From: Stanford L Kurland [mailto:pnmac.ceo@pnmac.com]
Sent: Friday, April 10, 2009 8:48 PM
To: LLPComments
Subject: Legacy Loans Program – Comments from PennyMac

Thank you for the opportunity to comment on the proposed Legacy Loans Program (LLP). Private National Mortgage Acceptance Company, LLC (PennyMac) is a specialty financial services firm created to address the dislocations in the U.S. mortgage market. REDACTED

PennyMac, as a potential investor and asset manager in the LLP, is pleased to provide responses to the FDIC's questions below.

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 assets eligible for sale should include all legacy loans where there is a legitimate liquidity constraint in the market today. This should include all residential and commercial real estate legacy loans.

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?

   An equity interest in the PPIF should be able to be transferred in some form or fashion. The greater the freedom of the available transfer of economic interests the better, provided that there is adequate regulatory oversight. There, however, must be considerable restrictions on changing the asset manager and underlying servicing arrangements. Initial investors will make their investments based on the quality of the asset manager, and the FDIC should be equally concerned with the asset manager's qualifications. Once parties enter into agreements with the FDIC, they should not be permitted to sell or transfer the asset management contract or servicing agreements.

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?
   From an investor's perspective, we believe there is adequate private capital available for equity investment in PPIFs if leverage is provided. However, we acknowledge the need for government participation that allows the taxpayer to participate in greater upside. We believe warrants, as opposed to TARP equity, provide a safer investment without putting taxpayer money at risk.

The TARP funds could be better used by investing directly in the troubled banking institutions that sell legacy loan portfolios (and may have a capital charge associated with the sale). We do not believe the amount of the government's investment should be portfolio dependent.

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

   We believe that investors' activities should be transparent. The FDIC should provide rules as to who are eligible primary investors (the transaction sponsor) and underlying investors and certify compliance with such eligibility. The identity of the primary investor should be made available to the public.

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?

   To attract the largest potential investor base, the FDIC should release the names of asset managers and servicers eligible to participate in the program. We suggest a two-tiered process for asset managers and servicers as previously posted. To the extent that the PPIF is required to follow future yet-to-be-announced government programs, e.g., for loan modifications, there should be a process in place for investors to be compensated for any negative impact. The FDIC should also facilitate the establishment of a secondary market for re-performing loans, thus shortening the duration of the investment and increasing the price investors are willing to pay. This could be accomplished, for example, by making re-performing loans eligible for delivery to Fannie Mae or Freddie Mac.

   The FDIC and Treasury can motivate sellers to bring assets to the program by minimizing the capital charge upon sale, for example, by providing preferred capital treatment to the FDIC-guaranteed notes or providing TARP capital infusions. Sellers also need to be confident that selling assets will not taint the accounting treatment for the rest of their held-for-investment portfolio.

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?

In order to encourage the broadest investor participation, the FDIC auction process should include a standard due diligence protocol using multiple best-in-class vendors (with a random distribution of loans per vendor) paid for by the seller prior to the bid being made public. This protocol should include credit, compliance, and property reviews. The winning bidder would reimburse the seller for all the costs associated with the due diligence. Pricing would be maximized with the use of standard documents (i.e., purchase and sale agreements) and standard reps and warranties. The FDIC should consider guaranteeing reps and warranties of weaker institutions.

Investors should not be allowed to bid on partial equity stakes in a PPIF. We believe that the asset management activities are an essential part of a bidder's structure and that there would be very few investors interested in a split interest. To the extent that investors would be interested in a minority passive equity investment (i.e., without rights to select the asset manager or negotiate terms), the Treasury could Dutch auction its equity stake (Treasury may set aside a higher equity reserve for this specific purpose).

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

   The highest priority should be single-family residential loans. Transferring control of these loans from the incumbent banks to new private investors would have the greatest and most immediate impact on homeowners and improving the housing market, issues at the core of the current financial crisis.

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

   The optimal pool for a PPIF would be relatively homogeneous with respect to loan type, borrower credit, and delinquency status (e.g., a pool of Alt-A performing 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?

   The cash flows on the debt need to match the cash flows on the underlying assets, and therefore all of the details of the note and its rate structure need to be known at the time of the equity auction. The note terms should include reasonable covenants and conditions that allow distributions to be made to equity investors as cash is collected. We have previously submitted to the FDIC a recommended structure that utilizes a reserve which protects note holders while following the cash flows on the underlying loans.

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 initially the selling bank should take back the note from the PPIF. However, the FDIC along with other financial institutions should work on creating a secondary market for the notes to facilitate their liquidity.

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?

    The fee should be a function of the risk characteristics and the capital structure of the PPIF. Lower leverage ratios on a pool with the same characteristics should result in a lower guarantee fee. Deferral of cash payments to investors in the form of a reserve (as we describe in #9 above) should also result in a lower guarantee fee.

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 in favor of greater participation by the government from a public-policy standpoint, but the timeframe for determining if a warrant is issuable is so far into the future that incorporating a warrant into the PPIF would diminish potential value. Any such warrants needs to be carefully considered and structured so as to not negatively affect the bids made by private investors.

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?

    Yes, the PPIF should allow multiple selling banks and encourage smaller players to co-offer a pool of assets. Sales proceeds should be allocated based on relative value provided in the bidding documentation.

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?

The primary potential conflict is any affiliation between the seller and participants in the PPIF (investor, asset manager). The selling institution's primary regulator must be involved in the process to ensure there are no conflicts. Outlier bids on the high side should be carefully evaluated for conflicts. Post transaction, the regulator should review the transaction for any irregularities. Bidder qualifications should require disclosing any and all conflicts.

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?

    The investor should select the asset manager, and that asset manager has to meet standards established by the FDIC. The FDIC should make the list of all approved asset managers available to the public. Terms of the indenture should provide for termination and replacement of the asset manager for cause, consistent with existing FDIC transactions. The asset manager should have reporting obligations that give the FDIC the adequate oversight of the government's investment, similar to existing FDIC transactions. The asset manager should have ultimate control over the disposition of the assets with the primary objective to maximize the value to the equity investors while preserving the interests of the note holders.

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?

    We believe all pools should be offered servicing released so that each investor can choose its preferred asset manager and servicer. There is every reason to believe that these choices will greatly impact the value of the assets going forward.

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?

    Making the data available to potential bidders should be the choice of the seller if it wants to disclose such information.