EAGLE POINT
CREDIT

The Opportunity in Regulatory Capital Relief at Eagle Point

Q3 2025

Key takeaways

The purpose of this white paper is to educate Eagle Point clients about the investment opportunities that regulatory capital relief (RCR) presents.

- **RCR investments provide access to high-quality bank assets, consistent cash flows and portfolio stability**
- **An RCR transaction enables a bank to share the risk and return of a diversified pool of core lending assets with investors such as Eagle Point to improve balance sheet efficiency and raise regulatory capital**
- **This opportunity exists due to increasingly stringent capital requirements related to assets held by banks**
- **We believe RCR often represents a better source of capital for banks compared to dilutive public equity issuances**
- **We expect the RCR market to continue to grow and offer attractive investment opportunities for specialized investment managers**

Reflects Eagle Point's current views based on historical information and Eagle Point's knowledge, discussion with market participants and current market conditions. Eagle Point's opinions and market conditions are subject to change without notice. See risk disclosures and important information on page 10.

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Defining RCR

What is RCR?

Regulatory capital is the amount of capital that banks are required to have on hand at any given time. This capital is designed to ensure that banks and, consequently, the financial system, can weather economic stress. Think of it as the buffer of the banking system, protecting depositors and the economy as a whole.

The amount of regulatory capital that a bank must hold is determined by the type and amount of assets it holds. These standards are set by regulatory bodies like the Federal Deposit Insurance Corporation or the Federal Reserve System in the US, and similar bodies in other jurisdictions, in tandem with the Basel Committee on Banking Supervision (BCBS), a body comprised of international banking authorities. Over time, regulatory capital standards evolved and new laws and regulations have been introduced to make the banking system more protective and robust. These iterations have resulted in higher capital requirements for banks.

Banks have a number of ways to raise capital. The most basic way is issuing common stock. With many banks trading at discounts to book value, that can be expensive. This has led banks to explore alternative approaches. One strategy is selling a portion of the assets banks hold on their balance sheets – but this also has significant downsides, like damage to longstanding customer relationships and declining profits.

RCR, also known as synthetic risk transfer (SRT), is a financial strategy that allows banks to keep their portfolios and relationships intact while raising capital. It also allows banks to optimize the amount of capital they need to hold for a given portfolio of assets in accordance with banking regulations.

At its core, RCR involves a partnership between banks and investors, where investors agree to absorb a specific amount of credit risk (potential losses) on a specific portfolio of bank assets in exchange for an equity-like return. This arrangement enables banks to reduce the amount of regulatory capital they are required to hold against these assets, improving their overall capital efficiency.

The bank generates an increase in its capital right away, which immediately changes its return on required capital. This allows the bank to continue doing business with its clients without having to cut back on its lending business.

Typically, these transactions are managed by the portfolio and balance sheet management groups within a bank and not driven primarily by risk mitigation considerations. The result of this has been that the performance of these transactions has stood out across cycles.

In fact, Eagle Point, to the best of its knowledge, does not know of any RCR transactions that have had a negative IRR for the equity investor. Further, the European Banking Authority completed a study that highlighted the performance of underlying collateral used in RCR transactions compared to other similar collateral held on bank balance sheets. One conclusion was that collateral used in RCR transactions performed better than similar collateral held by banks. This research suggests that banks are likely to use higher quality assets in RCR transactions than in other transactions where assets are sold off the bank's balance sheet.[1] We believe this is the case because banks want to keep RCR as a ready source of capital.

How does RCR work?

The mechanics of an RCR transaction typically follow these steps:

1. **Portfolio Selection:** A bank identifies a portfolio of assets on which it seeks capital relief. The portfolio is typically a homogenous selection of loans from a core lending portfolio of the bank. As examples, the

1. European Banking Authority, "Discussion Paper on the STS Framework for Synthetic Securitisation." Published September 19, 2019.

portfolios could be comprised of investment grade corporate loans, high yield corporate loans, loans to small and medium-sized enterprises (SMEs), consumer loans, trade finance loans, subscription finance loans or other types of assets originated by the bank.

2. **Risk Transfer Agreement:** The bank and investors such as Eagle Point engage to provide the bank with protection against an agreed-upon specific proportion of potential losses on the portfolio. For example, investors might agree to absorb the first 10% of losses on the specific reference portfolio of assets. The reference portfolio can contain up to 95% of the bank's exposure to each individual loan, with the bank retaining all risk on at least 5% but often the bank retains risk on much more than that on its balance sheet, with average portfolio retention much closer to ~15%-20%. This ensures alignment of interest between the bank and the investor, and satisfies regulatory risk retention requirements.

3. **Structure:** The risk transfer agreement is structured as a "synthetic transaction." This means that the portfolio of assets remains on the bank's balance sheet and the investors reference the performance of loans in that portfolio through the risk transfer agreement.

4. **Principal Payment:** Investors post a deposit with the bank upfront for the total loss they are providing protection against. As an example, if the reference portfolio is $100 million and investors are agreeing to absorb the first 10% of losses, they will deposit $10 million upfront with the bank. As the portfolio experiences losses, such losses will be deducted from the $10 million RCR investment and the remaining amount will be returned to RCR investors at the maturity of the transaction. Typical maturities range from five to seven years.

5. **Coupon Payment:** In exchange for taking on risk, the bank pays the RCR investors an equity-like return in the form of a coupon. Coupons typically end up between 10%-15%, though they can be higher. The coupon is usually floating in nature, comprising a base rate (e.g., SOFR) and a spread.

6. **Regulatory Benefit:** Based on this transaction, the bank can demonstrate to regulators that it has effectively transferred a portion of the risk associated with the reference portfolio, resulting in lower capital requirements for these assets. The regulator in each banking jurisdiction must approve each transaction for the bank to be able to reduce its regulatory capital requirement.
7. **Ongoing Partnership:** The bank retains the assets on its balance sheet and continues to manage the relationships with its borrowers, while sharing a portion of the risk and return with investors.

Why does a bank participate in RCR?

RCR is growing in importance due to increasingly stringent banking regulations, particularly in the post-Global Financial Crisis (GFC) era.

Most countries follow the recommendations of the BCBS when regulating their respective capital frameworks. Not surprisingly, after the GFC put immense strain on the banking system globally, the BCBS has continued to make capital requirements increasingly stringent with each iteration of rules. While countries diverge in their detailed implementations of these rules, the overall trend suggests that banking regulation globally is likely to tighten.

An RCR transaction is an important option in every bank's capital planning strategy, enabling it to meet these strict requirements and optimize its balance sheet while still holding the assets in its portfolio.

For example, let's suppose a bank lends to small and mid-sized businesses. It wants to keep this portfolio of loans on its balance sheet and continue maintaining its long relationship with each business. However, the bank is required to hold a lot of capital on that portfolio of loans under the updated Basel regulations.

Instead of selling these loans, the bank will approach an investor such as Eagle Point with that portfolio of loans, and the investor, after running an analysis, will agree to underwrite the first 5%-15% of losses on that portfolio of loans. In return, the bank will pay Eagle Point an attractive interest rate.

By doing this, the bank shows the regulator that it does not have any risk on that proportion of initial losses from that portfolio. The regulator recognizes that the portfolio is much less risky than it used to be, and the capital that needs to be held against the same portfolio decreases significantly for the bank.

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Example

Demonstrating the benefit of RCR to a bank

In the below example, by engaging in an RCR transaction with an investor, the bank can (i) reduce the amount of equity capital required from $105.0 million to $52.5 million and (ii) increase the return on its equity capital from 12.6% to 17.1%. The bank pays the RCR investor a coupon of 14.0% in order to achieve the benefits.

RCR EXAMPLE ($ IN MILLIONS)	NO RCR	RCR TRANSACTION	COMMENTS
Reference Portfolio	$1,000.0	$1,000.0	
Risk-Weighted Assets	$1,000.0	$500.0	
Portfolio Yield (7%)	$70.0	$70.0	
Coupon Paid to RCR Investors	$0.0	($12.6)	Bank pays the RCR investor a coupon in exchange for the RCR investment
Bank Cost of Portfolio Funding	($56.8)	($48.4)	
Net Interest Margin	$13.2	$9.0	
Tier 1 Capital Ratio	10.5%	10.5%	
Required Tier 1 Capital	$105.0	$52.5	RCR allows the bank to reduce regulatory capital required for specific portfolio
Return on Tier 1 Capital	**12.6%**	**17.1%**	**RCR allows the bank to increase its ROE**
Cost of RCR		14.0%	
Size of RCR		$90.0	
Bank Cost of Debt	4.0%	4.0%	
Bank Cost of Equity	20.0%	20.0%	

Example above is hypothetical and does not represent any particular investment or bank.

Why does an investor participate in RCR?

RCR transactions enable asset managers to invest in core banking books without being burdened by the cost of setting up an extensive origination, underwriting and servicing channel. The advantage of this becomes even more apparent given the diverse types of assets across geographies that investors can invest in through this asset class.

In addition, the high quality of assets in RCR transactions enables investors to earn consistently high risk-adjusted returns across economic cycles with low correlation to broader markets. Bank underwriting and risk models remain under constant scrutiny from regulators, especially post GFC, and this has resulted in banks generally holding higher credit quality assets. This is further enhanced by the selection criteria of assets for RCR transactions that tends to skew toward an even higher credit quality.

Furthermore, RCR transactions feature a strong alignment of interest between investors and the issuing bank, which retains a not insignificant portion of the risk on each loan in a transaction on its balance sheet.

Importantly, the performance of an RCR transaction is driven by the credit quality of the assets in the portfolio, specifically through defaults and losses, and not by any change in pricing on these underlying assets, such that any loan that does not default provides a par principal return to investors. This implies that these transactions are not subject to NAV risk, unlike CLO equity, thus protecting investors from NAV volatility during the investment and at its maturity. This is an important source of stability for RCR transactions across periods of market volatility.

The Opportunity in RCR

Recent History of RCR

While the RCR market has existed since the 1990s, it has evolved considerably since then and seen remarkable growth and evolution between 2016 and today. During this period, risk sharing surpassed an impressive milestone of $1 trillion in cumulative volume, demonstrating the increasing popularity of this investment opportunity. The volume of new RCR transactions in 2024 exceeded $30 billion.[1] This highlights the growing importance of private credit asset managers like Eagle Point in becoming bank partners and enabling them to optimize capital and balance sheet management.

Opportunities on the horizon

We believe the RCR market will continue to grow, driven by evolving market dynamics and regulatory landscapes. One of the most significant opportunities lies in the potential expansion of the RCR market to more asset classes, additional banks and new geographies.

The ongoing regulatory discussions, particularly in the EU, UK and US, present further avenues of opportunity. As regulators fine-tune their approaches to RCR transactions within the Basel III framework, there is potential for additional activity from banks that already utilize this approach as they expand the set of asset classes they use as reference portfolios. Moreover, this gives higher confidence to the rest of the banking sector to be able to utilize this structure and we are already witnessing an increase in the number of banks using this approach in the past two years.

Banks in geographies like North America and Eastern Europe have increased RCR activity, signaling a promising growth trend for the market. As these institutions become more familiar with RCR transactions, there is potential for strong market growth in such regions. This geographical expansion is expected to bring new issuers, innovative structures and increased liquidity to the global RCR market.

Technological advancements present another exciting opportunity. As financial institutions continue to digitize and automate their operations, there is potential for streamlining the RCR process. This could lead to more efficient structuring, pricing and management of RCR transactions, potentially reducing costs and opening the market to a broader range of issuers and investors.

As the RCR market continues to evolve, it stands at the cusp of a new era of growth and innovation. By capitalizing on these opportunities, market participants can help shape a more resilient, efficient and sustainable financial system, while earning an attractive return.

1. Bloomberg, "Loans Tied to SRTs Reach $1 Trillion on Record Pace of Sales." Published October 21, 2024.

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Eagle Point's Edge

Eagle Point is uniquely situated to lead in RCR investing

A multidisciplinary approach

We established ourself as a key player in the RCR market, leveraging our expertise across the credit market and our multi-disciplinary approach.

We bring together teams with diverse expertise, including:

- a CLO team with strong knowledge of securitization structures
- a private credit team to diligence corporate credit
- an ABS/MBS team experienced in statistical analysis and analyzing granular portfolios across credit cycles
- an infrastructure team with extensive experience across various infrastructure and project finance assets
- a fund finance team that understands the nuances of the fund lending market

This multi-disciplinary approach allows us to evaluate a wide range of transactions, providing us with a competitive edge in the market.

Flexible investment approach and complementary strategies

Unlike some firms that specialize in specific asset types, our diverse skill set allows us to invest across various asset classes within the RCR market. We believe this flexibility enables us to identify the most attractive opportunities across the market. Our experience in CLOs and other structured credit investments complements our RCR activities, allowing for a holistic view of credit markets and risk.

Focus on risk-adjusted returns

We emphasize structuring transactions with minimal probability of loss, while seeking strong risk-adjusted returns.

Long-term partnerships

Thanks to our longstanding relationships with banks, we have access to exclusive opportunities in the RCR space. This is fitting, as we approach RCR as a partnership with banks, understanding that these institutions are seeking long-term relationships rather than one-off transactions. This alignment of interests can benefit both the banks and our investors.

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Additional information is available upon request.

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