

Viewpoint: Stop Blocking FDIC Securitization Effort

American Banker | Tuesday, March 9, 2010

By Christopher Whalen

An important conversation began last year in the Washington regulatory community, led by the [Federal Deposit Insurance Corp.](#), about how to repair the market for bank securitizations, especially residential mortgages. Unfortunately a number of banks and trade associations are trying to derail the [FDIC](#) initiative.

In 2000, after the [Enron](#) collapse, the FDIC clarified the scope of its statutory authority as conservator or receiver of a failed bank to disaffirm or repudiate contracts with respect to off-balance-sheet entities. Now the accounting rules have changed, again, and the FDIC is likewise amending its regulations. The 2009 accounting rule changes affect whether an OBS entity must be consolidated under GAAP.

Last year the FDIC adopted a rule creating a safe harbor for these vehicles through March 31, 2010, meaning that if a bank fails the FDIC will not seek to seize any OBS securitizations in which the failed bank sponsored or participated. The FDIC also is proposing new standards that could finally create a national template for bank securitizations. The rules would apply only when a bank fails, but obviously a bank resolution is the point of maximum risk for investors. They want to know: What happens to my investment if the FDIC seizes the bank?

The FDIC has stated publicly that it wants to ensure that securitizations serve as a valuable liquidity management tool, not a source of losses to banks and the [Deposit Insurance Fund](#). The practical policy issue is the losses observed in failed banks over the past two years, averaging over 30% of total assets, versus just 11% on average in the S&L crisis. The common factor in failed banks with high loss rates is unsafe and unsound securitizations practices, thus the FDIC initiative.

When the original rule was issued in 2000, auditors and accountants expressed concern that the FDIC might try to recapture a loan that had been securitized back into the receivership and terminate the contract by which the loan was sold using the agency's repudiation power. Now the FDIC is again providing comfort to the investment community as to how it will perform the role as receiver. But does it make sense for the agency to give comfort to investors using the same ground rules as in 2000, especially

when securitization of private-label, nonconforming residential mortgages helped create the financial crisis? No it does not.

FDIC officials have a legal responsibility to control the risk of loss to the [DIF](#) via securitizations, as well as to the banks themselves. It is clear that problems with securitizations led to a lot of losses, yet many regulatory agencies such as the [Federal Reserve](#) Board and the OCC, financial institutions and their trade associations are fighting the FDIC effort.

The FDIC rule is focused particularly on residential mortgage-backed securitizations because there is clear evidence that this asset class is where most of the problems originated. The FDIC is focused on issues that investors, banks and many others have raised — transparency, simpler capital structures, clear terms defining the transaction, strengthened loss mitigation and risk retention.

That the banking industry would fight the FDIC effort is very revealing. Many of the financial institutions that are criticizing the FDIC proposal on securitizations were responsible for the destruction of the private-label securitization market. These critics have no credibility and should be rebuked for having the temerity to voice any opposition.

The other point that must be made in response to the critics of the FDIC effort is be careful what you wish for. The agency does not need to spend time and resources on a rulemaking process at a time of rising bank failures and record losses to the DIF. The FDIC could simply do nothing and start to claw back assets from securitizations next time a bank fails.

Would the critics of the FDIC initiative who work at the Fed, OCC, SIFMA, the American Securitization Forum and other interested organizations prefer that scenario? Since obviously neither the FDIC nor the investment community wants to see such an outcome, the critics of the FDIC's rule making effort should stop complaining and start to participate constructively in a process that is long overdue.

Before the financial crisis, more than half of all financing in the U.S. economy was provided by SPEs and other vehicles. Fixing the bank securitization process is a national priority that should transcend parochial industry and regulatory interests.

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