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Comments for FDIC Legacy Loans Program

No participating bank should be allowed to bid on any portfolio. By providing non-recourse leverage, the FDIC takes on all the downside risk with only nominal sharing of potential upside. If banks are permitted to bid on their own portfolios, or work with competitor banks to bid on each others' portfolios, they could effectively shift all risk of loss onto the FDIC which maintaining upside potential for themselves. For example, if a seller bank has a 30% reserve against a portfolio, and the FDIC provides 80% leverage, the seller can bid above its own reserve level (regardless of true underlying economic value), and effectively book a gain on the transaction and shift all risk of loss onto the FDIC. A group of banks could collaborate to effectively rig the market in this manner.

The whole-loan sale market has been active and transparent since the credit crisis began. The sale of the loans themselves, rather than the creation of complicated investment funds which will hold the loans, will provide higher pricing (due to lower fees) and more transparent pricing. Has the FDIC considered selling the whole loans themselves?

The market will price the investments based on an analysis of the loans in the package. Historically, better loan pricing has been obtained by selling individual loans or very small pools, rather than large portfolios together. Smaller pools, or offerings consisting of single borrower relationships, will drive a higher market price. Larger pools, and sale of derivative interests such as partnership shares, will result in lower prices and less transparency.

The FDIC should hire experienced loan sale companies with sufficient capacity, pricing expertise and execution capabilities. It should not hire the same large investment banks and commercial banks that created this mess to begin with.