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LEGACY LOAN PROGRAM COMMENTS

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The Legacy Loan Program ("LLP") is designed to facilitate the sale of pools of loans held by FDIC-insured institutions ("banks"), thereby cleansing the banks' balance sheets from the uncertainty associated with those assets, reducing market overhang, and creating a market, and pricing mechanism, for pools of currently-illiquid bank-held assets. Legacy Loans, as described in the term sheet for the LLP, include residential mortgages, commercial mortgage loans and securitizations of such loans. Potentially, those asset classes could be expanded.

Major features of the LLP, as currently proposed include:

- Bank sales of Legacy Loan pools to public-private investment funds ("PPIFs") comprised of private investors ("Investors"), and the Treasury, each of which is to make an equity investment;

- Leverage (up to 6 times the total equity investment, as determined by the FDIC) provided by means of debt issued by the PPIF, and guaranteed by FDIC, with such guarantees collateralized by the assets purchased ("Assets");

- Pricing set by the market participants (not Treasury) by means of public auctions conducted by the FDIC; and

- Upon a bank's acceptance of the highest bid, the Investor is to control and manage the assets, subject to FDIC oversight with sub-servicing to be performed, at least initially, by the selling bank subject to control by the PPIF.

Legacy Loan Program debt terms (including minimum loan sizes, repayment terms, amortization schedules, interest rates, servicing fees and maximum loan durations) have not yet been determined. The FDIC will guarantee the PPIF debt that is expected to be issued by the PPIF to the seller bank, in an amount and on terms specified by the FDIC. Treasury and the FDIC have requested public comments on the Legacy Loan Program, including comments and suggestions with respect to bank-provided financing or other types of FDIC-guaranteed debt, and comments or suggestions as to the composition of Asset pools.

Among the major issues facing Treasury and the FDIC are how to:

- Attract large, well qualified Investors that can act quickly, and that are approved by the FDIC as eligible buyers;

- Sell large pools of Assets to long-term Investors who will hold the Assets to maturity, thereby keeping them off the market;

- Provide transparency;

- Manage the Assets and structure the FDIC-guaranteed debt to minimize the FDIC's exposure on the guarantees and preserve Treasury's potential upside return on its investment;

- Determine the structure and terms of the FDIC guaranteed debt, and the permitted level for any specific deal; and

- Determine the type and amount of FDIC oversight the PPIFs will be subject to.

According to the Treasury's Fact Sheet and Term Sheet, pension plans are encouraged to participate as equity investors in the Legacy Loan Program. Clearly, State and local government pension funds have sufficient assets to become substantial Investors in PPIFs- - one current estimate is that State and local government pension funds control over $3 trillion. Many face substantial underfunded liabilities due to their historical commitment to defined benefit pension plans, substantial market losses during the economic downturn, increases in the costs of post-retirement medical care, and the longer post-retirement lives of beneficiaries. Projections indicate that due to decreased future revenues, increased costs, low investment returns and portfolio losses, within the next 5 years the level of underfunding may rise significantly.

The looming problem caused by that underfunding, coupled with a decreasing tax base due to the current economic downturn, and lower investment returns, is that there is virtually no way for State and local government pension funds to fill the economic gap between funding levels and liabilities.

One solution is to ensure that State and local government pension funds have the opportunity to become Investors in the PPIFs and therefore non-recourse obligors on the PPIF debt, or investors in the PPIF debt, providing them with loan repayment terms consistent with the State and local government pension funds' need to reduce future funding deficits for the public good.

To facilitate State and local pension fund investment in the LLP, the Treasury and the FDIC should adopt the following modifications to, and clarifications of, the Legacy Loan Program:

- State and local government pension funds should be permitted to become an equity or debt investor in one or more PPIFs to invest in the Legacy Loan Program, as well as the Legacy Securities Program.

- A State and local government pension funds' investment in the debt of a PPIF, should not be conditioned upon its investment in the equity of that PPIF or any other PPIF. State and local government pension funds should be permitted to offer debt financing to the PPIFs, both covered by the FDIC guarantee, or non-guaranteed debt collateralized by the PPIF's Assets not securing the FDIC guarantee;

- State and local government pension funds should be required to retain a professional manager, subject to pre-qualification by the FDIC ("Manager") to participate in the auction process on behalf of the State and local government pension funds and to manage each PPIF in which the State and local government pension funds invest; and

- The FDIC should permit or provide flexible alternative repayment schedules for the State and local government pension funds with respect to such pension fund's allocable share of any FDIC-insured debts, or other debt provided to the PPIFs.

The Treasury and the FDIC should consider alternative provisions for investment in PPIFs by the State and local government pension funds that offer to form, or invest in, PPIFs to purchase pools of Legacy Loans and hold those Assets, and the debt used to finance such PPIFs, to maturity because, among other things:

- The State and local government pension funds' will help to decrease permanently the number and aggregate dollar amount of Legacy Loans flooding the market, eliminate market overhang, help provide future market stability and potentially result in higher prices and more demand for Legacy Loans;

- The State and local government pension funds will enter into the Legacy Loan market as a means of closing the State and local government pension funds' funding gap and decrease the possibility that the State and local government pension funds' unfunded pension obligations will eventually require government assistance;

- From a public policy viewpoint, modifying the Legacy Loan Program to enable the State and local government pension funds to invest in, and potentially profit from, PPIF equity or debt investments expands the availability of funding for the LLP at no additional cost or risk to the Treasury or the FDIC, and should improve the State and local government pension funds' financial position and help fund their obligations to their participants;

- Investment in PPIFs utilizing a professional investment Manager is consistent with the goals of the LLP and will promote the likely returns on the PPIF and reduce the risks of such PPIFs to the Treasury and the FDIC, as well as adding transparency to investment by the State and local government pension funds;

- Professional Managers will be employed to represent the State and local government pension funds in preparing bids and bidding for Legacy Loan pools and to manage those Assets for the benefit of the State and local government pension funds thereby promoting equitable bidding and price transparency in the loan auction process;

- Reducing the underfunding of the State and local government pension funds will potentially reduce those pension funds' amount, and cost, of borrowing especially if State and local govenments are able to obtain ratings upgrades due to the decrease in their unfunded retirement liabilities;

- Any PPIF debt purchased by the State and local government pension funds, as well as any equity investments should lower the costs of the LLP and failed bank resolution costs to the FDIC and Treasury.

Whether investment in the Legacy Loan Program will help the State and local government pension funds decrease the amount of their unfunded liabilities will depend not only on the price, quality and management of the Legacy Loan pools purchased, but also upon the structure of the PPIF's debt obligation and the repayment terms. While we suspect that currently the FDIC may contemplate proportionate repayment of the FDIC-guaranteed debt allocable to any Legacy Loan that is sold or repaid (prior to maturity or otherwise), State and local government pension funds might reasonably request that the FDIC adopt alternative, flexible repayment mechanisms that permit asset value accretion in the hands of the State and local government pension funds by limiting the cash required to repay the debt under certain circumstances.

The repayment of the State and local government pension funds' portion of the FDIC-guaranteed debt or other PPIF debt could be structured so that some fixed percentage of receipts is used to pay debt service, with a moratorium on payment of the State and local government pension funds' portion of the debt service at times when there is insufficient cash flow from the Legacy Loan Assets. Such a structure might require three equity investors in the PPIF, a for-profit servicer (or the Manager) to provide advances to pay debt at times of insufficient cash flow, the Treasury, and the State or local government pension funds. Alternatively, to reduce risk to the FDIC, the Treasury and the PPIF, cash accumulated as liquidity in the PPIF could be used, at least in part, for making such payments.

Increasing the duration of PPIF debt invested in and held by State and local government pension funds could augment the PPIF's returns to its debt investors, improving the LLP's chances for success and reducing the FDIC's risk while providing the State and local government pension funds better matching of their assets and liabilities.

It would be extremely helpful to State and local government pension funds if their investment in PPIFs could be funded using tax-exempt debt.

Alternative payment schedules to be considered might provide that debt service on the PPIF obligations and fees (such as fees to the FDIC on the FDIC-guaranteed debt) be payable from only:

- X% of the cash flows from the Assets; or
- Y% of the *current* cash flows from the Assets; or
- Z% of the *current* cash flows from the Assets and some percentage of prepayments on the Assets; or
- A regular repayment schedule for the FDIC-guaranteed debt coupled with an alternative payment schedule for the State and local government pension funds' portion of FDIC-guaranteed debt or non FDIC-guaranteed PPIF debt held by the State and local government pension funds.

Potentially, requirements of the selling banks include:

- True sale treatment;
- Elimination of the sold Assets from the calculations of capital for bank regulatory purposes;

- Purchase money debt issued to the selling bank be eligible for investment by the seller bank, and preferably also be counted by the seller bank as capital for regulatory purposes; and

- Compensation, in the form of continued participation, an equity kicker or an extra return on debt funded by the State and local government pension funds, in return for a deferred or alternative payment schedule for the State and local government pension funds.

The possibilities are plentiful. State and local government pension funds can craft specific proposals that while reasonable to the banks, as well as to Treasury and the FDIC, will result in fairly rapid accretion in the value of the State and local government pension fund assets.

Although a totally customized PPIF debt obligation which includes special features such as deferral due to insufficient cash flow from the Assets may not be the norm for the PPIFs, the State and local government pension funds could be required to make certain concessions in return for alternative debt terms, including:

- holding performing Legacy Assets in the PPIF to maturity;

- agreeing to enact targets for the State and local government pension funds' investments in Legacy Loan PPIFs;

- modifying the relevant pension plan provisions (or State or local law) to the extent necessary to permit investment in Legacy Loan PPIFs and their debt instruments while satisfying the State and local government pension funds' fiduciary duty;

- investing up to specified dollar amount in PPIFs invested in Legacy Assets.

In addition, State and local government pension funds might reasonably request that each be permitted to bid on pools consisting of a specified percentage (or range) of real estate loans for which the borrowers or the properties are located in their State, as well as loans held by banks located in their State.

Respectfully submitted,

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