

***The U.S. Treasury Department
Summary Response to GAO Recommendations***

October 8, 2009

The Treasury Department (Treasury) welcomes the recommendations on the Troubled Asset Relief Program (TARP) made by the GAO. This report provides an updated response to the implementation of recommendations issued in the reports from December 2008, and January, March, June, and July 2009.

Treasury enjoys a productive relationship with the GAO. Treasury's communication with the GAO includes responding to specific requests for information and organizing comprehensive briefings on the progress of TARP programs with senior Treasury staff. Treasury keeps the GAO apprised of its progress on implementing recommendations, as well as on developments with current and proposed programs and policies under the Emergency Economic Stabilization Act of 2008 (EESA).

This report first identifies each open GAO recommendation and then provides a summary of Treasury's actions to address the specific recommendation. As described below, Treasury's Office of Financial Stability (OFS) continues to make tremendous progress on building out the organization and related frameworks and procedures, while simultaneously developing and implementing Treasury's policies to stabilize the financial system.

GAO Recommendation 1:

Treasury should establish a process to ensure compliance with all CPP requirements, including those associated with limitations on executive compensation, limitations on dividends, and stock repurchase restrictions.

Summary of Treasury's Actions in Response to this GAO Recommendation

As stated in Treasury's previous response to GAO recommendations, on June 15, 2009, Treasury published the Interim Final Rule (the "Rule") on executive compensation, promulgated under the EESA as amended by the American Recovery and Reinvestment Act of 2009. The Rule contains distinct requirements for recipients of TARP funding under certain programs, including participants in the Capital Purchase Program (CPP) and recipients of exceptional assistance.

The Rule establishes the Office of the Special Master for TARP Executive Compensation, (the "Special Master"), and requires that the Special Master review any bonuses, retention awards, and other compensation paid to the five senior executive officers and 20 next most highly-compensated employees of each TARP recipient prior to February 17, 2009, to determine whether the payments were contrary to the public interest. If the payment is determined to be contrary to the public interest, the Special Master will be responsible for negotiating for reimbursements of such payments. The Office of the Special Master is currently designing processes, tools, and techniques to

help the Special Master in his responsibilities in performing analysis for the review of prior period payments

All TARP recipients, including CPP participants, were required to adopt a luxury expenditure policy consistent with the requirements of the Rule, provide the policy to Treasury, and post the policy on their Internet website, in each case within 90 days following publication of the Rule or 90 days after the closing date of the agreement between the TARP recipient and Treasury, whichever is the later. These policies are generally required to address expenses including entertainment or other events, office and facility renovations, aviation or other transportation services. The Chief Risk and Compliance Office (CRCO) is currently conducting its receipt, recording and review of the luxury policies that were due 90 days after the Rule was published. This task is expected to be complete within the next quarter and will require action by recipients if their policies do not contain the elements required by the Rule.

Additionally, the Rule requires that the compensation committee, and CEO and CFO, of each TARP recipient provide certain certifications to Treasury with respect to compliance with the Rule. These certifications are due within 120 days of the completion of the TARP recipient's fiscal year. Processes regarding certifications are currently being developed by OFS.

In addition to the actions taken by OFS stated in Treasury's response to GAO's last report, OFS formalized its tracking the number of missed payments in the monthly Dividends and Interest Report starting with the July report. Other CPP requirements based on information received or obtained are reviewed and documented by the CPP team, including, if required, decisions made by that team. Instances of non-compliance with CPP requirements of which OFS becomes aware are reported to the CRCO and are evaluated to determine if further action is required.

OFS continues to investigate potential software solutions as well as other methods to improve compliance monitoring. One such possibility is the use of quarterly call reports to help determine compliance with warrant management or Treasury investment seniority.

GAO Recommendation 2:

Develop a communication strategy/vision that includes building an understanding and support for the various components of the program, specifically actions to preserve homeownership. Specific actions could include hiring a communications officer, integrating communications into TARP operations, scheduling regular and ongoing contact with congressional committees and members, holding town hall meetings with the public across the country, establishing a council of advisors, and leveraging available technology. Fully implement a communication strategy that ensures that all key congressional stakeholders are adequately informed and kept up to date about TARP.

Summary of Treasury's Actions in Response to this GAO Recommendation

OFS is developing an integrated communications plan in coordination with Treasury's Offices of Public Affairs, Legislative Affairs, OFS program offices, and is hiring the appropriate staff to execute this plan. The integrated communications plan will address both internal and external communications and develop recommendations on how Treasury can best communicate the goals and progress of TARP programs to Congress, the general public, Treasury employees, and other stakeholders.

Treasury has taken a number of important steps to improve dissemination of information about TARP. In March 2009, Treasury launched its *FinancialStability.gov* website, which provides comprehensive information on the Financial Stability Plan and all TARP programs, and also features reports issued by Treasury on TARP. Since its launch in March 2009, *FinancialStability.gov* has had over 33.5 million page views. In addition to the website, Treasury responds to numerous inquiries on TARP from Members of Congress and has begun to conduct periodic briefings with Congressional staff on TARP programs (the first one took place on May 15, 2009 with House and Senate staff and two additional briefings occurred in July). These briefings are in addition to Treasury Secretary Timothy F. Geithner's and Assistant Secretary Herbert M. Allison, Jr.'s frequent testimonies before Congress and many public statements on TARP and the Financial Stability Plan.

Treasury also regularly communicates all updates on TARP programs with oversight entities: the GAO, the Special Inspector General for the TARP, and the Congressional Oversight Panel.

With regard to its Making Home Affordable program, Treasury has developed an extensive communications strategy and continues to work with a council of advisors from various offices within Treasury including the Office of Public Affairs, the Public Liaison Office, and the Office of Legislative Affairs, as well as communications officials at the White House, Department of Housing and Urban Development, Federal Housing Finance Agency, Fannie Mae, Freddie Mac, NeighborWorks America, and the HOPE NOW Alliance. In addition, Treasury's Director of Marketing and Communications for the Homeownership Preservation Office (HPO) continues to work to better coordinate outreach efforts.

In March 2009, Treasury launched its *MakingHomeAffordable.gov* website, which contains a wealth of information for homeowners on refinancing and modification. Treasury is continually working to ensure that the website has the latest information and is a resource for borrowers, housing counselors, and the media. Since its launch in March 2009, *MakingHomeAffordable.gov* has had over 36 million page views. As part of the effort to disseminate information about the Making Home Affordable program, Treasury is working with NeighborWorks America to refresh a PSA campaign in both English and Spanish to target audiences who may be eligible for the program. To broaden the program's exposure to borrowers, Treasury hosted a Marketing Summit on September 30, 2009, with representatives of participating servicers to discuss better ways to present the program to eligible borrowers. The Homeownership Preservation Foundation is

providing free call center services on a 24/7 basis in English and Spanish to borrowers seeking program information. The call center recently implemented an escalation process to address urgent borrower needs in a timely fashion.

In addition to these efforts, Treasury continues its national outreach campaign in local markets hardest hit by foreclosure. In each area, Treasury hosts a partner roundtable to engage key local officials, including Congressional field office staff, housing officials, and advocacy groups, about the Making Home Affordable program. As part of these outreach activities, Treasury partners with local government and nonprofit housing organizations to provide borrowers a sit-down opportunity with mortgage lenders and housing counselors. Cities visited to date include: Miami, Florida; Sacramento, California; Las Vegas, Nevada; Phoenix, Arizona; Chicago, Illinois; Springdale, Maryland; Woodbridge, Virginia; and Boston, Massachusetts. By the end of October 2009, Treasury will have hosted events in Tampa, Florida; Stockton, California; Philadelphia, Pennsylvania; Riverside, California; San Diego, California; Atlanta, Georgia; and Cincinnati, Ohio. At Treasury's urging, HOPE NOW developed a reporting system so that Treasury now has day-of statistics measuring the outcome of the borrower discussions with servicers. Finally, to ensure widespread borrower participation, Treasury is hiring translators in each city to cover the major languages in that market.

HPO has also hired a Director of Intergovernmental and Industry Relations and is hosting meetings with housing advocacy groups to discuss the challenges they face on the ground and their recommended improvements to the Home Affordable Modification Program (HAMP). In addition, HPO has been working with HOPE NOW on identifying challenges that stakeholders are encountering with the HAMP and solutions to these challenges.

HPO has conducted numerous briefings for Senate and House Congressional staff, including several briefings for Senate Banking Committee staff and member staff, as well as several meetings with personal staffs of House and Senate members who are not part of the committees of jurisdiction. In the coming months, HPO will be aggressively reaching out to House Caucuses and other Congressional committees.

GAO Recommendation 3:

Develop a comprehensive system of internal control over TARP, including policies, procedures, and guidance for program activities that are robust enough to ensure that the program's objectives and requirements are being met.

Summary of Treasury's Actions in Response to this GAO Recommendation

Recognizing the complexity of TARP's programs, Treasury has taken a multi-faceted approach to its system of internal control, which includes risk management and internal control.

With regard to risk management, Treasury has implemented a comprehensive set of assessments geared toward identifying risks, evaluating their potential impact, and

prioritizing resource assignments to manage risks. Resource assignments include top-down assessments that poll the perspectives of senior members of OFS and cover a broad array of risks. The results are compared with bottom-up risk assessments that are based on the GAO's *Internal Control Management and Evaluation Tool*. The analysis of both the top-down and bottom-up assessments allows senior OFS management to effectively identify risks, prioritize them, and assign resources to manage and mitigate risks across the organization.

In addition to top-down and bottom-up risk assessments, OFS performs an additional assessment focused on identifying and assessing risk at the program and at the support function levels. OFS program and function managers use these assessments to improve their processes and effectively allocate resources.

With regard to internal control, Treasury has implemented a framework and plan for internal control over TARP. The Internal Control Framework serves as a guide to assist management in the establishment of controls for new programs. Whether deploying operational processes to support new TARP programs or implementing complex budget and financial reporting processes to support its first year of operation, OFS continuously strives to establish an effective initial operating capability for internal controls that are first and foremost effective at mitigating risk. Then, OFS enhances the initial operating capability to a sustainable level that is effective and efficient.

Treasury does this by managing and mitigating risks, and also ensuring that the appropriate controls are in operation on an ongoing basis. This work includes the preparation and maintenance of process flows and related controls documentation, as well as evidence of control execution. In addition, the Internal Control Department utilizes the risk matrices to ensure appropriate coverage of high impact areas. Treasury continues to monitor the operational controls related to program asset acquisition, asset management, and asset disposition activities. As part of its progression to a more efficient environment, Treasury is increasingly using technology to store evidence of control execution, and thereby reducing its reliance on hardcopy binders.

Leveraging its Internal Control Framework, OFS is on schedule to meet OMB Circular A-123 requirements; OFS completed the Interim Assurance Statement covering the effectiveness of Internal Control over Financial Reporting as of June 30, 2009. In support of the broader fiscal year-end management assurance statement, OFS is evaluating its management controls, internal controls over financial reporting, and compliance with federal financial systems standards. OFS completed the Fiscal Year 2009 Draft Annual Assurance Statement; this document represents the form of Assurance Statement which OFS anticipates issuing in conjunction with the September 30, 2009, year-end reporting process. This work is on track for completion by the Department due date.

Management delivered draft policies and procedures to the GAO on June 30, 2009. Final policies and procedures covering a majority of OFS were delivered to the GAO on

September 30, 2009. The Senior Assessment Team (SAT) and Internal Control Program Office continue to guide OFS' efforts to meet the statutory and regulatory requirements for a sound system of internal controls for the TARP. The bulk of the remainder of OFS policies and procedures will be delivered by December 31, 2009.

GAO Recommendation 4:

Update OFS documentation of certain internal control procedures and the guidance available to the public on determining warrant exercise prices to be consistent with actual practices applied by OFS.

Summary of Treasury's Actions in Response to this GAO Recommendation

Treasury has implemented this recommendation. Treasury clarified its procedures for determining warrant exercise prices by updating its FAQs on CPP repayment and the Capital Assistance Program and posting the updated FAQs on *FinancialStability.gov* website in May 2009. Treasury completed documentation of CPP process flows, risk and compliance matrices, and narratives on June 30, 2009. Treasury supplied the GAO with draft policies and procedures regarding validation of the warrant exercise price calculation on June 30, 2009 and provided final Acquisition Execution Procedures, which address warrant exercise price calculation validation on September 30, 2009.

GAO Recommendation 5:

Complete the review of, and as necessary renegotiate, the existing vendor conflicts-of-interest mitigation plans to enhance specificity and conformity with the new interim conflicts-of-interest rule. Take continued steps to manage and monitor conflicts of interest and enforce mitigation plans.

Summary of Treasury's Actions in Response to this GAO Recommendation

Treasury is actively renegotiating the contracts and financial agent agreements (FAAs) in place before the new Conflict of Interest interim final regulation became effective on January 21, 2009 and that remained active after April 30, 2009. To date, Treasury has successfully renegotiated the conflicts of interest provisions and approved the conflicts mitigation plans for five of the eight contracts/agreements that required modifications; Treasury is actively working on the remaining two contracts and one financial agency agreement. The complex nature of these contracts/agreements and the complexity of the contractors' businesses require significant time to develop mitigation plans that appropriately meet the provisions of the regulation. During the renegotiating process, the conflict of interest group within CRCO has been expanded. With the addition of new employees focused on conflicts of interest, the completion of negotiation of the contracts and agreements is anticipated to be completed by October 31, 2009.

Treasury has taken steps to systematize and formally document processes regarding conflicts of interests. CRCO works with the contractors at the outset of the contract to identify conflicts mitigation plans that meet Treasury's requirements under the new Conflict of Interest interim final regulations. In accordance with the regulations, the

contractors provide documentation related to conflicts of interest throughout the term of the contract. The Contracting Officer's Technical Representatives (COTRs) report any discussions regarding conflicts of interest with their contractors as part of their systematic monitoring of assigned contracts and promptly raise any perceived or potential conflicts of interest to the attention of CRCO for evaluation.

As stated in Treasury's May 2009 *Summary Response to the GAO*, in conjunction with Treasury Procurement Office, CRCO developed conflict of interest process flows. These flows became the basis of internal and external communications describing the formal processes and requirements contractors and financial agents must follow for conflict of interest communication with Treasury. Treasury delivered a presentation to COTRs and financial agent relationship managers to explain formal processes and distributed a formal email with the same message to all contractors and financial agents. To facilitate these processes, Treasury created a conflicts of interest mailbox as a central method for contractors and financial agents to communicate with Treasury. Types of communication that the mailbox facilitates include, but are not limited to: reports of possible conflicts of interest, updates to the mitigation plans, certification submissions, requests for interpretation of the regulation, and responses to contractors' and financial agents' requests. Additionally, Treasury created a database to document, archive, and monitor communications and information from contractors and financial agents; the database is populated with information shortly after it is received through the mailbox.

Treasury has vetted all public comments received on the interim final COI regulations, and is in the process of drafting revisions to the existing regulations.

GAO Recommendation 6:

In consultation with the Chairmen of the Federal Deposit Insurance Corporation and the Federal Reserve, the Comptroller of the Currency, and the Acting Director of the Office of Thrift Supervision, ensure consideration of generally consistent criteria by the primary federal regulators when considering repurchase decisions under TARP.

Summary of Treasury's Actions in Response to this GAO Recommendation

Treasury is not in a position to dictate criteria that regulators should apply in making such decisions. Federal banking law vests the primary regulator of each institution with the authority to determine whether and on what terms to permit the institution to reduce its capital, including by repurchasing or redeeming preferred stock held by Treasury. To the extent different regulators may apply different criteria in making that determination, that variation is a function of the division of authority under the bank regulatory system.

GAO Recommendation 7:

Explore options for providing to the public more detailed information on the costs of TARP contracts and agreements, such as a dollar breakdown of obligations and/or expenses.

Summary of Treasury's Actions in Response to this GAO Recommendation

Treasury has reassessed the information regarding contracts and agreements posted on the *FinancialStability.gov* website. Treasury intends to update its website to include descriptive information related to TARP contracts and agreements, including an overview and key data about procurement contracts and financial agency agreements and metadata to include contract/agreement numbers, category, performance periods, and obligations.

GAO Recommendation 8:

Consider methods of (1) monitoring whether borrowers with total household debt of over 55 percent of their income who have been told that they must obtain HUD-approved housing counseling do so, and (2) assessing how this counseling affects the performance of modified loans to see if the requirement is having its intended effect of limiting re-defaults.

Summary of Treasury's Actions in Response to this GAO Recommendation

Treasury believes that housing counseling is beneficial for high debt-to-income borrowers. Therefore, Treasury requires such borrowers to certify that they will obtain counseling. Borrowers participating in the HAMP are provided a list of local HUD-approved housing counseling agencies from which to select an appropriate counselor.

Counseling may have the benefit of helping to reduce re-defaults among borrowers with high total debt burdens. Treasury is exploring options for monitoring what proportion of borrowers is, in fact, obtaining counseling. Servicers have expressed concerns, however, about the potential difficulty and burden of communication with counseling agencies to certify that borrowers had received counseling. Treasury is first and foremost committed to preventing foreclosures and does not plan to deny modifications to borrowers who successfully complete the trial period and meet the other requirements for a HAMP modification, even if it is not feasible to confirm that they obtained counseling.

GAO Recommendation 9:

Reevaluate the basis and design of the HPDP program to ensure that HAMP funds are being used efficiently to maximize the number of borrowers who are helped under HAMP and to maximize overall benefits of utilizing taxpayer dollars.

Summary of Treasury's Actions in Response to this GAO Recommendation

In response to both GAO recommendations and as a result of internal analysis, Treasury made two fundamental changes in the Home Price Decline Protection (HPDP) program prior to its introduction. Both of these changes will improve the targeting of the subsidy. First, the size of HPDP incentive payments is based on the size of the unpaid principal balance (UPB) of the mortgage, as opposed to the property's value, as was originally described in early program documents. Mortgages with higher UPB stand to lose more

value in the case of default and, therefore, are provided with larger HPDP incentive payments. Second, HPDP incentive payments are scaled according to the mark-to-market loan-to-value market ratio (LTV): mortgages with higher LTVs will receive higher HPDP incentive payments.

These changes improve the targeting of HPDP payments and will help ensure a greater number of borrowers in areas with rapid and recent home price declines have the opportunity to stay in their homes. These changes will also help to stabilize housing prices in impacted areas.

Treasury believes that making HPDP incentives available only for loans that would not otherwise pass the NPV test would potentially result in a reduced number of modifications for otherwise eligible borrowers. Under an approach where the HPDP subsidy is set so that loans just pass the NPV test, servicers would have an incentive to select the highest discount rates and most pessimistic re-default rate in order to maximize the HPDP subsidy per loan modified. However, these assumptions could result in fewer loans passing overall. Therefore, this approach would either require a reworking of the NPV process to eliminate all servicer choice, or risk resulting in a reduced number of modifications as servicers select the highest discount rates and most pessimistic re-default rates in order to maximize HPDP payments.

GAO Recommendation 10:

Institute a system to routinely review and update key assumptions and projections about the housing market and the behavior of mortgage holders, borrowers, and servicers that underlie Treasury's projection of the number of borrowers whose loans are likely to be modified under HAMP and revise the projection as necessary in order to assess the program's effectiveness and structure.

Summary of Treasury's Actions in Response to this GAO Recommendation

Projections of HAMP program participation are updated quarterly as part of the process for setting servicer funding caps. These estimates rely on data from servicers about the current HAMP population and draw from analyses of housing data to generate key assumptions about participation rates. Treasury continues to gather data on the determinants of borrower participation as it becomes available. Treasury will continue to use the best available information to improve and build upon the economic and behavioral assumptions underlying the projections.

The scope and impact of the HAMP is monitored through regular and comprehensive data collection from HAMP participating servicers. This data collection covers a broad array of economic and demographic characteristics of the specific subset of mortgage borrowers who are participating in the HAMP. In addition to HAMP-specific data collection, Treasury actively monitors the nation's housing markets through evaluation of aggregate statistics, which include sales, prices, housing starts, delinquencies and foreclosures, as well as the analysis of loan level data. Treasury actively coordinates with other agencies to monitor the nation's housing markets.

Treasury makes HAMP-specific market data publicly available by publishing monthly reports detailing servicer-by-servicer performance, the number of trial modifications started, the number of trial period plan offers extended to borrowers, and the number of requests for financial information sent to borrowers on its *MakingHomeAffordable.gov* website.

Treasury also continues to review and refine the NPV model. Treasury's inter-agency NPV modeling team, which includes representatives from the agencies mentioned above, has assembled a list of model improvements to be incorporated into the next version of the NPV model. The forthcoming NPV model will include improvements to underlying assumptions and the use of additional data sources to estimate key components, such as the default and prepayment models.

GAO Recommendation 11:

Place a high priority on fully staffing vacant positions in HPO—including filling the position of Chief of Homeownership Preservation with a permanent placement—and evaluate HPO's staffing levels and competencies to determine whether they are sufficient and appropriate to effectively fulfill its HAMP governance responsibilities.

Summary of Treasury's Actions in Response to this GAO Recommendation

The approach to hiring within HPO has been to hire HPO's directors first and then hire the staff below each director. As of October 2, 2009, HPO has a staff projection of 36 full time equivalents (FTE) for fiscal year 2010; at present, HPO has 23 full time staff and one detailee.

Treasury continues to hire highly qualified individuals to administer the HAMP. HPO is making excellent progress in staffing vacant positions and in hiring a permanent Chief. Treasury will soon conduct its first quarterly review to evaluate the number of staff and their competencies.

GAO Recommendation 12:

Expediently finalize a comprehensive system of internal control over HAMP, including policies, procedures, and guidance for program activities, to ensure that the interests of both the government and taxpayer are protected and that the program objectives and requirements are being met once loan modifications and incentive payments begin.

Summary of Treasury's Actions in Response to this GAO Recommendation

Treasury has a comprehensive system of internal controls over the HAMP. Evidence of Treasury's internal controls, including testing and implementation, has been provided to GAO. Treasury continues to refine its internal control environment through close interaction with its financial agents, Fannie Mae and Freddie Mac.

Treasury has developed and implemented policies, procedures, and guidance over the HAMP. Starting with the inception of the HAMP, Treasury has publicly issued

directives to guide program participants, which include borrowers, servicers, investors and financial agents. The six directives are available on Treasury's administrative website for HAMP: *HMPadmin.com*. As new programs are developed or revised, including HPDP and Second Lien programs, additional directives containing policies and procedures will be issued as necessary to coincide with program implementation.

Treasury is also working with its financial agents, Fannie Mae and Freddie Mac, to assess the design and refine the internal controls implemented within their operations, including regular meetings exclusively on internal controls. The continuous implementation of new program components will require Treasury, Fannie Mae, and Freddie Mac to continue to work together to build out and refine internal control processes critical to the HAMP's ongoing success.

Treasury has developed a HAMP Compliance Committee with members from CRCO, Housing Preservation Office, Office of Financial Agents, Office of General Counsel, Freddie Mac and Fannie Mae. The Committee's objective is to understand servicers' compliance review results and other performance considerations to determine appropriate recommended servicer actions. Actions range from servicer operational enhancements to requiring improperly rejected loans to be modified to recommending compensation related remedies to the Assistant Secretary. A charter for the HAMP Compliance Committee has been approved. A policy on servicer remedies should be finalized by the end of October.

GAO Recommendation 13:

Expediently develop a means of systematically assessing servicers' capacity to meet program requirements during program admission so that Treasury can understand and address any risks associated with individual servicers' abilities to fulfill program requirements, including those related to data reporting and collection.

Summary of Treasury's Actions in Response to this GAO Recommendation

Treasury has worked with its financial agent, Freddie Mac, to develop a means of assessing servicers' capacity to meet program requirements. There are various components of the compliance program which address servicers' ability. An on-site review is conducted and includes walkthroughs of processes including borrower solicitation, eligibility, data collection and reporting and a review of supporting evidence of process effectiveness.

The initial round of on-site reviews for servicers representing 88 percent of the total cap allocation has been completed. Freddie Mac and Treasury are working to strengthen this process, and beginning in November, servicer reviews will take place within 30 to 45 days of signing a servicer participation agreement with Treasury. Reviews of all servicers who have elected to code the NPV model into their own system, rather than use the portal application, have also been completed. New requests to code the NPV model in a servicer's proprietary application or changes to existing models must be tested and approved prior to implementation.

Treasury does not believe these reviews need to be linked to the admission process because, upon admission, a servicer becomes contractually obligated to review a borrower for eligibility for a HAMP trial modification before beginning any foreclosure actions. This feature effectively forbears the mortgages until they can be reviewed, allowing servicers the time to make a determination. The benefit of this feature to borrowers is that they are guaranteed consideration for the program once servicers sign the agreement, regardless of the servicer's current capacity.