SECTOR IN-DEPTH
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TABLE OF CONTENTS

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Banks – Europe

SRTs to support bank capital despite concentration and regulatory scrutiny

Significant risk transfers (SRTs), which allow banks to reduce the capital charge on their loan portfolios by transferring associated credit risk to investors, have grown significantly in Europe. Fourteen of the largest European rated banks surveyed by Moody's have outstanding SRT transactions based on a total of €246 billion in loans. This reduces their risk-weighted assets (RWAs), reinforces capital ratios, but with a lower form of capital that can introduce some counterparty risk. Moreover, the SRT investor base is narrow and some investors have used SRT assets as security for loans from banks that also originate SRT transactions. Regulators are supportive but highlight potential interconnectedness and correlation risk.

European SRTs continue to grow. Total new SRT transactions in Europe rose to €156 billion in 2024 from €77 billion in 2021, according to the Assocation for Financial Markets in Europe (AFME)[1], rivaling public securitization markets. The 14 rated banks we surveyed have 181 outstanding SRT deals between them, referencing a pool of over €246 billion of loans, that represent around 6% of total loan books.

SRTs reduce surveyed banks' RWAs, with a lower form of capital. For our surveyed banks, RWAs related to the reference pool of loans fall from around €117 billion to just below €29 billion once the SRT benefits are incorporated. We calculate that this leads to an average uplift of 43 basis points to the surveyed banks' tangible common equity (TCE) ratios. We consider SRTs to be lower quality than CET1, given they can engender some counterparty risk.

Structures are mainly collateralised. The majority of surveyed banks' SRTs are collateralized - with segregated cash collateral available to absorb potential losses and offset counterparty risk from protection sellers. From the survey only 10% of SRTs have no collateral. Such unfunded SRT transactions remain relatively rare, are allowed only in Europe but are likely to grow. Around a quarter of surveyed banks have bespoke SRT structures.

SRT investor base is concentrated. The top 10 SRT investors hold about 75% of each bank's outstanding SRT exposure, and the top three about 50%. Specialized credit funds are the biggest category of investor. Around 20% of surveyed banks have advanced loans to SRT investors that are secured by SRT tranches, creating manageable interconnectedness and correlation risk. Though only 7% of banks lends against collateral references their own SRTs.

Supervisors are supportive, but are highlighting certain risks. The European Central Bank (ECB) is devising a fast track approval process for SRT related capital relief but has also warned that SRT deals bring potential correlation risk as banks are lending to investors in SRTs. The UK's Prudential Regulation Authority (PRA) has highlighted cases of insufficient collateral assessment in SRT lending and The International Monetary Fund (IMF) has cautioned that SRTs increase interconnectedness and systemic risk. The Basel Committee is also actively considering the benefits and risks of SRTs.

European SRTs continue to grow

The fourteen banks, that are all rated and among some of the largest in Europe, we surveyed had structured 181 SRT transactions referencing a pool of over €246 billion of loans as of year end 2024. This represents approximately 6% of the total loan books of the surveyed banks at the same date. The earliest SRT issuance among the surveyed group was in 1999, and many indicated that their first transactions took place in 2000 - 2010. Many lenders in Europe, the UK and Ireland also for the first time reported SRT issuance as part of their 2024 results, and plan to continue using such transactions to support their capital (see highlight box for an illustrative example of an SRT transaction).

According to IMF, $1.1 trillion in assets have been securitized using SRT globally since 2016, with Europe accounting for two thirds of the total[2]. According to the AFME, the reference pool for new European SRT transactions grew to €156 billion in 2024 from €77 billion in 2021[3], a compound annual growth rate of 26%. This means the SRT market is now approaching the size of the European public securitization market, which has annual issuance of around €240 billion.

The SRT market's size and recent rapid growth, driven by strong investor demand and bank capital management, reflects the benefits SRT transactions yield for banks. They allow banks to transfer credit risk from their balance sheets, thus reducing their risk-weighted assets (RWAs) and freeing up capital for other purposes[4]. SRTs can therefore be seen as a tool for banks to support their risk-based capitalization metrics, alongside earnings retention, balance sheet contraction, asset disposals and business mix changes. SRTs are also a tool to help banks manage increased regulatory capital requirements that will likely come from the updated Basel III capital regulations (also described as Basel IV, or Basel 3.1 in the UK). Under these regulations, there will be a limit on the benefit of using internal ratings based (IRB) approaches to assess RWAs. We expect this to be a driver for SRTs from a bank perspective.

SRTs can also help banks manage loan portfolio concentrations to particular industry sectors, geographies or individual borrowers. The reference pools for the SRTs of our 14 surveyed banks include large, midsized and small corporate loans, residential mortgages, unsecured consumer loans, commercial real estate, leveraged acquisition finance and project finance loans.

SRT transactions expose banks to the investors that take on their credit risk (counterparty credit risk) as a result banks typically require collateral to protect them against potential investor defaults, or deteriorations in investor creditworthiness.

SRTs reduce banks' RWAs, yet with a lower form of capital versus common equity

For our 14 surveyed banks, RWAs related to the pool of loans subject to SRT transactions falls from around €117 billion to just below €29 billion once the SRT benefits are incorporated. This represents a decline of 281 basis points in their total RWAs, which stood at €3 trillion as of December 2024. We estimate that the reduction in RWAs yields an average uplift of 43 basis points to their aggregated tangible common equity (TCE) capital ratios from 15.2% to 14.7%, showing that SRTs are still only a small share of the surveyed bank's capital source.

The weighted average terms remaining of the SRTs is 3.8 years versus an average term of 4.6 years for the loans in the reference pools. Of the SRT structures subject to our survey, 79% allow banks to add new loans into the revolving reference pool and 57% allow for the substitution of loans into the reference pool.

We expect European banks to continue using SRT transactions, encouraged by strong investor demand. Good investor interest in the asset class means that the duration mismatch between SRT transactions and the loans in the underlying reference pools will pose only a limited risk, assuming no significant losses.

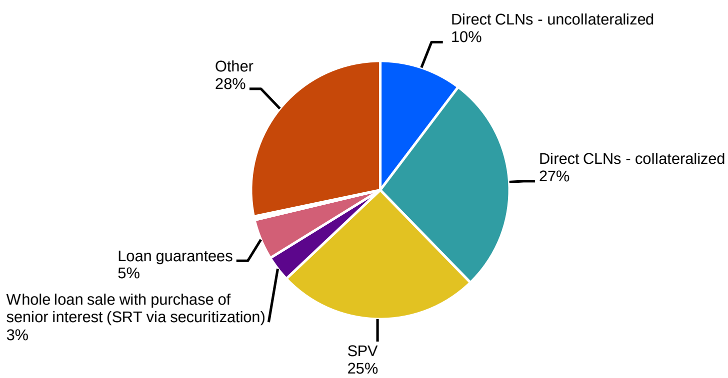
However, despite the benefits of SRTs, we also consider them to broadly be a lower form of capital than actual TCE and their extensive use could create dependence issues from banks. Capital relief granted in a transaction is point-in-time in nature whereas the underlying reference pools are dynamic and their creditworthiness can deteriorate in an unexpected manner, leading to higher risk weights on the tranches retained by the bank of the SRT which could negate the initial capital relief granted. SRT transactions are also complex in terms of modeling and legal documentation, and require strong risk management capabilities from banks, in addition to the their business as usual risk and operational management. Importantly, if not properly managed, deteriorating creditworthiness or a default by the protection seller could generate material losses at banks, which is why banks require collateral to address this risk.

Structures are mainly collateralised

Our survey shows that the majority of structures are collateralised, with segregated cash to offset the counterparty risk that SRT structures engender. From an economic perspective, most European SRTs are essentially insurance contracts that can be flexibly adapted to the two counterparties' needs. For example, originating banks have the option of using a special purpose vehicle, and the credit risk transfer or insurance contract can be based on various instruments, including guarantee agreements, credit default swaps or credit-linked notes.

Based on the 14 banks responses, 27% of SRTs were collateralized CLNs, 25% were executed through special purpose vehicles (SPVs) (Exhibit 1). A further 3% took the form of whole loan sales (including senior interest), and 5% were loan guarantees. The remaining 28% are less easy to categorize, and fall within the “other” grouping. This is because many SRT transactions are bilateral transactions based on specific bespoke terms.

Exhibit 1
Around quarter of our surveyed banks' SRT transactions are bespoke
Breakdown of SRT structures



Source: Moody's Ratings

However, 10% of the SRTs initiated by our sample of banks were uncollateralized, or unfunded in nature and can be structured in the form of a credit default swap (CDS) on a reference pool of assets. In such a structure, the protection seller would not provide cash collateral against its exposure and as a result banks would be exposed entirely to the counterparty risk. An example of what type of asset this could refer to would be longer term loans such as mortgages, where a an investor would not want to have its cash tied up for a significant amount of time. Such longer term structures could suit insurance companies that also tend to have long term liabilities and seen as highly creditworthy and posing limited counterparty risk to banks. Unfunded SRT transactions account for only a small share of the total. They are currently only allowed in the EU and prohibited in the UK. We expect unfunded transactions to likely grow given investor demand for such exposures, their lower pricing versus funded SRTs and if other regulators begin to permit their use, particularly in light of the increasing regulatory capital requirements mentioned previously.

SRT investor base is concentrated

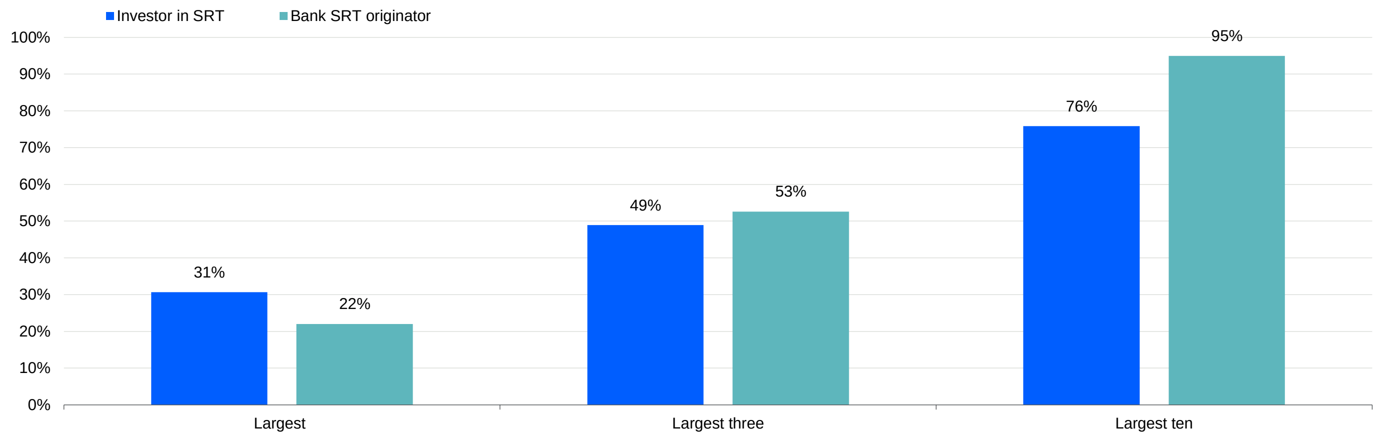
Based on information from the European Systemic Risk Board (ESRB), specialized credit funds, including private debt funds, hedge funds and general credit funds, are the largest counterparties to banks in SRT transactions. Large asset managers also invest in SRTs to complement the overall set of investment strategies they offer to their clients.

Supranational players such as the European Investment Fund, the European Bank for Reconstruction and Development (EBRD) and the International Finance Corporation (IFC) are also investors. Several monoline insurers are active in the SRT space, selling protection to banks via CDS.

A key finding of our survey is that the SRT investor base is highly concentrated. On a weighted average basis across the surveyed banks, the top 10 investors hold about 76% of each bank's outstanding SRT exposure, and top three holding about 49%. The single largest investor holds about 31% (Exhibit 2) of oustanding SRT exposure from the surveyed banks. This creates concentration risk for banks participating in SRT transactions.

There is a similar degree of concentration among the banks in our survey. According to our survey, the single largest SRT originating bank accounts for 22% of the market, the top three combined for 53% and the top 10 for 95%.

Exhibit 2
There is a high degree of concentration among both SRT investors and SRT originating banks
Values refer to percentage of outstanding SRT exposure per our survey



Note: For investor concentration, we use a weighted average of survey respondents top 10, 3 and single investor concentration. For Bank SRT originator concentration, we rank the total outstanding SRT reference pools of SRTs by bank.
Source: Moody's Ratings

The SRT market's lack of transparency makes it hard to establish whether the same investor is acting as a protection seller to several banks at the same time and it is precisely this lack of transparency which increases the risk of concentration in a small number of protection sellers. This compounds concentration risks and counterparty concerns for banks participating in SRT transactions, although at present given the relatively small share of SRTs in bank's overall TCE ratios, the risk is manageable. The market's opacity reflects its unrated nature, and its reliance on a largely private investor base. The extent to which investors are funds, themselves formed of various limited partners, this can serve as an offset to concentration risk.

Supervisors are supportive of the SRT market but are alluding to potential risks

Banks regulated by the ECB must obtain its approval to benefit from SRT related capital relief. As part of its assessment, the central bank considers whether there is any likelihood of the transferred risks being borne by the bank during the term of the transaction. This process currently takes up to three months.

The ECB and the European Banking Federation have jointly developed a fast-track approval that will take significantly less than three months, although it will not be open to more complex SRT transactions. We see this as an example of regulators' intent to support the SRT market while also enhancing transparency.

Regulators highlight risk of SRTs

Regulators are at the same time stepping up their scrutiny of the risks posed by SRT transactions. The ECB has warned of increased interconnectedness and correlation risk if banks lend to investors that also provide them with protection against credit risk through SRT transactions.

Around 21% of our surveyed banks have advanced loans to SRT investors that use SRT tranches as loan collateral. For 7% of the banks, the loan collateral references SRTs originated by the bank itself, creating correlation risk. While the precise volume of loans collateralized with SRT tranches is undisclosed, the ECB has urged banks to “mitigate risks linked to interconnectedness with investors.”

The UK's PRA in April 2025 published a letter to banks' Chief Financial Officers warning that banks are not "demonstrating a sufficiently thorough assessment of collateral eligibility" in securities financing transactions related to SRTs. The letter states that banks have potentially undercapitalized risks, and that as a result the repackaging of illiquid assets into a tradable format may not be enough to realize regulatory capital relief. The regulator has asked the CFO recipients to respond by 11 June in writing with details of how they are addressing the concerns raised. The risk being that banks have lent against illiquid collateral that is potentially insufficient to cover exposures in the event of default by the borrower, exposing the bank to losses.

In October 2024, the IMF also warned that certain characteristics of SRTs could increase risks to financial stability. These included their tendency to enhance interconnectedness by providing financing for SRT investors, effectively retaining risk within the banking system while capital ratios are lower. The IMF also cautioned that overdependence on the SRT market could mask a bank's inability to grow capital organically, and exposing it to risks if investor demand for SRTs tails off.

In March 2025, the Basel Committee also announced it will undertake a deep dive on the SRT market over the next year in which it will "seek to better assess the benefits and risks posed by SRTs" in light of their strong growth.

The regulators' concerns directly reflect the still opaque nature of parts of the SRT market. We consider that this highlights the additional steps banks may need to take to ensure that the capital relief they obtain via certain SRT structures is indeed weatherproof.

Moody's related publications

SRT securitizations help banks manage capital, but increase private debt market exposure, September 2024

Endnotes

1 Amounts refers to the underlying portfolio amount of new transactions issued in the calendar year.

2 October 2024 Global Financial Stability Report, pages 44 and 45.

3 Source: Association for Financial Markets in Europe. Amounts refers to underlying portfolio amount.

4 Please see Exhibit 1 - Example SRT reduces capital requirement for a €2 billion pool by €63 million - in the following report for an overview of a hypothetical SRT transaction: SRT securitisations help banks manage capital, but increase private debt market exposure

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