Dear FDIC:

In terms of background, my name is Theo Constantinidis and I am the founder of a financial advisory firm, PANAXIA Capital Management LLP, advising banks and corporations on restructuring their assets and liabilities as well as partnering up with established asset managers and funds to set up distressed asset and credit investment funds. Prior to setting up Panaxia, and over 18 years, I ran or worked in Structuring and Structured Credit Trading businesses at Merrill Lynch, Deutsche Bank, Lehman Brothers and Credit Suisse First Boston. My recent interaction with both banks and investors around "toxic" and other "problem" assets both in Europe and the US and my long experience in structured finance may be of some value to you in helping you fine tune the Legacy Loan program.

I attended the conference call on the 9th April and it was interesting to hear some of the comments made from some of the participants. I wanted to preface my comments with my opinion on the program's effectiveness in achieving its goals. I believe the program may face a great deal of resistance from banks, the public and investors depending on its actual details. While the government is willing to provide through the Treasury and FDIC generous amounts of leverage this is not enough to align everybody's interests in the same direction and unless that is achieved it may have adverse consequences for the following reasons:

1) The larger the amount of leverage the riskier the investment becomes for an investor. If for example an investor put $10 of equity and government helped fund it with $60 of debt in order to purchase an $100 face Legacy Loan portfolio for $70, then unless that loan portfolio recovers at least $70, the $10 of equity will be first to be whipped out. If the first $60+Interest of recoveries were to go to the FDIC Guaranteed lenders then investors need to make sure the next $10 is pretty certain as well. SO INVESTORS ARE GOING TO MAKE SURE IN BIDDING THESE ASSETS THEIR CAPITAL IS SAFE UNDER MOST SCENARIOS, RESULTING IN ROCK BOTTOM PRICES THAT MAY NOT REFLECT THE TRUE LONG TERM RECOVERY VALUE OF THE ASSETS.
2) As a consequence of 1) above Banks who accept the pricing may face significantly large additional writedown and capital losses. The government may find itself in the uncomfortable situation to infuse additional capital into the Banks to absorb these losses. Bank stock prices will plummet and the speculative attacks may restart. Letting THIS MARKET determine asset prices may not be the most efficient way to establish the TRUE value of these Assets.
3) I think the most likely outcome of 1) is that when Banks realise what gap exists between their own marks and the Market Bids they may decide not to participate in the asset sale and wait for bids to improve. This does not help the speedy resolution of the "problem" asset overhang that prevents the Banks from de-levering and starting new healthy lending.
4) A fundamental problem with today's market is the lack of liquidity for all but the most actively traded equities, currencies, commodities and bonds. Since investors can already achieve 10%+ returns from buying liquid A rated fixed income paper, they demand for more speculative issuers 20%+ and 30%+ returns. The Legacy Loan asset classes are unlikely to achieve a level of

liquidity that would allow them to trade like investment grade paper. Further the equity investment carries so much leverage that it would require much higher returns given its risk profile. What I am trying to say is that what you may be asking investors to bid for is not a portfolio of Legacy Loans but in effect the equity tranche of a CDO of a portfolio of Legacy Loans in which the government guarantees the $60 worth of the senior tranches and against investors' (and Treasury's) $10 of equity.

ALTERNATIVE AUCTION STRUCTURE

My overall suggestion to re-align everybody interest in the same direction may seem a bit unorthodox but I have seen it work in recent restructuring deals:

1) The FDIC/Government should agree with each interested bank the level of additional writedowns that are acceptable to it and who will take the hit (equity holders, tier 1,tier 2, etc...). Then it should offer the Legacy Loan portfolio at that level to the Investors. While investors do not determine the price of the portfolio they will still determine the price of their equity participation as explained below 2)-6)
2) The FDIC guaranteed loans/notes have light covenants, no triggers, and allow the PPIF to defer the coupon payments (cumulatively) until maturity depending on the cash flows generated by the portfolio. The maturity of the FDIC guaranteed loans/notes matches the expected legal maturity of the portfolio plus a time cushion depending on each case. The light covenants allow for payment of up to $10 of dividends to equity holders even if coupons on the notes have been deferred (still assuming investors have put in $5 of equity, Treasury $5 of equity, and $60 of notes/loans have been issued to purchase $70 worth of assets). This enables investors/Treasury to make back at least their principal but no additional return as long as there is some recovery on the assets. In essence investors/Treasury have underwritten the minimum value of the portfolio . If portfolio recovers less than the minimum value of $10, they will start losing principal as well. The loan is still legally senior to the equity and has first lien on all assets. The equity is not redeemed it is just allowed to earn dividends.
3) <u>The FDIC asks investors to bid for their % participation of the cash flows generated beyond the first $10 of dividends paid to them/Treasury.</u> The lowest bid wins the auction. This way the investor returns above principal are solely a function of how effective the PPIF is in recovery. For example an investor may require a 15% participation in cash flows above the first $10. In such case for every $100 received in recoveries $15 go to investors/Treasury and $60+Interest to repay the loans/notes and the excess can be kept by the Treasury/FDIC.
4) Since the debt maybe on sold to the market or kept by the banks, any upside on the Cash Flows to the Debt Holders above Principal and Interest (and Interest on Interest if coupons have been deferred) can be swept up by a Warrant the Treasury or FDIC holds enabling the government to participate in excess returns.
5) The FDIC should require the investors to hold to maturity the Legacy Loan portfolio and sell Loans only if they can achieve a minimum price set upfront and revised based on the performance of the portfolio.

6) The investors should be free to trade their equity shares in the secondary market.

While this is a very broad outline, I believe it achieves the following:

1) Minimizes writedowns of banks to the desired levels for government and FDIC which can enforce consistency between participating bank balance sheets. Buying assets at PAR or at current marks may create an inappropriate windfall gain for equity and other sub-debt holders. In other cases it may be fully justified given how conservative the Bank's marks are already.
2) Increases the interest for Banks to participate in the program as they can rid themselves of their Legacy Loan balance sheet overhang at acceptable marks and writedown levels with reduced and controlled need for additional capital or a new speculative run on their stock price.
3) Reduces the risk for investors/Treasury which are asked to guarantee the minimum value of the portfolio and would be fully committed to maximize recovery for themselves and the FDIC at the same time.
4) Potentially could allow the government a bigger say in the terms of the Loan Modification and other restrictions it may want to impose on the recovery process for these loans with less resistance from investors.
5) Allows government though warrants held by Treasury or FDIC to retain considerable upside in recoveries after principal of equity and debt outstanding repaid.

HYBRID AUCTION STRUCTURE

It is possible to combine the more traditional auction with such an alternative auction structure outlined above into a Hybrid Structure by modifying the participation percentages. In that case FDIC is auctioning the portfolio to the highest bid and at the same time asking investors to specify the level of FDIC guaranteed loans/notes (subject to announced maximum) they require and the waterfall participation %'s prior and after their principal recovery.

For example:

Cash Flow Waterfall	Traditional Auction Example	Alternative Structure Example	Hybrid Structure Example
Debt Holders ($60)	100% of first $60+Interest	0% first $10, then 85% of Cash Flows	X% prior to Investor principal recovery, then Y% of Cash Flows
Equity Holders ($10)	100% after first $60+Interest	100% first $10, then 15% of Cash Flows	100-X% prior to Investor principal recovery, then 100-Y% of Cash Flows
ASSET AUCTION	Highest Investor Bid	FDIC set price at $70	Best Terms a) Highest Bid, b) Lowest Leverage, c) Lowest % Cash Flows before and after investor principal

			recovery

The Banks/FDIC could determine if they wish to sell a Legacy Loan portfolio at the combined highest (equity bid+ leverage amount) with a lower participation in initial cash flows for debt holders or at the combined lower (equity bid+leverage amount) with a higher participation in initial cash flows.

MY COMMENTS TO THE QUESTIONS ON YOUR WEBSITE

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?*

   If the goal is to get the Banks lending again I would think they would need to be surveyed which loan portfolios pose the greatest problem in helping them de-lever and start lending again. I think Residential and Commercial Real Estate backed loans including mezzanine loans is a good place to start. I would think credit cards and other loan portfolios for which the securitization market is closed or limited should be considered as well.

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 more unrestricted the ability of the investors to trade their shares is the more eventual liquidity these shares may have. The underlying portfolio is not liquid and is unlikely to become liquid. In my recommended alternative there would be limited trading of the underlying portfolio that a PPIF buys. As such the shares of the PPIFs should be privately traded (and potentially some of them could choose to be publically listed in the future). The managers would have to adhere to existing rules/restrictions they already should have in place with respect to KYC/Money Laundering and Subscription of Investor.

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 % is less of the problem or the solution. The incentives of the government if aligned to those of the investors would be a real success. The government is also in effect the debt provider so the government’s incentives both on the debt and the equity need be thought of together.

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

   The identities of the PPIFs investing should be made public. The government should also have oversight over these PPIFs through its equity investment. If the PPIFs adhere to KYC/Money Laundering and other individual investor restrictions the government imposes then the PPIF Managers should ensure compliance allowing individual investors to stay private. Information about a certain individual investor buying or selling a certain PPIF’s shares may affect the price of those shares. Even with public entities the government does not require all investors to be disclosed, why would it require it for a private entity? Aren’t the Treasury and FDIC sufficient to safeguard tax payer’s interests in addition to existing and future rules and regulations with respect to private investment funds?

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?*

   AS DISCUSSED ABOVE

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 each Bank the portfolio should be broken down to smaller Sub-portfolios by a) state or districts within states, b) by collateral type: hotels, residential, malls, office buildings, etc…, c) by legal maturity (short, medium and long term). Then allow one winning investor group for each sub-portfol*io.*

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

   As stated above I would think those assets that get the lending going should be considered first.

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

   Sub-portfolios mentioned in 6 should be small $25-$50 million amounts allowing a PPIF manager to build a diversified pool to its investors' liking across collateral type, state or region, maturity and from potentially different banks.

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?*

   AS DISCUSSED ABOVE.

   Rate Structure could be fixed or floating allowing the PPIF manager and market to determine the optimal mix and demand.

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?*

    I would imagine allowing the banks to receive the cash enables them to de-lever their balance sheet and strengthen their core capital base. Both desirable outcomes. Notes-for-Legacy Loans exchange won't reduce their gross balance sheet even if the FDIC guarantee on the Notes should improve their capital treatment. Under BASLE II the Notes may also have to be rated to ensure they keep their regulatory capital advantage which is an additional cost and problem depending on the degree of leverage provided to the PPIF.

    The Bank could initially warehouse these Notes and use their sales network or the services of a bigger broker/dealer to sell these Notes to interested investors. Even in the case of the Covenant

Light Notes outlined in my example the FDIC Guarantee should enable a competitive market in these Notes.

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?*

    The FDIC should endeavor to cover its costs based on the recovery assumption/independent valuation it has on the portfolio and the equity/debt payment waterfall cash flow participations it has agreed to. The pricing alternatives should be announced ahead of the auction to enable investors to price their equity participation.

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?*

    Yes but don't limit investor upside if they take risk.

    In my Alternative Auction Structure the government retains considerable upside. The more distressed the price the higher the upside.

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?*

    Would not recommend it! The program should allow each PPIF to build its own desired portfolio of different Legacy Loans originated (and potentially serviced) by different Banks. As per my comments on 6. It is better to let the Investors and PPIF manager determine the mix by participating in different auctions of multiple sub-portfolios offered by one bank at a time. They can choose which sub-portfolios of which banks they desire. Some sub-portfolios get few bids some get many bids. Some PPIF Managers bid for the whole thing some bid for the pieces. There could be an option to provide an all-or-nothing alternative bid as well at the option of the PPIF in addition to individual sub-portfolio bids.

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?*

    In general there is a great deal of examples on well structured and not so well structured LLPs. For example most law firm specializing in setting up hedge funds (where LLP is a favorite structure) have a vast amount of experience given the recent turmoil in what to do and what not to in order to avoid such conflicts of interest.

    My advice is not to allow much trading of underlying assets, not to allow redemption of equity investments by sale of assets, but allow a broad and liquid market to develop in the underlying LLP PPIF shares to ensure liquidity for investors. Give General Partner the decision making ability subject to LLP voting rights. With respect to the Treasury being an LLP as well special rights need to apply as private investors may be less willing to invest in an LLP where government control 50% of the votes.

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?

Investors should choose their PPIF Manager using their own criteria, not the Government! If the Treasury does not like the PPIF Manager then it may wish not to take an equity participation and limit the FDIC debt available to it.

Investment should be allowed by non-US investors and well as management by non-US owned managers.

PPIFs should be US entities subject to the same tax rules as other private equity funds.

The Treasury should set up a Fund of PPIF Funds, select a top asset manager to which the Treasury as the sole investor can define its requirements and investment priorities. The Treasury can set up an Investment Committee comprised of industry experts to supervise the manager's investment decisions and ongoing asset management.

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?*

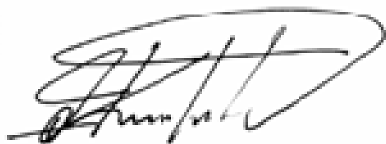
    Since many of these loans are not transferable (at least easily) and the Banks that originated them are most likely the most capable in servicing them (at least initially) they should be selected as the sub-service advisor to the PPIF which should have the servicing rights. They should be paid market fees for these services. However, PPIF should have right to transition the Sub-Servicer to a Sub-Servicer of its choice over a certain time frame if it feels it will get better results than the existing Bank or Bank fails on the Sub-Servicing contract.

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?

    I do not think it makes much of a difference unless such valuation is the minimum acceptable price at which Bank/FDIC are willing to consider selling the portfolio.

Hope this feedback is helpful. Please feel free to follow up with any additional comments or questions.

Sincerely,



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