THE FDIC LEGACY LOANS PROGRAM ("LLP")

Part A. FDIC Questions for Comment.

1. Assets to be Sold in Program. 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 program should initially focus on those asset categories having the most harmful affect on bank balance sheets. Common wisdom is that non-performing and problem loans secured by real estate have had the most obvious harmful affect.*

   The FDIC indicates that the initial focus will be on residential and commercial loans. There is speculation that the first loan pools to be sold will be residential. Initially, FDIC will start with one bank contributing loans for sale. Multi-bank pools will be a second phase.

2. Transferability of Interests in the PPIF. 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?

   - *Generally, yes as to non-controlling interests in the private investor entity. To the extent one of the bid selection criteria is the qualification of the "management team" to manage and resolve problem assets, tighter transfer restrictions with respect to the controlling interest can be justified. However, even in those situations the private investor entity should be able to transfer with Treasury's reasonable consent. Permitting pledges and transfers of interests in the PPIF will promote liquidity and broader participation by, among other things, allowing for a variety of private equity capital structures and means for investors to enter and exit during the life of the investment. If allowed by the PPIF, this flexibility may be realized by investors utilizing a tiered private investment structure in which the private entity in the PPIF is static but direct or indirect ownership interests in the private component of the PPIF are not.*

   - *Restrictions on transfer should primarily be left up to the sponsor of the private investor group. If the sponsor's investment group is close-knit/closely held, it will want to impose more restrictions upon transferability, especially if there is subscription debt involved and/or additional capital requirements. The sponsor will want to know who its partners are. Other issues would be public partnership concerns (more than 100 investors); ERISA issues; securities issues, etc. Again, the sponsor will set the requirements when it puts its private investment vehicle together.*

   - *Bidder eligibility requirements are not yet defined. Will they vary as a function of the offered pool? Eligibility rules should be no more restrictive than the eligibility rules that apply to purchase of loans from FDIC as receiver for a failed bank. Eligibility* *rules should only apply to direct or indirect controlling interests in the private component of the PPIF. Satisfaction of such requirements can be a pre-condition to the transfer of a controlling interest in the private component of the PPIF.*

- *In addition, it may be advisable for private investors to have accredited investor status. There may be a number of small investors on the sidelines that do not want to be left out of this opportunity like they were in the RTC era. However, this investment may be inherently risky and therefore may be ill-suited to non-accredited investors. Allowing non-accredited investors to participate would be less of a concern if their interests were freely transferable.*

3. Entity Structure. 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?

- *The LLP calls for private investors to bid for the opportunity to contribute 50 percent or more of the equity for the PPIF. The apparent intent of the LLP is for the private equity percentage to be established by the FDIC prior to bidding. One thought is to introduce another variable to the auction process by allowing bidders to indicate their willingness to increase their percentage interest up to some upper limit. Whether or not it is desirable to vary from a 50/50 equity structure may vary with the characteristics of the subject loan pool. Also, a larger private interest might be used to dissuade overbidding due to the attractive financing terms. The percentage of private equity above 50% might relate to the debt to equity ratio and risk profile of the subject loan pool. Presumably, the higher the ratio and/or the greater the risk profile, the greater might be the percentage of private equity up to a maximum set by the FDIC. In other words, the government's equity investment and guarantee of debt should be sized and structured to stimulate private investment without causing overbidding by reason of aggressive leverage with relatively limited downside risk to the private investor. Others should comment on the specific percentages and their affect on returns and integrity of pricing.*

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

- *Yes. In the interests of broad participation and administrative ease, such disclosures should be limited to controlling interests.*

5. Enhancing Private Participation. 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?

- *See response to items 6 and 8 below.*

- *The larger issue may be encouraging selling banks to participate in the LLP. There may already be sufficient incentives for banks to participate: regulatory oversight/pressure; attraction of new capital; availability of capital from the Capital Assistance Program; new lending at attractive spreads. Permitting selling banks to participate in the PPIF (either through obtaining an interest in the PPIF or by a participating feature in the note) may also stimulate seller interest. In addition, the valuation and bidding methodologies developed by the FDIC and its advisors with respect to loan and other asset pools of failed banks have seemingly been validated: The FDIC's statistics show that such sales (for real estate, performing loans and non-performing loans) historically yield very close to or exceed the FDIC appraised value using such methodologies and bidding. However, sellers who have not already marked down the value of their loan portfolios and have set aside appropriate loss reserves may have no incentive to recognize a capital shortfall.*

6. Auction Process; Multiple Private Parties. 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?

   - *One's answer may depend on the size/type of the pool. Also, the due diligence costs of the bidders and the limited time and ability to conduct due diligence need to be considered. Presumably, the history of DebtEx and First Financial Network, who have handled auction loan sales on behalf of the FDIC, would provide informed answers to these questions.*

   - *In addition, if the buyer is comprised of multiple investors entities, the investors will need to carefully consider the investment structure and the rights and obligations among investors. Generally, due to servicing, asset management and disposition decisions that will be made over the life of the PPIF, an ownership structure involving multiple unrelated private entities as direct investors is probably not feasible. Therefore a Dutch auction approach does not seem preferred. Rather, right sizing the pools and/or organizing them along geographic and/or asset type lines in order to stimulate bidding by investor groups with special expertise or geographic focus may do more to stimulate bidding and recover value.*

   - *Providing the selling banks with the final right to reject or accept a bid will chill bidding and it seems to fly in the face of the overall purpose of the program: let the market decide what these assets are worth and get these assets off the banks' balance sheets. If the banks are concerned about being forced to accept a bid that is less than what the banks are currently carrying these assets on its books, perhaps banks can be incentivized to participate by relaxing capital requirements or providing a tax break. For instance, is there leeway to not require the bank to recognize the difference between the value on its books and the sale price? The interplay of the LLP sales process/price realization and the FASB easing of mark-to-market rules needs to be* *considered: How can the LLP be designed to better work with those rules to the benefit of the banks?*

- *Alternatively, the FDIC/bank/third party valuation firm should establish a minimum acceptable bid amount for a specific pool prior to the auction and that "reserve price" should be disclosed upfront. If the reserve price is unacceptable to the selling bank, the auction would not proceed. If the bidding exceeds the reserve price, then the selling bank would be obligated to accept the highest bid over the reserve price bid.*

- *The procedures/criteria for bid acceptance are unclear. It seems implied that the highest price is the winner but this approach does not address the fact that the servicing could materially affect return on investment.*

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

   See responses to item 1. above and item 8. below.

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

   - *To attract more investors, pool sizes should be varied and pools of specific asset types and geographic concentration should be formed. If only large diverse pools (in terms of asset type and geography) are organized, due diligence barriers will limit the number of eligible bidders and real estate operators and funds with a distinct asset type or geographic expertise will be shut out of the process. Value recovery may suffer. Also, the pool should not be sized so that only the largest private investors can participate. Finally, consideration should also be given to limiting the aggregate value of pools and/or Treasury/FDIC commitments to any particular control group of investors so that the 'biggest boys' don't dominate the program.*

   - *The initial asset pools should include the "better of the bad." In other words, the banks shouldn't sell their least desirable loans out first. Banks should be encouraged to team up with one another to provide the right mixture of assets (good vs. bad, type, size, location). This shouldn't be an administrative problem. The third party valuation consultant can assist with allocating the value/sale price/notes receivable among the participating banks pre-bid.*

9. Debt Terms. 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?

   - *Besides knowing the debt to equity coverage (and therefore the principal amount), investors will need to know the rate of interest, term, prepayment rights, default charges and default interest, transfer/change of control restrictions and other triggers to acceleration, amortization terms, debt service coverage ratio and reserve accounts and exceptions to non-recourse liability. In addition, lender approval* *rights, if any, over servicing and/or asset management decisions and transfer restrictions would need to be disclosed.*

10. Alternative Debt Holders. 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?

- *If the terms of the FDIC guarantee are appropriately broad and apply equally to the seller take back financing and third party financing, there should not be major differences between a public issuance of debt by the PPIF versus the selling bank taking back the guaranteed debt and either holding or selling it. PPIFs should have all options available to them. Seller take back financing seemingly is preferable to the private investor (less costs; quickest to obtain) and would facilitate private investor participation. If the private investor has other financing alternatives, whether public or private, it should have the flexibility to determine the best alternative..... including arranging for a forward sale of the take back note by the seller of the loans. However, the FDIC guarantee of the debt and its terms will be of paramount importance to the seller and any alternative without such guarantee probably will be far less feasible. Ideally, the LLP would permit the FDIC to also guarantee the PPIF's publicly issued debt to the extent such debt conformed to the FDIC guarantee term sheet.*

- *Financing/debt alternatives should be flexible and encouraged. If third party lending institutions are willing to finance a certain level of the purchase price for the pool as opposed to the seller bank taking back a note for the purchase price balance, that's better for the selling banks; more cash and liquidity. If the selling bank is taking back a purchase money note, our understanding is that the FDIC guaranty of that note will be secured by the pool collateral; and the note to the selling bank will not be secured. The secondary market will need to weigh in on this; i.e., will it buy or finance unsecured notes backed only by the FDIC guaranty, or will it also require some interest in the pool collateral? How will the secondary market value the FDIC guaranty?*

- *In many cases the PPIF may have capital needs beyond payment of the cash portion of the purchase price and payment of administrative and guarantee costs. In other words, in some cases, asset resolution could require the PPIF to incur enforcement, restructuring, re-leasing and redevelopment costs. Will those costs be funded by reserves, cash flow, additional indebtedness or by additional contributions and if a contribution is required, will the Treasury be obligated to fund its share of those costs or will it be subject to dilution...and, if so, will the decisions regarding asset resolution and additional capital needs be entirely controlled by the private investor?*

- *If the PPIF should be structured to accommodate post-closing capital needs in connection with the asset resolution process, the PPIFs should also be able to obtain* *subscription lines of credit which are secured by the public and private investors funding commitments; or some portion thereof. Subscription lines are typically not considered as debt. Subscription lines reduce the actual cash capital required to be put into the investment vehicle unless and until necessary to repay or pay down a subscription line.*

- *A well balanced mix of equity, subscription debt and third party debt will attract more private investors, reduce cash required to be funded by the Treasury, and enhance returns. Foreign banks should be allowed to provide subscription lines and traditional third party financing.*

11. Guarantee Fee. 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?

- *Probably. This would serve the interests of more fairly allocating costs to benefits. The FDIC FAQs and other materials on the LLP do not clarify if the fee is paid equally by the private investor and Treasury. Presumably that is the case since each investor is equally benefited. However, this requires clarification.*

12. Structure of Return on Equity. 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?

- *Note that in the discussion of this concept, the guarantee fee also has to be considered since one must presume the basis for a higher return to the government would be its assumption of greater risk in the form of the guarantee of debt. If the guarantee fee is appropriate compensation for that risk, a back-end return could dissuade private participation and/or price integrity. It may be appropriate to consider a sliding relationship between the cost of the guarantee fee and an increased level of return to the Treasury. As mentioned above, it is also necessary to clarify whether the guarantee fee is paid by both the private investor and the Treasury.*

- *If Treasury was willing to subordinate to some level of priority return of capital and investment return to the private investor (perhaps to stimulate participation), then Treasury should be entitled to a greater share of overall investment return. Also there could be certain tranches of equity investment in these PPIFs: One Tranche would be for the investor who is looking for a return of its capital and a modest return. Other Tranches may subordinate return of capital in exchange for larger pieces of the profits. If the Treasury or private investor is willing to take more risk as to priority of return of capital, then certainly it should be entitled to a greater share of the investment returns.*

13. Pooling by Sellers; Small Bank Participation. 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?

- *Such arrangements should be encouraged since, without them, small banks may be disadvantaged in their opportunities to clean up their balance sheets. Small banks play an important role in local economies and their recovery to health is as important as large bank recovery. Small banks will need to rely on the FDIC appraised value methodologies and guidance re pool size and type and can take title to the PPIF take back note and security as holders of undivided interests in proportion to the appraised value of their components of the pool.*

- *See response to item 8 above*

14. <u>PPIF Entity: How Should Potential Conflicts Among Investors Be Addressed?</u> 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?

- *See item 10. above. One concern is the need to make capital investments in assets that are taken over by the PPIF. Will there be an obligation to contribute additional capital, a means to obtain additional capital or cash flow to such purpose and how will percentage interests/distributions be affected?*

- *The apparent intent is for Treasury to be a passive investor. The closer that is adhered to, the greater the private participation and pricing integrity will be. Standard entity documentation can adequately addresses the conflicts between a managing investor and the passive investors (e.g., remedies in the event of a breach of management duties). In addition, the FDIC's own public-private partnerships with respect to loan pools of failed banks can provide market tested examples of how co-investor rights and remedies can be balanced.*

15. <u>Asset Management</u>. 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 private investor must be in control of the selection and oversight of the asset manager. Control over asset management decisions also must reside with the private investor. Perhaps certain major decisions could be subject to review by the public investor. Too much control by the public investor will defeat the purpose of utilizing private sector expertise and encouraging broad private participation.*

- *Qualifications of, and FDIC controls upon, asset managers/sponsors will be a significant concern. The FDIC says that its executive compensation controls won't apply to private investors. What about asset managers? In many cases the asset manager will be controlled by the sponsor of the private equity and/or an affiliate of* *the sponsor. Can the asset manager be a member in the PPIF? What restrictions/parameters will be established for the asset manager's fee structure? Will it be entitled to a promote/incentive fees/distribution based upon the performance/success of the fund? Will the public and private equity be equally subordinate to the asset manager fee structure? If the asset managers receive some promote/additional incentive fee, should it be required to also contribute some of the capital to keep interests aligned?*

16. Servicing. 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?

    - *In the interests of maximizing prices, the loan pool should be sold servicing released and servicing rights should not be separately valued.*

    - *Servicing will be a key component of the program. Clarification of whether or not pools will be sold servicing released is required. The PPIF should have the right to determine who it will retain as servicer; maybe the selling banks will be the logical choice, or maybe not. In any event, the PPIF should have absolute control over the servicer.*

    - *What strings does the FDIC intend to impose upon the loan pools that are purchased? Residential mortgage pools will be subject to the Making Homes Affordable program. What else? Private equity needs to know this up front. To what extent can participants get comfortable the Treasury won't try to directly exercise control through changes in the Income Tax Law? If Treasury/FDIC change the rules in the middle of the game; i.e., after private equity has already been committed to a PPIF, and if that change of strategy or rules would have a material adverse effect upon the private equity, they should have the ability to put the private interest to Treasury/FDIC. Private equity wants to know up front what the rules of the game are.*

17. Scope of Bid Information. 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?

    - *One's response may vary depending on its own capabilities to collect and assess information regarding the underlying assets; however, as a general matter more disclosure is encouraged in the interests of accurate price determination; particularly given the potential taxpayer exposure as a result of the non-recourse financing. It will also level the playing field and encourage other investors. As an example, under several programs, derived investment values were disclosed by the RTC as guidance for bidders with good results.*

Part B. **Questions and Comments on Other Aspects of the LLP.**

1. Due Diligence. How will due diligence be run? - There will probably be a virtual data room. Will due diligence occur up front with auction price final or will pricing be subject to post-bid diligence by the top bidders? Will there be buyer right to put back assets? In the case of a difficult to assess loan pool, having a second round of due diligence for the high bidders and/or a buyer option to put back certain purchased loans based on post-bid additional due diligence would probably result in more accurate pricing.

2. Overbid Risk to Taxpayers. Between the limited private equity and the non-recourse nature of the financing isn't there a risk of competitive over-bidding? Will the program include protections for the taxpayer lenders?

3. Form of PPIF. What form will the PPIF take? Will it parallel the public private entities used by the FDIC in the 1990s and very recently when it has sold a partial interest in a pool assembled from one or more failed banks?

4. Treasury Warrants. Treasury is required to receive a warrant in the PPIF. What will the terms of the warrant be? What dilutive impact will the warrant have on the private investor? Is the warrant independent of Treasury's 50% equity interest?

5. FDIC Debt Guarantee. When will the FDIC Guaranteed Secured Debt for PPIF term sheet be available (the "Debt Term Sheet") for comment? The terms of the FDIC's guarantee and the implications of the same for the structure and marketability of the debt are key. Debt marketability will be affected by disclosure requirements, required qualifications of purchasers, the potential liability of the PPIF as issuer, transfer restrictions, etc.

6. Minority and Women Business Enterprise. How will minority and women-owned enterprise participation be encouraged and facilitated?

7. Staffing. Will the FDIC be properly staffed to administer the LLP? What resources is the FDIC devoting to the LLP?