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To: LLPComments
Subject: Legacy Loans Program comments

Please find below our comments:

The FDIC is requesting comment from interested parties on all aspects of the proposed LLP. In particular it has formulated the following questions for interested parties to consider:

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?**

Given uncertain investor demand and possible short-term constraints on the size of the program that the FDIC can administer, an initial focus on the largest and most liquid asset category would seem prudent. By focusing all of its resources on legacy real estate assets, the FDIC could help insure a successful launch for the program. The program could be expanded later on to include other asset categories.

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?**

Allowing initial investors to sell or transfer their interests in a PPIF, even if it were after 1 or 2 years, would help alleviate investor concerns about length of time that their cash is locked up and lower the perceived risk of the funds. Making the funds less risky in this way would attract more investors and add liquidity to the program.

The FDIC could require new investors to meet the same criteria as the initial investors.

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?**

A 50/50 partnership between private and public investors would seem appropriate.

Higher government participation could leave investors feeling underrepresented and increase the perceived risk of investing in PPIFs. Clearly, this would have a negative impact on investment, especially in light of the fact that Congress has already shown itself willing to unilaterally alter the terms of other government rescue programs.

At the same time, government participation at less than 50% might not offer an adequate return for the taxpayer.

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

Yes. Investors are also clients for asset managers and, as such, their identities should remain confidential. PPIFs should only be required to disclose the identities of their investors for regulatory purposes.

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?**

A broad and diverse range of investment participation would be encouraged by making standard pool sizes relatively small (perhaps $200-$300 million nominal) and allowing the largest possible number of private fund managers to bid for them. Fund managers could be required to demonstrate their ability to buy at least one pool of assets as part of the approval process.

A large number of investors submitting bids would make the market more transparent and reassure sellers that they are getting the correct price for their assets.

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?**

The LLP will need a robust auction process if it is to accommodate the targeted volume of asset sales. In theory, the program will need to auction around $10 billion of legacy loans each week for 6 months in order to reach the minimum program objectives. Requiring participants to bid for the entire equity stake would exclude all but the largest investors, thus reducing liquidity. However, allowing investors to bid on partial stakes would expose the difficult issue of asset management control.

Nor is a system whereby a handful of asset managers are pre-selected to bid (as in the Legacy Securities Program) a suitable arrangement. Such a system confers monopoly rights on the selected fund managers and a monopoly situation is never conducive to fair pricing.

What seems to be required is an arrangement that encourages the participation of mid-tier asset managers and allows the use of the Dutch auction system that has served the U.S. Treasury so well in the past.

Something along the lines of the following might work:

The FDIC could assemble a large pool of similar assets (i.e., same collateral type, same loan characteristics) offered for sale by participating banks and divide that pool into 40-50 roughly homogenous pools of $200-$300 million each. Those pools could then be sold together in a Dutch auction. The relatively small size of the pools offered for sale would permit the participation of mid-tier investors (who want to be able to manage the assets in their own fund), while the Dutch auction process would insure that the banks get the best price for their assets. Investors could bid for more than one pool (up to some maximum number of pools for each auction). Fund managers that buy more than one pool could merge them for ease of management and offer a single PPIF to their investors.

As the single pools will not be exactly homogenous, a further mechanism could be incorporated into the bidding process whereby the investor with the highest absolute bid among the winning bids would have first choice on which pool to take, the investor with the second highest absolute bid would have the second choice on which pool to take, and so on until all of the pools were distributed. In the event that two winning bids were identical, a further criterion such as the time of bid submission could be used to decide which investor had priority.

The success of this methodology would depend on the ability of the FDIC to divide large asset pools into smaller ones with similar prices and risk profiles.

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

As the initial auctions will be the most difficult, the most liquid asset types should be pooled first in order to produce the best bid/cover ratios at auctions and get the market to moving as quickly as possible. Once the market reaches critical mass, less liquid assets can be auctioned.

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

The optimal pool for a PPIF would include around 1000-2000 performing residential mortgages and have a cash value of about $250 million. Non-conforming and commercial mortgages could also be interesting separately. Non-performing loans would not be vey interesting.

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 essential features of the note would be: rate, coupon type (fixed or floating), maturity and call features.

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?**

It would it be preferable for the selling bank to take a note from the PPIF since it would be difficult and time consuming for even a mid-tier fund to access the capital markets directly (especially during the initial period when there is no secondary market for the notes).

In either case, the development of a secondary market in FDIC guaranteed notes is essential to the success of the program. Without an active secondary market, the banks (or the PPIFs if they have chosen to access the capital markets directly) will have difficulty in monetising the notes--the program will have succeeded in establishing a fair value for legacy loans but it will not have solved the liquidity problem for the banks since 85% of the value of the loans will still be tied up in illiquid (albeit government guaranteed) assets.

In order to encourage the development of a secondary market in FDIC guaranteed paper, the “note” could actually be an issue of notes, each with a $5-$10 million face value, since smaller, standard market sizes are more liquid. Furthermore, since a fund has no way of knowing exactly when a pool of assets will mature due to prepayment and extension risk, it is not necessary to match the maturity of each note exactly to the expected maturity of each pool. Funds could use standard maturity dates for their notes (such as the 21st of March, June, September, and December of each year) and thereby increase liquidity on the secondary market for guaranteed paper even more.

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?**

Yes. Guarantee fees should be like insurance: the higher the risk, the higher the premium.

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?**

No. The government is already earning money on guarantee fees and on their participation. Investors also need to be compensated for the risks they are taking and they should not be penalised if the returns are good.

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?**

The program will need to permit multiple banks to pool assets for sale. The proceeds could be allocated to the selling banks based on pre-auction valuations.

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 government may be tempted to use the funds to further public interests (to the detriment of private investors). For instance, public shareholders could try to prevent fund managers from foreclosing on certain homeowners or force them to offer generous loan modifications.

The participants should establish a clear and irrevocable contractual relationship that sets out the rights and responsibilities of each party.

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?**

Asset managers should be selected by the private sector and approved by the government. Restrictive covenants could be used to control what an asset manager may do. Standard collateralization, interest coverage and quality tests could be used to monitor the health of the pool.

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?**

The standard mortgage pass through methodology should be used whereby originators would continue to service mortgages for an annual fee.

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?

Yes, definitely. Easy access to data used by the independent valuation consultant, as well as the results of the consultant's analysis, is important for the transparency and liquidity of the program. Both buyers and sellers should have access to the same information.