

Comments on the Public-Private Investment Program: *Legacy Loans Program*

The goal of the Legacy Loans Program portion of the Public Private Investment Partnership Program (PPIP) to assist banks in selling illiquid assets is laudable. As with all financial programs, the effectiveness will be determined by the final program guidelines and regulations. Here are my comments regarding the Legacy Loans Program:

POOLING OF ASSETS: There are several unintended issues that arises in any sale where different types of assets are pooled into larger sales. The first is price.

The best buyers, who are often local, or specialized are precluded from purchasing very large pools. The pools are then sold “wholesale” with the buyer reaping the rewards of retail pricing by reselling assets (at a higher price) to the retail buyer.

Price Disparity in Mixed Pools:

By selling assets in mixed pools a seller may have to sell their loans at less than optimal price.

Example:

	<u>Contribution</u>	Bidder C <u>Price</u>	Bidder D <u>Price</u>
Bank A	\$50mm Loans	\$30mm	\$20mm
Bank B	\$50 mm Loans	\$20mm	\$35mm
Totals	\$100mm	\$50mm	\$55mm

Bank A would want to sell to Bidder C, or at least mark their loans at the bidder C price, Bidder D may not buy JUST the Bank B loans, preferring to spread his risk over more loans. This situation will absolutely occur if you mix pools! To avoid this, offered pools should be homogenous.

Also – If Bank A & Bank B have different loan characteristics, there stands a good chance there will be a disparity in the reps and warrants offered in the Loan Sale Agreement.

PRICE: It is contemplated that the FDIC will provide leverage and the UST will be a co-investor. With private investors having so little equity invested will there be a mechanism in place to prevent buyers from bidding too high? Illogical high bids may be encouraged by the small equity component of the structure. The assets in failed investment funds will eventually have to be remarketed by the FDIC.

SERVICING: “Parameters will be set by the FDIC and UST”. Will these be clearly delineated prior to any bids? How an asset is serviced will have a dramatic effect on potential resolutions, and therefore, price. Will servicing parameters be different depending upon the parameters of the pool? Can an investor take a 51% stake, therefore being in a majority and not have to have UST as an equal partner? The requirement of servicers to report to the UST and FDIC will increase the cost to service and therefore decrease purchase price. There was a question of establishing a market for servicing rights on these pools. The servicer should be paid a market fee for their services, and therefore the servicing should have no intrinsic value. Introducing the idea of trading servicing rights on pools that require special servicing is not a good idea. Servicing rights on very homogenous mortgages have value because it costs less to service them than the servicing fee. This will not be the case for legacy loans.

LENDER LIABILITY: Having the government (with theoretical unlimited resources) as a partner may encourage large amounts of counterclaims and lender liability claims, that could drown a private investor, even at 50% of the liability. Just fighting these suits can negate any potential profit. Will there be protections instilled for purchasers?

PURCHASE & SALE AGREEMENT: This will be a lynchpin in the process. Maximizing the price and effectiveness of the program will require that buyers get reps and warrants similar to those available in private sales. Standardizing a document to be used in all sales will be helpful, but difficult to achieve due to the differing standards of the loans being sold.

BID FORMAT: The only bid format that should be contemplated for the program should be a sealed bid format. There have been suggestions that a Dutch or English auction format should be contemplated. The fatal flaw of both the Dutch and English auction format is that the seller does not have knowledge as to where all the bidders are valuing the pool. In the instance of a failed trade (and this is a VERY real possibility) the English and Dutch auctions will require the process to be repeated from scratch. In a sealed bid auction, the seller will have the option to sell to any other bidder at the bidders proffered price.

FEES: There is a potential for the fees to be a large part of the purchase price (compared to private sales), due to the passed along costs of oversight and management. Sellers should be able to book the gross purchase price as the sales price for their legacy loans. Also, if a bank is given the option to reject bids, how do the fees get paid that are otherwise contemplated as being paid out of the sales proceeds?

POOL FORMAT & SIZE: Pools should be as homogenous as possible. Asset types and sellers should not be mixed. This will maximize price. The ideal pool size should be about \$200 million, with a range of \$50 - \$500 million. This will allow the greatest amount of participation from both large and small institutional buyers.

Respectfully Submitted
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