

CORRESPONDENCE

This appendix provides a copy of the following correspondence:

| CORRESPONDENCE | | | |
|-----------------------|-------------|--------------------------------|---|
| Date | From | To | Regarding |
| 5/17/2010 | SIGTARP | Congressman Elijah Cummings | SIGTARP's Review of Treasury's Small Business Lending Fund Act Proposal |
| 5/20/2010 | Treasury | SIGTARP | Follow-up on SIGTARP April 2010 Quarterly Report Recommendations on HAMP and CDCI |
| 5/20/2010 | Treasury | SIGTARP | Follow-up on HAMP Recommendations in the SIGTARP Audit Report |
| 6/11/2010 | Treasury | SIGTARP | Follow-up on Warrant Disposition Recommendations in the SIGTARP Audit Report |
| 6/29/2010 | Treasury | SIGTARP | SIGTARP Official Draft Audit Report |
| 6/30/2010 | Treasury | SIGTARP | Status Report on Recommendations in the SIGTARP Quarterly Report |
| 7/1/2010 | SIGTARP | Treasury | Treasury's Compliance and Internal Controls Program for PPIP |
| 7/16/2010 | Treasury | SIGTARP | Response to SIGTARP Quarterly Report to Congress |



OFFICE OF THE SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM

1801 L STREET, NW
WASHINGTON, D.C. 20220

May 17, 2010

The Honorable Elijah Cummings
2235 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Cummings:

On or about May 7, 2010, the Department of the Treasury ("Treasury") submitted to Congress proposed legislation entitled "the Small Business Lending Fund Act" ("Treasury's Proposal"). Under Treasury's Proposal, Treasury would establish and capitalize a Small Business Lending Fund ("SBLF") that would provide up to \$30 billion of preferred share investments in small banks (i.e., those with total assets of \$10 billion or less) to stimulate lending to small businesses. Although Treasury originally announced that funding for SBLF would come from the rescission of funds originally authorized for the Troubled Asset Relief Program ("TARP") (and, indeed, Treasury's most recent TARP allocation provided to SIGTARP still included reference to \$30 billion intended for small business lending), the Treasury's Proposal leaves the source of funding to be determined.

Treasury's Proposal similarly does not assign specific oversight responsibility for SBLF, stating that "the Administration will work with the Congress to determine the most appropriate form of oversight for the Program."¹ For the reasons explained below, I believe it is absolutely critical to protect taxpayers that the Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") be permitted to continue its oversight of what is essentially an extension, with relatively minor differences from an oversight perspective, of TARP's Capital Purchase Program ("CPP"). Accordingly, I write to recommend that Congress provide for SIGTARP oversight over SBLF in any resulting legislation.¹

Although Treasury's Proposal provides that SBLF would be established outside of TARP — and thus recipients would not be subject to TARP's executive compensation requirements or warrant provisions — the core goals and basic economic framework for SBLF are very similar to those of CPP, and the two programs share a wide range of features:

- As in CPP, SBLF involves capital investments in the form of preferred shares.
- As in CPP, the maximum amount of an investment under SBLF would be a percentage of the bank's risk-weighted assets — for banks with a \$1 billion or more in total assets, the amount available under SBLF (3% of risk-weighted assets), would be the same as under CPP; banks with \$1 billion or less in total assets could receive, under SBLF, as much as 5% of their risk-weighted assets.
- The initial SBLF dividend rate (5%) would be the same as the initial CPP dividend rate.²

¹ Pursuant to section 4(a)(2) of the Inspector General Act of 1978, as incorporated by section 121(c)(1) of the Emergency Economic Stability Act of 2008 ("EESA"), SIGTARP is charged with reviewing proposed legislation and making recommendations concerning its impact on the administration of TARP. Because the proposed legislation will likely result in the majority of TARP recipients from TARP, the increased taxpayer vulnerability to fraud if SIGTARP is not given oversight responsibility mandates that SIGTARP weigh in on the oversight provisions of Treasury's Proposal.

² SBLF would incorporate an incentive-based dividend structure that provides participants the opportunity to lower their cost of capital significantly compared to CPP investments. Under Treasury's Proposal, participating banks could reduce their dividend payments from 5% per annum to as low as 1% based on increases in their small business lending versus 2009 levels. Because of the need to monitor this new factor, this difference will only increase the

- As in CPP, banks' primary regulators would evaluate applications for new SBLF applications. In fact, many current CPP participants are likely to convert their CPP investments into SBLF. Based on Treasury's Proposal, which expressly permits CPP participants with total assets of \$10 billion or less to convert to SBLF, SIGTARP expects that up to 95% of the current CPP participants will be eligible to convert to SBLF; because of SBLF's financially more attractive and less restrictive provisions, SIGTARP anticipates that the overwhelming majority of eligible CPP participants will migrate to SBLF.

In sum, in terms of its basic design, its participants, its application process, and, perhaps, its funding source from an oversight perspective, SBLF would essentially be an extension of TARP's CPP program. Due to these similarities, SBLF will present many of the same oversight challenges that CPP has thus far presented, and, because SIGTARP has already developed the specialized expertise and resources to address these challenges in connection with CPP, SIGTARP is uniquely qualified to address them under SBLF. Failing to take advantage of such expertise and existing resources would not only be a waste of taxpayer money (as another oversight entity would have to expend substantial investigative and audit resources that SIGTARP already has on board) but would also unnecessarily expose the program and thus taxpayers to waste, fraud and abuse during the substantial time period that another oversight entity gets up to speed on the complex program.³

The CPP program had already been launched when SIGTARP began on December 15, 2008, and, from its inception, SIGTARP has made extensive investments in time, personnel and infrastructure to develop the expertise and relationships necessary to oversee CPP. Our Audit Division has focused many of its efforts on developing an understanding of the complexities of CPP, which have resulted in key recommendations that improved the program immeasurably. Similarly, our Investigations Division was built in many ways to attack potential fraud in CPP. Drawing on a team of investigators and attorneys with extensive experience in complex accounting and bank frauds, SIGTARP has developed a highly sophisticated forensic platform designed to detect and investigate CPP-related fraud.

On the audit and oversight side, SIGTARP's involvement in CPP oversight has included:

- obtaining regular detailed briefings and updates on CPP's design (again, including many aspects that will be incorporated into SBLF);
- making recommendations regarding the structure and transparency of CPP, many of which have been implemented;
- developing contacts with counterparts at Treasury, the bank regulators and outside contractors administering the program (many of which will presumably play the same roles within SBLF);
- conducting four in-depth audits of key aspects of CPP, including two audits on CPP recipients' use of TARP funds, which included analysis of the impact of these funds on their lending, an audit into the CPP selection process (which was very similar to that now contemplated for SBLF) and a review of its vulnerability to outside influences, and an audit into the initial decision-making process that led to the creation of the CPP program;
- working on ongoing audits into the conditional approval of CPP applications, the exit of banks from CPP, and a material loss review of a failed CPP recipient; and
- developing the expertise to provide detailed quarterly reporting on CPP, including descriptions of its structure, investment portfolio and participants' lending. To ensure transparency and

need for strong oversight from the outset of the program, and thus further militates in favor of SIGTARP's oversight.

³ It is worth noting that the conduct under investigation in many of the CPP-related fraud cases related to conduct that occurred during the time before SIGTARP existed; keeping SIGTARP from overseeing SBLF risks creating a similar gap in oversight during the period that another oversight agency obtains the resources and then develops the expertise to protect fully taxpayer interests.

accountability, if granted oversight, SIGTARP would include similar quarterly updates on SBLF in its mandated quarterly reports to Congress.

Perhaps even more importantly, SIGTARP has developed the expertise, infrastructure and law enforcement relationships to detect, investigate and refer for prosecution the kinds of frauds that appear in CPP and will appear in SBLF. SIGTARP has more than two dozen ongoing criminal investigations into CPP-related matters, including banks that may have sought to obtain taxpayer funds fraudulently. In one recent case, the former President and CEO of one CPP applicant, Park Avenue Bank, was criminally charged with trying to steal \$11 million from CPP through a complex accounting ruse uncovered with the assistance of SIGTARP agents. In another case, SIGTARP agents uncovered accounting irregularities at a now-failed bank that had received conditional approval for CPP funds, thereby saving taxpayers over \$500 million. SIGTARP is the co-chair of the Rescue Fraud Working Group of the President's Financial Fraud Enforcement Task Force, and it has developed strong relationships with other law enforcement agencies, enforcement bodies and prosecutors around the country necessary to detect the same kinds of complex frauds that will threaten SBLF. Stated another way, SIGTARP is already the "cop on the beat" for CPP; finding a different entity to police the same kinds of activity for the very similar SBLF would be both duplicative and potentially dangerous.

Disregarding SIGTARP's substantial resources and unique expertise in fashioning SBLF oversight would be a waste of taxpayer resources and would unnecessarily expose SBLF to waste, fraud and abuse. Even assuming that another oversight agency could find the available resources to address the challenges posed by SBLF, trying to assemble, from scratch, the expertise, staff, forensic capability, audit experience and relationships necessary to meet this responsibility would needlessly duplicate the capabilities SIGTARP has already developed, and would potentially leave \$30 billion of taxpayer funds vulnerable to waste, fraud or abuse for the significant amount of time another agency would require to develop the necessary expertise, capabilities and relationships. In other words, SIGTARP could provide vigorous and effective oversight of SBLF under ongoing initiatives already being conducted by our agency at no additional expense and without any gap in oversight. For these reasons, I believe that SIGTARP is the most appropriate oversight body for this program to protect taxpayers from potential fraud in the proposed SBLF, to ensure accountability in its management, and to ensure continuity of oversight.

I strongly urge that Congress explicitly provide oversight authority over SBLF to SIGTARP and permit us to continue our critical role in protecting taxpayer funds from waste, fraud or abuse. If you have any questions or comments about these issues, please do not hesitate to contact me.

Sincerely,



NEIL M. BAROFSKY
Special Inspector General

cc: Senate Committee on Appropriations
Senate Committee on Banking, Housing, and Urban Affairs
Senate Committee on Finance
Senate Committee on Homeland Security and Governmental Affairs
Permanent Subcommittee on Investigations
Ad Hoc Subcommittee on Contracting Oversight
Senate Committee on the Judiciary
Joint Economic Committee
House Committee on Appropriations
House Committee on Ways and Means
Subcommittee on Financial Services and General Government
Subcommittee on Oversight
House Committee on Financial Services
Subcommittee on Oversight and Investigations
House Committee on Oversight and Government Reform
Subcommittee on Domestic Policy
Congressman Elijah Cummings

Recommendation 2:
Treasury should launch a broader based information campaign, including public service announcements in target markets that focus on warnings about potential fraud and include conspicuous fraud warnings whenever it makes broad public announcements about the program.

Treasury is a key partner, along with the U.S. Department of Housing and Urban Development and other federal agencies, in the "Loan Scam Alert" campaign currently being led by NeighborWorks America® and the Ad Council. NeighborWorks America® was asked by Congress to create this initiative, which raises public awareness through advertising, events, and media. In addition to advertising, representatives from this campaign are present at all MHA events to work with homeowners who have been the victim of a scam, as well as to raise awareness about the increase in mortgage modification and foreclosure rescue scams. Presentations about scam awareness take place at all MHA events and Treasury representatives work with local media to share this information in interviews and promotions for events. The Loan Scam Alert campaign directs homeowners to a website and the Homeowner's HOPE Hotline where they can receive more information and direct assistance.

Treasury's two-phase campaign with the Ad Council is already underway and complements the above efforts. Advertisements remind homeowners that free help is available from the federal government and direct them to the Homeowner's HOPE Hotline and *MakingHomeAffordable.gov* website. This website features tips for homeowners about scams and an instructional video created with participation by the Federal Trade Commission. Further, we are developing an ancillary print flyer related to the campaign with anti-fraud tips. Treasury continues to seek ways to raise awareness about the increasing numbers of scams and to remind homeowners that there is no charge to apply for participating in MHA, which is the method of extracting money in most scams related to the program.

Recommendation 3:
Treasury should adopt a uniform appraisal process across all HAMP and HAMP-related short sale and principal reduction programs consistent with FHA's procedures.

Treasury specifically allows the use of certified AVM models in the HAMP program because they provide a reasonable estimate of property value, very quickly at very low cost. Appraisals cost between \$350 and \$500, which would ultimately either be charged to the borrower in the event the loan is not modified or would be capitalized if the loan is modified, increasing the borrower's debt. Additionally, the time required to obtain an appraisal would delay execution of trial period offers.

The MHA valuation guidance is consistent with the guidance provided by the Office of the OCC to its regulated banks. Banks are required to obtain appraisals at origination and are permitted to use certified AVMs or BPOs when valuing assets already in their portfolios. FHA, by contrast does not require its servicers to obtain an opinion of value when modifying delinquent loans, even those modified under the HHA-HAMP program.

Treasury does not dictate in its guidance what valuation method should be used, and instead instructs servicers to independently value the property according to investor guidelines. Given

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DEPARTMENT OF THE TREASURY
 WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

May 20, 2010

Neil M. Barofsky
 Special Inspector General
 Office of the Special Inspector General for the Troubled Asset Relief Program
 1500 Pennsylvania Ave., NW, Suite 1064
 Washington, D.C. 20220

Dear Mr. Barofsky:

Re: Follow-Up on SIGTARP April 2010 Quarterly Report Recommendations

Dear Mr. Barofsky:

The Department of the Treasury (Treasury) appreciates the recommendations made by the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) in the April 2010 Quarterly Report to Congress. This letter is intended to provide a follow-up from our initial response letter dated April 17, 2010 regarding Treasury's analysis of your recommendations regarding program changes to the Home Affordable Modification Program (HAMP). As described under the section below, we have given careful consideration to the five recommendations on HAMP raised in your April 2010 Quarterly Report, and where applicable, discussed additional actions we are taking to ensure that your particular concerns are addressed. We also have described below Treasury's progress in implementing three of the four recommendations regarding the Community Development Capital Initiative (CDCI) contained in your quarterly report.

Home Affordable Modification Program (HAMP): Treasury has given careful consideration to your recommendation on the program changes to HAMP. The actions that we have taken or plan to take to address your recommendations are described under each recommendation.

Recommendation 1: Treasury should publish the anticipated costs and expected participation for each HAMP program and subprogram, and that after each program is launched, Treasury should report monthly as to the programs' performance against these expectations.

Treasury plans to continue reporting monthly on program performance and participation metrics against our original published goal of offering up to 3 to 4 million homeowners' assistance in preventing avoidable foreclosure through all aspects of the Making Home Affordable (MHA) program. We publish monthly data reports on program performance – and have added additional sections to the report as more data becomes available. Our latest report includes additional information about servicer-specific conversion rates to permanent modifications, servicer performance in giving homeowners timely decisions, the number of borrowers eligible for HAMP modifications, and call center volume and borrower engagement efforts.

the above-mentioned reasons, Treasury feels that AVM and BPOs are sufficient options due to cost and efficiency considerations.

Recommendation 4:

Treasury should reevaluate the voluntary nature of its principal reduction program and, irrespective of whether it is discretionary or mandatory, Treasury should consider changes to better maximize its effectiveness, ensure to the greatest extent possible the consistent treatment of similarly situated borrowers, and to address potential conflict of interest issues.

In the initial announcement relating to HAMIP's principal reduction alternative waterfall, Treasury stated that the application of the alternative waterfall was voluntary. In response to SIGTARP's recommendation, Treasury is re-evaluating that position and will report on our conclusion in the near future.

Treasury's initial conclusion was that making the principal reduction alternative waterfall mandatory may cause many servicers to write down more principal than the related investors would otherwise wish. Many servicers, in particular servicers of securitized pools, may consider a mandatory principal reduction alternative waterfall to be a material adverse change because it would force them to write down extensive amounts of principal on the loans, which would in turn cause the trustees or securities administrators to write down the principal balances of the most junior outstanding securitization securities. Those affected junior bondholders would thereafter suffer a loss in interest payments as a result of those principal writedowns, and thus would likely consider the principal reduction alternative waterfall to be a material change under the HAMIP guidelines. Accordingly, many servicers would, in an effort to avoid such claims from securitization bondholders, pre-emptively "opt-out" of the alternative waterfall requirements, which is permitted under the Servicer Participation Agreements and Financial Instruments (SPAs). For these reasons, and because participation of servicers in HAMIP is voluntary, Treasury concluded that in order to drive housing relief to the maximum number of potential borrowers it could not risk a substantial number of servicers and investors withdrawing from the proposed principal reduction alternative waterfall.

Recommendation 5:

Treasury should reconsider the length of the minimum term of HAMIP's unemployment forbearance program.

After consulting with servicers, advocates, and other partners, Treasury has considered extending the unemployment program term limits. We understand that many borrowers are unemployed for much longer periods – according to the latest Bureau of Labor Statistics data from March 2010, approximately 44% of all unemployed persons were unemployed 27 weeks or longer. Given this data and our conversations with our partners, the final guidance, as promulgated in Supplemental Directive 2010-04, gives servicers the discretion to extend the forbearance beyond the initial three months with no set limit, subject to approval from the financial institution's regulator, or investor of any related mortgage backed security, as applicable. It should be noted that many borrowers may have shorter forbearance periods.

In addition, currently the OCC does not encourage unemployment forbearance periods longer than three months unless the borrower has found employment by the end of the initial forbearance period. If the forbearance lasts longer than six months, generally accepted

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accounting standards may require a financial institution to write down the value of the loan. Therefore, an investor's regulator or accountants may ultimately decide how long unemployment forbearances will last for the related borrowers.

Community Development Capital Initiative (CDCI): The actions that Treasury has taken or plan to take to address your recommendations are described under each recommendation.

Recommendation 1:

Treasury should institute careful screening before putting additional capital into an institution with insufficient capital to ensure that the TARP matching funds are not flowing into an institution that is on the verge of failure.

Treasury is developing a screening and approval process for the CDCI program that is similar to CPP. For each financial institution applying to participate in CDCI, Treasury will seek the recommendation of the appropriate federal regulator in determining eligibility for the CDCI. The eligibility recommendation will be based on an assessment of the overall strength and viability of the institution, which will take into account any proposed matching funds deemed necessary by the regulator to reach the viability standard. In certain cases, applications will also be reviewed by a council of representatives from appropriate regulators, including in all situations involving matching funds. Treasury officials will review the application received from the federal regulators and recommendations from one of the CDCI regulatory councils, if applicable, before approving any disbursement of funds under the CDCI. The screening and approval process will be in place before Treasury receives the CDCI applications from the federal regulators.

Recommendation 2:

Treasury should develop a robust procedure to audit and verify the bona fides of any purported capital raised and to establish adequate controls to verify the source, amount and closing of all claimed private investments.

Treasury will work with the federal regulators and its legal counsel to develop adequate controls to verify the source, amount and closing of all claimed private investments. Treasury is discussing options for identifying funds and obtaining a confirmation of receipt for the source of the funds. Treasury will implement a process before Treasury funds any approved CDCI applications.

Recommendation 3:

Treasury should revise CDCI terms to clarify that Treasury inspection and copy right continue until the entire CDCI investment is terminated and to expressly provide SIGTARP access to the CDFI records equal to that of Treasury.

The definitive documentation for CDCI will expressly acknowledge the jurisdiction and authority of SIGTARP and other oversight bodies. The definitive documentation will also state that both Treasury and SIGTARP will have access to personnel and any books, papers, records or other data relevant to ascertaining compliance with the financing terms and conditions of CDCI participants as long as Treasury owns the CDCI securities. Once the definitive documents have been fully executed, they will be published on our website, www.financialstability.gov.

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Recommendation 4: Treasury should consider more frequent surveys than annually, as currently contemplated.

As described in our April 17 letter, Treasury considered your recommendation to require more frequent surveys from financial institutions participating in the CDIC program and continues to believe that the required annual survey will provide sufficient transparency on the operational activities of these institutions.

Thank you again for your suggestions. We look forward to continuing to work with you and your team as we move forward.

Sincerely,



Herbert M. Allison, Jr.
Assistant Secretary for Financial Stability

Recommendation 2:
Treasury should set other performance benchmarks and publicly report against them to measure over time the implementation and success of HAMP.

Treasury has begun to report on servicer performance relative to key program objectives in the MHA Program Reports. Our latest report includes information about servicer-specific conversion rates to permanent modifications and servicer performance in giving homeowners timely decisions. Treasury announced plans for reporting performance measures on servicer compliance, program execution and homeowner experience beginning in July 2010. These new performance measures will include results of servicer-level loan-file reviews, average time from start of trial modification to start of permanent modification, information about alternatives made available to homeowners ineligible for HAMP, servicer handling of calls from homeowners, and servicers share of homeowner complaints to the HOPE Hotline.

Recommendation 3:
Treasury should undertake a sustained public service campaign as soon as possible, both to reach additional borrowers who could benefit from the program and to arm the public with complete, accurate information — this will help to avoid confusion and delay, and prevent fraud and abuse.

As described in our March 22 letter, Treasury is working with the Ad Council on a two-part public service announcement (PSA) campaign that is already underway. The campaign includes both television and radio advertising that has been sent to 12,000 media outlets across the country, as well as web banners and outdoor advertising. Treasury and HUD also continue to work with the Ad Council on a new multi-media campaign set to launch in the summer of 2010.

Early results from the first three months of advertising show 803 total airings of the TV PSA with over 1,483,000 household impressions. The Ad Council has reported 3,175 airings of the radio PSA, with the vast majority airing in the 100 largest media markets.

In addition, Treasury is a key partner, along with the U.S. Department of Housing and Urban Development and other federal agencies, in the "Loan Scam Alert" campaign currently being led by NeighborWorks America® and the Ad Council. Presentations about scam awareness take place at all MHA events and Treasury representatives work with local media to share this information in interviews and promotions for events. The Loan Scam Alert campaign directs homeowners to a website and the Homeowner's HOPE Hotline where they can receive more information and direct assistance. Further, we are developing an ancillary print flyer related to the campaign with anti-fraud tips.

Recommendation 4: *Treasury should reconsider its policy that allows servicers to substitute alternative forms of income verification based on subjective determinations by the servicer.*

As we described in our March 22 letter, we carefully considered your recommendation to restrict servicers from substituting alternative forms of income verification, and continue to believe that there are legitimate business reasons for allowing servicers to exercise good business judgment when evaluating income verification forms that auditors are able to assess during their fieldwork.

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

May 20, 2010

Neil M. Barofsky
Special Inspector General
Office of the Special Inspector General for the Troubled Asset Relief Program
1500 Pennsylvania Ave., NW, Suite 1064
Washington, D.C. 20220

RE: Follow-Up on HAMP Recommendations in the SIGTARP Audit Report

Dear Mr. Barofsky:

The Department of the Treasury (Treasury) appreciates the recommendations made by the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) in the official audit report titled "Factors Affecting Implementation of the Home Affordable Modification Program (HAMP)." This letter supplements our initial response letter dated March 22, 2010 and describes Treasury's progress in addressing the concerns raised in your audit recommendations. We have described under each recommendation the actions that we have taken, or plan to take, to address the recommendation.

Recommendation 1:
Treasury should rectify the confusion that its own statements have caused for HAMP by prominently disclosing its goals and estimates (updated over time, as necessary) of how many homeowners the program will help through permanent modifications and report monthly on its progress toward meeting that goal.

As we noted in our March 22 response, the goal of HAMP is to offer up to 3 to 4 million homeowners assistance in preventing avoidable foreclosures through all available avenues including modifications and alternatives to foreclosure, such as short sales and deed-in-lieu. Treasury believes it is on pace to achieve this goal and does not plan to revise it. We will continue to report each month on our progress towards meeting this goal in the ways described in our monthly reports as noted in our earlier response. This information is available in the Making Home Affordable (MHA) Program Reports that are available on our website at www.financialstability.gov. Treasury will also report on all other MHA foreclosure prevention programs as the data becomes available.

Additionally, we believe that reporting comparative performance metrics by servicer provides a good measurement of our progress in meeting program goals. As discussed further in the response to the next recommendation, Treasury will continue to publicly report on servicer-specific progress on HAMP modifications in the MHA Program Reports, including reporting on the conversion rate of trial modifications to permanent modifications by servicers that represent the majority of loans eligible for the HAMP program.

Recommendation 5: Treasury should re-examine HAMP's structure to ensure that it is adequately minimizing the risk of re-default driven by negative equity, high non-first-mortgage debt service, and other risk factors.

Treasury has re-examined HAMP's structure to ensure that it is adequately minimizing the risk of re-default driven by negative equity, high non-first-mortgage debt service, and other risk factors. The program changes to HAMP announced on March 26, 2010, were introduced in part to lower the probabilities of the risk of re-defaults in HAMP and were derived from a cost/benefit analysis of the proposed changes. These announcements include two alternatives for principal forgiveness on first mortgage liens in an effort to directly address the negative equity issue: the FHA Refinance program and Treasury's Principal Reduction Alternative. Treasury expects to publish guidance on these two new programs in June 2010. The FHA Refinance program will assist borrowers who are current on their first lien mortgage to refinance into a new FHA loan while also receiving a minimum 10% reduction of principal, and with a resulting maximum 115% combined loan-to-value ratio. Treasury's Principal Reduction Alternative will require servicers to compare the net present value (NPV) of HAMP modifications with and without principal forgiveness for all loans greater than 115% loan-to-value ratio. When the NPV of a modification with principal forgiveness is positive, servicers can choose to modify the loan with principal reduction applied in three equal installments over three years, assuming the borrower remains in good standing. Treasury will provide incentive payments of up to 21% of every dollar forgiven.

Additionally, revisions to the Second Lien Modification Program significantly increased investor incentives to encourage full or partial extinguishment of second mortgage liens. As of May 5, 2010, four large servicers that represent approximately 50% of all second mortgage liens have agreed to participate in the program and are actively modifying second liens in their mortgage portfolios. SIGTARP has acknowledged in its April 2010 Quarterly Report that the above announced revisions to the HAMP program structure will address the general concerns raised in the above recommendation.

Thank you again for your suggestions. We look forward to continuing to work with you and your team as we move forward.

Sincerely,



Herbert M. Allison, Jr.
Assistant Secretary for Financial Stability



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

June 11, 2010

Neil M. Barofsky
Special Inspector General
Office of the Special Inspector General for the Troubled Asset Relief Program
1500 Pennsylvania Ave., NW, Suite 1064
Washington, D.C. 20220

RE: Follow-Up on Warrant Disposition Recommendations in the SIGTARP Audit Report

Dear Mr. Barofsky:

The Department of the Treasury (Treasury) appreciates the recommendations made by the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) in the audit report titled "Assessing Treasury's Process To Sell Warrants Received From TARP Recipients." This letter supplements our initial response letter dated May 7, 2010 regarding your recommendations regarding the warrant disposition process.

As we noted previously, we are pleased that your report concludes that we have succeeded in negotiating prices from institutions for their warrants that are at or above our estimates of fair market value. We also are pleased that you found our process for estimating fair market value satisfactory. Your report should be helpful in explaining this complicated subject to the public.

With respect to your recommendations, which primarily address documentation and standardization of the process of evaluation of bids and negotiating with an issuer, we welcome your suggestions, and have set forth below the actions we are taking in response:

Recommendation 1: Treasury should ensure that more detail is captured by the Warrant Committee meeting minutes. At a minimum, the minutes should include the members' qualitative considerations regarding the reasons bids were accepted or rejected within fair market value ranges.

Treasury notes that the minutes of the Treasury Warrant Committee meetings include as an attachment a detailed valuation analysis that is prepared by Treasury's team with respect to each offer by an institution. This analysis sets forth, among other things, how the offer compares to each of the three fair market value ranges that Treasury estimates in accordance with its methodology and an explanation of how each of the ranges was derived. This document is the basis for the discussions by the Warrant Committee and its decision. Treasury's team then submits the detailed analysis and the committee meeting minutes articulating the committee's recommendation to the Assistant Secretary, who ultimately decides whether to accept or reject the institution's bid.

Nonetheless, in response to your recommendation, Treasury will expand the scope of the Warrant Committee meeting minutes themselves to state some of the specific factors that the members of the Warrant Committee considered when recommending to accept or reject an institution's offer.

Recommendation 2: Treasury should document in detail the substance of all communications with recipients concerning the negotiations of warrant repurchases.

We understand that you believe this will help measure the consistency of Treasury's decisions on whether to accept bids to repurchase warrants. Treasury believes that the primary way to achieve consistency is to apply the same valuation methodology and overall process to all institutions. Treasury's results – the prices at which warrants have been repurchased – evidence that it has done so. Nonetheless, in response to your recommendation, Treasury will maintain a record of communications with each institution concerning the negotiations of warrant repurchases.

Recommendation 3: Treasury should develop and follow basic guidelines and internal controls concerning how negotiations will be pursued, including the degree and nature of information to be shared with repurchasing institutions concerning Treasury's valuation of the warrants.

Treasury is reviewing its procedures for sharing information with institutions in order to ensure adequate consistency in the negotiation process itself. It should be remembered, however, that although we follow the same valuation methodology and same general procedures in dealing with any firm, the negotiation process will always vary by institution, in light of differences among institutions in their warrant valuation methods, decision-making processes and negotiating styles, differences in the amount by which a first offer varies from Treasury's estimate, and differences in market conditions at the time of the negotiation, to name just a few factors. Treasury must maintain flexibility in the way it responds while maximizing overall returns for taxpayers.

We would also like to take this opportunity to note certain statements in the report which we believe are not accurate in a material way. These are listed in [Appendix A](#).

We share your commitment to transparency and accountability in all of TARP's programs and policies. We look forward to continuing to work with you and your team as we continue our efforts to stabilize our financial system.

Sincerely,

Herbert M. Allison, Jr.
Assistant Secretary for Financial Stability

Appendix A

Statements with which Treasury Disagrees from SIGTARP's May 10, 2010 Report

Listed below are areas in which Treasury disagrees with specific statements made in the Report. After each section, and in certain cases immediately following the individual statement, Treasury's reasons for disagreement and responses are listed.

I. Consistency – SIGTARP states that Treasury's process is inconsistent.

SIGTARP's Report contains the following statements that we believe demonstrate a misunderstanding of the consistent process Treasury has established for the warrant disposition process:

- Executive Summary and page 36 of the Report: "Unless Treasury addresses these deficiencies, it risks subjecting itself once again, fairly or unfairly, to criticism from third parties that through TARP it is favoring some institutions over others—picking winners and losers—irrespective of whether in fact it had legitimate reasons to take the negotiating positions that it did."
- Executive Summary of the Report: "This lack of documentation makes it impossible to test whether Treasury is fairly and consistently making decisions that could mean a difference of tens of millions of dollars for taxpayers."
- Page 21 of the Report: "Without such documentation, SIGTARP could not further determine the extent to which institutions were treated consistently and objectively during these discussions."
- Pages 32–33 of the Report: "Treasury lacks detailed documentation supporting the decisions of the Warrant Committee.... This deficiency significantly limits the ability to test the consistency of Treasury's decisions."

Treasury's Response

Treasury has established a transparent warrant disposition process which is applied uniformly regardless of the size of the financial institution. Not only has Treasury developed and adhered to extensive policies and procedures for warrant valuation and disposition, Treasury has effectively disposed of warrants through repurchases by receiving fair market value, increasing the rate of return for TARP investments and, in turn, protecting the taxpayers, a fact that SIGTARP acknowledges in its Report—"[t]o its credit, Treasury has generally succeeded in negotiating prices from recipients for the warrants at or above its estimated composite value." (Executive Summary of the Report). These positive outcomes evidence the fact of a consistent process. Consistency should be measured by outcomes primarily and, as SIGTARP acknowledges, Treasury has succeeded in obtaining consistently positive results for the American taxpayers.

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2. Transparency – SIGTARP states that there are certain failings with regard to transparency.

The following portions of SIGTARP's report, which appear to allege certain failings with respect to transparency, are inconsistent with the robust procedures Treasury has in place to provide for effective transparency to the public:

- Page 8 of the Report: "Treasury had provided only limited information about the warrant repurchase process".
 - This suggests that Treasury was withholding information from release for no good reason rather than waiting until it could do so without harming taxpayer interests as described below.
- Page 17 of the Report: "Most of the meeting minutes from Warrant Committee sessions were limited and included only the name of the institution, the institution's offer amount, the name of the analyst who presented Treasury's analysis of fair market value, the analyst's recommendation on whether to accept or reject the offer, whether the offer was at or close to the analyst's composite value or fair market value range, and the final vote of the of the Warrant Committee members".
 - This statement ignores the fact that the Warrant Committee Memo, which contains a detailed analysis of a bid and how it compares to Treasury's range, is attached to the meeting minutes from the Warrant Committee sessions.
- Page 32 of the Report: "The first area of concern is that Treasury does not sufficiently document important parts of the process, impairing transparency and making a comprehensive review of the integrity of the decision-making process impossible."

Treasury's Response

Treasury's process for disposing of the warrants is transparent and Treasury has evidenced this transparency through multiple means. First, Treasury provides minutes of its decision to either accept or decline offers for the repurchase of the warrants. These minutes include as an attachment the Warrant Committee Memo, which sets forth detailed information upon which the Warrant Committee provides its advice on whether to accept the offer to the Assistant Secretary. Second, Treasury publicly reports the results of each of its transactions, which includes the disposition of the warrants either by repurchase by the issuer or through the auction process, on its publicly available transaction report. Third, Treasury produced a fulsome warrant report which provided detailed information, including, among other items, regarding the various bids provided by the issuers for the repurchase of their warrants from Treasury. Treasury produced this report once the release of bid information would not compromise its bargaining position in warrant negotiations. That point was reached in late December, once Treasury had disposed of most of the large bank warrant positions through negotiated repurchases and established a successful warrant auction platform for future dispositions. The latter was important because it confirmed that the market would value the warrants in generally the same manner as Treasury was doing in negotiated transactions. Treasury also made it clear in public testimony and to

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SIGTARP and the other oversight agencies in meetings that it would release the bid information once it had achieved these objectives. Furthermore, Treasury has agreed to supplement the report as additional details become available as additional issuers either repurchase their warrants or have their warrants auctioned to the public. Finally, Treasury publicly posts its agreements with third-parties for public scrutiny on its website. These steps, among others, demonstrate Treasury's commitment to transparency and the results of those commitments.

3. Negotiation Consistency – SIGTARP believes negotiations were not consistent.

The following portion of the SIGTARP Report evidences a misunderstanding of the negotiation process:

- Page 34 of the Report: "Treasury does not have established guidelines or internal controls over how the negotiations proceed, and in particular as to how much information is shared with recipient institutions about Treasury's estimated fair market value and the price it will accept for the repurchase of the warrants."

Treasury's Response

Negotiations are consistent within certain parameters. No counter offers are provided by the analysts. Consistent with the securities purchase agreement, valuation metrics are discussed in order to resolve objections to the company's determination of fair market value. If a valuation is close to acceptable Treasury valuation metrics, more detail may be offered in order to resolve the difference. Each negotiation is specific to that institution. Although we follow the same valuation methodology and same general procedures in dealing with any firm, flexibility is necessary to protect taxpayer's interests when responding to differing negotiating tactics, market conditions, and factors specific to those discussions. Treasury continues to perfect its processes, including the negotiation process, which continues to evolve in light of past performance in line with best practices as they are learned.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

June 29, 2010

Neil M. Barofsky
Special Inspector General
Office of the Special Inspector General for the Troubled Asset Relief Program
1500 Pennsylvania Ave, NW, Suite 1064
Washington, D.C. 20220

RE: SIGTARP Official Draft Audit Report

Dear Mr. Barofsky:

Thank you for giving the U.S. Department of the Treasury (Treasury) the opportunity to review and comment on your official draft audit report regarding compliance activities in connection with institutions receiving exceptional assistance under the Troubled Asset Relief Program (TARP). As Assistant Secretary Allison is travelling, he has asked me to respond on his behalf.

We take very seriously our responsibility to monitor compliance with TARP requirements by all recipients of TARP funds. We have carefully reviewed the statements made in your report and the recommendations based on those statements. Although we agree with a portion of your third recommendation regarding increasing the Office of Financial Stability's compliance staff, we strongly disagree with many of the statements and two of your recommendations in this report. Treasury is fully committed to a robust compliance regime, and is likewise fully committed to protecting the interests of taxpayers.

We will respond more fully to your findings and, provide a detailed description of Treasury's actions with regard to the concerns expressed in your report within 30 days of the final audit report's issuance.

We share your commitment to compliance with all of TARP's requirements. We look forward to continuing to work with you and your team as we continue our efforts to stabilize our financial system.

Sincerely,

Timothy G. Massad
Chief Reporting Officer
Office of Financial Stability

**The U.S. Department of the Treasury
Summary Response to SIGTARP's Outstanding Recommendations**

June 30, 2010

The Department of the Treasury (Treasury) welcomes the recommendations on the Troubled Asset Relief Program (TARP) from the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP). This summary response serves as a status report on Treasury's response to specific recommendations included in SIGTARP's quarterly and audit reports, which appear in the SIGTARP recommendation chart included in the April 2010 Quarterly Report to Congress.

Treasury has given careful consideration to all recommendations in SIGTARP's quarterly and audit reports. Treasury's policies and programs currently address many of the issues raised in your recommendations, and in many cases, Treasury has taken specific actions to implement Treasury's statutory duties under the Emergency Economic Stabilization Act (EESA). We have developed alternative ways to address the underlying concerns SIGTARP has raised and have explained the measures we are employing to do so in our summary responses to SIGTARP and to Congress. Finally, SIGTARP Recommendations 1, 3, 4, 5, 6 and 7 identified in this summary response should be closed because Treasury has either implemented the recommendation or believes that no further action is necessary or appropriate.

Specific Recommendations from SIGTARP's Reports

Recommendation 1 (re Use of Funds): Treasury should require TARP recipients to report on the actual use of TARP funds.

Treasury collaborated with SIGTARP on designing a process that addressed this recommendation, which includes a *Use of Capital Survey*. The scope of the annual *Use of Capital Survey* covers how each financial institution has employed the capital infusion of funds received under the Capital Purchase Program (CPP) from the date they initially received the funds until the end of the fourth quarter 2009.

Treasury sent the *Use of Capital Survey* to CPP participants in March 2010, and received survey responses from many CPP participants. Treasury will post all answers that are collected from each individual CPP recipient through the *Use of Capital Survey*, and will publish the names of any financial institutions that fail to submit a survey response to Treasury, on the *FinancialStability.gov* website. Treasury expects to complete this process shortly. Additionally, Treasury has posted a summary of quantitative data on the categories provided in the overall Quarterly CPP Report for each individual CPP recipient on the *FinancialStability.gov* website.

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

June 30, 2010

Neil M. Barofsky, Esq.
Special Inspector General
for the Troubled Assets Relief Program
United States Department of the Treasury
1500 Pennsylvania Ave., N.W.
Washington, D.C. 20220

Re: Status Report on Recommendations in the SIGTARP Quarterly Report

Dear Mr. Barofsky:

This letter comments on the actions taken by the U.S. Department of the Treasury (Treasury) in response to the outstanding recommendations outlined in the Special Inspector General for the Troubled Asset Relief Program's (SIGTARP) *Quarterly Report to Congress*, dated April 21, 2010. As Assistant Secretary Allison is travelling, he has asked me to respond on his behalf.

Treasury looks forward to the release of the SIGTARP's seventh major report on the Troubled Asset Relief Program (TARP) in June 2010, and has continued to take significant steps to address recommendations from the SIGTARP's quarterly and audit reports. We request that you include the enclosed *Summary Response to SIGTARP Recommendations* in your upcoming quarterly report.

As described in our enclosed *Summary Response to SIGTARP Recommendations*, Treasury has made significant progress in addressing the SIGTARP's comments. We agree that Treasury must do more in many of these areas, and appreciate the SIGTARP's recognition of the significant progress we have made in your report. The enclosed summary outlines steps Treasury is taking to implement action plans that are responsive to the SIGTARP's outstanding recommendations as well as the progress made in completing the action plans for each outstanding recommendation.

We appreciate the open and collaborative relationship with you and your team, and have strived to achieve the highest standard for protecting taxpayers while carrying out our mandate of promoting financial stability. We look forward to continuing to work with you and your team as we move forward.

Sincerely,

Timothy G. Massad
Chief Reporting Officer
Office of Financial Stability

Enclosure

overleveraged loans were NPV positive under the alternative waterfall. Treasury does not wish to promote strategic defaults among homeowners.

The next and equally serious consideration was the recognition of the very real frustration on the part of responsible borrowers who, although they are overleveraged, are continuing to make their scheduled payments but believe that their tax dollars are being used to subsidize principal reduction even in instances where investors would otherwise be unwilling to offer this benefit. Finally, as SIGTARP is aware that HAMP is a voluntary program in which servicers elect to participate, Servicers' obligations are based on contractual terms identified in Servicer Participation Agreements (SPA). The form of SPA requires servicers to implement HAMP in accordance with Treasury directives, including those issued after the date a servicer signs the SPA, so long as Treasury does not issue guidance that represents a material change to the original program terms. Principal forgiveness has a substantial financial impact on investors and, based on discussions with both servicers and investors prior to issuance of the final guidance, would be construed as a material change to the SPAs. Investors were clear that they would challenge any mandatory principal reduction requirement and servicers, in an effort to avoid these legal challenges could preemptively "opt out" of the program which ultimately would negatively impact borrowers struggling to retain homeownership. Treasury determined that the risk of having a substantial number of servicers withdraw from HAMP, and the adverse consequences of such withdrawals to the program's ability to help borrowers, were too great.

Recommendation 3 [re PPPP]: Treasury should have appropriate metrics defined and an evaluation should be in place to monitor the effectiveness of the PPPP managers, both to ensure that they are fulfilling the terms of their agreements and to measure their performance against pre-established benchmarks and against each other.

Treasury continues to develop appropriate metrics to monitor the financial performance of the Public Private Investment Program (PPP) Funds. Metrics are expected to include each PPPF's actual cumulative net returns on equity investments relative to the total equity investment returns promised by each fund manager. At this time, the most appropriate metric that we are monitoring is the return being generated by each fund manager. Treasury is in the process of identifying a qualified sub-contractor to assist in our ongoing monitoring of the portfolio and development of appropriate metrics. Treasury also continues to develop policies and procedures specific to the ongoing administration of the PPPP to ensure that the fund managers achieve Treasury's investment objectives while also protecting taxpayers from potential risks through robust oversight of the business, legal, operational, and compliance requirements of the PPPP. We expect to have these procedures finalized in August 2010.

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Recommendation 2 [re HAMP]: Treasury should reevaluate the voluntary nature of its principal reduction program and, irrespective of whether it is discretionary or mandatory, Treasury should consider changes to better maximize its effectiveness, ensure to the greatest extent possible the consistent treatment of similarly situated borrowers, and to address potential conflict of interest issues.

The final principal reduction alternative (PRA) waterfall guidance requires all servicers to evaluate every Home Affordable Modification Program (HAMP) eligible borrower whose first mortgage lien exceeds 115 percent of the current market value of the property using both the standard and an alternative waterfall that includes principal reduction. Requiring servicers to evaluate homeowners for modifications with principal reduction will require a structural change in servicing and modifications. Servicers will now be required to analyze rigorously and systematically the benefit of principal reduction modifications. This increased transparency around the value of modifications with principal reductions should cause the industry to make better decisions for homeowners and investors. In addition, in many cases, where a modification with principal reduction has a higher NPV than a standard HAMP modification, servicers may be required by investor guidelines or other legal obligations to perform the modification that yields the highest NPV for the investor. It also includes significant financial incentives to offer principal reduction.

Additionally, servicers must have a written policy describing the circumstances under which borrowers will be offered principal reduction and that policy must be consistent with Fair Lending requirements. Treasury believes that the loans most likely to test NPV positive are those that under the standard waterfall require substantial principal forbearance in order to achieve monthly payments that represent 31 percent of the borrower's gross monthly income.

Supplement Directive 10-05 also clarified the appropriate treatment of principal forbearance in the HAMP context (in the absence of any other guidance in a pooling and servicing agreement), essentially requiring servicers to treat forbearance as a realized loss, in the same manner that they treat principal forgiveness. Because both events represent a realized loss, servicers and investors have additional motivation to forgive rather than forbear in order to receive principal forbearance incentives.

Following the initial announcement of the PRA waterfall on March 26, 2010 and the issuance of PRA guidance on June 3, 2010 in SD 10-05, Treasury gave careful consideration to SIGTARP's recommendation to require mandatory principal reduction whenever the alternative Net Present Value (NPV) result was positive. As described in SD 10-05, Treasury's final determination was to leave principal reduction as voluntary choice, as initially announced by the Administration. There are three primary reasons for this decision.

First, the most serious consideration was the potential moral hazard of strategic default created by "promising" a significant amount of principal reduction to all HAMP borrowers whose

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Recommendation 4 [re CDCI Program]: Treasury should institute careful screening before putting additional capital into an institution with insufficient capital to ensure that the TARP matching funds are not flowing into an institution that is on the verge of failure.

Treasury has developed a careful screening and approval process for the Community Development Capital Initiative (CDCI) program that is substantially similar to CPP. As part of this process, Treasury will not approve a financial institution applying to participate in CDCI without the recommendation of the appropriate federal regulator. This screening and approval process is currently in place for all financial institutions applying to participate in CDCI. Treasury has documented the process for inclusion in the existing policies and procedures.

Recommendation 5 [re CDCI Program]: Treasury should revise CDCI terms to clarify that Treasury inspection and copy right continue until the entire CDCI investment is terminated and to expressly provide SIGTARP access to the CDFI records equal to that of Treasury.

The SPA expressly acknowledges the jurisdiction and authority of SIGTARP and other oversight bodies. The Agreement also clarifies that both Treasury and SIGTARP have access to personnel and any books, papers, records or other data relevant to ascertaining compliance with the financing terms and conditions of CDCI participants as long as Treasury owns the CDCI securities. The form documents, which include those provisions, have been published on our website, www.financialstability.gov.

Recommendation 6 [re Warrant Dispositions]: Treasury should ensure that more detail is captured by the Warrant Committee meeting minutes. At a minimum, the minutes should include the members' qualitative considerations regarding the reasons bids were accepted or rejected within fair market value ranges.

Treasury has expanded the scope of the Warrant Committee meeting minutes themselves to state the additional factors that the members of the Warrant Committee considered material when recommending to accept or reject an institution's offer. This additional documentation supplements the detailed valuation analysis that is attached to the Warrant Committee meeting minutes.

Recommendation 7 [re Warrant Dispositions]: Treasury should document in detail the substance of all communications with recipients concerning the negotiations of warrant repurchases.

In response to SIGTARP's recommendation, Treasury currently maintains a record of communications with each institution concerning the negotiations of warrant repurchases.



OFFICE OF THE SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM
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JUL 1 2010

Mr. Herbert M. Allison, Jr.
Assistant Secretary
Office of Financial Stability
U.S. Department of the Treasury
Main Treasury Building
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: Treasury's Compliance and Internal Controls Program for PPIP

Dear Mr. Allison:

As you know, the Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") began a review of Treasury's Public-Private Investment Program ("PPIP") compliance and internal controls program in October 2009, shortly after the first Public-Private Investment Fund ("PPIF") manager signed its Limited Partnership Agreement ("LPA"). We met with the Office of Financial Stability ("OFS") Compliance officials on numerous occasions and discussed their compliance and oversight efforts.

SIGTARP also consulted with officials at the New York Stock Exchange's Market Surveillance Team ("NYSE") and the Securities and Exchange Commission's Office of Compliance, Inspections and Examinations ("SEC") regarding best compliance practices for a program such as PPIP. We believe Treasury's compliance and internal controls program would greatly benefit by having incorporate the following suggestions.¹

Treasury's PPIP Policies and Procedures

In its Quarterly Report to Congress issued July 21, 2009 (the "Quarterly Report"), SIGTARP recommended that metrics be defined and an evaluation system be put in place to monitor the effectiveness of the PPIF managers, ensure that they are fulfilling the terms of their agreements, and to measure their performance. The Quarterly Report noted that, without standardized policies and procedures, including written guidance as to how they would evaluate and test the PPIF managers' compliance with program rules, it is unclear how Treasury can consistently and properly identify and act on any potential risks to the program.

¹ These suggestions supplement and are not intended to replace any recommendations found in SIGTARP's Quarterly Reports.

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July 1, 2010
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Although Treasury reported that it would adopt this recommendation and was developing appropriate metrics and internal controls, nearly one year later, nothing has yet been issued. The Quarterly Report cautioned that expecting the PPIF managers, without detailed guidance, to design policies and procedures that meet Treasury's and the public's expectations is not appropriate in light of the risk of conflicts of interests inherent in the design of PPIP.

On February 17, 2010, Treasury informed SIGTARP that it had contracted with PricewaterhouseCoopers ("PwC") to develop PPIP compliance policies and procedures within six weeks. On June 18, 2010, however, Treasury stated that a recently completed draft of its PPIP compliance policies and procedures was going through a final approval process. SIGTARP has yet to see the draft and therefore cannot comment on specifics, but we suggest the policies and procedures include key provisions, such as:

- Guidelines to evaluate and test: (1) whether a PPIF manager has an overriding personal conflict of interest such as investment of his own money in other funds; and (2) whether other funds in a PPIF manager's portfolio could be benefiting at the expense of the PPIF fund.
- Plans to review PPIF managers' compliance with other provisions of the LPA, not covered in the analysis performed by PwC, and actions it will take on instances of non-compliance (for example, how the PPIF manager keeps complete, accurate and appropriate books and records, or maintains compliance with the various trade and fee restrictions in Section 1.8 of the LPA).
- A framework addressing how Treasury will detect and report potential fraud or other potential securities laws violations by the PPIF managers. Treasury may want to incorporate step-by-step procedures that delineate, at a minimum: (1) whether and how Treasury will test for securities violations; (2) how potential securities violations will be treated; and (3) who supervises the process to ensure all steps are followed.

PPIF Manager Compliance and Internal Controls Review

Treasury stated that, as part of the due diligence during the asset manager selection process, the PPIF manager internal controls were reviewed. Although Treasury is assessing the need for a formal compliance review, Treasury has yet to initiate a formal review of those internal controls.

SIGTARP suggests that such a review is imperative. Review of the PPIF managers will provide Treasury the opportunity to analyze and determine whether each PPIF manager documents and complies with its internal controls requirements and provide a mechanism to monitor the program's risks and determine whether the PPIF managers are operating in accordance with the guidelines and rules in the LPA.

Currently, Treasury relies solely on the PPIF managers' Quarterly Certification. Although self-certifications are important to a compliance program, they alone are not sufficient

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July 1, 2010
Page 3

to ensure compliance with the LPA. Further, Treasury may want to consider incorporating processes where The Bank of New York Mellon, as administrator, custodian and valuation agent, could validate the integrity of the data provided by the PPIF managers.

Treasury's reviews, which should be done periodically, should focus on at least the following areas:

1. Compliance Program: review the PPIF managers' policies and procedures for effectiveness
2. Portfolio Management: evaluate how the PPIF managers select securities and engage in risk management such as evaluating ratings of securities and trade allocation analysis
3. Valuation: assess reasonableness and accuracy of valuation process
4. Reporting: evaluate whether monthly reporting requirements are met and review accuracy of the reports
5. Conflicts: assess potential misappropriation of government funds, insider trading, and other conflicts of interest
6. Asset Verification: verify the existence of securities by reviewing settlement of trades and how errors are accounted for both in PPIF and non-PPIF accounts.²

Monitoring of Trade Data

Finally, Treasury, through PwC, analyzes the PPIF managers' trade data for compliance with certain elements of the LPA on a monthly basis.³ SIGTARP has learned that the PPIF manager's weekly trade data is made available to Treasury on the FTP secured website. Both the SEC⁴ and NYSE informed SIGTARP that a comprehensive surveillance program requires real-time monitoring along with a monthly review of trading.

The NYSE and SEC told SIGTARP that both real-time monitoring for trade aberrations such as significant price movements and monthly trade surveillance for fraud schemes based on trends over time are necessary. Each serves a unique purpose and together they provide a

² Treasury may want to consider instituting an asset verification process on an annual basis. This annual analysis would allow Treasury to review the entire universe of each PPIF manager's trade data to validate whether all eligible asset positions and trades have been captured in the current monthly reports. This would require a complete download of all purchases and sales in every PPIF and non-PPIF account, including eligible and non-eligible assets. The trade data download would come directly from the PPIF managers' trade order management system.

³ Treasury told SIGTARP that it also performs other analyses like looking at trade settlement dates, outside of the monthly trade analysis.

⁴ The opinions expressed by individuals at the Securities and Exchange Commission are the opinions of those individuals, and the Commissioners, the agency or any other employee of the Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees.

A/S Herbert Allison
July 1, 2010
Page 4

comprehensive surveillance program. We recognize that real-time monitoring may be difficult, but at least a weekly analysis would be possible and might assist Treasury in identifying irregular trends or market movement.

SIGTARP encourages Treasury to adopt these suggestions in its PPIF compliance and internal controls program. These suggestions will strengthen Treasury's oversight of the program and further protect the taxpayers' investments from fraud, waste and abuse. As always, we are available to meet with you to discuss these issues.

Very truly yours,



NEIL M. BAROFSKY
Special Inspector General



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

July 16, 2010

Neil M. Barofsky
Special Inspector General
Office of the Special Inspector General for the Troubled Asset Relief Program
1500 Pennsylvania Ave., NW, Suite 1064
Washington, D.C. 20220

RE: Response to SIGTARP Quarterly Report to Congress

Dear Mr. Barofsky:

The U.S. Department of the Treasury (Treasury) appreciates the opportunity to review the recommendation section of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) July 2010 Quarterly Report to Congress to be issued next week. We welcome and consider policy recommendations received from SIGTARP as we design and execute TARP programs under the Emergency Economic Stabilization Act (EESA).

We have previously indicated our willingness to accept several of these recommendations at least in part, and have also described the measures we are employing to address the underlying concerns raised in your prior audit and quarterly reports. In this report you have reviewed our responses and stated why you believe our responses are not satisfactory and the additional steps you believe we should take. While we disagree with some of your characterizations of your responses, we wish to take more time to review your suggestions and comments in detail. Therefore we will respond more fully in the near future to your comments.

We take very seriously our responsibility to develop effective and efficient policies that fulfill the purposes and requirements of EESA. We also take seriously our responsibility to insure transparency in our programs.

We appreciate the open and collaborative relationship with you and your team, and have strived to achieve the highest standard for protecting taxpayers while carrying out our mandate of promoting financial stability. We look forward to continuing to work with you and your team as we move forward.

Sincerely,

Herbert M. Allison, Jr.
Assistant Secretary for Financial Stability