ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 7, 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 Update on Recommendations in the SIGTARP Quarterly Report

Dear Mr. Barofsky:

This letter describes the actions taken by the U.S. Department of the Treasury (Treasury) in response to the outstanding recommendations contained in the Special Inspector General for the Troubled Asset Relief Program's (SIGTARP) *Quarterly Report to Congress*, dated July 21, 2010.

Treasury looks forward to the release of the SIGTARP's eighth quarterly report on the Troubled Asset Relief Program (TARP) in October 2010. We request that you include the enclosed *Status Update on SIGTARP Recommendations* in that 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 recommendations you have made as well as the constructive relationship we have with you and your team. We look forward to continuing to work together as we move forward.

Sincerely,

Timothy G. Massad
Acting Assistant Secretary
Office of Financial Stability

Enclosure

The U.S. Department of the Treasury
Status Update on SIGTARP's Outstanding Recommendations

October 7, 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 June 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 to in our summary responses to SIGTARP and to Congress. Finally, SIGTARP Recommendations 1, 2, 5, 7 and 8 identified in this summary response should be considered 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: HAMP]: 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.

Recommendation 2 [re: HAMP]: 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 has been working with the Ad Council on a two-part public service advertising (PSA) campaign since fall 2009.

For the first part of this campaign, Treasury partnered with the U.S. Department of Housing and Urban Development (HUD) and NeighborWorks America to refresh an existing foreclosure prevention PSA campaign by changing the focus to the Making Home Affordable Program. The new campaign included a call-to-action for struggling homeowners that directed them to the Homeowner's HOPE Hotline and MakingHomeAffordable.gov to receive free assistance from a

HUD-approved housing counselor. The campaign included both television and radio PSAs that were distributed to 12,000 media outlets across the country, as well as web banners and outdoor advertising.

The refreshed TV PSAs achieved 2,448 detected airings through June 2010 with airings in all of the Top 10 Designated Market Areas (DMAs), geographic areas defined by Nielsen Media Research Company. This equates to more than 6,143,000 household impressions. The refreshed radio PSAs achieved 7,531 detected airings through July 31, with a majority of airings in the 100 largest DMAs. TV station rights to air the refreshed PSA ended in June but the radio ads will continue to air.

In terms of the second part of the collaboration with the Ad Council, on July 28, 2010, Treasury and HUD, together with the Ad Council, launched a new campaign that featured homeowners who had benefited from the Making Home Affordable Program. The campaign outreach included: a multimedia news release (MNR) distribution via PR Newswire and Treasury and Ad Council media contacts which garnered more than 1.4 million impressions; English and Spanish bites and b-roll (BBR) packages shared with the top 40 markets as well as additional markets with high foreclosure rates; customized Web Packages distributed by Treasury to more than 600 partners; and a pre-packaged news story to English and Spanish newspapers (10,000 news weeklies nationwide).

At the time of launch, Treasury reached out to Fannie Mae, Freddie Mac, NeighborWorks and HOPE Now which shared broadly the campaign news and MakingHomeAffordable.gov PSA page link with their employees, non-profit partners, members, and other contacts. While over one million homeowners have already received assistance from the Making Home Affordable program, the national PSA campaign encourages struggling homeowners who may be eligible for assistance to reach out for the help they need through free resources made available by the Federal Government. The PSAs direct homeowners to visit MakingHomeAffordable.gov or to call 1-888-995-HOPE (4673) to see if they can make their mortgage payments more affordable and to understand options they may have to avoid foreclosure.

The campaign includes English and Spanish television, radio, print, out of home (e.g., billboard and bus shelter advertising) and web advertising. The effort also includes real stories of homeowners featured in the campaign, which are posted on MakingHomeAffordable.gov. The Ad Council distributed the PSAs to more than 33,000 media outlets nationwide. The PSAs air in advertising space donated by the media. On a monthly basis, the Ad Council will provide a media detection report based on monitoring of 18 percent of the television and radio stations across the country. A quarterly report will combine this monthly raw data with station self-reporting which will produce an accurate estimate of final detections and donated media value. During the month of August 2010, in 18 percent of the markets, the Ad Council reports significant and above-average media pickup compared with other Ad Council campaigns. The pickup was immediate and the airings were at least three to four times higher than Treasury saw with the refresh campaign. Additionally, in August, in terms of out-of-home advertising, the Ad Council reports 240 orders for billboards and bus shelters.

Treasury continues to work with government agencies, GSEs and non-profit partners such as NeighborWorks America to raise awareness about the increasing number of scams, the changing nature of scams and to remind homeowners that there is no charge to apply for the Making Home Affordable Program.

Recommendation 3 [re HAMP]: Additional anti-fraud protections should be adopted in MHA to verify the identity of the participants in the transaction and to address the potential for servicers to steal from individuals by receiving Government subsidies without applying them for the benefit of the homeowner.

Treasury's Program Administrator for HAMP, Fannie Mae, has contracted with a vendor to design a fraud detection application and has established associated processes focusing on borrower identity. The application was tested, and a pilot, using IR2 new trial data from two servicers, started at the beginning of September 2010. When borrower identity discrepancies or potential misrepresentations are identified, servicers will be notified through the application and will be required to take appropriate action to resolve the discrepancy prior to any incentive being paid.

Treasury's Compliance Agent for HAMP, Making Home Affordable – Compliance (MHA-C), a separate division of Freddie Mac, has developed procedures to verify that incentives paid to servicers are accurately applied to the respective borrower participating in HAMP during its servicer compliance reviews. MHA-C selects and reviews a sample of mortgage loans serviced by participating servicers. MHA-C then compares the source information from the loan files to IR2 to validate existence. In addition, for loans that have passed the first (to fifth) modification anniversary date, MHA-C assesses the servicers' controls and processes for appropriately applying such borrowers' reduction in principal and, for a selected sample of loans, determining whether the servicers appropriately reduced those borrowers' principal amount of the loans. MHA-C also reviews on a sample basis the investor payments remitted to the servicer to verify that servicers are not retaining these incentives. Additionally, MHA-C will receive reporting from the Fannie Mae surveillance application described above, once the process is implemented across all servicers, and will randomly sample loans to ensure the servicers have appropriately resolved flagged items.

Recommendation 4 [re HAMP]: Treasury should set other performance benchmarks and publicly report against them to measure over time the implementation and success of HAMP.

Since the inception of the program, indicators of performance have been monitored closely, and Treasury has published extensive information about performance. To ensure accountability, Treasury's website, www.FinancialStability.gov, provides transparency for a wide range of programs, including HAMP, with all monthly MHA Public Reports and program fact sheets.

Treasury has also established two additional websites to provide information about MHA – www.hmpadmin.com and www.MakingHomeAffordable.gov. These websites include comprehensive documentation and information about MHA with complete lists of all servicers participating in the program, copies of all contracts signed by servicers, the Supplemental Directives (SDs) that establish additional requirements for MHA, hundreds of frequently asked questions, a white paper describing the Net Present Value (NPV) test methodology, and all borrower application documents.

The Monthly MHA Public Report currently includes a variety of performance metrics including but not limited to, the number of trial and permanent HAMP modifications, modification activity by servicer, how canceled trial modifications are being disposed, mortgage delinquency by state, HAMP activity by State, HAMP eligibility of delinquent loans and compliance review of homeowners not selected for HAMP modifications. Treasury continues to enhance its data collection efforts, as well as its public disclosure of key operational metrics. Treasury's servicer survey has recently been expanded to include timely information on newly implemented programs such as FHA-HAMP, 2MP, HAFA and UP, while the MHA Public Report (www.financialstability.gov/docs/AugustMHAPublic2010.pdf) now includes data on incoming borrower calls, complaint volumes and resolution times for escalated issues. With the additional performance metrics being collected and compiled, Treasury plans to publish servicers' efforts towards these new measures, as well as continuing to publish already established metrics.

Recommendation 5 [re: HAMP]: Treasury should publish for each HAMP program and subprogram the anticipated costs and expected participation in each and that, after each program is launched, it reports monthly as to the programs' performance against these expectations.

Treasury, in its monthly 105a report, publishes the total amount of funds disbursed for the housing programs as well as a breakout of the obligation by the three major programs: HAMP, Help for the Hardest Hit Markets (Hardest Hit Fund) and the FHA Letter of Credit. The 105a report is available on our website www.financialstability.gov. In addition, Treasury provides the cap allocations for HAMP and related programs on www.FinancialStability.gov. We will update these cap allocations quarterly as these programs mature and servicers revise their estimated eligible loan populations. In the case of the Hardest Hit Fund, we have published state allocations of funds and will consider what additional data to provide as these programs ramp up.

With respect to performance goals, we refer you to the TARP Retrospective Report recently published by Treasury which discusses the TARP housing programs in detail, the policy rationales behind them, and the effects of the programs on the markets. The report discusses the establishment of the MHA goal of offering help to 3-4 million people, the various ways of measuring the impact of the program, and the issues that arise in measuring performance against a numerical standard.

We also refer you to the monthly report Treasury publishes on program performance. This provides 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 MHA program. The information contained in this report is quite detailed as noted above. It includes, among other things, detailed statistics on trial and permanent modifications as well as servicer-specific progress on conversion from trial modifications to permanent modifications, aged trial modifications as well as survey data on how homeowners in canceled HAMP trials are disposed. We have added additional metrics and sections to the report as more data becomes available. Our latest report includes additional information about servicer-specific "second look" compliance reviews and a description of areas of compliance activity emphasis, which we will continue to publish on a quarterly basis.

Finally, we note that insofar as the rationale for SIGTARP's proposal for numerical goals is to promote accountability in the use of taxpayer funds, we believe a key means to achieve such accountability is the "pay for success" design of the program, which insures that funds are disbursed only to the extent that permanent modifications are entered into and sustained.

Recommendation 6 [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 has and continues to develop a robust monitoring program to review the effectiveness of the PPIF managers and to ensure that each manager fulfills its obligations to the program. Since the inception of the program, Treasury professionals have held monthly calls with each PPIP fund manager to review fund performance, their assessment of RMBS and CMBS fundamentals and risks as well as their positioning of the PPIF. Treasury also monitors each PPIF's asset coverage ratio to ensure that Treasury's debt investment is adequately protected. Over time, Treasury will review each PPIF's net internal rate of return to Treasury relative the returns that each fund manager proposed during the pre-closing process and the basis on which each fund manager raised equity capital from their private limited partners.

Treasury cautions that PPIFs are absolute return investment strategies and due to the type of securities eligible for investment and the structure of these funds, it is difficult to specify a benchmark that is directly comparable by which the performance of a PPIF can be measured. Performance will also vary among PPIFs due to different risk/return objectives, leverage ratios and sector allocations, among other reasons. Moreover, PPIFs are still in the early stages of their three-year investment periods and early performance may be disproportionately impacted by structuring and transaction costs and the pace of capital deployment by each PPIF. Because of this, we believe that any performance analysis done on these funds at this stage is of limited value and it would be premature to draw any long-term conclusions about the performance of individual PPIFs or PPIP in general from the data reported to date.

Over time, as performance data becomes more meaningful, Treasury will begin to review each PPIF's net internal rate of return relative to proposed returns to private limited partners as well as additional analytics and risk metrics. In connection with this, Treasury is working with its fund advisor, Ennis Knupp, to identify a subcontractor to assist with providing these analytics and metrics on the PPIP portfolio, which will include risk assessments, intrinsic valuations (including expected losses) and scenario/sensitivity analyses on each of the PPIFs as well as the PPIP portfolio as a whole. By doing so, Treasury expects to enhance its existing monitoring capabilities regarding the effectiveness of each PPIF and the business risks to the program as a whole. This process is ongoing and a subcontractor is expected to be selected by December 2010.

Treasury's monitoring program and internal controls procedures combined with the analytics support and expertise of a third party subcontractor will help ensure that the PPIP 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. In addition to the asset management monitoring procedures finalized as of June 2010, Treasury has finalized procedures related to Treasury's oversight of the compliance requirements of the PPIP.

Recommendation 7 [re CDCI Program]: Treasury should develop a robust procedure to audit and verify the bona fides of any purported capital raise and to establish adequate controls to verify the source, amount, and closing of all claimed private investments.

Funding under this program was completed as of September 30, 2010. To implement SIGTARP's recommendation Treasury developed controls to verify the source, amount, and ranking of each private investment made pursuant to the matching capital provisions of the program. These controls included a review of relevant legal documents, a due diligence check on all sources of new matching capital, as well as a validation that the matching capital originated from sources identified. Two CDCI participating institutions received matching capital funds and in each case Treasury performed the due diligence check as described herein.

Recommendation 8 [re Warrant Dispositions]: Treasury should develop and follow 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 reviewed its procedures for sharing information with institutions in light of SIGTARP's recommendation. While we believe that sufficient internal controls are in place, such as the warrant committee review and third party valuations, to ensure adequate consistency in the negotiation process itself, we will formalize the manner in which we communicate with issuers that are looking to repurchase their warrants in order to address SIGTARP's concerns.

Treasury will use the following procedures in its communications and information sharing with issuers: (1) Treasury will not discuss any specific valuation or valuation range with an issuer prior to receiving a bid; (2) Treasury will initially only discuss warrant value inputs and its valuation methodologies in attempt to clarify issuer questions; (3) Treasury personnel will only discuss specific valuation ranges (or other information deemed helpful to Treasury's negotiating position) after approval is granted from the warrant committee. Any such additional information shared with an issuer will be recorded in the warrant committee minutes.

As we have previously stated, 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.