Värde
PARTNERS

April 10, 2008

Mr. Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW.
Washington, DC 20429.
LLPComments@FDIC.gov.

RE: Legacy Loans Program

Dear Mr. Feldman:

Thank you for the opportunity to respond to the FDIC's questions regarding the Public Private Investment Partnership ("PPIP"). Please find our responses attached.

By way of introduction, Värde is a leading private investor in subperforming and non-performing loans and securities. We were founded in 1993 and have been an active participant in a number of transactions with the FDIC and other government agencies. We currently manage capital in excess of $4.5 billion. Our capital comes from a number of well-known and highly regarded endowments, foundations and pension funds.

We hope you find our responses useful and informative as you develop the PPIP program. We would welcome the opportunity to discuss our thoughts in more detail with your office.

Kind Regards,

Jason R. Spaeth
Managing Partner
Phone: 952 893 1554

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?**

We believe *if properly structured* the program offers participating financial institutions an opportunity to sell a majority of the assets they hold. The includes loans to small and medium sized business, loans to consumers, loans to finance commercial real estate, leases, and securities backed by such loans. Specifically, the program could include the following:

1) Performing and non-performing commercial real estate loans secured by multifamily, office, retail, and industrial and warehouse;

2) Acquisition and development loans secured by land, partially finished residential developments, and commercial properties;

3) Real Estate Owned assets included in 1 and 2 from above;

4) Residential mortgages including jumbo, alt-A, prime, subprime, HELOC's, and other related loans;

5) Consumer loans such as performing and non-performing credit cards, auto loans, student loans, personal lines of credit, and similar obligations;

6) Performing and non-performing commercial and industrial loans, secured and unsecured;

7) Small and medium ticket lease portfolios; and

8) Other loan assets where there is no remaining or immaterial funding commitments.

The critical structural issues which we feel the FDIC should address in order to ensure a successful program include the following: (a) Execution Risk; (b) Leverage; (c) Servicing Standards; and Political Risk.

A. Execution Risk:

Selling Institution: As currently drafted, the discretion to sell appears to rest solely with the banks. We believe that the rules should establish a clear process to set minimum standards for the number of bidders, sale structure, and contractual terms. Without such a process, investor appetite for the program will be low.

We are not suggesting that the government—Treasury or the FDIC—"force" the banks to sell, but rather participants in the program should sell if the rules established by the FDIC are adhered to by the bidders. Such bidding rules could include:

1. If at least three bidders provide conforming bids, the selling institution sells at the highest price; or

2. As currently drafted the program calls for valuations on the portfolios of loans. These valuations could form the basis of establishing a "reserve price" for the portfolio of loans. This reserve price is published at the time the sale is announced. Bidders could then determine if the price is reasonable before spending c

The FDIC could provide the selling institution with a share of the upside if the institution agrees to sell to the highest bidder. The FDIC could then work with the various regulatory agencies to determine the proper accounting treatment for this share in order to assist the selling bank with potential capital problems that may arise as a result of marking its portfolio to market. Upside sharing will be priced into the transaction and may result in lower prices all else being equal, but the benefits of more banks participating and, importantly, more sales closing may outweigh the costs.

We wish to emphasize that the costs of a "no trade" are great. We have been buying portfolios of whole loans, securities, and similar assets for over 15 years from the private sector and government agencies and are well aware of the time and money spent on preparing and submitting a bid. We also respect a competitive process. If trades are not happening, we will have little patience for continuing our participation in the program.

Bidding Institutions: The FDIC should ensure that its bidder qualification process is robust enough to avoid bidders being awarded portfolios but not closing. Requiring deposits is a step in the right direction, but does not go far enough in our opinion. Minimum balance sheet requirements, source of capital, experience, asset management plans, and track records are important elements the FDIC should consider in selecting bidders.

B. Leverage:

We are concerned over the prospect of introducing leverage into certain assets that are likely candidates for this program.

We suggest that leverage terms should be tailored to the specific risks of the assets. For example, non-performing loans should generally not include leverage from the taxpayer. Take for example the ANB Portfolio recently sold by the FDIC. Very few assets in that example lend themselves to any degree of leverage. The assets were largely busted residential land developments, a very risky asset class with uncertain prospects in the short to medium term. In fact many of the loans in the pool were liabilities disguised as assets as the cost to maintain and preserve the collateral was in excess of the asset's future value. These assets should not be leveraged as the taxpayer is exposed to too great of risk based on the terms of the leverage.

Furthermore, it invites a class of investor that may be attracted to the program principally given its relative low risk—pay a modest premium (50% of the equity in a highly leveraged 6:1 structure) for a potentially large upside.

On the other hand, leverage may work in particular assets that were (a) well underwritten; (b) have strong payment histories; and (c) are secured. In today's environment, we would argue that there is a liquidity problem, which is impacting. A sensible degree of leverage on such assets makes sense. However, the terms of the leverage should match the underlying assets. For example, certain assets like some residential mortgage backed securities or whole loan residential mortgages have average lives that are in excess of seven years and also have modest coupons. The taxpayer as equity investor and the private investor should not be subjected to undue risk posed by refinancing or interest rates. Maturities of liabilities, the FDIC guaranteed debt in this case, should be matched with the underlying maturities of the assets. Interest rates—fixed vs. floating—should also match the nature of the underlying loans. The cost of the debt should match the underlying risk of the assets. Leverage should also be structured in a way to resolve issues with unfunded commitments, servicer advances or other future funding liabilities.

We believe that much of the current financial crisis was caused by excessive leverage in the economy. We should not solve a leverage problem with more leverage. We should seek to achieve a sensible and perhaps conservative approach to leverage in order to protect the taxpayer, mitigate the number of speculators entering the program, and help ensure a successful result.

C. Servicing Standard:

Based on the current structure of the FDIC structured sales such as Arkansas National Bank, we are concerned about the servicing standard that may be imposed on the investors. We would prefer a better balance between protecting the taxpayers' interest and the contingent liabilities created by the current guaranties required by the FDIC. We would much prefer a more limited recourse structure whereby the assets of the particular investment are pledged to back-stop a guaranty. Furthermore, we would like to see the guaranty limited in scope. Without limits, we put our $4.5 billion balance sheet and 120 employees at risk while some of the smaller participants risk much less. We would be pleased to talk more specifically about our ideas with the FDIC.

Additionally, we feel strongly that investors should have the option of purchasing assets on a servicing released basis and that the servicing standard required by FDIC should fit with the assets being purchased. For example, if non-performing or distressed assets are being purchased, the taxpayer and the investor should be more interested in maximizing the present value of the underlying loan rather than working through a number of parties to obtain releases or approvals for a particular loan. The risks of subpar servicing can be greatly reduced by a robust qualification standards as well as a consistent structure that best aligns the interest of taxpayer, investor and servicer. In other words, assuming private investors have meaningful capital in the transaction, both the investor and the taxpayer equally share in good and poor servicing decisions (assuming little or no leverage). We feel that the structure of the RTC's N-series transactions in the early 90's provided for a balanced way for loans to be resolved.

Finally, with proper controls on the part of the investor as to servicing, we believe that pricing will in most cases be better. We underwrite investments based on internal rate of return requirements. As you know, IRR is influenced by time and recovery amounts. Having experienced asset managers (which the investor brings to the transaction) can greatly enhance the timing of recovery, the cost of the recovery, and the overall recovery amount. This provides far better pricing for the seller.

D. Political Risk:

One of the risks that we are concerned about is the potential that the rules established by the government for the PPIP change to the determent of the investor, selling institution, asset manager, and/or taxpayer. Although impossible to safeguard these parties completely, it would be helpful if the FDIC could mitigate some of these risks in the definitive contracts used in the PPIP. The parties to these agreements should be protected as much as possible from undue political risk. We do not want political issues to distract us from maximizing the value of the investments for the benefit of our investors and the taxpayer.

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?

We do not have a major issue with a restriction on selling or transferring our interest as we are typically buy and hold investors. The more critical issue relates to the assets. Investors should have the flexibility to control the resolution of the loans in the portfolio—whether on a bulk sale basis or a single sale basis (see "Servicing Standards" above).

However, the FDIC should consider the following as it contemplates restrictions on sales of the private investor's interest in the PPIF:

1) The more flexibility the program offers, all else being equal, the higher the price the bank will achieve for its assets. Furthermore, some otherwise qualified funds or institutions may be unable to participate if the assets are non-transferrable because of those funds' internal rules. These restrictions would limit the number of potential bidders that the FDIC is hoping to attract.

2) There is also the prospect that sales of the fund interest may help the FDIC achieve greater recoveries on the underlying assets. For example, Investor A purchases a pool of subperforming loans. Investor A is excellent at turning subperforming loans into performing loans. Investor B is excellent at maximizing the value of the performing loans. Investor A should be allowed to sell its interest

to Investor B. As long as the FDIC allows bulk sales of assets, this example is less relevant as Investor A could sell the portfolio to Investor B.

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?**

   We think the 50% equity participation is the maximum the government should provide. The government should be interested in attracting sophisticated partners that have meaningful "skin in the game" to mitigate the risk of speculation (investors coming into the program based on option value). A 50/50 deal also helps to align the interests of the taxpayer and the investor. The partnership is on an equal basis.

   Finally, in order to have to broad support from a variety of institutional investors, the FDIC should consider that we have some certain minimum investment sizes. A 50/50 structure and an adequate size of the portfolio will help ensure broad participation in the program from institutional investors while mitigating the risk of having a more speculative investor or undercapitalized investor enter the program. These limits also help to protect the taxpayer by reducing its investment in the transaction.

   We are also happy to do transactions where the government's equity participation is below 50% or even 0%. We appreciate, however, that the taxpayer should participate in the recoveries on these assets given the level of support it is providing to a number of these selling institutions.

4. **Is there any reason that investors' identities should not be made publicly available?**

   We believe that a degree of confidentiality should be maintained throughout the program. As such, we would prefer that our identity remain confidential to some degree. Furthermore, a degree of confidentiality will likely attract more investors to the program.

   However, it is essential that the identities of our investors remain confidential. The reason is that many funds that likely qualify under PPIP have underlying confidentiality provisions in their fund documents. This confidentiality should be maintained as part of the program. Many of our investors are well-known endowments, foundations and pension plans and they prefer to keep their identities confidential. Furthermore, the terms of the underlying funds that may be part of this program should be respected as these are trade secrets. Finally, we would prefer that the identities of our employees and directors remain confidential as we see no reason why these should be made public.

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?**

We believe that the best way the FDIC can encourage a broad and diverse range of investment participation is to structure the PPIP with the following principles in mind:

1. Provide a clear process where an investor has the confidence that assets will trade to the highest bidder (see "Execution Risk" above;

2. Limit an investor's risk under servicing guarantees and provide investors with proper controls on servicing (see "Servicing Standards" above);

3. Provide some degree of confidence that the rules and contractual provisions of the partnership will be stable over time (see "Political Risk" above);

4. Allow investors to partner with one another to pursue larger transactions;

5. Include sufficient information on the underlying assets, such as documentation, collateral information, title searches, borrower information, etc. so as to limit an investor's due diligence expenses;

6. Include as part of the purchase and sale agreement basic representations and warranties including, at a minimum, existence, enforceability and completeness. As with most private party transactions, the buyer should not have an obligation to obtain a release on behalf of the FDIC or selling bank before amending, modifying or taking any other action on any loan or asset purchased through PPIF (see "Servicing Standards" above); and

7. Provide for contractual provisions that allow investors flexibility on selling assets in the portfolio or its interest.

To encourage participation, the FDIC can structure its valuation and bidding process as follows (see "Execution Risk" above):

1. Provide selling institutions a team of professionals to organize the sale. These professionals should be experienced loan sale advisors in order to mitigate the time, expense, and opportunity cost of the sellers in preparing for the sale;

2. Attract multiple bidders to the process;

3. Provide complete due diligence documentation and information as part of the sale to minimize the amount of questions from the bidders;

4. Consider including valuation, title search, and bankruptcy searches as part of the due diligence information to reduce the time between sale announcement and closing;

5. Limit future contingent liabilities on the part of the seller as part of the sale;

6. Consider allowing the selling institution to participate along with the investor and taxpayer in the upside from a portfolio; and

7. Require that assets are sold at the highest price subject to a minimum number of bids. Failed auctions are bad for both sellers and buyers.

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?**

The best type of auction process will contain the following elements:

1. A clear process and time line;
2. Comprehensive information being made available to buyers (reduces due diligence expenses, time, and provides better pricing);
3. A draft purchase and sale agreement being made available at the time of due diligence;
4. A simplified investment structure were cash flow waterfalls, fees, and leverage terms are provided at the time of sale announcement;
5. Updates on underlying loans are provided to all bidders on a timely basis during due diligence; and
6. The highest bid wins the auction.

The FDIC may wish to offer a few different auctions for assets. For example, in the case of specialized assets or large portfolios, the FDIC may wish to run an indicative and final bid process in order to limit an investor's exposure to high due diligence costs.

We believe that all investors should be required to bid on the entire equity portion of a PPIF. Negotiations during the auction process should be limited to the price of the asset and the purchase and sale agreement. Allowing for additional areas of negotiation provide for greater uncertainty in the process and, therefore, detract certain investors from the process.

7. **What priorities (i.e., types of assets) should the FDIC consider in deciding which pools to set for the initial PPIF auctions?**

We buy loans of all types. Therefore, we are indifferent as to the types of assets the banks sell first. We feel if structured properly, the PPIP could work well for a variety of assets. See "Execution Risk", "Servicing Standards", "Leverage" and "Political Risk" above for our comments on structure.

8. What are the optimal size and characteristics of a pool for a PPIF?

We are most interested in auctions where our minimum investment is in excess of $10 million per pool. We have the institutional capability to underwrite a wide-variety of loans from performing, subperforming and non-performing. Furthermore, we are not overly sensitive to loan characteristics such as secured vs. unsecured, REO vs. non-performing, large balance vs. small balance, commercial vs. consumer, etc. In some cases, this may make the FDIC's job easier.

However, in order to attract a wide variety of bidders, the FDIC may wish to consider structuring the underlying pools with similar characteristics as follows:

1. Loan performance (performing, nonperforming, subperforming);
2. Average loan size;
3. Collateral type;
4. Underlying loan or security structure (subprime RMBS, multifamily term loans, small business unsecured term loan, etc.);
5. For performing loans, interest rate structure (fixed, floating, etc.) and maturity dates;
6. For non-performing loans, "age class" or number of days delinquent; and
7. U.S. vs. non-U.S. 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?

See our comments on "Leverage" above.

The FDIC should make it clear upfront the terms of the leverage and the cash flow waterfall. Again, the FDIC, in order to protect taxpayer interests, should seek to avoid excessive leverage and avoid putting unnecessary risk elements in a transaction. If leverage amounts are negotiable, there will be too many speculative investors attracted to the program and may cause more problems down the road for the FDIC, the private investor and the taxpayer. If leverage amounts and terms are negotiable, we would have less of interest in the program.

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?

See our overall comments on "Leverage" above. So long as the leverage is matched with the assets (maturities, interest rates, cash flow waterfalls) and conservative, as an investor we are indifferent between the government, the public capital markets, or the selling institution providing leverage.

However, it may 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 if it provides the bank some degree of upside from the sale of the assets (see "Execution Risk" above). This could potentially encourage more sales. An additional benefit could be that there is a greater potential to structure the terms of the financing to the underlying characteristics of the assets.

These benefits do come at a cost. Investor's will pay lower prices all else being equal if the selling institution maintains upside in the deal. Furthermore, it is unlikely that a private institution can issue debt more cheaply than the federal government. This also has an impact on pricing.

Additionally, it would be preferable to have the FDIC finance the sale as it allows the bank to realize a greater amount of cash at closing. These cash payments can be put to more productive uses in the cases of non-performing or sub-performing assets.

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?**

Yes the guaranty should match the risk of the pool. We agree that the FDIC should provide some degree of leverage to certain types of assets (see "Leverage" above). This guaranty fee should match the degree of risk of the underlying pool.

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?**

No, the upside should be shared by the equity participants (the government and the private sector) for taking the risk on the investment. However, the servicer and selling institution should all be incentive to maximize returns and provide for efficient execution (see "Execution Risk").

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?**

As a potential investor, we are somewhat supportive as it may help with minimum deal sizes. This only works from our perspective if the program provides for a clear resolution potential liability created by the transaction on the part of the selling institution (representation and warranty violations).

The critical elements to make this work properly is to provide for a fairly homogeneous pool of assets in the case of unsecured loans whereby the aggregate price paid is split by the selling banks based on the face value contributed. For the secured loans, the bidders can provide the pricing on a loan by loan basis. The FDIC should insist on the highest aggregate bid clears the market to avoid conflicts between the banks regarding the individual loan prices.

The Selling institutions will also need to agree upfront to a reasonable way of sharing potential liabilities with respect to the purchase and sale contract. Perhaps a portion of the purchase price is held in escrow to cover representation and warranty breaches is the best way to deal with these contingent liabilities. After a period of time the escrow is returned to the Selling institutions.

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?

The taxpayer as lender and equity participant provides the biggest potential conflict of interest on an individual pool basis. If leverage is structured poorly, these conflicts will be magnified. For example, if the terms of the FDIC leverage come at a time before the underlying assets mature, the FDIC as lender may force the FDIC as equity investor into a situation where value is compromised. In this example, the equity investors may be forced to sell assets into a market that still suffers from a liquidity problem in order to meet the maturity of the FDIC leverage.

In aggregate, the taxpayer will be participating across a wide number of pools where in one pool the taxpayer may have a subordinate position and in another a senior position to the same borrower, but different private equity partners. If the FDIC controls the servicing, it may be incented to promote a course of action that is beneficial to its senior position, but detrimental to its subordinate position. Therefore, the FDIC should ensure arm's length agreements and provide investors with a fair degree of latitude to service the assets (see "Servicing Standards"). Furthermore, the FDIC should provide that it is a fairly passive partner with regards to asset resolutions.

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?

The FDIC should be a relatively passive partner as it relates to the resolution of the underlying loan or security pools (see "Servicing Standards"). The best way to ensure that the tax payer is getting its value for money is to ensure a proper structure and qualification of investors and asset managers upfront. For example, the FDIC should consider a fee structure that allows the asset manager to participate in the upside while earning a fairly nominal fee that approximates the asset managers cost to manage the loan pool. Furthermore, the FDIC may wish to consider having each asset manager pledge this upside across multiple pools to ensure steady performance of each deal.

Additionally, the FDIC should consider dealing with investors that have the following characteristics:

1. Minimum balance sheet requirements or capital under management or a reasonable amount committed to the PPIP;

2. Experience of management;

3. Track record and experience in dealing with asset class;

4. Source of capital (not leveraged equity); and

5. Background check of institution.

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?

See "Servicing Standards" above. The portfolio should support and pay for the costs of servicing the assets. The structure of the transaction should allow servicer to recover the costs of collecting the assets first before the taxpayer or the investor receive cash. Secondly, the servicer should be properly incented to earn a fair profit if they do a good job and a large profit if they do an excellent job.

We attribute limited value to the servicing rights per se as they are a means to an end. Overall, if there is a market participant that can do a better job at servicing the assets as the selling institution, then the selling institution will achieve a higher price for the portfolio. Again, control of this decision should rest with the private investor.

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?

See "Execution Risk" and our responses to various questions above. We think that the information should be provided to all parties as it makes for a more transparent and efficient process.