ROSE LAW GROUP pc

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Federal Deposit Insurance Corporation
Legacy Loan Program
Via E-mail Only

RE: LEGACY LOAN PROGRAM – FDIC REQUEST FOR COMMENT

Rose Law Group pc represents a variety of pre-qualified prospective purchasers and submit these comments on their behalf. We would be happy to discuss any of these further as we have clients who will participate in the auctions depending, of course, on the final structure of the program. Thank you for the opportunity to comment. Contact me anytime at 480-505-3939 or jrose@roselawgroup.com.

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?

In order to maximize private investor interest in the Program and to facilitate truly competitive bidding, the Program should not only include real estate loan assets but also bank-owned REO assets. Like-kind assets should be pooled in similar regions, including commercial and residential loans and mortgages. Keeping assets localized by region and in similar asset classes will make pools easier to evaluate and underwrite for the private investors. In addition, assets should be pooled as performing or non-performing in order to allow investors to better value and understand expectations. The auctions will be more lucrative and successful if they are localized.

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?

Investors must be allowed to pledge, sell, and transfer their interest in the PPIF. This gives private investors the opportunity to exit the PPIF should their financial situation or objectives change. In order to protect the interests of the FDIC and U.S. Treasury, subsequent buyers of the original investor's interest would have to be qualified and approved by the FDIC just like the initial investors. However, once a private investor is qualified, a transfer of their interest in the PPIF into another entity controlled by the qualified investor should not require requalification.

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?

In order to optimize the amount of private investment in the Program, there should be two programs, one that provides the government as an equity participant and another that has the government simply providing financing and guarantees but not providing any equity. For the first option, the current proposal regarding the government's level of equity participation in the PPIF is adequate. While a larger investment percentage from the government will broaden the scope of investors that can participate, if the investment level is too high there is the risk of inviting unsophisticated private investment into the program. However, maximum government participation should be given to the most risky asset pools in order to induce private investors to take on that level of risk.

The second potential program, would allow the private investor to fund the entire equity component of the PPIF without any equity participation from the Treasury, thus limiting government and taxpayer funding and risk. The government would play the essential role of financing the purchase and guaranteeing the loan. This option would be ideal for private investors with adequate funding who may not need or even want to partner with the government large investments and will save the government money, risk and time. We would suggest that this second program be offered for all asset pools.

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

There is a strong preference on the part of private investors to keep their identity private, so as to avoid unnecessary public attention. We would presume that especially in this market, if it is publicized that a group has the money to participate in this program they will be on every contractor, vendor, and charity list and inundated with solicitations. Qualifying the private investor with the FDIC should provide sufficient protection to the 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?

In order to encourage a broad and diverse range of participation from both private investors and sellers, the following guidelines should be implemented:

<u>Increased Investor Participation</u>

- **The FDIC must ensure that the size of the asset pools vary in size from $50 million up to $10 billion. There are very few investors that can take**

down the larger asset pools. By having a range of asset pool sizes, a variety of private investors will be encouraged to participate.

- **The FDIC needs to ensure that the valuation and bidding process is localized by region. Asset pools need to be grouped and valued locally so that sellers are confident that they are being evaluated by people who understand the local real estate market.**

- **Sellers must be required to establish a reserve price on all asset pools. If sellers retain the ability to ultimately reject winning bids, investors are in the exact same position they are today as they negotiate directly with the banks. Without a reserve price in place, private investment interest will be greatly diminished.**

- **The FDIC should include both real estate loans and REO assets.**

- **The investor qualification process should no more onerous or rigid than the existing FDIC qualification requirements. If qualification requirements were to mandate that the FDIC delve into the background of a potential investor you may find, for example, that large funds will likely have multiple instances of being a member of an entity where the managing member defaulted. The FDIC should not eliminate potential investors from qualifying for this program in such cases, as many investors would be affected.**

- **The government should build-in economic incentives for the private investors (in the form of lower interest rates or discounted annual fees to the FDIC) to sell off the distressed assets once they reach their predetermined internal rate of return. This will have a trickle-down effect of stimulating the local economy where the assets are located by bringing local investors into the market once the initial private investors have moved on. In order to encourage ongoing private investment and further jump start the market, such economic government incentives are recommended.**

Increased Seller Participation

- **Localize the valuation process. Sellers will be motivated to include assets in the pool in order to obtain a better measure of the assets' true market value.**

- **The FDIC should encourage/incentivize sellers to include both real estate loan and REO assets.**

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 FDIC will be able to have the broadest investor participation by localizing the auction process by state or region and conducting live auctions. Live localized auctions will provide the greatest transparency to the process and may help boost local economies. Also, investors must be required to bid on the entire equity stake in the PPIF. Allowing partial investment in "shares" would severely complicate the process and discourage investment, as private investors will be required to conduct due diligence on their fellow shareholders as well as the asset pools. By having one private equity investor per PPIF, the FDIC will avoid problematic asset management and exit strategy control issues.

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

It will be critical for the success of the program that the initial auctions generate broad investor participation. For this reason, localized, like-kind asset classes, long with bank-owned REO properties and commercial and residential loans and mortgage assets should be the initial priority.

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

The optimal pool size for the PPIF is $50-100 million. The pool should be comprised of like-kind REO assets (i.e. a pool of foreclosed homes, a pool of commercial property, a pool of finished lots, a pool of vacant land), as well as like-kind loans and mortgages. The pools should be regional (*i.e.* Mountain West, Arizona, Nevada, Colorado, New Mexico, Idaho, Wyoming, California). In addition, the pools should be classified as "non-performing" vs. "performing" assets.

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?

Private investors will need to know the rate structure and term of the FDIC note, as well as any default provisions and recourse liability. Also, the debt-servicing requirements, asset management fees, and fees to the FDIC for its guarantee will need to be set forth in the note as well. Finally, in the wake of the AIG bonus issue, private investors will need contractual assurances regarding the protection of their upside profits prior to finalizing the transaction.

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?

The selling bank would be happy with either a note guaranteed by the FDIC or with cash, but may prefer a performing note guaranteed by the federal government. They would essentially replace a group of poorly performing notes with one large performing note. Banks almost always prefer a portfolio of performing loans over ready cash. The advantages of issuing public debt would be a quick payoff to the selling bank and a wide ranging disbursement of bank debt. The debt burden could be spread over thousands of investors rather than just the investor in a particular PPIF. The main disadvantages would involve a decrease in administrative efficiency and a fragmented management structure. Issuance of public debt would bring in waves of vested parties, which would not be the case on a simple note. In addition, issuance of public debt would make management and operation of the underlying assets extremely difficult as a substantial number of parties would theoretically have a say in such operation. However, given the current conditions in the public debt markets, issuance of a public bond is likely not a viable option.

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?

Assuming the FDIC's "annual fee" is in addition to interest payments, the interest rate (not the annual fee) should be adjusted to reflect the risk of the underlying asset. If the FDIC increases the interest rate, as well the annual fee based on risk, it could likely deter the enticing effects of the FDIC loan guarantee as being too expensive.

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?

The government should not receive a disproportionate amount of profits once the investment reaches a certain level. Indeed, by including such inequitable profit-sharing provisions, the government takes a disproportionate share of the profit while the private investor's potential upside profits are capped. Moreover, the private investor's overall risk of losing their entire equity stake in the PPIF remains the same. Profits and losses should be shared in proportion to each parties equitable contribution to the PPIF.

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?

The government should not permit multiple selling banks to pool assets for sale, as this could potentially increase the risk of each asset pool, and investors will need to evaluate multiple banks' REO and commercial paper portfolios, which increases the time and cost of due diligence significantly. Also, if investors are required to conduct due diligence efforts with multiple banks, only those investors with substantial manpower and resources will be able to evaluate each asset pool. This could have the unintended consequence of limiting investor participation.

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 private investors need contractual guarantees that their potential upside won't be retroactively taxed due to public outcry or political wrangling. If the deal is not structured in such a way that private investors are assured that the rules will not be altered later, the auctions will not bring in the kind of money taxpayers would demand as the asset valuation will be much lower with such a huge risk. Also, the private investors need to be the managing-member/shareholder of the PPIF (subject to government oversight), and have the sole discretion of managing the asset pools and ultimately selling them off. It really comes down to management of the underlying assets. The private investor needs to have exclusive control over the management and disposition of the underlying assets.

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 private investor should be asset manager of all PPIF assets, or have the ultimate decision in selecting the asset manager. Also, management fees should be allocated proportionately amongst the private investor and the U.S. Treasury according to their respective equity investments in the PPIF.

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?

The ongoing servicing requirements of the underlying loans and mortgage assets sold to the PPIF should be the responsibility and benefit of the equity investor and U.S. Treasury. As the investor and U.S. Treasury are risking their equity, they should be entitled to reap the benefit of the loan servicing of PPIF assets.

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?

The data and results from the independent valuation consultant should be made available to potential bidders. Most investors will be conducting their own due diligence prior to auction, but will rely on the FDIC's independent valuation consultant's data and pricing in making their final bid. Valuation data should also be made available to sellers, but sellers cannot be permitted to reject winning bids through the auction process. Allowing sellers to reject winning bids will cause the Program to fail as potential investors will be stuck in the same position they find themselves now as they negotiate directly with banks.

Sincerely,

Jordan Rose