



TOPICS:

Banking System

SOURCE:

Bank for International Settlements

BIS: The Rise and Risks of Synthetic Risk Transfers

- The article examines the increasing use of **synthetic risk transfers (SRTs)** by banks as a tool for managing credit risk and regulatory capital requirements. SRTs enable banks to transfer part of the credit risk of a loan portfolio to investors - typically through derivatives or guarantees - while keeping the underlying loans on their balance sheets. This structure differs from traditional securitisation, where assets are sold and removed from the bank's balance sheet. The mechanism allows banks to reduce **risk-weighted assets (RWA)** and improve capital ratios without divesting customer relationships or loan ownership.
- The paper documents **significant growth in the SRT market** since the mid-2010s. Despite this expansion, **the market remains relatively small compared with overall bank balance sheets** - representing roughly 2% or less of total bank loans across major jurisdictions such as the EU, United States, United Kingdom and Canada. European banks continue to dominate issuance, although North American banks have recently increased their participation.
- **SRT structures** typically involve dividing a loan portfolio into tranches with different risk levels.

Banks generally retain senior tranches while transferring junior or mezzanine tranches to investors. This arrangement can materially reduce RWAs and capital requirements, though banks must pay a premium to investors for credit protection. Investors - such as credit funds, asset managers and pension funds - are attracted by the potential for risk-adjusted returns and access to bank-originated credit exposures that may not be available in public markets.

- From a financial stability perspective, the article concludes that **current systemic risks from SRTs appear limited**, largely due to post-Global Financial Crisis regulatory reforms and the relatively small size of the market. Nevertheless, several emerging risk channels are identified. These include potential **rollover risk** if banks rely on continuous issuance of SRTs, **leverage and liquidity risks among investors**, and **increasing interconnections between banks and non-bank financial institutions (NBFIs)**. Complex risk-transfer chains and cross-border exposures could amplify shocks in stress scenarios.

