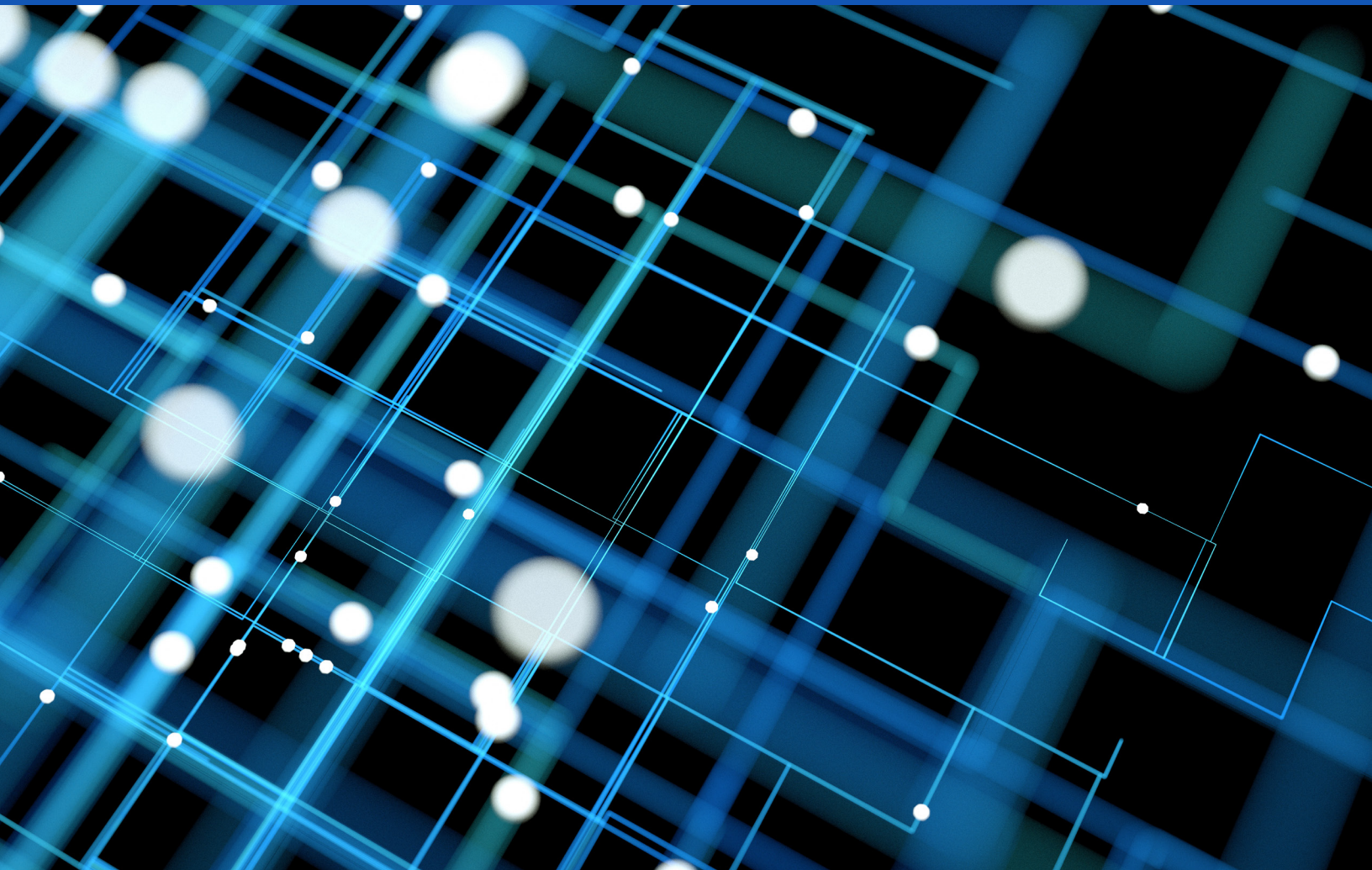


Navigating Synthetic Risk Transfer: An Overview for ABS Investors

A look at the structural differences between traditional ABS and SRTs, key considerations, and potential regulatory changes on the horizon.

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Executive Summary

Traditional asset-backed securities (ABS) represent one of the most established and liquid segments of the securitization market. Synthetic risk transfer (SRT) securities, issued by banks and other regulated financial institutions, enable originators to transfer credit risk on portfolios of loans to private investors, thereby achieving capital relief under their respective regulatory frameworks.

Both ABS and SRT may use securitization technology to transfer credit risk to investors, but they serve different purposes, involve different structures, and offer different risk-return profiles. Institutional investors may be considering SRTs — commonly referred to as credit risk transfer (CRT) transactions in the US market — as a complement or alternative to traditional ABS and other securitized credit investments.

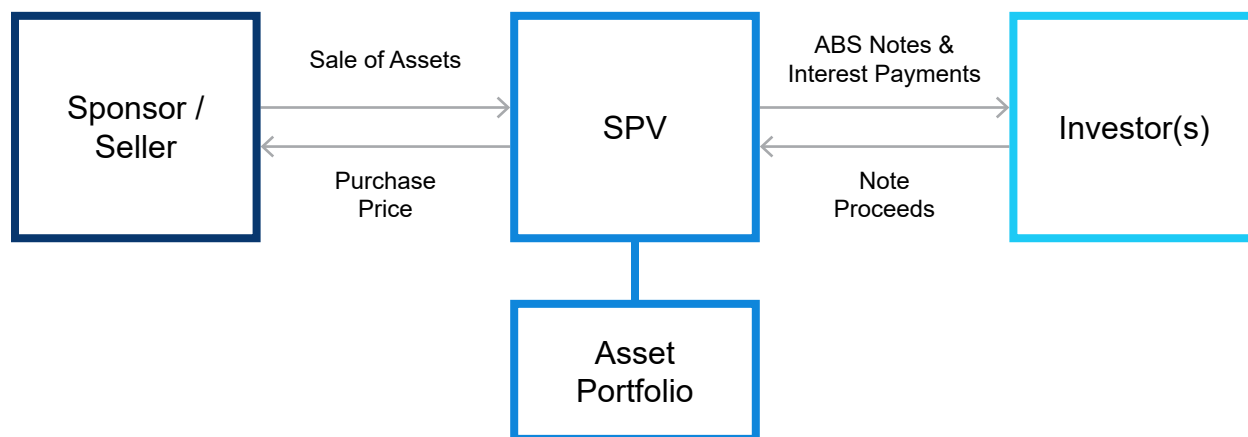
This report provides an overview of the structural differences between traditional ABS and SRTs, key considerations, and potential regulatory changes on the horizon.

Structural Differences: The Basics

Asset-Backed Securities

ABS are financial instruments collateralized by financial assets, including loans, leases, mortgages, and other types of secured and unsecured receivables. ABS transactions are typically structured to isolate the underlying assets from the originator's balance sheet. This isolation is accomplished by transferring the assets into a special purpose vehicle (SPV), whose sole purpose is to issue ABS. The assets are legally isolated from the originator or transferor; therefore, the investor returns are based on the performance of the securitized assets. Investors are isolated from the operations and the financial condition of the originator or transferor. For a more detailed discussion of ABS, see our report [Decoding the Exchange Act ABS Definition: A Practical Guide to Classifying Structured Finance Transactions](#).

Typical ABS Structure



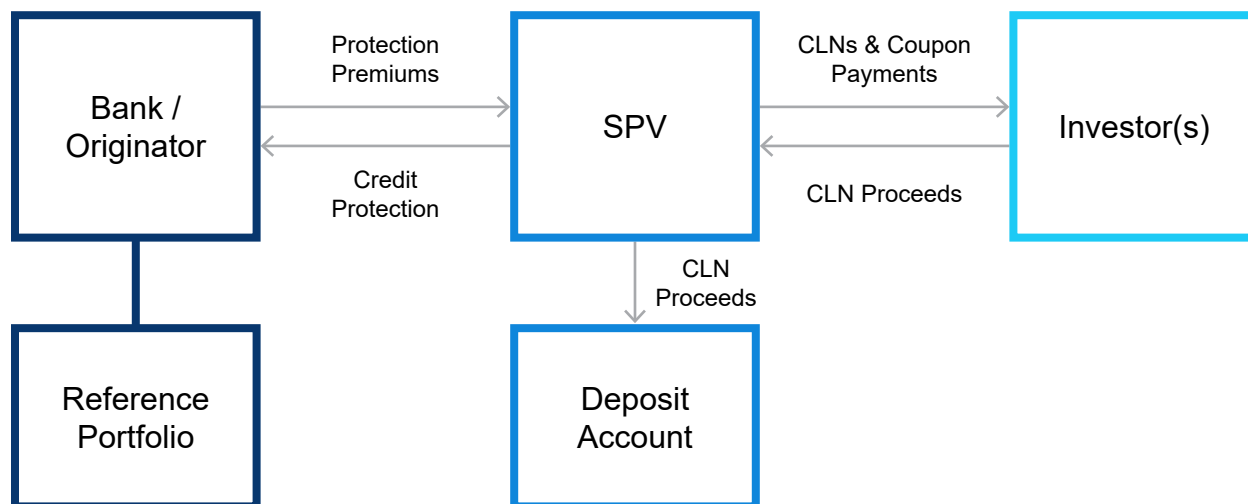
Synthetic Risk Transfer

Since 2013, Fannie Mae and Freddie Mac (the government-sponsored entities or GSEs) have issued SRT securities (also known as CRT securities) to transfer mortgage credit risk from their balance sheets to the capital markets. Unlike in an ABS, where the underlying assets are transferred into an SPV, in an SRT the underlying assets remain on the balance sheet. As discussed below, SRTs or CRTs can be structured in different ways; however, in general, an SRT provides investors with “synthetic” exposure to the financial assets while also exposing investors to the operations and financial condition of the issuer. While SRT structures existed prior to 2008, the GSEs’ programs helped establish a model that has since been adopted more broadly by banks.

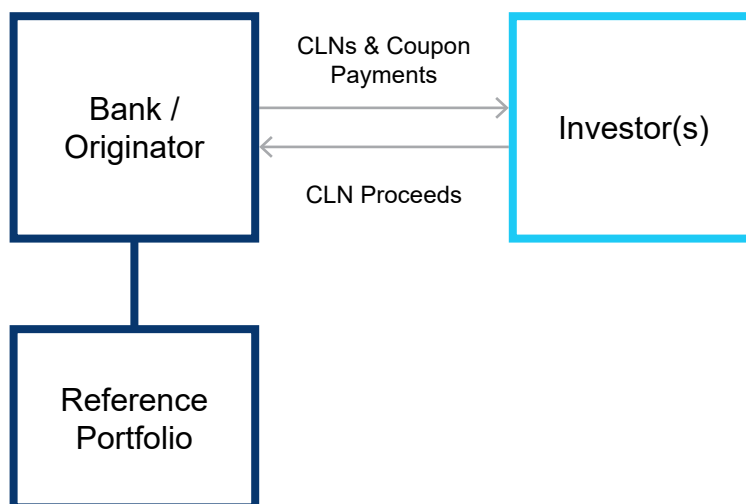
For example, a bank will use SRTs as a regulatory capital management tool. In a typical transaction, a bank identifies a portfolio of loans and transfers the credit risk associated with a specified tranche of that portfolio to third-party investors, while retaining ownership and servicing of the loans and its customer relationships. Rather than selling the loans, the bank transfers only the economic risk of specified credit losses. Because the underlying loans remain on the bank’s balance sheet, a synthetic transfer of credit risk is effected through a credit default swap (CDS) or financial guarantee. If the transaction satisfies applicable regulatory requirements, the transaction may obtain capital relief, thereby freeing up capital that the bank may use to pursue additional lending or other activities.¹

SRT securities are issued as credit-linked notes (CLN), either directly by the bank or through an SPV. In a bank-issued CLN structure, investors purchase the CLNs directly from the bank and look to the bank for payment. In an SPV-issued CLN structure, the SPV enters into the credit protection agreement, issues the SRTs, and uses the proceeds to collateralize its obligations to the bank. This is a meaningful structural distinction from a bank-issued CLN, where the note is a general unsecured obligation of the bank and investors are fully exposed to the bank’s credit risk. However, investors in an SPV-issued SRT are still dependent on the bank for payment.² The party establishing the SPV may vary by market, with the SPV often established by or on behalf of the bank in euro-area transactions and by or on behalf of the investors in US transactions.

SPV-Issued CLN Structure



Bank-Issued CLN Structure



Structural Differences: Investor Considerations

Investors should consider a number of factors when comparing investments in ABS and SRTs. In this report, we cover:

- underlying credit exposures and portfolio composition,
- structural protections and loss allocation,
- counterparty credit exposure,
- regulatory capital,
- liquidity, and
- prepayment risk.

Underlying Credit Exposures and Portfolio Composition

Traditional ABS issuances provide exposure to pools of receivables within a defined asset class, including auto loans and leases, credit card receivables, student loans, equipment loans and leases, and a range of more specialized assets. SRTs may reference a different and a broader set of exposures drawn from bank lending books, including exposures for which traditional securitization markets are less established.³ Corporate and SME lending, including receivables and trade finance, remains the largest category, but SRT reference portfolios also include project and object finance, commercial real estate,

fund finance and capital-call facilities, leveraged loans, residential mortgages, auto loans, and other retail exposures.⁴ Per IACPM, banks participating in its survey executed SRTs in 2025 referencing €378 billion of loans and providing €30 billion of first-loss and mezzanine protection. Corporate and SME exposures continued to represent more than 70% of the underlying reference portfolios, while specialized lending increased from 2% in 2024 to 10% in 2025.⁵

The composition of SRT reference portfolios also varies by jurisdiction. US SRT pools are comparatively diverse, with corporate loans representing the largest category, followed by capital-call facilities, and auto loans and residential mortgages accounting for a substantial portion of the remainder. Euro-area transactions are more weighted toward corporate lending, while UK transactions include leveraged loans and project finance and, increasingly, retail exposures such as auto and other consumer loans.⁶

As the range of SRT reference exposures has broadened, the distinction from traditional ABS has become less about the asset class itself and more about the pool of credit being accessed; SRTs may provide investors with exposure to portions of banks' retained lending books that may not otherwise be readily available through traditional ABS or public credit markets.

Structural Protections and Loss Allocation

In ABS, the originator transfers the pool assets to a bankruptcy-remote SPV through a true sale, rather than pledging the assets as collateral. If the originator later becomes insolvent, the transferred assets will not form part of its insolvency estate, and investors look instead to the assets for payment. SRTs take a different approach, with the loans in the reference portfolio remaining on the bank's balance sheet, and the transaction documents instead defining the portion of credit losses to be transferred to investors. In an SPV-issued CLN structure, the note proceeds are also held as collateral for the SPV's obligations under the credit protection agreement (the CDS or financial guaranty).

Both products apply tranches and allocate losses among different levels of risk. In ABS, the payment waterfall gives senior tranches payment priority, with subordinate tranches absorbing losses first. Investors may select among the tranches offered across the capital structure based on their respective risk appetite. SRTs use the same basic concept, but these typically transfer a specifically defined tranche of the reference portfolio's credit risk to investors, with the bank retaining the remaining risk. The investor tranche covers a specified band of cumulative losses on the reference portfolio, with *attachment* and *detachment* points marking the percentage levels at which the tranche begins to absorb losses and is fully exhausted.⁷

In a three-tranche SRT structure, which is more common in the euro-area, the bank retains a thin first-loss tranche and the senior tranche, with investors providing protection on the mezzanine tranche in between.⁸ However, a significant number of SRT transactions in Europe are structured with a two-tranche structure, with a first-loss tranche being transferred to investors. In the United States and Canada, SRT coverage generally applies to first losses. US investor tranches also tend to be thicker, with a typical two-tranche US SRT providing protection on the first 12.5% of portfolio losses.⁹

Risk-retention requirements vary by jurisdiction and transaction type. In the United States, if ABS risk-retention rules apply, the sponsor generally must retain at least 5% through a vertical interest, a horizontal first-loss interest, or a combination of the two. Whether and how risk-retention requirements apply to SRTs depends on the relevant jurisdiction. For example, EU/UK SRTs are generally subject to a 5% risk-retention requirement, but that requirement does not necessarily require the bank to retain a 5% first-loss tranche.¹⁰ A common way of retaining risk in EU/UK SRTs is for the bank to reference only up to 95% of the exposure in the reference portfolio, with the remaining 5% unhedged.

Both ABS and SRTs may include protections that apply if the underlying pool or reference portfolio deteriorates. In ABS, overcollateralization provides a pool balance in excess of the outstanding notes, excess spread may be used to cover losses or payment shortfalls, and reserve accounts provide another source of funds. Performance triggers may trap cash in the transaction or redirect payments from junior to senior classes.

In SRTs, eligibility criteria limit the loans that may enter the reference portfolio, while replenishment conditions govern how the bank replaces or adds exposures after initial closing (SRTs typically have an average life of three to five years, depending on the structure and characteristics of the reference portfolio).¹¹ These provisions are intended to limit the originating bank from modifying the composition of the reference portfolio such that the credit risk for the investors materially changes from what was agreed at the onset of the facility. Transactions on SMEs or consumer loans may also include synthetic excess spread, which absorbs losses before the investor tranche starts to be impacted.

Counterparty Credit Exposure

As previously discussed, a true sale in ABS structures limits investors' direct exposure to the originator. Investors look to the issuing SPV and the cash flows of the transferred assets for payment, rather than to the general credit of the originator. The transaction may still depend on the originator to service the pool. If the originator (as servicer) can no longer collect and administer the receivables, then the servicing responsibilities must be transferred, which may disrupt collections, reporting, or payments during the transition.

SRTs have a more direct connection to the originating entity. In a bank-issued CLN structure, the originator bank receives proceeds from the issuance and is responsible for payments on the CLNs (after accounting for losses allocated to the protected tranche). Investors therefore take the credit risk of the bank in addition to the credit risk of the reference portfolio. A default by the bank may affect payments even if the protected tranche of the reference portfolio has not produced losses.

In an SPV-issued CLN structure, the issuance proceeds are held in a segregated deposit account (in the name of the SPV) as collateral for the SPV's obligations, reducing the investor's reliance on the bank's general credit for repayment of principal. The segregated deposit account may be initially maintained with the protection-buying bank itself, with the requirement to transfer the deposit if the credit rating of the protection-buying bank falls below certain thresholds.

Investors may still indirectly rely on the bank for payments on the CLNs in an SPV-issued CLN structure. These payments are often sourced, at least partially, from the protection premium paid by the bank under the credit protection agreement. Further, if the deposit account remains with the protection-buying bank, the remuneration and return of such collateral may be the source for the redemption of the CLN principal and also for part of the CLN coupon.

The bank remains responsible for administering the reference portfolio in SRTs. The loans are serviced under the bank's usual servicing standards, workouts are conducted under its credit and collections policies without regard to the purchased credit protection, and losses recorded in the bank's systems are translated into claims under the credit protection agreement. Investors therefore continue to depend on the bank's data, servicing, and loss-determination processes, even where repayment of CLN principal is supported by segregated collateral.

Regulatory Capital

A primary driver of an SRT for the protection-buying bank is more-efficient regulatory capital treatment for the originating bank or other regulated institution. Accordingly, investors should understand how the applicable regulatory capital framework treats SRTs, as those rules can dictate important structural and economic features of the transaction.

The Basel framework provides several methods for calculating risk-weighted assets (RWAs) for securitization exposures. The method available depends on the jurisdiction of the institution, the nature of the underlying exposures, the availability of external credit ratings, and whether the institution is permitted to use an internal-ratings-based approach. Implementation of those methods also varies by jurisdiction.¹²

Traditional ABS transactions that meet the applicable criteria are treated as “traditional” or “cash” securitizations for purposes of the capital rules. As discussed above, the pool of underlying exposures in ABS is sold to a bankruptcy-remote SPV. Where the transaction transfers significant credit risk and satisfies the applicable operational requirements, the institution may exclude the underlying pool from its RWAs and instead hold regulatory capital against any tranches or other securitization exposures it retains.

Qualifying traditional securitizations may also qualify as “simple, transparent and comparable” (STC) under the Basel framework or as “simple, transparent and standardised” (STS) under applicable EU or UK rules. These frameworks identify transactions that meet prescribed criteria relating to the underlying assets, transaction structure, and disclosure. Because the capital rules apply different risk weights to different tranches, with junior and mezzanine tranches generally attracting higher capital charges than senior tranches, an institution may reduce its RWAs by retaining the senior tranches and transferring junior or mezzanine risk to investors.

SRTs that meet the applicable criteria may qualify as “synthetic securitizations” under the Basel framework. As discussed above, the underlying exposures remain on the institution’s consolidated balance sheet, but the capital rules recognize a transfer of their credit risk through a financial instrument, such as a CDS, financial guarantee, or insurance policy. Obtaining recognized credit protection on a junior or mezzanine tranche can reduce the total RWAs associated with the pool, while the institution continues to hold regulatory capital against the exposures it retains.

Euro-area/UK and US regulators have taken different approaches to implementing the Basel framework, contributing to wider adoption of SRTs in Europe and the UK and differences in the types of portfolios and structures used across jurisdictions.

In March 2026, the federal banking agencies issued a package of proposals to revise the US regulatory capital framework, including the treatment of synthetic securitizations for purposes of RWA calculations. The proposals would establish rules for recognizing eligible prepaid credit protection arrangements, including certain CLNs, apply a 15% risk-weight floor to securitization exposures other than re-securitizations, and revise the definition and operational criteria for synthetic securitizations. If adopted, these changes could improve the regulatory and operational efficiency of SRTs in the United States and support further growth in the market.

Liquidity

Liquidity varies across the ABS market. Some asset classes, such as CMBS and credit card and auto securitizations have well-established public and 144A ABS markets. Smaller, non-traditional, or esoteric sectors are not issued in public ABS markets, and thus may experience lower liquidity.

By comparison, SRTs are generally less liquid than ABS as there is no registered or 144A market. Most SRT investments are held to maturity rather than actively traded. This has been attributed to the bespoke nature and smaller size of the market and, in some transactions, transfer restrictions and confidentiality provisions tied to the reference portfolio.¹³ Public pricing information is also limited, with no consistent repository or regulatory reporting of pricing or performance data across jurisdictions. This may hinder the ability to exit an SRT position with less transparent secondary pricing than in established ABS sectors.

Nevertheless, SRT CLNs can potentially be pledged in repurchase transactions, allowing investors to obtain financing against their positions despite the limited secondary market.¹⁴ However, investor use of such financing (often referred to as “back leverage”) has attracted regulatory and supervisory attention, because it may amplify liquidity risks and create additional links between banks and non-bank investors.¹⁵

Prepayment Risk

Prepayment risk in ABS depends on how principal from the underlying assets is passed through the transaction. In an amortizing securitization, investors receive principal as the underlying assets pay down, and optional prepayments may return principal earlier than expected.

In SRTs, however, when a loan is repaid, it leaves the reference portfolio. During a replenishment period, the bank can replace the repaid loan with another eligible loan subject to compliance with the agreed portfolio concentration limits. After the replenishment period, repayments reduce the size of the reference portfolio and the aggregate tranches. That reduction may be applied pro rata across the tranches or first to the senior tranche, leaving the junior or mezzanine tranche outstanding for longer (the so-called *sequential amortization*). If pro-rata amortization applies after the end of the replenishment period, the transaction always has portfolio performance triggers, which switch the amortization to sequential.

SRTs may also permit a time call or clean-up call, which gives the bank the option to terminate the credit protection after a specified period or once the reference portfolio has amortized below a specified threshold, respectively. A change in regulation that results in the transaction being less capital-efficient than on the closing date or adverse tax consequences may also constitute termination events.

Conclusion

ABS and SRTs should be viewed as complementary to an investor portfolio, rather than a substitute. ABS may be better suited for investors prioritizing established structural protections, liquidity, and isolation from originator credit risk, while SRTs may appeal to investors with the analytical resources to underwrite bespoke bank portfolios and who are willing to accept illiquidity and counterparty exposure in exchange for higher yields and access to credit exposures not otherwise available in public markets.

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Endnotes

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- ² This report focuses on fully-funded SRTs whereby investors must contribute 100% cash at the time of issuance of the SRT.
- ³ Bank for International Settlements, “The rise and risks of synthetic risk transfers,” March 2026, <https://www.bis.org/publications/rise-and-risks-synthetic-risk-transfers>.
- ⁴ International Monetary Fund, “Recycling Risk: Synthetic Risk Transfers,” October 2025, <https://www.imf.org/-/media/files/publications/wp/2025/english/wpiea2025200-source-pdf.pdf>;
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- ⁵ IACPM, “Global SRT Market Overview 2025: Bigger, Broader, More Diverse,” June 2026, <https://iacpm.org/global-srt-market-overview-2025-bigger-broader-more-diverse/>.
- ⁶ Bank for International Settlements, “Synthetic risk transfers,” February 2026, <https://www.bis.org/publications/synthetic-risk-transfers>.
- ⁷ The protected tranche may itself be divided into multiple investor tranches or sub-tranches, each covering a different band of losses and having separate attachment and detachment points; see Bank for International Settlements, “Synthetic risk transfers,” February 2026, <https://www.bis.org/publications/synthetic-risk-transfers>.
- ⁸ In euro-area SRT transactions, banks generally retain a first-loss tranche equal to 0.5% to 1.5% of the reference portfolio, while the retained senior tranche typically attaches at 7% to 9%; see Bank for International Settlements, “Synthetic risk transfers,” February 2026, <https://www.bis.org/publications/synthetic-risk-transfers>.
- ⁹ Bank for International Settlements, “Synthetic risk transfers,” February 2026, <https://www.bis.org/publications/synthetic-risk-transfers>.
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