

## 5% solution for securitization? (April 3, 2009)

Eliminating ability to walk away from loans may improve underwriting, Barney Frank suggests

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By Steve Cocheo, executive editor

One of the failings of the securitization model in the pre-crisis period was the ability of lenders, especially nonbank lenders, to originate loans with questionable standards, and then walk away with profits from loan sales and no possibility of suffering if loans went bad later on. Barney Frank has a simple solution to propose: Make the loans sticky.

No lender should advance a borrower more than they can afford to repay, nor more than they are worth, said Congressman Frank (D.-Mass.), chairman of the House Financial Services Committee.

To enforce this in private-sector securitization markets, Frank suggests making lenders retain an interest—say, 5%—in loans or loan packages sold into secondary markets. Frank believes the securitization model—built on the concept of enabling lenders to continue turning over a capital stake by selling loans to investors and making new loans with the proceeds—is sound.

“But only if it is done right,” he added.

He said he has wondered how those responsible for the collateralized debt securities market debacle could have messed up so badly. He said he has concluded that they were counting on events never happening that happened.

“It was like having life insurance policies on vampires,” Frank told the bankers, using one of his favorite analogies. “Vampires aren’t supposed to die. And then the vampires started to die.”

Frank said as his committee continues to consider revisions to financial services markets structure and regulation, the model for addressing previously unregulated or under regulated entities and functions will be the approach taken to the traditional banking business. Among the measures he finds attractive are the traditional bank regulations that control the degree of leverage lenders can exercise based on a given chunk of capital.

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