Center for American Progress Action Fund

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April 10, 2009

Via Electronic Mail (LLPComments@fdic.gov)
Robert E. Feldman
Executive Secretary
ATTN: Comments
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Center for American Progress Action Fund Comments on the Legacy Loan Program of the Public-Private Investment Program Announced by the Treasury Department

Dear Mr. Feldman:

Thank you for the opportunity to comment on the proposed Legacy Loan Program (LLP), which was jointly announced by the FDIC and Treasury Department on March 26, 2009. We submit this letter on behalf of the Center for American Progress Action Fund (CAPAF). CAPAF is a nonprofit, nonpartisan research and policy thinktank dedicated to improving the lives of Americans through progressive ideas and action.

We commend the FDIC for seeking out innovative solutions to the problem of legacy assets that is plaguing our financial system, as well as for its aggressive efforts to modify at-risk mortgages it has acquired through its resolution activities. As FDIC Chairman Sheila Bair has frequently and eloquently noted, sustainable loan modifications for homeowners at risk of default serve to stabilize the credit markets by maximizing the value of these mortgages, ultimately returning more money to uninsured depositors, creditors, and investors. Any successful resolution of the credit crisis must ultimately focus not only on restoring the health of bank balance sheets, but also on stabilizing the housing market through such sustainable mortgage modifications.

We have a number of potential concerns about the broader Public-Private Investment Program (PPIP), including several that are specific to the LLP, which can be found in our piece which we released yesterday, titled "Recommendations for the Public-Private Investment Program" and available at http://www.americanprogress.org/issues/2009/04/ppip.html. We will discuss two specifically herein.

First, while we are cautiously supportive of the LLP, insofar as it aims to jumpstart the illiquid markets for legacy loans, we are concerned about the potential negative impacts LLP could have on loan modification efforts, particularly those contemplated by President Obama's Home

Affordable Modification Program (HAMP). We believe that, absent additional clarification and guidance, LLP could seriously undermine HAMP by providing potential HAMP participants a lucrative opportunity to divest themselves of HAMP-eligible mortgages, leaving borrowers with no clear path to obtaining modifications. The FDIC, working with Treasury to draft program rules, should ensure that moving mortgages off the books of lending institutions does not adversely affect the ability of borrowers or investors to seek the modification of mortgages under HAMP.

One effective way to accomplish this objective is to require any public-private investment funds (PPIFs) that purchase whole loans under the terms of the LLP to participate in HAMP. Such a requirement would serve the public policy goals of helping homeowners, mitigating the downward pressure on housing prices caused by foreclosures and maximizing investor value. Alternatively, we believe that the FDIC and Treasury should, and perhaps must, under Section 109 of the Emergency Economic Stabilization Act of 2008 (EESA), craft rules and guidance to ensure that LLP does not erode the effectiveness of HAMP.

Second, we echo the concerns that have appeared in various publications that PPIP could be "gamed" by the institutions that currently hold legacy assets. We believe that one simple and effective way to prevent such gaming, and more importantly, to provide confidence to the American people that PPIP is not being manipulated, is to implement common sense limitations on sellers of legacy assets, so that they are not buying significant amounts of legacy assets at the same time.

Reconciling the LLP with HAMP

As you are aware, HAMP requires participating loan servicers (including all future recipients of TARP funding—although major past recipients have agreed to participate) to work with mortgagors to modify their loans in cases where modification preserves more value for the mortgages in the mortgagee's portfolio than proceeding to foreclosure. Under the LLP, however, many of those loans are destined to be sold to investors currently under no such obligation to make modifications. To ensure that the purposes of the HAMP modification program are not thwarted, special care will have to be taken in the implementation of PPIP.

The loans eligible, or likely to become eligible, for modification under HAMP are among those most likely to be sold by banks under PPIP. Delinquent loans which are the domain of HAMP must be, by the strictures of accounting rules, written down on banks' books—inflicting harm to bank balance sheets that they can ill-afford. HAMP offers banks incentives for modifying loans, and the loans are of greater quality after modification, but the shaky banks are likely to decide that they are better off selling the loans to completely move the risk from their books.

Requiring PPIFs to play by the rules of the modification program would offer a consistent outcome for homeowners and mortgage holders. PPIFs would be required to make the modifications under the same conditions as the banks and would also benefit from the incentives offered by HAMP. This ensures that the objective of HAMP is not thwarted and that taxpayers, as new partners in the ownership of the assets, aren't saddled with the costs of servicers choosing foreclosure when modification offers a better return on investment.

It has been suggested that too many strings on investors might keep them from participating and that maintaining the HAMP requirements in some form might be viewed in that light. The burden, however, will not generally be significant. Much of the analysis that will be needed to evaluate the parameters for loan modification under HAMP will have likely been done as part of the LLP process—where the FDIC analyses the risk of the loan to determine the amount of debt that it will guarantee as part of the transaction. In addition, the buyers of these loans are not likely to directly service these loans but hire a third party to do it, possibly even hiring the current owners to service them. As such, it does not present a significant burden for the buyers. In addition, since modification under HAMP takes place only when the net present value of modification is greater than foreclosing, it creates net value for the buyer rather than imposing a cost.

Finally, the Emergency Economic Stabilization Act of 2008, which established TARP, shows a clear Congressional intent that it expected Treasury to acquire mortgages for the purpose of modifying them to keep families from foreclosure. To that end, Section 109 of the bill requires the Secretary of the Treasury, upon acquiring mortgages, to establish a modification program (such as HAMP) and to encourage servicers to modify mortgages. Because Treasury is buying an interest in mortgages as an equity partner in each PPIF, this obligation should attach.

In conclusion, now that we have a program in place that will finally offer sustainable modifications in keeping with a commitment to maximize returns to the note holders, we should not put up public funds to transfer loans to third parties without this component.

Commonsensical Limitations on Sellers of Legacy Loans

We believe that banks and other financial institutions are participating in the LLP as sellers of legacy loans should face reasonable limitations on being LLP buyers. Such banks would have a clear conflict of interest. As buyers, they would want prices as low as possible, but as holders of substantial quantities of these legacy loans, they would want prices to be high as possible. Were these types of financial institutions to have a substantial presence in the market as buyers, they could potentially inflate the prices paid, and just as importantly, undermine confidence that the market is accurately setting the value of these assets. This could ultimately undermine PPIP's objective of providing price discovery and restoring private liquidity to the markets for these legacy assets.

The end goal of PPIP is to have private funds will partner with the public sector to purchase these legacy assets off the books of distressed banks. But if these distressed banks are playing a significant role in the buyer side of the market, this desired result won't happen. And if they have played a significant role in purchasing these troubled assets, it is hard to understand how confidence in the pricing of these assets will be maintained. That would leave us mostly back where we started, with banks holding large volumes of troubled assets of indeterminate value, except that the taxpayer will have absorbed a significant exposure in the process.

Ultimately, we believe that certain common sense restrictions should be place on firms participating as sellers in the LLP. First, there should be some limitations on the level of participation as buyers that such firms, or their affiliates, can have. While there may be some legitimate reasons for such firms to want to purchase small amounts of legacy loans under the terms of the LLP, caps can and should be implemented to prevent the prospect of a firm selling lots of distressed assets while simultaneously buying up similar assets using LLP financing. Second, there should be an outright ban on a firm purchasing its own assets, either directly or indirectly, under the program—a potential practice that has raised concerns by Nobel Prize winning economist Jeffrey Sachs, among others.

Conclusion

Thank you for the opportunity to comment on the Legacy Loans Program. We are confident that the FDIC will continue its leadership in adopting policies to facilitate sustainable loan modifications as a means to maximize asset value and stabilize the banking and housing markets. If you have any questions or would like more information, please do not hesitate to contact Andrew Jakabovics at ajakabovics@americanprogress.org or David Min at dmin@americanprogress.org.

Sincerely,

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Andrew Jakabovics
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