From: Mark Alexander Wolf [mailto:markwolf@roadrunner.com]
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To: LLPComments
Subject: Legacy Loans Program COMMENTS

To the FDIC:

Comments on the Legacy Loan Program ("LLP"):

A. LLP's general structure: I apply over 30 years of legal practice, litigation and business experience in commenting on the LLP. During the questions period of the 3/9/09 investor conference call, I made a comment on the LLP's structure which I would like to expand here. From my perspective, the behavior of the humans that run the lenders which the LLP seeks to attract, the LLP structure (all my comments are based on my understanding of the LLP structure) is likely to create a number of real problems that should be addressed.

The LLP is one of a series of efforts designed to "drain" toxic (non-performing) loans from lender portfolios as quickly as possible. However, the lenders' officials determine what loans to put up for auction and when that happens, those loans are more likely to be released very slowly, like a dripping faucet, rather than steadily, like an open spigot (to stretch the plumbing analogy). Here is why:

1. Economic incentives not to sell toxic loans: With the recent accounting rules change from Mark-to-Market to Fair Value, as long as non-performing loans are owned by the lender and not sold, they can be listed on the books at Fair Value, and the lender need not recognize any market loss for that loan. Under the previous Mark-to-Market rule, a lender would have more incentive to sell toxic loans, since they should be carried on the lender's books at the current market value, even if it is a very low value.

Once a pool of loans is sold through the LLP process at, for example, 30% of face value, that capital loss MUST be recognized by the lender. So far in this economic decline, many lenders that are - in reality - insolvent under Mark-to-Market due to toxic loans and assets have operated under the fiction that the toxic loans they are holding are worth their Fair Value, not Market Value. Thus, lenders holding toxic loans will not sell many of those loans during any quarter because each sale will force recognition of capital loss the lender can ill afford to recognize. If the lenders really valued their toxic loans at a realistically low market value, they would be insolvent. This is a fact that is supported by the fact that lenders have argued for Fair Value over Market Value accounting rules, knowing that each toxic loan is carried on its books at a significantly higher Fair Value that the loan would sell for under the LLP process or in any other current market.

2. Behavioral incentives not to sell toxic loans: Essentially, the same individuals who had their institutions invest in or create non-performing loans will

be in charge of deciding how many of their toxic "legacy loans" will be sold through the LLP process and when that will happen. From a behavioral standpoint, we should remember that the same reckless officials who drove these lenders into this financial pit are still in control. They understand that selling more than a few of their toxic loans in any quarter will push their banks into insolvency. If their banks become insolvent, these officials lose their jobs, their pay and their bonuses. Under the *status quo* they aren't personally suffering - they are able to keep their jobs and benefits, keep their pay and bonuses (why is no one mad at the directors who approved such exorbitant bonuses?), and recent history teaches them that even if they steer their banks into more trouble, the government will bail them out again. Why should they upset the *status quo* and change their behavior? Recent history has taught them that the government can do little to force them to sell toxic loans, and that it is likely to again bail them out if they come close to insolvency;

3. <u>Structural defects in the LLP process</u>: Since lenders will be able to submit a pool of loans for auction and then decide whether or not to accept the winning bid, lenders will not be forced to make any firm commitment to sell their toxic loans. This is a significant difference from the process for failed bank loan pool auctions, and it is likely to be a fatal change, since it will take only a few banks backing out accepting the winning auction bid to cause potential investors not to bid. Potential investors do a lot of due diligence time and effort to put in a bid for a loan pool, and will understandably back away from a process that allows the lenders to renege on an auction result.

There is no mechanism to overcome the lenders' economic incentive to retain toxic loans, which sit at higher values on their books than they would sell for in the LLP auction process. Nothing in the LLP program counterbalances that incentive and encourages banks to use the LLP auction process to dispose of lots of non-performing loans. Sadly, what we are more likely to see is lenders using the LLP process to sell <u>performing</u> loans with a smattering of non-performing loans, in a bid to reduce the capital losses associated with selling those few non-performing loans. The LLP mechanism is a great potential market for selling performing loans, but is not currently structured to make financial sense as a way of disposing of non-performing loans.

B. Suggestions:

1. Choose a percentage of face value at which an offered loan pool MUST be sold. That is, if a loan pool has a face value of $100M, and the winning bid is at least, for example, 25% of the face value, the lender must sell that pool. Otherwise, lenders will simply "dip their toes in the pool" (so to speak) by rejecting winning auction bids for the same loan pool until the bank gets 60% or 70% of face value. The LLP should not be run so lenders can abuse investors this way, since a lot of time, cost and effort goes into the due diligence process from investors. If even a handful of lenders reject bids for their loan pools, investors will be unwilling to bid.

2. Allow lenders to amortize losses from the sale of a toxic loan pool over a period of years.

3. Create an Advisory Panel for this program, including representatives from different potential investors, and from banks. I would be interested in participating in such an advisory panel.

4. Assets to be sold should be legacy loans only, to prevent the use of the LLP process as a highly leveraged market place to dispose of performing assets.

5. Try to allow legacy loan pools - at least those targeted at smaller investors - to be concentrated by geography, to make the management of those assets more feasible for smaller investors. In doing this, it would make sense to allow multiple lenders to pool their loans.

6. Develop a mechanism to target pools for smaller investors. While pools need to be large enough to be economically feasible, clustering loans by geography should help lower management costs. Pools for smaller investors should be between $2 to $5 million dollars, using a hypothetical 5-to-1 leverage factor.

7. As the process of developing the rules for the LLP auction process takes shape, solicit additional comments on the emerging structure. It is particularly difficult to comment on a structure which is really unformed at this point. Again, an Advisory Panel would help in this regard.

Thank you for your attention to this input.

Sincerely,
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