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**From:** Luke Knapp [mailto:lrknapp@gmail.com]  
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**To:** LLPComments  
**Subject:** Legacy Loans Program

Now that the Treasury Plan to "cleanse" the market of "toxic assets" has been put forward, I have noted that The FDIC is the entity that will both guarantee the debt issued and vet the bidder list.

I also note the following quote from [The FDIC](#):

The FDIC will provide oversight for the formation, funding, and operation of new public-private investment funds ("PPIFs") that will purchase loans and other assets from depository institutions. The Legacy Loans Program will attract private capital through an FDIC debt guarantee and Treasury equity co-investment. Private market equity investors ("Private Investors") are expected to include but are not limited to financial institutions, individuals, insurance companies, mutual funds, publicly managed investment funds, pension funds, foreign investors with a headquarters in the United States, private equity funds, and hedge funds. The participation of mutual funds, pension plans, insurance companies, and other long term investors is particularly encouraged.

There is a potential problem here.

Let's say that I am a bank ("financial institution") with \$100 billion in "toxic assets". I have them on my balance sheet at 80 cents on the dollar. The market has them marked at 30 cents. We do not know what the held-to-maturity performance will be, since that requires knowing the future, although for the moment let's assume that they are cash-flowing at the present time.

What I (the bank) do know, however, is that if I sell them at 30 cents I take a monstrous loss - perhaps enough to force me under Tier Capital limits and thus render me subject to an FDIC enforcement action. I therefore will not sell for 30 cents so long as I have any belief whatsoever that the cash flow - or any government subsidy - will exceed that value.

If I, as a "financial institution" can participate as a bidder in these auctions I can foist off my loss onto the taxpayer. Here is how I can rig the game so as to avoid an otherwise-inevitable loss:

- I become a "bidder" and "bid" on my own assets at 75 cents.
- I am providing 5 or 10% of the money. The rest is covered by Treasury, The Fed and the FDIC via guaranteed bond issuance.
- The loan, ex my contribution, is non-recourse. That is, I can lose 5 or 10% of the total portfolio purchased, but nothing more.

Now the "assets" (a passel of CDOs?) turn out to be worthless. I lose 5% of \$75 billion, or \$3.75 billion that I put up, plus the other nickel on the original mark, but that's all.

**The taxpayer gets hosed for the remaining \$71.25 billion dollars.**

This can **and will** be done if the "sellers" of these assets are allowed to bid either directly or indirectly as it provides a means for banks to intentionally dump bad assets at a certain loss that is **much smaller** than their expected realized loss over time, shifting the rest of the loss to the taxpayer.

This program has the potential to shift literally \$500 billion or more in losses onto the taxpayer, not through the operation of "bad luck" but rather through what amounts to a bid rigging operation.

Be aware that I, along with many others, have figured this out. Also be aware that as taxpayers and your ultimate boss, we do not intend to sit still and allow the public treasury to be looted in such a fashion.

The FDIC's job is to prevent that sort of looting operation by prohibiting the sellers of these assets from having any financial interest in the bidding side of the equation, directly or indirectly, and I along with many others intend to hold you to that obligation.

I like the outline of this program if and only if it cannot be gamed in this or similar fashion. Provided that does not occur, this program has the potential to provide great benefit to both the banking system and our economy.

If, however, the financial institutions that created this mess in the first place are allowed by the FDIC and Treasury to use it as a looting operation to intentionally shift their bad assets onto the Taxpayer you can expect that we the people will hold our government to account.