Legacy Loans Program

Response to a

Request for Comment by FDIC

Quick Launch:

From the standpoint of the expectations of the Congress and the Administration, an early launch of the program is likely to be critical for its success. Getting the Legacy Assets quickly off the books of the banks to give them new headroom for loans to qualified customers is also dependent on a quick start for the program.

From the tenor of your questions, the machinery and the methodology for executing the program is the key issue at hand.

The fundamental concept in your present thinking is to have the market determine the price to pay for these assets such that the government does not pay too much for their share of the assets. Not a bad idea. However, the process of valuation of troubled assets in a dynamic and stressed market is going to be tough.

A Thought:

Here is a thought for the way the FDIC can use market forces to determine the valuation of assets without building a huge administrative infrastructure.

The FDIC becomes the market-maker that stands between the selling banks and the buying investors. The banks package their legacy loans with supporting documentation. The investors decide on the price they are willing to pay for the package and the banks decide whether they are willing to sell at that price. The FDIC takes a 50% stake in the transaction when the deal is done. The investor owns the loan in full and has the task of seeking the highest and best ultimate return in which the FDIC shares 50-50.

Once the package leaves the ownership of the bank, it becomes fully tradable on the open market With buyers that are acceptable to FDIC. This step is essential to create a vigorous exchange of willing buyers and sellers of the paper to create a current price as the economy evolves (hopefully upward).

Investors can create pools of such loans and trade these pools as bonds with appropriate risk ratings. Some hedge funds are already considering jumping into this market. The original investors would have responsibility to resolve the original loan package and report to the FDIC.

Simplified Machinery:

Nothing in life is ever really simple. But the structure outlined above would eliminate a complex administrative structure that would have to be built by the FDIC -- A structure that would take a long time to build, man and administer. The approach of FDIC as a market-maker would provide the necessary protection to the taxpayer and yet accomplish the fundamental task of freeing capital to be applied to permit banks to lend again.

But the central attraction is that it can be done quickly with known risks to the FDIC.

<u>FDIC's Role As Market-Maker:</u>

The FDIC would set the standards for the content of the loan packages and circulate them for bid by the investors. Once the investor determines a price the FDIC informs the banks and the bank can accept or decline the bid. If the bank accepts the bid, the investor and the FDIC own the package. The investor has the responsibility to work out the package through the disposal of the assets with a 50-50 split with the FDIC for the returns.

With the banks once again able to lend, the market should begin recovery and the assets held by the investors (and the FDIC) would increase in value and thus recapture the lost wealth that was imbedded in the loans in the first place.

It could be a win-win situation for the investors, the FDIC and the taxpayer.

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