

**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 your recommendations. When we believe a particular recommendation would not help carry out 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.

*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

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 PPIP]: Treasury should have appropriate metrics defined and an evaluation should be in place to monitor the effectiveness of the PPIF 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 (PPIP) Funds. Metrics are expected to include each PPIF'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 PPIP 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 PPIP. We expect to have these procedures finalized in August 2010.

*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](http://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.