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April 9, 2009

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

Re: Legacy Loans Program

Dear Mr. Feldman:

The California Bankers Association (CBA) is a non-profit association established in 1891 and represents most of the depository financial institutions in the state of California. We appreciate the opportunity to provide comments on the Legacy Loans Program (LLP) proposed by the Department of Treasury and the FDIC. The LLP seeks to create a public-private partnership to acquire distressed assets from financial institutions through a combination of Treasury and private equity investments, FDIC debt guarantees, and sharing of profits and risks. CBA and its members believe this concept is worth pursuing and we provide these comments to the proposal.

FDIC involvement. The LLP poses a financial risk to the FDIC through its debt guarantee. If the FDIC experiences losses in excess of the fees it collects to manage the program, the FDIC will seek to recover the losses through assessments on all insured banks regardless of whether they participate in the LLP. Our threshold concern is whether the FDIC's role in the LLP is consistent with its primary mission of insuring bank deposits. We do not question that creating a means for financial institutions to remove distressed assets from their books is intended to produce salutary effects, including potentially reducing the risk to the deposit insurance fund. But the FDIC should clarify with no uncertainty whether the DIF, either directly or indirectly, will be tapped to support the LLP.

Even if the FDIC believes it has sufficient authority to assess banks to back up its guarantee of this stimulus program, we ask whether it is prudent for the FDIC to do so. The DIF, which consists of bank contributions, supports deposit insurance and the FDIC's operations. Those operations may now include guaranteeing stimulus investment activities. If the FDIC bears any losses under the program, it is the same banks that will make up the loss.

As the FDIC is aware, banks are facing a potential special assessment of up to 20 basis points and perhaps further assessments in future periods. These come on top of the regular enhanced risk-based quarterly premiums and premiums for the Temporary Liquidity Guarantee Program (TLGP). These expenses may significantly affect bank earnings and even impair some banks' financial ratios and negatively affect their CAMELS ratings. CBA supported EESA and we support in concept the purposes of the LLP. However, we are very concerned that the responsibilities the FDIC assumes under the LLP may both undermine the FDIC's core mission and place additional financial burdens on banks. If the investments go bad, the FDIC will incur losses, which will be borne by the banking industry.

If the LLP should be adopted, CBA recommends that only banks that sell assets through the LLP are subject to potential assessments. Banks that choose not to participate should not be placed at risk of paying the program's losses. Furthermore, the activities and obligations of the LLP should be carefully segregated from the DIF, except that it is appropriate for excess FDIC revenues to be placed into the DIF. This is because participating banks achieve the benefit of their bargain from the successful sale of their distressed assets. Partaking directly in the FDIC's potential earnings is not part of the bargain (though all banks benefit from contributions to the DIF). On the other hand, if supporting the FDIC's guarantee is part of the LLP, then those who wish to participate do so fully apprised of that additional potential cost.

Our final point about the FDIC's involvement pertains to the FDIC's potential conflict of interest. In the proposed transactions, the FDIC is administrator and guarantor, and it is also a regulator of the seller. As the guarantor its incentive are aligned with investors who, for example, will seek to acquire assets at the lowest price. As regulator, its interests are aligned with the safety and soundness of sellers, which may be undermined by low sales prices.

Participation. As the stated purpose of the LLP is to clear banks' balance sheet of distressed assets and thereby place banks on more secure footing to make loans, the LLP should be structured in a way that maximizes potential participation and avoids favoring certain kinds of assets over others and thus certain kinds of banks over others. The LLP should be available for a broad range of assets, not just those backed by mortgages.

We also recommend that banks not be excluded from participating in the LLP as purchasers. The objectives of the program would be advanced by increasing the pool of bidders. The banking industry is diverse in terms of capital strength, types of assets held, types of investments desired, tolerance for risk, etc. The LLP is designed to benefit banks by reducing the liquidity discount associated with selling certain assets. If eligible banks are willing to purchase other banks' illiquid assets, that would only promote the LLP's goals. For the same reasons, bank affiliates should not be precluded from purchasing its affiliated bank's assets. The LLP's stated process of evaluating pricing should alleviate concerns about the inability to effect arm's length transactions between a bank and its affiliate that purchases through a public-private investment fund.

Uncertainties. We anticipate that some sellers and investors will be reluctant to participate in the LLP because of possible additional constraints that may be placed on them in the future. One concern is whether banks would be subject to the kind of pressures experienced by institutions that have accepted funds through the capital purchase program. Once the Treasury and FDIC have settled on the terms, they should commit to live with them and not leave open unspecified future demands. Specifically, the FDIC and Treasury should state clearly that banks that sell loans through the LLP will not be subject to any unstated additional requirements.

Another concern that our members have is how the accounting treatment of bank assets would be affected by the LLP. Specifically, would aggregate sales data of assets sold through the LLP affect the valuation of assets that are not sold? Would the valuation of an asset offered for sale but subsequently withdrawn be affected by the rejected bid prices after they are returned to the bank's portfolio? What if there were no bids? Would aggregate sales data affect valuations of assets held by banks that do not participate in the LLP? It is important for banks to know the answers to these questions before deciding whether to participate in the LLP.

Once again, CBA appreciates this opportunity to furnish comments. We hope the FDIC considers them carefully.

Sincerely,

Leland Chan
General Counsel