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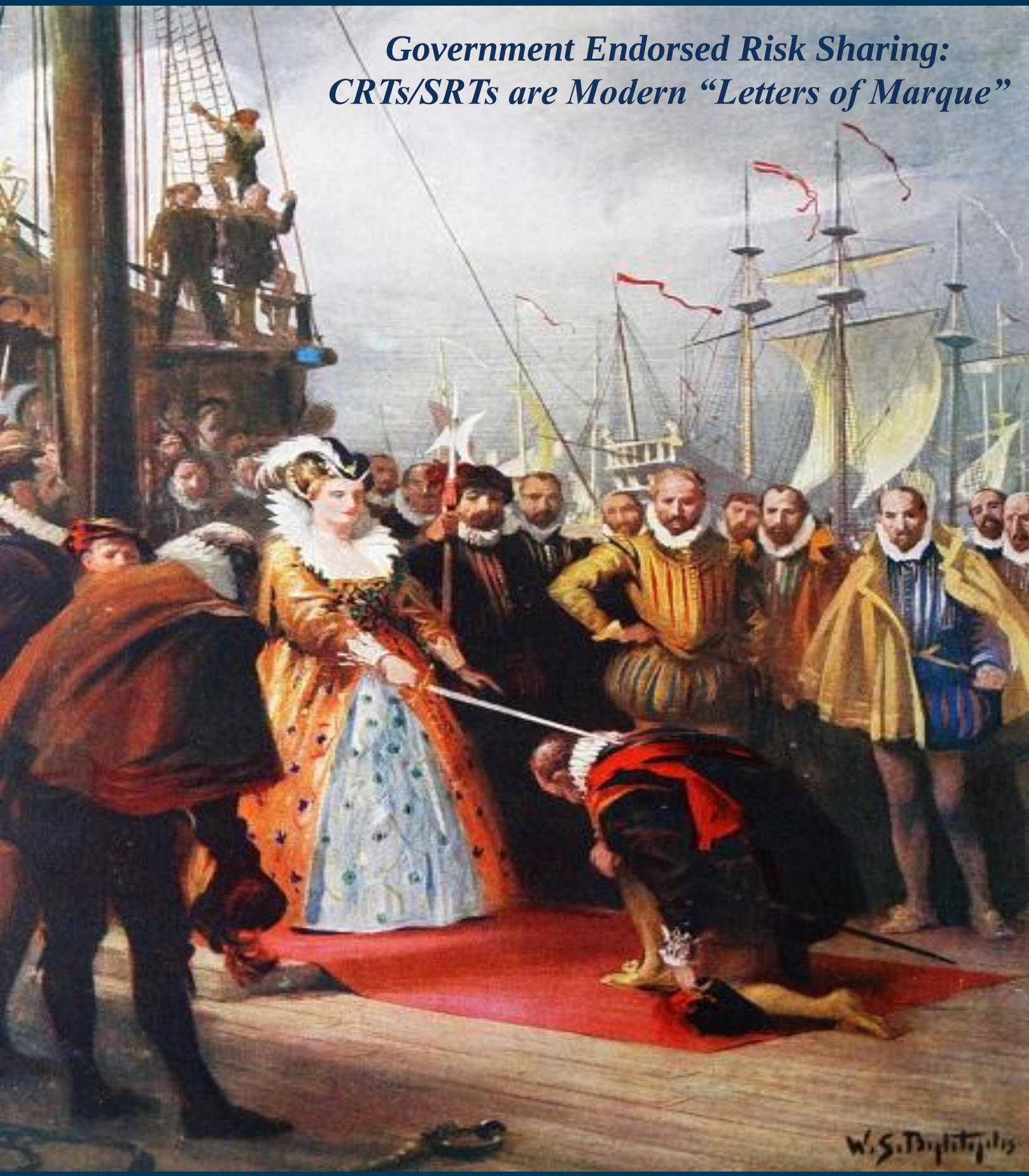

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Government Endorsed Risk Sharing: CRTs/SRTs are Modern "Letters of Marque"

by Neal J. Wilson

One of the most obscure provisions of the U.S. Constitution authorizes Congress to "grant letters of Marque and Reprisal."[1] In the time of war, such a letter permits a private person, or privateer, to seize property of an enemy and profit from the proceeds of the sale of that property as the letter so proscribes. Indeed, the word "marque" derives from the Old English word "mark", as in a "boundary marker".[2] The Continental Congress proliferated the issuance of such letters to great effect during the American Revolution, with the then Commander George Washington, among other Founding Fathers, profiting handsomely from the funding of privateers who had secured letters of marque. After the birth of the United States with the ratification of the Constitution in 1789, Congress issued numerous letters of marque to equal great effect against Barbary pirates off the Atlantic Coast in the 1790s and during the War of 1812, with British vessels being seized in that conflict at a rate three times that of American vessels captured by the British.[3]

The concept of a government explicitly enlisting private citizens in its war efforts dates back to the Middle Ages, with King Henry III of England issuing the first letter of marque in 1243 sanctioning specific individuals to seize property of the King's enemies at sea in return for splitting the proceeds between the privateer and the Crown.[4] Three centuries later, Queen Elizabeth I of England made the practice common, with the Crown financially benefitting from the likes of Sir Francis Drake seizing enemy Spanish ships at sea (such benefits sufficient to earn a knighting, as the cover portrait portrays).[5] In the 19th Century, privateers acted pursuant to letters of marque throughout the Napoleonic wars in Europe and during the American Civil War, although more frequently deployed by the Confederacy than the Union.[6]

The Role of Government

It is important to understand that privateering is not the same as piracy. The difference between the two practices is the role and imprimatur of the government. Pirates contribute to lawlessness by profiting at the expense of their victims, while privateers act with the specific authority granted and policed by the government. In practice, letters of marque specifically identified the enemy and the type of property that could be seized (the "marque"). Punishment and penalties applied to those seizing property beyond that allowed or of nations not at war with the

[1] U.S. Const. art. I, § 8, cl. 2.
[2] FRANCIS H. UPTON, MARITIME WARFARE AND PRIZE 170–71, 176 (N.Y., D. Van Nostrand 1863).
[3] Cong. Research Serv., Letters of Marque and Reprisal (Part 2), CRS Legal Sidebar (Feb. 26, 2025), https://www.congress.gov/crs-product/LSB11273.
[4] RALPH D. PAINE, FAMOUS PRIVATEERS OF NEW ENGLAND 1 (N.Y., Macmillan 1923).
[5] Alexander T. Tabarrok, The Rise, Fall and Rise Again of the Privateers, THE INDEP. INST.; LORD RUSSELL, THE FRENCH CORSAIRS 10 (London, Seeley & Co. 1887).
[6] Cong. Research Serv., Letters of Marque and Reprisal (Part 1), CRS Legal Sidebar (Feb. 26, 2025), https://www.congress.gov/crs-product/LSB11272.

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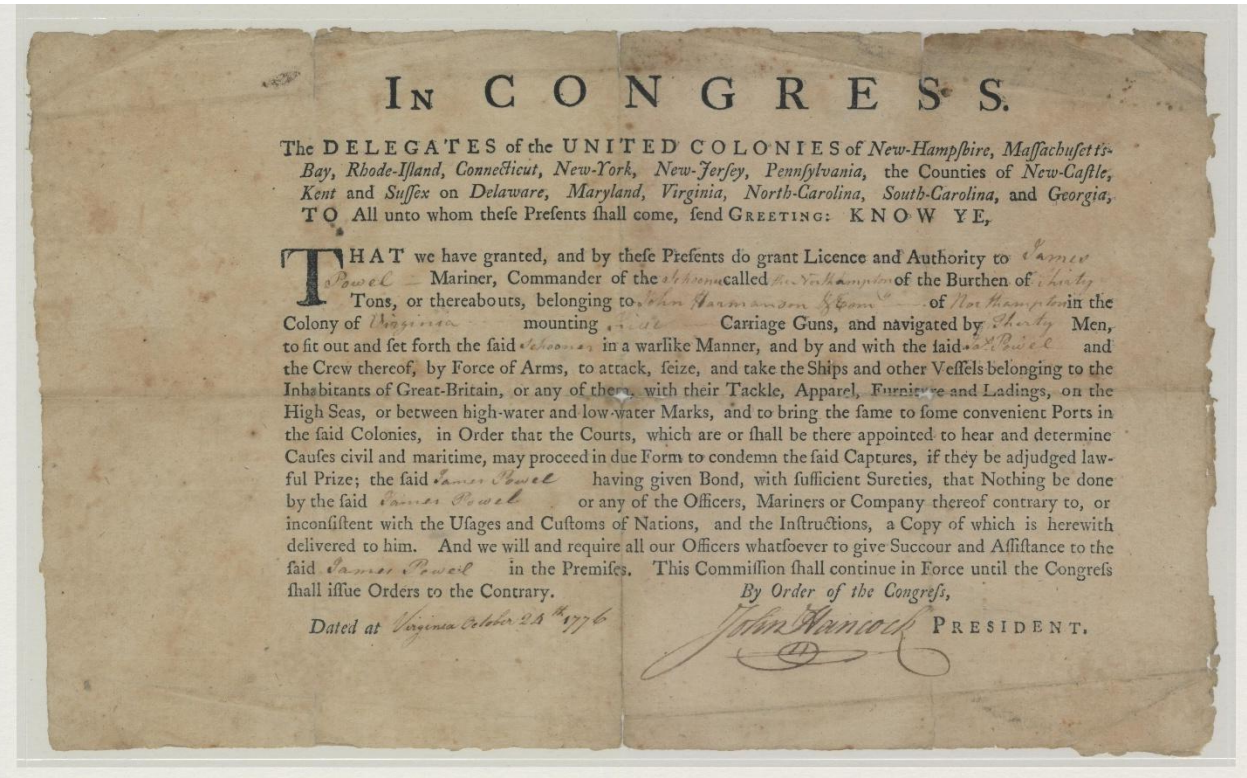
granting government (the limitations on letters of marque, "the boundary").[7] Letters of marque had to be applied for by stating the name, description and tonnage of the vessel, as well as the targeted vessel's owner and owner's residence. The grants were for a limited period of time, contained the obligation to obey the government's laws and those recognized by international law, and typically required the payment of a bond on the part of privateer to ensure compliance with the letter's proscriptions. The respective profit interests of the captain, crew and the government were pre-agreed, and the sale of seized property was subject to the jurisdiction of an admiralty court, which conducted an auction of the properties and distributed the proceeds. Admiralty courts had the authority to revoke letters of marque, to refuse to award prize money, to seize bond money and to even award tort damages against the privateer's officers and crew.[8] In short, letters of marque were highly regulated.



IN CONGRESS.

The DELEGATES of the UNITED COLONIES of *New-Hampſhire, Maſſachuſett's-Bay, Rhode-Iſland, Connecticut, New-York, New-Jerſey, Pennſylvania,* the Counties of *New-Caſtle, Kent* and *Suſſex* on *Delaware, Maryland, Virginia, North-Carolina, South-Carolina,* and *Georgia,* TO All unto whom theſe Preſents ſhall come, ſend GREETING: KNOW YE,

THAT we have granted, and by theſe Preſents do grant Licence and Authority to James Powel Mariner, Commander of the [illegible] called [illegible] of the Burthen of [illegible] Tons, or thereabouts, belonging to [illegible] of [illegible] in the Colony of Virginia mounting [illegible] Carriage Guns, and navigated by [illegible] Men, to fit out and ſet forth the ſaid [illegible] in a warlike Manner, and by and with the ſaid [illegible] and the Crew thereof, by Force of Arms, to attack, ſeize, and take the Ships and other Veſſels belonging to the Inhabitants of Great-Britain, or any of them, with their Tackle, Apparel, Furniture and Ladings, on the High Seas, or between high-water and low-water Marks, and to bring the ſame to ſome convenient Ports in the ſaid Colonies, in Order that the Courts, which are or ſhall be there appointed to hear and determine Cauſes civil and maritime, may proceed in due Form to condemn the ſaid Captures, if they be adjudged lawful Prize; the ſaid James Powel having given Bond, with ſufficient Sureties, that Nothing be done by the ſaid James Powel or any of the Officers, Mariners or Company thereof contrary to, or inconſiſtent with the Uſages and Cuſtoms of Nations, and the Inſtructions, a Copy of which is herewith delivered to him. And we will and require all our Officers whatſoever to give Succour and Aſſiſtance to the ſaid James Powel in the Premiſes. This Commiſſion ſhall continue in Force until the Congreſs ſhall iſſue Orders to the Contrary.

By Order of the Congreſs,

Dated at Virginia October 24th 1776

John Hancock PRESIDENT.

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Letters of marque first fell out of use in Europe through the 1856 Declaration of Paris, with seven countries renouncing the practice. Eventually 45 additional countries signed the

[7] Letters of Marque and Reprisal, CONST.ORG, https://constitution.org/1-Activism/mil/lmr/marque_it.htm (last visited Sept. 23, 2025).
[8] RALPH D. PAINE, SOME FAMOUS PRIVATEERS 45 (N.Y., Outing Publ'g 1925).
[9] State Library & Archives of N.C., Letter of Marque Issued to "Northampton", N.C. Digital Collections, https://digital.ncdcr.gov/Documents/Detail/letter-of-marque-issued-to-northampton/412416. (last visited Sept. 23, 2025).

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Declaration.[10] Interestingly, the U.S. Congress never signed the Declaration and still technically possesses the authority to issue letters of marque as no Amendment to the Constitution removes this enumerated Congressional power (although tacitly Congress abandoned the practice domestically after the Civil War). In fact, there have been recent calls in the 21st Century to use letters of marque to respond to acts of terrorism, modern piracy and cyberattacks originating offshore. In 2001 and then again in 2007, Congressman Ron Paul introduced a "Marque and Reprisal Act" in the wake of the September 11, 2001 attacks and the Somali pirates operating in the Gulf of Aden.[11] In 2022, Congress considered a bill to "[authorize] the President to issue letters of marque and reprisal" in order to seize yachts owned by Russian oligarchs in the aftermath of Russia's attack on Ukraine.[12] Neither bill was enacted into law.

The Analogous Link Between Letters of Marque and CRTs/SRTs

The principle behind the issuing of letters of marque is that the government may find it advantageous to allow private citizens to share in a risk borne by the government in exchange for a financial benefit not paid by the government directly. In appropriate circumstances, deputizing private citizens to engage in a specific common good certainly makes logical policy sense. Allowing such private citizens to financially benefit as compensation for their risk and effort equally makes good policy sense. Although the development of a modern and well-financed U.S. Navy renders letters of marque for privateers at sea anachronistic and indeed unhelpful, the principle underlying their issuance persists.

In a typical Credit Risk Transfer ("CRT") or Synthetic Risk Transfer ("SRT"), a private investor assumes the risk of the performance of a specific basket of loans originated by a regulated bank. Investors assume the first (or in some cases, the second) risk of loss on those loans, thereby reducing the bank's required level of capital reserves against those loans. In exchange for a cash infusion to the bank, the investor receives a premium to what the underlying reference portfolio of loans produces, assuming no loan defaults. The bank selectively engages in such transactions in order to achieve one or more of a number of strategic and or regulatory objectives: (1) to increase its overall capital levels in order to meet regulatory requirements; (2) to reduce loan concentration in a particular type of loan; (3) to increase the size of loan that it can make in a particular instance; (4) to ringfence legacy lower interest rate bearing loans in order to free up capital to deploy in a higher rate environment; and/or (5) to achieve other internal risk mitigation targets.

The analogous link between letters of marque and CRTs is the role of government. Bank regulators must approve CRT transactions, either specifically or in form (based on precedence set in prior, similar loan classes and transactions), to ensure the safety and soundness of the banking system. This fundamental policy objective is achieved if a bank can shift certain loan risk to non-bank investors who contractually or structurally agree to assume that risk. Such risk-shifting to unregulated third parties reduces the financial risk the government bears when a specific bank runs

[10] See supra note 3.
[11] Paul Offers President New Tool in the War on Terrorism, U.S. HOUSE OF REPRESENTATIVES (Apr. 29, 2007).
[12] H.R. 6869, 117th Cong. (2021–22).

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into trouble, and on a broader market basis, reduces the government's systemic financial risk when a crisis in the form of multiple bank failures take place.

The Modern "Letters of Marque"

The first risk transfers in the bank loan context took place in the form of off-balance sheet CDOs. JPMorgan innovated the use of synthetically transferring loan risk to investors via derivative instruments in 1997/1998 with its publicly traded "BISTRO" series of transactions. These instruments were structured off-balance sheet as collateralized debt obligation vehicles, or CDOs.[13] German development bank KfW followed suit utilizing synthetic structures on SME and mortgage loans for the explicit purpose of freeing up capital for making new loans.[14] The Great Financial Crisis of 2008-2009 ("GFC"), however, ended the practice of banks using off balance sheet CDO structures as it became clear that similar structures (primarily by non-banks) had passed along the risk of high defaulting loans, like subprime mortgages, to investors. Importantly, these early efforts to offload risk to investors did not have the explicit imprimatur of government approval.

Just as with the first letters of marque, the first ***government approved*** sharing of bank loan risk by non-bank investors took place in Europe. The European Banking Authority ("EBA") – "an independent EU Authority which works to ensure an effective and consistent level of prudential regulation and supervision across the European banking sector"[15] – developed between 2017 and 2021 a quasi-formal regime for allowing on-balance-sheet SRTs, setting detailed safeguards such as credit protection requirements, third-party verification agents and synthetic excess spread rules. These efforts to embrace SRTs ultimately culminated in the EBA's May 2024 Guidelines on STS ("simplicity, transparency and standardized") Criteria for On-balance-sheet Securitisations.[16] These SRT guidelines provided much needed clarity by which the EBA endorsed SRT as a tool for member nation banks to reduce capital levels. Clarity in turn resulted in a proliferation of issuance by EU banks: in 2024, 21.4 billion Euro of credit risk on 260 billion Euro of loans, an increase of nearly a third from the previous year.[17] European SRT represented approximately 60% of the total SRT/CRT issued in 2024. A predictable process for pre-approval by European bank regulators of proposed SRT transactions has been a significant factor in the volume of issuance, reflecting the standardization of the risk-sharing SRT tool. The broad expansion throughout the

[13] Fin. Crisis Inquiry Comm'n, *Preliminary Staff Report: Credit Derivatives and Mortgage-Related Credit Derivatives* (June 25, 2010), https://fcic-static.law.stanford.edu/cdn_media/fcic-reports/2010-0630-psr-credit-derivatives.pdf.
[14] Eur. Inv. Fund, *EIF Participation in KfW's PROMISE Securitization Programme* (Apr. 26, 2002), https://www.eif.org/what_we_do/guarantees/news/news_2000_2007/2002-09-eif-participation-in-kfws-promise-securitisation-programme.htm.
[15] Eur. Banking Auth., https://www.eba.europa.eu/english (last visited Sept. 23, 2025).
[16] Id.
[17] Mayer Brown LLP, *Credit-Linked Note FAQs from Federal Reserve Are One Step Forward for U.S. Banks* (Oct. 2023), https://www.mayerbrown.com/en/insights/publications/2023/10/credit-linked-note-faqs-from-federal-reserve-are-one-step-forward-for-us-banks.

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Europe Union has also been noteworthy. For example, UniCredit Bank Romania issued its first SRT in 2025.[18]

The approval and explicit endorsement of CRTs/SRTs developed more slowly in the U.S. Although several globally systemic banks such as JPMorgan and Bank of America issued SRTs patterned after the European-adopted on-balance sheet structures, bank regulators initially did not come out and explicitly endorse CRTs until September 2023. The Federal Reserve's endorsement of CRT came in response to an FAQ from a regulated bank:

> Through a directly issued credit-linked-note transaction, [regulated banking] firms can, in principle, transfer a portion of the credit risk on the referenced assets to the [CRT] investors at least as effectively as the synthetic securitizations that qualify under the capital rule…. A Board-regulated institution may request a reservation of authority under the capital rule for directly issued [CRT] in order to assign a different risk-weighted-asset amount to the reference [loan] exposures.[19]

The accelerating volume of SRT/CRT transactions in the U.S. demonstrates that the Federal Reserve has fully embraced the structure. In 2024, there was approximately $9 billion of credit risk issued to investors, representing approximately 30% of the total global issuance. In 2025, the number of CRT transactions issued by U.S. banks has substantially increased and the volume in terms of number of transactions and credit risk amount issued has exceeded the full year 2024 through August.[20]

CRT/SRT Investors as Government Sanctioned "Privateers"

As in the case of letters of marque, the government in CRTs does not compensate investors for sharing in a risk the government already bears. The investor, like the privateer, must risk his own capital and expense in pursuing the "marque." This point cannot be emphasized enough as it underscores the point that SRT/CRTs are an elegant and prudent way for the government to strengthen the banking system in an efficient way. According to an estimate by the MIT Sloan School of Business, the cost to the U.S. government of bailing out banks in the aftermath of the GFC was approximately $498 billion; the principal vehicle for bank bailouts was the Troubled Asset Relief Program ("TARP") for which Congress authorized $700 billion in total.[21] Instead of

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[18] Eur. Bank for Reconstruction & Dev., *EBRD and UniCredit Sign Their First Synthetic Securitisation* (Apr. 2025), https://www.ebrd.com/home/news-and-events/news/2025/ebrd-and-unicredit-sign-their-first-synthetic-securitisation-in-.html.

[19] Bd. of Governors of the Fed. Reserve Sys., *Legal Interpretations: Regulation Q Frequently Asked Questions*, https://www.federalreserve.gov/supervisionreg/legalinterpretations/reg-q-frequently-asked-questions.htm (last visited Sept. 23, 2025).

[20] EJF Capital LLC Research.

[21] U.S. Dep't of Treasury, *Troubled Asset Relief Program*, https://home.treasury.gov/data/troubled-asset-relief-program (last visited Sept. 23, 2025).

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bailing out banks after or as they fail, in CRTs the government allows third party investors to choose which loan risk to adopt, at what premium and on their own dime. This market driven approach, with explicit government blessing, encourages widespread SRT/CRT adoption over time.

As suggested above, the market not the government determines what amount should be paid for sharing in government bank failure risk. Just as in detailed and bespoke letters of marque, CRTs are often individually negotiated between the banks and investors that purchase their CRT loan pools. This is particularly true with respect to emerging areas of CRT, such as U.S. small banks with less than $50 billion in assets. There have to date only been six such transactions in total; in 2024 alone, there were a total of 127 SRT/CRT transactions globally.[22] One would expect that as an increasing number of small banks utilize CRTs and receive bank regulatory approval, more such banks will adopt this risk-shifting tool just as larger banks did first in Europe and later in the U.S.

Conclusion

Government endorsed risk-sharing has taken place since the dawn of sovereign nations. The benefits of this risk-sharing policy approach are often overlooked in the context of CRT/SRT transactions. Investors are attracted by the returns such transactions potentially offer, while banks recognize the benefit of this precise tool for managing risk and capital levels. But as importantly, and just as in the case of letters of marque in the age of rudimentary war, the government also materially benefits when bank regulators endorse the sharing of risk with private citizens -- risk that the government inherently bears as a sovereign supervising and protecting its financial system.

[22] EJF Capital LLC Research.
Cover Image: Queen Elizabeth knighting Drake, Getty Images, news photo, 1581, https://www.gettyimages.co.uk/detail/news-photo/queen-elizabeth-knighting-drake-1581-news-photo/629458395 (last visited Sept. 23, 2025).

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