SIFMA
Securities Industry and
Financial Markets Association

April 10, 2009

BY EMAIL TO: LLPComments@FDIC.gov

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Legacy Loans Program

Dear Mr. Feldman:

The Securities Industry and Financial Markets Association ("**SIFMA**") appreciates this opportunity to respond to the FDIC's Program Description and Request for Comments on the Legacy Loans Program. SIFMA brings together the shared interests of more than 600 securities firms, banks and asset managers with a mission to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets.

SIFMA supports the shared goals of the FDIC and Treasury in the Public-Private Investment Program and believes it is important that the Legacy Loans Program be a success. To that end, our comments are aimed at increasing the Legacy Loans Program's likelihood of success while maximizing taxpayer upside, with the understanding that no government program will work without taxpayer fairness and transparency.

The fundamental difference between the Legacy Loans Program and other programs implemented by the US government in response to the financial crisis is the nature of the partnership between the private sector and the taxpayer. This partnership, as administered by the FDIC and Treasury, asks that both parties commit new money to a ***long-term equity*** investment. This creates several challenges in terms of establishing guidelines for the program. Certain elements of the program (*i.e.*, the scope of eligible assets, pre-clearance of investors and asset managers, auction processes, diligence mechanics) will need to stay flexible so that they can evolve as experience is gained in the auctions and in the investment process. Other elements of the program (*i.e.*, governance, terms of warrants, fees charged by the FDIC, nature of oversight, TARP and other restrictions on investors and sellers, investor disclosure) need to be firm at the outset. Any changes or fears of retroactive changes will chill participation and reduce the program's effectiveness.

Investors considering contributing fresh capital to a long-term equity partnership with the US government worry that contractual obligations, regulatory structures and even the statutory framework might be changed after they have committed to invest. Unlike previous programs that involved bank capital or short-term funding needs, the long-term equity and fresh capital nature of the Legacy Loans Program means that it will be crucial to assuage investor fears that rules will be changed after they have committed scarce capital to the program. We realize that neither the FDIC nor Treasury controls all of these risks, but nonetheless we believe that the two agencies could and should allay investors' most fundamental concerns by issuing strong assurances that signed contracts will not be subject to unexpected change and that TARP executive compensation, H-1B visa and other restrictions, once clarified, will not be applied to investors, fund managers or selling banks. In addition, we believe it would be helpful if Treasury would make clear that it will manage its PPIF investments to maximize the economic returns of the investments for the US taxpayer and not to achieve social and political goals best implemented elsewhere. Without some limits on political risk, the private sector will be reluctant to participate.

This letter responds to each of the questions in the FDIC's Request for Comments.

1. **Which asset categories should be eligible for sale through the Legacy Loans Program? 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 Legacy Loans Program?**

Ultimately, a broad range of assets on a bank's balance sheet should be eligible for the Legacy Loans Program. As an initial matter, however, selling banks will be particularly motivated to sell their legacy commercial real estate assets, non-agency residential mortgage assets, and other assets that can no longer be securitized, including construction loans, land loans and condominium loans. Other assets ripe for sale into the PPIP include OREO assets, corporate loans and revolving credit facilities. The FDIC might therefore consider tailoring the Legacy Loans Program in its initial stages to encourage the sale of real estate assets to create a track record of success. Given the right terms, we anticipate that investors would consider buying assets in any category, and so we urge the FDIC to maintain flexibility in the program.

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?**

We believe that it is critical to the success of the PPIP that direct investors in any PPIF be able to pledge, sell and transfer their interests, subject of course to applicable securities law considerations and, in the case of a sale or transfer, investor eligibility requirements as established by the FDIC. It is the strong view of our members that the absence of the ability to pledge, sell or transfer PPIF interests will negatively impact asset pricing and investor demand, particularly among retail investors. Lack of transferability will also defeat an important goal of the PPIP, which is to restore liquidity. With fewer investors competing for assets, banks and investors will be less likely to find a clearing price, especially with respect to riskier assets. This could decrease private demand and increase costs for the taxpayer. By contrast, permitting asset transfers allows aggregation of PPIF equity interests in portfolios, which should help create more demand.

In designing safeguards to ensure that subsequent purchasers of PPIF interests meet the Legacy Loans Program's criteria for investors, the FDIC might be inspired by the requirement for offerings under Rule 144A of the Securities Exchange Act of 1934 that subsequent purchasers be qualified institutional buyers. Taking cues from the 144A framework, the FDIC could condition subsequent sales on, for example, requirements that PPIF interests be sold only to purchasers pre-qualified by the FDIC, that sellers act reasonably to ensure that FDIC-qualified purchasers are aware of the continuing nature of conditions on sale of PPIF interests and that PPIFs commit to provide certain information to these prospective purchasers.

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?**

SIFMA believes that Treasury should fix its equity participation at 50% for all PPIFs in the Legacy Loans Program. Aside from the benefit to investors of predictability, consistency and simplicity, establishing a static percentage of government equity participation would reinforce several policy goals.

A fixed Treasury equity contribution would ensure that taxpayers participate equally with private investors in the most profitable transactions. Private investors should not be able to cut taxpayers out of the most promising deals by requesting minimal equity participation from Treasury, yet still taking advantage of taxpayer-funded leverage. Other measures, such as allowing a range of possible Treasury subscription amounts, would unduly complicate the auction process since the FDIC and Treasury would need to consider both the price and the amount of equity contributions proposed by bidders. We believe that it would unnecessarily complicate the process if Treasury had to choose among bids contributing different levels of equity.

In the absence of a fixed equity participation, various stakeholders may urge Treasury to engage in risk pricing with its equity contribution. We do not think it should do so. Instead, we believe that the amount of leverage available to a fund, as determined by the FDIC, is a more powerful and more precise tool for adjusting taxpayer exposure to risk based on assets purchased. Changing the degree of leverage offered by the FDIC for each pool of assets, within the 6 to 1 maximum ratio, should be an adequately versatile risk pricing tool.

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

Before answering this question, we believe it appropriate to describe how we believe investors will participate in the Legacy Loans Program. It seems likely that each PPIF will have both direct and indirect investors. Direct investors, which will likely be certain types of funds, would be equity co-investors with Treasury in one or more PPIFs. Indirect or ultimate investors, ranging from US retail investors in mutual funds to any domestic or foreign investor who can participate in pooled investments, will invest in the direct investor funds. In many cases, direct investors will not know the identities of every one of their indirect investors.

With respect to direct investors, Treasury and the FDIC will certainly want to know the identities of those with whom they are investing. Consequently, we suggest that direct investors be pre-cleared in a pre-qualification process, resulting in transparency of direct investor information to Treasury and the FDIC.

Although we believe it is essential that direct investors' identities be transparent to the government, *public* disclosure will chill private sector participation, increase costs and raise fears of retroactive rule changes. The public interest is clearly served by disclosure of investor information to the government, which will protect the interests of taxpayers and private investors alike, but wholesale public disclosure is unnecessary.

Disclosure of indirect investors' identities would also contravene market convention, which protects the identities of bidders because disclosure with respect to specific auctions disadvantages those bidders in future auctions. Once a bidder's identity is known, competing investors can reverse engineer and exploit bidding patterns, likely asset targets and pricing strategies to unfair advantage. Additionally, the sheer impracticability of producing retail investor information will drive away many large investment managers and reduce retail participation in the PPIP. We have no objection to public disclosure of the names of the pre-cleared asset managers.

We suggest that the government can adequately protect the public interest in transparency through aggregate disclosure of the results of the Legacy Loans Program without disclosing the identities of individual investors or the results of individual auctions. For example, the FDIC might make quarterly disclosures identifying the number of auctions that took place in a particular time period, the type and value of assets offered and/or sold, the average price of a successful bid and the types of investors who participated across all auctions during the period.

We also suggest that the FDIC look to the TALF program for guidance with respect to disclosure of investor information.

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?**

SIFMA believes that the FDIC and Treasury should allow a broad range of investors to participate in the Legacy Loans Program. There are multiple interests to balance in terms of encouraging investors and creating a workable auction system. Obviously, the US government needs to know with whom it is investing. As a result, we believe that the FDIC should adopt transparent eligibility requirements for direct investors who wish to participate in the Legacy Loans Program. To this end, investors will need to provide appropriate information to the government. These eligibility requirements might include factors like the amount of similar assets that a bidder currently owns, assurances that the closing of any successful bid is not dependent on contingencies and either a demonstrated ability to service the loan assets through the use of a qualified asset servicer approved by the FDIC or, alternatively, an agreement to accept a servicer designated by the FDIC.

SIFMA also suggests greater clarity around PPIF structuring. In particular, it would be helpful if the FDIC could clarify that a single PPIF could be formed, if desired, to hold multiple different pools of assets for separate classes of investors. Such a structure would avoid the administrative costs and inefficiency of having to set up a separate fund for every pool of assets or group of investors. In addition, we suggest that the FDIC expressly acknowledge that interests in an investment fund that invests in a PPIF may be distributed to the public, provided that the investment fund complies with the requirements of the Investment Company Act of 1940 and the regulations promulgated thereunder, whether as a registered closed-end fund, a registered business development company or an entity exempt by statute.

The FDIC should clarify precisely to what extent purchased legacy assets will be subject to the government's loan modification program, and make clear any other limitations on the ability of asset managers to direct the servicing or management of the legacy assets. Investors and selling institutions need this vital information in order to price the assets, the value of which will be affected by uncertainty.

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?

SIFMA believes that an important key to broad investor participation is the reasonable assurance that sellers will part with assets at market prices. To facilitate broad participation, and to encourage participants to perform the necessary investment of time and capital prior to bid, we recommend that auction administrators publish a reserve price in advance. Insofar as many packages will involve preliminary bids to be updated to final bids following diligence, bidders would provide price bid matrices that show resultant prices for various underlying variables that could change after diligence (*i.e.* loan-to-value). This would allow for a variance of bid to be calculated and the highest preliminary bid awards to be based on expected final price as opposed to non-variance-adjusted preliminary price. Bidders would be bound by the matrix if diligence were to uncover changes in the pricing variables to maintain integrity to the process.

Details of various expected mechanics related to pool purchases will assist potential investors in beginning to formulate appropriate structures to most efficiently access the program. For example, the FDIC should establish expectations for settlement timing (e.g., whether payment will be due immediately after the auction concludes or at some later time that permits private investment funds time to call capital) and whether the purchase agreements will be substantially uniform or subject to negotiation on a transaction-by-transaction basis.

Safeguards should also be implemented to minimize the possibility of price gaming, whereby a participant submits a high preliminary bid only to reduce the final price dramatically following due diligence. These safeguards could include inviting the highest bidders to perform diligence and submit final prices, and excluding from future auctions those bidders who unreasonably lower their bids by a significant margin.

We believe that investors should not be permitted to make partial bids for PPIF assets, whether the partial bid is for a vertical slice of the pool or a subset of the assets, for the following reasons:

- Accepting partial bids (carve-outs of specific assets) puts auction administrators in the position of having to value the remainder of the pool to calculate an equivalent ‘all-in’ bid. Market participants will surely have differing opinions about the value of the pool remainder, raising questions about the fairness of the overall process.

- Awarding partial interests in asset pools to multiple bidders will diminish the value of owning loans versus securities. Loans generally trade at a premium to securities due to the value inherent in actively controlling the loss mitigation process (loans) vis-à-vis passive participation in loss mitigation (securities). If asset control can conceivably be lost to vertical slice participants, investors will be forced to bid more conservatively. The likely result is that the prices at which loan pools trade will remain at distressed levels rather than reflect a premium that can be extracted by providing control of the loans. Additionally, in more distressed sectors the assurance of a critical mass of assets is important to covering the substantial costs of servicing, administration and due diligence.

- For the same reasons, awarding PPIF assets in a Dutch auction is inadvisable. We recommend that bids be accepted solely on an all-or-none basis, with market participants organizing their own consortiums if necessary.

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

Please see our response to question 1.

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

The Legacy Loans Program guidelines should retain a high degree of flexibility on this point since the answers may change over time and across classes of asset pools. That said, we believe that larger pools are preferable for most buyers due to the high fixed costs associated with the diligence process.

Generally, we believe that the asset pools should be relatively homogenous by type and by geographic region in order to appeal to specialist investors and asset managers with particular skill sets. For example, construction loans would fetch higher prices if competed for by investors with experience in real estate development. Homogeneity would also aid the FDIC in deciding how much leverage a particular asset pool can support.

Since the appropriate size of an asset pool should vary by the type of asset within the pool, homogeneity of assets will simplify the size determination. Performing assets, for example, are more marketable in larger lots than are troubled or generally higher-risk assets, such as land loans.

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?

Certain terms of the note and other standard market information must be available to investors prior to the auction in order to encourage the highest bids for asset pools. Investors will need to know, among other data:

- the debt-to-equity ratio;

- the note rate (fixed or floating);
- required debt service coverage ratio and required reserves;
- the expected and legal final maturity (and whether it is a bullet maturity);
- collateral prepayment assumptions;
- optional termination provisions;
- prepayment rights;
- call and redemption features;
- whether additional debt can be incurred, terms of the security interest, and other disclosures.

The FDIC and Treasury should also publish the expected timeline of the investment process, including details on the permitted periods for negotiating the note, timing of payments and negotiating the purchase contract.

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?

We believe that the Legacy Loans Program should be structured so that both options are available. Certainly, the fact that the debt would be FDIC-guaranteed would make it an attractive and suitable investment for retail investors. There may, however, be advantages to issuing notes to selling banks in exchange for assets, including avoiding the costs of public issuance. In such an instance, selling institutions will want to secure some form of true sale opinion in order to avoid accounting issues attendant to seller financing.

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 should base its guarantee fee on the risk characteristics of the underlying assets. The FDIC should also take into account a number of other factors, including the weighted average life of the asset pool, the leverage ratio, interest rate risk, liquidity risk, geographic concentration risk, sector concentration risk, servicer strength and other counterparty risks generally.

Debt asset pools of identical risk character serving as collateral for guaranteed debt could be subject to different fee amounts, due to the risk-weighting effect of the length of the term of the debt.

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 believe that the combination of Treasury's equity participation, which as we noted above we would set at 50%, and warrants sufficiently protects the taxpayer's ability to capture returns. With equal equity participation, taxpayers and private investors should enjoy identical upside in the event of an unexpected windfall. Private investors' returns should not be capped any further, particularly not in a way that runs the risk of subjective application. SIFMA urges Treasury to move quickly to establish the terms of these warrants. The current lack of clarity surrounding the terms of the warrants introduces significant uncertainty for investors that will affect program participation and asset prices.

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?**

Pooling by multiple banks should be permitted so as to encourage smaller banks to participate and to facilitate homogeneity of asset pools as discussed above. We believe that multiple-seller auctions would have a greater chance of success if the selling group were required to appoint one decision-maker to participate in the auction and to deal with investors. This decision-maker should be empowered to select winning bids and to negotiate with buyers over issues such as diligence and servicing rights. Similarly, the FDIC should consider consolidating servicing functions for multi-bank pools in a single servicer. The standard market terms used by aggregators in securitizations provide a good model for allocating rights and obligations. Streamlining asset pooling in these ways would render the pooled assets more marketable by eliminating the need for costly multi-party negotiations.

14. **What are the potential conflicts which could arise among Legacy Loans Program participants? What structural arrangements and safeguards should the FDIC put into place to address or mitigate those concerns?**

The Legacy Loans Program can be expected to generate conflicts of interest that will have to be mitigated and managed. One mitigation already in place is the prohibition on private investors purchasing from their affiliates, which will prevent selling banks from also investing in PPIFs to which they have sold loans. Asset managers who are affiliates of sellers or investors will also be subject both to applicable law governing principal transactions and to any conflict procedures agreed to among the asset managers, the investors, the FDIC and Treasury.

The government side of the partnership also has potential conflicts to manage. Among them are the government's conflicting risk appetites as both equity holder and secured creditor and the effect of this dual role on the government's relationship with its co-investors. We believe that the FDIC and Treasury should formally establish a separation between those who manage the government's equity investments and those who regulate financial institutions. This separation could happen as part of the trust structure announced by President Obama in the Financial Stability Plan or by an information wall between the government as an equity investor and the government as a regulator. Moreover, we believe it important that the government establish clear guidelines and principles for its equity investments in PPIFs, making it clear that government decisions will be taken to maximize the economic return to taxpayers and not to further social or political goals that would best be implemented in other programs.

We assume, given the work that the Legacy Loans Program will generate within the FDIC, that a director will be appointed to supervise the program and that appropriate staffing will be provided through internal re-allocations and new hires. We also assume that a special inspector general will be appointed or that staffing will be made available to the current inspectors general to oversee the Legacy Loans Program. We hope that the staffing will comprise a mix of current regulators and individuals with recent private sector experience.

The FDIC might also consider, in order to mitigate concerns about political risk, appointing an independent ombudsman for the Legacy Loans Program who could receive, investigate and report on investor and asset manager concerns. Appointing such an official might be an effective means of providing the FDIC with ongoing, real-time feedback on private sector concerns about the administration of the Legacy Loans Program.

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 recommend that the FDIC pre-clear a wide group of asset managers and that investor groups be permitted to choose from a list of pre-cleared asset managers on an ongoing basis, particularly as new asset classes are added. Investor group bids should state which asset manager the group has selected. This will permit investor groups and asset managers to work out their commercial arrangements in advance of the auction. The FDIC should select asset managers on the basis of criteria designed to ensure that only effective, professional managers are hired, but permitting a diverse range of managers to participate, including specialists and smaller managers. Eligibility criteria might include a candidate manager's assets under management, the experience of its professional staff, tenure in the business and specialized skills or regional focus.

The FDIC should clarify the scope of its planned oversight role. Investors should have a clear understanding of how the FDIC's oversight mandate will interact with the ability of asset managers to make decisions regarding PPIF assets.

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?**

Our recommendation is that the FDIC provide flexibility in each auction such that bidders and sellers can decide who should hold the servicing rights. If a selling bank wanted to retain servicing rights, for example, investors should be free to contract with the bank to that end. In fact, we expect this to be the most likely arrangement with respect to many performing loans. In other circumstances, investors and asset managers may believe that they can maximize the value of the underlying loans if they control the servicing rights. We expect this to be the case for many non-performing loans, where the servicing rights are bound up with the asset manager's workout. Moreover, if loans are to be pooled together by multiple sellers, it may make sense to aggregate servicing rights, as described above. Finally, we note that control of the servicing could imply the ability to work directly with borrowers.

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?**

SIFMA believes that the results of the independent valuation consultant's analysis should be made available both to selling banks and to pre-qualified bidders prior to the auction. We further suggest that this valuation serve as the primary component of a reserve price to be established for each auction. A reserve price will simultaneously protect sellers from having to accept less than the intrinsic value of an asset and protect bidders' commitment of time and money to the diligence process.

Thank you for giving SIFMA the opportunity to comment on the Legacy Loans Program. If you have any questions or would like additional information, please do not hesitate to contact Randy Snook (rsnook@sifma.org) or Joseph Sack (jsack@sifma.org) of SIFMA, or Margaret E. Tahyar of Davis Polk & Wardwell (margaret.tahyar@dpw.com), the law firm that has advised us with respect to this comment letter.

Respectfully submitted,

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