

February 5, 2010

FDIC Eyes Plan to Securitize Seized Assets

By Erika Morphy

WASHINGTON, DC—Talk has revived that the Federal Deposit Insurance Corp. is putting in place a plan to securitize assets from the failed banks that it currently holds on its books. Last October, the agency indicated that such a plan was under consideration; more recently similar comments have been made.

In Washington, such comments are considered one step away from official announcements. Indeed, the question for many has become not if but when.

—FDIC was seeking a financial advisor as early as last August, — Kenneth Kohler, a partner at Morrison & Foerster, tells GlobeSt.com. — So this has been percolating for some time. That tells me two things: it is not on a fast track and the FDIC is serious about it. —

There are other, more fundamental questions as well, starting with what shape this program will take — and whether the structure the FDIC develops is one the private market can or will want to follow. If past history serves as any guide, the answer to the latter point would be a resounding yes.

The FDIC, quite obviously, is borrowing a page from the RTC era, says Brian Olasov, managing director for the Atlanta office of international law firm McKenna Long & Aldridge LLP. — The CMBS market grew out of what had been these non-performing commercial loan securitizations by the RTC.

— The securitizations of non-performing loans from failed thrifts proved to be very successful — ultimately the bonds not offered to the marketplace at the time were offered up in later years, when the market was more receptive. The government made quite a bit of money from the later sales of those certificates. —

It is not that simple, however, to re-apply the old lessons. Much is dependent on two factors, Olasov says: — the rate of failed institutions and the cost of resolving those institutions relative to the cost of securitization. That is an analysis that the FDIC has to make. —

Assuming it decides that securitization would be a net positive for taxpayers, there is also the private sector to consider: would there be demand for the paper and would the issuances jump start other transactions? **Developers Diversified Realty Corp.'s well-subscribed, TALF-backed CMBS offering last year** [http://www.globest.com/news/1542_1542/washington/182279-1.html] would suggest that there would strong demand for a FDIC deal.

A FDIC securitization program would also provide a pool of assets that can be used as the guinea pig for new procedures dictated by the marketplace to return integrity to the securitized markets, says Adam

Weissburg, partner with Cox Castle & Nicholson. "One significant fallout of the capital crisis is the widespread view that the securitization mechanism is flawed. Some perceived that rating agencies were not as diligent as they could have been," he tells GlobeSt.com. "Others that bankers were not appropriately incentivized because they had no economic stake in the game but, rather, received income from the booking of a given loan and its sale."

"Unfortunately, it will be similarly difficult for lenders to originate "securitization ready" loans without knowing that ultimately they can be sold in secondary markets."

A successful FDIC securitization, Kohler and Olasov both say, would also deliver a strong psychological boost to the market. "Certainly there is still a certain amount of demonization of securitization that exists that would be offset by the government's own endorsement," Kohler says.

That boost, though, might be more subdued if FDIC actually guaranteed the securities "essentially equating them to Fannie and Freddie, he adds. "In a way it would be a slightly different market proposition because they would seem to be more in the same class as government securities."

Furthermore in the short run, Kohler speculates, it could have a slightly negative impact depending on the terms and rates of the securities. "What we are talking about here is putting more supply on the market and that should put pressure on prices in the short term."

Whatever price fluctuations are introduced would be more than mitigated by a strong sense of valuations that the market would receive by a FDIC securitization program, Patrick Sargent, a partner in the Dallas offices of Andrews Kurth LLP, and president of the Commercial Mortgage Securities Association, tells GlobeSt.com.

FDIC securitizing its seized assets "will very likely bring much-needed stability and consistency to valuations and confidence from sidelined investors who are waiting to get back in the market," he says.

"The FDIC has a lot of product, which is unfortunate for the system, but it's important to get really close to valuations that people will acknowledge as accurate. We're seeing widely varying appraisal amounts. We've got to get "price discovery" in order to find out where valuations really are. Once people are comfortable with that, there are many investors on the sidelines waiting for what they perceive to be the bottom and valuations that they can justify."



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