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To: LLPComments
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Subject: Legacy Loans Program

To whom this may concern,

I would like to make public comment on these issues, both as a tax payer funding this and as a community banker whose small, community bank will be funding this through increased FDIC assessments.

1. Which asset categories should be eligible for sale through the LLP? Should the program initially focus only on legacy real estate assets or should any asset on bank balance sheets be eligible for sale? Are there specific portfolios where there would be more or less interest in selling through the LLP?
   Answer: If the FDIC will be providing a fall back guarantee on these loans, the loans sold should be only the legacy or toxic real estate related assets. Because of the standardization of traditional mortgage underwriting, more focus should be put on residential real estate mortgages, which will also create a side benefit of helping out all those whose homes are in danger. However, home equity loans, small business loans and some consumer loans should also be considered as assets that could be sold under this program since they make up a large part of a bank's balance sheet.
2. Should the initial investors be permitted to pledge, sell or transfer their interests in the PPIF? If so, how should the FDIC ensure that subsequent investors meet the program's criteria for investors?
   Answer: The initial investor should be permitted to pledge, sell or transfer their interest; however, the guarantee provided by the FDIC should be limited to the initial investor only. The initial investor should be rewarded for taking on the risk but not be permitted to speculate and profit from this speculation by selling these assets later because the FDIC is providing a guarantee. Otherwise, the initial investor should not be permitted to pledge, sell or transfer their interests.
3. What is the appropriate percentage of government equity participation which will maximize returns for taxpayers while assuring integrity in the pricing by private investors? How would a higher investment percentage on the part of the government impact private investment in PPIFs? Should the amount of the government's investment depend on the type of portfolio?
   Answer: Since no-one knows what these assets are really worth, an even

split between the government and private investors seems only logical. Having each share the risk equally hedges both sides of the bet. This answer would not change when factoring the type of investment in the portfolio (i.e. residential mortgages vs. any other type of loan).

4. Is there any reason that investors' identities should not be made publicly available?
   Answer: No there is no reason. These investors should be willing to let the public know who they are because their loss will be limited by the public's money through the FDIC guarantee.
5. How can the FDIC best encourage a broad and diverse range of investment participation? How can the FDIC best structure the valuation and bidding process to motivate sellers to bring assets to the PPIF?
   Answer: The FDIC will not have any control over the market that will have the appetite for these investments. It can only structure the valuation conservatively to portray a realistic value and expectations of default rates. The FDIC could create a "reserve price" like in any other auction to provide a floor value of the sellers' investment. If the sellers' loans are higher quality, then they will fetch a better price; however, if their investment is fraught with poorly performing loans that are well in excess of its peers, then they will not fetch much. Fetching anything is better than writing these assets to $0, though.
6. What type of auction process facilitates the broadest investor participation? Should we require investors to bid on the entire equity stake of a PPIF, or should we allow investors to bid on partial stakes in a PPIF? If the latter, would a Dutch auction process or some other structure provide the best mechanism for bridging the potential gap between what investors might bid and recoverable value? If multiple investors are allowed to bid through a Dutch auction, or similar process, how should asset management control be determined?
   Answer: Allowing an investor to bid only what they want is the most equitable way of handling this. It will also engage more investors if they are not being forced to buy assets they do not wish to have. So, pooling of dissimilar loans or pooling of loans from several banks should not be permitted. A Dutch auction process should work. If multiple investors wish to come together to bid on an asset, let them form an LLC to hold that asset. Through the LLC they can work out the details as to how the asset is managed, which takes the government out of the equation.
7. What priorities (i.e., types of assets) should the FDIC consider in deciding which pools to set for the initial PPIF auctions?
   Answer: Owner occupied residential real estate first. Owner occupied commercial real estate second. All other residential real estate including home equity loans third. All secured consumer loans fourth. All secured commercial loans fifth. All unsecured loans last.

8. What are the optimal size and characteristics of a pool for a PPIF?
   Answer: Size should be small enough pools to allow investors of all sizes to bid in the auction. $1 million pool of assets are not too small. Each asset pool should include a majority share of toxic or legacy assets (75% no doc. or low doc. residential mortgages for an example) with the remaining port made up of less risky, higher quality assets of the same type (25% of the less risky, fully documented residential mortgages). The same would then go of different assets classes, such as commercial mortgages, consumer secured loans and consumer unsecured loans.
9. What parameters of the note and its rate structure would be essential for a potential private capital investor to know at the time of the equity auction to provide equity?
   Answer: Rate structure -- Index to which the rate is tied if the loan(s) are variable. Frequency of reset. Cap and collar, if applicable. Other terms of the note -- projected duration based on the actual loans in the pool, not based on historical models. Lumping together loans with identical maturities would also be beneficial. The number of loans in a pool to determine the average size of the loan would also be beneficial.
10. Would it be preferable for the selling bank to take a note from the PPIF in exchange for the pool of loans and other assets that it sells? Alternatively, what would be the advantages and disadvantages of structuring the program so that the PPIF issues debt publicly in order to pay cash to the selling bank? Would a public issuance of debt by the PPIF limit its flexibility compared to the issuance of a note to a selling bank?
    Answer: Taking a note in exchange for a loan pool sounds an awful lot like buying a swap contract for the net present value of the incoming cash flow for a lump sum presently, which based on the current situation puts the underlying assets value at a huge discount. To clean up the balance sheet of a bank, I would strongly encourage the pool of loans be bought outright (with no servicing rights left to the selling bank). The selling bank needs to receive cash, not an IOU in the form of a note based on the perceived market value of the = underlying cash flow. This would imply issuance of debt as the only viable way to generate the necessary cash to pay banks for these assets. The advantage to debt issuance is that rates will be set by the market and will change as more of this debt is issued. I surmise that initially the cost of this type funding will be low, given the current rate environment, the market and the need to get this going. However the disadvantage would be as more debt is issued I believe investors will demand a higher rate of return as the auctions move forward. Investors will become more suave as they become more experienced with these unique investments and would likely begin to command a premium be paid as the true default rates become more evident. Additionally, inflationary pressures will come into play as this economic crisis comes to a head and is paid for by the Treasury increasing

the supply of money to fund this. Pent up inflation will become a huge factor if it takes years for these assets to sell, which I believe it will, because rate will swing up quickly as soon as the economy rebounds. Issuing debt would not hinder the flexibility. There may be a time in which these assets are no longer desired by investors. This would leave either leave pools unsold or pools that would have to be discounted to entice investors. The PPIF would run the risk of having to hold some of these assets or take a write down themselves.

11. In return for its guarantee of the debt of the PPIF, the FDIC will be paid an annual fee based on the amount of debt outstanding. Should the guarantee fee be adjusted based on the risk characteristics of the underlying pool or other criteria?
    Answer: If the FDIC is risk based pricing the premium for its insurance that it charges banks, and it does, then it must do the same for the PPIF debt. There is no difference between insuring these high risk, illiquid assets and insuring an de novo bank (an untested bank with an untested portfolio of loans). The criteria for the assessment must be tied to the risk of default and the class of assets in the pool. Higher risk loans (i.e. consumer unsecured debt) would need to be assessed at a much higher rate than lower risk loans (i.e. residential mortgages).
12. Should the program include provisions under which the government would increase its participation in any investment returns that exceed a specified trigger level? If so, what would be the appropriate level and how should that participation be structured?
    Answer: If the question is: Should the Government (read tax payers) receive a higher rate of return if yields are higher because conservative assumptions were used? The answer is Yes! However, the investors should be rewarded for assuming the risk as well. Should the split be equally? Probably not. I would argue that the FDIC and Government be given a larger share of the investment returns if they hit a trigger, and these excess returns be set aside for other pools that are not performing as expected. The investor should share in this though and the amount should be large enough to keep an investor interested in staying with this investment for its full life.
13. Should the program permit multiple selling banks to pool assets for sale? If so, what constraints should be applied to such pooling arrangements? How can the PPIF structure equitably accommodate participation by smaller institutions? Under what process would proceeds be allocated to selling banks if they pool assets?
    Answer: No. The secondary market for credit froze up because no one can determine the value of these assets. Part of that is due to poor underwriting by some banks and part of that is due to a lack of interest in buying any assets because they are presumed to be tainted, toxic assets. The way banks underwrite loans is not standardized, so pooling assets

does mean pooling risk, but this is predicated on the fact that all banks would need to underwrite loans identically. That is not the case. If a bank used prudent underwriting, which resulted in a better rate of repayment resulting in lower risk loans, it would be penalized if it sold more assets in the future when its loans were bundled with banks that were not prudent in their underwriting. If banks were not prudent in their underwriting, they should not be permitted to dilute the assets of a better bank in these assets pools. Let each bank stand on its own. Let better banks with better underwriting be rewarded for their better lending practices and poor banks be penalized for their bad practices. The idea here is to create liquidity, not reward those who took high risk loans with below market pricing and poorly structured loan agreements. If a market can be created for these assets, this market does not have to pay 100% of the face value of the assets being sold. Then give the selling bank the opportunity to refuse to accept a bid that is too low or put in a "reserve price" that must be met make the sale happen. Let the market determine the value of these assets based on the bank and its underwriting. To provide access to smaller institutions, make the threshold of bundled loans small enough ($1 million) to make sense for these smaller banks to participate in this program.

14. What are the potential conflicts which could arise among LLP participants? What structural arrangements and safeguards should the FDIC put into place to address or mitigate those concerns?
    Answer: Timing of sales could cause conflict. As more time passes and investors are better able to determine the real risk of the assets they bought, the required rate of return will go up. (I am implying that market's understanding the default rates, the real duration and the real rate of return on these assets will improve as time passes and the economy stabilizes. I am also assuming that experience will prove these investments are more like highly volatile "junk bonds" rather than less risky asset backs.) Since rates of return are inversely related to price, the longer a selling bank waits, the greater the risk their assets will be worth less. Additionally, if there is a huge glut of assets put up for sale all at once, the market will likely not have a balance between buyers and sellers. If the supply exceeds demand for too long, pricing will need to be reduced to entice investors to enter into this new market. Forcing participants to sell their assets over the course of a year or more instead of all at once could solve this. Also, for asset and liability management, making sellers schedule their debt for sale would also be prudent. Otherwise, you may have conflicts between sellers all trying to jump into the market all at once and creating a fight for a very limited number of investors and their money. If sellers of debt were to be forced to schedule out the assets they are to sell over the course of a year in monthly or

quarterly auctions, the FDIC would address this issue and avoid the conflict.

15. What should the relative role of the government and private sector be in the selection and oversight of asset managers? How can the FDIC most effectively oversee asset management to protect the government's investment, while providing flexibility for working assets in a way which promotes profitability for both public and private investors?
    Answer: Oversight of these assets should be as long as these assets are backed by the FDIC. That would imply the FDIC could provide a limited guarantee; limited to a finite period of time in years, or would be overseeing these assets until they are paid in full way in the future. The FDIC would need to train some if its regulators to specialize in the oversight of these assets and regulate the investors. This would be the carrot and stick (FDIC guarantee and FDIC oversight) that should come with these assets.
16. How should on-going servicing requirements of underlying assets be sold to a PPIF and paid for? Should value be separately attributed to control of the servicing rights?
    Answer: I would propose that these assets be sold with a service release. I would also propose that the sale of servicing not be permitted at any time. Have the investors who buy these assets service them. Part of the problem being faced currently it that servicers of residential mortgages are unable or unwilling to make decisions about the loans they are servicing. If the owner is the servicer, the owner can make decisions about the pool of loans and eliminate this issue going forward.
17. Should data used by the independent valuation consultant, as well as results of such consultant's analysis, be made available to potential bidders? Should it be made available to potential sellers prior to their decision to submit assets to bid?
    Answer: Yes, the results of the independent valuation consultant's analysis should be provided, but no warranty be extended that their predictions about these investments will come to be. Raw data should be available for the investors to analyze on their own or a standardized model be created that would allow an investor to change certain assumptions and generate different results based on the actual, underlying data may be an alternative. The only way to create confidence in this process is transparency and disclosure. Investors need to know exactly what they are bidding on and should have the ability to analyze raw data from the loan pool they are interested in to determine if they are comfortable with the risk and what they are willing to pay for the investment being offered.

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