

# Banking Brief: Barclays And Santander Lead European Banks' Significant Risk Transfer Activity

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**Significant risk transfer (SRT) securitizations are an established part of European banks' capital and risk management toolkits.** Pillar 3 disclosures on retained SRT tranches indicate that the region's largest lenders dominate issuance volumes, led by Barclays and Santander. Some midsize banks are also active relative to their balance sheet sizes. S&P Global Ratings thinks that SRT issuance will grow and become broader based as further banks look to manage their credit portfolios more actively through the implementation of the final Basel III standards.

**PRIMARY CREDIT ANALYST**

**Richard Barnes**  
London  
+ 44 20 7176 7227  
richard.barnes  
@spglobal.com

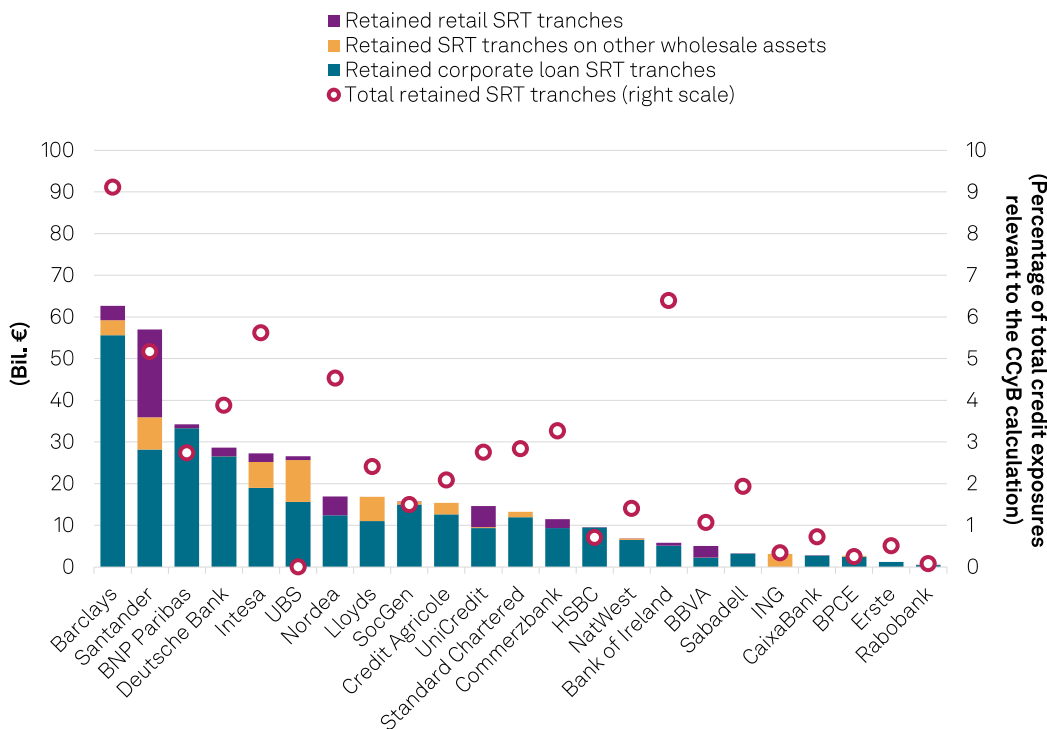
**SECONDARY CONTACTS**

**Matthew S Mitchell, CFA**  
Paris  
+33 (0)6 17 23 72 88  
matthew.mitchell  
@spglobal.com

**Andrew H South**  
London  
+ 44 20 7176 3712  
andrew.south  
@spglobal.com

## Barclays and Santander lead European banks' SRT activity

Banks' non-trading book exposures to originated SRTs



The data for BPCE and UBS include all originated securitizations, some of which may not be SRTs. Total credit exposures relevant to the CCyB calculation exclude certain counterparties such as governments and central banks. The figure for total credit exposures relevant to the CCyB calculation is not available for UBS. CCyB--Countercyclical buffer. SRT--Significant risk transfer. Source: Tables SEC1 and CCyB1 from June 2024 Pillar 3 reports. Copyright © 2024 by Standard & Poor's Financial Services LLC. All rights reserved.

## Background In Brief

We see Pillar 3 disclosures on retained SRT tranches as a reasonable indicator of banks' issuance activity because transaction structures are similar--but not identical--across the region. European banks' SRTs are mostly bilateral, synthetic deals in which they typically retain the senior tranche representing about 80%-95% of the reference portfolio and sometimes a small first loss tranche covering the expected losses on the reference loans. They usually sell a mezzanine tranche that is generally up to about 15% of each deal and transfers most unexpected losses on the portfolio to the protection seller.

## What's Happening

### **Strong investor demand for SRTs lowers the cost of capital and encourages new issuance.**

SRTs enable banks to assign future credit losses on reference loan portfolios to third-party investors. The transactions provide regulatory capital relief and mitigate expected loss provisioning requirements under International Financial Reporting Standard 9. SRTs have existed for a long time in Europe and banks historically used them primarily to offset regulatory risk-weighted asset inflation. Issuers' motivations have since moved on to proactive management of loan books to improve capital efficiency and shareholder returns.

## Why It Matters

**SRTs have a track record of loss absorption.** For example, Barclays disclosed in its second-quarter 2024 results that it had claimed about £250 million of credit losses since 2016 through its SRTs. Similarly, Deutsche Bank reported credit loss provisions on two particular corporate exposures in its third-quarter 2024 earnings, and said that about 70% of this sum was mitigated by credit concentration hedges. Corporate loans are the traditional focus of European SRTs but we see growing activity in other wholesale asset classes and retail loans.

**We see well-designed SRTs as an effective capital and risk management tool.** They complement similar measures including loan syndications and trading position hedges. We do not see a material risk of a bank becoming overly dependent on SRTs in view of the limited market size and regulatory constraints including the leverage ratio requirement.

**SRTs contribute to the transfer of traditional banking risks to non-banks.** Most European SRTs are funded structures in which investors collateralize their potential obligations. European banks typically sell one or more junior SRT tranches and we have not found evidence of material leverage or direct bank financing of investors' positions, although there is a lack of data in these areas. Banks may provide secured financing to funds that invest in SRTs but this exposure is largely in the form of subscription lines, which are secured on the limited partners rather than the fund assets.

## What Comes Next

**Regulatory changes will influence the development of the European SRT market.** European regulators appear generally supportive of SRTs and the broader securitization market. Examples include:

- In their implementation of the final Basel III securitization rules, EU authorities compromised on the level of the non-neutrality p-factor add-on to help maintain the risk-sensitivity and economic viability of SRTs. The U.K. regulator has proposed a similar approach.
- The September 2024 Draghi report on EU competitiveness recommended measures to encourage the growth of the region's underdeveloped securitization market. A subsequent European Commission consultation paper invited feedback on the regulatory framework for securitization, including SRTs.
- The U.K. regulator has proposed joining the EU in recognizing unfunded credit protection, which is generally provided by highly rated investors such as certain insurers and multilaterals.

**SRTs are likely to become more expensive for issuers.** Despite the regulatory concessions, we expect that banks will need to sell thicker tranches to achieve capital relief under the final Basel III standards. In addition, as SRT supply increases, transaction pricing may not remain as favorable to issuers as it has been so far this year.

## Related Research

- ABS Frontiers: The Credit DNA Of Synthetic Risk Transfer Securitizations, Sept. 3, 2024
- ABS Frontiers: Looming Basel 3.1 Rules Could Incentivize More Bank Securitization, June 3, 2024
- Banks Ramp Up Credit Risk Transfers To Optimize Regulatory Capital, Feb. 22, 2024

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