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FDIC gets into the securitization business

Agency packages and sells home loans originated by 16 failed banks

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SAN FRANCISCO (MarketWatch) -- The Federal Deposit Insurance Corp. is getting into the securitization business.

The government agency said late Friday that it sold securities in a deal backed by $471.3 million of performing single-family mortgages originated by 16 failed banks. The transaction, part of a pilot program, marks the first time the FDIC has securitized assets during the current financial crisis, it noted.

The top five failed banks involved in the deal were CF Bancorp, IndyMac Bank, Desert Hills Bank, Warren Bank and Republic Federal Bank, according to an FDIC spokesman.

The U.S. housing meltdown and broader financial crisis has triggered a wave of failures in the U.S. banking system, and the FDIC is tasked with cleaning up the mess. Earlier on Friday, it seized its 106th bank this year. Read more about the latest failure.

The FDIC usually sells failed banks to other lenders as quickly as possible to protect depositors. However, the process leaves the FDIC with lots of loans, which are sold at regular auctions. But the financial crisis has been so severe that the agency is trying other ways to unload these assets.

"The FDIC uses several strategies to sell assets from failed banks," it said in a statement late Friday. "Securitization is one of the ways in which the FDIC intends to maximize the value of these assets for the benefit of creditors of the failed banks."

Securitization involves packaging up loans and other assets into a security, and then selling it to institutional investors such as pension funds and hedge funds. The securities are sliced into different tranches offering different risks and rewards. The top bits pay the lowest interest rates, but are the last to experience losses if the underlying loans go bad. The bottom slices offer the biggest returns, but also are the first to absorb losses.

Securitization helped fuel the housing boom as lots of mortgages were packaged up and sold to institutional investors looking for extra yield in a low-rate environment. When house prices slumped and defaults jumped, many securitized products became illiquid and hard to value, exacerbating the financial crisis. See full MarketWatch coverage on securitization and subprime.

The FDIC said Friday that its securitization was sliced up into three tranches. Roughly $400 million of senior certificates were sold. These are guaranteed by the agency and will pay a fixed interest rate of 2.184% for about 3.66 years.

The other two bits are a mezzanine slice and an over-collateralization tranche. They are being held by the failed bank receiverships, which may sell them in the future, according to the regulator.

RBS Securities, a unit of Royal Bank of Scotland (LSS:UK:RBS) , was the lead underwriter on the deal. Co-underwriters were Bank of America Merrill Lynch (NYSE:BAC) , Deutsche Bank (NYSE:DB) and Williams Capital.