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OPEN LETTER TO HENRY PAULSON, U.S. TREASURY DEPARTMENT:

Enhancing The Paulson Plan Through the Creation of a

Federal Bond Insurance Corporation

September 24, 2008

Dear Secretary Paulson:

Last week's market chaos demonstrated the extent of our economy's credit crisis, and I applaud your bold actions. Your decisive leadership has been a beneficial influence on the markets and on our economy. I am a strong supporter of your proposal, and I hope that the legislative and regulatory processes treat it with the seriousness it merits.

I also have a suggestion: In order to maximize the effectiveness of your proposal, rather than have the US government directly purchase up to $700 billion of illiquid mortgage backed securities, it would be far better for US taxpayers and our nation's economy to create a federal program that supports ***financing*** rather than ***purchasing*** these securities. Such a solution would jumpstart the significant participation of private capital in this market, which I'm sure you can appreciate, in view of your professional background.

The true cause of the credit crisis has been the wholesale and irrational shutdown of the securitization market, and the lack of any reasonable, existing replacement for it. For over 30 years, the markets have relied on pooling loans together and repackaging them as income-generating securities – or securitization – for financing, with well over $1 trillion of new securitizations issued each year in recent years until the crisis began. Many types of loans essential to the day-to-day operation of a modern economy were financed this way – business loans, commercial equipment leases, residential and commercial mortgages, auto loans, student loans.

The securitization market worked exceptionally well for decades and was the financing tool of choice for large and small institutions alike. As investments, performance for securitized assets typically exceeded corporate and Treasury bond investments for decades.

Where securitization went wrong in recent years was with subprime mortgages. These securitizations performed disastrously, causing people to mistakenly question the practice of securitization itself. Decades of historical data were ignored, with the subprime experience exclusively driving market perceptions: The entire securitization market was effectively shut down, and ***this*** explains the depth and persistence of the ongoing credit crisis.

Government purchases of illiquid mortgage assets from the system will cost taxpayers significant sums and expose them to downside risk, without addressing this fundamental issue. Billions of dollars held by all the major institutional bond managers, hedge funds and distressed funds are already available to purchase mortgage assets. However, in the absence of a way to finance the purchase of these assets, such funds must bid at prices which represent an attractive absolute return acceptable to their investors (15% to 25% typically), resulting in typical transaction terms that have significantly impeded the sale of mortgage securities to these funds. If these funds could finance their purchases, especially under efficient financing terms, they would still require similar returns, but would be able to buy many more assets, and bid higher prices for the assets.

Our financial system needs the capital markets and the natural power of securitization to get a jumpstart from the government. I propose using the powers granted to Treasury to create “vehicles that are authorized…to purchase troubled assets and issue obligations” under currently contemplated legislation to more efficiently address the crisis and establish a program which we might call the Federal Bond Insurance Corporation ("FBIC"), as an alternative to simply having the government directly purchase assets.

FBIC would work in a way similar to how Ginnie Mae works. It would provide a government guaranty (for a fee) to AAA-rated senior classes of securitization of a variety of assets, and could also optionally require that bond insurance from a AA or AAA rated monoline bond insurer first be secured (with a lower government guaranty fee).

If implemented properly, the FBIC program would have the following key benefits over direct government purchases of mortgage-related securities:

- ***Invigorating Private Capital.*** Just as private financing is widely available for Ginnie Mae securities, it would also be available for FBIC securities. Once you add a government guaranty, investors are willing to purchase, trade, finance, and easily mark to market.

- ***Lower Cost to US Taxpayers.*** The risk capital to support the AAA ratings would come from private pools of money such as bond funds, hedge funds and other private vehicles. Moreover, such a program would not require any immediate use of government cash.

- ***Lower Risk for US Taxpayers.*** The FBIC would be subject to losses only in the most extreme of scenarios – after private investors and possibly other bond insurers lose everything – and it collects a guaranty fee immediately to offset potential future losses.

- ***Precedent and Infrastructure Already Exist.*** There is precedent in programs for other asset classes (Ginnie Mae and SBA) which can be applied to the current mortgage securities that ail our financial system. At the same time, there is an existing infrastructure for securitization which can be mobilized immediately to address the problem.

- ***Opportunities for Ratings Reform.*** An FBIC plan also provides an opportunity to reform the ratings process. For example, we could insist that ratings agencies, investment bankers, and all of the other players involved in the securitization process only get paid ***after*** the securitizations insured by the government are no longer at risk.

Government assistance that jumpstarts securitization and the free markets will directly address the credit crisis in a significantly more effective and cheaper way than any other alternatives.

Bringing back securitization will not recreate the current crisis, as some might believe. Lack of borrower data verification and an imperfect ratings process, ***not*** securitization, created the mortgage crisis. Data verification and the ratings process are addressable. Limiting the economy’s ability to get financing through securitization just creates a whole new set of problems that not even $700 billion of taxpayer money will resolve.

Underscoring this point are comparisons made between our current predicament and the 1980s Savings & Loan crisis. You may recall the technique used by the Resolution Trust Corporation in conjunction with private capital to resolve that crisis? It was securitization. I urge you to seriously consider this enhancement to your proposed plan.

Sincerely,

Christopher Ricciardi

Chief Executive Officer, Cohen & Company