

Why is synthetic securitisation not only the most efficient but often the only way to achieve Significant Risk Transfer ?

A bank's balance sheet has two distinct constraints:

1. **Funding and liquidity** (how to finance assets)
2. **Regulatory capital and risk** (how much capital must be held against assets)

When these objectives are separated, each can be optimised independently. Modern balance-sheet management is increasingly based on **specialisation**: optimise funding through the cheapest liability mix and optimise capital through targeted credit risk transfer.

- For **funding**, European banks already benefit from a large, stable deposit base, and of one of the world's **deepest covered bonds** markets (€2.5 trillion on €3.3 trillion globally).
- For **credit risk transfer**, European banks benefit from the **largest synthetic SRT** market globally, protecting €500 billion of mostly corporate and SME loans by end 2025 (on €900 billion globally), according to IACPM SRT survey 2016-2025.

For effective risk transfer, synthetic SRT is not only easier and more efficient, but often the only portfolio-level tool for achieving Significant Risk Transfer (SRT).

Trying to solve both funding and risk transfer with a single true-sale securitisation forces a compromise that is economically inferior to separating them.

The reasons therefore are economic, operational, regulatory, and strategic.

- Banks want to keep loans and client relationships, and SRT investors want credit risk, not loan ownership: synthetic SRT does not disrupt banks' client management nor lending operations.
- Most European loans cannot easily be sold due to client confidentiality and transfer restrictions.
- Funding by senior tranches is expensive and often unnecessary, and the features needed to achieve effective SRT are the inverse of those which investors in a senior tranche are looking for.
- The need to issue the full capital stack for traditional SRT grosses up banks' balance sheet and creates undesirable mark-to-market accounting volatility on the securitized loans.
- Synthetic SRT enables to execute only the tranches to be placed to achieve the targeted risk transfer.
- Synthetic SRT is more scalable than traditional securitisation, because less than 10% of the notional amount of loan pools must be placed.
- Execution of a synthetic securitisation is much simpler and faster than execution of a true sale securitisation.

Effective funding and risk transfer cannot be achieved by a true sale securitisation even if the underlying assets can be sold, like residential mortgages or auto-loans, because

- Funding and risk transfer have different pricing,
- Funding and risk transfer have different investor bases, with different requirements which cannot be reconciled, notably on liquidity and call options,
- Cash flows generated by relationship-based loans might not be sufficient to pay the coupon on the first loss and/or mezzanine tranches, after paying the coupon on the senior tranche.

However, because loans remain on balance-sheet, it is perfectly possible to execute both a traditional securitisation for funding purposes and a synthetic SRT securitisation for capital purposes on the same exposures, or to protect the underlying loans of covered bonds by an unfunded synthetic SRT transaction.

- ⇒ The success of synthetic securitisation stems from the fact that it separates **credit risk** from **loan ownership**. This allows banks to retain customer relationships, servicing and funding benefits while transferring the targeted portion of credit risk that drives regulatory capital.

For European banks - whose primary constraint is increasingly capital rather than funding - that makes **synthetic securitisation not only the most efficient**, and for many corporate, SME and specialised lending portfolios, the **only practical means of achieving Significant Risk Transfer** and releasing capital to be redeployed in new lending.