Capital Relief Transactions

Offering banks the chance to redeploy capital and improve RoE, Capital Relief Transactions[1] (CRTs) are an efficient tool to consider as part of balance sheet and capital optimisation strategies

How CRTs work

- CRTs enable banks to manage risk, reduce their RWAs and increase their CET1 ratio by transferring most of the credit risk of a reference portfolio to a third party investor(s)
- The CRT is achieved, in most cases, through the issuance of a funded or unfunded CDS/guarantee from the investor to the bank
- In exchange the bank pays the investor an annual premium
- If losses in the reference portfolio materialise, these will typically be absorbed by investors who hold the junior tranche(s)
- The bank may also suffer part of the loss if total losses in the reference portfolio exceed the size of the junior tranche
- The investor's cash collateral carries no regulatory capital requirement but the bank will still have to hold regulatory capital against the retained senior tranche

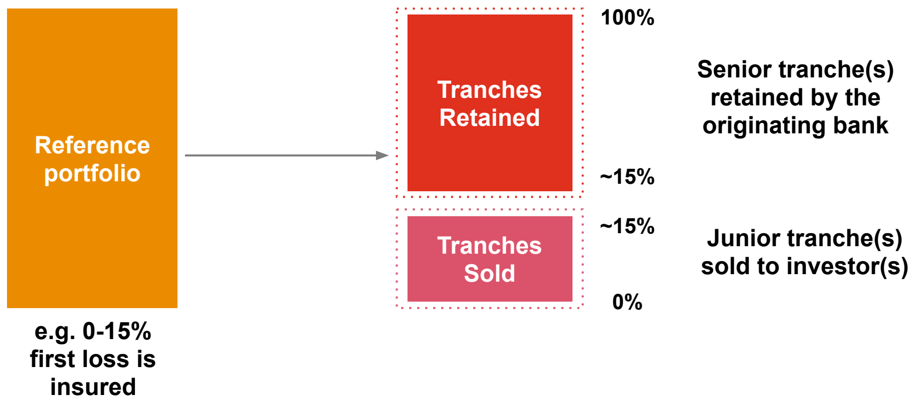
What are the benefits?

- The released capital can then be redeployed elsewhere to improve the bank's overall RoE
- The bank retains the reference portfolio on its balance sheet, legal title, the economic interest in the loans and borrower relationships

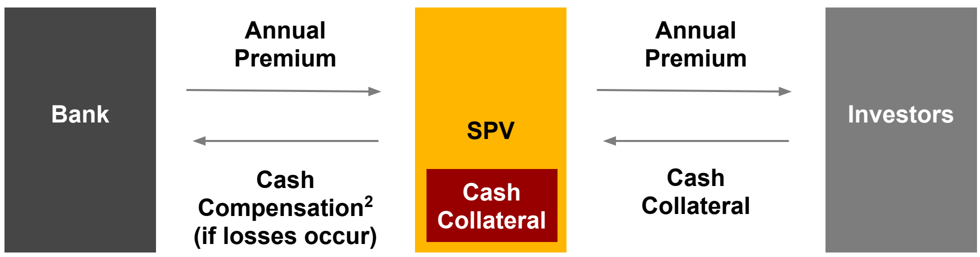
[1] Also Significant Risk Transfers (SRTs)

Illustrative example CRT structure

Reference portfolio structure & flows



Collateral and premium structure & flows



[2] Through issuance of CDS/guarantee

What could a CRT look like for you?

This example structure demonstrates the potential risk-weighted asset (RWA) savings available for an illustrative reference portfolio at an annual investor premium of ~8%

Tranche type	Tranche holder	Tranche attach	Tranche detach	Tranche size (£m)	Est. RWA (after CRT)	Est. RWA £ (after CRT)	Est. premium pa	RWA (before CRT)	RWA £ (before CRT)
Senior	Internally retained	15%	100%	425	20%	84	n/a	75%	319
Junior	Externally placed	0%	15%	75	n/a	n/a	8%	75%	56
-	**-**	**-**	**-**	**500**	**20%**	**84**	**8%**	**75%**	**375**

Key considerations

- The final capital structure is impacted by the number of tranches, thickness of tranches and their assigned rating
- Optimise the junior tranche attachment and detachment points to meet investor demands whilst reducing capital at a reasonable cost
- High granularity of the reference portfolio will reduce correlation and increase diversification of credit risk
- Demonstrate to the regulator that real economic risk is transferred externally to financial markets and is commensurate to the regulatory capital reduction achieved

Ideal reference portfolio characteristics

- High RWA assets, e.g. CRE, SME, Corporates loans, asset & invoice finance
- Relatively low expected loss ~200bps pa
- WAL of ~3-5 years - depending on the nature of the underlying assets the reference portfolio can be fixed or revolving / replenishing

How can we help?

1. **Feasibility** - structuring and strategic options analysis of potential target reference portfolios
2. **Investors** - identification and selection, we have relationships with over 30 CRT investors
3. **Process** - end-to-end lead advisory process support
4. **Regulatory** - advice on capital implications and risk monitoring process for demonstrating compliance to the regulator

We expect more activity in the CRT market over the next few years, driven by both supply and demand-side factors;

- UK and European banks keen to explore new tools to manage their regulatory capital requirements
- Growing demand from an increasingly diverse pool of investors on the hunt for alternative sources of yield

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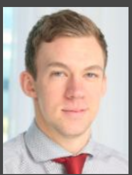

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