Legacy Loans Program – Program Description and Request for Comments

The Treasury and the FDIC recently announced that they will establish the Legacy Loans Program (LLP) to remove troubled loans and other assets from banks. This program is necessary because uncertainty about the value of these assets makes it difficult for banks to raise capital and secure stable funding to support lending to households and businesses. All FDIC-insured depository institutions will be eligible to participate in the program.

While the idea of having the government purchase loans and other assets from banks has been proposed before, the problem of determining a fair price for the assets has prevented the idea from moving forward. The concern has been that a price set by the government might result in overpaying for the assets.

To address this concern, the Treasury will join with private investors to purchase these assets. This combination uses the expertise of the private sector and discipline from the financial markets to determine a market-based price for loans and other assets that have been hard to value.

The vehicle for purchasing assets from a bank will be Public-Private Investment Funds (PPIFs). Private investors will bid for the opportunity to contribute up to 50 percent of the equity for the PPIF. The winning bid for this equity share will set the implied value of the equity share held by the Treasury. With proposed financing guaranteed by the FDIC, this will define the overall price offered to the selling bank.

Because the government will be in partnership with private investors, the government will share in any profits. If private parties profit from their investment, as they expect to, the Treasury will also. At the same time, the Treasury will only suffer losses if the private investors do.

Credit markets have not functioned well recently because of a lack of financing for certain assets. To address this, a PPIF will be able to issue FDIC-guaranteed debt. For providing the guarantee, the FDIC will be paid a fee, a portion of which will be allocated to the Deposit Insurance Fund. The FDIC will be protected against losses by the equity in the pool, the newly established value of the pool's assets, and the fees collected.

This program will be coordinated with the other components of the financial recovery package to clean up bank balance sheets so that banks can once again provide the lending to further the recovery of the U.S. economy.

II. Request for Comment

The FDIC is requesting comment from interested parties on all aspects of the proposed LLP. In particular it has formulated the following questions for interested parties to consider:

> General comment to the program descriptions and term sheets:
> We are a private sector company, one of the larger in the commercial development and construction industry. We would like to set up a PPIF managed by us where we would invest together with the UST. We would only go after commercial properties/real estate, ideally the underlying assets as such rather than loans secured by real estate that fit with our core area of expertise. Our answers will reflect this wish.
> Overall the program description is conceptual without much detail, hence it has been difficult to interpret what the exact thinking is around the management of the PPIFs. A

prerequisite for our interest to invest in PPIFs will be the ablility to manage the PPIF on the basis of our current business model, policies and procedures as well as sound commercial principles. We hence do not expect FDIC, UST or any other government entity to regulate operations and management of the assets.

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?

   Our interest is investment in the area of commercial real estate. We would prefer as little pooling as possible for the sale of these assets to ensure transparency in what we are bidding for. In case of pooling, each portfolio of assets should have common characteristics in terms of eg geography and type of real estate, tenants, and structure of lease agreements.

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?

   The attractiveness of PPIF investments, and hence the pricing of the assets, will very much depend upon the investors' ability to e.g. sell or transfer PPIF equity interests and manage the assets in the same manner as any other investment portfolio. A key question in this is if the FDIC guaranteed debt is transferable to new equity investors and in case of divestment of individual assets?
   Assuming that there will be clear criteria established with respect to investor qualification credentials, such criteria should also apply to new investors as long as FDIC and/or UST have an interest in the fund.

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?

   The plan is fine as is but we would prefer to know what commitment the UST would be willing to make should our fund management decision be to make additional investments into an already acquired asset. Our general objective would be to make a profit for our private investors/UST over the long term which may entail making additional investments into already acquired assets for the purpose of maximizing their value.

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

   No

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?

   Any entity complying with clear criteria established with respect to investor qualification credentials should be qualified to bid. The criteria should be non-discriminatory with respect to e.g. type of organization and focus on reputable investors objective capabilities to successfully manage and develop the value of the asset(s) in question.

We would propose a two step procedure for pre-qualifying bidders. A first step through which potential bidders are pre-qualified with respect to certain general basic requirements. A limited number of bidders (typically no more than 5) should then, after applying for pre-qualification, be selected based on merit to bid for a specific asset or pool of assets,

Such a procedure will secure that only well qualified bidders will have the opportunity to invest in PPIF. The second asset specific selection of pre-qualified bidders will then serve as guarantee for an efficient bidding process, involving only the entities best suited to maximize the value of the asset(s) and hence capable of offering the best possible deal for the seller, FDIC and UST. Preparing for each bid will for any serious investor have a substantial cost associated and if we as a bidder know that only serious bidders enter into the bidding we will be prepared to assume the pre-bid costs.

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?

   For the sake of transparency, ability to objectively compare different bids and achieving the best possible price, each auction should be for a given asset or pool of assets. In order to secure efficient management of the asset(s) it is then also important that each bid is with respect to the entire private sector equity stake.

   The Dutch auction question implies that you expect to “fill the orders” incrementally. We would only buy assets were we controlled 100% of the asset. In general, more information about the assets is better and the more bids are likely to be placed. The more bids that are placed the more convincing it will be to the seller that this is where the market price is at and therefore potentially reconsider a previously higher reserve price.

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

   In case of pooling, each portfolio of assets for sale should have common characteristics in terms of e.g. geography and type of real estate, tenants, and structure of lease agreements

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

   It would probably be helpful to solicit feed-back from the PPIFs before an auction takes place to make sure the assets put out for bid are packaged in the most attractive and transparent way. Perhaps you would be able to get the PPIFs to pre-register their investment profile and by that know which ones to consult with before preparing the bid packages.

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?

   All information needed for financial modeling purposes and for calculating a projected net present value of the investment.

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?

    As long as the financing is guaranteed by FDIC and non recourse to the equity investor it is not important who originates the debt financing. More importantly, the selling bank should have no interest in, or influence over the management of, the asset(s) after the sale.

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?

    FDIC has already adjusted the risk of the loan by providing leverage tied to the risk profile of the asset so we think that you have already calibrated your risk and therefore the risk premium charged can be held more stable.

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?

    Certainly not. Investment returns should be shared by equity partners in relation to their respective equity participation. To the extent that an equity partner then provides services to the PPIF, such an equity partner should receive reasonable compensation for that service in addition to any investment return
    Recipients of TARP injections should not be allowed to invest in the PPIFs.

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?

    Not a benefit for us since we do not have an interest in the portfolio diversification that comes from pooling a lot of diverse assets into one group.

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?

    If your final design of the plan is as outlined by us above the potential conflicts will not be more than you would get in any investment fund or REIT. However, if you do not allow the investors enough flexibility to manage the asset(s), then you may end up with conflicts over the best course of action on a foreclosed property for example.

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?

    We believe we have provided our stance above and that is on asset managers. FDIC should keep a very close eye on PPIF managers but leave the asset management decisions completely up to the private sector PPIF investors. Profitability for private equity and the UST is completely aligned.

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?

    For what we are interested in and with our competency we would prefer to take care of the servicing within our PPIF or outsource if more cost efficient. Again, this should be the private sector investors right and obligation to decide have to best handle such matters.

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 Q9 above.

Comments on the LPP may be submitted until April 10, 2009.

You may submit comments by any of the following methods:

- E-mail: LLPComments@FDIC.gov. Include "Legacy Loans Program" in the subject line of the message.
- Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.
- Hand Delivery/Courier: Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m. (EDT).

Public Inspection: Please note that all comments will be posted generally without change (including any personal information) to the FDIC's website (http://www.fdic.gov/llp/index.html). Paper copies of public comments may be ordered from the Public Information Center by telephone at (877) 275-3342 or (703) 562-2200.