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THE CLEARING HOUSE®
Advancing Payment Solutions Worldwide

April 10, 2009

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Attn: Comments

Re: Legacy Loans Program

Dear Mr. Feldman:

The Clearing House Association L.L.C. ("The Clearing House"), an association of major commercial banks,[1] appreciates the opportunity to comment on the Legacy Loans Program (the "LLP") proposed by the Federal Deposit Insurance Corporation (the "FDIC"). Our member banks regard the LLP as a critical component of the government's comprehensive effort to restore confidence in the banking system and increase credit availability. Our comments are designed to increase the likelihood of the success of the LLP in achieving these goals.

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1 The members of The Clearing House are: ABN AMRO Bank N.V.; Bank of America, National Association; The Bank of New York Mellon; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank, National Association; UBS AG; U.S. Bank National Association; and Wells Fargo Bank, National Association.

The Clearing House Association L.L.C.

I. Introduction

The success of the LLP is inherently dependent upon the establishment of "clearing prices", i.e., prices at which investors are prepared to buy bank loans and banks are willing and able to sell those loans. In addition, clearing prices must be available for a sufficient volume of bank loans so that the market will perceive the banks as having truly derisked their balance sheets.

In this context, both investors and banks must be willing to engage in transactions that involve prices for loans that approximate intrinsic values and reasonable profit expectations for the equity investors. We are concerned, however, that investor return requirements may involve pricing at which banks are unwilling, and even unable, to sell loans. If the pricing is significantly below intrinsic value, many banks will not be willing to participate in the program. For those banks that are willing to participate, not only would they be surrendering substantial value to the investors, but the resulting capital hole could prove very difficult to fill. Such a transfer of value would be inconsistent with the government's objective of stabilizing the banking system and increasing lending.

The FDIC's willingness to support leverage should enhance potential returns for investors and support prices that represent intrinsic value. It should be recognized, however, that the leverage proposed by the FDIC is well below the leverage at which even the most well capitalized banks maintain the loans. Accordingly, it is essential that the FDIC support as much leverage as it can justify. Likewise, the cost of this leverage should not exceed the banking industry's cost of funds and, ideally, match the FDIC's cost of funds.

As set forth in the next section of this letter, we recommend an alternative for loans dispositions that we believe is more likely to create clearing prices and facilitate the LLP's success. We also propose a second alternative that is designed to deal with the situation where clearing prices cannot be readily achieved from third party investors. In addition, many of our responses to the specific FDIC questions are directed to the clearing price issue.

II. Loan Disposition Alternatives

1. *Bank as a Co-Investor.*

The Clearing House believes that the selling bank should be able to participate as an equity investor in a Public-Private Investment Fund ("PPIF") to the extent of 50% of the equity designated for the private sector.[2] We also believe that a selling bank that does participate should be permitted, in its discretion, either to retain its equity interest in its PPIF or, as a dividend to its existing shareholders, distribute all or a portion of its equity interest. This approach should help in achieving a clearing price for at least five reasons.

First, banks may be more willing to accept a lower initial price if they and their shareholders have a meaningful opportunity to share in the upside.

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2 The FDIC's LLP proposal does not either explicitly permit or prohibit this co-investment.

Second, one likely restraint on pricing by third-party investors is the informational asymmetry. No matter what depth of due diligence is conducted, the selling bank will have more information and knowledge about the loans than the potential investor. If the seller participates in the equity, the third party investor may have more confidence in the value of the loans and thereby increase the price it is willing to pay.

Third, selling bank participation in the equity would help prevent an undue transfer of value from the banks to the private investors. This would increase the stability of banks and their capacity to lend.

Fourth, reducing the amount that private investors invest in any single PPIF because the selling bank also invested would enable the investors to spread their investments to apply to a wider group of banks and a greater amount of assets.

Fifth, a natural concomitant of selling bank participation in the equity would be the availability of continued servicing of the loans by the selling bank. If the selling bank or its shareholders have a financial interest in the success of its PPIF, the selling bank may have a greater interest in acting as the servicer. Retention of servicing, with the servicer's and other parties' interests aligned, could considerably reduce the cost to the PPIF, which should improve the pricing of the loans. It would certainly be more efficient in most cases to service the loans from existing servicing platforms. Moreover, many of the loans that are sold will be complex and difficult to service.

Servicing by the selling bank may also reduce a potential competitive disparity. If the investors are responsible for servicing the loans, it could produce a competitive advantage for those investors with large existing servicing platforms. The availability of seller bank servicing may enable a wider variety of investors to participate on a competitively equivalent basis.

We recognize that some investors may have concerns about bank servicing because of perceived conflicts of interest or just different investment philosophies. In such a case, the bank servicing could be limited to the administrative aspects, with the investor retaining control over such matters as modifications of loan terms and sales.

2. *Bank as the Private Sector Investor.*

We believe that, in appropriate circumstances, the selling bank should be able to participate as the only private sector equity investor. We recognize the government's concern that such an approach, which lacks investor pricing validation, could result in an undue subsidy for the selling bank (and loss to the taxpayer). That concern could be adequately addressed, however, by an expanded utilization of the independent valuation consultants ("IVCs") proposed by the FDIC. The IVCs will value the loans a bank proposes to sell in order to establish the leverage level to be provided by the FDIC, and that same valuation can be used to establish a sale price.

Under our recommended approach, in the event that the highest bid by an investor is below (or, perhaps, 5% below) the value determined by the IVC, a selling bank would have the option, with the concurrence of the FDIC and the Treasury Department, of creating its own PPIF. The PPIF would be capitalized with equity provided by the bank itself and the Treasury Department; the Treasury Department would retain the option to own up to 50% of the equity. The loans would be purchased at the price determined by the IVC (perhaps reduced by 5%), and the leverage would be that recommended by the IVC.

This alternative would be available only if investors are not prepared to offer intrinsic value. In that event, it would provide a means to derisk bank balance sheets and enhance credit availability with limited risk to the taxpayer.

III. Preliminary Accounting Issues

We believe that the LLP is at risk unless there is a clear and logical resolution of two preliminary accounting issues:

(1) Would a bank's expression of interest in selling a pool of loans create an accounting event for loans held-for-investment even if the sale were not consummated?

(2) Would a bank's sale of a pool of loans create an accounting event (e.g., valuation changes due to "price discovery") for similar loans retained by the bank and carried or disclosed at fair value?

Unless the answers to both of these questions are clearly in the negative, there will be a substantial reluctance on the part of banks to begin and consummate the sale process. With respect to the first question, banks will be concerned that there may be an unbridgeable gulf between the price at which the bank is prepared to sell the loans, on the one hand, and the IVC's valuation or the private investor's bid, on the other hand. If the pricing divide is so wide as to preclude a sale, the bank does not want to be in the position of still being required to mark the pool of loans down to the pricing indication from the IVC or investor (or even the price at which the bank was prepared to sell). If the initiation of a potential sale process required a bank to transfer loans to the held-for-sale classification, the bank will be highly reluctant to begin that process.

With respect to the second question, a bank will be reluctant to sell a pool of loans at a meaningful discount if the sales price will result in price discovery for similar loans that the bank holds at fair value, or discloses at fair value pursuant to SFAS 107. The impact on capital will just be too great.

There is no logical reason why affirmative answers to these two questions are compelled or even appropriate. A bank may be willing to consider a sale of loans if the pricing and other terms are acceptable, but that consideration is preliminary and conditional (and, therefore, not a formal plan to sell). Presumably, almost all assets are for sale at the "right price", and a preliminary exploration of a sale is far from a decision to sell. Likewise, although sales prices for loans may provide a relevant input to valuation of similar loans carried or disclosed at fair value, the sale of one group of loans does not necessarily mean that the value of another group of loans has changed.

IV. Tax Considerations

A principal obstacle to the willingness and ability of banks to participate in the LLP is the current tax treatment of net operating losses ("NOLs").

If a bank were to sell a loan to a PPIF for less than face value during 2009, a tax loss generally will be triggered that may create or increase an NOL for 2009. Under current law, NOLs may be carried back for only two years (and any remaining amounts are carried forward). Many banks may lack sufficient taxable income in 2007 and 2008 to absorb a carry-back of NOLs that already may be anticipated for 2009, and any increase in NOLs triggered by LLP sales would only exacerbate this situation. If, however, a longer NOL carry-back period were provided, a bank would have both an added incentive and increased capacity to sell assets into the LLP. An expanded NOL carry-back period should also reduce concerns that an LLP sale would increase a bank's deferred tax assets to a level at which Tier 1 capital is reduced with the attendant consequences for the bank's lending capacity.

The President's fiscal year 2010 budget includes a proposal to allow taxpayers to elect an extended NOL carry-back period. If this proposal were made available to all banks, participation in the LLP could be greatly encouraged.

V. Specific FDIC Questions

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?*

The Clearing House believes that the objectives of the LLP can be most successfully achieved if all, or virtually all, asset categories (including OREO) are eligible for sale. As the FDIC release suggests, it is uncertainty about the value of troubled loans in general, rather than any specific class of loans, that is making it difficult for banks to raise capital and obtain the stable funding necessary to support lending.

We recognize that some banks may be more interested in selling certain categories of loans than other banks. Likewise, certain investors may be more interested in purchasing certain loan categories than other investors. In addition, it may prove easier to establish a clearing price for certain categories of loans than others.

We are not aware, however, of any basis for determining in advance which loan categories are most likely to find willing buyers and sellers. Accordingly, we recommend that these decisions be left to the market as it develops.

We also believe that "covered" assets (i.e., those which have FDIC or other government protection) should be eligible for sale. This would not only encourage the establishment of PPIFs, but would provide an incentive for banks to bid more aggressively on whole bank FDIC transactions.

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 Clearing House believes that investors should have the maximum possible flexibility to dispose of their interests in the PPIF, whether by sale, pledge or otherwise.[3] The liquidity arising from this flexibility should improve pricing above what would otherwise be the case, and thereby help in establishing clearing prices. It will also help reestablish the active secondary markets necessary to promote economic recovery. In addition, absent such flexibility, smaller investors, including most individuals, would be unable to participate in PPIFs.

We also note that, beginning next year, the PPIF equity owners may need to be able to transfer their equity interests in order to avoid accounting consolidation.

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3 Such dispositions would, of course, need to comply with applicable securities laws.

We do not believe it is necessary for the FDIC to impose significant conditions on secondary investors. The conditions imposed on the initial investors are designed to assure that the establishment of the PPIF is facilitated, and those considerations will have less relevance in a secondary market.

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?*

Consistent with The Clearing House's basic approach of improving pricing by maximizing flexibility, we believe that each PPIF should be able to request a higher or lower government equity participation, subject to a floor and ceiling of perhaps 25% and 75%. It is difficult to prejudge how these loan markets will develop, and more rigid requirements could frustrate that development.

A level of government participation below 50% would be particularly useful if the selling banks are permitted to participate in the equity. A standard division of the equity might then be a one-third participation by each of the government, the third-party investor and the selling bank.

If the FDIC is concerned by the government's control over the PPIF at a participation level below 50%, this concern could be addressed through veto rights or weighted voting arrangements with respect to relevant issues.

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

The Clearing House is concerned that the public disclosure of investors' identities may discourage some investors. At a minimum, we believe that any legitimate request for privacy should be honored to help assure maximum participation and pricing. In addition, we believe that any requisite disclosure should be limited to initial investors and not include subsequent purchasers.

5(a). *How can the FDIC best encourage a broad and diverse range of investment participation?*

As indicated in our responses to prior questions, we believe that investor participation can be encouraged by minimizing investor eligibility criteria and restrictions on the transfers of PPIF equity and maximizing structural flexibility and asset eligibility.[4]

It is also necessary to deal with the impact of recent developments, which have unfortunately made the private sector leery of engaging in economic relationships with the government. The legislation proposing a 90% tax on all the bonuses of all employees of all TARP recipients earning, together with their spouses, more than $250,000 may have been only a spasmodic and symbolic reaction to perceived abuses. This proposed legislation, however, together with other governmental actions and statements, imposes an additional level of risk for potential investors. As just one other

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4 In this context, the impact of new legislation on the viability of certain asset sales to PPIFs should be carefully evaluated. For example, proposed legislation requiring retention by loan originators of a certain portion of the credit risk could make it uneconomic to sell those loans to PPIFs because of the capital charge on the required retained portion.

example, TARP recipients were subjected to special restrictions on hiring persons in the United States on H-1(B) visas.

Increased risk produces lower prices. It is, therefore, exceedingly important that Administration and Congressional leadership make clear that investors will not be subject to restrictions or requirements by reason of their investments in PPIFs. Likewise, there need to be assurances that profits achieved by investors will not be subject to any special tax. Finally, whatever assurances may be given will be treated with skepticism so long as the government imposes special restrictions and penalties on participants in other government programs.

5(b). *How can the FDIC best structure the valuation and bidding process to motivate sellers to bring assets to the PPIF?*

The Clearing House regards the second part of this question as of crucial importance to the viability of the LLP.

At the outset, there appears to be a widespread perception that the regulators will place pressure on banks to participate in the LLP. We believe that such pressure would be ill-advised and would ultimately destabilize the banking industry. If banks are effectively required to sell assets at a discount to their intrinsic value, the consequence will be a direct transfer of value from banks to the investors. This will reduce bank capital and lending capacity.

We believe that it is essential for the FDIC and other bank regulatory agencies to declare that they will not place pressure on banks to sell loans. Absent strong, affirmative statements to that effect, investors will be encouraged to make loan offers based on the assumption that banks will have no choice but to sell.

As set forth above, we strongly recommend that banks be able to participate in the PPIF equity and, if ultimately necessary, to be the only private sector investor in the PPIF (with the government being the other investor). This would help banks sell their loans at their intrinsic value.

We also recommend that the FDIC consider the use of additional leverage through mezzanine financing from the private sector, including the selling bank, or the Treasury Department. The liabilities resulting from this additional leverage would be subordinated to the claims of the FDIC, and warrants could be issued.

Because the loan sales will create a reduction in capital, it is essential that the government help facilitate new capital investment. Among other things, additional government investments in banks should be made on economic terms and barriers to private sector investment should be reduced.

Of most importance, recipients of government capital investments should not be subject to severe and unnecessary restrictions and requirements. If the all-in price for government capital is too high, banks will be highly reluctant to take actions—such as selling loans—which would lead to government investment. No legitimate purpose is served by government requirements that are punitive rather than preventive or progressive.

6. *What type of auction process facilitates the broadest investor participation?*

We believe that it would be most efficient if both (i) potential investors bid on the entire non-government equity stake in a PPIF and (ii) investors (including the selling bank) could combine to make a joint bid. Asset management control would be determined by the investor consortium.

If a Dutch auction is used, the selling bank must nonetheless retain the ability to reject even the highest bid or be able to set a "reserve" price. Otherwise, the bank would be vulnerable to unanticipated and unreasonable losses.

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

We believe that the priorities are best established by the selling banks themselves. We can understand the attraction of "jump starting" the process by selling loans that have been sharply marked down as a result of an acquisition or selling high value loans such as prime residential mortgages. Nonetheless, we are concerned that such an approach will actually discourage a robust market process for later sales of loans that are not readily disposable.

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

We believe that selling banks should have significant flexibility in determining both the size and composition of loan pool for a PPIF. This market will develop over time, and the selling banks and investors should be able to make appropriate adjustments.

> 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?*

In addition to normal financial terms, such as level of leverage, rate, maturity and amortization, investors are likely to need more detail regarding the scope of FDIC control and the servicing standards.

> 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?*

It may be helpful, in some circumstances, for the selling bank to take a PPIF note (presumably guaranteed by the FDIC) rather than cash. Because, however, we believe that cash is generally a superior form of consideration, the PPIF note should be an option rather than a requirement. Cash would be available for new lending or to repay existing liabilities, as opposed to accepting low-yielding FDIC guaranteed obligations.

We recognize that the sale to investors of FDIC-guaranteed notes issued by the PPIFs will create various issues, including prepayment risk. The notes should be structured to ensure maximum participation at par. It may be helpful to pool the debt issued by multiple (or even all) PPIFs.

> 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?*

We believe that the FDIC's risk on its guarantee is quite low due to a variety of factors. These include the significant writedowns on the loans in the context of the sale, the substantial equity underpinning, the evaluation by the IVC and the return expectations of the private investors. We also believe that a fee based on the risk characteristics of the assets would create undue complexity and confusion, and make it more difficult to attract investors for "higher risk" pools.

> 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?*

We are concerned that any arrangement that potentially transfers additional value from private investors to the government—in effect a government tax—would depress the prices that investors are prepared to pay. We also do not see any need for such an arrangement as the government would already receive 50% of any outsized returns. Indeed, if there were to be any transfer of returns above a designated level, the more logical transferee would be the selling bank, which would have demonstrably sold the loans at well below intrinsic value.

> 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?*

We believe that pooled PPIFs should be developed so that the benefits of the LLP are available to banks regardless of size. There will, however, be substantial complexity in developing a structure for pooled PPIFs, and we do not believe the implementation of single-bank PPIFs should be delayed pending the completion of the structuring decisions on pooled PPIFs. We do think that the IVCs could be useful here in dividing the purchase price of a pooled PPIF among the bank participants.

> 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?*

We believe that some media stories about "gaming" the system, such as banks swapping loans at artificially high prices, are more a product of a feverish imagination than of reality. The consideration of constraints should take into account the importance of flexibility in maximizing pricing and the availability of existing legal processes to deal with fraudulent conduct if it actually occurs.

Perhaps the greatest conflict exists because the government is both an equity investor and a potential creditor, whereas private investors in the PPIF will normally have only an equity position. Resolution of this issue should be accomplished through the asset manager guidelines (discussed in response to the following question).

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?*

Because of the substantial economic interest of both the government and the investors, each should have a significant role (even a veto) in the selection of the asset manager and the establishment of basic guidelines for the manager. Once the asset manager is selected, however, it should have substantial discretion with the guidelines and be subject to minimal oversight. An independent and skilled manager can protect the government's investment. If the government and/or the investor has a substantial operational decision-making role, including a veto, it could discourage private investment.

The basic guidelines should be generally consistent with those followed by the banking industry, particularly in the areas of foreclosure and loss mitigation.

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?*

As discussed above, we believe that the most efficient way for servicing the loans is for the selling bank to retain the servicing. We further believe that servicing should be paid for at a market-based rate, which would avoid any adjustment of the purchase price. Any servicing standards imposed by the FDIC should be consistent with industry practice.

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?*

We believe that a transparent process will facilitate the LLP. Disclosure of the statistical models, basic assumptions and the results used by the IVC will help both sellers and investors in formulating their proposals. It will also serve as a check on the accuracy of the IVC process.

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Thank you for considering the views expressed in this letter. If you would like additional information regarding this letter, or if it would be helpful to meet with representatives of our member banks, please contact me at (212) 612-9205.

Sincerely yours,

Norman R. Nelson