



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

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.

1. **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.

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 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

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.