticut Avenue Securities (CAS) is the benchmark for US mortgage credit", capitalmarkets.fanniemae.com/credit-risk-transfer/single-family-credit-risk-transfer/connecticut-avenue-securities; Fannie Mae, CAS pricing capitalmarkets.fanniemae.com/credit-risk-transfer/single-family-credit-risk-transfer/connecticut-avenue-securities/cas-pricing; Fannie Mae, "Fannie Mae prices $708 million Connecticut Avenue Securities (CAS) REMIC deal", press release, 17 September 2024, www.fanniemae.com/newsroom/fannie-mae-news/connecticut-avenue-securities-2024-r06-deal; Fannie Mae, "Fannie Mae announces 2025 Connecticut Avenue Securities (CAS) issuance calendar", press release, 18 December 2024, www.fanniemae.com/newsroom/fannie-mae-news/2025-connecticut-avenue-securities-cas-issuance-calendar; Federal Housing Finance Agency, *Performance of Fannie Mae's and Freddie Mac's single-family credit risk transfer*, May 2021, www.fhfa.gov/sites/default/files/documents/CRT-Overview-05172021.pdf; Freddie Mac, "STACR: product summary", capitalmarkets.freddiemac.com/crt/securities; Freddie Mac, "Freddie Mac upsizes another credit risk transfer offering: STACR REMIC 2020-DNA4 distributes risk through nearly $1.1 billion issuance", press release, 25 August 2020, freddiemac.gcs-web.com/news-releases/news-release-details/freddie-mac-upsizes-another-credit-risk-transfer-offering; Kroll Bond Rating Agency, "KBRA assigns preliminary ratings to Freddie Mac's STACR 2025-DNA1", 9 January 2025, www.kbra.xcom/publications/SdSyVsyr.

4. Range of approaches to supervisory and regulatory treatment

The Basel Framework sets out operational requirements for the recognition of synthetic securitisations for risk-based capital purposes.[31] These include provisions on the compliance of credit risk mitigants, collateral eligibility, eligibility of guarantors, restrictions on terms and conditions that would limit the amount of credit risk transferred, requirements to obtain a legal opinion on contract enforceability and requirements specific to clean-up calls.[32]

This section sets out SRT regulatory requirements and supervisory approaches in use across jurisdictions. In addition to the factors set out below, when capital relief is the primary incentive for entering an SRT, banks' decisions regarding the assets it seeks to protect via SRT, the SRT structures it will use and the tranche structure of the SRT can all be motivated by jurisdictional differences in capital requirements (ie whether banks are subject to a standardised approach or internal ratings-based approach). Banks will generally determine the design of an SRT (eg underlying assets, transaction type, tranche structure and thickness) in a manner that optimises capital relief under applicable local capital requirements relative to the cost of protection.

4.1 Recognition of risk transfer/capital relief

In the European Union and United Kingdom, following the requirements in CRE40.25(4), banks may recognise reductions to the risk-based capital requirement of a credit portfolio where a significant portion of the credit risk has been transferred to third parties via securitisations. Under the current framework, where the credit risk of the mezzanine tranche is subject to protection, the bank must transfer the risk of at least 50% of the RWA amount to a third party; if protection is provided on the first loss tranche in a two-tranche structure and that first-loss tranche substantially exceeds the expected loss on the underlying pool, at least 80% of the RWA amount must be transferred. In the United Kingdom, the PRA expects firms to consider the thickness of tranches sold to third parties or tranches on which protection is purchased, for portfolios of standardised approach exposures, in a prudent manner (1.5 x Ksa). In Canada, a reduction in RWA of at least 60% including an expected loss adjustment for internal ratings-based pools after securitisation for exposures retained by the originating institutions is required. In the United States, there are no specific requirements for how much protection must be provided to recognise capital relief. In most cases, US banks generally structure SRTs to provide protection on the first loss tranches covering the first 12.5% of losses to maximise the RWA reduction allowed on the retained senior tranche under the US capital rule.[33]

SRTs must meet eligibility requirements, including operational and legal criteria to ensure the effectiveness of the credit risk transfer, to achieve capital relief. Although some SRTs that feature implied or embedded derivatives (eg directly issued CLNs) may not be executed using standard International Swaps and Derivatives Association (ISDA) documentation, supervisors generally seek to confirm whether the terms of such transactions meet the same credit risk transfer criteria as those that are executed under ISDA documentation.

Supervisors generally do not subject banks to limits on the aggregate amount of capital relief that they may achieve via SRT. Some exceptions to this include (i) limits to the capital relief that can be achieved via directly issued CLNs that the Federal Reserve has approved for bank holding companies upon

[31] See CRE40.25.

[32] CRE40.9 defines a clean-up call as "an option that permits the securitisation exposures (eg asset-backed securities) to be called before all of the underlying exposures or securitisation exposures have been repaid. […] In the case of a synthetic transaction, the clean-up call may take the form of a clause that extinguishes the credit protection."

[33] US banks have been noted to calibrate the size of the tranche differently to maximise capital relief for assets that attract lower risk weights (eg mortgages).

request;[34] and (ii) a Pillar 2 capital requirement for rollover risk that the Swedish authority applies to banks that reduce their total capital ratio by at least 50 basis points over a 12-month period or if the exposure value of securitised assets exceeds 15% of the bank's total exposure in those relevant exposure classes.

In the United Kingdom, the PRA expects relevant senior management of a firm to be appropriately engaged in the execution of securitisation transactions that lead to a reduction in RWA.

4.2 Supervisory approval requirements (pre- and post-approval)

In many jurisdictions, supervisors reserve the right to review and challenge the eligibility of capital relief for specific SRTs throughout the duration of the transaction. When they determine the capital relief of the SRT is not commensurate with the transfer of risk achieved via the transaction, in some instances supervisors may elect to require a higher risk weight to the transaction, subject the bank to a Pillar 2 add-on, consider restrictions on the bank's use of SRTs or not recognise the risk transfer, resulting in less or no capital relief.

In the United Kingdom, while there is no pre-approval process for SRTs, banks are expected to engage supervisors at an early stage in the transaction for more complex structures. In addition, UK banks are required to notify the PRA within one month of initiation for transactions that result in capital benefit.[35] In the European Union, supervisors can object to the recognition of capital relief where it is not justified by a commensurate transfer of credit risk, even if these quantitative criteria for risk transfer are met.[36] The European Central Bank (ECB) set out a supervisory notification process for banks that seek capital relief via SRT. It calls on banks to provide notice at least three months in advance of the expected closing date of the transaction.[37] In the United States In the US and Canada, provided that the transaction structure satisfies requirements under the relevant capital regulation, supervisors generally do not require pre-approval or notification of SRTs that will result in capital relief.[38,39] However, banks typically engage their supervisors to confirm the eligibility of novel or more complex transactions.

4.3 Early termination provisions[40]

Supervisors set restrictions on and scrutinise early redemption or termination provisions of credit protection to ensure they satisfy criteria for effective risk transfer. Provisions may be permissible if they

[34] As an example, see approval letters available at www.federalreserve.gov/supervisionreg/legalinterpretations/bhc_changeincontrol2023.htm.

[35] Bank of England Prudential Regulation Authority, *Supervisory statement SS9/13: securitisation: significant risk transfer*, July 2020, www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2020/ss913update-july-2020.

[36] See Regulation (EU) no 575/2013 of the European Parliament and of the Council, Article 245, eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20250101.

[37] Public guidance on the recognition of significant credit risk transfer. The ECB is piloting a fast-track process, aimed at reducing the lead time for SRT applications significantly. See European Central Bank, "Securitisations: a push for safety and simplicity", *Supervision Newsletter*, 19 February 2025, www.bankingsupervision.europa.eu/press/supervisory-newsletters/newsletter/2025/html/ssm.nl250219_1.en.html.

[38] In the case of directly issued CLNs, the Federal Reserve provided guidance on requests that banks may pursue to obtain capital relief. This guidance clarified that although the characteristics of directly issued CLNs do not specifically satisfy the definition of synthetic securitisations, the Federal Reserve acknowledges that CLNs can, under certain conditions, transfer risk at least as effectively as synthetic securitisations that qualify under the US capital rule. Federal Reserve, *Frequently asked questions about Regulation Q,* 28 September 2023, www.federalreserve.gov/supervisionreg/legalinterpretations/reg-q-frequently-asked-questions.htm.

[39] In November 2025, the Office of the Superintendent of Financial Institutions issued for public consultation certain requirements related to SRT notification and reporting. See www.osfi-bsif.gc.ca/en/guidance/guidance-library/capital-adequacy-requirements-car-2027-chapter-6-securitization#toc-id-0.

[40] The related provisions in the Basel Framework are included in CRE40.25 to CRE40.30.

are not at the discretion of the protection provider or if they cannot be initiated by the bank without supervisory approval (absent regulatory, tax or legal events that are outside the bank's control). In some cases, controlled early amortisations may be allowed, provided a limited amount (eg no more than 10%) of the original notional exposure of the portfolio remains outstanding or the resultant reduction in risk transfer and increase in capital requirement of the remaining exposures is limited (eg time calls allow banks to terminate the protection after the weighted average life of the underlying portfolio and before the final maturity).

4.4 Currency and maturity mismatches

Currency and maturity mismatches between the underlying exposures and the protection provided reduce the effectiveness of an SRT's credit risk mitigation. For currency mismatches, supervisors apply an adjustment that considers the proportion of loans within the reference portfolio that are denominated in a currency other than that of the protection provided in line with CRE22.82.

Where an underlying portfolio includes exposures with different maturity dates, supervisors generally require the bank to use the longest residual maturity of any of the individual protected exposures as the residual maturity of the entire protected portfolio. Banks carefully monitor the nature of the underlying assets to identify extensions of individual loans that might result in changes to the entire portfolio's residual maturity, possibly removing loans with maturities that extend beyond the terms of the protection in order to preserve intended capital relief. Indeed, banks would have to hold additional capital for maturity mismatches between the protection and the protected portfolio when the residual maturity of the protection falls below five years. Early termination provisions could further reduce the maturity of the protection (see Section 4.3 above).

4.5 SRT financing

Supervisors are in the early stages of understanding banks' SRT financing activities and determining appropriate prudential approaches to address associated risks. While there are few explicit limits on financing in current Pillar 1 requirements, supervisors may exercise their authority to apply higher capital requirements to exposures that may not be appropriately capitalised under Pillar 1 requirements.

Supervisors have made recent public statements on SRT financing being an area of focus. In April 2025, the UK PRA set out its supervisory concerns in this regard via a public Dear CFO letter which reinforces Basel standards associated with the trading book/banking book boundary for illiquid and structured financing portfolios, with a specific focus on SRT financing. The ECB published a newsletter in February 2025 that acknowledged that bank financing of SRT could lead to hidden risks being retained in the banking system, with lower capital coverage overall, and expressed an expectation that banks identify and mitigate risks linked to interconnectedness with securitisation investors.[41] The European Banking Authority (EBA) acknowledged such risks in its June 2025 *Risk assessment report*.[42] The International Monetary Fund (IMF) noted concerns about leverage in SRTs in its October 2024 *Global financial stability report*, citing anecdotal evidence of banks providing leverage for credit funds to buy CLNs issued by other banks.[43]

[41] European Central Bank, "Securitisations: a push for safety and soundness", *Supervision Newsletter*, 19 February 2025, www.bankingsupervision.europa.eu/press/supervisory-newsletters/newsletter/2025/html/ssm.nl250219_1.en.html.

[42] European Banking Authority, *Risk assessment report of the European Banking Authority*, June 2025, www.eba.europa.eu/sites/default/files/2025-06/93431cb8-4877-4325-82f9-0a41ba71e45a/Risk%20Assessment%20Report%20Spring%202025.pdf.

[43] International Monetary Fund, *Global financial stability report: Steadying the course: uncertainty, artificial intelligence, and financial stability,* October 2024, www.imf.org/-/media/files/publications/gfsr/2024/october/english/textrevised.pdf.

4.6 Recognition as credit risk management

Supervisors generally do not set explicit limits on the extent to which banks engage in SRTs for purposes other than regulatory capital relief, such as for internal credit risk limit management purposes. However, supervisors engage with banks on their use of SRTs for such purposes to assess whether specific transactions or the approach used by the bank contribute to prudent risk management.

4.7 Disclosure and reporting expectations

Banks are expected to disclose qualitative and quantitative information on their securitisation exposures via Pillar 3 reporting expectations, although the level of detail provided differs by jurisdiction. As a consequence, supervisors rely on regular engagement with banks active in SRTs to monitor developments in outstanding transactions.

In the European Union and the United Kingdom, originators must disclose any underlying documentation that is essential for understanding the transaction to investors and market supervisors. They are also required to report to investors on the performance of the underlying assets on a quarterly basis, and to report detailed data on the SRT structure and the underlying pool to the supervisor.[44] Originators disclose their use of SRTs and its impact on capital through Pillar 3, though the level of detail varies. In Europe, it is only mandatory to disclose the aggregate RWA of securitisation positions (not necessarily exclusive to SRTs) while banks may voluntarily disclose further details such as type of assets, number of transactions and aggregate RWA or capital savings. In the United States and Canada, there are no specific regulatory reporting requirements applicable to SRTs.

5. Potential risks to banks

Banks' use of SRTs may give rise to a number of potential risks. Several of these risks are acknowledged by market participants and by current regulation and are, to some extent, being actively mitigated by stakeholders. However, further growth of SRT markets may make these risks more relevant from both supervisory and macroprudential perspectives. This merits close monitoring by supervisors. Other risks may emerge as SRT markets evolve.[45]

5.1 Risks arising from banks' high dependence on SRT

While SRTs provide risk-bearing capacity, their use results in bank lending that is subject to lower capital requirements, supported by cash collateral or guarantees, with a maturity that may not match the bank's ongoing relationship with its clients. Banks that heavily rely on SRTs to manage credit risk and their capital position could become vulnerable to market fluctuations and to shocks affecting the health of the NBFI sector that serve as protection providers, and their credit provision could become procyclical.[46]

Banks often intend to maintain lending relationships beyond the maturity date of the SRT. In that case, they would need to structure a new SRT transaction, raise equity or sell the loan to avoid a decrease

[44] See Article 7 of the EU Securitisation Regulation.

[45] A recent IMF working paper highlights concerns similar to those discussed in this report. See F Cortes, G Fernandez Dionis, Y Li, S Ramirez and X Zhang, "Recycling risk: synthetic risk transfers", *IMF Working Paper*, no 25/200, 2025, www.imf.org/-/media/files/publications/wp/2025/english/wpiea2025200-source-pdf.pdf.

[46] Similar concerns may apply to guarantees or CDS, if these instruments were to be used widely to transfer credit risk to NBFIs.

in capital ratios.[47] This means the lending capacity of the bank is partially dependent on the ability and willingness of NBFI protection providers to take on credit risk. The ability of a bank that wishes to replace a maturing SRT transaction to do so may depend on a combination of factors under the bank's control and on exogenous factors. The former includes a bank's performance, governance, underwriting standards and credit management processes. The latter could include macro-financial developments or a shift in investor appetite for the credit risk of bank loans. These factors could make it difficult or prohibitively expensive for banks to conduct SRTs, especially if they arise together.

The effects on bank capital of an inability to issue new SRTs could be compounded by poor performance of the portfolios protected by outstanding SRTs. If credit losses on these portfolios exceed the projections made at the inception of the SRT transactions, the risk-bearing capacity provided by SRTs could be significantly depleted. If risk transfer criteria are no longer met, capital requirements on retained senior and mezzanine tranches may increase sharply.[48] Similarly, reliance on unfunded SRTs could add to bank stress, as banks must hold capital against the risk that the SRT protection provider would default on its obligations and this capital depends on the credit quality of the protection provider. Additionally, poor performance of assets underlying SRTs might deter potential investors.

High dependence on SRTs as a means to maintain risk-bearing capacity may be of more concern during economic downturns, when credit losses are high and investor appetite for risk is limited. In this case, banks using SRTs to transfer risks might face the same issue at the same time. From a macro-financial perspective, the aggregate credit supply could become more procyclical, and more dependent on the financial strength of the NBFI sector. A contraction in credit caused by a protracted freeze in SRT markets could exacerbate an economic downturn and increase stress in the non-financial sector, possibly triggering an adverse deleveraging feedback loop.

Banks' dependence on SRT transactions could be mitigated in several ways. Banks can manage execution and rollover risk by spacing out SRT maturities and matching the maturity of SRT protection to that of the underlying loans. While these mitigation strategies help protect the banks, they may not mitigate the risks for bank customers, who may face difficulties with rolling over their loans and obtaining new credit. Risks may grow if banks use few protection providers and do not apply high standards of scrutiny when selecting protection providers.[49] Prudent SRT structuring can mitigate a bank's concern about whether the protection provided by investors is adequate. For example: structuring relatively thicker tranches for lower credit quality and/or less granular reference portfolios; ex ante counterparty, industry and geographical diversification; close monitoring and stress-testing of underlying pools; appropriate scrutiny or limits on the use of unfunded SRTs; appropriate margining and netting arrangements for unfunded SRTs; and prudent amortisation mechanisms.[50] Investors can also mitigate risk by applying due diligence to lender's origination and credit management practices and diversifying their SRT exposure. While risk mitigation techniques are used by market participants, it is not clear whether they are sufficient to address the underlying risk, as the SRT market has grown in the past few years in an environment of subdued credit losses, which may not have put it to a real test.

Supervisors who monitor the risk of banks' dependence on SRT transactions have been or could consider assessing a range of metrics, including the overall capital relief obtained by individual banks and the banking system, the share of assets and specific portfolios protected by SRT in the respective totals,

[47] While banks often structure SRTs to provide protection until the expected maturity of the underlying loans, these loans may represent long-term customer relationships and customers may depend on these relationships for funding beyond the legal maturity of specific loans.

[48] Credit losses are likely to affect non-securitised exposures at the same time, as banks are expected to apply the same credit origination and management policies regardless of whether the exposures are protected by SRT.

[49] A narrower investor base may have an advantage as it can develop expertise in monitoring loan pools and discipline banks to maintain sound lending standards, mitigating other risks associated with SRT use.

[50] For example, if pro-rata amortisation is used, banks should include triggers that can switch transaction amortisation back to sequential structure to allow a build-up of protection proportion if credit risk deteriorates beyond pre-defined levels.

the cost of obtaining credit protection via SRTs, the maturity structure of outstanding SRTs and any maturity mismatches between SRT and underlying assets. Supervisory tools and upper limits on the proportion of lending covered by SRTs or on capital relief via SRTs could serve as the means to limit potential risks of overreliance on SRTs. Moreover, if banks obtain credit protection at a high cost, BCBS guidelines lay out an expectation for supervisors to scrutinise high-cost credit protection transactions closely and consider the relevant costs of protection purchased when assessing a bank's capital adequacy.

5.2 Risks related to bank funding to SRT protection providers

Bank-provided financing of SRT protection providers against SRT collateral could reduce the extent of risk transfer from banks to the NBFI sector and increase interconnectedness. This is because it leads to protection offered to banks to absorb credit losses being partly funded by debt to banks.[51] Reliance of NBFIs providing protection to banks on short-term market financing may amplify the risks outlined in Section 5.1 as the availability of such financing could influence the appetite and ability of NBFIs to continuously provide protection to banks. SRT financing exposes banks to credit and counterparty risk, and SRT protection providers to funding risk as the maturity of the financing transactions is usually shorter than that of the SRT collateral. If protection providers take too much risk and fail to repay the secured loan or if they are unable to roll over secured loans at maturity, the bank would take the SRT note as collateral and try to liquidate it. In doing so, the bank would effectively become a protection provider. The value of the SRT note is likely to decline sharply in such a scenario. Even if the quality of the SRT note is robust, to date SRTs are highly illiquid. Especially if the repo transaction is held in the trading book, for which the risk-based capital requirements are calibrated based on the assumption that the collateral can be liquidated, the capital held against SRT financing transactions may not adequately reflect the underlying liquidation risk.

Banks can mitigate these risks through prudent valuation and haircuts that would reflect the credit risk and liquidity of the collateral, setting exposure limits, decreasing the term of any financing transactions and margining.[52]

5.3 Other potential risks associated with SRT use

Weakening underwriting standards

Although SRT investors aim to gain exposure to loan portfolios underwritten to a bank's credit standards, high demand for SRTs could potentially weaken a bank's incentives to prudently screen and monitor its borrowers. Weaker origination standards may increase the total amount of risk in the financial system, reducing overall resilience and amplifying financial cycles.

Banks have faced strong incentives to date to maintain prudent underwriting standards to facilitate their ability to market their SRTs at a reasonable cost. To date, SRT investors appear to be primarily focused on the track record of underwriting banks. Associated risks could be further mitigated by the monitoring of lending standards by supervisors and diligence by SRT protection providers. To align incentives, some jurisdictions require banks to retain a share in the transferred portfolio and not to

[51] Hypothetically, banks may also provide protection to other banks by investing in SRT notes. However, that SRT note, if held directly, would attract a 1250% risk weight if the SRT note represented a first loss position and a very high risk weight if it were a mezzanine position, making such transactions uneconomical.

[52] Margins may be linked to triggers, which could be related to ratings, credit spreads or net asset value of the counterparty. These mitigating actions may be procyclical as they would require the SRT protection provider to post more collateral or reduce recourse to repo financing at the same time as it would face financial stress.

differentiate the lending standards between retained and securitised portfolios.[53] SRT protection providers can monitor and assess the transferred portfolios and bank credit management practices as part of the transaction process, though SRT markets can be opaque.

Resecuritisation of SRTs

Resecuritisation of SRT transactions refers to the synthetic transfer of credit risk of existing SRTs.[54] While resecuritisation of synthetic securitisations emerged prior to the GFC, the investigation team has not identified instances of SRT resecuritisation.[55] If market participants were to engage in resecuritisation of SRTs, it would make it difficult for market participants and regulators to assess the risk retained by the originating bank and the protection provided by the newly created tranches. Modelling complexity and reduced transparency can mask the true risk profile of SRT exposures, potentially allowing a reduction in capital requirements without a commensurate decrease in the underlying risk exposure. Furthermore, resecuritisation exposures are generally subject to substantially more conservative treatment under the Basel standard (eg higher supervisory p-factor).

Step-in risk

Step-in risk refers to the risk that a bank provides financial support to an unconsolidated entity experiencing stress beyond or in the absence of any contractual obligations (eg to prevent reputational damage or to maintain market confidence).[56] The potential for step-in risk challenges is present whether or not the core objective – to transfer credit risk off the bank's balance sheet – is truly met. In the SRT context, the possibilities for banks to terminate SRT early is an example of step-in risk; however, such possibilities are tightly restricted (see Section 4.3). Another form of step-in risk could materialise if a bank were to provide financing to a protection provider that faces constraints in accessing the repo market. Banks are expected to identify and manage step-in risks, including specifically for securitisation vehicles.[57]

6. Summary and conclusions

SRTs enable banks to obtain credit protection on a portfolio of loans to reduce credit risk exposure and the corresponding regulatory capital requirements. SRTs take a variety of forms and are usually structured as funded transactions, which means the counterparty provides collateral upfront and losses are offset against that collateral on an ongoing basis. SRT protection is most often provided by NBFIs, such as specialist credit funds, hedge funds, insurers and pension funds, as well as by development banks.

Banks use SRTs as part of a broader capital planning process and credit risk management toolkit, which includes true-sale securitisations, CDS, guarantees, credit insurance and loan sales as well as issuance of capital instruments or retention of profits. A key feature of SRTs is that they allow banks to obtain protection on a portfolio of loans while maintaining customer relationships with these borrowers.

[53] For example, in the European Union, Article 9 of the Securitisation Regulation explicitly requires that originating institutions shall apply to securitised exposures the same sound and well-defined criteria for credit-granting which they apply to non-securitised exposures. See eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20250101.

[54] Resecuritisation should be seen as a different process from retranching, which may refer to splitting existing tranches into thinner tranches that address risk-return expectations of different investor types.

[55] Resecuritisation is not permitted in some jurisdictions. In the European Union, the Securitisation Regulation prohibits resecuritisation, with the exception of certain legitimate purposes. Similar regulations apply in the United Kingdom.

[56] V V Acharya, P Schnabl and G Suarez, "Securitization without risk transfer", *Journal of Financial Economics*, vol 107, no 3, March 2013, pp 515–36, pages.stern.nyu.edu/pschnabl/research/AcharyaSchnablSuarez2013.pdf.

[57] Basel Committee on Banking Supervision, *Guidelines on identification and management of step-in risk*, October 2017, paragraph 27, www.bis.org/bcbs/publ/d423.htm.

Banks view SRTs as particularly advantageous for loan portfolios that incur regulatory capital requirements that they deem to be higher than their economic capital needs.

SRTs can provide investors with access to loan portfolios that they may otherwise be less able to access. Investors value that the exposures underlying SRTs are underwritten to a bank's credit standards, and that the bank bears the expense associated with origination and servicing of the exposures. SRTs allows investors to benefit from embedded leverage. Some investors use secured financing from banks to further leverage their exposure to bank credit portfolios via SRTs.

The use of SRTs has increased steadily in recent years, in part due to increased clarity around associated regulatory requirements. Euro area, UK and North American banks are among the most active SRT issuers. While G-SIBs have traditionally accounted for the large majority of SRT issuance, smaller banks are becoming active. The scale of SRT issuance remains moderate relative to the total credit exposures of the banks, with large variation across banks. However, banks, investors and market analysts expect the use of SRTs to grow further.

Given growth in their usage and evolution in their structure, supervisors are focused on determining whether SRTs achieve effective risk transfer and/or introduce additional risks into the banking system. Supervisory reviews of individual SRT structures cover, among other things, complex features, currency and maturity mismatches, and provisions for early termination. They may require the bank to limit the capital relief benefit achievable via SRTs, increase Pillar 2 requirements or restrict the use of SRTs if they conclude the capital relief of the SRT is not commensurate with the risk transfer achieved via the transaction. Supervisors generally do not set explicit limits for the overall use of SRTs for regulatory capital or credit risk management purposes, although they may do so in some cases such as the limit set for the direct issuance of credit-linked notes in the United States.

Banks' usage of SRTs can be opaque to market participants. Pillar 3 disclosures are valued as they enable an estimate of the capital relief obtained through SRTs. However, further granularity of public data on protected portfolios, investors in SRTs and costs of SRTs could be desirable to provide a clearer picture of how a bank's use of SRTs affects its risk profile.

Given the growth of SRTs, it is important that supervisors continue to monitor their use and resilience under stress conditions. Excessive reliance on SRT could reduce the resilience of the banking system if the risk-bearing capacity of transactions were to fail. Sustained credit provision may become conditional on banks' ability to replace maturing SRTs with new transactions, introducing a rollover risk not to be found with traditional equity issuances. It may also make the credit supply more dependent on NBFIs, which provide credit protection, and increase interconnectedness between banks and NBFIs. As a result, bank capital and credit provision could become more procyclical. Bank capital requirements could increase significantly if SRT markets freeze for an extended period or if losses on underlying assets exceed expectations. Banks can mitigate this risk by aligning the maturities of SRTs and loans, staggering the maturities of SRT issuances, diversifying their protection providers and utilising funded SRT transactions. Investors can also mitigate risk by screening bank origination and credit management practices at inception and during the lifetime of the transaction. While these risks are understood and acknowledged, the robustness of the SRT structures and markets to sizeable loan losses has not yet been tested.

The use of leverage by SRT investors reduces the amount of equity provided by NBFIs to absorb credit losses, which is replaced by short-term debt provided by banks and could imply that transferred credit risk comes back to the banking sector. Data gaps hinder assessment of the scale of bank funding to SRT investors. Banks which fund investors in SRT transactions can mitigate the credit risk by applying prudent haircuts and limits, assessing liquidity of the SRT collateral, and not accepting their own SRTs as collateral – since this would go against the very core principle of risk transfer.

Supervisors are monitoring emerging risks as the SRT market evolves. Increased investor demand for SRTs may lead to pressures to weaken loan origination standards, amplifying credit cycles and undermining resilience.

Compared with the pre-GFC securitisations, SRTs in use recently appear to be more prudently structured and managed, both by banks and investors. Enhanced prudential regulation and supervision have contributed to more sound risk transfer practices. However, the SRT market is evolving in its scale and transaction structures. Growth in SRT usage should continue to be carefully monitored relative to the potential risks highlighted in this report. The increased interconnectedness of banks and NBFIs via the SRT market may warrant closer cooperation and coordination between banking supervisors and regulators and supervisors of NBFI entities, to ensure that financial stability risks are monitored and addressed in a timely manner.

Annex – Comparison of traditional and synthetic securitisations

Comparison of traditional securitisations and synthetic structures

Pre- and post-GFC Table 1

Features	Pre-GFC traditional securitisation	Post-GFC traditional securitisation	Pre-GFC synthetic structures	Post-GFC synthetic structures
Banks' risk retention level	**Minimal risk retention**. Banks typically sold exposures outright to SPEs achieving full derecognition of assets from their balance sheets.	**Explicit risk retention requirements**. Regulatory reforms, including national implementations in line with Basel III and IOSCO recommendations, have introduced explicit risk retention requirements – although the Basel III framework itself does not mandate them. Basel III framework imposes higher capital requirements on resecuritised exposures.	**Minimal risk retention.** Risk commonly transferred to third parties via credit default swaps.	**Explicit risk retention requirements in some jurisdictions** (eg European Union, United Kingdom).
Supervision and regulation	**Limited supervisory scrutiny.** Cross-jurisdictional inconsistencies.	**Standardised capital requirements**.	**Limited supervisory scrutiny.** Cross-jurisdictional inconsistencies.	**Standardised capital requirements and enhanced supervisory review processes**.
Use and scale	**Rapid growth leading up to the GFC**, driven by mortgage-backed securities, asset-backed securities, and collateralised debt obligations.	**More selective use and focus on high-quality and transparent structures with "true" credit risk transfer**.	**Banks expanded use for large corporate and SME loan portfolios** without true sale requirement.	**Growing usage, but subject to limits on use and scale**.
Investors and protection providers	**Wide investor base**, tranches sold widely in public and private markets.	**More sophisticated, risk-aware institutional investor base**. Constrained by stricter rules and requirements.	**Protection provided by insurance companies** (eg AIG), **monoline insurers and SIVs**.	**Predominantly institutional investor base** including credit funds, hedge funds, pension funds, insurers, development banks and other institutional investors
Renewal risk upon expiry of protection	**Low renewal risk** mitigated by the fact that most securitisations were longer term and funded.	**Low renewal risk** as most traditional securitisation structures are funded via "true sale".	**Higher renewal risk**, especially in structures with liquidity put options or rolling short-term liabilities.	**Higher renewal risk.** Originating banks must manage the potential need to replace or extend protection to maintain capital relief and risk management objectives.

Re-securitisation considerations	Collateralised debt obligations squared (CDO-squared), and ABS CDOs were common, with increasing opacity in underlying asset quality.	**Heavily discouraged or banned in some jurisdictions**	Often embedded in re-securitised products or used as protection legs in synthetic CDOs. Their opaqueness and reliance on CDS made them less understood by regulators and investors.	**Heavily discouraged or banned in some jurisdictions**. Regulators and market participants have adopted a more cautious stance towards resecuritisation. Basel III framework imposes higher capital requirements on resecuritised exposures.

GFC = Great Financial Crisis, SPE = special purpose entity, IOSCO = International Organization of Securities Commissions, SIV = structured investment vehicle, CDO = collateralised debt obligation, ABS = asset-backed securities.

Sources: The Joint Forum, *Credit risk transfer: developments from 2005 to 2007*, July 2008, www.bis.org/publ/joint21.htm; Financial Stability Forum, *Report of the Financial Stability Forum on enhancing market and institutional resilience*, April 2008, www.fsb.org/uploads/r_0804.pdf; Bank of England, *Financial stability report*, no 26, December 2009, www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2009/december-2009.pdf; Office of the Superintendent of Financial Institutions Canada, *2006–2007 to 2008–2009: Report on plans and priorities*, www.tbs-sct.canada.ca/rpp/2006-2007/osfi-bsif/osfi-bsif-eng.pdf; International Monetary Fund, *Global financial stability report: containing systemic risks and restoring financial soundness*, April 2008, www.imf.org/en/publications/gfsr/issues/2016/12/31/global-financial-stability-report-april-2008-containing-systemic-risks-and-restoring-21707.