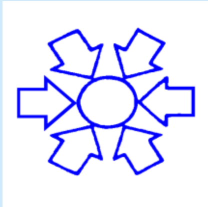

FedFin Client Report

Thursday, November 12, 2009

FDIC Takes Aim At Securitization Reform

Client Report: **ABS5**

Executive Summary

Today, the FDIC adopted an interim final rule for the treatment of assets in securitizations and a final rule to require the pre-payment of DIF assessments (see FSM Report **DEPOSITINSURANCE79**). The interim final rule provides a transitional safe harbor through March 31 for existing securitizations and transactions in process, allowing them to keep the "legal isolation" protections of the FDIC's 2000 securitization rule. The FDIC will propose a more stringent set of conditions for banks seeking safe-harbor relief after March 31 in a notice of proposed rule making at its December 15 meeting. FDIC staff have already developed draft conditions which are being circulated among the banking agencies. Chairman Bair believes these new conditions will go far in correcting the weaknesses in the securitization model, allowing insured depositories to profitably securitize loans, while still aligning incentives to support a more stable structured-finance process. The final rule on prepaid assessment is similar to the proposal but provides an earlier date to refund unused premiums and modifies the exemption process for liquidity-stressed institutions. This report analyzes today's session.

Analysis

Securitization Safe Harbor

The FDIC's 2000 securitization rule stated that the agency as conservator or receiver would not try to reclaim assets in securitization trusts as long as the original transfer met all the conditions for sale accounting treatment under GAAP. In June, FASB announced changes to GAAP that would prevent most securitizations from being treated as off-balance sheet sales for accounting purposes. As a result, under the FDIC's 2000 rule, most securitizations would not be treated as sales and could be considered a secured borrowing, which

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would require the consent of the FDIC as conservator or receiver before any action could be taken against the collateral for up to 90 days. This prompted ratings agencies to question whether securitizations should merit their own ratings or whether all securitizations would have to defer to the financial health of the sponsoring insured depository.

As noted, the FDIC notes that this interim final rule is only a temporary safe harbor. The forthcoming NPR will propose stronger conditions to qualify for the FDIC's protection against reclaiming assets in securitizations.

Director Curry said the situation clearly warrants a transitional safe harbor, but said that the FDIC, as receiver, must address the ongoing treatment of these assets after March 31 to provide strong incentives for sustainable structured finance practices. Comptroller Dugan agreed and called for a robust interagency process in developing a long-term rule, noting that it could have profound effects on securitization. He also called for extensive comment on the forthcoming NPR by all parties, specifically inviting views on timing issues. Vice-Chairman Gruenberg stressed the complexity of crafting a long-term rule and emphasized the propriety of using the FDIC rules to address weaknesses in the securitization model in return for relief.

Chairman Bair noted that the current ambiguity is holding up the ratings and issuance of securitizations. She noted the damaging role that the originate-to-distribute model played in the crisis.

Prepaid Assessments

As noted, the final rule is similar to the proposed rule, calling for the prepayment of estimated quarterly regular risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012 on December 30, 2009. The risk weight for the prepaid assessment will be zero percent and the assessment could only be used to offset regular assessments, not any future special assessments or penalties.

Events during the prepayment period, such as slower deposit growth or changes in CAMELS ratings, could cause an institution's actual assessments to differ from the estimated assessments used to determine the prepaid amount which could result in an institution either paying assessments in cash before the prepayment period has concluded or ultimately receiving a rebate of unused amounts. Any prepaid assessment not used by June 30, 2013 would be returned to the institution, a change from the proposed date of December 30, 2014.

Under the final rule, the FDIC will pre-identify exempt institutions and notify them by November 23, 2009. Institutions can petition for an exemption if the prepayment would significantly impair the institution's liquidity or otherwise create extraordinary hardship by December 1 with the FDIC making all final determinations by January 14. Exempt institutions could also request that the FDIC withdraw the exemption.

The measure was supported by all five Board members. Vice-Chairman

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Gruenberg praised the final rule, saying it is the best option available to support the DIF. Comptroller Dugan emphasized that this is not the time to increase assessments on banks. While he hoped to receive more detail on the level of liquidity strain this would place on banks, he agreed that the final rule would allow necessary flexibility to deal with stressed banks on a case by case basis. Chairman Bair lauded the measure for supporting DIF liquidity, protecting bank earnings, and remaining consistent with the model of an industry-funded insurance system.

Mortgage Originator Licensing

The FDIC adopted a final rule implementing the Secure and Fair Enforcement for Mortgage Licensing Act requiring all state non-member bank mortgage originators to register with a web-based system administered by the Conference of State Bank Supervisors. Originators would be required to provide borrowers with their unique identifier in the system, and, per FHFA, the GSEs will require this identifier on all mortgage applications after July 1, 2010. The rule includes a *de minimis* exception for individuals that originate less than six mortgages within 12 months. The final rule was supported by all members and adopted without opposition.

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