This article was published prior to McKee Nelson LLP's combination with Bingham McCutchen LLP on August 1, 2009.

Coming to Grips with **Government Intervention**

The scale of government intervention in financial markets over the past year is unprecedented. By some calculations the U.S. alone has already spent, invested or committed around $9 trillion of taxpayers' money. That has stoked controversy. Should the government have invested in banks? Should Tarp revert to its original aim of buying assets? What role can private capital play in government plans? Can any of this really help homeowners? And what are the dangers of intervention? *American Securitization* sat down with some of the market's top names to discuss the issues.

The Panel:

The Moderators
AmSec - Antony Currie, American Securitization
ASF - George Miller, ASF

The Investors
RD - Ralph Daloisio - Natixis
ES - Ed Steffelin - ICP Capital

The Lawyers
JA - John Arnholz - McKee Nelson
EG - Ed Gainor - McKee Nelson

The Advisors
SA - Steve Abrahams - Citadel
EM - Elizabeth McCaul - Promontory Group
PS - Peter Sack - Credit Suisse

The Trustee
DM - Doug Magnolia - BNY Mellon

The Analysts
CF - Christopher Flanagan - JPMorgan
JR - Jeff Rosenberg – Banc of America Securities
KW - Karen Weaver - Deutsche Bank

AmSec: Let's start with a warm-up question. After a year of ever more government intervention in the markets as the credit crisis has escalated, how would you characterize the problems authorities face?

Steve Abrahams: Clearly the biggest issue is that no one thought that what looked like a temporary bank solvency and market liquidity issue in late 2007 would turn into a severe market dislocation.

What has changed lately is there is a second problem the government is trying to address: the solvency of consumer balance sheets as home prices are declining for a lot of households. That is their largest source of equity. As asset prices decline in a world where we have collateralized lending, it becomes progressively harder and harder to lend against assets that are depreciating in price.

Ralph Daloisio: Intervention initially was more surgical in nature, as governments tried to identify and address specific institutions or pockets of weakness that could pose systemic threats and address them. Once the systemic threats started to broaden across a number of institutions that escalated the government response mechanism into more of a rescue mentality.

The escalation became self-reinforcing as various countries adopted different measures at different times. For example, once the UK started trying to recapitalize its banks and Ireland basically guaranteed bank deposits, you saw deposit money actually flowing out of areas that were not as well guaranteed by governments into areas that were. That created another challenge for policy makers as the rescue stakes were raised to a global level.

And then at some point it became apparent that you couldn't really stabilize the balance sheets of key financial institutions nationwide in the U.S. simply by addressing the asset side. That is when they started to convert Tarp into really a capital investment program.

AmSec: Recapitalizing the banks first was a better use of Tarp capital. Without it, direct purchases of troubled assets could well have caused more writedowns that could have left a number of banks either insolvent or on the brink. Agree or disagree?

Chris Flanagan: I disagree. I feel the solution has been very straightforward and very simple, but philosophy has prevented it from happening. The simple cause of all this is negative equity for homeowners. The simple solution is for the government to step up and purchase delinquent loans out of securitizations at a fair price for the securitization and restructure those loans.

The arguments against are that it will create enormous moral hazard, that it's too much money, that we can't spend government funds that way. But what's ignored is the potential cost of inaction. If I go back to March 2008, the potential cost to the government of intervening in that way might have been something like $400 billion, no more.

Instead, we are sitting here eight months later, and we are minus $20 trillion to $30 trillion in aggregate wealth in the U.S., so inaction hasn't been a very good trade. Buying mortgage loans out of securitization is still the right move. I am encouraged to see Chairman Bernanke now advocating it.

There are $350 billion of funds left in Tarp that could be deployed very effectively to purchase delinquent loans, restructure them, resecuritize them and sell them. A revolving structure would get a lot of leverage out of that remaining $350 billion. November's election was effectively a referendum against the idea of no government intervention. Voters want and need government intervention.

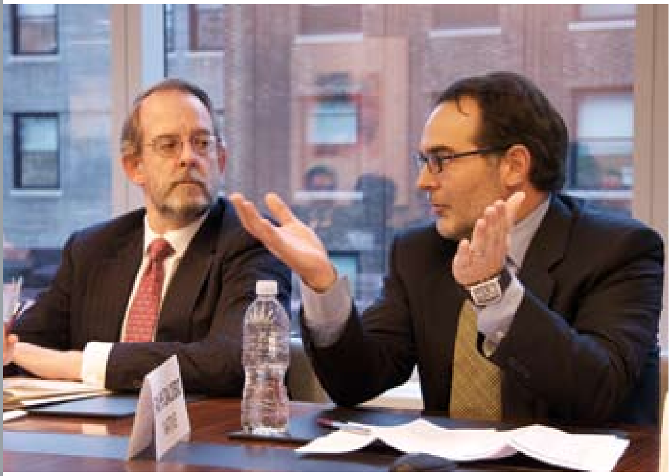
The government is the only player in the market not subject to the problems or perils of FAS 157 accounting. It does not have to worry about having its books marked down. The idea of injecting capital into the banks in lieu of actually solving the root problem was crazy. It was complete insanity. Mark-to-market accounting creates a never-ending, downward spiral of prices which meant that injected capital was going to be largely wasted.

We now appear to be moving in the direction of addressing the root problem, the loans. I'm disappointed it took us so long to get here, and not 100% confident we're where we need to be. But a broad consensus is growing that it's a social good to restructure these loans, keep people in their houses and prevent endless foreclosures creating a spiral of home price declines.

Ed Gainor: Perhaps we needed to recapitalize the banking system. But Chris's prescription for solving the housing problem illustrates how the potential power of the Tarp has really been squandered. It was designed as a revolving facility. The Treasury could buy assets, repackage them, enhance them if they're mortgage loans, modify them, sell them back into the market and recycle those funds. The impact of that $700 billion on the market, if used wisely, could have been $2 trillion or more.

John Arnholz: If you were to talk to the Treasury and Tarp administrators about the success of the program so far, they would point to the dramatic reduction of credit default swap spreads on key financial institutions and bringing the financial system back from the brink of utter collapse. But I agree with Chris. If you look at the root cause of what has happened, it's declining real-estate values and underwater loans. I've been surprised and troubled that the administration has not moved faster to address the issue. Do you have any sense whether or not the new administration sees it the way you do?

CF: No. But Chairman Bernanke's recent remarks appear to hint at a willingness to use the government balance sheet. He has exhibited excellent leadership as of late. Pledging that the Fed would buy $600 billion of agency mortgages was extremely powerfully well-timed. That market was on the verge of very severe problems. It really was very important in addressing the moral hazard issue. If you can give benefits to good, conforming borrowers who have actually made payments, and get conforming mortgage rates down, then they begin to feel like, well, at least they getting some benefits for their good behavior.



McKee Nelson's Ed Gainor and Ralph Daloisio of Natixis

Doug Magnolia: One of the businesses I run at the Bank of New York is our role as Tarp administrator, so I can't comment too much about some aspects. But we have been involved with it since mid-September, and it has been a fascinating process to see the Treasury working on this.

The Act was crafted in 48 hours and is some 200-odd pages long and some of the language is extremely broad and not narrowly defined as one might expect. It is clear that actions at the ECB and the central banks in the UK and Ireland over just one particular weekend were almost tipping our government's hand on how they should react.

And they started right off the bat pursuing multiple avenues for Tarp in all of its guises. Many people didn't know that there was a program in there to deal with what they termed systemically significant failing institutions. I didn't even know it was in there until they told me that we were going to be making an investment under that program. Even the capital purchase program wasn't mentioned much in the early days because they were focusing on purchasing whole loans and securities.

How do we achieve the primary directive of the act, which is economic stabilization, whether that is for a financial institution or consumers? How do we implement that? How do we keep people in their homes? How do we ensure that the taxpayer doesn't take it on the chin because we end up buying a whole bunch of assets at 70 cents on the dollar when their real value is probably somewhere closer to 50 cents, or less?

Given the limited resources available, the political pressures and the timing, the people there have really done an incredible job to date. It may seem like there is inactivity and confusion, but that is not exactly the case. How they progress from here is really hard to say. How is Mr. Geithner going to treat the remaining balance of the Tarp funds? What is the new administration's focus going to be?

SA: I actually liked the switch in how the government uses Tarp: moving away from buying mortgage assets to providing capital directly to the balance sheet of banks. My sense was that the Fed was operating under the assumption that if banks felt like they had impaired capital bases, they would stop lending, perhaps entirely.

RD: Banks didn't necessarily just have problems with lending assets, either. I wondered what it was that put PNC on the A-list with Treasury when it received permission to use Tarp capital to buy National City. So I looked at PNC's 2007 balance sheet — a little out of date, but still relevant. If I have my numbers right, PNC had about $150 billion in assets and about $15 billion in shareholders' equity. But over half of that equity, $8 billion, was goodwill, which is not required to be tested for impairment more frequently than annually, and another $6 billion was invested in equities. So almost all of its equity capital was accounted for by two very volatile assets.

That left very little real capital for its sizeable lending and securities portfolios. It's anecdotal, but it solidified my understanding of the real issue that we have: that both sides of the balance sheets of these premier financial institutions had become very questionable.

SA: The Fed's target was not necessarily the mortgage problem first, but primarily the ability to get debt and capital flowing in the banking system. Conceptually the idea of buying the mortgage assets was an attempt to basically unbake the cake. These assets have been spread throughout the system. Everybody recognized that they were, and remain, extraordinarily difficult to value, and as a result nobody had confidence in what the net asset liabilities of these banking institutions were. So the thought was that by extracting the toxic assets we would create a cleaner, more transparent balance sheet and institutions would feel comfortable lending to one another again.

But once they started confronting how to extract these assets, such as how to run reverse auctions for an intrinsically heterogeneous asset, they realized that buying assets was going to be very difficult to pull off.

I can think of better things that they might have done, but trying to repair their capital base was really important. I would argue that it has had measurable effects — money markets indicators look a lot healthier now.

Ed Steffelin: I think you are going to have the opposite problem. Banks are levered 20 times and asset prices are down 10 points since the capital injections started. Apply that leverage multiple and the capital you put in just got sucked down in write-downs and you're back where you started.

The government has been attacking the symptoms, not the causes. The government's role is to bring confidence. Forget which option you choose for Tarp. The government has the ultimate balance sheet. After failing to halt Lehman, stuttering on AIG and flip-flopping on Tarp, government needs to make a decision, carry it out and inspire confidence in doing so.

AmSec: What would you suggest?

ES: They made a big mistake by not bringing in private capital. The government is going to have a very hard time doing this on its own. In September everybody in asset management was talking about how to get their piece of Tarp. It was a porkfest. What the government should have done was become the world's biggest prime broker. Private investors would happily put up cash in front of the government for a 50% return. It keeps a modicum of decision-making in the hands of the private market and that cash would bring leverage back into a delevered system. Done right, that would be an efficient use of capital.

Next, even if the government buys out loans, that alone won't save all housing markets. You still have neighborhoods that are blighted. What do you do about troubled municipalities like Stockton, the foreclosure capital of the U.S? They need to plow houses into the ground. They need to literally put in parks where empty houses stand. That or increase immigration: "Buy a foreclosed home and get a green card." Of course, that may not be politically popular.

Karen Weaver: There are housing disaster areas that need almost the same help you'd give after a natural disaster. And you're right that a big issue was the execution on Tarp. The language in the Act was extremely broad, effectively saying the government can buy any asset for any price. Only later did they ask how, and there wasn't a good mechanism for harnessing the intellectual capital from the private market to make sure funds were used appropriately. Also, when Tarp was first proposed, investment banks would have benefited most, selling assets they had already written down. They weren't going out the next day to originate loans.

EG: Treasury was politically tone deaf in how they executed on Tarp. There was no sensitivity to what Congress expected to see out of this program. In the end, the Economic Stabilization Act was littered with provisions regarding loan modifications. Whether or not that is what was necessary to save the financial system, Congress expected to see that. Treasury was completely oblivious to that at the start of the process, and, as a result, Tarp has been tainted in the eyes of many on the Hill.

KW: One of the first drafts basically said the government could modify any loan that it owned or controlled. It didn't have any other qualifiers around it, and I thought, wow, they are really serious. Then that old NPV language was in there, and, as long as it is, the incidence of modifications is going to be lower. But I should make clear that I am a curmudgeon on modifications.

AmSec: We'll explore why later. First, Peter, you had some thoughts.

Peter Sack: It was clear when Tarp was conceived, and it remains clear today, that something still has to be done with the loans. But securitization is a fundamental inhibitor. The only way to resolve the issue is if one entity owns the bad loans, and that is obviously supposed to be the government. Maybe it is a little bit after the fact, but I don't think that means we cannot still do now what was a better idea several months ago.

AmSec: Can you expand on your comment that securitization is a fundamental inhibitor?

PS: Purchasing RMBS is extremely difficult and has a limited benefit because it doesn't really use leverage. The modifications are not working for a variety of reasons, even though many of the pieces needed already exist. Hope for Homeowners, for example, in a modified fashion could be an avenue to refinance some of these loans.

But it can't be done in securitizations. What Chris describes has two primary benefits. First, the leverage. You can spend something like $250 billion to cure the entire subprime market — which is not that much money relative to what has already been spent.

The other benefit is to improve the position for all of these consumers — assuming that is one of Tarp's purposes. The practical way to accomplish that is having the government as portfolio manager. Now, the program that Chris describes might not be the only solution, but it certainly should be a component of it.

CF: Whether Tarp should have invested in banks is irrelevant at this point. The question is how to move forward. But it's remarkable that the government really has not wanted to spend money to solve the problem, and in particular give money to individuals. Partly that's just logistics — it's easier to give money to banks than to millions of homeowners.

It's a consequence of a deeply rooted philosophical resistance that this country has developed at least over the last 30 years. But overcoming this resistance is absolutely critical. Buying loans out of securitization pools would have benefited everyone from the government sector to individuals in the household sector.

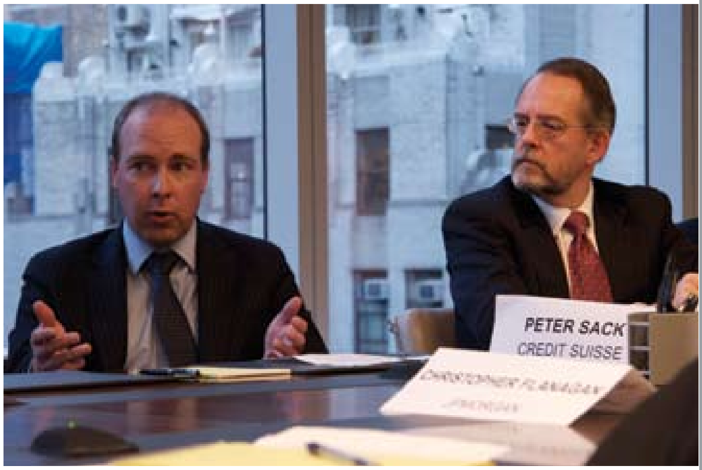
RD: But that was politically unachievable until very recently. I remember being in your offices when you had Neel Kashkari and Seth Wheeler and some others from Treasury making a presentation. At the time I asked why the government isn't positioning itself to use more of its fiscal resources to help remediate problems for homeowners. The answer was that many representatives on the Hill didn't feel it was their problem — that we had very serious pockets of problems concentrated in a few states. It took an escalation of the crisis to polarize the political process.

Jeff Rosenberg: There was definitely still the sense coming into September that housing problems were regionalized, that this wasn't yet a Main Street problem. It was presented as a Wall Street problem. That undermined political support.

Second, the steps to intervention were backwards: to get political motivation, they had to create expediency, and in doing so stoked systemic risk. Having let the cat out of the bag there, they realized, well, we have Tarp as a program and ultimately the program's core purpose is ambiguous: is it to buy assets at their real price, or is it to buy assets at an inflated price and thereby effect a recapitalization?

That sounded like a debate about price. But it was really a debate around purpose. What was the purpose of the Tarp: recapitalization or cleaning up the asset? The problem with the latter is that, if you force that issue, you force the solvency issue. And if you force the solvency issue, you create systemic risk without any mechanism to mitigate it. In realizing that mistake, they had to switch purposes and say, okay, now we have got to deal with systemic risk. We have to prevent the collapse of the financial system first, and we have the Tarp to do that.

Steve mentioned improvements in money markets, which is really a consequence of the other programs, like the temporary guarantee program. These put us in a position in 2009 to go after the assets without stoking the systemic risk of massive insolvencies. We're not going to have those. We're going to have PNC buying National City, or JPMorgan buying WaMu. Or, as in Citigroup's case, we are going to have another capital infusion. We have bought ourselves time to go after the core problem, which is to work out the asset uncertainty.



Peter Sack of Credit Suisse and Ed Gainor

SA: Whatever solution the country ends up with, if it involves purchasing assets, it also has to address how to kickstart lending. It is not crystal clear to me how purchasing existing assets solves that problem. The original intent is that it would clean up a lot of balance sheets. That action should start banks lending to one another and eventually they would be brave enough to lend to consumers.

But at the same time there is still significant home price depreciation and delinquencies are rising in other consumer assets. My concern would be that even well-capitalized banks freed of a lot of the contaminant would still wait and see how the consumer was going to fare.

KW: Treasury's hope was just to restart new lending. But what was missing was any consideration about the competitive effect of legacy assets on new lending. You really have to have a way to go after both of them.

PS: Some of the fixes or policy changes from all of this dislocation are going to prospectively make mortgage lending even more difficult. And I don't just mean that historically it is going to be a bad story to sell to an investor. There is the practical matter of the non-recourse nature of residential mortgage loans. That problem is only going to get worse. As the bankruptcy cramdown happens, it will be even more difficult to price mortgage risk. You can maybe make room on balance sheets by moving aside the bad assets and you can capitalize banks sufficiently to make loans. But it is going to be very difficult to value mortgage risk in the future.

CF: As long as home prices are declining, banks won't want to lend. You have to stabilize home prices, and that is why the idea of preventable foreclosures and loan modification around it is critical. That should eliminate the excess foreclosure inventory that drags down prices.

Identifying the root cause of today's problem is key — and simple. If people have negative equity, they're exercising their default option, because it is a non-recourse loan as far as they're concerned. So one must turn the corner a little bit to get people to start thinking, look, prices aren't going down that much more. We can restructure a negative equity position, we can work with that, stay in the house if it makes sense.

The question you raised about recourse is extremely important, and needs changing. We should be able to say: we have restructured your loan and you are going to pay this back like you are going to pay back your student loan — no ifs, ands or buts. You pay back the modified balance.

KW: Unfortunately, the political winds are not blowing that way. Among the most important things the government could do is to try to keep this marginal propensity for default for people who have negative equity as low as possible. Historically, it is something like 7%. We know it's going to be higher now, but the really scary thing is as many as 20 million homeowners may end up with negative equity. You don't want to change their behavior. You want people to take the obligation to pay back their mortgage very seriously. That is where you get into difficulty trying to apply loan modifications, because once you start down that path you change the behavior of borrowers and end up with up to 20 million people wanting a loan mod.

ASF's George Miller, Promontory's Elizabeth McCaul, BNY Mellon's Doug Magnolia, Sack, Gainor, Daloisio and Deutsche Bank's Karen Weaver

ASF: Are there other mechanisms to achieve the same goal across government programs, like shared appreciation mortgages? Conceptually that sounds like a pretty good way to distinguish among borrowers who might want a loan modification from those who might really need one.

KW: It's hard to disagree with the phrase "preventing preventable foreclosures," which I think is a Bernanke terminology. But I don't think there are that many preventable foreclosures and the recent OCC data stating many borrowers were already defaulting on modified loans seem to support that. Now we might find a lot more preventable foreclosures as we go further into this cycle. But I don't think there are that many cases of subprime loans where we can really prevent foreclosures.

CF: There is if you do something about the balance. That's the reason all these re-defaults are occurring. Offer help with forbearance or forgiveness, turn loans into shared depreciation mortgages and perhaps you can begin to get people back to maybe a zero equity position. Then their default option isn't so valuable anymore. The OCC data is not too meaningful as the problem with principal has not really been addressed.

AmSec: Karen, you called yourself a loan mod curmudgeon. So what would you suggest?

KW: In contrast to an earlier comment, I actually think we should deal with the symptoms and not the cause, which sounds very strange. But we have built too many granite countertops, we have overinvested in the housing market and we are now experiencing a necessary, inevitable and painful correction.

We should prevent an overcorrection by focusing on people who have very solid credit. The Treasury proposal to take mortgage rates down to 4.5% for new buyers who meet the GSE qualifications is a good idea, for example. As is shoring up the economy more generally with stimulus packages.

But we have to go through the correction. There is probably little that can be done about the large wave of foreclosures coming.

CF: I would argue the eventual correction has already become much worse than it needed to be precisely because of lack of intervention.

What has been lacking when we talk about moral hazard is the flip side: moral leadership in setting a standard. Yes, some people will be inclined to default or look for a mod if they see somebody else getting one, but not everyone. That is where moral leadership needs to appeal to the broader sense of responsibility people still have: I borrowed this money. I have to pay it back. It would be nice to get a forbearance on my principal, but I understand if I'm not going to get that.

There are enough people like that who you can appeal to. You work with those who are truly struggling, and then you have the others who are either just flat-out deadbeats where foreclosure is the only option and then people who never should have gotten loans in the first place. You write those off and move on.

If you make such distinctions and leverage the various servicing capabilities we have, you can begin to contain the problem and prevent foreclosures. Just saying look, this is a necessary correction, is not the answer.

KW: You think the market has already over-corrected?

CF: No, not yet. But if the government does not directly intervene, we will not see a bottom in prices next year because unemployment will skyrocket. Then we'll have a whole second chapter to this story.

JA: Karen, your view is that there just aren't that many people who can be successfully helped?

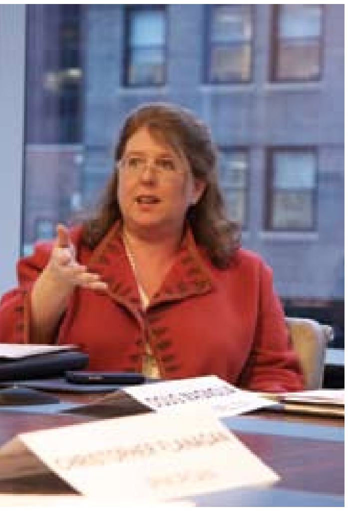
KW: Right. But it's a fair point that modifications to date haven't been very serious modifications. But the more important thing is that it is very dangerous to send a message to folks that they are going to get some relief on loans. Statistics show that the vast majority of people pay their mortgages even when they have negative equity. You don't want to send a message to people that says don't take a second job, don't call your mother-in-law: just go in and see the government to get the thing changed. There are just too many people. It's too expensive to send that message.

ES: Looking at the second liens is the easiest way to segment people who are completely irresponsible. A high percentage of those with a negatively amortizing mortgage also have second liens, and virtually all of them are in Florida and California.

KW: That gets you into another difficulty, because those are the markets that will really need the most help.

ES: But I'm saying you could actually have the government go in and buy all second liens at, say, ten cents on the dollar. Then the government could allow the first to be modified.

RD: If you look at the individual situation and make an economic assessment as to what is the best alternative, in many cases that may produce relatively aggressive loan modifications. Because in the current environment it seems like even aggressive principal restructurings may be better than the exit price for a number of these loans especially since the exits only depress values further.



Promontory's Elizabeth McCaul

Capitol Hill has a tendency to try to solve problems with a stroke of the pen, which creates other issues and challenges and problems. But this crisis is so insidious: if we could just manage to the economics, we could start to dig our way out. But whose economics? The economics of servicers are different from the economics of investors even though mortgage servicers work on their behalf. The economics of borrowers, particularly given the moral hazard dimension, also differ. All that has to be sorted out. Unfortunately, we have the values positioned and allocated among participants in such a manner that it makes it very difficult to do.

ES: That's why it should be in the hands of the private sector. The government could say to anybody who wants to buy a defaulted loan: we will finance you at 50 cents for term, no mark to market. We will stimulate the best use of people coming in and putting private capital. They will go to the servicer and say: hey, this is what we need to be doing, and they will find the best use for that house. But, as you said, the government cannot do it with the stroke of a pen. It has to be smart entities that are motivated and aligned with the government. The government oversees it, sets the ground rules but remains somewhat remote day to day.

RD: I like that idea, because so far the approach has been that the government decides what the program is and only afterwards tries to get the private sector to go along with that.

DM: We've been talking for almost an hour now, with a degree of consensus on the causes of the crisis. But a lot of different opinions as to the right way forward. We are supposedly experts in this business, we have been around it for years, and the people working on this at Treasury have not. I mean the people are smart, but they do not come from a securitization background.

So you can see the difficulty that they have. But they have been thinking about all of these things. Do we just focus on a very small segment of the market and try to buy out the troubled assets and then work them out loan by loan, neighborhood by neighborhood? The constituencies on the Hill all get their say, too.

You have all the political pressures you can imagine compounded by the fact that it was an election year. There are oodles of difficulties and bureaucratic issues surrounding this problem. And you're right: let's get the private sector involved. But how? Who do they go to? How do you even start that process?

CF: What is the role of the ASF in formulating a coherent view from the Street, and is that a realistic thing to expect?

ASF: All of you can probably help me understand how realistic that is. ASF has an important role in trying to develop and present consensus views that by definition represent the breadth of constituencies that comprise this market. For better or worse the range of issues is pretty broad. But we are also looking at how we can reenergize and reinvigorate the securitization markets and the primary lending markets.

We as an industry need to do a far better job of defining goals and measures of success in terms of what should be expected from the securitization industry in delivering loan modification solutions or in loss mitigation generally. I agree with Karen that there are probably fewer borrowers out there who can be assisted effectively through loan modifications and securitized products than many believe. The problem is that we haven't really quantified that. It is essential to do that, because then at least you can have an informed discussion about what we really can or should expect from the industry. Then the debate can shift to what the government's role should be and if, as a matter of social policy, we want to contribute additional public resources to help address this problem.

The other part relates to the most appropriate and beneficial uses of government intervention, and let's focus on Tarp for a second. How might that help stabilize the housing market and to what extent can asset purchases contribute to price discovery and contribute to greater certainty around asset valuations, whether in the mortgage sector or elsewhere? Is that an important use of asset purchases? Is that a dimension that really hasn't been sufficiently pursued?

ES: Even with Tarp, there are more sellers than buyers. We are still very much in a deleveraging environment. That said, buying a couple of hundred billion dollars of assets makes a dent. In fact, it inspires some confidence. Talk to pretty much anybody in any asset class and everybody says their asset class is cheap.

The government coming in to buy assets will certainly help to determine how cheap they are. But it's not a cure-all. You need the private sector involved. From the start everybody wondered how Tarp was going to work. I would love the government to buy assets at these levels in the mortgage market. I am a taxpayer and the assets are cheap. The government is going to get great risk-adjusted returns, especially based on the Treasury's current cost of funds. Stimulating the economy isn't the best use of government funds, but some type of leverage which provides some stability to stimulate asset purchases is a much better path. They need to create a positive multiplier by encouraging private capital to enter and to use leverage responsibly.

DM: It's a question of how one sets a price for any asset purchase. Even with the offbeat concept of the reverse sealed bid auction which was bandied about early on, however you set a price there are lots of fundamental problems with that, because the idea of price discovery, one of the components was that, if we can have some asset purchases and very specific targeted classes, that would be beneficial for either cleaning up balance sheets or at least putting some benchmarks out into the market.

And then there is a question as to whether or not the price set by reverse auction would set a FAS 157 benchmark, meaning everybody would have to reprice to that. Which might be fine if you have already written down your portfolio — if it's in a trading book, for example. But what if it is a hold-to-maturity book, as a lot of banks have, and maybe it is not marked down as low as it should be? Would the new benchmark have triggered a whole new slew of write-downs as a result?

You also have to consider that Congress is very keen on making sure the taxpayer is not really harmed, so you don't want to buy for 80 cents something that really is only worth 75 cents. But you certainly don't want to offer to buy it at 20 cents, because who is going to sell?

Hence the idea of a competitive, blind bidding process. The hope was that a large enough pool of people would compete about where they thought this was truly priced. That would start setting some price discovery in the market, which would start to trickle out.

But executing that is unbelievably complicated. For most MBS securities, if you had to take a guess, out of single Cusip, how many holders are there? Broadly speaking? Say for some of the billion-dollar triple-A tranches. Not that many, just a handful. So how do you run an auction and what happens if you have got an auction for a particular Cusip and only one person bids? Do you have to buy at that rate? What if it is a terrible price for the taxpayer or what if it is a terrible price for other reasons?

ASF's George MIller.

KW: It is not workable.

ES: I agree, it's not workable. But they could have easily done something like this: okay, you are going to sell me a $100 million block. Take $10 million of that and sell it in the open market. Wherever that clears is the market-clearing price.

SA: But there are bids out there now. There is private capital out there looking at whole loan

Citadel's Steve Abrahams and Chris Flanagan of JPMorgan

packages every single day and bidding 20 points below where the seller would like to let it go. So you have the market at loggerheads. What worries me about putting the government in the asset buying business is that it is really easy to get in and sometimes really hard to get out.

RD: By that definition, they will be the best bidder in the market.

SA: So the only way that it makes sense to get the government into the asset management business, which is really what we are talking about, is that they go in explicitly with the goal of drawing in private capital by offering attractive returns. Nobody's interested if the government produces a 5% return on equity. It needs to produce let's say a 20% return on equity, and then everyone will come in.

Elizabeth McCaul: You can't consider the asset purchase question on a stand-alone basis. We are in a vicious circle. I agree with Chris: we are at the point where we have to consider some kind of a large-scale loan modification program that addresses the hole in household balance sheets.

Asset purchases are incredibly important, but I wouldn't have the government in the business of just buying assets on a stand-alone basis. I would do some things that this group is probably unbelievably great at, and that is to create some structures which will encourage private sector money to come in.

In other words, let's just skip the cash market for a minute and talk about the derivatives markets, which is more of a problem for bank balance sheets because we don't have any of the fixes and the accounting rules to deal with the derivatives valuation issues.

There is a market for buying some of that recovery value. We have seen a couple of deals. If you encourage some structures involving third-party investors where you allow a first-loss position to be taken by the banks, say to the amount of the write-down they have already taken, and then sell recovery value up to a certain internal rate of return to someone on the Street and provide a line of credit in the form of a facility from the government as a second-loss position, you would find a tremendous amount of interest from private equity. And you could leverage what is a drop in the bucket that is now in the Tarp program in a very effective way. But I don't see that program or something like it working at all on a stand-alone basis.

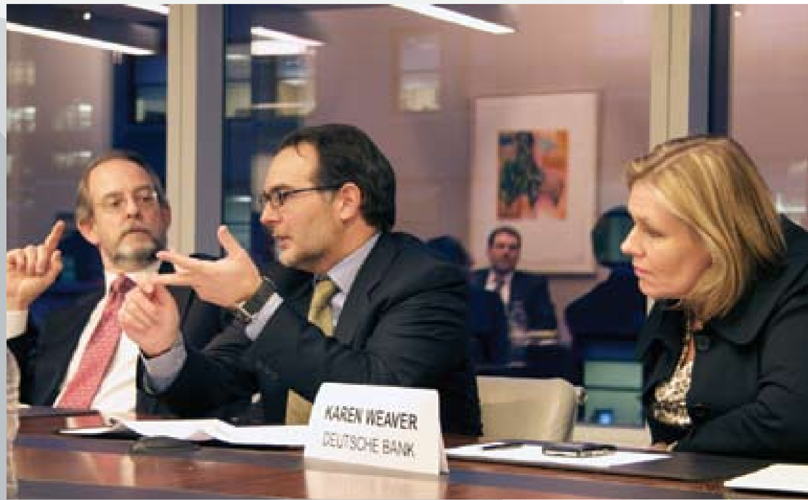
We are at a very critical juncture in the economic cycle. We have an opportunity to arrest the situation, but it has to be done with a number of tools and not one, and it has to be done incredibly quickly.

JA: I'm not sure we've quite answered George's question, which is whether or not you find intrinsic value in pricing. We pump money into the economy by using the pricing mechanism no matter what you select as the recapitalizing approach. I'm not sure anyone has answered that question.

KW: I thought the idea was that you would buy not above or below market, but pretty close to market. But the issue is that your capital would be less because you were targeting a lower return. If you plug that into the equation, you could bring the price up.

JR: But there is a big ambiguity around market value versus intrinsic value. Banks have it marked closer to intrinsic value. Trading accounts have it marked closer to market value. Where you set that price creates a different impact on insolvency.

PS: One of the nice things about buying loans, though, is the disproportionate share of the defaulted loans that are in securities. No question it is very difficult to value a security. But, if you buy the loans out, there isn't a FAS 157 issue regarding the sale price of the distressed loan.



Ed Gainor, Ralph Daloisio and Deutsche Bank's Karen Weaver

If the loan is significantly in default, it is going to be foreclosed, and at some point there are going to be liquidation proceeds. There is an expense associated with the liquidation process, so there is some margin for error. If the loan is going to generate proceeds of 50 cents on the dollar, then you can pay 55 cents for it. The deal is a little better off than it would have been had the property been liquidated, and from the government's perspective it still bought it cheap, because maybe the property, leaving aside the foreclosure expense, is worth 60 cents.

Now that is a difficult calculation to make on a loan-level basis, which is why it has to be done probably by one portfolio manager rather than by 20 servicers across thousands of securities. But at least in concept it is pretty straightforward and probably you could make a very rough guess that would come in close.

You could say we are going to buy anything originated in 2006 in California at a 35% discount to original appraisal. You would definitely lose pretty big on some loans and wouldn't do so bad on others. But the result would be that all of the securities would be cured and the government would own a portfolio of loans that in some cases are going to perform okay or a portfolio of property that is probably going to come in pretty close to what they paid. The government will then have carte blanche to reconfigure them as it sees fit.

KW: I was under the impression that the servicer couldn't sell loans out of a portfolio for less than par. Also, depending upon how you define whether the loans are weak enough to merit this kind of program, if you are buying these loans too far into the delinquency cycle, there is much less ability to modify them.

PS: On the first point, I think that's unclear, so I would defer to Ed or John. Generally speaking, though, securitization documents don't prohibit selling loans for less than par. They are just unclear about whether you could. It wouldn't be that hard to get the government in the next version of Tarp to come up with well, not quite a safe harbor, but a clarification. If you can refinance the loan into Hope for Homeowners, then it seems like you should be able to sell.

In any case, if the result is a sale at something greater than what the servicer calculates to be liquidation proceeds as compared to a principal forgiveness modification or a forbearance modification, neither of which are very well received by bondholders, it might not be such a bad outcome to make it more clear to security holders that you can do that.

AmSec: Ed, can you shed some light on what the documents allow?

EG: In most cases, in my experience, the pooling and servicing agreement or the trust agreement does not necessarily specifically prohibit the trustee or servicer from selling a defaulted loan. Sometimes it does. Sometimes it is silent. For simplicity's sake I'm making the assumption here that these are homogenous Remic private-label securitization trusts that are off-balance sheet — as most of them are.

When the agreement is silent, the sponsor's auditors usually presume that the trust does not have the power to sell that loan. I'm not an accountant, but as a general matter under FAS 140, treatment of the trust as a QSPE has been conditioned on the trust being passive. Whenever a provision has been inserted allowing the trustee or servicer to sell defaulted loans that immediately defeated sale treatment for accounting purposes.

For loans that are not in default there is also a Remic issue which the government could obviously solve easily enough.

PS: Legislation can resolve both issues. More difficult is whether a private investor should carry the burden of financing public policy or paying the liability costs associated with poor underwriting, for example via loan modifications. I think that is actually a more intractable problem than selling loans out of the trust at a decent price.

EG: If you do a net present value analysis, is the investor really in a different position depending on whether the loan is purchased or modified?

PS: The devil is in the detail on pricing, but at least conceptually the investor should be better off from a loan sale than a house going into foreclosure.

CF: How is the sale of a delinquent loan in the end any different than just a short sale on the property?

EG: Well, in a short sale you are just selling the property. You are not selling the pool asset. The issue is you need the power to sell the assets of the trust. I have heard lawyers argue that the sale of loans ought to be permitted under the documents as they are drafted now without any changes. I just point out that the accountants have a different view of that and that the Remic rules as they currently exist have a different view, if the loan is not in default. If the loan is in default, you could sell it out of Remic from a tax perspective.

PS: When they wrote the contract, the lawyers contemplated short sales and didn't contemplate asset sales.

JA: The agreements are not entirely clear, but this could be cured with corrective legislation, assuming there is the political will to do that.

PS: My understanding is that we were very close to including a provision in Tarp that would have clarified the Remic issue as the original concept included buying the loans from a securitization trust. But I understand that it was taken out because someone involved in the drafting concluded it would be irrelevant, because under the securitization contracts it would be impermissible. So perversely the fact that it might be permissible under the contract contributed to it not being included in the legislation. But it could be now that people have concluded that pricing implications associated with buying securities and the lack of any leverage benefit make the original idea of loan purchase actually much easier and more beneficial.

EG: Theoretically, investors could address this themselves by simply acting to unwind the trust.

KW: It seems to me that the ASF should be behind this relatively minor legislative fix. Enabling the securitization trust to sell a loan at a recovery rate that is arguably better than the NPV in the alternative shouldn't be controversial from an investor standpoint. And it could be important in allowing the government to target particularly hard hit areas and really get after that core of the problem.

AmSec: Let's pass this to Ralph, in his capacity as chair of ASF's Investor Committee.

RD: It's actually a more difficult call for the ASF than you might think. Let me just lay out the background as I see it. First, yes, there is a lot of confusion over what the agreements require, allow and don't allow. This confusion is warranted — there is in my experience a lot of seemingly contradictory language.

But in general if the servicers are acting in the best economic interest of the investors in the aggregate without regard to any class of security holder, that should adequately protect them from any complaint that they haven't properly fulfilled or discharged their duties and responsibilities. That would allow a fair amount of latitude to pursue modifications.

Typically, though, the arrangements are structured such that modification is not necessarily a requirement but an option, and it is an option that is controlled by the master servicer, which could allow the servicer to modify the loan. If the servicer chooses to modify the loan at the direction or with the consent of the master servicer, then the NPV of that modified loan has to be either the best NPV of the alternatives or at least better than the NPV of foreclosure.

If the master servicer doesn't elect the option to modify the loan, then you could still have an economic litmus between the NPV of selling a defaulted loan out of the trust versus foreclosing.

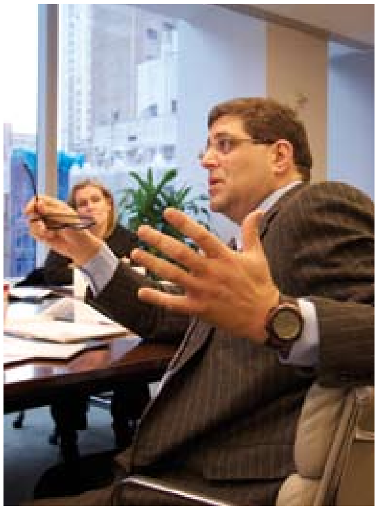
That keeps the calculation simpler, but it still raises the issue to what extent that servicer is exposing itself to liability for its assumptions around the net liquidation proceeds it would receive from a foreclosure that does not happen. Foreclosure is a mechanical process that produces an independent, certain value for the liquidated property that is difficult to challenge. Alternatives require some measure of guesswork, judgement and unconventional practice.

And that is where we are hung up, because it is my belief that the servicers need some clarity about what they can do. Providing that clarity is where it becomes difficult for the ASF: we don't want to offer new standards that disregard hundreds of years of contract law even if it produces what might be perceived as an expedient and necessary end.

AmSec: So there is no clarity that can be given at all that wouldn't upset contractual law?

RD: It is hard to generalize the agreements. One shelf's agreements may be different from another shelf's.

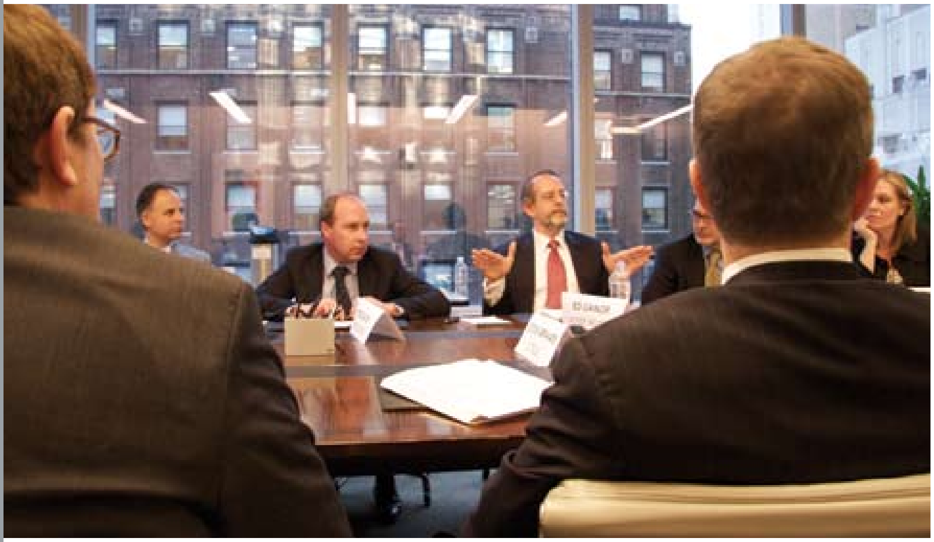
EG: It's fair to say that the documents did not contemplate current circumstances. But who did? I'm not sure that the documents are the problem. The problem is that there is a perceived need to venture into uncharted waters.



McKee Nelson's John Arnholz

Doug Magnolia of Bank of New York Mellon

CF: Say we can get past the hurdle of selling delinquent loans by some sort of legislative fix.



Then you just determine a price that is in excess of the servicer's NPV analysis of the loan — say 10% — and sell it to the government. Forgive me for trying to make things so simple.

RD: I don't understand why something like that couldn't work provided servicers can at least reach a position of indifference between the certainty produced by mechanically foreclosing on the property and the assumptions required to evaluate optimal alternatives.

EG: For example, some kind of legislative solution generally to the effect that we fix the Remic issue, we will fix the accounting issue and then any pooling and servicing agreement that does not contain a specific provision to the contrary is deemed to permit the sale of defaulted assets.

JA: Chris, does that go to the heart of the problem? Is that the simple fix for the complicated problem?

CF: Yes.

AmSec: How does legislation get enacted? That seems to be the crux of the issue.

CF: Is anybody talking to somebody about this? Can we say Tim Geithner is the guy we talk to to say please get this done? Assuming he's confirmed as Treasury Secretary — and he'll have a pretty powerful boss who can get things done.

EG: There is a provision in the Economic Stabilization Act that could take the uncertainty out of modifications. Section 109 provided Treasury with one sentence of guarantee authority allowing it to use credit enhancements or guarantees to facilitate modifications to prevent avoidable foreclosures. FDIC chairman Sheila Bair had proposed a plan similar to this that the Bush Administration did not adopt.

Generally the plan was to give servicers a fee for modification. She said $1000. Then guarantee the balance of the modified loans. She said 50%. I would say guarantee the whole thing. At that point the question of redefault is taken out of the equation. Servicers can do a true NPV analysis: government-guaranteed balance versus foreclosure.

JA: That is all doable, but what loans do you go after? What do you buy out? To me that goes to the heart of executing a solution.

SA: I think the guarantee issue is getting at some of the problems that have come up in discussion. It basically allows the lender to give money to a borrower and not have to worry about the principal repayment, and that is the essence of the problem.

CF: Well, there would be a forbearance amount.

SA: True. But I am actually interested in the guarantee idea as it would be applied against new originations — essentially a new version of the FHA, because that is exactly what the FHA was.

EG: Restart the whole securitization market. The MBS securitization market. If the government stands behind it ...

SA: The GSEs have a quasi-government guarantee, and now they are absorbing a lot of the risks in the market, so I like that idea. A general use of capital to provide guarantees and not necessarily just for mortgages, but potentially for other assets where there is a lack of lending as long as they are creditworthy borrowers, is a good solution to our problem.

KW: I don't know if I want the government in the decision-making process.

JA: You don't need to have the government decide what a good underwritten mortgage is. Standards can be determined for sensible guidelines and private originators can make conforming loans. Ed and I worked on a proposal very similar to what Steve is talking about: the government providing a guarantee for eligible mortgages, as long as that loan was underwritten sensibly and in accordance with agreed standards.

EG: How do people feel about that? That the securitizer could be required to retain some risk of loss, presumably first-loss risk?

PS: The market already has effectively done that. It is hard to imagine that a strong securitization market exists for mortgages that doesn't involve a government guarantee, at least for the foreseeable future. Anyone who has sold mortgages to the GSEs knows that they have plenty of recourse. They will be back if it doesn't perform. Whether you have some statutory requirement that you own an interest, or you effectively create what might look like an FNW security or a government wrap by a GSE, you are going to have an interest in whether the loan performs. And presumably that would be sellable. This is going to compete with FDIC-secured bank debt and all sorts of other stuff that is out there. But as a practical matter it would be difficult to finance mortgages in any other way aside perhaps from covered bonds, so that is probably the only way to do it, I think, in the near future.

SA: It would certainly attract private dollars back into the market, at least as a source of funds and a source of risk-bearing for the non-credit-related risks in the loan. FHA has had a steady history, except for the late '80s, of being a positive contributor to the government balance sheet.

AmSec: Elizabeth, having worked at the FDIC, how do the ideas generated in this discussion sound?

EM: They sound fabulous. The problems the country is facing need an enormous amount of intellectual capital applied to them, and I think we should take these suggestions down to Washington.

There has been a lot of criticism about what government and regulators have done to date. Frankly, some of it is certainly warranted. Some of it isn't. A lot of the ideas that you have come up with here I would expect to be part of the program that gets rolled out in the weekly addresses even ahead of the new administration taking office. For sure we are going to have much stronger regulation. I think we're going to have government-sponsored loan modification or a guarantee program, and we will see purchases of some of these assets in some way through a Tarp program. My concern is that it must happen quickly enough that we don't end up in a very deep recession. That is less related to the mortgage assets and much more related to corporate assets. That cycle is just beginning.

CF: Do you have a sense that anyone in the incoming administration has a clear idea of what needs to get done? And if so, do they have specific ideas or is it still very much in discussion phase?

EM: My general sense is that there is a very clear agenda that is principle-based, and the design is being conducted day and night at the moment. Principle-based meaning keeping Americans in their homes, stabilizing the solvency of the financial services system, and keeping employment steady. In addition, strengthen regulations and in some very broad-based way make sure that participants in the financial services industry are subject to roughly the same rules instead of having pockets of the financial services system subject to some differing requirements. I am very optimistic about the ability of our economic leaders to address the issue, if they have the will, and all the indications are that they do.

We don't have time to wait until January 21st, though. But I think that some of the work is already being done. We are seeing something unprecedented in this transition: the Treasury Department is working very closely with the new administration's team. Political issues are being put aside in the interests of trying to move things forward.

AmSec: The assumption earlier in the year was that buyers of distressed debt would kickstart the process. Deals certainly started happening in size — UBS's asset sale to BlackRock and Merrill Lynch's to Lone Star. But it seems like they have been sitting on the sidelines since September waiting, like almost everyone else, to see which direction the government jumps.

ES: Actually, no, there were a number of investors willing to buy throughout the fall and into winter. There continue to be investors buying in size. But without leverage they cannot stem the tide of leveraged sellers. Too many discussions are centered around the credit and related price of the assets and not enough on the price of liquidity.

It is not all credit-driven: a part of it is a severe lack of liquidity. So we could all stand on our heads and say my asset class is cheap and yours is cheaper, but do you have any money? I don't think people have got their heads around that. The market is experiencing a very particular liquidity problem, and that is a tough one to solve. Overhangs will continue as locked-up hedge funds will be selling some time in 2009. The one positive here for mortgages is that the distressed cycle is already two years in and the government is focusing on the sector. The distressed corporate cycle, though, is just beginning.

SA: One of the big takeaways from this whole episode is that the value of an asset isn't just the value of cash flows. It is also the ability of all the other participants in your market to continue holding their positions. A large part of the devaluation of assets over the last year and a half has been related to that trend. So you not only have to somehow address the issue of the cash flows in the solution, but you are going to have to build the infrastructure of institutions that are able to hold and sustain their positions. Both of those things are going to have to get fixed before we are back to whatever now qualifies as normal.

AmSec: We have talked a lot about what the government should do. But what are the limits to government intervention?

JR: First, there's speed: the concept that any of these changes is going to have an immediate impact is not a good idea. The government has to manage expectations. We are now well into a consumer mortgage problem, a C&I loan problem and unemployment is rising. So what began in 2006 and 2007 as a subprime problem has now rapidly gone well beyond that. It's folly to try to expect any of that to turn around very quickly.

Nor is the idea that the government can restart lending a good one. The task is to prevent the collapse in lending and prevent even worse scenarios than we have experienced already.

But there's a broader issue: all these ideas we have been discussing sound great, the objectives fabulous. But we are paying for it right now by printing money. The U.S. Government has its own form of mark-to-market accounting — the value of its currency, and, while no one likes to talk about, there is a limit. We're heading towards it and that puts us at great risk of turning the credit crisis into a currency crisis.

At some point, we are going to have to recognize it. It was most encouraging to hear President-Elect Obama address that outright at the governors' meeting, where he said we can't just print money to solve these issues.

RD: The government should do as much as necessary to restore the markets so that they can start functioning as they will function, but not do more than that. When you start going beyond that point, we invite more hazard.

There is a tendency or temptation for governments to take on even more once they see some of their programs actually working. You can almost see it in the way the personalities and participation have changed on Capitol Hill. A lot of individuals appear to regard this as a way to get their stars rising. But restraint is key.

As an analogy, any government intervention that starts to rigidly impose too much of the government's view on free market operations is dangerous: the black market is much larger than the official economy in countries with a strictly controlled official system.

Free-market forces will manifest themselves one way or another, and it is best if the government tries to create the structures necessary to make that a healthy manifestation and resurgence rather than just continuing to substitute the private sector with the government's solution.

DM: Isn't there a way to successfully marry the two? Let's look at Talf. Tarp is putting $20 billion in essentially a first-loss position for the New York Fed to then lend another $200 billion. It is going after targeted asset classes for a defined period of time. But is there a way instead of doing it so that the private sector participates instead of another branch of the government?

ES: Yes, there is a way of doing it in both securities and whole loans. I know a lot of people went into whole loans early. They had a vision of securitizing them and holding the residuals. They can't do that now. But buying senior parts of that would provide liquidity and they could recycle that capital and invest it. And you can do it with securities if you gave someone non-recourse financing. They need someone to lend them half the value at the distressed level. I have a feeling a lot of people would be buying triple-A CMBS and ABS bonds all day long and that would increase the price. Again, what we should be focused on is the liquidity of the bonds. Triple-A cards are trading at 500 over. This is what prevents the functioning of capital markets and keeps leverage from consumers.

What you really need to do is get rid of the stuff that facilitates the capital structure because that is the stuff that makes things work — triple-As. However, we have learned that any joint public and private effort is tough. Look at Fannie and Freddie. I don't know why the government doesn't explicitly guarantee them. Maybe it is due to the budget, or fears about the currency, but they trade wide to Treasuries on an option-adjusted basis. If the government were to explicitly guarantee the agencies right now, mortgage rates would drop further. Much

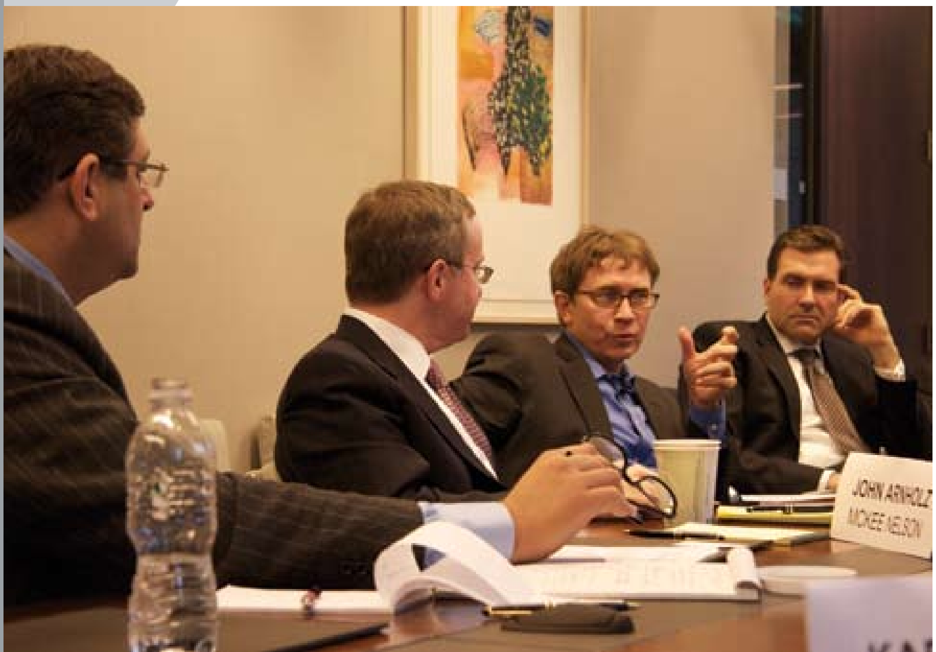

(from right) BofA's Jeff Rosenberg, Ed Steffelin of ICP Capital, Flanagan, Abrahams and Arnholz

like Freddie and Fannie, the government also has to have an exit strategy. It is clear you want to get in and help, but you want to have an exit. That's a tough one, and that is also a good reason to bringing in the private sector.

DM: So let's say Treasury follows its original plan and ends up with a giant portfolio of whole loans of securities, equity investments, and so on. A lot of talk was, well, they have got the balance sheet. They don't have the mark-to-market issues. They will just ride it either into the ground or to maturity and try and work it out as best as they can, and hopefully over time we, the taxpayer, will come away with a little extra something.

ES: RTC.

DM: Yes, it is RTC all over again. But the entity shouldn't just accumulate assets, it should also provide an inventory of them online, almost like an exchange: what it's currently holding, at what price and what they would be willing to sell it for. That would be better for private sector investors than having to shop around every single institution, which has been one of the problems.



I know just from clients of mine worldwide that they are not seeing every bid list that comes around. But some of them have tons of money and are looking for a place to invest. I'm sure there are hedge funds or private equity shops that are also not seeing everything.

An investor at, for example, the Dallas-Ft. Worth Airport Authority who wants to sell is only going to be put in touch with a buyer in Stockholm if the two are covered by the same desk. The banks don't have the balance sheet to be able to warehouse these trades any more and the old model isn't working.

CF: You touched on something that is extremely important, term financing. I think Talf is a fantastic structure, but the execution is a little warped because the term financing is not long enough. Five-year financing for purchased loans would give the government a specific exit date. As it stands, Talf doesn't quite hit the right spot.

ASF: What do others think about Talf?

KW: Chris has mentioned the biggest issue by far, that funding is too short. Think about what the government has to bring to the table: a very low cost of funds and very long horizons. Nobody else has that. So why say let's keep it short in case it doesn't work out? It just doesn't make sense to me. If it doesn't work out a year from now, it will still be the government's problem and we'll need to create some other program. The government should not be the one looking for an exit strategy if things don't work out — it should be looking for an exit strategy if things do work out.

The other issue that markets don't like about government involvement is the extent to which it seems to involve political whims. One week everybody is worried about auto loans, so let's have a solution for auto loans. Then in a couple of weeks people are going to say, hey, you know what, that commercial mortgage thing, that is important too, so let's solve that.

The programs should be as broad and as flexible as possible and should involve private sector money and risk-taking. We shouldn't define asset types, and whether they are new or legacy assets because we really need all of these sectors to be functioning. We really need to restart the market, not just address problems as they become politically important.

JR: That goes back to an earlier question about the right avenue for government intervention. But it is very hard to get the balance right. Whether or not to bail out the auto industry is a really good example of this. The process is highly politicized. You see it in the companies' testimony. You see it in how they drove their hybrid automobiles to D.C.

The problem is, you can't have your cake and eat it too. If you ask for government intervention, you have to accept the political process and politicization that comes with it.

And actually, to use the corporate example of the autos again, the initial political response is encouraging. The government is intervening to force a private market solution. In other words the presidential advisor is basically playing the role of a non-bankruptcy bankruptcy judge.

It's an interesting example for those involved with consumer assets to watch, because half the viewpoint is, outside of the bankruptcy judge forcing you to make the required concessions, private markets aren't working. The reason for government intervention is, fundamentally, because the market has failed. Individual private investors operating to achieve their own value maximization have created a solution which is not socially acceptable — mass foreclosures. That is why government intervention is required.

ASF: Is there any evidence to suggest that individual owners of portfolio loans are adopting different and more aggressive strategies than we are seeing in securitization. If so, is there evidence to suggest that those strategies are more successful in terms of total recovery or maximization of recovery?

SA: There is evidence out there. I know of some servicers that are operating portfolios of distressed loans they have purchased which are effectively outside the bounds of securitization. I think once you are outside those bounds there is an incredible amount of latitude and creativity that you can bring to the problem that I suspect isn't being exercised in securitized problem-solving.

We have a small servicer that has been extremely creative in developing analytics to calculate on the fly a lot of these NPV issues that came up before. The analytics look at all of the programs that are rolling out and changing day by day to figure out how each program would affect those NPVs. Further, I would argue that the best time to try to mitigate your losses is when a loan is performing, but is showing other signs of stress.

Our group is making a very active effort to identify loans at risk even though the traditional signs of stress haven't shown up yet. Then people ask me, well, how are we supposed to apply that kind of creativity to what is going on in securitized loans? And honestly, the whole conversation we had before comes up, and I just don't know how to inject that creativity. Securitization has created some real obstacles.

RD: I saw somewhere that WaMu was at one point remarketing its REO properties rather than auctioning them. They would remarket them with financing to creditworthy borrowers who wanted to make a commitment to homeownership and could afford the loan terms provided by WaMu, the cash flow of which was superior to selling the house in the REO market. That is just not achievable on a securitization.

ES: Wachovia is doing the same on the Frank Dodd program. They are going to anybody who qualifies, razing the balance on the optional ARM right down to an FHA level, writing a loan, putting it on their balance sheet and using very little capital, which is a very good way to do it.

EG: Something like that could be managed in a securitization. If you had a cooperative borrower, it would be possible to market that property and effect an assumption, have another borrower assume the terms of a modified loan within the securitization. That could be done. I don't know that it is being done, but it could be. It doesn't work with REO once a property has been taken, but it would work as a Remic matter if you could sell the property in a short sale while the borrower was still obligated on the loan.

AmSec: Final question: earlier Elizabeth said the ideas we are discussing offer the kind of solutions Washington needs to hear. So let's take that a step or three further: would you take a job with either the regulators or the next Administration to help solve this crisis?

JR: Absolutely.

ES: Tough one.

CF: I can't. But I'll give advice.

SA: Sure.

JA: I would be delighted.

KW: I only work part time. I would work part time. I won't work full time.

RD: In due time, they may be the only ones hiring.

EG: It would certainly be an enormously satisfying challenge to tackle. But I'm not sure if I could handle the bureaucracy.

PS: Sure.

DM: Technically I am, so, yes.

EM: This is the equivalent of a war, and these are the people who have the skills to fight this war. It's sort of a patriotic duty.

ASF: Given the issues that ASF is dealing with, I feel like I already am.

McKee Nelson LLP

American Securitization and ASF would like to thank all participants and in particular McKee Nelson, our sponsor, for their support of this roundtable.